

World Equity Market - Outlook for 2012 and beyond

Trigon Investment Seminar 2012

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For professional advisers only - not suitable for retail clients



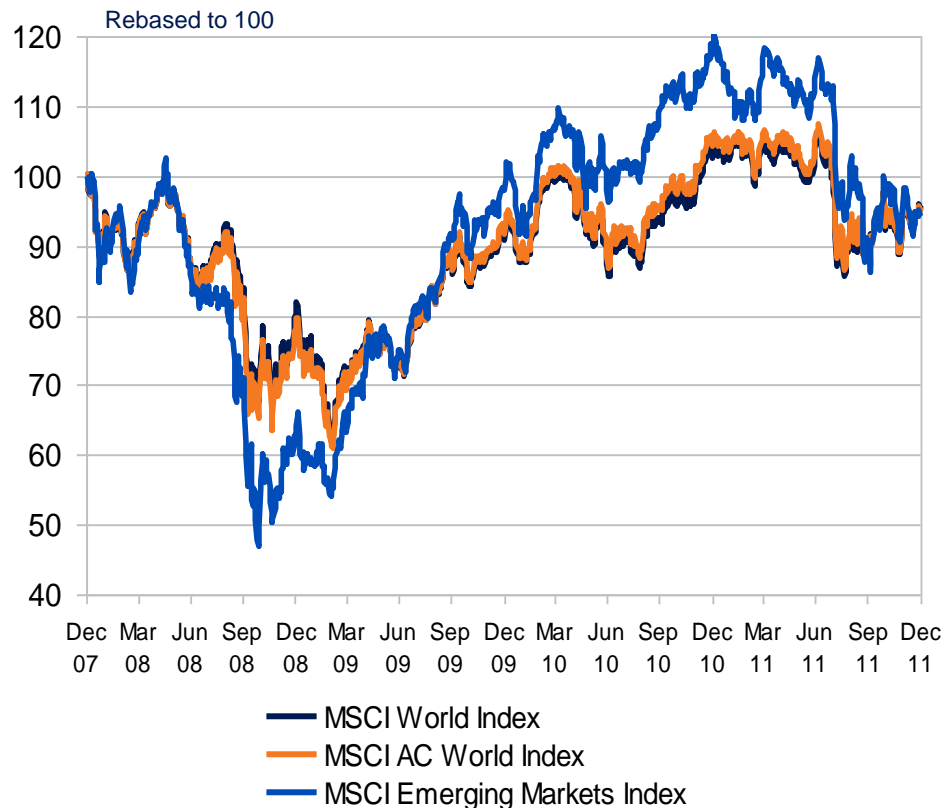
Schroders

2011 World Equity Market Review: Risk on - Risk off

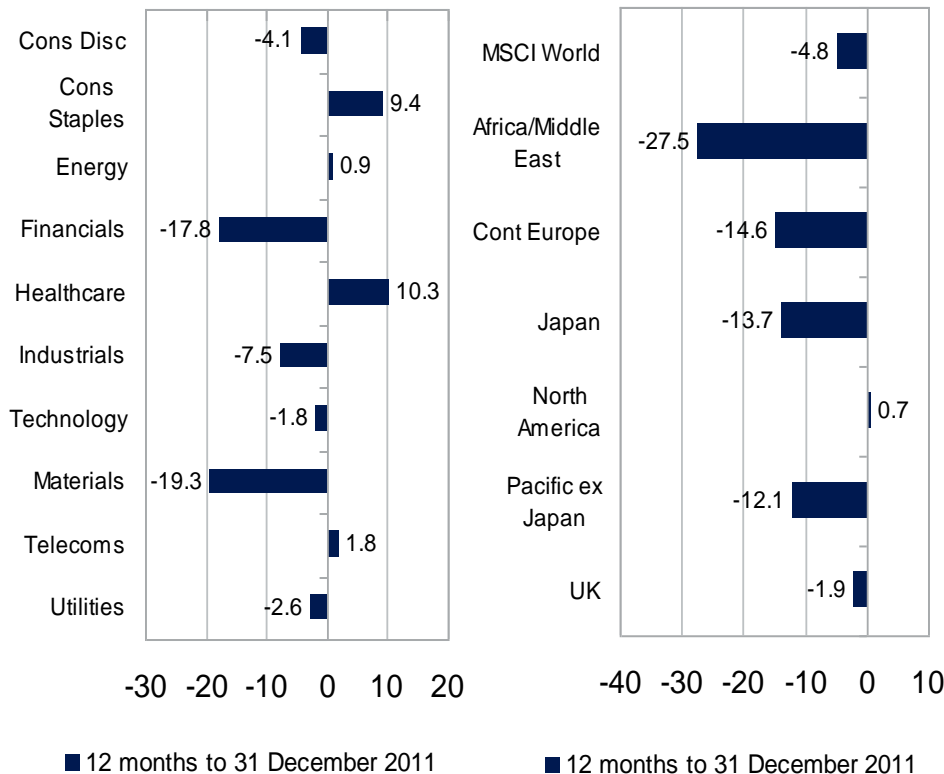
Market background

Defensive sectors drove returns

Market returns in GBP



Market returns year to date to 31 December 2011 in GBP



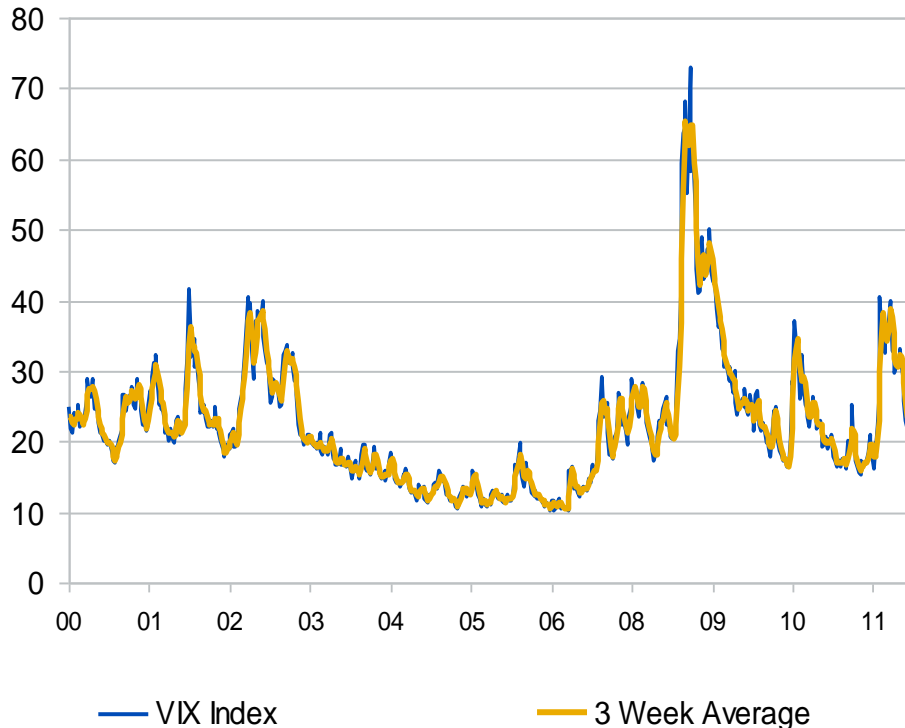
Source: Thompson Datastream, MSCI, as at 9th January 2012

Source: Factset, PA2, MSCI.

Macro drives volatility and Equity Risk Premium

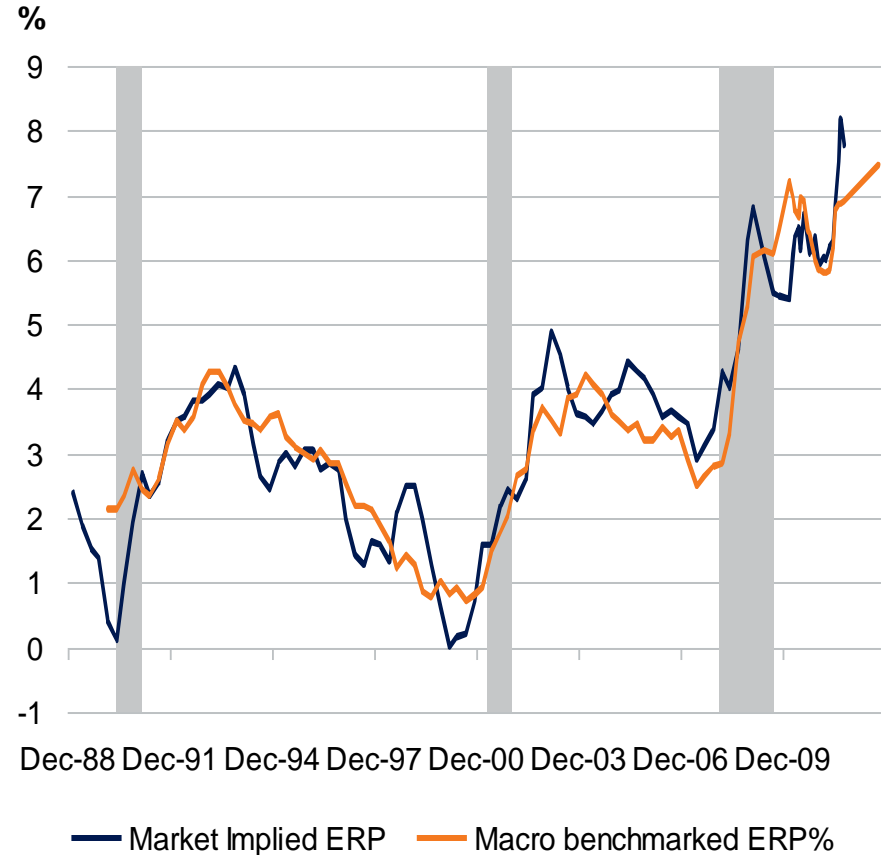
Stocks rotated around 'risk on / risk off' trade

Volatility remains high YTD



Source: CBOE, Morgan Stanley Research, as at 5th January 2012

ERP is back to trough recession level

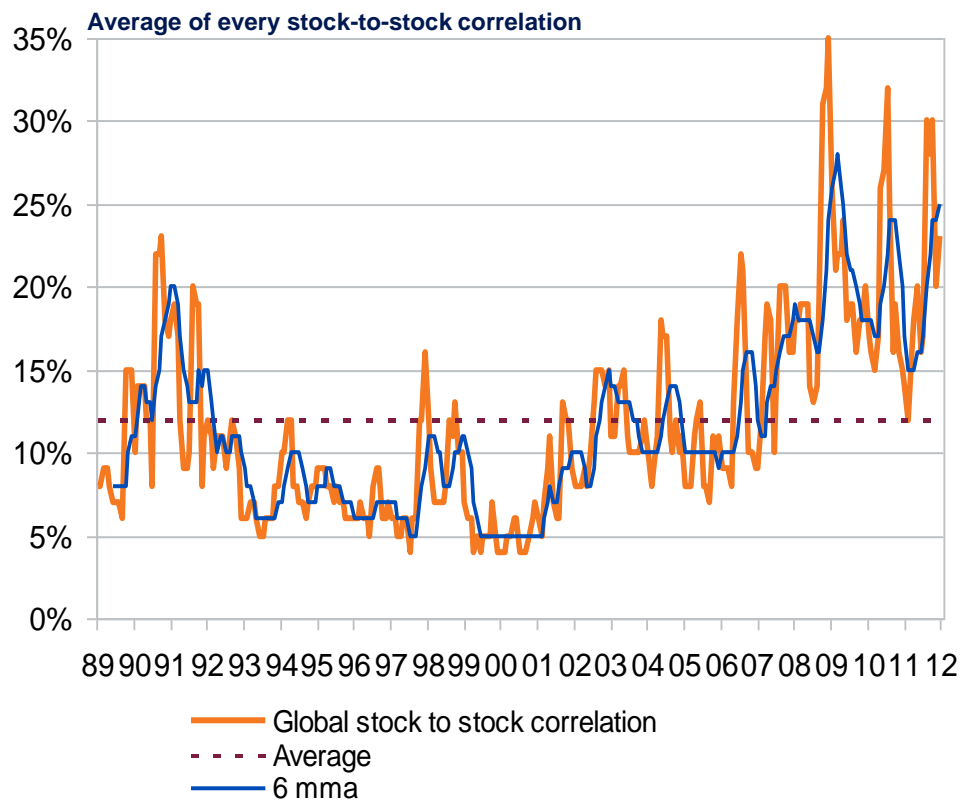


Source: Datastream, Goldman Sachs Global ECS Research

Macro drives correlations higher

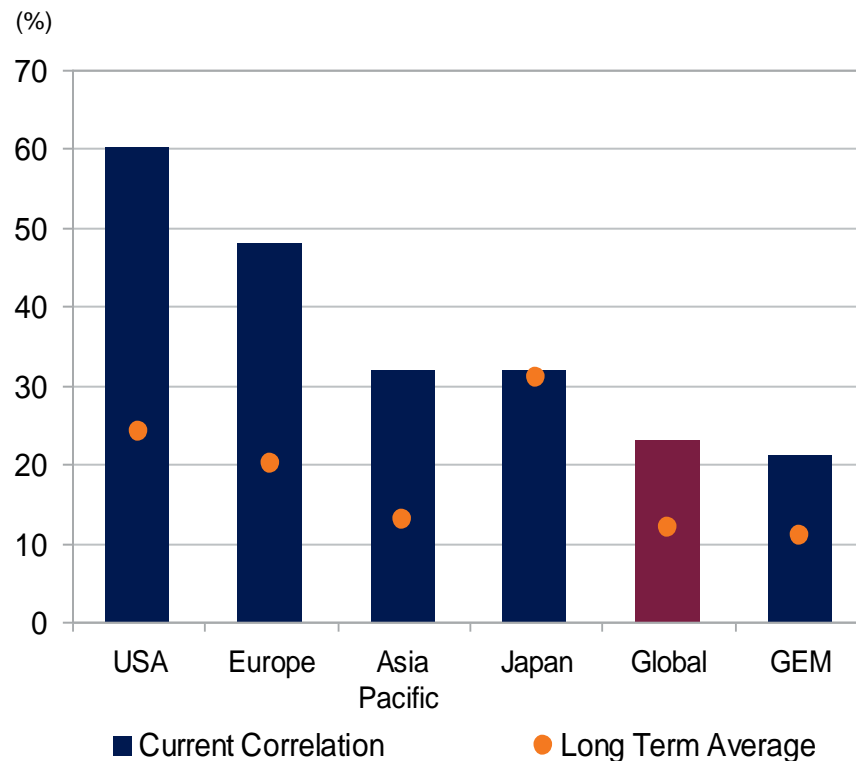
Indicating stock returns being driven by macro factors

