

# Schroders

## Quarterly markets review

### Overview of markets in Q4 2015

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#### Highlights:

- Global equities delivered positive returns for the fourth quarter despite generally poor performance in December. Government bond markets broadly reflected the policy trajectories of the world's major central banks.
- US equities gained over the quarter. The Federal Reserve increased its main policy rate in December following strong domestic macroeconomic data.
- Eurozone equities posted positive returns overall, buoyed by hopes for further quantitative easing. However, the eventual announcement disappointed investors and weighed on returns in December.
- Japan was the best performing equity market over the quarter. A sharp rebound in October was driven by a recovery in cyclical sectors.
- Emerging market equities underperformed their developed world counterparts. The Chinese equity market posted a solid gain as the central bank provided further support to the economy. Economic data in Brazil continued to deteriorate.

#### US

The S&P 500 index recorded a total return of 7.0% over the quarter. Risk appetite was supported early in the period by speculation that the Federal Reserve (Fed) would delay into 2016 a much-anticipated 'lift off' in rates. In the event the central bank increased its main policy rate in December, following positive domestic macroeconomic data. The US central bank increased rates for the first time since 2006 following strong October and November non-farm payrolls. The unemployment rate fell to a seven-year lower of 5.0% and the Conference Board measure of consumer confidence improved in December, following November's dip, amid the renewed strength in the jobs market.

The market was led higher by a recovery in the large cap companies. These had sold off heavily during the sharp market correction of the third quarter when worries about emerging markets growth and China had dominated sentiment. In turn they responded well during October's liquidity-driven rally, as other major central banks (notably in China and Europe) either loosened monetary policy or suggested they would do so, amid the Fed's decision to stall tightening.

Merger & acquisition activity remained a key theme with Pfizer and Allergan agreeing to combine to create the world's largest drugs company by sales. The healthcare sector was one of the top performers, followed by technology where the 'Fangs' - Facebook, Amazon, Netflix and Google - led the way, particularly Amazon following strong third-quarter results.

The period ended on a negative note amid renewed weakness in crude prices which weighed heavily on the energy sector. Utilities also performed poorly as benchmark bond yields rose over the period as expectations grew that the Fed would raise rates.

#### Eurozone

Eurozone equities delivered positive returns overall in the quarter, despite a poor month in December. Equities were buoyed during October and November by hopes that the European Central Bank (ECB) would announce substantial further monetary policy easing. However, the announcement in early December left the market disappointed. The timetable for purchases was extended to March 2017 from September 2016 but the €60

billion per month amount was left unchanged. The deposit rate was cut to -0.3% from -0.2%. The euro was 2.8% weaker against the dollar over the quarter but strengthened in December.

Economic data from the eurozone was largely encouraging. The flash composite purchasing managers' index (PMI) for December dipped to 54.0 from 54.2 in November. Overall, the PMI for the fourth quarter was the strongest for the eurozone in four and a half years. Annual inflation ticked up to 0.2% in November from 0.1% in October.

Politics was a source of uncertainty in southern Europe as first Portugal and then Spain held inconclusive general elections. In Portugal, the centre-right initially retained power as the largest party although they lost their parliamentary majority. However, this proved unsustainable and Antonio Costa, leader of the Socialist Party, was sworn in as prime minister in November. In Spain, Mariano Rajoy's governing People's Party emerged once again as the largest party but lost a significant number of seats, raising the possibility that a second election could be held. The Paris terrorist attacks and the ongoing migrant crisis also dominated headlines during the quarter.

Automobile stocks were particularly strong in Q4, rebounding from the weakness experienced in the wake of the Volkswagen emissions scandal and also supported by strong demand for autos (new passenger car registrations in the EU rose 13.7% year on year in November). The food, beverage and tobacco sub-sector was another gainer amid the takeover of SABMiller by Anheuser Busch InBev. Pharmaceutical stocks were the laggards.

## UK

The UK equity market rose over the fourth quarter as it recovered from the sharp correction in the summer when fears about global growth and the outlook for the Chinese economy had dominated sentiment. There was a pronounced rally in October as China's central bank eased monetary policy and the ECB hinted that it would do likewise. The FTSE All-Share Index delivered a total return of 4.0% over the quarter, despite ending the period on a negative note amid fresh concerns about the outlook for the Chinese economy and renewed weakness in crude oil prices.

