

Greek gift overlooked as markets unwrap other surprises

22 February 2010*

NEWS

- During the week, debt-laden Greece championed its own programme of deficit reduction, its gift to appease those who have been angrily debating exactly what to do with the flagging Eurozone member. On his visit to London, Greek prime minister George Papandreou proclaimed, "We are not looking for bailouts...we are simply saying that we have a programme". Greece has promised to cut its deficit from 12.7% of gross domestic product to 8.7% this year by introducing a series of measures, including a public sector pay freeze and higher taxes on alcohol and petrol, in order to slash the deficit. For now, his rhetoric seems to have worked and markets appear much calmer as a result; global equities had generally moved higher by close of play on Friday.
- The week had other surprises in store – good and bad – that soon eclipsed talk of Greece. Earnings results continued largely on the upside, US regional survey data showed improvements, and there were a number of positive broker upgrades. However, the Federal Reserve's (Fed) announcement that it was increasing the discount rate* by 25 basis points (bp) initially came as a shock to market participants; investors were panicked by the earlier-than-expected timing of the decision, before acknowledging that the change was driven by a more positive economic picture. In short, markets dislike unexpected 'presents', until they've had time to fully 'unwrap' them.

*the rate at which member banks may borrow short-term funds from a Fed bank

VIEWS

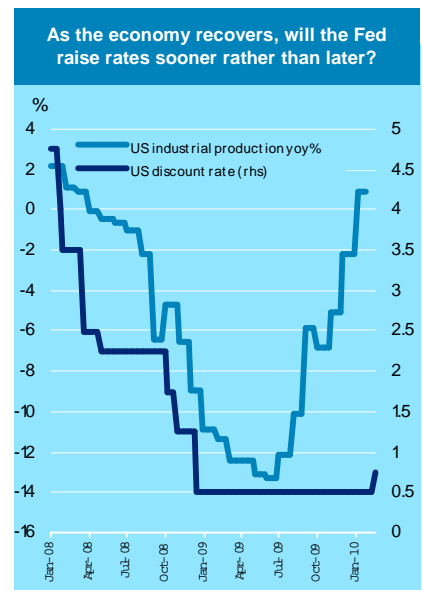
- Improving economic growth, rising inflation, normalising interest rates and heavy issuance will likely send government bond yields higher in 2010.
- The dollar could continue to appreciate on the back of solid US data during the first half of 2010, but the path of least resistance for the dollar remains down in the longer term. Despite an attractive valuation, sterling will struggle against most G10 and emerging market currencies until there is more clarity on the UK government's fiscal position.
- We believe the equity market rally will continue during the first half of 2010 on the back of positive earnings growth and continued positive surprises in both industrial production and household consumption data.

THIS WEEK

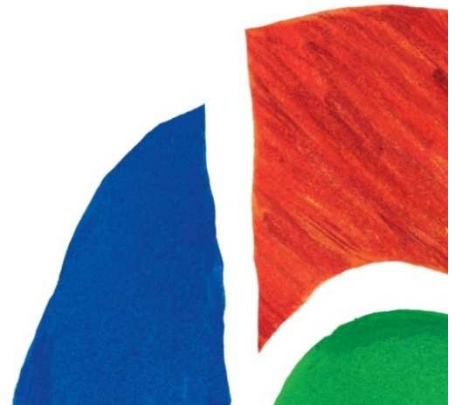
- This week's events are likely to be dominated by US news flow, with analysts watching for any further developments in potential 'exit strategies'; Wednesday sees Fed Chairman Bernanke's eagerly-anticipated semi-annual monetary policy testimony before Congress. Following the Fed's move to increase the discount rate, investors will be watching for any further signs of a tightening in US policy, which has so far remained sufficiently loose to support the rally in equity markets.
- Inflation also remains a key theme, with Eurozone CPI numbers due on Friday, with expectations that moderate inflation will continue coming through in developed markets.