Stock-to-stock correlation in recent years



Source: Merrill Lynch Global Quantitative Strategy, MSCI, as at 31 December 2011

Intra-stock correlations move to record levels as investors ignore fundamentals



Source: BofA Merrill Lynch US Quantitative Strategy, MSCI

Macro drives correlations higher

Indicating stock returns being driven by macro factors

2011 – Sector Performance has rotated violently

	31-Dec-10 17-Mar-11	17-Mar-11 2-May-11	2-May-11 4-Oct-11	4-Oct-11 28-Oct-11	28-Oct-11 21-Nov-11
Materials	(4.97)%	12.75%	(32.24)%	25.01%	(13.63)%
Financials	1.36%	7.01%	(30.96)%	21.45%	(15.20)%
Energy	8.67%	6.58%	(27.76)%	25.20%	(8.93)%
Industrials	0.93%	10.20%	(27.59)%	19.54%	(9.65)%
Consumer Discretionary	(1.71)%	9.86%	(19.43)%	16.35%	(9.75)%
Information Technology	(2.02)%	7.68%	(14.31)%	14.50%	(7.47)%
Telecommunication Services	1.30%	9.11%	(14.05)%	10.22%	(6.94)%
Utilities	(1.58)%	7.92%	(12.66)%	7.75%	(6.50)%
Health Care	0.78%	12.28%	(12.47)%	9.91%	(6.96)%
Consumer Staples	(2.45)%	11.45%	(8.65)%	9.01%	(4.92)%
MSCI World	0.32%	9.17%	(21.98)%	16.81%	(9.65)%

Best performing sectors

The last two periods of rotation were especially short: 4 weeks each

Source: Factset, Schroders, MSCI. Returns in USD.

Market risk has been the dominant factor return - Investment style performance (%)

Investment Styles	Global	UK
Low vs. high Beta	16.6	14.1
Low vs. high dispersion of analysts' forecasts	12.4	8.9
High vs. low EPS momentum	6.6	1.1
High vs. low relative price momentum (12m)	6.6	2.4
High vs. low historical EPS Growth	9.0	5.7
High vs. low historical EPS stability	6.1	6.3
High vs. low Year 1 EPS growth	-3.7	-6.8
High vs. low dividend yield	4.9	7.7
High vs. low long-term EPS growth	-4.1	-4.8
Small vs large market capitalisation	0.3	0.3
Low vs. high P/E ratios	-1.9	-1.1
Low vs. high price to book	-4.5	-3.0
1-month price reversal strategy	-3.7	-1.9
High vs low Year 2 EPS growth	-11.8	-11.1

Source: SG Cross Asset Research 2011.

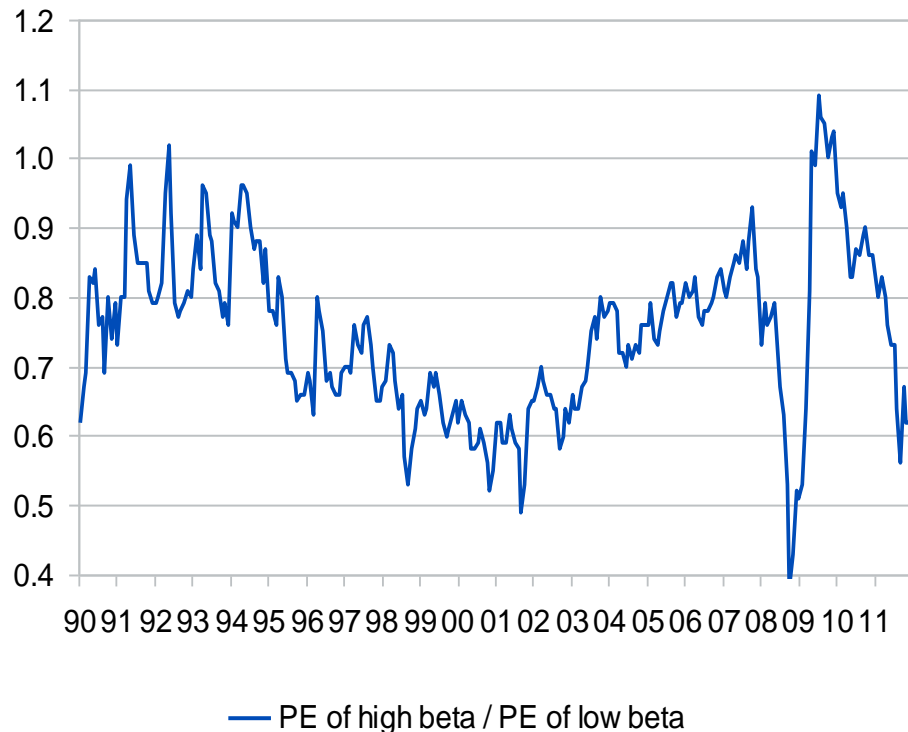


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Valuations

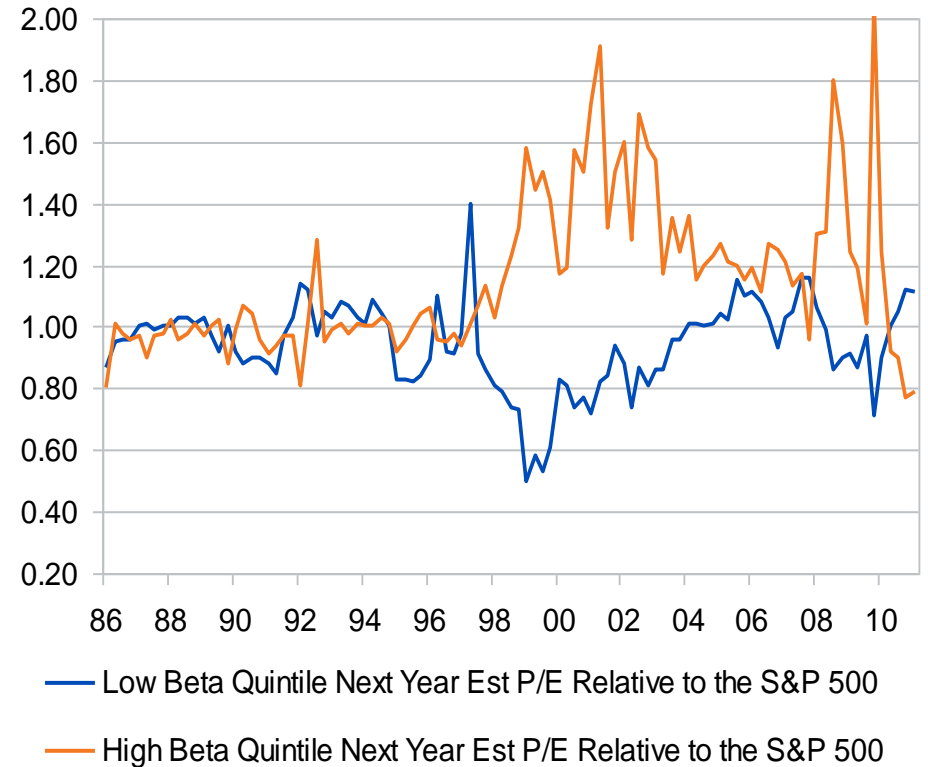
Inexpensive stocks have grown cheaper

Valuation of high beta names reflects risk aversion



Source: Merrill Lynch Global Quantitative Strategy, MSCI, IBES.
As at 31 December 2011.

High beta stocks trade at largest discount since 1986



Source: BofA Merrill Lynch US Quantitative Strategy.
As at 31 December 2011.

2012 World Equity Market Outlook



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Global Equities Outlook: 2012: a “Wei ji”* year

The “great rebalancing”

The Positives

- Global liquidity / coordinated effort
- Closer to reality
- EM growth still strong. Lower global growth >inflationary pressure > relaxation of monetary policies
- USA macro slowly improving
- China putting measures to help economy
- Companies are in good shape (strong cash flow)
- Valuations are attractive
- Equities under owned and pricing is disconnected from fundamentals

Source: Schroders

* Wei Ji in Chinese means challenge and opportunity

The opinions stated in this presentation include some forecasted views. We believe that we are basing our expectations and beliefs on reasonable assumptions within the bounds of what we currently know. However, there is no guarantee that any forecasts or opinions will be realised.



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Global Equities Outlook: 2012: a “Wei ji”^{*} year

The “great rebalancing”

Challenges:

- Public finances and sovereign risk remains
- Refinancing needs high in 2012 and some concentration in 1q12
- Growth in an environment of budgetary constraints and deleveraging / European recession
- Lack of leadership / election cycles
- Adapting to the “new normal” in a bipolar world: picking the next winners in a low DM growth / thirsty EM world; shifting demographics
- Europe:
 - Peripheral Europe and the European banking system
 - Nationalism, democracies and fiscal integration
 - Social unrest

Source: Schroders

^{*} Wei Ji in Chinese means challenge and opportunity

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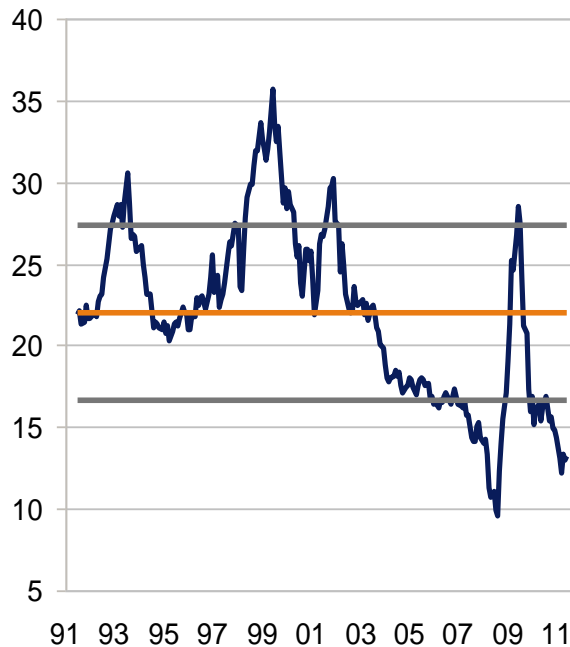


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What are markets pricing?

Equity valuations are attractive

Trailing PE



— MSCI World 12-month trailing PE
— 20-year average
— +/- 1 s.d.

Forward PE



— IBES MSCI World 12-month forward PE
— 20-year average
— +/- 1 s.d.

Trend-adjusted PE



— MSCI World trend-adjusted PE
— 20-year average
— +/- 1 s.d.

Source: RIMES, Thomson Datastream, Schroders, 31 December 2011.

Note: Trend-adjusted PE is based on earnings per share based over 20 years of history.

The opinions stated in this presentation include some forecasted views. We believe that we are basing our expectations and beliefs on reasonable assumptions within the bounds of what we currently know. However, there is no guarantee that any forecasts or opinions will be realised.



