

# Schroders

## Monthly Markets Review

### Overview of markets in October 2009

#### Highlights:

- Many global stockmarkets finished October in negative territory, following strong recent performance, as investors began to question the strength of the economic recovery.
- Equity markets were buoyed in the first half of the month by broadly favourable economic data in the US and Europe. The US exited recession over the month, reporting 3.5% growth for the third quarter (on an annualised basis). However, markets fell back later in the month as several economic releases disappointed and highlighted lingering risks. Persistently high unemployment, weak manufacturing activity, consumer confidence and new home sales data all weighed on sentiment.
- Although the majority of US companies which announced earnings figures over the period beat analyst expectations, reflecting in many cases cost-cutting efficiency, few reported results demonstrating a genuine pick-up in final demand. A growing number of analysts said that equities' climb since the March lows left the market vulnerable to a pull-back.
- Corporate bonds continued to post positive returns, due to the tentative improvement in economic data, and outperformed government bonds and cash.

#### US

Surprisingly strong GDP data showed the US economy officially exited recession in the third quarter. Retail spending was better than expected, while the corporate sector also contributed with spending on equipment and software, together with a slowdown in inventory liquidation. This welcome news sent US equity markets higher in the first part of the month, but they subsequently fell as the unemployment rate continued edging higher and consumer confidence remained stubbornly low. The markets finished lower overall. Corporate news was generally supportive, with most of the S&P 500 companies that have so far reported beating estimates. Individual sector performance varied greatly, with financials the weakest on renewed concerns about bank loans, while energy had the best returns on the back of a strong oil price.

#### Eurozone

Equities rallied in the first half of the month as broadly encouraging economic data and some positive corporate earnings announcements continued to fuel investor risk appetite. For example, the German IFO Business Climate Index improved, with the expectations component of the index rising from 95.7 in September to 96.8. However, by the second half, confidence waned and investors adopted a more cautious approach. The banking sector suffered the biggest share price retreat as markets contemplated the implications of recent action taken by the EU competition commission to redress the enormous amounts of state-funded liquidity pumped into the sector during the financial crisis. Notably, in October, EU state aid rules prompted the forced split of ING, with the company set to dispose of its insurance arm and investment management operations. The European Central Bank (ECB) left interest rates on hold at 1.0% as the market expected. However, the ECB sounded a little more hawkish, suggesting it is now more confident about the strength and pace of economic recovery.



## UK

Given an unusually straightforward and significant run since March, it was not remarkable that UK equities took a break during October. The FTSE All-Share hit a one-year high mid-month before falling back into negative territory by month end, as investors began to take stock of market fundamentals. This was despite further positive data points from both a corporate and a global economic perspective, but the lack of progress from the UK market suggested that investors had already factored this in. As a result, many of the top performers of the past few months – the formerly beaten-up financial and cyclical (economically sensitive) names – were hit by some degree of profit-taking. Economic news was a little mixed. Consumer confidence improved and there were signs that the rate of unemployment was beginning to slow. However, on a negative note, retail sales were flat in September and manufacturing data for August was incredibly weak, with output falling 1.9% month-on-month. As expected, the Bank of England left interest rates at 0.5%.

## Japan

The Japanese market seemed to ignore pretty positive local macro data and instead was infected by the mood from the US, and the TOPIX finished down in yen terms. A broad array of reports surprised on the upside and suggested that the Japanese economy had good momentum heading into the current quarter. This included September industrial production and also consumer spending, which appeared to be benefiting from signs of stabilisation in the labour market. Earnings expectations were a major driver of stocks' performance over the month; the earnings season so far has been broadly positive, with good numbers particularly from tech and auto companies. Sector performance was a mixed bag. Brokers performed strongly, helped by the higher oil price over the month and good results from Nomura. Several export sectors also did well thanks to a somewhat weaker yen, including glass & ceramics and transportation equipment. Unusually for a falling market, defensive sectors underperformed, including electric power & gas, pharmaceuticals and telecoms. The insurance sector was hit by talk of forced unwinding of bank cross-holdings.

## Asia (ex Japan)

Asian stockmarkets finished a volatile month slightly lower. Share prices trended higher for most of October following encouraging data on the global economy and continued positive earnings results. However, as the month progressed, risk appetites retreated amid concerns that the eventual withdrawal of government stimulus could stall the global economic recovery. Such worries were evident following the release of GDP data in China showing the economy had accelerated 8.9% in Q3, with investors focusing on when Beijing will unwind ultra-loose monetary policy. During the month, the Australian central bank also raised interest rates by 25 basis points, becoming the first G20 country to hike rates. The financial and consumer staples sectors were the best performing areas for Asian markets during the month, while technology and telecoms were the weakest.

## Emerging Markets

Emerging market equities outperformed global equity markets during the month, with stronger commodity prices benefiting several emerging markets, although they weakened in the latter part of the month. China, Poland and Malaysia were among the strongest performing emerging markets following previous underperformance. In China, data releases showed the domestic economy continuing to grow strongly, with Q3 GDP growth coming in at 8.9% year-on-year while the Purchasing Managers' Index also continued to pick up. In Malaysia, data was released showing industrial production contracting by -5.7% in August, which was ahead of consensus expectations for a decline of -6.0%. The energy-dominated Russian market also outperformed, benefiting from a rise in oil prices, while the country's central bank continued to cut interest rates. Colombia was the weakest performing emerging market in October following its strong previous performance. The government and central bank announced measures aimed at tackling the appreciation of the

Colombian peso – the currency weakened considerably against the US dollar in the wake of this. The Thai market also underperformed due to rumours that the King of Thailand was seriously ill.

## Global Bonds

The global economy continued its recovery with generally better-than-expected economic data released in October. For example, US GDP growth expanded at an encouraging annualised pace of 3.5% in Q3 2009, which was slightly higher than the market expected. In addition, business and consumer confidence in the eurozone, continued to show resilience.

The improving economic data continued to fuel investor risk appetite and corporate bonds outperformed government bonds and cash. However, global government bond performance was supported by concerns over the strength and pace of the global recovery, following weaker data reported later in the month.

### Overview – Total Returns (%) – to end of October 2009

	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
<b>Equities (MSCI)</b>						
World Index	-2.67	-1.76	-4.68	16.21	23.34	7.58
World Value Index	-3.51	-2.61	-5.50	14.48	21.50	5.98
World Growth Index	-1.80	-0.88	-3.82	17.87	25.11	9.12
World Smaller Companies Index	-4.82	-3.93	-6.78	27.32	35.14	17.88
US	-2.85	-1.94	-4.85	10.78	17.58	2.56
Eurozone	-4.39	-3.49	-6.36	19.74	27.10	10.86
UK	0.35	1.29	-1.72	27.90	35.75	18.41
Japan	-3.41	-2.51	-5.41	0.50	6.67	-6.96
Emerging Markets	-0.80	0.13	-2.84	55.55	65.10	44.01
Asia ex Japan	-1.45	-0.53	-3.48	51.70	61.01	40.44
	1 month			YTD		
<b>Government bonds (JP Morgan)</b>	EUR	USD	GBP	EUR	USD	GBP
US	-0.97	-0.05	-3.02	-8.17	-2.54	-14.99
UK	1.81	2.77	-0.29	8.85	15.54	0.78
Japan	-2.46	-1.54	-4.47	-5.70	0.09	-12.70
Germany	-0.04	0.90	-2.10	1.81	8.06	-5.75
<b>Corporate bonds (Merrill Lynch)</b>	-0.12	0.82	-2.18	12.38	19.28	4.04

Source: Datastream to 31 October 2009

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