Schroder Emerging Markets Fund Update – October 2009

Market Summary

Although economic activity, particularly in the US, Europe and Japan, will be very weak this year, there are clear signs that a recovery is underway with various economic indicators such as the PMI and ISM indices now signalling an expansion in activity. However, any recovery next year is likely to be modest. Our 2010 OECD GDP forecast is for growth of +1.3% and global growth of +2.2%. Given this scenario GDP in the emerging world will also slow, but remain 3%-4% above that of the developed economies. With the improvement in data such as the OECD leading indicator, US existing home sales etc. investors now appear to be focused on recovery. This improvement should not be too surprising as we are witnessing a sharp improvement in the inventory cycle. However, there is yet to be any meaningful recovery in final demand, which remains weak. Real consumption in the US remains subdued despite the fiscal stimulus as those in work increase savings. Activity in Europe continues to lag that in the US, but business surveys are improving, although the ongoing weakness of the US dollar could undermine the recovery due to the dependence of the Euro-zone on exports. In addition we expect the pick-up in the inventory cycle will begin to fade and in our opinion the developed economies continue to face substantial headwinds. Bank lending growth is still anaemic and the benefits from falling oil prices and fiscal stimulus will begin to fade as we head into 2010. Nevertheless, there is sufficient evidence to suggest that the risk of a slump is now very low. We think there is only a 10% chance of a significant deterioration in activity. GDP growth in the emerging world is expected to slow from +6.3% in 2008 to +1.5% in 2009 before recovering to +4.5% in 2010.

The pick-up in economic indicators has generated a sharp improvement in investor sentiment and produced a strong recovery in markets, which although losing momentum somewhat seems to be well supported. With uncertainty over the strength of future economic growth still prevalent, the abundant liquidity being provided by central banks around the world is unlikely to be removed anytime soon. This should be positive for equity markets. Moreover, earnings momentum is improving. For example, following aggressive cost cutting operational gearing in the US is relatively high, and forward looking estimates are being revised up. Furthermore, emerging markets earnings growth is expected to be 25-30% over the next 12 months and valuations remain attractive. We continue to believe an economic recovery will be underway by early 2010, albeit an anaemic one, and although the risk of a significant correction in the near term has receded, a moderate pull-back in markets would not be too surprising given the strength of the recovery year-to-date. However, the benign monetary and fiscal policy together with attractive valuations and growth prospects for the emerging world suggest that the outlook for GEMs remains favourable. Consequently portfolios are fully invested.

Current Strategy

What Have We Done:

We made several changes to strategy as this was a quarterly meeting. Thailand was moved from neutral to overweight as valuations are attractive and the outlook for growth has improved. Both the Czech Republic and Malaysia moved from underweight to neutral. Malaysian valuations are not that attractive but the economic outlook is improving. Czech growth is also improving, but attractive valuations are offset by poor earnings growth. We reduced the extent of the overweight positions to China, Korea, Russia and Turkey to move in line with the magnitude recommended by the model. Growth and earnings should be strong in China and valuations are reasonable. Korea is benefiting from the global recovery and valuations are attractive. Attractive valuations and improving economic conditions are also evident in Russia and Turkey. Elsewhere we increased the overweight to Hungary as interest rates continue to fall and financial conditions are easing, valuations also remain attractive. We also moved from overweight to neutral in Indonesia as valuations are now full and the earnings outlook is less appealing. Finally we moved from neutral to underweight Chile as valuations are expensive and the outlook for earnings growth is poor. We are now fully in-line with the model directionally and have only two small magnitude overrides.

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Main Allocation Changes to Portfolio:

Allocation changes in weights

Thailand	+2.3%	China	-0.5%
Malaysia	+2.7%	Korea	-0.5%
Hungary	+0.5%	Indonesia	-2.6%
Czech Republic	+0.5%	Chile	-1.4%
		Russia	-0.5%
		Turkey	-0.4%
Total	**+6.0%**	**Total**	**-5.9%**

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