

Obama's reforms take the edge off risk appetite

25 January 2010*

NEWS

- Major equity markets suffered last week as the US Administration proposed the largest reforms of banking regulation since the Great Depression and China sought to tighten monetary policy following higher-than-expected inflation and GDP growth. Global equities fell 3.3% over the week.
- Kraft's protracted takeover of one of the UK's most iconic brands, Cadbury, appeared to be resolved as both agreed terms on an £11.9bn deal for the UK confectionery firm. Months of hostile relations between the two were ended as Kraft increased its bid, valuing Cadbury at 850p a share. Hershey's chose not to counter-bid, ruling out the prospect of a bidding war.
- UK inflation managed to surprise market participants to the upside once again in December, driven largely by the effects of the cut in value added tax November 2008 dropping out of the annual comparison. Less Christmas discounting by retailers than in previous years and unchanged fuel prices added to inflationary pressures in December.

VIEWS

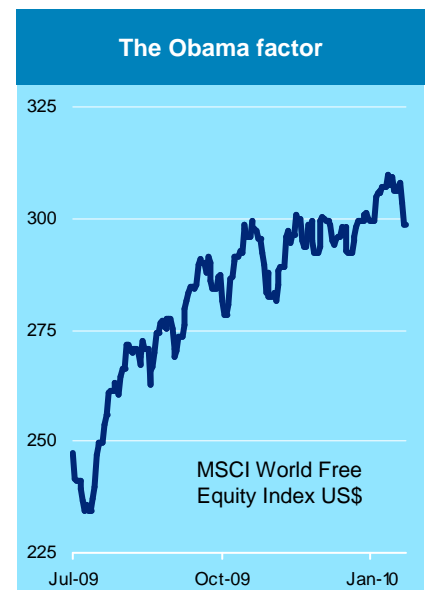
- The markets' reaction to the change in Chinese policy shows how sensitive and nervous they are about exit strategies while the global economy remains fragile. However, China retains an elevated target for lending during 2010, so while policymakers are keen to pre-empt potential inflationary pressures, they are likely to wait to see lenders' response to this initial policy change before making further adjustments.
- The persistence of low readings in small business optimism is a concern as this sector has created many new jobs over the past 15 years. However, the ADP employment report that analyses payrolls across sectors reveals that small businesses have slowed their labour shedding in line with the broader economy, so hopefully the improving unemployment picture will remain intact.
- The slightly disappointing data from the US and muted inflation data is unlikely to change the Federal Reserve's focus on the labour market and further signs of economic recovery before deciding when to implement an exit strategy.

THIS WEEK

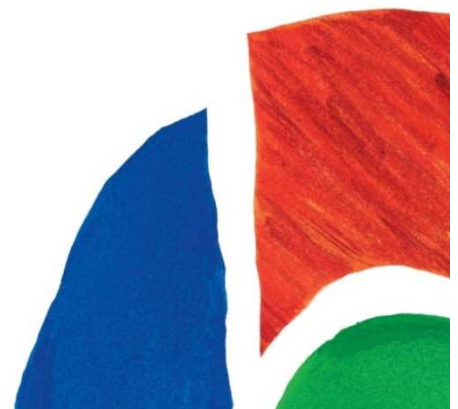
- A number of central banks meet this week (including the US Fed and Bank of Japan) to decide on the direction of interest rates; however, no changes are expected. There are also a number of releases from different countries on unemployment and labour costs.

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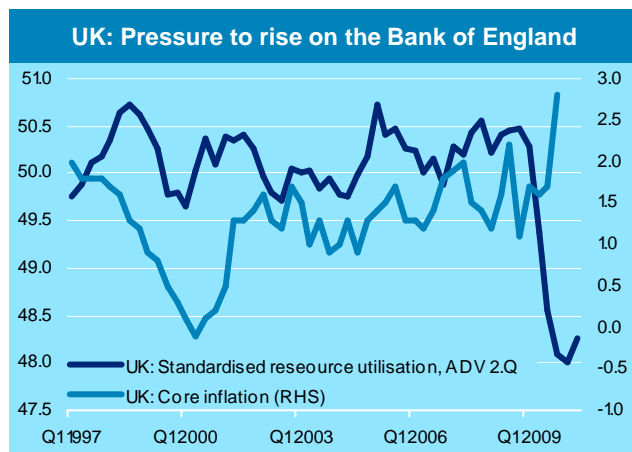
*All data to week ending 22 January 2010
unless otherwise stated



