Pan Europe Update

Aberdeen

Market Overview

European markets fell in January on renewed risk aversion, as the FTSE World Europe Index closed 3.8% lower. Sentiment was hurt by credit tightening in China, proposed banking curbs in the US and sovereign debt fears. Defensive sectors such as consumer goods and services as well as health care proved resilient, whereas basic materials and financials lagged.

Markets in Greece, Portugal and Spain saw heavy sell-offs, as concerns about the fiscal health of Europe's peripheral countries escalated. The European Commission reproached Greece for falsifying its public debt data, even as the country announced an ambitious three-year plan to curb its massive budget shortfall. Fitch cut Greece's debt rating to BBB plus. Subsequently, Greece issued €8 billion in new debt but the heavy oversubscription failed to assuage fears. Deficit worries soon spread to Spain and Portugal, leading to a spike in the cost of underwriting the sovereign debt for the three countries. The euro also sank to near eight-month lows against the US dollar.

On the policy front, the European Central Bank and Bank of England kept interest rates unchanged, as was widely expected. Inflation in the Eurozone, Switzerland and the UK accelerated but slowed unexpectedly in Germany as jobless fears dampened consumption.

Eurozone services and manufacturing activity expanded sharply in December but unemployment remained a key worry. The region's jobless rate worsened unexpectedly to the highest level in more than 11 years, with job prospects weakening in Italy, Germany and Spain.

In Germany, the government raised its 2010 growth forecast, as exports picked up, but cautioned that the recovery was still fragile. Industrial orders were resilient although production fell, while business confidence improved.

The UK, meanwhile, became the last major economy to turn around, though fourth-quarter GDP expanded only marginally. In a setback for its financial services sector, Standard & Poor's downgraded UK banks, citing their high dependence on state support. It said the weak economy would continue to hinder the country's credit profile and warned of further downgrades if the government failed to tackle the record budget deficit.

Looking ahead, sovereign debt risk is likely to continue to weigh on sentiment. As it is, the ECB may have to halt the withdrawal of emergency lending measures, given that fiscal problems have severely eroded confidence in Europe's economic recovery. The possibility of a bailout package for Greece has been raised, but both Germany and France have reiterated that the country needs to first put its fiscal house in order. The tone could change if uncertainty over a resolution to Greece's debt problems further unnerves markets and contagion spreads to the rest of the continent.

Model Portfolio News (Pan Europe)

In portfolio activity, we pared Mothercare and Portugal Telecom on recent relative strength. Against this, we added to Standard Chartered, which has exposure to growing Asia markets and a conservative balance sheet, and Rolls Royce, which has a robust order book and recurring revenue from its aerospace business.

Note:
The changes mentioned in this part refer to our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations among these, so the above descriptions might not apply to the actual portfolios.

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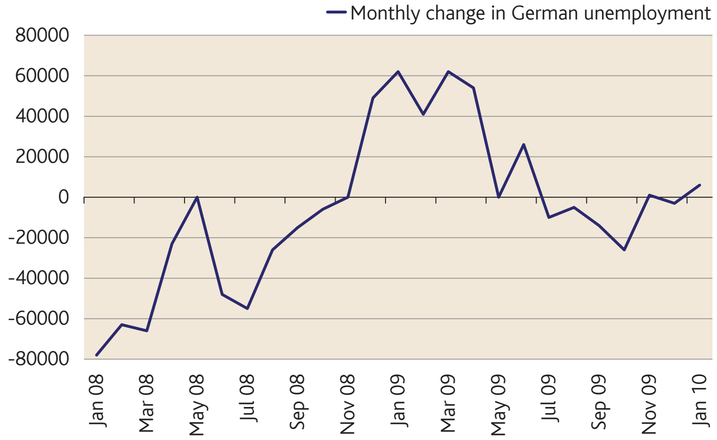
Focus: Jobs on the line



Source: Bloomberg, 31 Jan 10

Germany's labour market continues to hold up well but longer-term job prospects appear more uncertain. The Kurzarbeit scheme, under which the government subsidises wages, has kept unemployment largely in check, with the latest monthly jobless total – for January – lower than expected. But the country's industry-led recovery appears to be faltering, given the recent weakness in industrial production. Signs of further cost cutting by businesses, along with the expiry of Kurzarbeit subsidies later in the year, will offer a stern test of the labour market's resilience.

Corporate News

Basic Materials: BHP Billiton reported solid growth in petroleum and iron ore production. Separately, it approved US$2 billion of capital expenditure to expand iron ore capacity in Western Australia and separately bought Canada's Athabasca Potash.

Consumer Goods: BMW China reported the best sales growth for the group, rising by 38% last year against a 10% decline worldwide.

Consumer Services: Mothercare poster higher third-quarter sales, as international demand remained solid.

