Contents

Economics & Strategy

Global Snapshot

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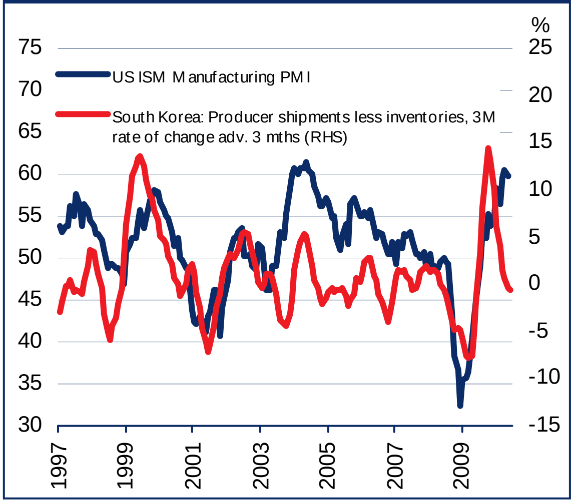
July 2010

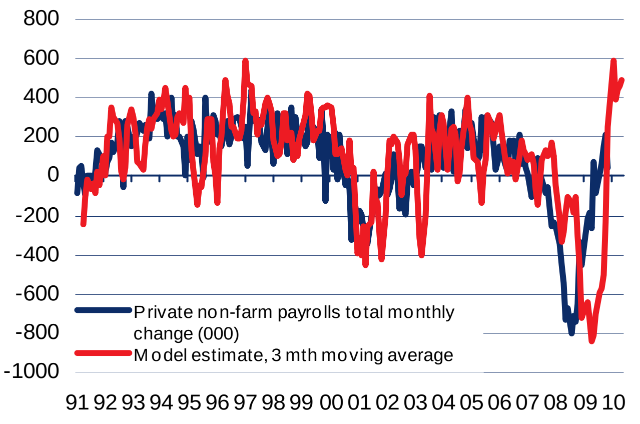
- Negative sentiment towards risk assets remained pervasive in June, but for a brief bounce following China's announcement that it will allow the *yuan* to modestly appreciate.
- Government bonds in countries with healthy balance sheets, or those that have committed to fixing their balance sheets, continued to rally. Within risk assets, there was some differentiation, with emerging market currencies and external debt faring somewhat better than equities on the month. The euro appeared to have stabilised whilst the trade weighted US dollar was under pressure most of the month.
- Along with continued fears over Eurozone government fiscal sustainability, a slight softening in some leading indicators of economic growth came into focus in June. Though fears over a potential 'global slowdown' appear overdone, markets are likely to remain volatile over the summer months as global growth begins to downshift slightly.

Asian moderation a harbinger for the developed world?



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

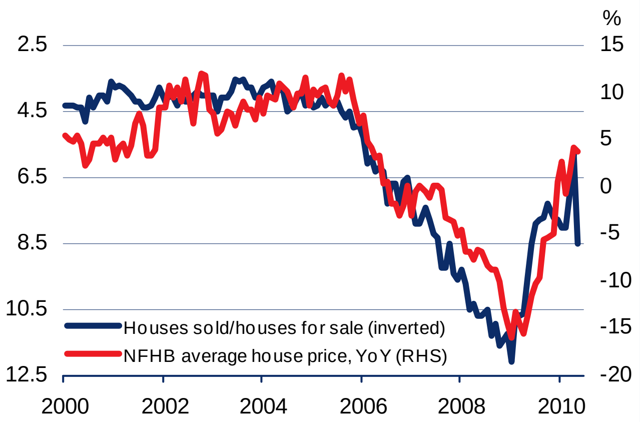
Outlook remains positive for US labour market



Source: Bloomberg, latest data available as at 31 May 2010

- Recent US payrolls data has been described by some economists and pundits as 'soft' or 'disappointing'.
- Whilst it is true that data has come in below expectations in the last two months, underlying labour market fundamentals continue to point to a robust recovery in payrolls over the next six months at least.
- Our model, which is driven by such fundamentals, suggests that private non-farm payrolls should increase by an average of 440,000 per month over the next six months.
- Such a labour market improvement should continue to drive an improvement in household income and demand and lead to more broad-based and sustainable growth.