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Market volatility

- Stimulated by on going global fragmentation



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Investing in an increasingly volatile world:

Growing fragmentation within the “global village”

Global village

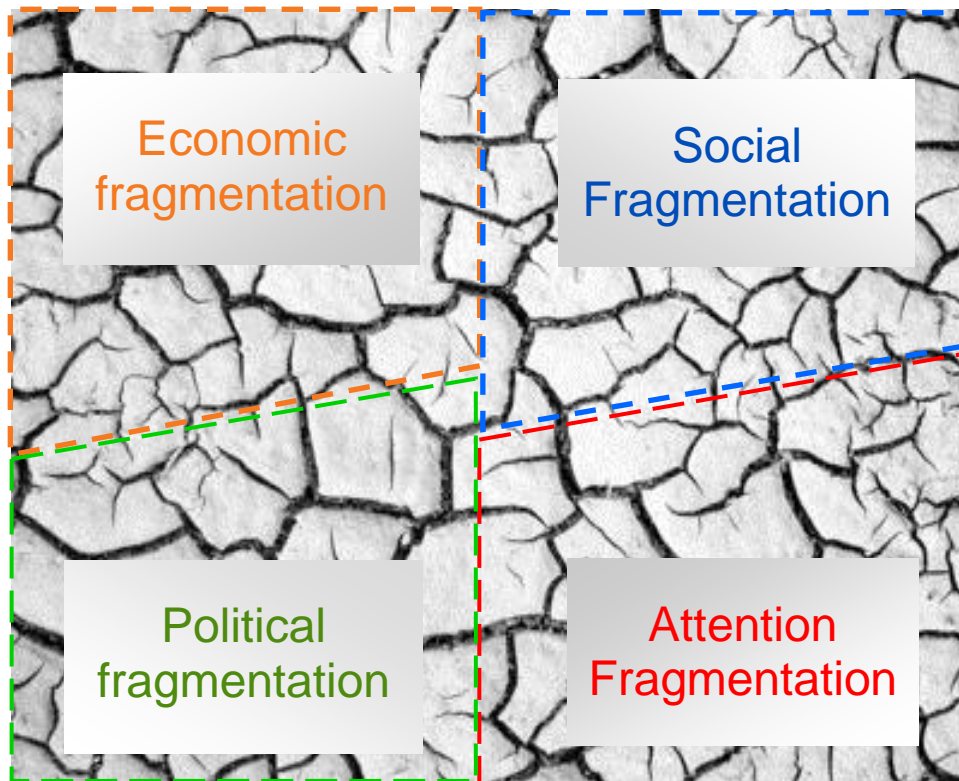
- The widening, deepening and speeding up of worldwide interconnectedness in all aspects of contemporary life
- Facilitated by technology
- Increasing trade and capital flows

Fragmentations

- Adds complexity to the dynamics of globalisation and investment analysis
- May materialise in conflicts, drive economic divergence or add confusion to decision-making processes
- May create unpredictable patterns of volatility contrary to the usual “sector / region / country” lines?

Fragmentation in the Global Village:

Emergence of new fragmentations



Fragmentation in the Global Village:

Emergence of new fragmentations

Economic fragmentation

- Convergence becomes divergence

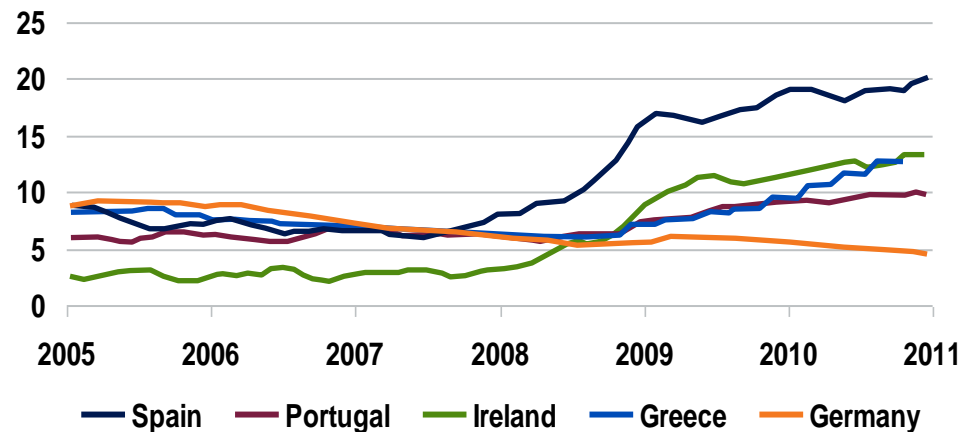
- Economic divergence in highly connected and relatively homogenous units
- New phase for Europe?

Social Fragmentation

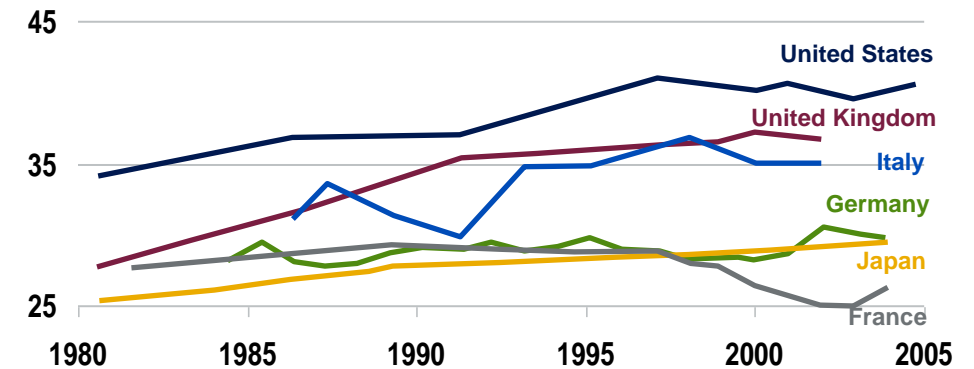
- Income inequality and the skill premium

- Rising income inequality due to 'skill premium' in the global labour market
- Richest 1% in the US earn 25% of all income
- Emerging markets remain highly unequal
- Financial crisis has aggravated problem

Unemployment rates (%)¹



Gini coefficient in the developed world²



¹Source: Thompson Datastream, Schroders. Updated April 21, 2011. ² Source: IMF (2008), Rising Income Inequality: Technology, or Trade and Financial Globalisation?

Fragmentation in the Global Village:

Emergence of new fragmentations

Community fragmentation

- Belonging to a community – but which one?

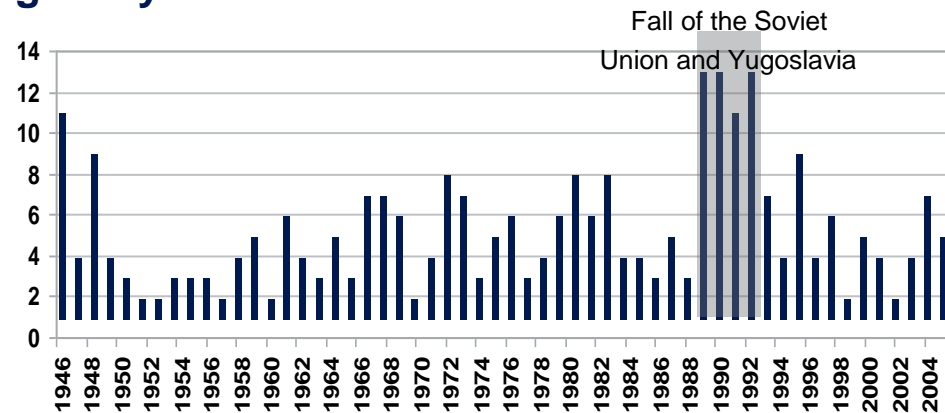
- Traditional religious, ethnic and tribal divides remain salient
- Now overlaid by new dimensions of group identity and notions of community
- Technology provides the means to bypass and challenge established structures e.g. Middle East

Attention Fragmentation

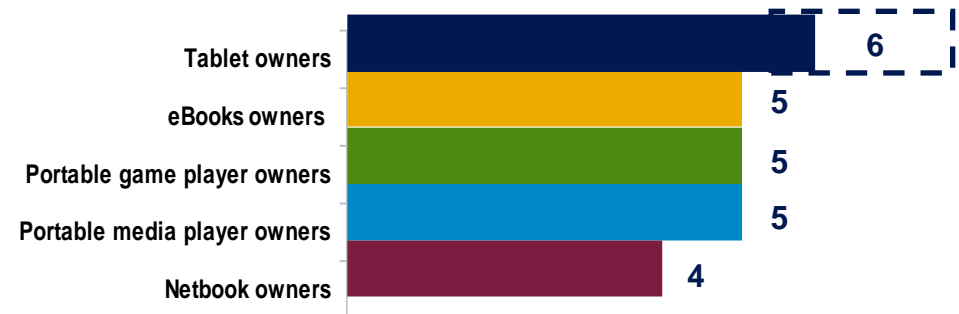
- Information overload

- Many professionals now own 5 – 6 connected devices, meaning constant distractions
- Overloaded investors lose sight of long-term trends: average holding period has fallen from 7 years to 7 months since 1970s
- Short-termism causes excessive volatility and poor performance

Number of ethnic conflicts starting in a given year¹



Average # of Connected Devices Owned²



¹ Source: Cederman et al (2008), "Ethnic Armed Conflict dataset". ² Source: The Nielsen Company

Global Competitiveness

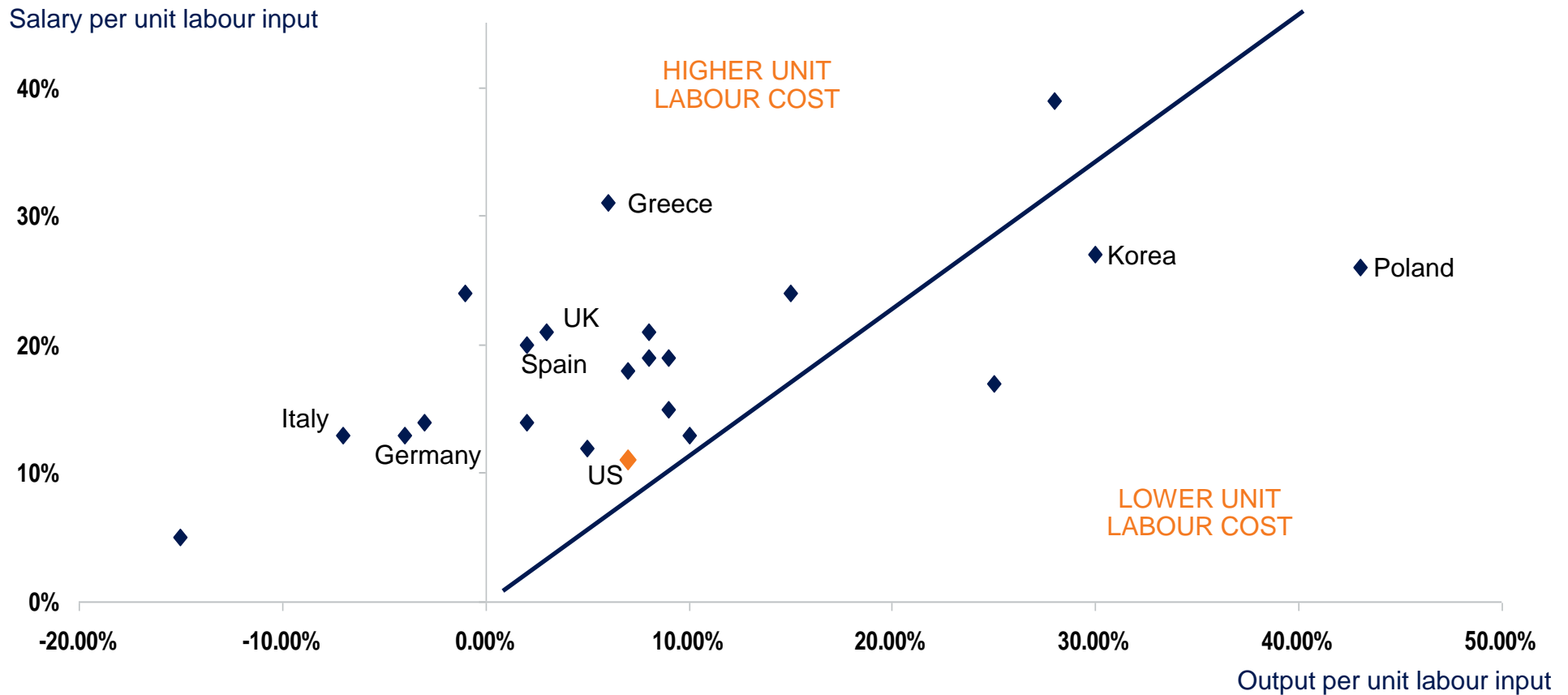
Is Tennessee the new Guangdong?

- Influential variables include productivity, labour costs and currencies
- Shifts in relative competitiveness in the developed world – US versus Europe
- Emerging markets still have a significant competitive advantage in manufacturing
- International competitiveness has been altered by the financial crisis

Global Competitiveness:

A new game?

