

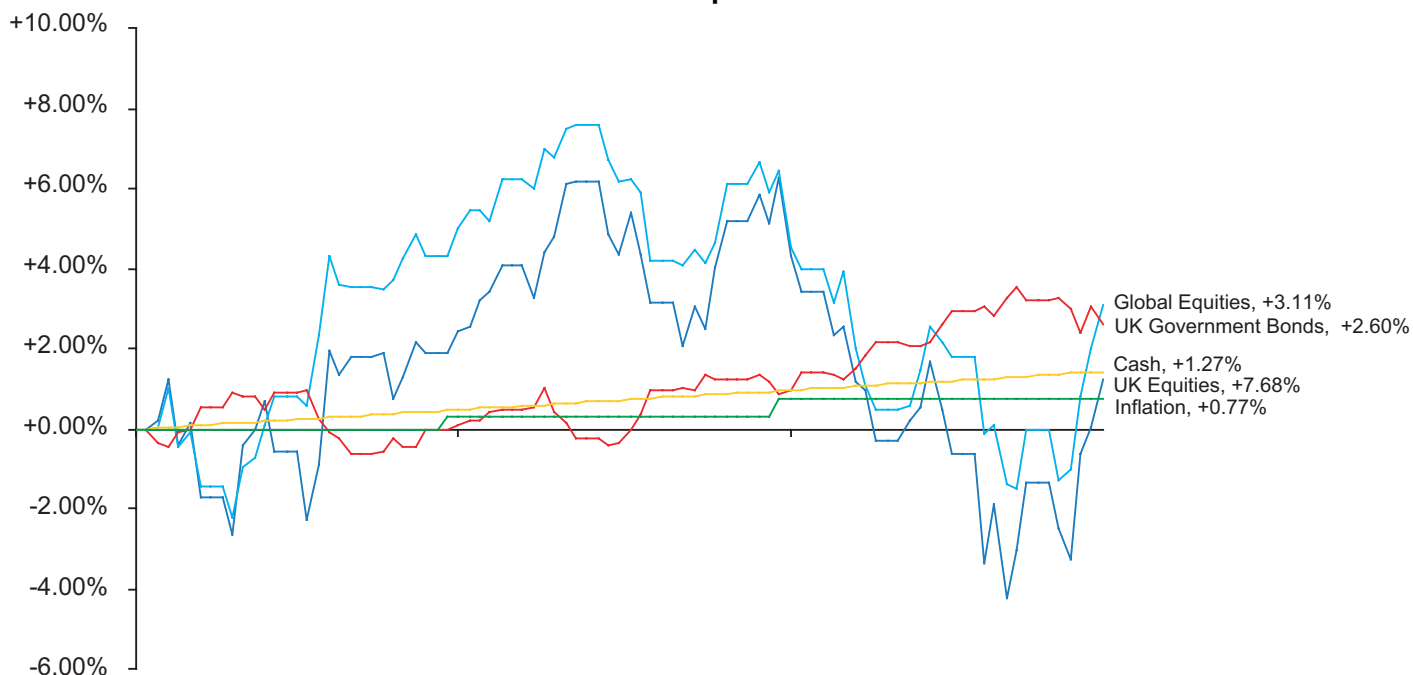
# CCLA INVESTMENT MANAGEMENT LTD

## MARKET REPORT DECEMBER 2007

### Summary

- Markets remained volatile in November as risk aversion increased on concerns about subprime related problems, and slowing growth and persistent inflation in the US and other major economies
- Global equity markets lost ground but rallied towards the month end on the expectation that the US Federal Reserve would cut interest rates
- The flight to safety pushed up government bonds while the spread between corporate and government securities widened to its highest level in 5 years
- The slowdown in the UK commercial property market continued

Market returns - 1 September to 30 November 2007



Source Bloomberg: FTSE All-Share Index, FTSE All-World Index, UK Govt All-Stocks Index, 7 Day Libid, RPI

Global equity markets fell back during November in volatile conditions but were rescued by an end of month rally built on the expectation of an interest rate cut in the US. At the sector level, banks saw some of the greatest falls early in the month but were among the market leaders on the way back up again. Bond markets benefited from increasing risk aversion as investors sought the comfort of government securities. The spread between yields on government bonds and corporate bonds rose to its highest level in five years. Sentiment in the UK commercial property market deteriorated further with activity, largely led by forced sellers, at depressed levels.