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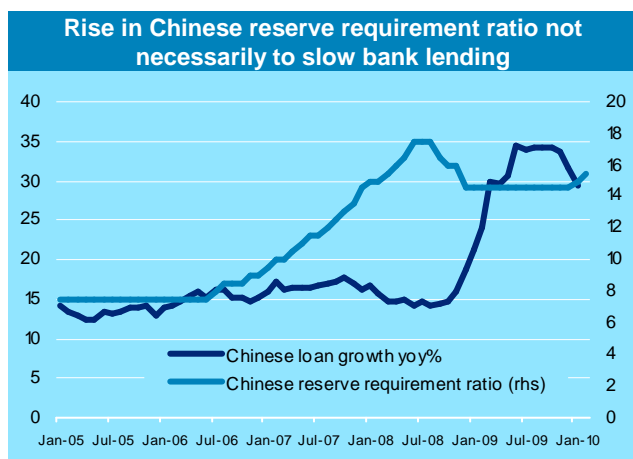
*All data to week ending 19 February 2010 unless otherwise stated



Source: Datastream, Henderson Global Investors, as at 19 February 2010



ECONOMIC DATA



Source: Datastream, Henderson Global Investors, as at 19 February 2010

GDP Growth %	2009	2010*	2011*
US	-2.5	2.9	3.1
Japan	-5.4	1.3	1.5
Eurozone	-3.9	1.3	1.6
UK	-4.7	1.5	2.2
G7	-3.6	2.0	2.2
Asia ex Japan	5.2	7.8	7.4
World	-2.2	3.0	N/A

Inflation %	2009	2010*	2011*
US	-0.3	2.2	1.9
Japan	-1.3	-1.0	-0.3
Eurozone	0.3	1.2	1.5
UK	2.1	2.4	1.7
G7	0.0	1.4	1.5
Asia ex Japan	1.8	3.6	3.7
World	1.4	2.6	N/A

Bond Indices	12 Feb	19 Feb	% cge
FTA Government Stocks	2282	2263	-0.8
FTA Index-Linked	2413	2414	0.1
JP Morgan Global Govt Bond Index	548	550	0.2

10-year Bond Yield (%)	12 Feb	19 Feb	Dec 2010*
UK	4.14	4.27	↑↑↑
US	3.69	3.78	↑↑↑
Eurozone	3.19	3.28	↑
Japan	1.33	1.33	↑

Other	12 Feb	19 Feb	June 2010**
Interest Rates (%)			
UK	0.50	0.50	0.50
US	0.25	0.25	0.25
Eurozone	1.00	1.00	1.00
Japan	0.10	0.10	0.10

Currencies & Commodities	12 Feb	19 Feb	Dec 2010**
£/€	0.87	0.88	↑
\$/£	1.56	1.54	→
\$/€	1.36	1.35	↓
¥/\$	90.0	92.0	↑
Oil (Brent crude \$/barrel)	71.3	77.1	↑
Gold (\$/Troy oz)	1087	1119	↑

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

Source: Datastream, Henderson Global Investors, as at 19 February 2010
 * Consensus economics, as at 11 January 2010
 ** Henderson Interest Rate Team forecast

MACRO

It was a fairly quiet week for economic data, but what was released suggests the recovery remains intact. Regional US survey data improved; US production data was positive and stronger than expected, with the growth fairly broadly based amongst the underlying sectors; utilisation rates rose, but remain below the levels associated with inflationary pressures. Inflation data in the UK and the US supported this view as annual price rises were higher than last month, but rose less than expected by the consensus of economists.

The most noteworthy developments for the week were in relation to the so-called "exit strategies". This is the label given to the shift from loose monetary and fiscal policy to a tighter stance, which seems inevitable given the pick-up seen in the economy over the last few months.

Last Friday, the Chinese authorities unexpectedly increased the reserve requirement ratio, which is the amount of capital banks are required to keep with its central bank, and follows a rise instigated in mid January. Although investors believe that the Chinese are trying to inhibit bank lending, it seems more likely that it is being used as a tool to control "hot money" inflows. Indeed, loan growth should remain strong throughout the year, although will be biased toward the start of 2010.

On Thursday night, the US Fed increased the discount rate by 25bp to 0.75%. This should come as no surprise to markets as it was telegraphed in Chairman Bernanke's testimony to Congress in early February. The fact it was done between interest rate setting meetings further emphasises that this action was not to be interpreted as a change in policy. That said, all eyes will be on the Fed's comments following its next meeting for any evidence of a desire to accelerate the time frame of rate rises.

BONDS & CURRENCIES

Ten-year bond yields climbed (prices fell) as persisting sovereign debt fears, and anxiety over the withdrawal of quantitative easing – reawakened by the Fed's earlier-than-expected 25bp increase in the discount rate – drove the sell-off. Gilt prices dropped when figures revealed that the UK Treasury had borrowed a further £4.3bn last month – its first January 'in the red' since records started in 1993 – with some commentators suggesting that the UK's fiscal position could be worse than Greece's as a percentage of GDP, once data is extrapolated. Greek 10-year yields failed to stabilise (+27bp).