Financials and the more defensive sectors of consumer goods, healthcare and telecommunications were positive influences on market performance. The oil & gas and basic materials sectors performed relatively poorly, the latter recording fresh losses over the quarter as weak commodity prices called into question the resilience of balance sheets and the sustainability of dividends.

Large caps performed particularly well during October's liquidity-driven market recovery. Mid caps then outperformed in November, their relative strength driven by a recovery in some of the mid-sized industrial companies, and particularly the UK defence sector as the UK military spending outlook improved following the Strategic Defence and Security Review and as geopolitical tensions increased.

Risk appetite waned again in December after the ECB stopped short of expanding its quantitative easing programme. The large cap resource sectors came under pressure as the oil price fell and Anglo American suspended its dividend. Mid and small cap domestically focused companies performed relatively well in December as expectations for the first increase in UK bases rates moved out, following dovish minutes from the Bank of England's rate-setting meeting.

## Japan

The Japanese equity market started the last quarter of 2015 by rebounding sharply in October after the correction in August and September. The Topix Index then moved broadly sideways, returning +9.8%, in yen terms, for the quarter. However, the relative strength of the yen over the period saw this boosted to a +12.7% return for a sterling investor.

The rebound in October was driven by a recovery in cyclical, although this was followed by a resumption of outperformance by more defensive areas in November and December. Half-year corporate earnings results were moderately better than expectations. Economic data remained mixed, with gradual progress in wage growth and inflation numbers but data early in the period revealed a Japanese economy in a technical recession.

However, in December revised third quarter annualised GDP ended up showing a 1% expansion, significantly ahead of the preliminary figure of a 0.8% decline. Meanwhile, the Bank of Japan's quarterly Tankan survey was relatively lacklustre. Although the government can legitimately claim that Japan has exited deflation, the break with the past has not been as decisive as hoped, although this is undoubtedly due in part to the unexpected weakness in energy prices.

External events dominated late into the quarter, including the negative reaction of investors to the latest measures announced by the ECB, which fell short of expectations. In contrast, the first increase in US interest rates for more than six years was, in the event, universally anticipated by investors and therefore had no significant impact on equity markets.

## Asia (ex Japan)

Asia ex Japan equities delivered positive returns in the last quarter of 2015, as the robust gains in October offset negative returns in November and December. In December, the US Fed raised its interest rate for the first time since 2006, as was widely expected. Positive gains were driven by developments in China. Chinese equities were up over the quarter as late October saw another interest rate cut by the People's Bank of China (PBoC), the sixth such cut in a year. However, the data for the economy continued to remain 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.

Meanwhile, in Hong Kong, stocks saw positive returns on the back of hopes of further stimulus measures in China. Over the strait in Taiwan, equities finished in positive territory on heightened expectations for the island's technology sector after a strong earnings season for US technology firms. In Korea, stocks delivered strong gains over the quarter as its export-oriented firms posted robust earnings on the back of a weaker Korean won.

In ASEAN, the Philippines and Thailand both finished down. However, Indonesia bucked the trend and surged over the period as a rebounding Indonesian rupiah and plans for extensive infrastructure spending drove gains. Indian stocks fell back in the last quarter of 2015 on a weaker-than-expected earnings season and the lack of progress on reforms.

## Emerging markets

Emerging market equities increased in value in the fourth quarter, although a stronger US dollar and concerns over slowing growth in China, which put pressure on commodity prices, served to weigh on returns. The MSCI Emerging Markets index posted a positive return but lagged the MSCI World. Emerging Asian markets performed relatively well. Indonesia was the best performing index market, with a 6.4% appreciation in the rupiah supporting returns as Q3 data indicated a narrowing in the country's current account deficit. China posted a solid gain as the People's Bank of China (PBoC) provided support to the economy. This included moves to cut the interest rate, the reserve requirement ratio (RRR) for banks, and remove a deposit cap that limited the rate banks can pay savers. Thailand posted a decline and was the worst performing regional market.

Emerging EMEA equities were relatively weak. Hungary was the exception, posting a sharp gain. Russia lagged the benchmark, with currency weakness, precipitated by a 22.9% decline in the price of Brent crude, the main drag on returns. Despite some stabilisation in the Ukraine crisis, Russia's entry into the Syrian war added a new dimension to geopolitical risk. Underlying macro data remained weak and Q3 GDP growth contracted 4.1%. Greece was the weakest index market, largely due to major declines in banking stocks.

