

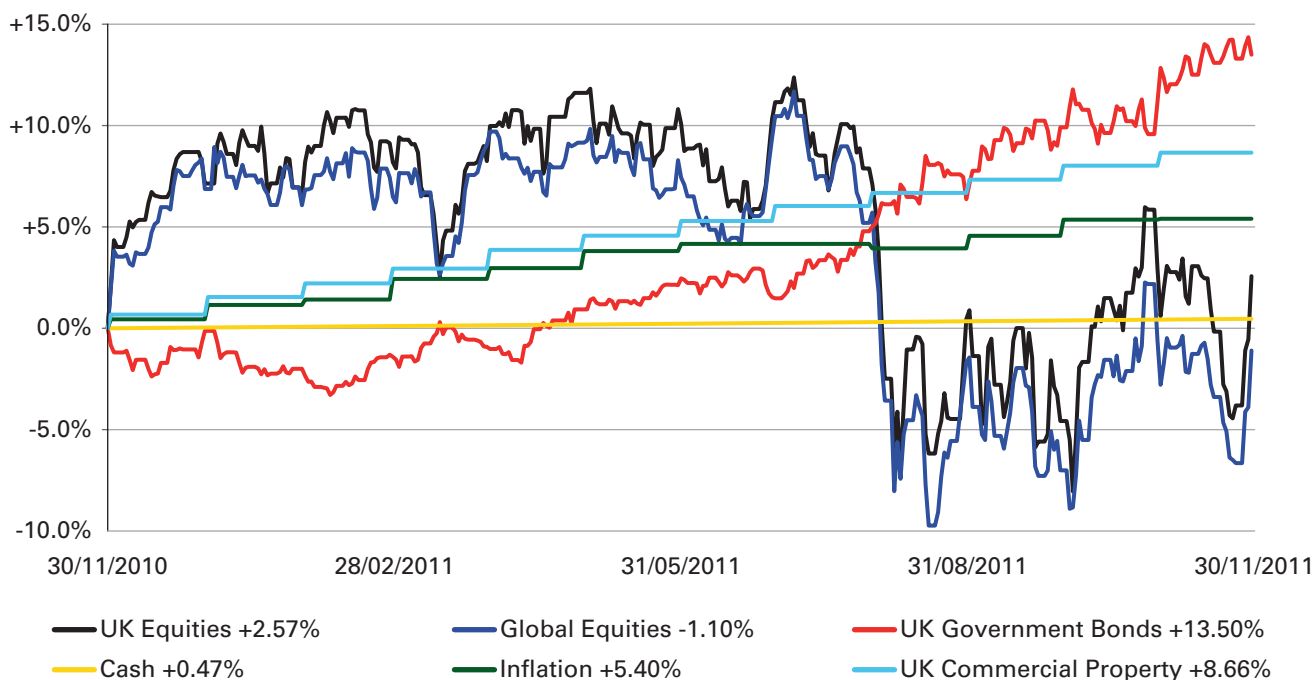
CCLA INVESTMENT MANAGEMENT LTD

MARKET REPORT NOVEMBER 2011

Headlines

- Global equity markets ended a very volatile month only slightly lower.
- In fixed interest markets risk aversion dominated, government bonds (gilts) rose but most corporate bonds moved lower.
- Property values were unchanged overall but there was more weakness for secondary assets.
- Sterling rose relative to the euro but fell against the US dollar and the yen.

Investment market returns over the past year



Sources: Bloomberg, IPD, FTSE All-Share Total Return Index, FTSE All-World Total Return Index, FTSE UK Govt All-Stocks Total Return Index, IPD Monthly Total Return Index*, 7 day LIBID, Retail Price Index* (*Lagged by 1 month).

Market review

Global equity markets experienced a volatile month, declining for much of the time before rallying strongly at the end. The FTSE All-World Index gave a negative return of -0.51% after a positive contribution from exchange rate factors; in US dollar terms the decline was -3.32%. Over 2011 to date the return to a sterling based investor has been -7.45%. Of the major regional markets only the US rose, by +2.34%. Japan fell by -1.90%, Europe by -3.01% and Asia by -5.31%. Few national markets gave positive returns. In Europe, Ireland and Denmark rose, by +4.15% and +5.52% respectively whilst in Asia only Thailand moved higher, by +0.85%. In an environment where declines were the norm, Greece stood out, falling by another -15.10%, this index is now -57.09% lower on the year. India was another weak performer dropping by -12.70% in reaction to economic growth data which disappointed. The UK equity indices followed the international trend, losing -0.15% during the month. Most of the various sub-indices gave similar returns but smaller companies proved an exception, falling by -4.49% and -10.78% for the past 3 months, compared to a rise of +2.11% for the market as a whole. This sector outperformed earlier in the year but has faltered as investors have tried to take profits in an illiquid market with few current buyers.

