

WORLD MARKET VIEWS SUMMARY

AUGUST 2010



Asset Allocation Summary

Current Investment Policy	--	-	0	+	++
Asset Allocation	Cash		Bonds	Property, Equities	
Equities			Asia, Emerging Mkts <<US, <<Japan	Europe (ex UK), UK	
Bonds			Overseas Bonds, UK Gilts, UK Investment - Grade Bonds		

Policy changes over the month, when applicable, are shown by arrows (<<, >>)

We remain mildly overweight in equities and slightly more so in UK commercial property, funded by an underweight stance in cash. Following July's equity market rallies, the overweight positions in the US and Japan were removed.

Global Forecasts

Economic growth. Our growth forecasts are unchanged. We forecast 2.2% growth in 2010 for the main developed nations (the average of the US, UK, continental Europe and Japan), and 2.6% for 2011. For the world including developing nations, we expect 4.1% growth in 2010 and a 4.3% pick-up the following year.

Inflation. There have been no major changes to our inflation forecasts. The developed world's headline rate of inflation is expected to average 1.3% this year and 1.1% in 2011. Forecasts for core prices (excluding food and energy) are basically unchanged, with projected increases of 0.7% this year and 1% in 2011. Risks to our forecasts are wider than usual and skewed to the downside in the short term, but biased to the upside in the medium term.

Interest rates. We have not made any adjustments to our interest rate forecasts. The Bank of England is expected to raise interest rates to 2% by the end of 2011, while the European Central Bank is expected to

tighten policy to 2%. In the US, the Federal Reserve is still expected to start raising interest rates towards the end of 2010, with hikes to 2.5% by December 2011. Given the persistence of deflation in Japan, the Bank of Japan is forecast to keep interest rates at 0.1% until at least the fourth quarter of 2011.

Bonds. Our forecasts for ten-year government bond yields are unchanged. For US Treasuries currently yielding 2.6%, we expect a rise in yields to 4.1% by June 2011. In the UK, we forecast 4% for gilts; we think German bund yields will rise to 3.25%; and in Japan we see the market at 1.2%. In other words, we expect a simple weighted average of these government bond yields to rise by about 91 basis points over the coming year.

Equities. Our central economic case translates into a FTSE 100 level of 6,000 by the end of 2010 and the same level for the end of 2011. The tug-of-war continues between short-term positives and longer-term concerns over the strength and sustainability of global growth. The focus

most recently has been the rally in government bond markets and the flattening of yield curves. Investors' faith in equities has taken another knock, and we believe there is a moderate probability of above-average equity returns in the short run.

UK

Economics. The UK economic outlook is subject to considerable uncertainty, given the extent of fiscal tightening that is being put in place. The most likely scenario is that there will be a moderate negative impact on growth in the shorter term but little impact – or conceivably some positive impact – further out. On that basis we remain relatively optimistic, with GDP growth forecasts of 1.3% this year, 2.7% in 2011 and 3.4% in 2012. The increase in VAT from 17.5% to 20% in January 2011 is likely to keep CPI inflation above the 2% target until early 2012, with some risk that longer-term inflation expectations may drift upwards.

Interest rates. Rates were again left on hold at 0.5% at the most recent meeting of the monetary policy committee. The latest Inflation Report reveals considerable uncertainty on the outlook, perhaps reflecting a wide range of views on the committee. But a combination of risks to economic output and the prevailing belief that inflation will eventually fall below target indicates no interest rate increases in the near term. We anticipate a first increase in the official bank rate during the first quarter of 2011 and now see relatively gradual increases to 2% by the end of 2011.

Equities. In July, UK equity markets rose for the first time in four months. They were helped by strong second-quarter earnings and positive results from European bank stress tests, which helped banks in particular to perform well. In contrast, more defensive areas such as tobacco and pharmaceuticals were left behind. We think the FTSE 100 will rise to 6000 by the end of 2010, with most of the equity market returns over the next two years materialising sooner rather than later.

US

Economics. The US economy has now entered a period of slower growth, but the economic recovery is likely to gather pace again in 2011, driven by a revival of capital spending from depressed levels. Economic data releases have been generally uninspiring, but are consistent with a period of slow growth rather than a plunge back into “double dip” recession. We think GDP growth will accelerate from 2.7% this year to 3.2% next year and 3.6% in 2012.

Interest rates. The Federal Open Market Committee has moved in recent months from contemplation of some reduction in the extent of monetary accommodation to consideration of further easing. It now seems probable that it will take strong evidence of renewed economic upturn to produce a hike in interest rates. The start of an upward move in rates now looks improbable until some way into 2011.

