

2nd Quarter 2009

Market views

- Central banks adopting quantitative easing
- Building blocks falling into place to allow the global recession to end
- Investors need to look widely for yield in a low interest rate environment

Global Outlook Q2



The Extractive Industries Transparency Initiative

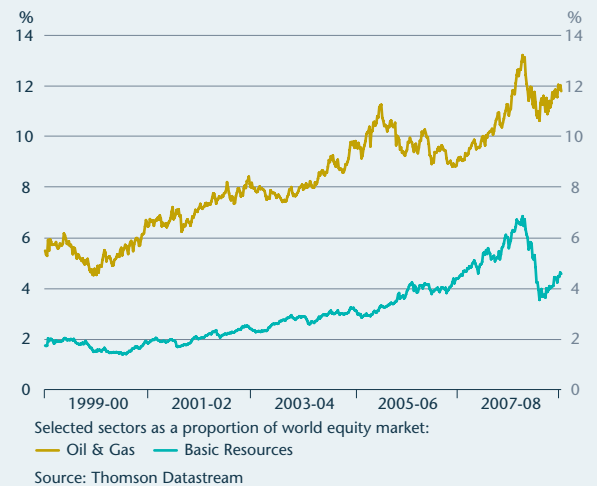
Contributing to a better investment climate

Corporate governance developments are an important driver for global investors to take into account in their decision making, as well as the more normal economic, business and regulatory concerns.



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Initiative

Chart 1
The growing importance of commodity stocks



Transparency on resource revenues

Investors regularly evaluate a number of risks which could impact on their investments, whether economic, financial, or increasingly political. It is clear that certain companies operating in areas of political instability, or in countries suffering from violence, bribery and corruption, face business risks that can significantly affect their commercial prospects and thus returns to investors. Companies in the extractives industries - oil, gas and mining - are increasingly subject to these problems as they move to source more production from assets in countries with higher risk profiles.

Over eighty global investment institutions, which in June 2008 collectively managed over \$14 trillion of assets, have therefore seen it in their interest to support the Extractive Industries Transparency Initiative (EITI). The EITI is a collaborative effort by countries, companies, investors and civil society to strengthen accountability and good governance in resource rich countries that are often affected by the 'resource curse'. This phrase has been used to describe a paradox seen in some countries and regions. Sometimes those with an abundance of natural resources experience worse development outcomes and slower economic growth than countries with fewer natural resources.

The EITI aims to improve governance through the verification and publication of company payments and government revenues from oil, gas and mining. This increased transparency sends a clear signal that a government is committed to high standards. It also strengthens accountability and can promote greater economic and political stability. All of these factors can enhance the prospect for investment returns from companies operating in participating countries.

How does the EITI work?

The EITI has developed specific criteria for the implementation of a validation process that leads to the disclosure of companies' payments and governments' receipts from oil, gas and mining activities. The criteria require the commitment and participation of governments, companies and civil society in a multi-stakeholder group (MSG) that oversees implementation in each country.

There are two stages in EITI implementation. The first requires implementing countries to comply with four initial criteria in order to qualify for Candidate status. Once these have been met, then Candidate Countries have two years

to complete the second stage of EITI Validation. The key requirements of Validation include the establishment of an MSG and the publication of a Country Work Plan with measurable targets and a timetable for EITI implementation. Also, implementing country governments must ensure the removal of any legal or regulatory obstacles, such as confidentiality clauses in contracts, which block companies' disclosure of payments to governments.

The MSG is responsible for appointing an independent Validator to prepare a report that includes a review of progress against the Country Work Plan. It also includes the indicators specified in the EITI criteria and an overall assessment of the implementation of EITI. The Validator's report is reviewed by the MSG, the government and the EITI Board. If the EITI Board concludes that the country meets all of the EITI criteria, the country will be designated as EITI compliant. To maintain this designation, further Validation exercises must be completed at a minimum of every two years. Where the Validation report shows that a country has made progress but does not meet all the EITI criteria, the country will remain a Candidate. Where Validation shows that no meaningful progress has been achieved, the Board may revoke the country's candidate status.

Current status of EITI

The EITI is receiving broad support. Over 500 participants from 80 countries attended the fourth EITI Global Conference in Doha, Qatar in February 2009. Global financier George Soros, a keynote speaker at the Conference, expressed his belief that the countries implementing the EITI would have a competitive advantage in attracting greater investment in a global economy that has become highly risk-averse. The high standards of accounting and reporting inherent in the EITI are attractive to investors seeking to minimise risk, by ensuring greater openness and a more level playing field in the business environment.

In February 2009 the EITI reached a milestone when Azerbaijan became the first country to have completed an EITI Validation and be designated as EITI Compliant. With another 25 Candidate countries in the process of implementing EITI, the next few years will be crucial to the overall success of the initiative and its role in contributing to improvements in the investment climate in participating countries. The final mix of Asian, Middle Eastern and OECD countries that eventually adopt EITI will be an important measure of its success.

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House View

This page sets out our House View as it applies to a UK based balanced fund. Details of how the House View applies to other UK-based funds and funds based in other parts of the world can be obtained from your Standard Life Investments representative.