US housing market likely to weaken in the short term



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

- US housing numbers for May have mostly come in softer on the previous month. Weak data included housing starts, home sales, and new home prices.
- The weakness is attributable to the expiration of the first time home buyer tax credit on 30 April, which is likely to continue to weigh on the housing market for a number of months.
- However, with the labour market improving, credit availability continuing to loosen, and housing affordability at record highs, any softness related to transactions having been brought forward is likely to be temporary.

Slowing in Chinese domestic demand... but from a very high level

Source: Datastream, Henderson Global Investors, as at 30 June 2010

- Various indicators of Chinese domestic demand have been slowing in recent months, albeit from very high levels.
- Loan and fixed investment spending growth and, most recently, Purchasing Manager's indices are amongst the indicators to have eased in recent months prompting predictions of a Chinese economic hard landing.
- Talk of a Chinese hard landing seems unjustified. Though it has slowed, domestic demand growth is running at 12% annualised and a large portion of the fiscal stimulus funds have yet to be spent.

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Consensus GDP growth estimates (%)	2009	2010*	2011*
US	-2.4	3.3	3.1
Japan	-5.3	3.2	1.7
Eurozone	-4.1	1.1	1.4
UK	-4.9	1.3	2.3
G7	-3.6	2.3	2.2
Asia ex Japan	5.5	8.5	7.5
World	-2.1	3.5	3.3

Source: Consensus economics, as at 14 June 2010. GDP – Gross Domestic Product
* Forecast

Consensus inflation (CPI %)	2009	2010*	2011*
US	-0.3	1.7	1.7
Japan	-1.4	-1.0	-0.2
Eurozone	0.3	1.4	1.5
UK	2.2	3.1	1.9
G7	0.0	1.3	1.4
Asia ex Japan	2.0	4.0	3.9
World	1.4	2.7	2.6

Source: Consensus economics, as at 14 June 2010. CPI – Consumer Price Index
* Forecast

Interest rates (%)	30 June 2010	Dec 2010*
US	0.25	0.25
Japan	0.1	0.1
Euro-area	1.0	1.0
UK	0.5	0.5

Source: Datastream, Henderson Global Investors, as at 30 June 2010
* Henderson Interest Rate Team forecast

- Despite continued improvement in the labour market, economic growth has begun to ease. Going forward, growth is likely to ease further in the second half of 2010 as global fiscal policy begins to tighten and some central banks normalise interest rates.

- Whilst a ‘virtuous cycle’ of falling unemployment, rising household income and improving household demand is in train, the European fiscal crisis has the potential to derail this dynamic if it were to persist.

- Policymakers appear to be committed to avoiding such an outcome. To that end, central banks’ ability to monetise government debt in a fiat money system is instrumental and is likely to occur if global deflationary pressures escalate.

- With resource utilisation rates at very low levels and renewed commodity price weakness, developed market sequential headline inflation rates are likely to surprise to the downside in the very near term.

- Emerging market inflation rates are likely to continue to rise as those economies operate above their potential growth rates, although the recent declines in commodity prices should relieve some of the inflationary pressure.

- It is looking increasingly likely that rate hikes will be delayed until the first quarter of 2011 as a result of the broadening out in global government fiscal consolidation plans.
- The US Federal Reserve (the Fed) will likely employ other tools – including reserve management, reverse repos, and paying interest on excess reserves – to tighten monetary policy toward the end of this year and in 2011. In our view, the Federal Funds target interest rate may not be increased until the end of 2011, or possibly longer.
- A number of emerging market central banks have begun tightening monetary policy and more are expected to, if Europe-related financial market dislocations do not escalate.

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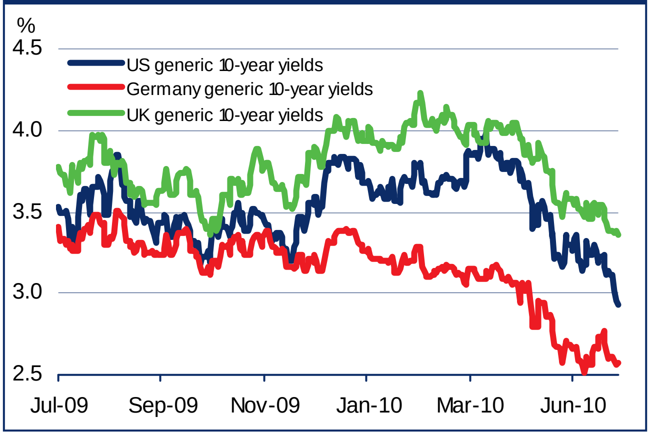
Performance divergence in government bonds



