Henderson Global Investors

Weekly Market & Economic Update

Markets suffer from 'winter blues'

18 January 2010*

NEWS

- Equities came under pressure last week amid disappointing results from JP Morgan, a less than compelling outlook for retailers, and an increase in banks' capital requirements in China. The only major developed market to post a gain was Japan.
- Google highlighted the difficulties some companies with western, liberal values face whilst doing business in China. The company revealed that email accounts belonging to Human Rights activists had been hacked, and as a result it would cease censorship of its Chinese website, which might entail a withdrawal from the Chinese market altogether. Some commentators said that Google was trying to create PR capital, when in reality it was exiting China due to a poor financial performance.
- The oil price dropped below $80 per barrel as the International Energy Association suggested that demand may be weaker than some analysts expect, despite the biting cold of this year's winter. People were beginning to show a clear preference for cleaner, more sustainable sources of energy, a statement said.

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

- The US markets are closed on Monday for a public holiday. In the Eurozone, there are a number of data releases on economic activity, while in Asia, the focus will be on real GDP growth releases in China and South Korea.

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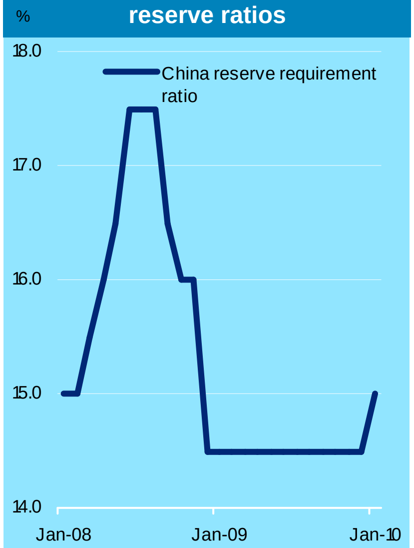
*All data to week ending 15 January 2010 unless otherwise stated

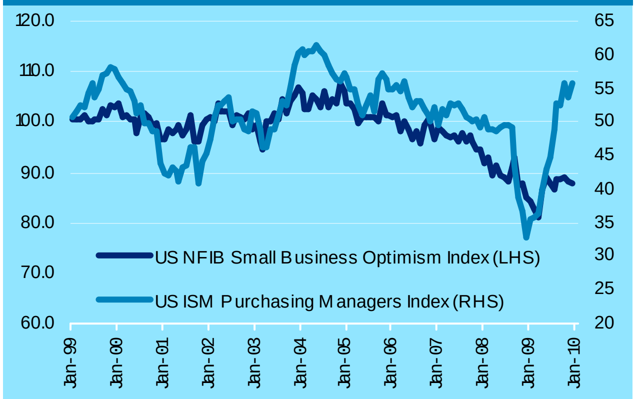
Chinese increasing bank reserve ratios



Source: Datastream, Henderson Global Investors, as at 15 January 2010

ECONOMIC DATA

Small business confidence



Source: Datastream, Henderson Global Investors, as at 15 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	8 Jan	15 Jan	% cge
FTA Government Stocks	2278	2300	1.0
FTA Index-Linked	2493	2516	0.9
JP Morgan Global Govt Bond Index	538	535	-0.4
10-year Bond Yield (%)	**8 Jan**	**15 Jan**	**Dec 2010***
UK	4.16	4.04	↑↑
US	3.83	3.68	↑↑
Eurozone	3.38	3.27	↑
Japan	1.35	1.32	↑

Other Interest Rates (%)	8 Jan	15 Jan	June 2010**
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	**8 Jan**	**15 Jan**	**Dec 2010****
£/€	0.90	0.88	↑
$/£	1.60	1.63	↑
$/€	1.43	1.44	↑
¥/$	93.0	90.9	↑
Oil (Brent crude $/barrel)	80.7	77.1	↑
Gold ($/Troy oz)	1132	1133	↑

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

Source: Datastream, Henderson Global Investors, as at 8 January 2010
* Consensus forecast, as at 31 December 2009
** Henderson Interest Rate Team forecast

MACRO

After a steady start to the year in asset markets and positive economic data, last week's events reminded investors that the path of recovery is still shaky. Once again, Chinese policymakers attempted to moderate last year's aggressive expansion of credit, expressing concerns of overheating and asset price bubbles in certain sectors of their economy. The People's Bank of China sold 1-year bills at the highest interest rate for about five months and was interpreted by investors as a sign that policymakers are attempting to anticipate inflationary pressures. In addition, they announced a 50bp increase in the reserve requirement ratio, the first increase in the ratio since June 2008.