The US dollar reached a nine-month high against the pound and euro late in the week, after the US Fed's announcement about the discount rate. But the euro continued to suffer from uncertainties over fiscal deficits in key member countries, plunging to a nine-month low against the strengthening dollar. The pound was also in trouble, dented by the depth of the UK's borrowing: sterling stands at \$1.54 versus the dollar. It has fallen from grace since its 26-year high of \$2.12 (Nov 2007).

COMMODITIES

On Wednesday, the International Monetary Fund announced that it would be selling 191.3 tonnes of gold (about 5% of annual global demand) on the open market. The news initially saw a sell-off in the precious metal, as commentators feared a lack of buying interest from central banks, but gold rallied again into Friday, closing up 2.9% on the week.

'Black gold' also tracked the rally in most commodities, with West Texas Intermediate for March delivery reaching \$79.8/barrel by Friday's close. This was despite some tensions surrounding demand weakness in the US, where inventories data showed that crude stocks had risen by 3.1m barrels for the week ending 12 February.

UK EQUITIES: UK markets brushed aside sovereign fiscal woes, and some initial fears over the tightening of US monetary policy, choosing instead to accentuate the positives, by focusing on better-than-expected earnings, and macro data that supported the global recovery story.

The FTSE 100 booked five straight days of gains, adding 4.2% as banks (+8.7%) and mining (6.7%) won out against defensive plays (pharma & biotech +1.5%; healthcare equipment +1.5%). Barclays was the FTSE 100's biggest winner, its stock soaring 19.2% after recording bumper annual profits – up 92% at £11.6bn – that smashed City estimates and triggered four broker 'Buy' recommendations. This helped cheer Royal Bank of Scotland (+10.5%) and Lloyds Banking Group (+8.5%) to a weekly outperformance, with Lloyds reporting this coming week. It is hoped that both banks will reveal lower-than-expected impairment charges.

Mining stocks also found favour after Merrill Lynch added Rio Tinto (+6.5%) to its 'Europe 1' recommended list, citing a low valuation and strong upside potential; Merrill anticipates that metal demand will climb after the Chinese new year. Eurasian Natural Resources, Xstrata, and Vedanta posted gains of 10.2%, 8.2%, and 8.1%, respectively.

At the bottom end of the table, BT Group underperformed the rising market, losing 3.2% after S&P unexpectedly downgraded the firm, citing fears that it will struggle to rein in its £9bn pensions deficit, and that its plans to pay £533m into the scheme each year until 2029 will negatively impact shareholder returns.

Mid and small caps: troubles for small-cap oil explorers were lurking in Argentine waters last week, as the government there moved to restrict foreign ships' movements from its ports. Argentina has long voiced its contempt over foreign drilling around the Falklands archipelago, despite losing its claims to sovereignty over the islands when its war with Britain ended unsuccessfully in 1982.

Despite Argentina's defiance, oil rig Ocean Guardian – operated by Desire Petroleum – arrived to drill on Friday, as planned, and related stock prices recovered from Wednesday's lows. Desire (13.6%), Rockhopper (11.7%), Borders & Southern (unchanged), and Falkland Oil & Gas (-1.5%) have all been exploring drilling opportunities within the Falklands basin.

Continuing the theme of oil exploration, Kea Petroleum (-1.3%) debuted on Monday – the second AIM flotation this year – raising £6m through a placing at 8p per share.

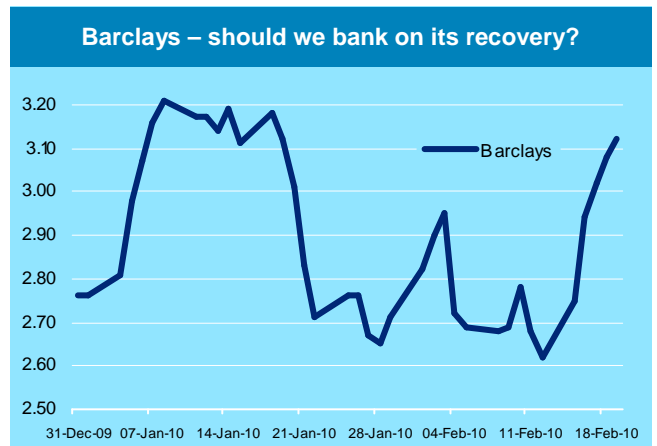
OVERSEAS EQUITIES

European markets: Continental markets were in accordance with their UK counterparts for the week, with the DJ Euro Stoxx adding 4.0% over the five-day period.