Source: Bloomberg, Henderson Global Investors, as at 30 June 2010

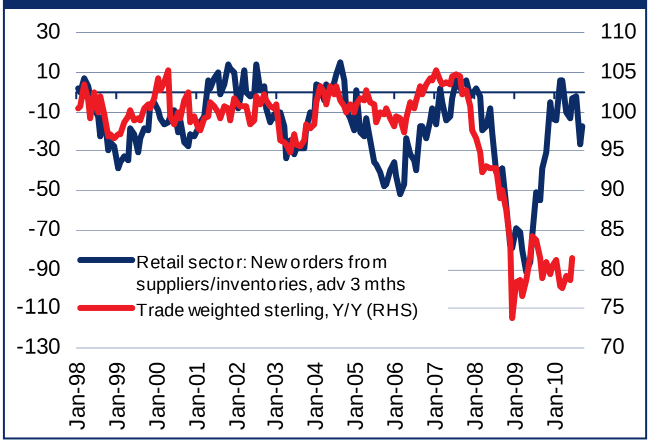
- Government bond performance varied widely for the second month in June. US Treasuries led the way (-35bp) as the 'flight-to-quality bid' gathered pace whilst UK gilts put in another solid month (-23bp) as domestic real money investors began to buy the market after a number of months of shunning it. After outperforming the previous month, German bunds lagged (-9bp) as investors began to gauge what the peripheral fiscal crisis means for the Eurozone as a whole.
- The trade-weighted US dollar came under pressure and some emerging market and commodity producers' currencies rallied mid-month as some risk appetite returned to the market.

Government bond markets continue to be driven by data surprises

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

- The number of negative economic data surprises (versus prior estimates) has increased globally in the last two months.
- The combination of these negative data surprises and the ongoing Eurozone fiscal crisis have led to a significant rally in traditional safe-haven assets, including the Swiss franc, Japanese yen and US Treasuries (and other government bonds in countries with strong/improving government balance sheets).
- Data is likely to continue to disappoint in the near term, which should keep a lid on government bond yields. However, given that a 'double-dip' recession remains highly unlikely, government bond valuations have become stretched on a medium-term view and should move higher once expectations come into line with actual data.

UK: sterling normally moves with the cycle



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

- Following an almost 30% depreciation in trade-weighted terms in 2007/08, the British pound has had little impetus to rally despite a very cheap valuation.
- The reason for this has been the dire state of the British government's finances which, at almost 11% in 2009, had the second largest budget deficit in the G8, and one of the largest in the world.
- However, since the UK government's announcement of its plan to undertake aggressive fiscal consolidation, sterling has found some strength.
- Thus, with a cheap valuation and a credible fiscal consolidation plan in place, we are upgrading our view on sterling and expect it to continue rallying against both the euro and the US dollar.

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Bond and currency outlook

10-year bond yields (%)	30 June 2010	2010*	2011*
US	2.93	↑	↑↑
Japan	1.09	↑	↑
Eurozone	2.58	↑	↑↑
UK	3.36	↑	↑↑

Source: Datastream, Henderson Global Investors, as at 30 June 2010
* Henderson Interest Rate Team view

- Mixed macroeconomic data, ongoing government fiscal concerns, renewed weakness in inflation and developed market interest rates, which are likely to remain on hold until 2011, are likely to keep government bonds range-bound, with a weakening bias over the next two-to-three months.
- Discrepancies in government bond performance have become more pronounced. The bonds of some countries with strong balance sheets that have already begun their hiking cycle (Australia) have outperformed countries with weaker balance sheets (EU, UK, US), whose central banks are likely to remain on hold the rest of this year. We expect this dynamic to continue to play out to varying degrees.

Currencies	30 June 2010	2010*	2011*
Yen/$	88.4	↑	→
$/Euro	1.22	↓	→
Euro/£	1.22	↑	↑
$/£	1.50	↑	↑

Source: Datastream, Henderson Global Investors, as at 30 June 2010
* Henderson Interest Rate Team view

- The US dollar appears to be peaking, though a renewed bout of global risk aversion could cause it to rally again. The path of least resistance for the dollar remains down in the longer term.
- Sterling remains cheap and is likely to continue to rally as international investor confidence returns following the government's announcement of an aggressive fiscal consolidation plan.