US data was largely disappointing with small business optimism dipping to its lowest level for five months. The lacklustre pickup seen since the survey's low point in March 2009 is a concern as this sector of the economy has provided just under two-thirds of jobs growth in the US over the last 15 years. Retail sales were worse than expected, recording a fall for December when economists expected a rise. On a more positive note, November's figures were revised up and the trend for sales and therefore consumption remains on an upward trajectory despite last month's setback.

US industrial production grew in line with expectations in December with the gain in electric and gas utilities being a principal driver due to the cold weather. For the fourth quarter as a whole, industrial production grew by 7% at an annualised rate. Industrial production for November was stronger than expected in the Eurozone, but still remains far below early 2008 levels. With some way to go to reach these levels, it is unsurprising that the European Central Bank (ECB) left rates on hold at 1%: ECB President Trichet indicated that they will wait for more signs of recovery in the economy before removing support.

BONDS & CURRENCIES

A move by China to tighten monetary policy caused concerns over the prospects for growth in the country, prompting extra demand for haven currencies such as the Japanese yen, and a reduced favour for commodity-linked currencies such as the Australian dollar. Chinese authorities said that they would be increasing the capital requirements of banks amid concerns that some banks' balance sheets were becoming over-extended.

Continuing problems in Greece negatively affected the euro's performance, which fell by 0.4% against the dollar. Greek sovereign debt was also under pressure, with the yield on a 10-year note climbing to 6.02%. This compares to 3.68% yield on the US equivalent issuance. Sterling, meanwhile, rose 1.5% against the dollar and 1.9% against the euro after strong industrial numbers were released.

COMMODITIES

The oil price retreated below $80 per barrel, after the International Energy Agency left its demand forecasts unchanged, when many were expecting an increase in light of the northern hemisphere's particularly cold winter. However, the agency noted that people were increasingly heating their homes with cleaner sources of energy, such as natural gas. Copper and aluminium also fell slightly from recent highs due to rising inventories. The gold price was flat.

UK EQUITIES

Retailers came under pressure last week, after a series of trading updates suggested that despite strong demand in the run up to Christmas, the outlook for 2010 was less positive. Citigroup, for example, moved the sector's weighting to 'underweight', citing the possibility of a rising tax burden on households and the political uncertainty faced in the run-up to a general election. HMV, for example, had a particularly poor week. Despite revealing that total sales had increased year-on-year, the market remained unimpressed, moving the stock down 12.7% over the course of the week. It was simultaneously revealed that Gerry Johnson, head of the underperforming Waterstones business, would be leaving the company.

The battle over Cadbury's (+2.0) is nearing its climax, with both sides using the power of rhetoric to try and convince shareholders of the value of their position. Roger Carr, chairman of Cadbury's, has repeatedly told the market that he considers Kraft's current offer, which values the company at around 771p per share, as 'derisory', and said he would not consider opening the books to Kraft unless the bid moved up to 850p per share. Kraft has until close of trading on Monday 18 January to revise its offer, though it is unclear exactly how determined the company is, with major shareholders Warren Buffet and Legal & General, publicly criticising the bid.

Shareholders in defence company QinetiQ (-13.6%) will have been disappointed last week, as the company issued its second profit warning in two months, saying it would not receive the normal uptick in second-half performance. A lack of clarity in UK and US government defence spending policy has led to poor visibility in earnings for QinetiQ, and even though Obama has now announced his Afghanistan strategy, this has not yet translated into orders for the group.