A major factor exerting downward pressure on the equity market was continued concern about the fallout from problems in the US subprime mortgage market and in particular its impact on financial services companies. Investors were taken aback by further huge write-offs announced at several major global banks and the accompanying resignation of some high profile chief executives. Early in the month, in the US, the Federal Reserve put \$41 billion in reserves into the banking system, the biggest one-day injection of liquidity since September 2001. The heightened price of oil and other commodities such as gold remained another concern, raising the prospect of increasing inflation while activity in some of the world's major economies is slowing. Technology stocks amongst others were also hit by worries that companies will begin to cut back on their capital spending plans as the credit crunch continues.

During the month, the outlook for the UK economy became more clouded raising pressure on the Bank of England to cut interest rates, which have remained on hold at 5.75% since July. The minutes of the November meeting of the Bank's Monetary Policy Committee revealed that two members voted for an immediate 0.25% cut but the rest were swayed by the view that any cut in rates before there were clear signs of a slowdown could be counterproductive. There were growing signs that UK consumers are becoming more cautious and finally starting to curb their appetite for spending with a number of major retailers warning of difficult trading conditions. There were further signs of moderation in both the domestic and commercial property markets, with house prices registering falls in November according to several major surveys. In its quarterly Inflation Report, the Bank of England indicated that it expects growth to slow in 2008 even with

prospective interest rate cuts but said that there is little chance of recession. The Bank believes that tighter credit conditions will continue to put pressure on consumer spending while commercial property construction activity will slow as a result of more difficult market conditions. In setting monetary policy, the Bank will remain mindful of the risks of inflation highlighted by the unexpected rise in the annual rate of consumer price inflation to 2.1% in October.

In the US, Ben Bernanke, Chairman of the Federal Reserve, warned of weaker economic growth and higher inflation in the near term. He also predicted that conditions in the US housing market were likely to get worse before they get better. The housing market remains a major area of weakness for the economy with existing home sales down by 1.2% in October, hitting their lowest level in eight years. There are also signs that domestic demand is beginning to moderate due to the impact of falling house prices and rising energy costs, with shop receipts over the key Thanksgiving weekend 3.5% lower than in the previous year. The US dollar remains weak, hitting a record low level against the euro during the month before recovering slightly. The weakness of the dollar has provided a boost to exporters which should help to keep overall economic growth positive.

In continental Europe, the economic picture is becoming more mixed with evidence of robust growth in some countries, notably Germany, and signs of slowing growth in others such as Spain. The pick up in growth across the region and the appreciation of the euro against the dollar has led to increased inflationary pressures, with the annual rate of inflation rising to 2.6% in November, well above the European Central Bank's target of 2%. However despite warning of the need for higher interest rates to combat inflation in recent months, the ECB left rates on hold again at 4.5% at its November meeting, reflecting concerns about the global impact of the credit crunch and the strength of the euro.

The Japanese economy has been showing signs of slowing for several months, dragged down by sluggish consumer activity and a slump in housing activity. However, industrial production remains strong, supported by rising exports. Elsewhere in Asia, economic growth remains strong but regional markets sold off during November as investors became more nervous and took profits after the strong run up over recent months

## Outlook

There are clear signs that the global economy is beginning to slow moderately, led by a fall in domestic activity in several major economies including the US, UK and Japan. However, activity in emerging economies such as China and India remains very robust and central banks in the developed economies have felt able to take action to shore up growth, despite worries about inflation.

Markets dislike uncertainty, and with questions still remaining about the extent of sub prime related problems, volatility is likely to remain at elevated levels for some time to come. Equity markets are not expensive however in terms of historic valuations and should be supported by companies' earnings and cash flows. As the global economy slows, we expect that there will be an increasing worldwide focus on the quality of companies and their ability to pay and sustain good dividends.

For now bonds are buoyed by the prospect of lower interest rates but there are risks that inflationary pressures will rise, undermining returns.

We expect that commercial property prices will fall back in the face of low transaction volumes, but that over time the prospect of attractive rental growth will support prices, with superior performance associated with higher yields and yield growth.

## James Bevan

Chief Investment Officer CCLA



CCLA INVESTMENT MANAGEMENT LTD  
80 Cheapside, London EC2V 6DZ

Client Service T: 0800 022 3505 F: 0844 561 5126  
[www.ccla.co.uk](http://www.ccla.co.uk)

**Please note that the content of this report should not be interpreted as investment advice.**

CCLA Investment Management Limited (registered in England No. 2183088 at 80 Cheapside, London EC2V 6DZ) is authorised and regulated by the Financial Services Authority and is the manager of the COIF Charity Funds (Registered Charity Nos. 218873, 803610, 104249 and 1093084).