

Schroders

Monthly markets review

Overview of markets in October 2015

Highlights:

- Global equity markets staged a rebound in October. A Chinese rate cut and speculation over the prospect of looser monetary policy from several other central banks helped to support risk appetite.
- US equities rose amid a better-than-expected start to the earnings season. The Federal Reserve kept rates unchanged but indicated that a hike in December remains a possibility.
- Eurozone and Japanese equities were supported by expectations that their respective central banks may soon move to ease monetary policy further.
- Emerging markets posted positive returns, narrowly lagging developed markets. China's central bank cut interest rates following a Q3 GDP print which indicated growth eased to 6.9% year on year.
- In fixed income markets, European sovereign yields fell and Treasury yields rose due to the divergent outlook for monetary policy. The 'risk-on' environment helped drive the outperformance of high yield bonds versus their investment grade equivalents across the US, Europe and UK.

US

US equities performed strongly with the S&P 500 returning 8.4% following a better-than-feared earnings season and as the Federal Reserve (Fed) again delayed raising interest rates. The Federal Open Market Committee's statement following its two-day meeting raised the prospect of an interest rate 'take off' in December, but the market chose to focus primarily on the more reassuring assessment of the global economy.

Equities performed strongly despite some disappointing macroeconomic data as industrial production, durable goods and trade numbers failed to inspire. The latest non-farm payrolls¹ also raised questions about the consumer's ongoing buoyancy as September's print of 142,000 was much less than expected (more than 200,000) and August's number was revised down to 136,000 from 176,000.

The heavyweight energy sector led the market higher following speculation that Russia and Opec might work together to curb the global oil supply glut. Meanwhile the US shale oil industry further retrenched, as was evidenced in another fall in the North American rig count and US oil production. The integrated oil majors reported better-than-expected third-quarter results as they adjusted to the lower oil price environment, in contrast to some disappointing third-quarter numbers from some of their European-based global peers.

Merger and acquisition (M&A) activity remained a key trend as PC-maker Dell made a recommended bid for data-storage specialist EMC and Botox-maker Allergan confirmed that it was in buyout talks with Pfizer. These deals underpinned strong performances from the technology and healthcare sectors. The consumer discretionary sector also performed well amid evidence of continued strength on Main Street, as forward-looking consumer sentiment indicators remained strong and historic data on house prices, home construction and car sales all pleased.

Eurozone

Eurozone equities rebounded in October with the MSCI EMU index returning 9.7%. Sentiment towards risk assets was helped by dovish central bank policy. Stockmarket gains accelerated after Mario Draghi suggested that the European Central Bank (ECB) could expand its quantitative easing programme and cut the deposit

¹ In the US, monthly non-farm payrolls measure the total number of people employed in non-agricultural enterprises.

rate, perhaps as soon as December. Eurozone bond yields moved lower and Italy joined the roll-call of countries that have been able to sell debt at a negative yield. Sweden's Riksbank expanded its QE programme to SEK200 billion from SEK135 billion. Portugal's general election saw the centre-right, led by Pedro Passos Coelho, retain power as the largest party although they lost their parliamentary majority.

Economic data from the eurozone was generally encouraging. The flash composite purchasing managers' index for the region rose to 54.0 in October from 53.6 in September, indicating a faster pace of economic expansion. The ECB's Bank Lending Survey showed a further broad improvement in credit conditions in the third quarter, particularly for corporates. Eurozone annual inflation improved to 0.0% in October, up from -0.1% in September, while the bloc's unemployment rate dipped to 10.8% in September. Meanwhile, the German Ifo business climate survey fell only slightly, to 108.2 from 108.5, suggesting that the Volkswagen emissions scandal has had a relatively limited impact on business confidence.

On a sector view, consumer-related shares performed strongly. The automobiles & components sector rebounded from the weakness seen in September while beverages stocks were supported by news of AB InBev's takeover of SABMiller. The information technology sector also performed well. All sectors produced positive returns but financials was the laggard amid disappointing earnings from several companies including Deutsche Bank. On a country view, German equities were among the top performers.

UK

UK equities recovered strongly in line with global markets amid the return of risk appetite. However, disappointing third-quarter results from the oil & gas sector and lingering fears about the global growth outlook took some of the gloss off the recovery in the heavyweight resource sectors, leaving the benchmark FTSE All-Share lagging other equity indices, up a more modest 4.7% over the month.

The precious metal miners performed particularly well as the prices of platinum, gold and silver rallied strongly. However industrial metal prices performed less convincingly as the International Monetary Fund cut its global growth outlook for 2015 and 2016. Barring the ongoing recovery in Glencore, after its share price was previously heavily impacted by worries about the company's indebtedness, the diversified miners delivered a mixed performance.

