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Market Update

For immediate release
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"Good news from Washington is desperately needed to prevent further turbulence."

Summary of latest events:

- **President Bush** warns of a "serious financial crisis" and a "long and painful recession" if Congress does not back a $700 billion bail-out package for financial institutions
- **Spreads in the interbank market are at record levels** suggesting that perception over counterparty risk is actually getting worse

Commentary:

We have moved from outright panic last week on fears of financial failures, into euphoria as details of concerted US action emerged, back into a jittery and nervous market as investors await details of the planned TARP (Troubled Assets Relief Programme). The market dislikes uncertainty and the longer that it takes for Congress to approve the measures that Hank Paulson is pushing for, the more concern rises that the final measures will be delayed or will be watered down. In the last 24 hours we have had President Bush warning of a "serious financial crisis" and the US risking a "long and painful recession" if Congress do not pass the proposed $700bn bailout package. In addition, presidential candidates Obama and McCain have issued a joint statement to encourage their parties to work together to prevent an "economic catastrophe". It seems that Alistair Darling is not alone in talking down prospects for his domestic economy!

Aside from the dire predictions over the results of inaction from key politicians and policymakers we have seen senators wanting to be seen to challenge the socialisation of debt in order that the perceived protagonists in this whole episode – the banks and bankers – are made to pay their pound of flesh. This politicking, (not unexpected), bureaucracy, and posturing by senators is heightening anxiety that the ‘bailout’ may not provide the desired relief. Indeed, it is likely that the downside to the market is greater if the TARP is not passed than there is upside. In that sense, risks remain asymmetric in risk assets right now.

As well as the ongoing uncertainty over timing and content of the TARP, there is unprecedented dislocation in money markets. Spreads in the interbank market are at record levels suggesting that perception over counterparty risk is actually getting worse, rather than better, despite the ongoing push from policymakers and central banks to restore calm. In addition, duration of investors has been cut to the very short end, pushing down overnight rates close to zero. Partly these factors are due to hoarding of cash into the quarter end and aside from swift resolution of TARP a solution is the swift recapitalisation or consolidation amongst the banking sector.

Current behaviour is entirely consistent with the banks being unwilling to lend, despite being awash with liquidity. In this sense, the recapitalisation of the banking system is key – and must be addressed urgently. The increasing stress in money markets shows that credit is significantly declining in availability and rising in cost. This will quickly start to hit borrowers who are refinancing and cause rising defaults if left unchecked. TARP should contain some of the solutions but credit creation will be muted for a very long time. Tighter lending standards will exclude borrowers even as the price of credit begins to diminish and the actual demand for credit from borrowers will fall as wealth is eroded and incomes are squeezed. The seizing up of the money markets is another manifestation of the credit crisis and those who thought that we were home and dry as a function of government action are being forced to think again. The TARP should provide some relief over coming days but economic and market risks still appear skewed to the downside. The market is beginning to crush the lifeblood of the economy to an extent that exceeds that of the panic gaining headlines last week. Good news from Washington is desperately needed to prevent further turbulence.

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25 September 2008

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Notes to Editors

F&C Investments

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- F&C is an active fund manager with a multi-specialist investment model where individual teams have strong accountability for their products and processes. The group is also an active shareholder with a leading franchise in governance and sustainable investment.
- F&C now manages £96.5 billion (€121.9 billion) of assets* for a diverse range of institutional, insurance and retail clients across all major asset classes – equities, bonds, cash and property – as well as alternative and specialist product classes such as Socially Responsible Investment funds, hedge funds, funds of hedge funds, private equity funds, Global Tactical Asset Allocation products, enhanced alpha funds and Liability Driven Investments. F&C invests globally and has been a longstanding investor in emerging markets.
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  * As at 30 June 2008.