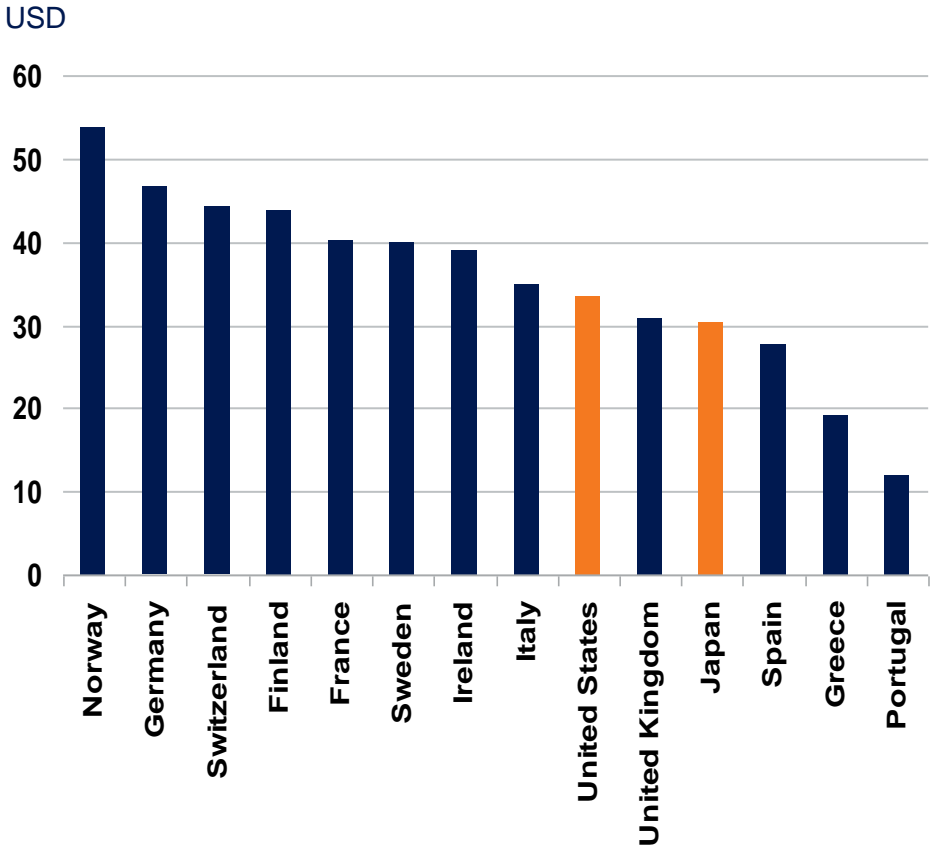
Salary versus productivity in manufacturing - % change 2005-2009



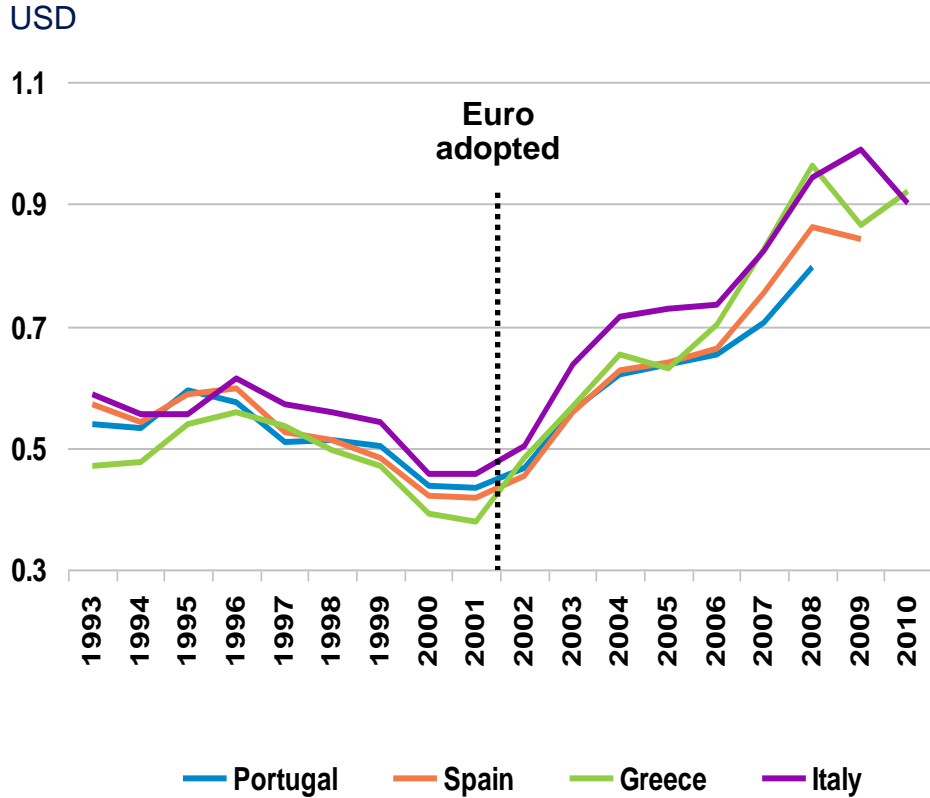
Source: OECD Statistics, extracted 1/7/2011. N.B. Unit labour input in most cases equals hours worked, but equals persons employed for some countries including the United States, United Kingdom and Poland. Japan is excluded because the most recent data points are for 2007.

Global Competitiveness:

Hourly compensation costs in manufacturing U.S. dollars, 1996-2009¹



Exchange-rate adjusted unit labour costs, 1993-2009²



¹Source: US Bureau of Labour Statistics. ² Source: 19 Jun 2011 OECD



The importance of structural growth



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Structural backdrop to decision making

- Key themes support sustainability of growth

‘There are three important long-term themes which will shape the investment world in years to come because they will impact significantly the environment companies operate in and affect their earnings sustainability’

	Facts	Opportunity
Climate change	<p>Emissions per unit GDP need to be 25% of current levels by 2050 to avert disaster</p> <p>\$20,000 billion investment in energy infrastructure required by 2030</p>	<p>Changing competitive landscape has implications for sales, margins, earnings AND valuations</p> <p>Costs yet to be factored into consensus earnings forecasts or valuations</p>
Demographics	<p>Global population up by 50% to 9.3 billion by 2050</p> <p>98% growth from developing markets</p> <p>16% of population over 60 years old</p>	<p>Global demographic shifts shape consumption patterns and demand trends</p> <p>Investors fail to recognise long-term trends and under-react to slow-moving data</p>
Super cycle	<p>Emerging markets account for more than half of global growth</p> <p>Estimated \$32 trillion investment required by 2030 in transport, energy, water and communications infrastructure</p>	<p>Secular demand for commodities, infrastructure, transport, communication and energy</p> <p>A ‘super cycle’ of infrastructure-based demand will over-ride previous cycles</p>

Megatrends: Supercycle



Supercycle: The great rebalancing

Tomorrow's world

Chart 1: The largest economies in 2007¹

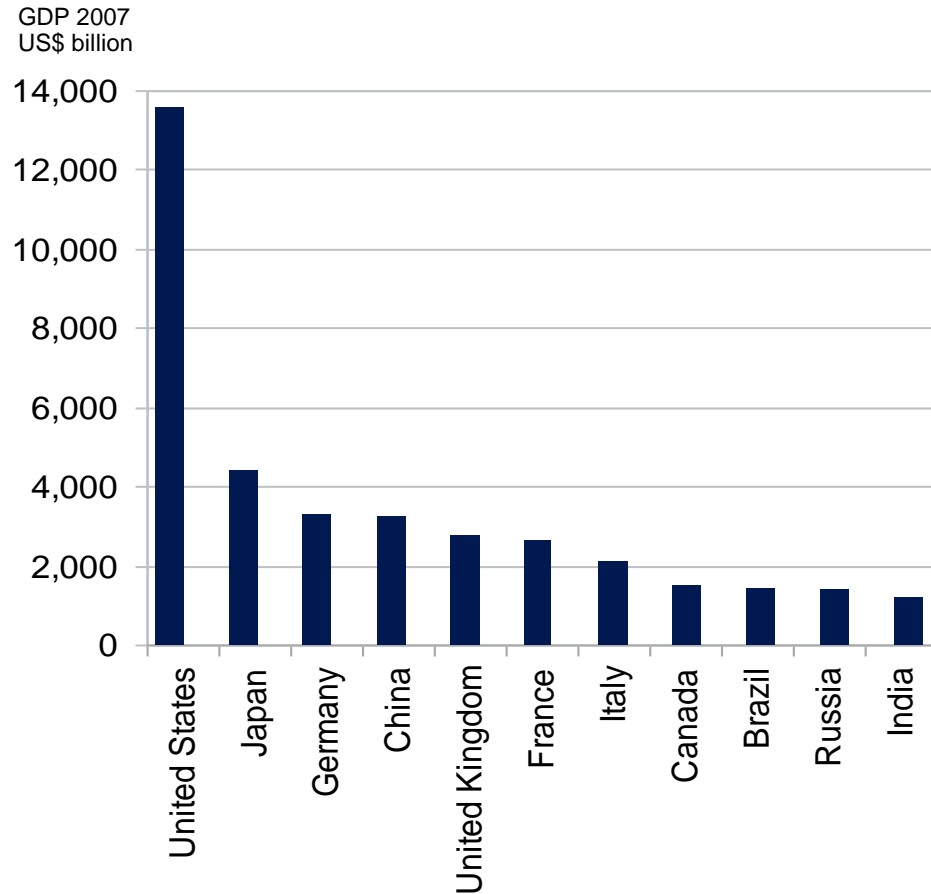
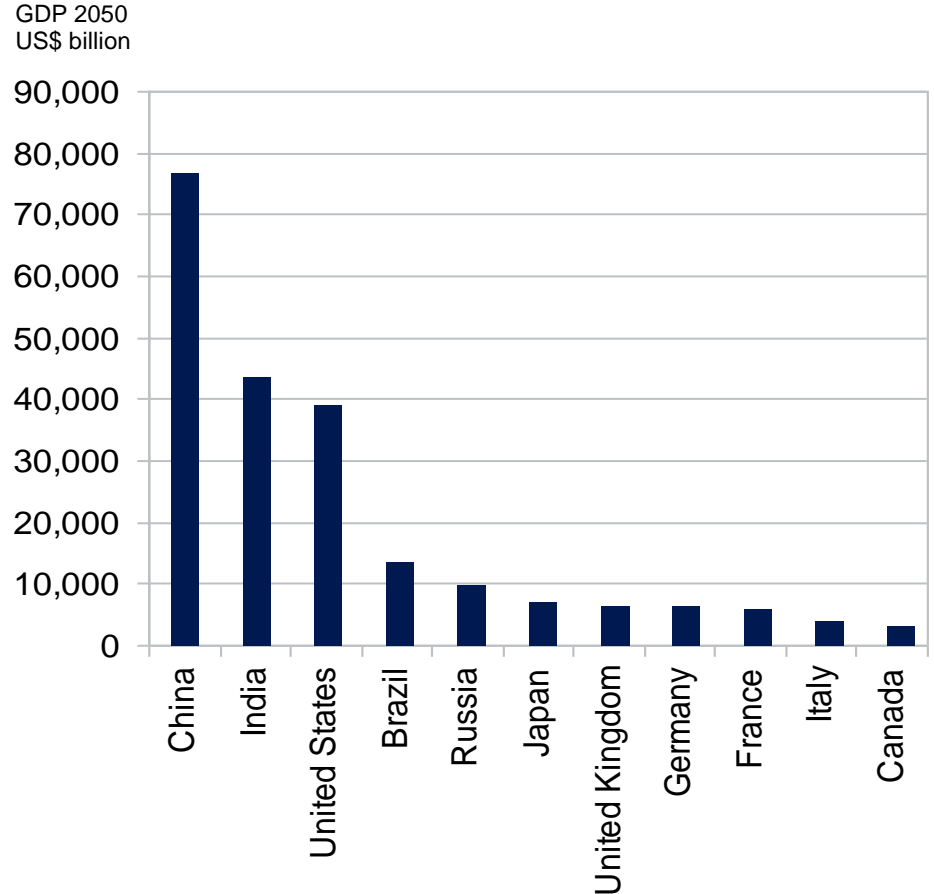


Chart 2: The largest economies in 2050²



¹Source: Goldman Sachs

²Source: Goldman Sachs calculations

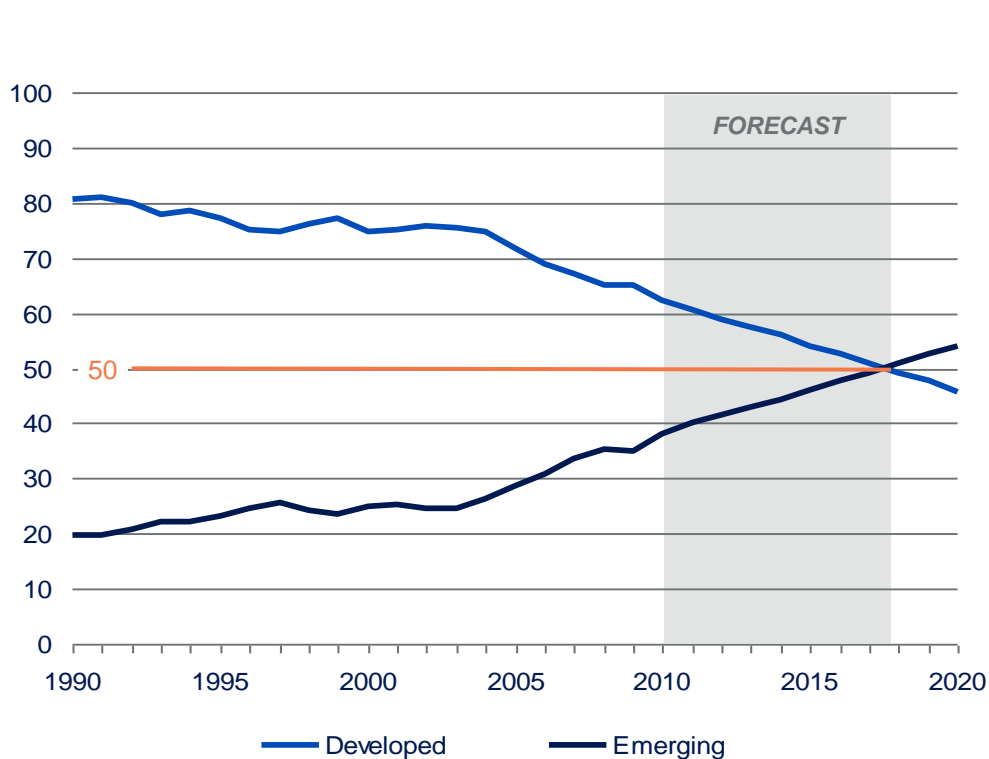
Forecast risk warning: Please refer to the important information slide at the end of the presentation