Source: MSCI, Bloomberg, as at 22 January 2010



ECONOMIC DATA



Source: Datastream, Henderson Global Investors, as at 22 January 2010

GDP Growth %	2008	2009*	2010*
US	0.4	-2.5	2.7
Japan	-0.7	-5.3	1.5
Eurozone	0.5	-3.9	1.3
UK	0.6	-4.5	1.4
G7	0.3	-3.5	1.9
Asia ex Japan	6.6	5.2	7.7
World	2.0	-2.2	2.9

Inflation %	2008	2009*	2010*
US	3.8	-0.4	2.1
Japan	1.4	-1.3	-1.0
Eurozone	3.3	0.3	1.2
UK	3.6	2.1	2.3
G7	3.3	-0.1	1.4
Asia ex Japan	6.6	1.8	2.5
World	4.9	1.4	2.4

Bond Indices	15 Jan	22 Jan	% cge
FTA Government Stocks	2300	2301	0.1
FTA Index-Linked	2516	2495	-0.8
JP Morgan Global Govt Bond Index	535	539	0.6

10-year Bond Yield (%)	15 Jan	22 Jan	Dec 2010*
UK	4.04	4.01	↑↑↑
US	3.68	3.61	↑↑↑
Eurozone	3.27	3.21	↑
Japan	1.32	1.32	↑

Other	15 Jan	22 Jan	June 2010**
Interest Rates (%)			
UK	0.50	0.50	0.50
US	0.25	0.25	0.25
Eurozone	1.00	1.00	1.00
Japan	0.10	0.10	0.10

Currencies & Commodities	15 Jan	22 Jan	Dec 2010**
£/€	0.88	0.88	↑
\$/£	1.63	1.61	↑
\$/€	1.44	1.41	↑
¥/\$	90.9	90.1	↑
Oil (Brent crude \$/barrel)	77.1	73.1	↑
Gold (\$/Troy oz)	1133	1092	↑

↑↑↑	Strong upward trend
↑	upward trend
→	Little change
↓	downward trend
↓↓↓	Strong downward trend

Source: Datastream, Henderson Global Investors, as at 22 January 2010
 * Consensus forecast, as at 31 December 2009
 ** Henderson Interest Rate Team forecast

MACRO

There has always been a chance of regulatory overshoot following the deepest recession since World War II which was, in no small part, caused by one of the biggest failures in banking and financial market supervision. Last week, the US Administration made the possibility somewhat more realistic as it announced its plan for the single largest re-enforcement of US bank regulation since the Great Depression. Details of the potential legislation – which is by no means assured passage through Congress (especially following the Democrats' loss of the Massachusetts Senate seat last week) – remain sparse, but the plan has two broad goals: limit both banks' sizes and their ability to trade using their own capital. Risk assets reacted negatively as the S&P 500 plummeted more than 1% immediately following the announcement. Global equities were 3.3% lower on the week.

UK inflation data for December managed to surprise market participants to the upside once again, driven largely by the effects of the cut in value added tax in November 2008 dropping out of the annual comparison. Less Christmas discounting by retailers than in previous years and unchanged fuel prices added to inflationary pressures in December.

UK gilts fell sharply following the release and underperformed their developed market counterparts on the week. The common belief is that the 2008 collapse in sterling continues to feed through to prices, but opinions remain divided on whether this is a single or multi-year event. Our belief remains that the effects of the fall in sterling will continue to wane, and excess slack in the economy will push inflation lower toward the end of 2010 after the temporary effects of the VAT hike and rises in energy and food prices wane.

Minutes of the Bank of England's meeting held during the first week of January reiterated its belief that the current bout of resurgent inflation is transitory in nature and that spare capacity will bear down on inflation toward the end of 2010. However, the Bank expressed some uncertainty as to the exact level of spare capacity in the economy and indicated that it would endeavour to investigate this issue further.