	Positive	Negative	Our View
US Equities	<ul style="list-style-type: none"> Further policy measures such as quantitative easing to offset sharp economic downturn Valuations are attractive, especially for financials and some cyclical 	<ul style="list-style-type: none"> Squeeze on corporate margins is forcing cuts in employment and investment Continued uncertainty about extent of downturn in the housing sector 	Market supported by improving valuations and easier monetary and fiscal policy despite credit concerns STAY HEAVY
European Ex-UK Equities	<ul style="list-style-type: none"> Management responding to pressures on margins through cost cutting and more M&A activity Parts of the region did not experience as large a credit boom as other countries 	<ul style="list-style-type: none"> Exports coming under pressure as euro appreciates and global trade slows sharply Growing concern about lack of policy response in Europe versus other regions 	The region is vulnerable to a continued slowdown in world trade growth and weaker earnings STAY LIGHT
UK Equities	<ul style="list-style-type: none"> More aggressive monetary and fiscal support appearing Valuations such as dividend yields provide underpinning for the market 	<ul style="list-style-type: none"> Oil and resource companies vulnerable to sharp falls in commodity prices Concerns remain about extent of consumer and housing bad debts as unemployment rises 	Although financials and retailers are under pressure, the market is supported by favourable valuations STAY HEAVY
Japanese Equities	<ul style="list-style-type: none"> Japan's financial sector is stronger than those in some other countries Increasing dividends plus share buybacks are helpful for investors 	<ul style="list-style-type: none"> Companies facing much weaker export demand from the US and Europe Domestic economic data suggests economy experiencing a severe recession 	Policy response looks to be more limited than in other countries. Move into sustained deflation is hitting margins STAY LIGHT
Pacific Basin Ex-Japan Equities	<ul style="list-style-type: none"> Infrastructure spending remains a primary driver of many economies More governments taking action to support domestic activity 	<ul style="list-style-type: none"> Earnings at risk from the marked slowdown in OECD demand Dangers of global capital flows moving back towards developed markets 	Valuations are not yet attractive enough while earnings growth is slowing STAY VERY LIGHT
Global Emerging Market Equities	<ul style="list-style-type: none"> Current-account surpluses protect some countries from credit concerns More central banks able to ease monetary policy as inflation pressures ease 	<ul style="list-style-type: none"> Vulnerable to a prolonged global recession affecting commodity prices General investor risk-aversion is still a negative 	Continued capital outflows from emerging markets as part of the global credit crisis STAY VERY LIGHT
International Bonds US	<ul style="list-style-type: none"> Quantitative easing by the US authorities seen as capping Treasury yields 	<ul style="list-style-type: none"> Vulnerable to increased supply as the fiscal position deteriorates rapidly 	STAY HEAVY STAY HEAVY within international bonds as Treasuries benefit from quantitative easing
Euro-zone	<ul style="list-style-type: none"> Slow response by the monetary authorities to the financial and economic crisis 	<ul style="list-style-type: none"> Extent of likely debt issuance from easier fiscal policy 	STAY HEAVY within international bonds on expectations of further ECB interest rate cuts
Japan	<ul style="list-style-type: none"> Return of deflation and the lack of policy-levers to stimulate economic growth 	<ul style="list-style-type: none"> Valuations starting to look stretched 	STAY NEUTRAL within international bonds on concerns about effective Bank of Japan action
UK Bonds Gilts	<ul style="list-style-type: none"> Interest rates are close to zero, anchoring short-dated gilt yields while the authorities begin quantitative easing to affect longer dated yields Defensive characteristics of index-linked debt increasingly recognised 	<ul style="list-style-type: none"> Continued concerns about the extent of the rise in the public sector deficit Uncertainty about the details of quantitative easing worrying some investors 	Within UK bonds: STAY HEAVY in conventional gilts STAY NEUTRAL in index-linked debt
Corporate	<ul style="list-style-type: none"> Strong retail and institutional investor demand for extra yield 	<ul style="list-style-type: none"> Downturn in corporate cash flows will lead to higher corporate bond defaults 	STAY VERY HEAVY corporate bonds Corporate bond valuations are increasingly attractive although individual issues still require careful examination
Property UK	<ul style="list-style-type: none"> Property income yields relative to gilt yields have risen to highs last seen in the 1930s. Increasing number of property investors emerging to buy back into the asset class. 	<ul style="list-style-type: none"> Rental values are falling as occupational demand for property mirrors weaker economic environment 	We favour well located properties with tenants of good financial strength with a sector bias towards dominant retail locations STAY LIGHT
Global	<ul style="list-style-type: none"> Continued, albeit lower, economic growth in a number of overseas markets will support property returns 	<ul style="list-style-type: none"> Credit constraints have spread to most international property markets, impacting negatively on the availability of capital for property investment 	We prefer selective European markets such as Central & Eastern European logistics, based on infrastructure improvements, and Nordic retail, where consumption is expected to be more robust
Cash	<ul style="list-style-type: none"> Cash is an attractive alternative when corporate earnings and dividends are under considerable pressure 	<ul style="list-style-type: none"> Cash yields close to zero are encouraging some investors to seek higher-yielding assets 	Official interest rates are at the lowest level on record STAY LIGHT

The terms, Very Heavy, Heavy, Light, Very Light and Neutral express Standard Life Investments' view of a balanced portfolio against a given benchmark.

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