M&A activity remained a feature of the market as drinks group SABMiller said it was prepared to recommend an increased offer of more than \$100 billion from AB InBev, which would be one of the largest-ever M&A deals. Corporate reporting was mixed, in particular from the major oil & gas producers, with Royal Dutch Shell publishing worse-than-expected third-quarter numbers as it struggled with the lower oil price environment.

Aerospace and defence was the worst performing sector after Chemring warned on profits following the delay in a contract to supply ammunition to the Middle East. Meanwhile, engineering specialist Meggitt used its third-quarter update to flag that full-year profits were likely to be 'meaningfully below' consensus forecasts, following a fall in demand for spare aircraft parts. Its energy business, which supplies valves for oil and gas projects, also suffered as a result of the lower oil price.

Japan

After the sustained weakness in global markets in August and September, the Japanese equity market bounced sharply in October, with the Topix Index recording an impressive gain of 10.4%. However, a renewed weaker trend for the Japanese yen against major currencies reduced this return to 7.5% for a sterling-based investor.

In line with the change in market direction, stocks and sectors exhibited a classic return reversal pattern. Thus, the market was led upwards by strong moves in paper companies, steel companies, leasing companies and machinery stocks. All sectors rose in absolute terms during the month, but relative weakness was seen in retail and construction.

Investor sentiment recovered somewhat in October, perhaps on the realisation that a slowdown in global growth, and especially in China, may not be as bad as previously feared. There was also a renewed focus on possible changes in monetary policy by the Bank of Japan (BoJ), especially following the decision by the US Fed to leave interest rates unchanged in the previous month. In the event, the BoJ decided not to loosen policy further, despite growing evidence that it seems virtually impossible to reach the inflation target within the

central bank's own timetable. The expectations for additional easing measures over the coming months have therefore increased.

The interim results season for the period ended in September got underway towards the end of October, but the bulk of companies will report in early November. Early indications are that the aggregate numbers could be marginally ahead of expectations but, for the second half of the year, companies remain extremely cautious on the external environment, especially demand in China.

Lastly, the privatisation of Japan Post moved ahead as planned with shares offered to investors in three separate entities: Japan Post Bank, Japan Post Insurance and Japan Post Holdings. Although all three are likely to remain low-growth prospects over the next few years, the privatisations are aimed primarily at domestic individual investors and have been relatively well-received.

Asia (ex Japan)

Asia ex Japan equities bounced back from a challenging third quarter to post robust positive returns for October, spurred on by dovish comments from the US Federal Reserve (Fed) and signs of further easing by Chinese authorities. Chinese equities gained over the month on hopes of stimulus measures by the authorities as the government's leaders gathered in Beijing at the end of the month to discuss the country's 13th Five-Year Plan. Another interest rate cut was announced by the People's Bank of China (PBoC) in late October, the sixth such cut in a year. However, data continued to be mixed. Third quarter GDP growth came in at 6.9% year-on-year, falling below 7% for the first time since 2009, although marginally beating expectations of a 6.8% expansion. The closely-watched Caixin China manufacturing PMI reading for September fell to a six-and-a-half-year low of 47.2.

Meanwhile, in Hong Kong, stocks rallied on policy support initiatives in China while in Taiwan stocks gained as a strong quarterly earnings season in the US from large consumer electronics firms boosted the island's technology sector. Korean equities saw strong returns on a robust earnings season for export-oriented firms on the back of a lower Korean won which has boosted the economy's export competitiveness.

In ASEAN, all markets finished in positive territory, with Thailand and the Philippines posting gains on the back of the broader global easing trend while Indonesia was the region's biggest winner as the Indonesia rupiah rallied strongly against the US dollar from a multi-year low. Indian stocks also gained after an interest rate cut by its central bank, but underperformed the region, as its earnings season was weaker than expected.

Emerging markets

Emerging market equities posted strong gains, with those countries most vulnerable to changes in the external liquidity environment recording the strongest returns. The MSCI Emerging Markets index posted a positive return but slightly lagged the MSCI World. Emerging Asian markets registered the strongest returns. Indonesia, one of the markets perceived as most sensitive to global liquidity, rallied sharply with gains magnified by strong appreciation in the rupiah. China registered a robust return and outperformed as the People's Bank of China (PBoC) moved to cut interest rates, lower the reserve requirement ratio for banks, and remove a deposit cap that limited the rate banks can pay savers. The moves followed a Q3 GDP print which indicated growth eased to 6.9% year on year. Some alleviation in near-term US-dollar liquidity and China growth concerns was beneficial for Malaysian equities and the ringgit, although the market modestly lagged the index. The Philippines and India, two of the best performing markets on a year-to-date basis, lagged but were positive in absolute terms.