Supercycle: The great rebalancing

Global balance

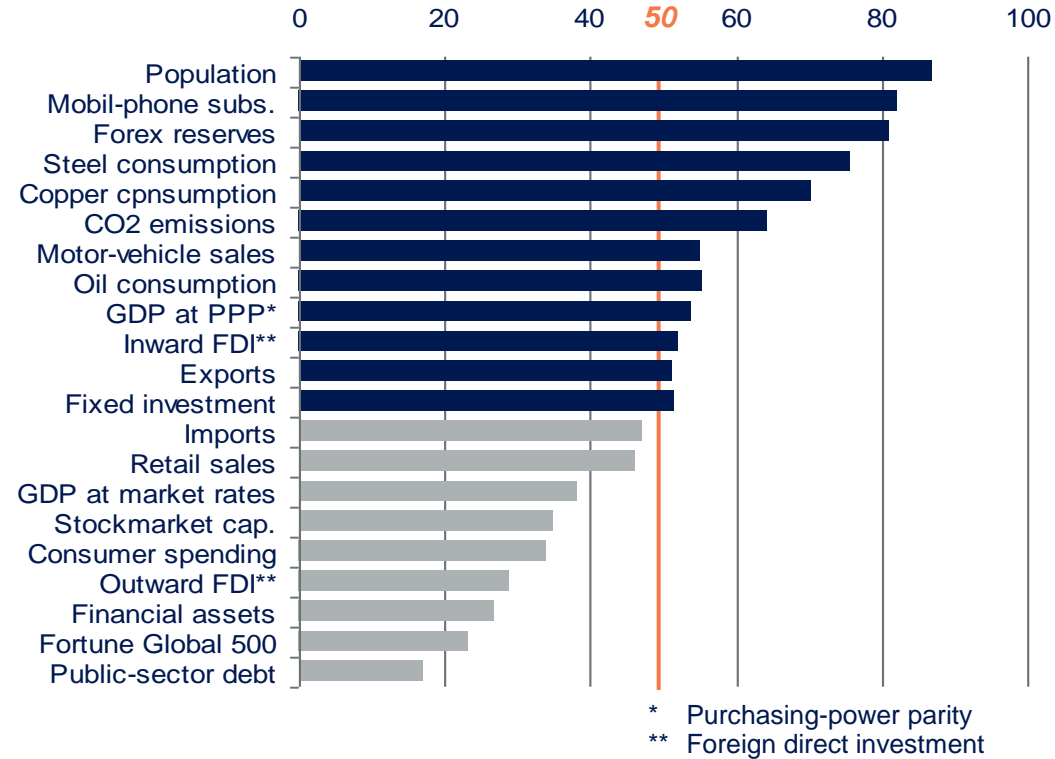
Economies' share of world GDP, %

At market exchange rates



Emerging economies' world share

2010, %

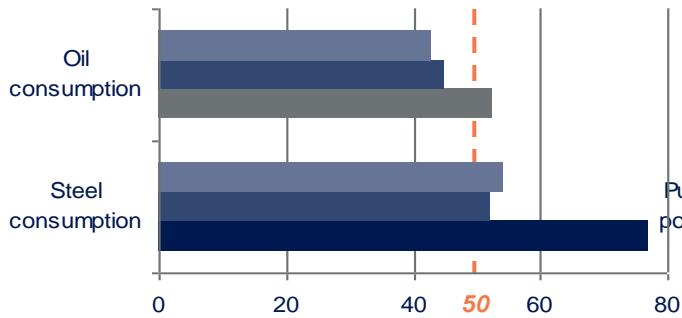


* Purchasing-power parity
 ** Foreign direct investment

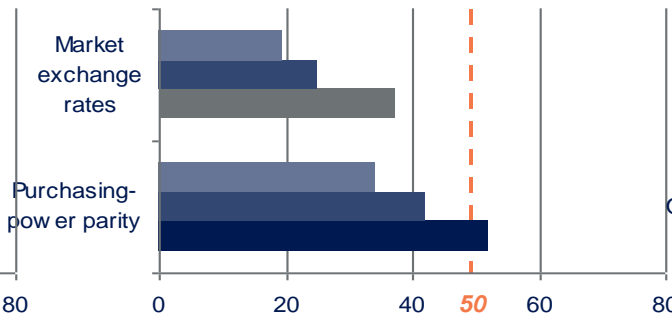
Supercycle: The great rebalancing

Emerging economies: World share by year, %:

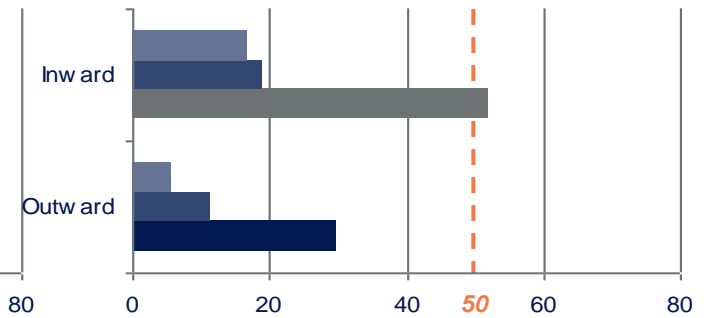
Commodities



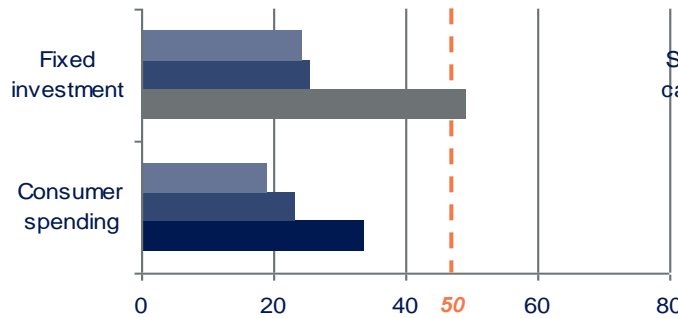
Output



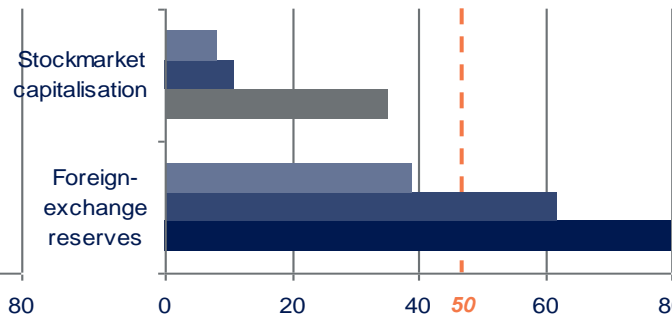
Foreign direct investment



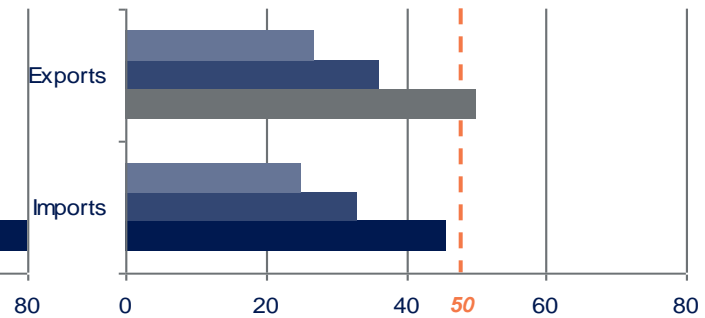
Spending



Finance



Trade



■ 1990 ■ 2000 ■ 2010

Sources: Bloomberg; BP; IMF; UBS; UNCTAD; World Steel Organisation; WTO

Facts:

- The increase in urban population in China by 2050 will be larger than the entire US population today (= 40 billion sq m of floor space, and skyscrapers equivalent to NYC x 10!)
- By 2025, three out of the world's most populous cities will be in India (over 70 million habitants between them)
- By 2050, China will pave up five billion square meters of road and add 28 000 km of metro rail
- Global Manufacturing: The third transition
- Emerging market share of manufacturing: 1970: 11%, current: 37% (US 20%, Japan 8%)
China vs USA in 2011/ 2012
- Wage convergence

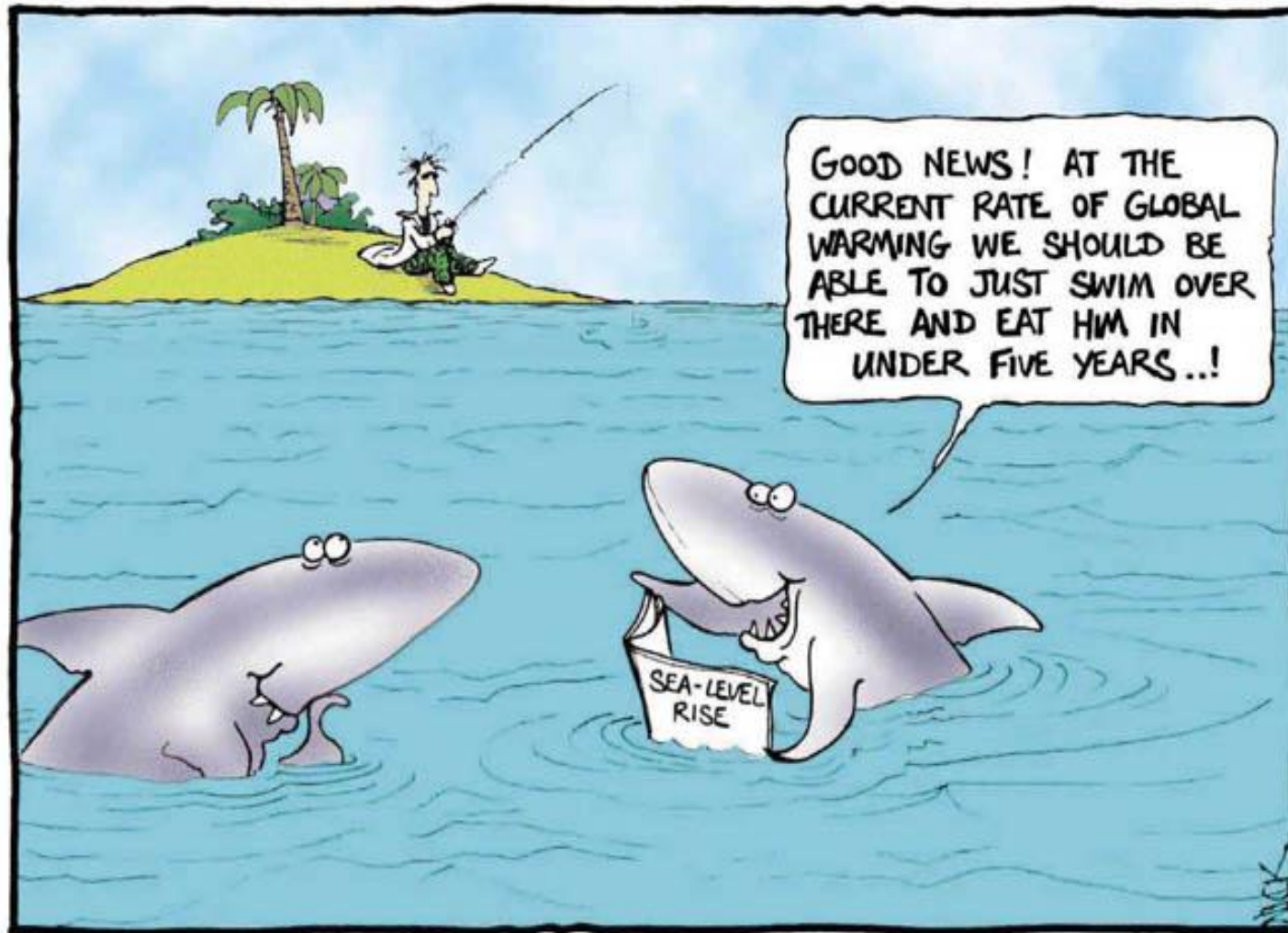
China in a global context: Bigger than you think?