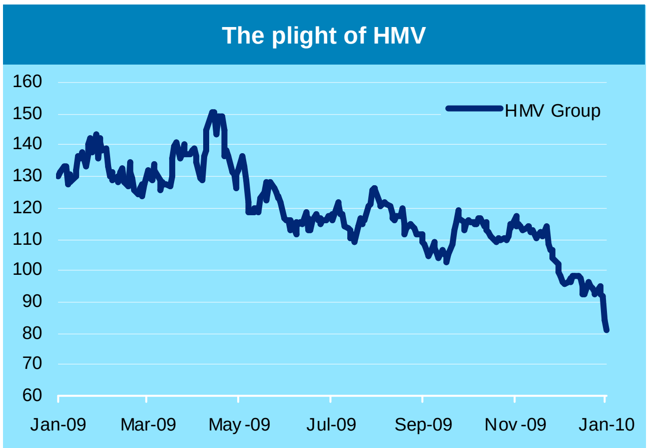
Mid and small caps: RM Group, provider of educational IT services, moved up 7.5% over the week. Brokers reacted positively to developments in the 'Building Schools for the Future' campaign by the UK government and the company's strong position at a trade fair designed to increase RM's profile both in the UK and in the US - a new market for the company. Aga (+15.8%) seems to have weathered the economic downturn, announcing that it now expects to post a profit for 2009.

OVERSEAS EQUITIES

European markets: the FTSE Eurofirst moved down 1.2% over the week, with banking shares making gains early on before giving them up as trading drew to a close on Friday.

On the German exchange, Commerzbank and Deutsche Bank were down 3.2% and 8.3% respectively, whilst elsewhere, Societe Generale (SG) fell 5.9% and Italian bank Unicredit fell 2.5%. The falls seem to reflect a feeling that banks may have risen too far, after SG suggested that its profits may fall short of some analysts' estimates. French supermarket giant Carrefour advanced 3.9%, after saying that 2009 performance was in line, but that the outlook was improving. Bank of America Merrill Lynch analysts raised the price target slightly, and seemed rather pleased that the newly- appointed managing director of Carrefour in France would be British.

MARKET DATA



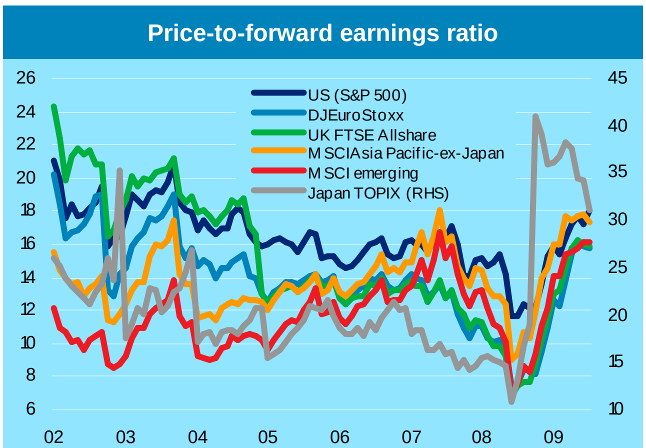
Source: Datastream, as at 15 January 2010

Equities	8 Jan	15 Jan	% cge
UK - FTSE All-Share	2829	2790	-1.4
UK - FTSE 100	5534	5455	-1.4
UK - FTSE 250	9689	9538	-1.6
UK - FTSE Small Cap	2858	2881	0.8
Eurozone - DJ Euro Stoxx	281	275	-2.1
US - S&P 500	1145	1136	-0.8
US - Nasdaq	2317	2288	-1.3
Japan - Topix	941	966	2.7
Hong Kong - Hang Seng	22297	21654	-2.9
MSCI Emerging Markets (US$)	1016	1011	-0.6

Source: Datastream, as at 15 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