BONDS & CURRENCIES

Concerns over monetary tightening in China, continued worries over Greece's sovereign debt and Barack Obama's proposals to restrict the activities of US banks, saw investor flight to the relative safety of the yen and dollar. The yen's rise was largest against commodity-linked currencies such as the Australian dollar, which faced the reality of less demand from China for its raw materials. Japan's currency also rose 1.8% against the pound and 0.8% against the dollar. The euro came under further pressure during the week, crashing to a five-month low against the pound, as the fiscal situation in Greece continued to hammer the single currency. The spreads of 10-year government bond yields over German bunds hit their highest levels since 2001.

The flight to safer assets benefited US government bonds with the 10-year treasury yield falling to 3.61%, as well as the 10-year bund yield shedding 5bp to 3.21%.

COMMODITIES

Oil prices fell to their lowest levels since 23 December 2009 following China's decision to implement measures to cool the economy; this was in spite of Chinese data showing monthly crude imports passing the 5 million mark for the first time last month. Prices were further hampered by a stronger dollar. Copper prices regained some of their losses earlier in the week to finish slightly lower at \$7,380 a tonne.

UK EQUITIES: the FTSE100 (-2.8%) completed a miserable week ending in negative territory, with banks and miners suffering. Financial stocks were hit by the proposed reforms limiting the activities of US banks and signs of fiscal tightening in China put pressure on miners.

On Thursday, President Obama called for commercial banks to be banned from running their own trading desks as well as "owning, investing or sponsoring" hedge funds and private equity groups. Barclays (-12.8%) appears to be one of the British banks most at risk following its acquisition of Lehman Brothers' American trading desk. This, combined with fears that it will need to raise fresh capital from shareholders, saw the share price tumble. Both Lloyds (-5.6%) and RBS (-5.6%) also fell following the news. Miners were in focus for the wrong reasons as speculation grew that China would increase interest rates amid signs the economy was overheating. Their problems were further exacerbated by news that Australia's tax system had recommended a change to the way miners were charged. Rio Tinto was among those to suffer falling by 8.1% over the week, one of the biggest fallers in the FTSE100.

Kraft's protracted takeover of Cadbury (+4.9%) appeared to be resolved this week as both agreed terms on an £11.9bn deal for the UK confectionery firm. Months of hostile relations between the two were ended as Kraft increased their bid, valuing Cadbury at 850p a share. The deal was met with mixed responses, notably major shareholder Warren Buffett describing it as a "bad deal". Buffett had earlier signalled his intent to veto any rights issue but in the end Kraft's bid included more cash and fewer new shares, removing the need for shareholder approval. The loss of one of Britain's most iconic brands to an American firm is a major blow for the UK, with Gordon Brown urging Kraft to preserve Cadbury's UK business. In the wake of the deal, Hershey's ruled out any counterbid.

Elsewhere, British Airways (+8.0%) was the best performing stock of the week as cabin crew decided not to strike over Easter and encouraging results from rival Easyjet saw its price take off. Vodafone also finished the week strongly as analysts remained confident ahead of quarterly figures due out next week despite a recent price war in India.

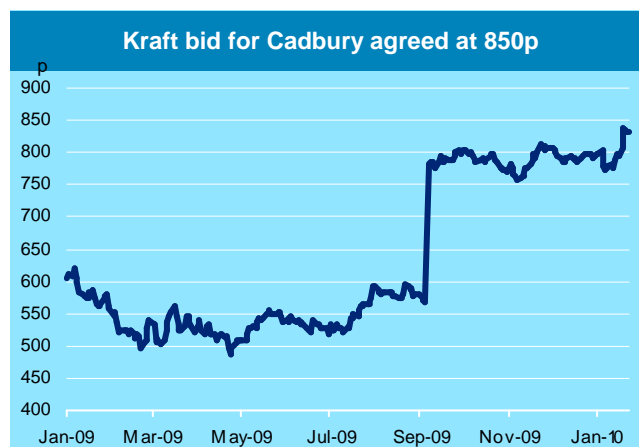
Mid and small caps: Entertainment One (+17.0%), the media firm behind the Twilight vampire films, surged ahead after predicting better-than-expected full year results after a strong third quarter. The firm, which has made just under 100 releases so far this financial year and has a strong pipeline, remains confident that momentum will continue. Petra Diamonds (-12.2%) suffered heavy trading on Friday as Lehman Brothers administrator sold 20 million shares held as collateral against a loan. The stock was sold at up to a 28% discount to Friday's opening price.