- Second largest global economy. Global economic leader by 2020
- Largest global vehicle market (5x Japan by 2015)
- Chinese monetary supply (M2): \$11.4 trillion (USA: \$ 8.9 trillion)
- Size of China trade to exceed the USA in 2016
- By 2020 and 2025: Largest aviation and largest luxury good markets
- Foreign exchange reserves (\$2.85 trillion at December 2010, vs Japan: \$1.1 trillion, EU \$790 billion, USA: \$133 billion)

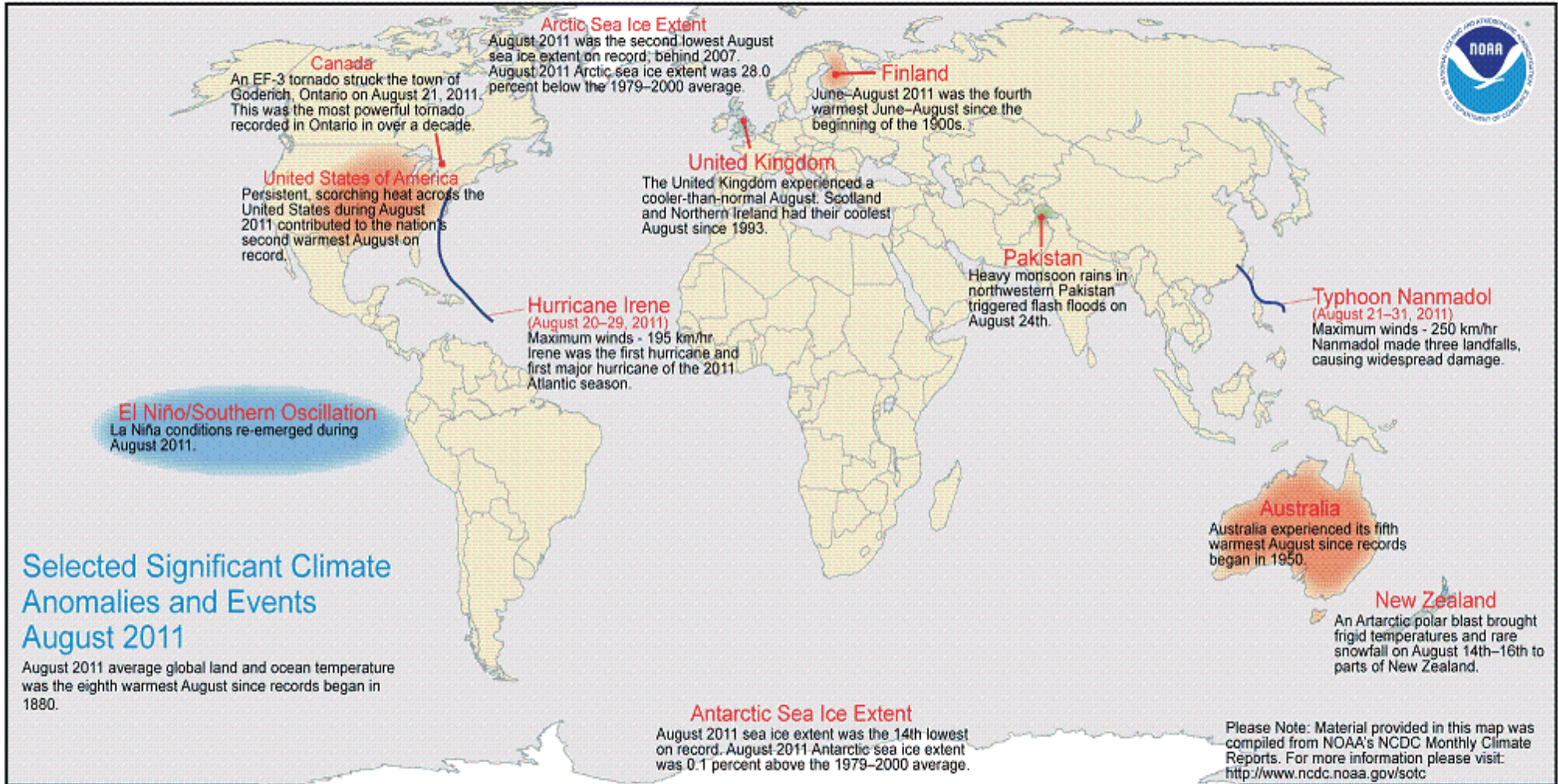
Megatrends: Climate change



Climate change



August 2011 was the 8th warmest August since 1880



Source: State of the Climate Global Analysis August 2011, National Oceanic and Atmospheric Administration National Climatic Data Center



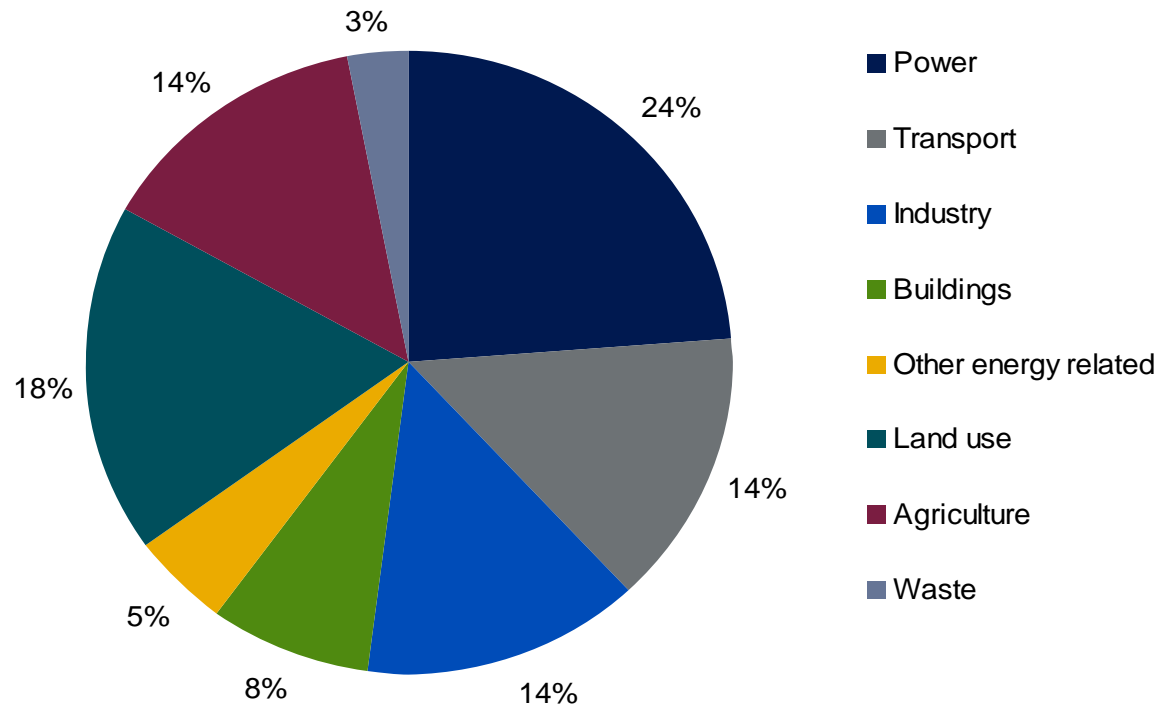
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Our investment thesis

Major impacts on growth, profitability, and valuation

- Climate change will have large financial consequences for most companies
- Policy implications are already broad and far reaching
- The competitive landscape is changing, with implications for sales, margins, earnings and valuations
- There will be significant variations in the impact on earnings, intra-country and intra-sector
- These impacts are poorly understood, creating an attractive investment opportunity today

Global energy and non-energy emissions, by source



Two tons of CO₂ per capita per year are quickly used up with today's energy supply

Automobiles



Annual CO₂ emissions of a medium-sized passenger car

→ 2 t CO₂/a

Heat



Heating of a single-family home with four people

→ 2 t CO₂/a/person

or

Air travel



Return flight
Frankfurt – Los Angeles

→ 2 t CO₂/a/passenger

Products



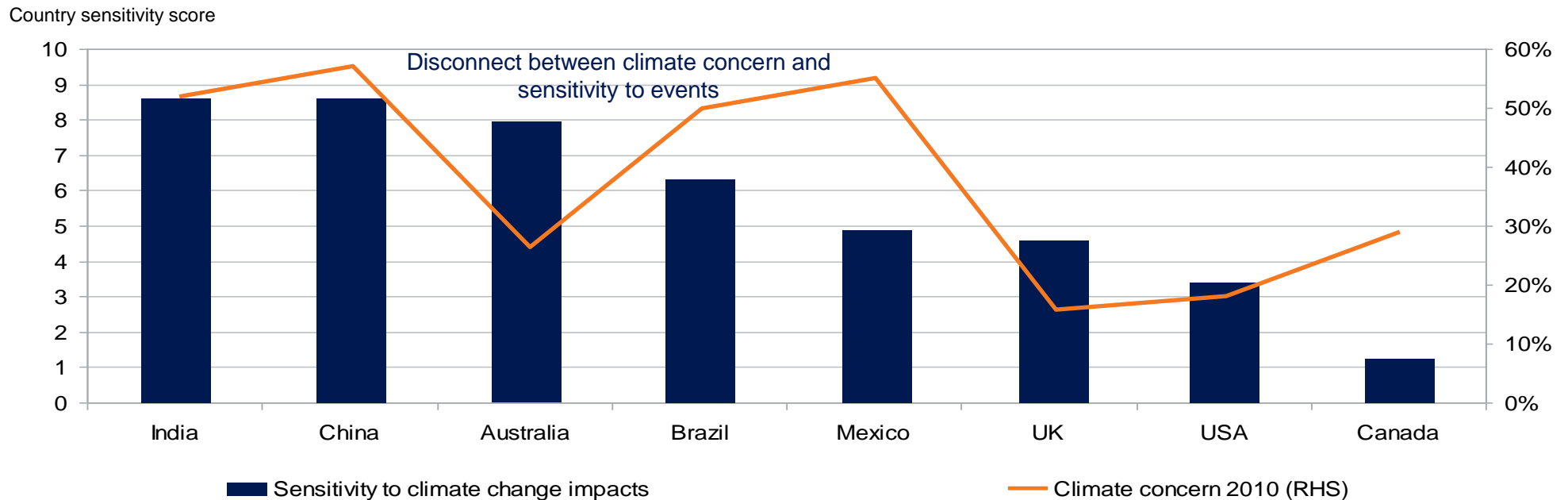
Production of goods worth approx. €4,000

→ 2 t CO₂

With today's energy supply: Exhaustion of the "2 ton limit" by every single action

Public opinion on climate concern

Climate change sensitivity and public opinion on climate concern



National policy action continues

UN negotiations are becoming a side-show

Most of the new action is in Asia and emerging economies

- **China:** 2020 energy intensity 45% lower than 2005. Clean and efficient energy use is a major pillar of the 12th five year plan
- **India:** Eight national missions to address climate change
- **South Korea:** Five year national plan for green growth
- **Japan:** Passed a renewable energy bill in Aug 2011; Copenhagen Accord commitment to reduce emissions 25% by 2020 and 80% by 2050

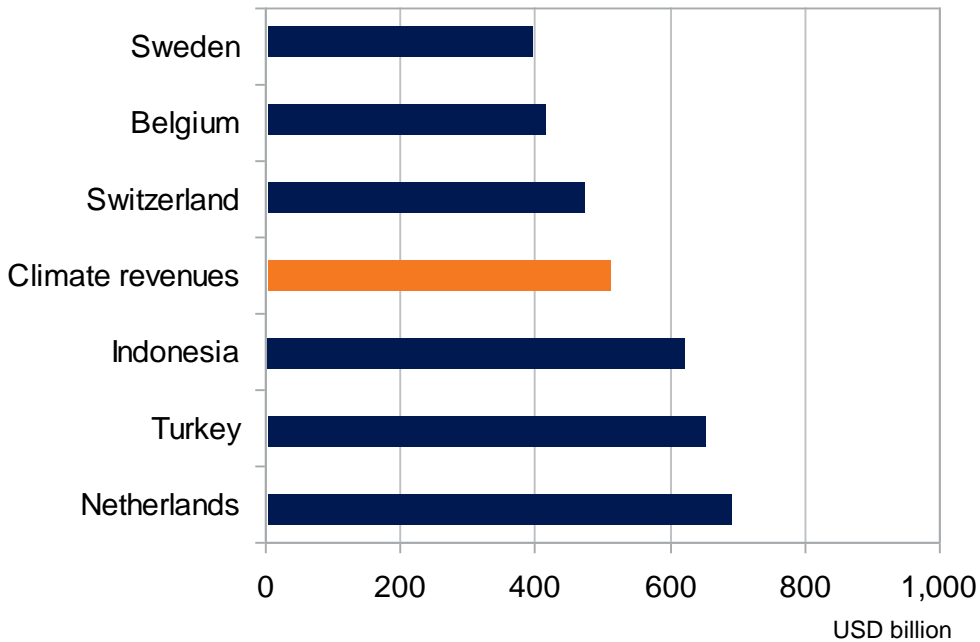
Actions in developed world

- **Europe:** Continues as planned, to reduce emissions 20% by 2020 but no new policies required – full auctioning of permits in 2013, a key year for the scheme getting real
- **Australia:** New carbon trading system planned
- **US:** Major increase in vehicle fuel efficiency standards, and new EPA regulations driving significant future closure of coal fired power stations.