In Latin America, all of the regional countries underperformed, with commodity price weakness weighing on performance across a number of markets. All of the region's central banks, with the exception of Brazil, moved to hike rates in line with the Fed in December. Chile proved most resilient as macro data indicated some recovery and GDP growth climbed to 2.2% year on year. In contrast, economic data in Brazil continued to deteriorate. Amid ongoing political wrangling in Congress, the fiscal budget target was changed several times from a small surplus to a deficit. The downgrade of Brazil to non-investment grade by two ratings agencies then prompted the finance minister to resign in December. Impeachment proceedings against the president also commenced in December.

## Global bonds

Government bond market movements over the final quarter of 2015 broadly reflected the diverging policy trajectories of the world's major central banks. Mounting expectations of a rate rise from the US Fed were fulfilled in December; with the 25 bps rate rise the first in almost a decade. In the eurozone, the ECB delivered on its promise to extend policy accommodation, but the measures ultimately fell short of market hopes. The 10-year Treasury rose from 2.04% to 2.27% over the final three months of the year. The 10-year Bund yield rose from 0.59% to 0.63%. The 10-year gilt yield rose from 1.76% to 1.96%.

In corporate bonds, investors in euro and sterling credit markets balanced a general improvement in domestic economic data with negative developments from emerging markets and high profile companies such as Petrobras, Glencore and Volkswagen. In the US, the oil price weighed more significantly on corporate bonds, with high yield particularly vulnerable to the energy price declines.

Total returns for the investment grade BofA Merrill Lynch Global Corporate Bond index were broadly flat over Q4 at 0.03%, while high yield bonds declined -0.7% (local currency)<sup>1</sup>. The weakness was led by US dollar credit. US dollar investment grade corporate bonds fell -0.6% while high yield bonds fell -2.2%. Euro and sterling corporate market returns were positive in Q4 across investment grade and high yield.

### Overview: total returns (%) – to end of Q4 2015

Equities	3 months			12 months		
	EUR	USD	GBP	EUR	USD	GBP
MSCI World	8.53	5.62	8.55	11.03	-0.32	5.45
MSCI World Value	7.70	4.82	7.72	6.81	-4.11	1.45
MSCI World Growth	9.34	6.41	9.36	15.28	3.50	9.49
MSCI World Smaller Companies	7.20	4.33	7.22	11.52	0.12	5.92
MSCI Emerging Markets	3.50	0.73	3.52	-4.87	-14.60	-9.65
MSCI AC Asia ex Japan	6.73	3.87	6.75	1.47	-8.90	-3.63
S&P500	9.99	7.04	10.01	12.93	1.38	7.25
MSCI EMU	6.51	3.66	6.54	10.55	-0.76	4.99
FTSE Europe ex UK	6.05	3.21	6.07	10.92	-0.42	5.35
FTSE All-Share	3.93	1.15	3.95	6.32	-4.55	0.98
TOPIX*	12.36	9.35	12.38	24.41	11.69	18.16

Government bonds	3 months			12 months		
	EUR	USD	GBP	EUR	USD	GBP
JPM GBI US All Mats	1.79	-0.94	1.81	12.36	0.87	6.71
JPM GBI UK All Mats	-1.34	-3.98	-1.32	6.51	-4.38	1.15
JPM GBI Japan All Mats**	3.50	0.73	3.52	12.41	0.92	6.76
JPM GBI Germany All Mats	-0.38	-3.05	-0.36	0.37	-9.89	-4.67
Corporate bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global Broad Market Corporate	1.89	-0.84	1.91	7.19	-3.77	1.80
BofA ML US Corporate Master	2.18	-0.56	2.20	10.69	-0.63	5.12
BofA ML EMU Corporate ex T1 (5-10Y)	1.57	-1.15	1.59	-0.83	-10.97	-5.81
BofA ML £ Non-Gilts	0.48	-2.21	0.50	6.04	-4.80	0.72
Non-investment grade bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global High Yield	1.47	-1.25	1.49	6.74	-4.17	1.38
BofA ML Euro High Yield	1.26	-1.46	1.28	0.73	-9.57	-4.33

Source: DataStream. Past performance is no guarantee of future results. Index returns shown for illustrative purposes only. Actual results would vary. Investors cannot invest directly in any index. Returns for periods less than one year are not annualized. Local currency returns in Q4 2015: \*9.83%, \*\*1.17%.

<sup>1</sup> 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.

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