Equities. The S&P500 rallied 6.9% in July, more than recouping its June losses. The recovery was driven by a strong earnings reporting season. While all sectors rose, cyclical stocks led the way. Materials were pushed higher by commodity price gains while industrials and telecoms were boosted by strong earnings reports. In contrast, healthcare, consumer staples and financials all lagged.

Important Notes

The information contained in these notes has been derived from internal sources that we consider to be reasonable and appropriate. It also includes our views and expectations, which cannot be taken as fact. Investment markets and conditions can change rapidly and as such the views expressed should not be taken as statements of fact nor should reliance be placed on these views when making investment decisions. Past performance is not a guide to future performance. Furthermore, for non-sterling denominated investments, currency movements may cause an additional favourable or unfavourable change in value. Due to the above factors, you may get back less than you invested. The value of investment may fluctuate and are not guaranteed.

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EUROZONE

Economics. Sentiment has swung into positive territory, reflecting a marked pickup in survey results and optimistic official comments on GDP growth. A rise in manufacturing output is benefiting the heavily industrial core European economies. As corporate confidence returns, the investment cycle is beginning to support the economic recovery. Private consumption remains weak as car scrappage schemes come to an end and unemployment remains high. That said, there are tentative signs of improvement in the labour market. Inflationary pressures are expected to remain muted. We forecast economic growth of 1.2% in 2010, rising to 2.1% next year and 2.2% in 2012.

Interest rates. The European Central Bank left interest rates unchanged at its July meeting. The ECB is aiming for a normalisation in interest rates, but given the extent of Portuguese and Greek banks' reliance on central bank funding, this may be difficult. Although we still expect the first increase to be in the first quarter of 2011, we now expect rates to remain lower for longer, with interest rates increasing only to 3.25% by the end of 2012.

Equities. In July, the FTSE Europe (ex-UK) index rose by 5.3%, driven by strong results from banks, life insurance and the travel sector. Pharmaceutical companies, household goods and hardware equipment suppliers were laggards. Our forecast is that the benchmark index will rise to 375 by the end of 2010, and will remain around that level at the end of 2011. In other words, we expect most of the equity market returns over the next two years to materialise sooner rather than later.

JAPAN

Economics. Economic momentum appears to have slowed, but this was to be expected given that the economy was expanding at a rate significantly above trend. Corporate profits have rebounded sharply. This, together with the improving trade surplus and continued fiscal stimulus measures, should feed through to the domestic side of the economy. That said, the pickup in global GDP is constrained by the strength of the yen. Also, the worldwide pickup has lost some momentum. Given this, we expect growth to slow from 3.1% in 2010 to 1.9% in 2011.

Interest rates. We think the Bank of Japan is broadly happy with the way recovery is developing, and expect the interest rate to be left at 0.1% for some time. Indeed, with underlying inflation set to remain negative, the rate is unlikely to be increased before the final quarter of 2011.

Equities. Japan's equity markets made little progress this month, with the Topix index ending the month just 1% ahead in yen terms. Fears of slowing growth in China were partly responsible as July began, and Japanese stocks touched a seven-month low after predictions that China's property market was starting to “collapse”. Analysts observed that such an event would cause the yen to strengthen further. Market sentiment was also hit by the ruling Democratic Party of Japan's defeat in July's Upper House election.

FAR EAST AND EMERGING MARKETS

Economics. Commodities – and in particular the oil price – rose and the dollar fell. The Brazilian real has strengthened almost 6% over the last few months. China's second-quarter GDP slowed to 10.3% year-on-year from 11.9% in the first quarter, but this had been widely expected. India, South Korea, Brazil and Chile all raised interest rates in a bid to combat inflation. Australia has already raised rates consistently, but these were held at 4.5% in July. Thailand raised rates by 0.25 percentage points; its GDP is forecast to reach 6% for the full year. The Thai government announced an extension to the state of emergency for another three months in the wake of recent civil disturbances.

Equities. Developed Asian markets performed well in July, rising 7.1% in US dollar terms. Markets rallied following better economic data releases from Europe and hopes of a shift in Chinese policy (which we think unlikely at this stage). Emerging markets, too, rebounded in July. Year-to-date investment inflows have reached \$26 billion, including \$10 billion in the last two months. Poland, Turkey and other eastern European markets performed best as fears over the European debt crisis eased somewhat. Brazil was also strong. Overall, the economic backdrop for emerging markets remains robust, despite the anticipated slowdown in China that will inevitably have some impact.