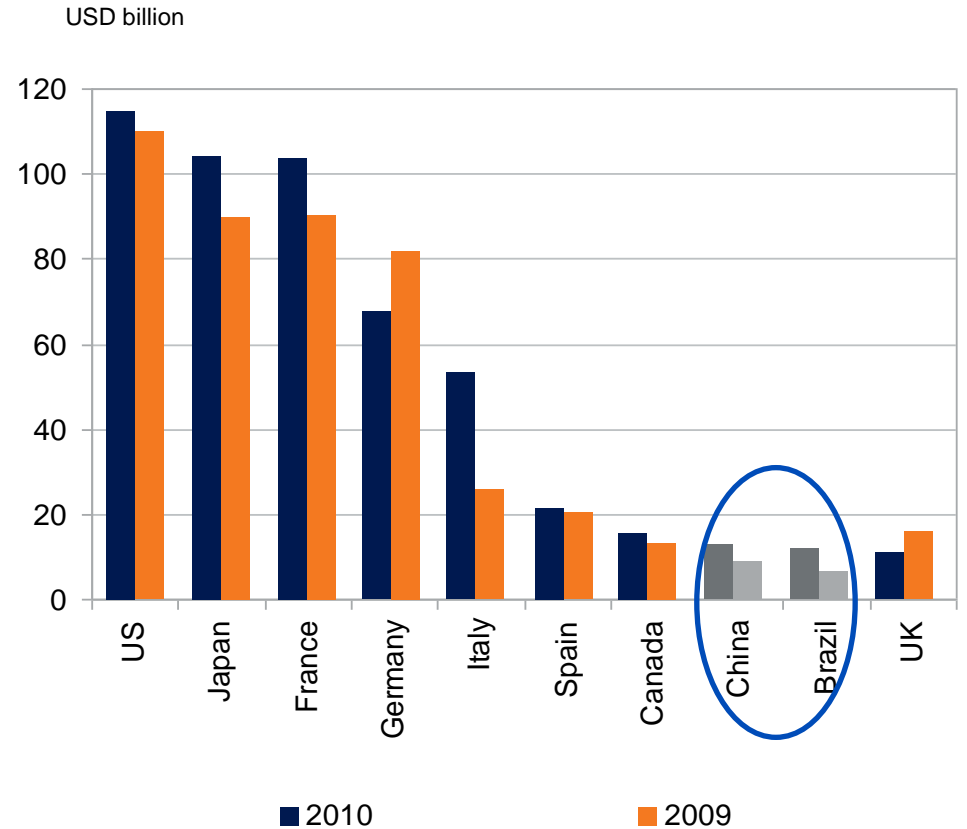


The economics of climate change

Climate revenues versus country GDP in 2010



Top 10 climate countries based on revenues



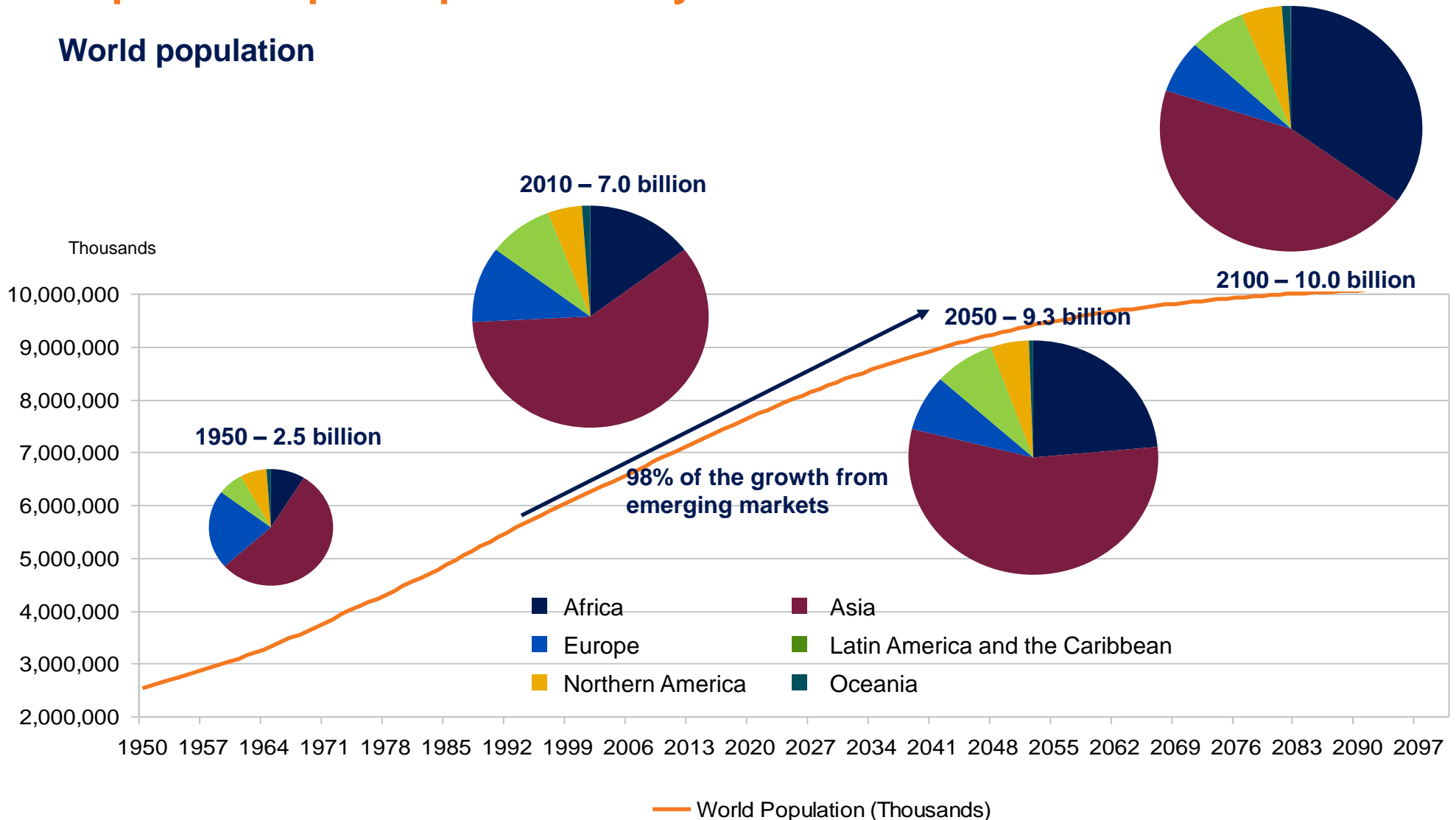
Megatrends: Demographics



Demographics: Increased world population forecast

Population quadruples in 100 years

World population



Source: World Population Prospects: The 2010 Revision, United Nations

Goodbye youth, hello middle age



Between 1970 and 2050 the global median age will almost double from 22 to 39

Source: UN World Population Prospects, 2008 revision

Say hello to the new big spenders



By 2050, for every 1
Western consumer...

...there will be 6 in Asia, Africa
and Latin America.

Divergent demographic trends will alter the composition of consumption globally

100,000,000 job vacancies

2010



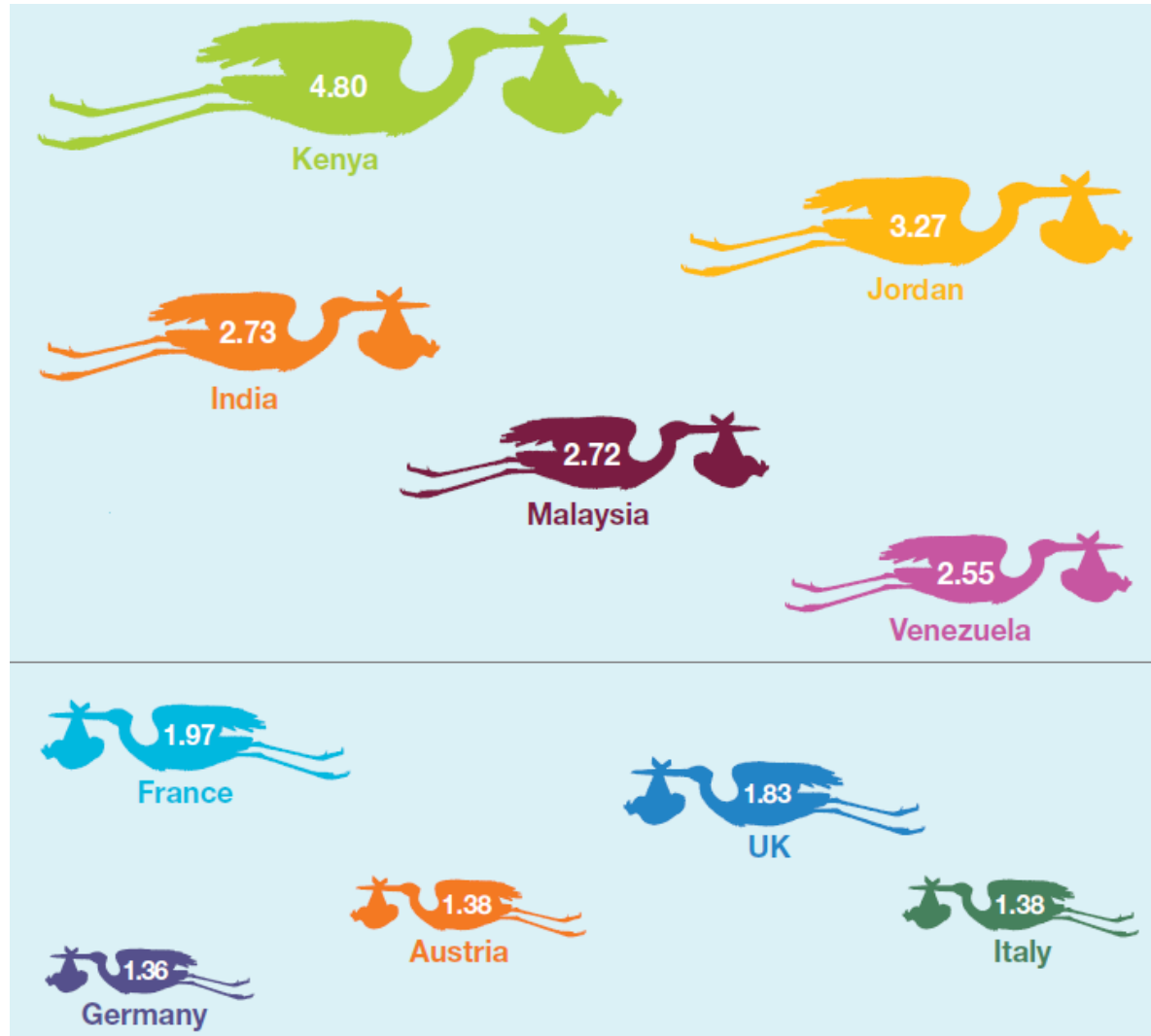
2050



Between 2010 and 2050 the Chinese workforce will shrink from 970 million to 870 million workers. This is primarily due to the impact of China's one child policy

Infertile Europe

Replacement rate
per average female
= 2.1 children

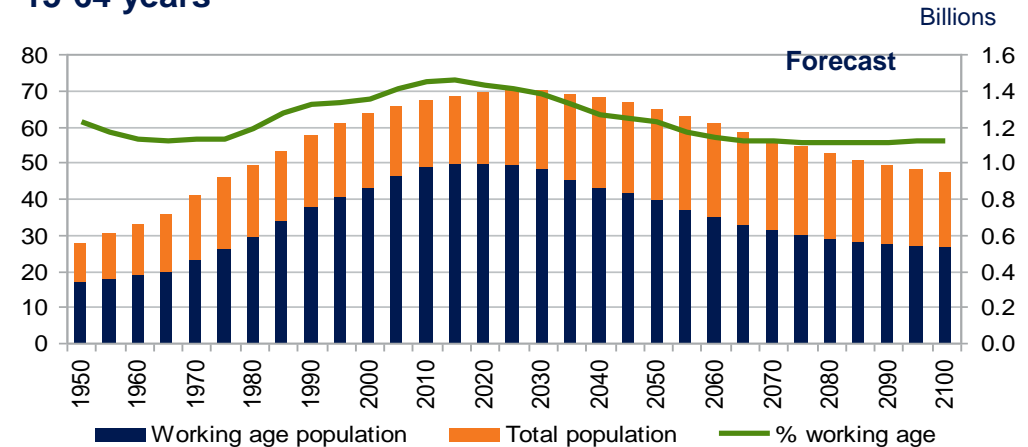


China

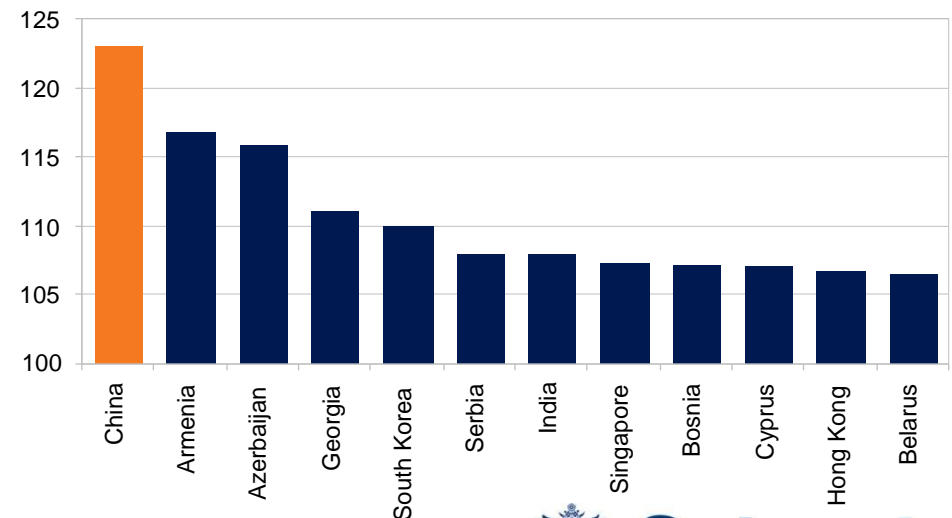
Impact of One Child Policy: Slow population growth and labour force growth