OVERSEAS EQUITIES

European markets: after hitting a 15-month high on Tuesday the FTSEurofirst300 (-2.6%) closed the week at its lowest level in a month. European financials suffered from Obama's calls for banking reforms with Deutsche Bank (-7.2%) and BNP Paribas both falling (-7.0%).

German investor confidence, as measured by the ZEW index, fell more than expected as signs emerged of the economic recovery losing steam. Having recently been surpassed by China as the world's biggest exporter ECB President Jean-Claude Trichet emphasised that the euro area still faced a "bumpy road" to recovery. Concerns in Europe also grew over Greece's ability to manage its large budget deficit.

MARKET DATA



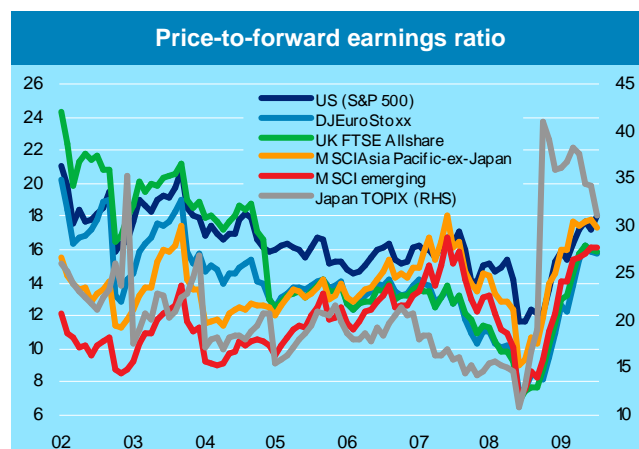
Source: Datastream, as at 22 January 2010

Equities	15 Jan	22 Jan	% cge
UK - FTSE All-Share	2790	2714	-2.7
UK - FTSE 100	5455	5303	-2.8
UK - FTSE 250	9538	9325	-2.2
UK - FTSE Small Cap	2881	2819	-2.2
Eurozone - DJ Euro Stoxx	275	267	-3.2
US - S&P 500	1136	1092	-3.9
US - Nasdaq	2288	2205	-3.6
Japan - Topix	966	941	-2.6
Hong Kong - Hang Seng	21654	20726	-4.3
MSCI Emerging Markets (US\$)	1011	964	-4.6

Source: Datastream, as at 22 January 2010

Consensus EPS Growth %	2010* (yoy)	2011* (yoy)	2012* (yoy)
US	1.8	29.4	21.8
Japan	N/a	91.1	26.0
Eurozone	-26.6	32.2	23.2
UK	-32.9	28.9	24.9
Asia ex Japan	3.3	22.1	17.6
MSCI Emerging Markets US\$	2.4	27.9	20.2

Source: Datastream, Henderson Global Investors, as at 31 December 2009
* Consensus forecast

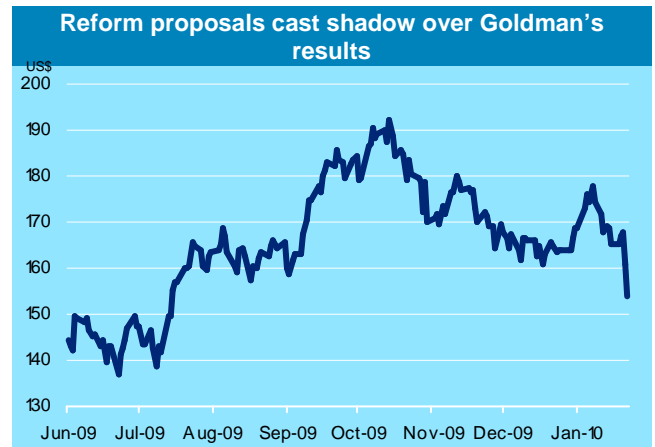


Source: Datastream, Henderson Global Investors, as at 31 December 2009

US markets: concerns about banking reforms ensured the S&P500 (-3.9%) endured its worst week since October. Earnings releases from US banks were overshadowed by sweeping sector reforms proposed by President Obama. Despite releasing positive results, Goldman Sachs (-6.7%) and other major investment banks ended the week in the red.