Financials: Aviva acquired US equity manager River Road Asset Management, as it sought to expand its third-party institutional business in North America. Spain's **BBVA** reported strong income growth and good cost control for the full year, but profits fell as the lender took write-downs and provisions in anticipation of a challenging year ahead.

Health Care: Novo Nordisk's diabetes drug Victoza received regulatory approval in Japan.

Industrials: MAN will merge its military vehicle business with Rheinmetall. It is also expanding capacity at its Brazilian production plant to meet growing demand for commercial vehicles in Latin America. **ThyssenKrupp** raised the projected start-up costs for a new plant in Brazil and a stainless steel mill in the US. **Rolls Royce** will supply engines for up to 90 Jetstar aircraft.

Oil and Gas: Total will buy 25% of Chesapeake Energy's shale gas assets, in a deal worth up to US$2.25 billion. **OMV** announced that Abu Dhabi-based IPIC increased its shareholding in the company to 20%. **Amec** won a contract to provide engineering services for new UK gas storage facilities and acquired a small Australian project services consultancy. Italy's energy company **Eni** will develop oil fields in Venezuela.

Utilities: Centrica denied it plans to cut 5000 jobs in the UK. **GDF Suez** plans to partner Areva to develop nuclear reactors. Meanwhile, the former said it has not ruled out future talks with International Power after negotiations broke down earlier.

We hold the companies highlighted above.

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Performance of European Stock Markets^

Region/Country	Index/Fund	USD Dollars			Local Currency		
Developed Markets		MOM	3M	YTD	MOM	3M	YTD
UK	FTSE Allshare	-4.38%	0.97%	-4.38%	-3.56%	3.67%	-3.56%
UK	FTSE 100	-4.89%	0.91%	-4.89%	-4.08%	3.61%	-4.08%
UK	FTSE 250	-1.48%	1.82%	-1.48%	-0.64%	4.55%	-0.64%
UK	FTSE Small Cap	0.43%	-1.47%	0.43%	1.29%	1.17%	1.29%
UK	FTSE 350 Real Estate	-7.81%	-6.10%	-7.81%	-7.03%	-3.59%	-7.03%
Europe	FT Europe	-5.91%	-1.62%	-5.91%	-3.76%	2.93%	-3.76%
Europe	FT Europe ex UK	-6.43%	-2.66%	-6.43%	-3.65%	2.62%	-3.65%
Denmark	Denmark - OMX Copenhagen 20 Index	2.02%	3.17%	2.02%	5.39%	9.51%	5.39%
Finland	Finland - OMX Helsinki 25 Index	-1.97%	5.06%	-1.97%	1.21%	11.47%	1.21%
France	France - CAC 40	-7.93%	-1.74%	-7.93%	-5.00%	4.25%	-5.00%
Germany	Germany - DAX	-8.81%	-2.38%	-8.81%	-5.85%	3.58%	-5.85%
Ireland	Ireland - ISEQ Overall Index	-3.03%	-1.96%	-3.03%	0.05%	4.02%	0.05%
Italy	Italy - MIB30	-8.48%	-6.15%	-8.48%	-5.82%	-0.37%	-5.82%
Netherlands	Netherlands - AEX	-5.23%	2.63%	-5.23%	-2.22%	8.90%	-2.22%
Norway	Norway - OBX	-4.66%	6.54%	-4.66%	-2.80%	10.20%	-2.80%
Portugal	Portugal - PSI 20	-9.23%	-10.43%	-9.23%	-6.34%	-4.96%	-6.34%
Spain	Spain - IBEX	-11.05%	-8.39%	-11.05%	-8.16%	-2.80%	-8.16%
Sweden	Sweden- OMX Stockholm 30 Index	-2.61%	-3.14%	-2.61%	0.21%	0.96%	0.21%
Swiss	Swiss - SMI	-3.84%	-1.01%	-3.84%	-1.61%	2.47%	-1.61%
World	MSCI AC World Free	-4.30%	1.77%	-4.30%	-3.70%	3.11%	-3.70%
World	Citigroup World Government Bond	0.13%	-1.90%	0.13%	0.13%	-1.90%	0.13%

^ Total indices performance table for the month ended 31 Jan 10

During the month, we met the following companies:

Austria: Zumtobel

France: Medica

Germany: Deutsche Post, E.ON, ElringKlinger, Palfinger, Salzgitter, SGL Carbon and Wincor Nixdorf

Greece: Jumbo

Italy: Banca Popolare Di Milano

Spain: BBVA and Indra

Switzerland: SGS and Dufry

UK: Berkeley Group, Braemar Shipping, British Land Company, Cairn Energy, Chemring, IG Group, Interserve, Kesa Electricals, McBride, Pinewood Shepperton, PZ Cussons, Real Estate Investors, Rentokil Initial, Sage and Tesco

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Important information