Latin American markets recorded solid gains. Colombia was the only market to outperform what was a strong index return, with a 6.6% appreciation in the peso versus the US dollar enhancing performance. On the data front, a series of economic indicators surprised to the upside, notably industrial production. Brazil underperformed as weakness in economic indicators persisted and the government revised its fiscal target to a deficit from a surplus.

EMEA emerging markets in aggregate performed well. The Turkish market rebounded as global liquidity concerns were eased following the decision by the Fed to delay tightening and supportive comments from the ECB. The lira sharply strengthened following recent weakness. Meanwhile politics remained uncertain ahead of parliamentary elections on 1 November (in a post month-end event the AKP has achieved a parliamentary majority). The UAE was the weakest index market, with a 2.4% decline in the oil price weighing on sentiment.

Global bonds

The significance of central bank policy decisions for bond investors was reaffirmed in October, when risk assets performed strongly despite macroeconomic data offering little to elicit such optimism. The Federal Reserve (Fed) downplayed last month's concerns of slower global growth and referenced the possibility of a rate rise in December. The People's Bank of China (PBoC) meanwhile, cut its benchmark interest and deposit rates for the sixth time in 12 months to combat slowing growth. China's reserve requirement ratio was further reduced. Finally, there were additional comments from the European Central Bank (ECB) President Mario Draghi to confirm that the central bank stands ready to extend its existing monetary policy support if needed.

Government bond yield movements reflected the greater clarity in central bank policy projections. The 10-year Treasury yield rose from 2.04% to 2.14%, with similar rises visible across the Treasury yield curve. The 10-year gilt yield rose from 1.76% to 1.92%. In the eurozone, the 10-year Bund yield fell from 0.59% to 0.52% and peripheral government yields also declined.

In corporate bond markets, the investment grade BofA Merrill Lynch Global Corporate Bond index rose 0.7%, while the high yield equivalent index rose by 3.1%² (local currency returns). Euro-denominated corporate bonds were stronger than sterling and US dollar equivalents over the month.

Overview: total returns (%) – to end of October 2015

² Investment grade bonds are the highest quality bonds as determined by a credit ratings agency. High yield bonds are more speculative, with a credit rating below investment grade.

Equities	1 month			12 months		
	EUR	USD	GBP	EUR	USD	GBP
MSCI World	9.08	7.95	5.88	16.06	2.34	6.01
MSCI World Value	8.84	7.71	5.64	11.42	-1.76	1.77
MSCI World Growth	9.31	8.19	6.11	20.74	6.46	10.28
MSCI World Smaller Companies	6.86	5.76	3.73	16.35	2.58	6.27
MSCI Emerging Markets	8.26	7.14	5.08	-2.71	-14.22	-11.14
MSCI AC Asia ex Japan	9.09	7.96	5.89	5.51	-6.97	-3.63
S&P500	9.57	8.44	6.35	19.31	5.20	8.98
MSCI EMU	9.70	8.57	6.48	16.67	2.87	6.57
FTSE Europe ex UK	8.18	7.06	5.01	15.13	1.51	5.16
FTSE All-Share	7.85	6.74	4.69	12.76	-0.58	2.99
TOPIX*	10.73	9.59	7.49	25.44	10.61	14.58

Government bonds	1 month			12 months		
	EUR	USD	GBP	EUR	USD	GBP
JPM GBI US All Mats	0.67	-0.37	-2.29	16.41	2.64	6.32
JPM GBI UK All Mats	1.62	0.57	-1.36	15.85	2.15	5.82
JPM GBI Japan All Mats**	0.73	-0.31	-2.23	7.99	-4.78	-1.37
JPM GBI Germany All Mats	0.45	-0.59	-2.49	3.44	-8.80	-5.52
Corporate bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global Broad Market Corporate	1.66	0.62	-1.32	10.17	-2.86	0.63
BofA ML US Corporate Master	1.58	0.54	-1.40	14.50	0.96	4.58
BofA ML EMU Corporate ex T1 (5-10Y)	1.77	0.72	-1.21	0.87	-11.07	-7.87
BofA ML £ Non-Gilts	2.82	1.75	-0.20	13.36	-0.05	3.54
Non-investment grade bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global High Yield	4.06	2.99	1.01	9.99	-3.03	0.46
BofA ML Euro High Yield	3.09	2.03	0.07	3.12	-9.08	-5.82

Source: DataStream. Local currency returns in October 2015: *10.42% **0.44%. Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of any overseas investments to rise or fall.

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