In fixed interest markets perceived safe havens were in demand but riskier assets were avoided, this resulted in quite different performances by gilts and corporate bonds. The FTSE Government All-Stocks Index rose by +2.11% over the month, extending the gains achieved over the year to date to a total return of +13.50%. In contrast, corporate bonds declined, leading to a fall of -2.16% in the iBoxx non-gilt BBB Index.

Returns from the property sector remained positive but the overall data masked differences between income secure, good quality properties, particularly in London and secondary assets. Over the month it emerged that non-UK investors now own more than 50% of the freeholds in the City of London, an indication of the strength of overseas demand over the recent past.

In currency markets we saw a continuation of the trends which have prevailed for most of 2011, sterling improved against a weak euro but fell back against the dollar and yen.

Economic developments

The main domestic economic news was an Autumn Statement which underlined the frail underlying condition of the economy. The disappointing message was that, even after £42 billion of tax increases and spending cuts, government debt levels have hardly declined at all. The problem has been a basic lack of growth in the economy as consumer spending, the biggest contributor to activity, has been squeezed by rising unemployment, higher taxes and wage growth which has lagged inflation. Higher taxes and rapid increases in fuel and heating costs, imposts which are hard to avoid, have meant that the squeeze on disposable income has been even greater than on spending overall, limiting the ability for example, to take advantage of the numerous promotions which have peppered the High Street. Not only is current growth below previous expectations but expectations of future growth potential have been scaled back, limiting the potential for a catch up when the euro crisis passes. The government is near to policy exhaustion, unable to cut interest rates any further, unable to afford significant initiatives to support growth and worried that more austerity now will be counter-productive, shrinking activity further. The options still available are limited. Against that background new 'Plan A' is old 'Plan A' but for longer, including promises of further cuts in spending after the next election.

Despite the dreary backcloth the Monetary Policy Committee of the Bank of England decided that there would be no immediate additional support to the economy beyond the current easing programme scheduled to run until February. This was due to a concern that too aggressive a programme would distort the market (the Bank bought all of the government bonds issued in October) but there is too a suspicion that they want to keep some powder dry in case conditions deteriorate in the New Year.

Overshadowed by this announcement was news that inflation had edged down to 5.0% but also that unemployment had moved higher to 8.3%. Unemployment will continue to increase due to the weak economy and public sector cut backs. The official forecast is for a peak unemployment rate of 9%, but there many higher estimates.

There is no respite from dull data in developed economies overseas. In the US estimates of third quarter growth were revised down, from 2.5% to 2.0%. European expectations were reduced too and more severely. Leading indicators of activity were particularly weak, leading to a change in expectations from growth to recession. New governments in Italy and Spain were denied a honeymoon by markets which kept upward pressure on interest rates, despite regular and substantial intervention by the European Central Bank.

There was positive news from China where, after two years of policy tightening to combat inflation and slow uncomfortable levels of growth, we saw the start of an easing programme. Chinese growth rates, currently around 9.2%, could decline below 8% in the early months of 2012 as export growth slows, after that domestic demand expansion should boost growth again.

Outlook

Investment markets are being influenced by two main factors at the moment; economic data which have signalled falling growth rates and political developments which have yet to deliver a solution to the debt crisis which is choking activity. We think that dull growth prospects are now reflected in valuations which are at substantial discounts to long term averages. So far so good. The debt crisis however remains a severe threat, with clear strategic differences between governments resulting in reactive policies which have failed to gain the initiative from markets. Whilst this situation continues short term volatility will stay high and with confidence thin, there is a risk that prices decline sharply on a failure to progress.

We view fixed income markets as overvalued. Property will be a good source of income but the prospects for capital returns are dull and we expect no progress until later in 2013. In equity markets we favour a high international allocation to include exposure to faster growing economies overseas. At home and abroad we favour strong franchises producing good and consistent cash flows and providing good dividends. Income is the most predictable and consistent source of returns in current conditions.

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