Emerging markets and commodities	2010*	2011*
G4/EMFX	↑	↑↑
Emerging market interest rates	↑	↑↑
Oil	↑	↑↑
Base metals	↑	↑↑
Precious metals	↑	↓↓
Agriculture	→	↑↑

Source: Datastream, Henderson Global Investors, as at 30 June 2010
* Henderson Interest Rate Team view
EMFX – Emerging Markets Foreign Currency

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

- Strong productivity growth, higher relative interest rates, positive demographics and, in some cases, an abundance of natural resources should ensure emerging market currency appreciation against the major, non-commodity producing developed markets.
- Gold has benefited from the spike in global risk aversion and flight to safety. However, as global liquidity is removed in the second half of 2010, gold will likely suffer.
- Oil and base metals should continue to benefit from positive global growth and tight supply conditions.
- Any further escalation of the Eurozone debt crisis has the potential to reverse these dynamics.

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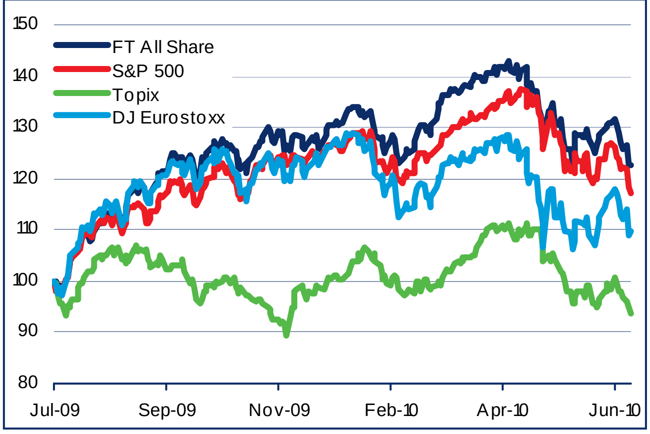
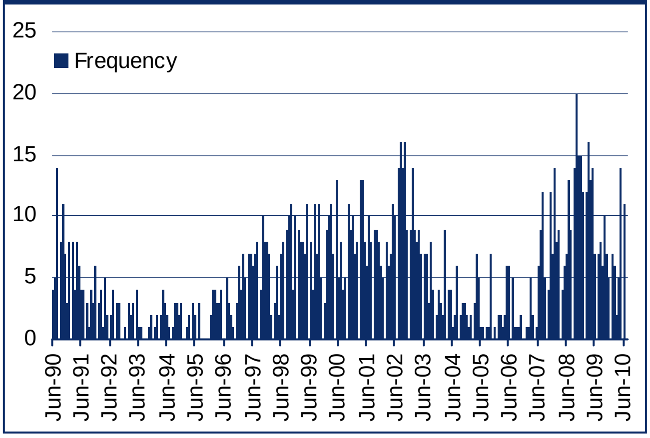
Equity markets end the quarter at year-to-date lows



Source: Datastream, Henderson Global Investors, as at 30 June 2010

- The 'risk-on, risk-off' nature of global equity markets continued in June. The rally at the start of the month soon disappeared as sovereign debt concerns and waning economic indicators contributed to a bout of risk aversion, which dragged all indices down.
- Investors were faced with disappointing economic indicators while also having to digest the implications of the newly announced austerity measures in Europe and the UK. China showed signs of economic slowdown and talks of a double-dip recession were revived.
- In Europe, performance was mixed, with the UK witnessing the worst of the declines led by BP's collapsing share price as the Gulf of Mexico oil disaster continued. The pressure placed on the company to set up a US$20bn fund to pay for claims, added to the company's woes.

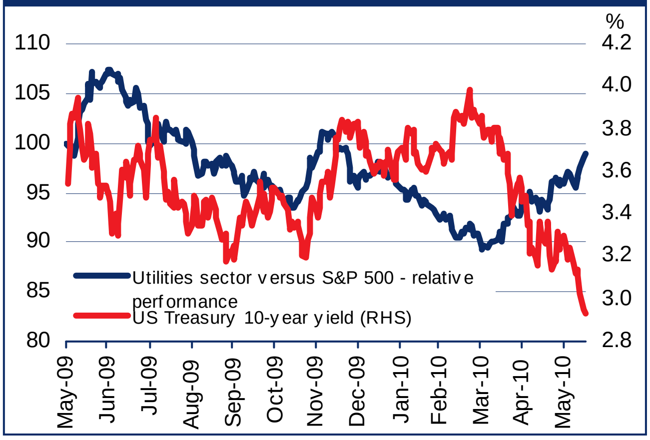
Volatile equity markets reassert themselves