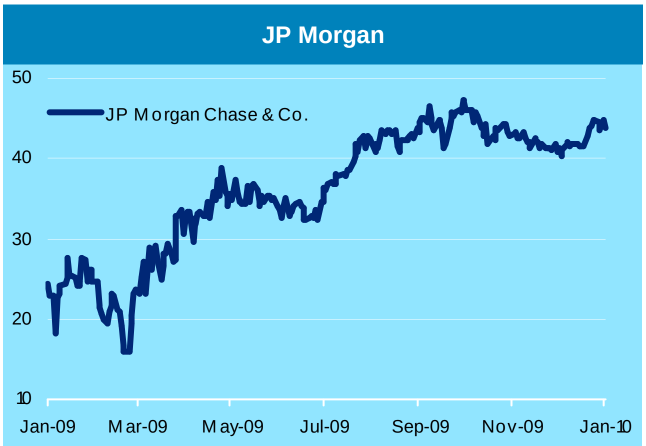


Source: Datastream, Henderson Global Investors, as at 31 December 2009

US markets: JP Morgan's results missed consensus expectations on Friday, with repercussions felt keenly throughout the rest of the US as well as international markets. Despite a strong performance in its investment banking business, the company's retail division fared poorly, with losses in retail lending activities such as credit cards and mortgages. The company's stock fell by 2.2% throughout the week. Bank of America and Citigroup fell in sympathy, by 3.1% and 4.7% respectively. US banks were also in focus earlier in the week, as the US government publicly pondered ways in which the banking sector could be made to repay the financial costs to the taxpayer. Added to further controversy over extravagant bonuses, investors in the sector may have felt that a 1.8% fall over the week was not the worst that could have happened.

Things were chipper at Intel, after world's largest microprocessor manufacturer beat analysts' expectations, sending the stock higher on Thursday, but finishing more or less flat after investors took profits. The company said that consumer demand for electronic products was improving.

Elsewhere in Silicon Valley, Google was hitting the headlines after it announced it would be reversing its decision to censor search results through its Chinese website. The decision came after Google email accounts belonging to human rights activists and corporations were hacked from within China. Although Google didn't overtly accuse the Chinese government, the implication was clear. The market seemed relatively sanguine about the financial implications of this move as Chinese revenues account for only 1.5% of Google's total.



Source: Datastream, as at 15 January 2010

Asian markets: Google's main competitor in China, Baidu, responded bullishly to the news, moving up over 15% during the week. Investors were clearly relishing the thought of significant extra market share to be gained by Google's exit.

Japan had another good week, with the Nikkei posting a 1.7% increase, despite a strengthening yen. The Shanghai stock exchange was also strong, despite being severely tested by news of increased capital requirements for banks. The Shanghai Composite ended up 0.9%.

Week ahead		Consensus
Monday 18 January	**TRADING ANNOUNCEMENTS :** ASOS, Taylor Wimpey	
Tuesday 19 January	**INTERIMS :** Games Workshop Group, IG Group Holdings, Zetar **ECONOMICS**: UK: CPI (Dec mom and yoy) UK: RPI (Dec, yoy) Germany: ZEW sentiment surveys (Jan) Eurozone: ZEW economic sentiment survey (Jan) Australia: Consumer sentiment (Jan)	 Slight rise as VAT and petrol price cuts from last year come out House price falls and large mortgage rate cuts last year drop out No change expected
Wednesday 20 January	**FINALS:** Wynnstay Group **TRADING ANNOUNCEMENTS**: Kesa Electricals **ECONOMICS:** UK: Bank of England minutes published UK: Claimant count rate (Dec) UK: Jobless claims change (Dec) UK: Average earnings (Nov yoy) US: Producer price index (Dec, mom) US: PPI ex food & energy (Dec, mom)	 Unanimous decision Flat Broadly unchanged Falling energy prices will cause the headline index to decline
Thursday 21 January	**INTERIMS:** Begbies Traynor Group, NCC Group **ECONOMICS:** France: PMI manufacturing (Jan, prov) Germany: PMI manufacturing and services (Jan, actual) Eurozone: PMI manufacturing and services (Jan, actual) UK: PSBR and money supply (Dec, mom, yoy) US: Initial jobless claims (16 -Jan) China: Real GDP (Q4 09, yoy) China: Retail sales (Dec, yoy)	 Upward move expected Services continue to outperform; cold weather affects manufacturing At the turning point Acceleration expected Increase expected as incomes grow
Friday 22 January	**ECONOMICS:** UK: Retail sales (Dec, mom, yoy) Eurozone: Industrial new orders (Nov, mom, yoy)	Underlying growth continues; robust pre-Xmas sales Orders positive again