Commercial banks were boosted after France's largest bank, BNP Paribas (+11.5%), announced its fourth straight quarterly profit, with net income at €1.37bn, beating consensus estimates. Optimism spilled over into Erste and Natixis, which climbed 9.6% and 8.4%, respectively. Societe Generale (+1.8%), however, could not match their gains after commentators expressed disappointment following its fourth quarter figures (net profit €221m).

Elsewhere, materials experienced a tough week, as Akzo Nobel (-5.2%) and Solvay (+2.5%) posted disappointing earnings results, heightening concerns about the troubled European chemicals industry.

MARKET DATA



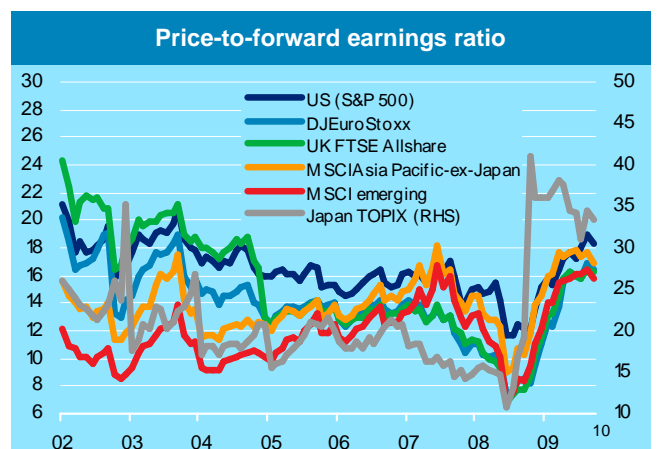
Source: Datastream, as at 19 February 2010

Equities	12 Feb	19 Feb	% cge
UK - FTSE All-Share	2633	2742	4.1
UK - FTSE 100	5142	5358	4.2
UK - FTSE 250	9053	9431	4.2
UK - FTSE Small Cap	2759	2796	1.3
Eurozone - DJ Euro Stoxx	252	262	4.0
US - S&P 500	1076	1109	3.1
US - Nasdaq	2184	2244	2.8
Japan - Topix	892	889	-0.4
Hong Kong - Hang Seng	20269	19894	-1.9
MSCI Emerging Markets (US\$)	922	933	1.3

Source: Datastream, as at 19 February 2010

Consensus EPS Growth %	2009* (yoy)	2010* (yoy)	2011* (yoy)
US	3.2	29.6	20.8
Japan	N/A	88.1	25.5
Eurozone	-27.5	33.7	23.1
UK	-33.3	31.2	24.7
Asia ex Japan	4.1	24.2	16.8
MSCI Emerging Markets US\$	3.4	29.6	19.7

Source: Datastream, Henderson Global Investors, as at 31 January 2010
* Consensus forecast



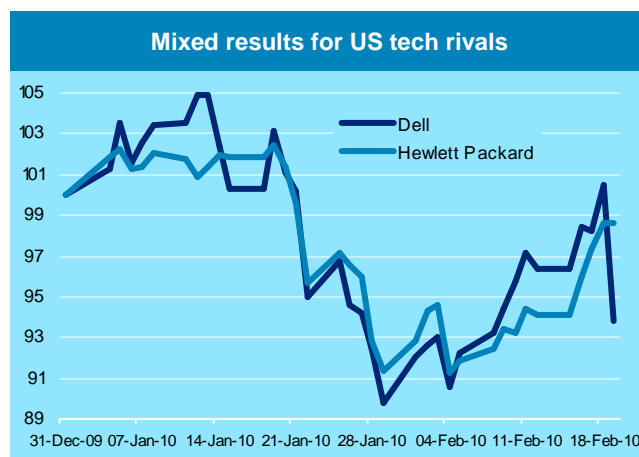
Source: Datastream, Henderson Global Investors, as at 31 January 2010

US markets: the S&P 500 toasted a 3.1% rise over the four days that markets were open, having been closed on Monday for President's Day. Equities gained despite wobbles on Friday following the Fed's discount rate decision, with investors shrugging off initial fears over tightening; they seem to be seeing policy changes as a response to a strengthening economy. Sentiment was also lifted by lower-than-anticipated inflation numbers, with core CPI falling 0.1% in January.