Source: Datastream, Henderson Global Investors, as at 30 June 2010

- A slew of business indicators signalled deterioration in the state of the US economy, causing a spike in volatility. A measure of current volatility is the number of days that are characterised by a move greater/less than 1% of daily return. In June, the S&P 500 index witnessed moves comparable to levels last seen in the equity markets in H2 2008.
- Equity markets swung from euphoria to despair with investors keeping a keen eye on growth prospects, only to be disappointed by negative news. The lack of consensus on whether stimulus measures should remain in place until the economic recovery is deemed strong enough, added to the general unease.
- Although it is normal for economic momentum to 'pause' mid-cycle, news of improved fiscal health and a robust corporate environment could send a very powerful message to markets and spark a rally into early 2011.

Utilities – appealing in a low growth environment



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

- Flows into utilities improved sharply; with institutional investors buying the sector for the first time in over a year. The hitherto period of prolonged selling of the sector coincided with more than a year of underperformance due to regulatory reviews and significant falls in valuation multiples. The sector now trades only modestly above its decade average. The recent inflows mark a shift in investor sentiment towards gaining exposure to the energy sector.
- Furthermore, the high dividend yields of utility companies are attractive to income investors after BP cut its dividend this month. In a low growth environment, the yield advantage of stock over debt (which is less risky), is appealing to investors, and utilities have the requisite characteristics.

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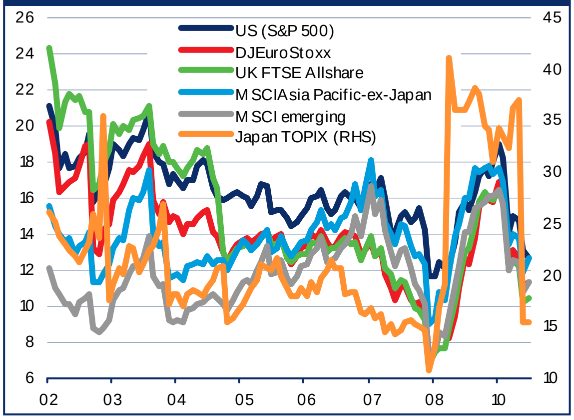
Equity market levels	2010*	2011*	2012*
US	→	↑	↑↑
Japan	→	↑	↑
Euro-area	→	↑	↑↑
UK	→	↑	↑↑
Asia ex Japan	↑	↑	↑
MSCI Emerging Markets US$	↑	↑	↑

Source: Henderson Global Investors, as at 30 June 2010
* Henderson Interest Rate Team view

Price-to-forward earnings ratio



Source: Datastream, Henderson Global Investors, as at 30 June 2010

Consensus EPS growth forecast	2010	2011	2012
US	37.1	17.5	14.3
Japan	90.4	22.8	14.4
Euro-area	32.4	21.1	14.6
UK	46.9	21.4	12.5
Asia ex Japan	31.4	15.0	11.5
MSCI Emerging Markets US$	33.5	18.3	13.5

Source: Datastream, Henderson Global Investors, as at 30 June 2010
EPS – Earnings Per Share

Equity market returns for June 2010 (%)	Local	Sterling	Dollar
US	-5.4	-8.0	-5.4
Japan	-4.4	-4.1	-1.4
Euro-12	-1.4	-4.6	-1.9
UK	-4.9	-4.9	-2.2
MSCI Far East ex Jap (US$)		-1.6	1.2
MSCI Emerging Markets US$		-3.6	-0.9

Source: Bloomberg, Henderson Global Investors, as at 30 June 2010

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

- As long as the economy continues to expand, albeit at a slower rate, companies should be able to continue to grow their earnings in 2010.
- Forecast earnings growth rates for 2010 look very high. This is partially due to base effects: earnings were so depressed in 2009 that small improvements can look dramatic in year-on-year terms.
- However, analysts maybe a little too optimistic following the sharp recovery seen in economic indicators. Although earnings growth is likely to be strong, the rate of positive earnings surprises is likely to begin to fall as economic momentum fades.
- With resource utilisation rates beginning to bottom out and unchallenging valuations, equities should be able to make some headway in coming months.
- However, a slowdown in the amount of positive earnings surprises and the expectation of more mixed economic data going forward is likely to lead to a more range-bound equity trading environment in the short term.