In other news, Republican Scott Brown won the vacant Massachusetts Senate seat buoying some healthcare stocks as hopes that the overhaul of the industry could face hurdles in Congress. Winners from the results included Humana (+5.1%), a health insurer, which would have seen its businesses shrink under the reforms, whilst owners of hospital stocks like Tenet Healthcare (-14.5%) lost out. The result of the election now means the Democrats lose their 60-vote Senate majority that enabled them to clear any Republican hurdles without a single Republican vote.

Asian markets: news in Asia was dominated by events in China as Q4 2009 GDP growth accelerated to 10.7%, the fastest pace since 2007, and Chinese banking authorities sought to rein in bank lending following a burst in credit growth in January. This prompted analysts to speculate that the government will raise its benchmark interest rate sooner rather than later to prevent overheating of the economy. Asian markets fell on the news with the Shanghai composite falling 3.0% extending its disappointing start to the year and the Nikkei 225 (-3.4%) unable to maintain its strong start to the year.



Source: Datastream, as at 22 January 2010

Elsewhere, Warren Buffett announced plans to increase his stake in South Korean steelmaker Posco. Buffett is already showing a profit in excess of \$1.3bn in his current holding but is keen to take advantage of an area he feels is undervalued - South Korean stocks. Posco announced a 77% rise in Q4 profits as well expansion into various foreign markets in 2010, which was welcomed by the investor guru.

Week ahead	Consensus	
Monday 25 January	INTERIMS: City of London Investment Group, Filtronic ECONOMICS: US: Existing home sales (Dec)	The sharp drop in the National Association of Realtors Pending Home Index points to a drop in existing home sales
Tuesday 26 January	INTERIMS: Ashley House, PZ Cussons FINALS: Porvair ECONOMICS: Japan: Bank of Japan rates decision Japan: Trade balance (Dec) Germany: IFO business climate survey (Jan) UK: GDP (Q4 2009 advanced figure)	No change Expected to show continuing recovery in exports Modest improvement Modest rise indicates UK exiting recession
Wednesday 27 January	INTERIMS: Best of the Best, Renishaw, System C Healthcare FINALS: Galleon Holdings TRADING ANNOUNCEMENTS: Britvic, Gottex Market Neutral Trust Ltd., Tullow Oil, Vedanta Resources, WH Smith ECONOMICS: US: FOMC rates decision US: New home sales (Dec) Japan: Retail sales (Dec, yoy) Germany: CPI (Jan, yoy and mom)	No change Little change from previous levels Minor increase Modest rise in energy and transport costs
Thursday 28 January	INTERIMS: British Sky Broadcasting Group, Eaga FINALS: AstraZeneca ECONOMICS: Germany: Unemployment rate (Jan) Eurozone: Business climate indicator (Jan) Eurozone: Industrial, economic, consumer and services confidence indicators (Jan) US: Durable goods orders Japan: Unemployment rate (Dec) Japan: Industrial production (Dec, mom)	Minor increase as recent winter weather hits construction industry Further improvement Higher petrol prices dampens consumer confidence Reasonably strong Expected at just over 5% Recovery supported by exports
Friday 29 January	FINALS: Safestore ECONOMICS: Eurozone CPI (Jan, yoy, estimated) US: GDP (Q4 2009 advanced) US: Chicago Purchasing Manager survey (Jan) US: University of Michigan confidence index	Growth driven primarily by the inventory, residential and government Modest slowdown from previous month Similar to previous month

Markets returns source Datastream price index for equities, total return for bonds, local market terms. This document has been produced based on Henderson Global Investors' research and analysis and represents our house view. The information is made available to clients only incidentally. Unless otherwise indicated, the source for all data is Henderson Global Investors. Any reference to individual companies is purely for the purpose of illustration and should not be construed as a recommendation to buy or sell or advice in relation to investment, legal or tax matters. Please remember that past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. Tax assumptions may change if the law changes, and the value of tax relief will depend upon individual circumstances.

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