Market update

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Reaction to the sharp falls in equities overnight by Bill McQuaker, Deputy Head of Equities at Henderson Global Investors

It has been an unsettling week for investors, particularly for equity and commodity markets. In local currency terms key markets such as the Nikkei, Hang Seng, Euro Stoxx and FTSE 100 are down as much as 9% on the week. The S&P 500 has fallen more than 7% in the first four days alone.

There is not a great deal of new information that has precipitated the fall; rather a collective loss of confidence. The active ingredients in the toxic brew have been a weakening of economic data together with a destabilised political environment, all of which has been amplified by the loss of market liquidity that occurs during the holiday season.

First, the economic data. The last few months has seen a trend towards weaker economic momentum. For the most part, markets have taken this in their stride as company fundamentals have remained robust, in terms of the cash generated by business and the strength of balance sheets, but a broadening of weakness in economic data has triggered commentators to question whether the malaise is deeper than merely a mid-cycle slowdown.

Second, the politics. In Europe, politicians struggled to agree a coherent strategy to the eurozone debt problems as individual national interests were aired. This was echoed in the unseemly spat between parties in the US over the raising of the debt ceiling. Investors were subjected to watching politicians prepared to gamble with the global economy in order to score political points. This is not a conducive environment in which to be taking long-term investment decisions and it is the pause in activity by both companies and consumers that has weighed on equity market prices in recent days.

So, what developments could prevent further market deterioration? Policymakers need to move to restore confidence so that companies and households are comfortable making the investment and consumption decisions that lead to economic growth. In the eurozone it would be helpful if the European Central Bank were more proactive in intervening in the markets, buying more bonds to give breathing space for the politicians to determine a long-term solution to the eurozone's fiscal problems and bridge the gap between today and the ratification of recent agreements, which is likely to happen in mid-September. In the US, it means prioritising growth over interparty squabbling because economic growth is the surest way to deal with the budget deficit.

Markets are in flux, but if policymakers can provide reassurance then investors would very likely be reminded that equity market valuations are undemanding and company fundamentals are in robust shape. With markets at current levels there looks to be considerable value in equities and if the positive developments we have described above come to pass we believe this could, with the benefit of hindsight, look like an opportune moment to be gaining exposure to risk assets.

Source: Datastream

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For further information please contact your local sales office or visit our website: www.henderson.com

AUSTRIA
Henderson Global Investors Ltd
Falkestrasse 1
A-1010 Vienna
Austria
Tel: +43 13 19 32 22 18
Fax: +43 13 19 32 22 90
Email: info.austria@henderson.com

GERMANY
Henderson Global Investors Ltd
Bockenheimer Landstrasse 24
D-60323 Frankfurt/Main
Germany
Tel: +49 69 86 003 110
Fax: +49 69 86 003 355
Email: info.germany@henderson.com

NORDICS
Henderson Global Investors Ltd
201 Bishopsgate
London
EC2M 3AE
United Kingdom
Tel: +44 20 7818 4397
Fax: +44 20 7818 1819
Email: sales.support@henderson.com

UNITED KINGDOM
Henderson Global Investors Ltd
201 Bishopsgate
London
EC2M 3AE
UK
Tel: +44 20 7818 1818
Fax: +44 20 7818 1819
Email: sales.support@henderson.com

BENELUX
Henderson Global Investors BV
Roemer Visscherstraat 43-45
1054 EW Amsterdam
The Netherlands
Tel: +31 20 675 0146
Fax: +31 20 675 7197
Email: info.nederlands@henderson.com

ITALY
Henderson Global Investors Ltd
Via Agnello 8
20121 Milan
Italy
Tel: +39 02 72 14 731
Fax: +39 02 72 14 7350
Email: henderson.italy@henderson.com

SPAIN
Henderson Global Investors Ltd
Miguel Ángel 21, 5°
28010 Madrid
Spain
Tel: +34 91 562 6245
Fax: +34 91 564 6034
Email: info.spain@henderson.com

FRANCE/GENEVA/MONACO
Henderson Global Investors Ltd
7 rue Scribe
75009 Paris
France
Tel: +33 1 53 05 44 80
Fax: +33 1 44 51 94 22
Email: info.france@henderson.com

LATIN AMERICA
Henderson Global Investors Ltd
201 Bishopsgate
London
EC2M 3AE
United Kingdom
Tel: + 44 20 7818 6458
Fax: + 44 20 7818 7458
Email: sales.support@henderson.com

SWITZERLAND
Henderson Global Investors (Schweiz) AG
Rennweg 28
8001 Zurich
Switzerland
Tel: +41 43 888 6262
Fax: +41 43 888 6263
Email: info.switzerland@henderson.com

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