- Currently 20% of global population, but growth **slowing**. Absolute **decline** after 2025, will **fall by a third** by 2100
- Proportion of population in working age will peak in 2015; workforce will **shrink** thereafter
- Rapid aging - population over 65 will more than treble by 2050
- Implies wage inflation and slowing growth, but labour force still world's largest
- Dramatic gender imbalance and shift to nuclear family structure unprecedented - impact on Chinese society hard to predict
- By 2025, almost a fifth of Chinese men will not be able to find a partner

Total population and population of working age 15-64 years



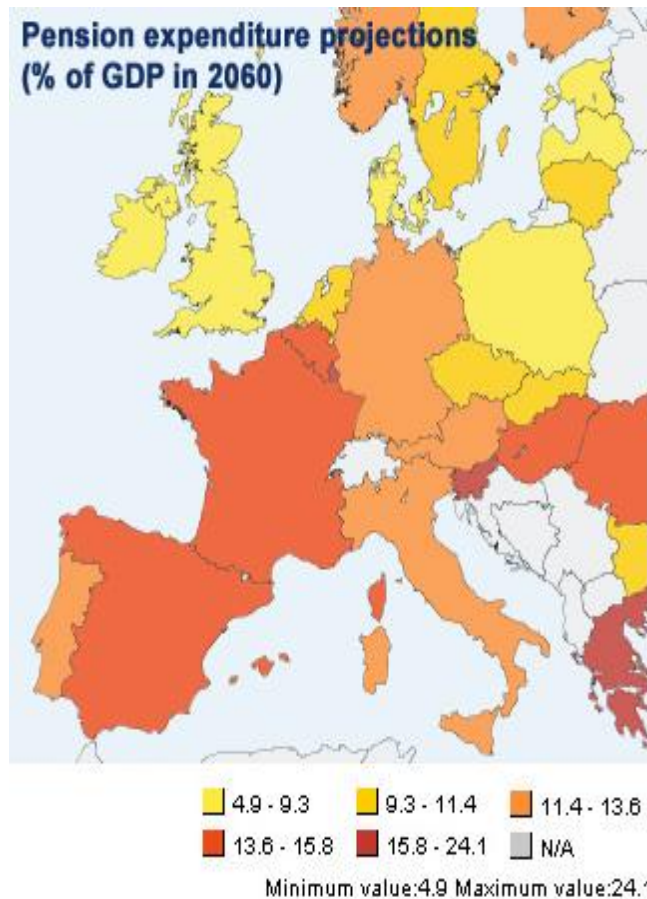
Males per 100 females at birth, 2005-10



Europe

Confronting the challenge

Curbing age related spending must become priority



- Working age population will decline from 2010. By 2050, 30% of the population will be over 65. In Western Europe, there will be **one retiree for every two workers**
- Potential GDP growth in the EU will almost halve, and the fiscal cost of aging will reach **28% of GDP** p.a. by 2060
- The net present value of this cost is **ten times the cost of the fiscal crisis**, driving average government debt in the G20 to **300% of GDP**
- There are no demographic solutions, but structural reforms and ameliorative policies can be used to manage economic outcomes. Will **fundamentally alter the investment environment**

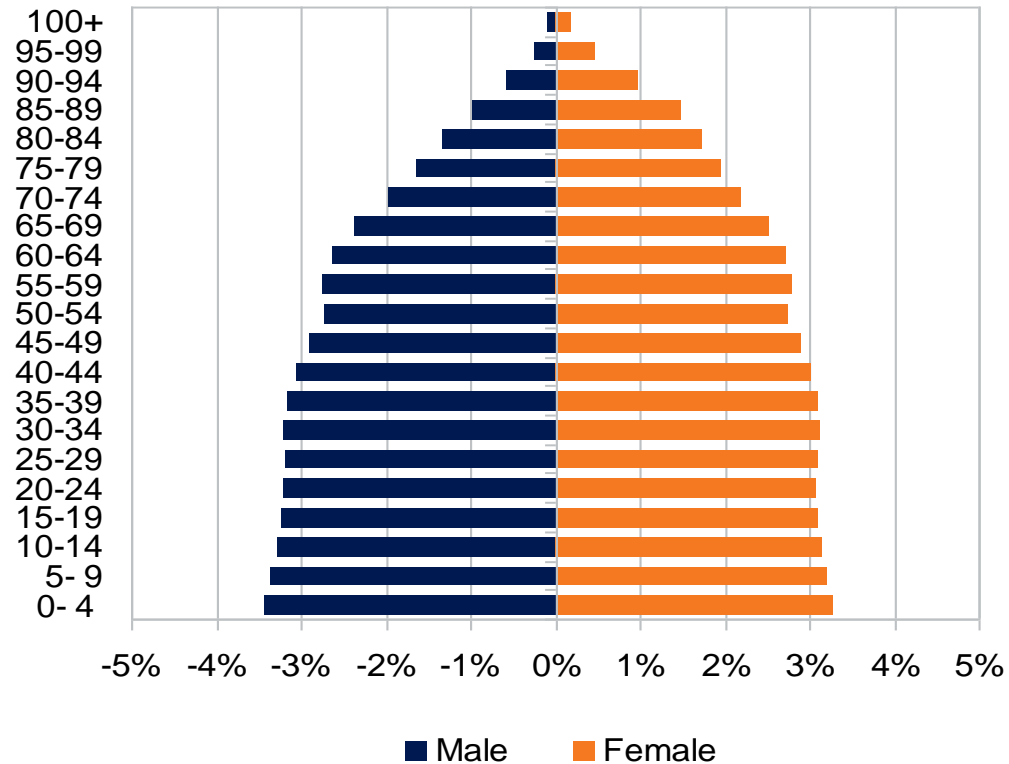
United States

Manageable headwinds

- Most favourable demographic profile in developed world: ‘Country competitive advantage’
- Higher fertility and a relaxed attitude to immigration imply that the prospects for sustained economic growth and consumption are better than in Europe, Japan and, in the long-run, even China
- Prospects for overall growth and consumption remain solid, but careful stock-picking increasingly important
- First 3.4 million boomers eligible to retire in 2011; **78 million over next 20 years**. Possibility of skills shortage in some industries e.g. manufacturing, health and education
- The US healthcare system is already the **most expensive** in the world, consuming a massive 16% of GDP compared to the OECD average of 8.9%

USA 2050

Age range

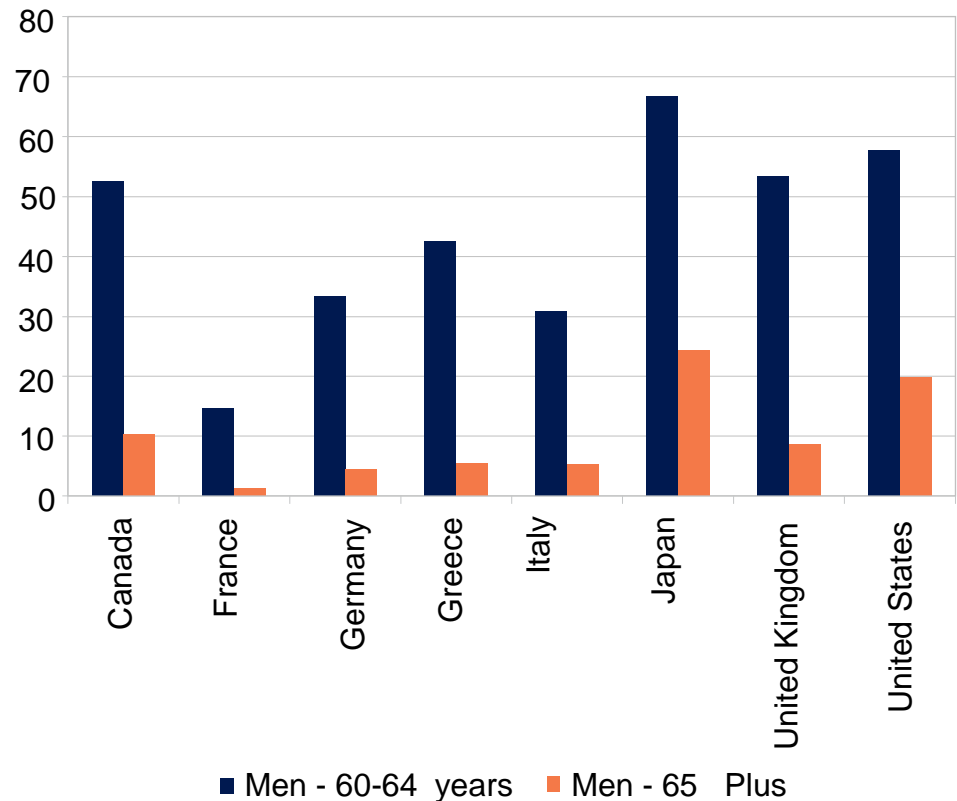


Japan

Response to the challenges of aging

- Oldest country in the world, median age 15 years higher than global average. Growth prospects poor
- Highest participation rate for over 60s- reduces pressure from shrinking prime-age population
- Time spent in retirement is below the OECD average
- Flexible ‘re-hiring’ program limits wage burden
- Health and pension reforms better prepared Japan for the consequences of a rapidly aging population than much of the Western world
- Finances in better shape than commonly thought - net debt 105% of GDP and cost of aging under control. Spending per retiree on health and pensions well below OECD average

Economic activity rate, 2009¹



Source: Kohler, Billari and Ortega (2006), Low Fertility in Europe: Causes, Implications and Policy Options
UN Population Division (2000), Replacement Migration. Figures for Europe include Russia
¹ILO (2010)

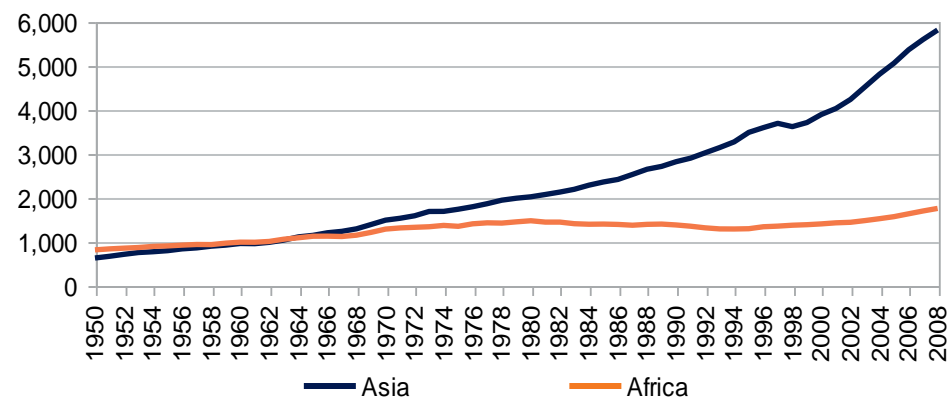
Africa

Huge potential – but will it be realised?

- Sub-Saharan Africa accounts for **~15% of the world's population** but just **2.4% of GDP**
- In 1950, Africa was **25% richer than Asia**.¹ GDP per capita in **Korea was lower than Somalia** in 1960; now its output is **higher than the whole continent**
- **60% of world's uncultivated arable land**; rich in minerals, precious metals and fossil fuels. Sahara could supply **whole world's electricity**
- Falling fertility in most countries creates potential **demographic dividend**. Best population structure globally from 2050 onwards
- Historically, corruption, conflict and poor health (among other factors) have prevented potential from being realised. **Will this time be different?**

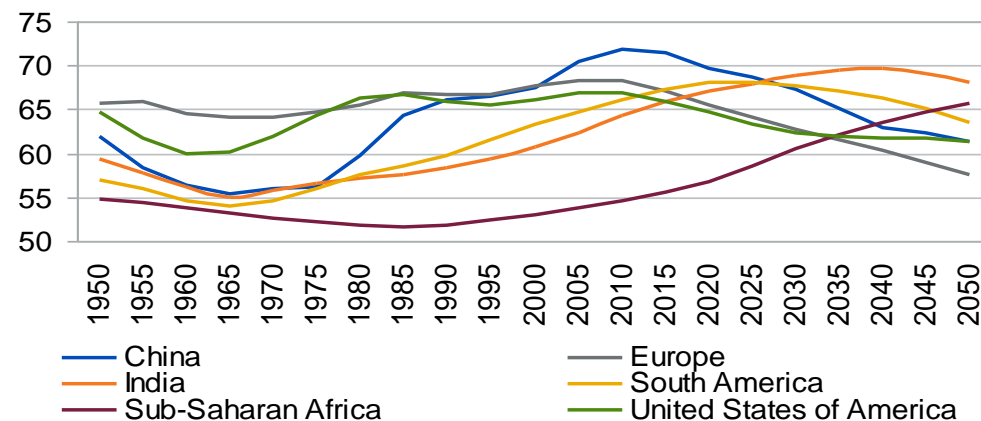
Average GDP per capita

PPP terms



Working age population

% of total



¹ In GDP per capita terms

Source: UN World Population Prospects, Schroders, Maddison tables, Socgen



Schroders

Conclusions

What does it mean for investors?

- Stock picking is key: Companies are confronted to the trends shaping the world continuously
 - Only the best corporate management teams, wherever they are, will grow in this global environment of heightened challenges and opportunities
- Give your portfolio managers the largest possible universe : Finding growth and competitiveness wherever it is
 - Country of listing increasingly irrelevant; what's important is the source of revenue and earnings growth
- Concept of Sustainability should be at the centre of investors mind

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