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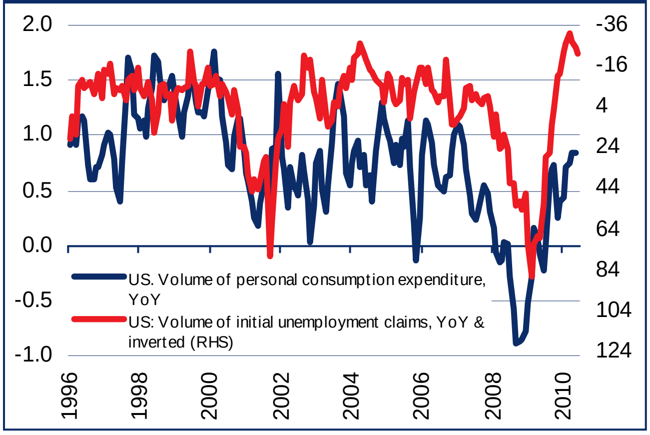
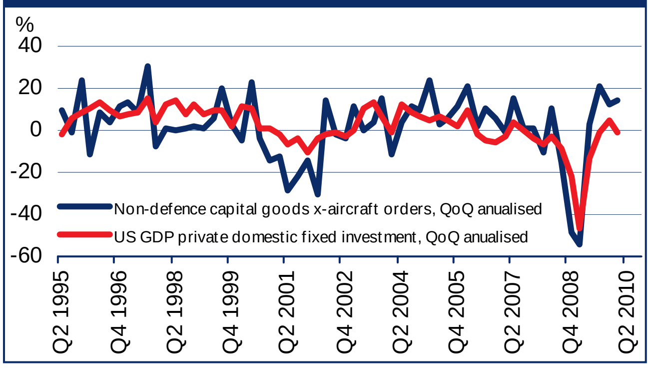
US: improving labour market should continue to drive consumption



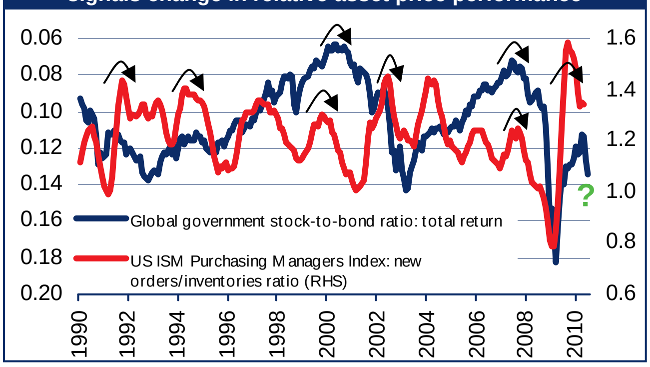
Source: Datastream, Henderson Global Investors, as at 15 June 2010

Fixed investment spending expected to pick up



Source: Datastream, Henderson Global Investors, as at Q1 2010

Peak in new orders-to-inventory ratio signals change in relative asset price performance



Source: Datastream, Henderson Global investors, as at 30 June 2010

- US household consumption has been improving gradually since the recession. The ongoing labour market recovery is driving labour income growth which is, in turn, driving household consumption growth.
- According to our fundamentally-driven US payrolls model, the labour market improvement is set to continue, which bodes well for household consumption growth.
- However, household consumption growth is likely to remain below the types of levels seen in the previous cycle given the ongoing dynamic of household deleveraging (mostly secured), which is expected to play out over the next two-to-three years.
- Investment spending (excluding inventories) has been weak throughout the developed world during the recovery as companies have lacked confidence and had too much spare capacity to add new capacity.
- However, according to traditional leading indicators, this looks set to change: sales and new orders of non-defence capital goods (excluding aircraft) have rocketed to near-record highs and evidence shows that the stock of some categories of fixed assets i.e. information technology have begun to decline – the first time this has ever happened in the modern era.
- As a result, fixed investment spending is expected to pick up imminently throughout the developed world and should give a much needed boost to growth.
- Global equities and credit (corporate and emerging external) had been outperforming global government bonds until the beginning of the most recent market riot, some time toward the end of April.
- There are numerous indicators that have historically confirmed an extended period of either government bond outperformance or bond/equity equal performance.
- The US ISM Purchasing Manager's Index new orders-to-inventory ratio is one of these indicators and it has recently rolled over, suggesting that neither equities/nor credit are likely to outperform global government bonds over at least the next six months.