US financials received a boost when Morgan Stanley issued a positive note about the sector, recommending that investors buy US banks. The broker was positive on those firms exposed to rising rates and those with improving credit. Firms mentioned included Bank of America, which rallied 9.9% over the week, with JP Morgan and Wells Fargo also benefitting from the positive press (+2.8%; +1.8%).

Within technology, Hewlett Packard's (+4.8%) first-quarter results easily beat estimates, but rival Dell lost 2.7% after reporting strong revenue that failed to translate into higher net profits. Additionally, Microsoft's (+3.0%) planned partnership with Yahoo! (+2.7%) was given the EU regulators' seal of approval. The firms are hoping that together they can challenge Google's dominance of the search engine market.

Asian markets: the lunar new year of the tiger saw China's markets closed for a week of festivities: some of its Asian neighbours were therefore left fidgeting following China's decision on Friday 12 February to clamp down on bank lending. Hong Kong investors took profits in the recent market rebound and were unwilling to commit to large positions ahead of Shanghai's reopening; the Hang Seng index finished down 1.9%. Hong Kong-listed financials and developers slipped on the week, with Bank of China (-2.6%) and China Overseas Land (-2.8%) amongst the laggards.



Source: Datastream, as at 19 February 2010
Prices rebased to 100

Japan's performance was lacklustre, with trading volumes at their lowest levels this year. Woes over Greece and China subsided, only to be replaced by jitters over the Fed's decision to raise the discount rate: the broader Topix posted a negative return of -0.4%, with the Nikkei 225 rising a fragile 0.3%. Property suffered during Friday's sell-off, with Mitsui Fudosan down 1.4% and Mitsubishi Estate 3.6% lower over the week.

Elsewhere, worries over consumer lenders were triggered when Citigroup Global Markets Japan downgraded the sector. Japan's latest money lending law, which will come into effect in June, will cap the amount of unsecured debt an individual can hold.

Finally, Toyota Motor's (-4.6%) president Akio Toyoda has agreed to testify in front of US lawmakers this week about the company's series of safety recalls.

Week ahead		Consensus
Monday 22 February	INTERIMS: Albemarle & Bond, Petra Diamonds FINALS: Bunzl, Hammerson, XP Power	
Tuesday 23 February	INTERIMS: Dechra Pharmaceuticals, Minerva FINALS: Brammer, Croda International, Dragon Oil, Kerry Group 'A', Mondi, Morgan Sindall, Pendragon, Spectris ECONOMICS: Germany IFO survey – expectations (Feb) US new home sales (Jan) Japan trade balance	There may be a pull-back in outlook Tax credits should be supportive of sales (consensus 351K) Asian demand likely to maintain net exports
Wednesday 24 February	INTERIMS: A&J Mucklow, Barratt Developments, Galliford Try FINALS: Huntsworth, Logica, Moneysupermarket.com, New World Resources, Rathbone Brothers, St. James's Place ECONOMICS: Eurozone industrial new orders (Dec: mom, yoy) US Bernanke semi-annual monetary policy testimony	Could slow after strong showing in Nov (consensus -1.3%; 7.6%)
Thursday 25 February	INTERIMS: Ashmore Group, Capita Group, Centaur Media, Dunelm Group, Genus, Go-Ahead Group, Hays, Redrow FINALS: BBA Aviation, British American Tobacco, Centrica, Royal Bank of Scotland Group, RSA Insurance Group, SEGRO ECONOMICS: German unemployment rate (Feb) Eurozone industrial confidence (Feb) US durable good orders (Jan) Japan nationwide CPI, retail sales and industrial production	Expected to climb following withdrawal of support scheme Expected to be 1.4% Plane building should be supportive of numbers Higher food prices should help offset deflation
Friday 26 February	INTERIMS: Helphire Group, Ricardo Group FINALS: Bayer AG, Lancashire Holdings, Lloyds Banking Group, Rightmove, Serco Group, William Hill ECONOMICS: Eurozone core CPI (Jan, yoy) German CPI (Feb, mom)	Expected to come in at 1.0% 0.5% anticipated

Markets returns source Datastream price index for equities, total return for bonds, local market terms. This document has been produced based on Henderson Global Investors' research and analysis and represents our house view. The information is made available to clients only incidentally. Unless otherwise indicated, the source for all data is Henderson Global Investors. Any reference to individual companies is purely for the purpose of illustration and should not be construed as a recommendation to buy or sell or advice in relation to investment, legal or tax matters. Please remember that past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. Tax assumptions may change if the law changes, and the value of tax relief will depend upon individual circumstances.

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