

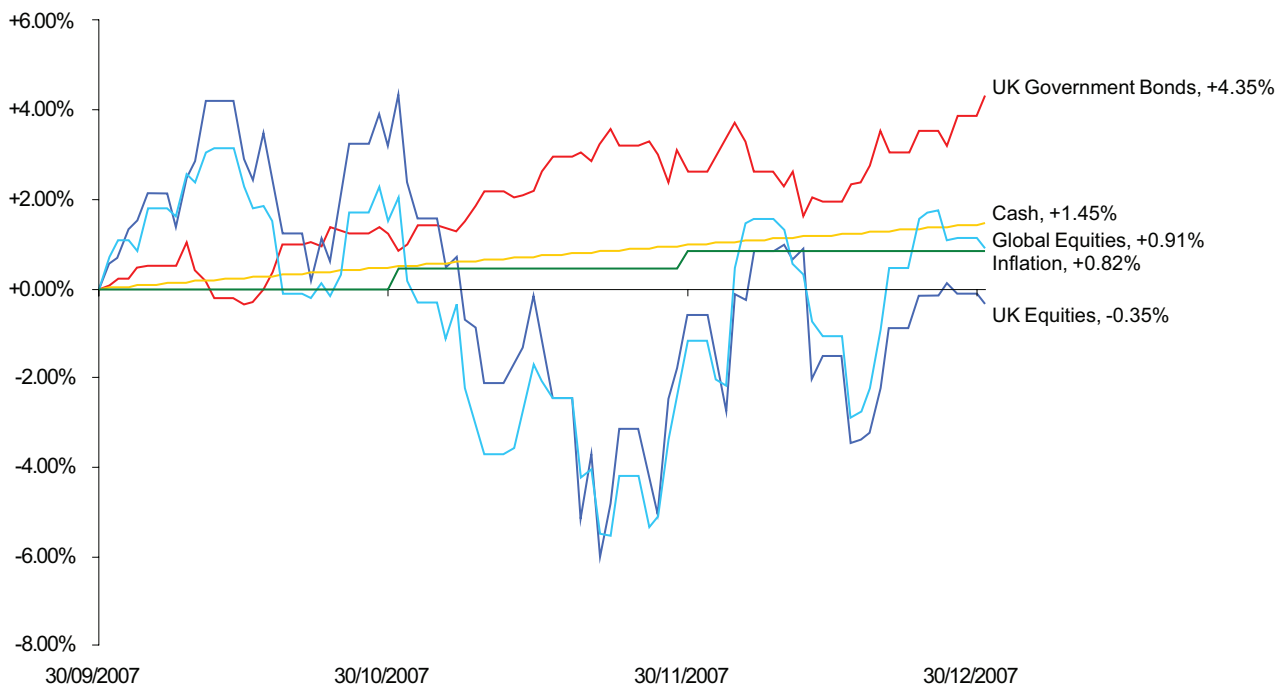
# CCLA INVESTMENT MANAGEMENT LTD

## MARKET REPORT JANUARY 2008

### Summary

- Global equity markets produced positive returns in December but remained volatile prior to the quiet holiday trading period
- The UK bond market also made progress following a 0.25% interest rate cut from the Bank of England
- The slowdown in the UK commercial property market continued
- The outlook for markets going into the first quarter of 2008 remains uncertain, however over the longer term support should continue to come from sustained global growth

Market returns 30 September to 31 December 2007



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

Prior to the quiet holiday period, December was another fairly volatile month for global markets as concerns about the impact of the credit squeeze on the global economy persisted. Over the early part of the month, equity markets made tentative gains as hopes grew that the US central bank, the Federal Reserve (the Fed), would continue to cut interest rates aggressively to shore up growth. The mood was helped by the interest rate cut in the UK and some healthy US employment and consumer spending numbers, which alleviated fears of impending recession in the world's largest economy.

In the middle of the month however, equity markets fell back sharply after the Fed reduced interest rates by 0.25% to 4.25%, rather than slashing them by 0.5% as many investors had been hoping, and made a measured statement which provided no indication about further cuts. This was followed by data showing that US inflation had spiked during November, which was seen as limiting the scope for the Fed to ease monetary policy further. Nerves were also tested by the announcement of further losses at a number of financial companies relating to subprime mortgage lending in the US. A degree of stability returned as leading central banks announced coordinated efforts to ensure that there was adequate liquidity in the global financial system over the year end period.

The Sterling bond market rose during the month, benefiting from investors' increased appetite for lower risk assets against a background of central bank rate cuts and a perceived deterioration in the economic outlook.

The commercial property market remained in a depressed state, with valuations likely to register another month-on-month fall.

In the UK, the Bank of England's Monetary Policy Committee (MPC) voted unanimously to cut interest rates by 0.25% to 5.5% at its December meeting. The MPC judged that a cut was necessary at this juncture because of signs that the credit squeeze could be causing growth in the UK to slow at a faster rate than it had previously expected, with anecdotal evidence of tough trading conditions on the High Street. The MPC's view was that on balance the risks of increasing inflationary pressures were outweighed by those posed by slower economic activity. Consumer Price Index (CPI) inflation figures released in December were close to the Bank's 2% inflation target, suggesting that there is scope for more rate cuts in the early part of the year.

During the month there were further clear signs that the US economy has been slowing, following on from the rapid growth seen through the middle part of the year. Surveys of the manufacturing and service sectors showed that activity has weakened while the bombed-out housing market shows no sign of improving in the near future. However, the picture was not uniformly bleak and other data releases pointed to continuing resilience within the economy. The number of jobs on offer rose at a healthy pace between September and November, consumer spending over the Thanksgiving period was robust and export performance remained strong, helped by a weaker US dollar. The question is whether the economy is now likely to fall towards recession led by the housing market slump and declining manufacturing activity or will reaccelerate after a short lived blip, helped by rising exports. The answer is likely to lie somewhere in-between, with much depending on the Federal Reserve's ability to take action and consumers willingness to continue providing a degree of support in the face of tougher credit conditions, higher energy costs and depressed house prices.

As expected, the European Central Bank (ECB) left interest rates on hold at 4% in December. The ECB is faced with a dilemma in setting monetary policy, with signs that growth is weakening while inflation is picking up sharply. In his monthly statement, ECB President Jean Claude Trichet reiterated the Bank's primary commitment to controlling inflation.

The Bank of Japan also left interest rates unchanged at 0.5%. This followed the release of the quarterly Tankan survey of business confidence, which showed that large manufacturers in Japan are at their least optimistic in two years. Despite a strong rise in exports, growth has been held back by sluggish domestic consumption. The government has recently revised down its forecast of growth for the fiscal year to March 2008 from 2.1% to 1.3%, although this is partly a result of new construction standards which have reduced the number of housing starts.

In contrast to elsewhere, the People's Bank of China raised interest rates in December for the sixth time in 2007, reflecting worries about overheating within the economy and mounting domestic concerns about inflation. For an extended period, China has had a disinflationary impact on the global economy as a cheap centre of production. We are now seeing signs of this trend beginning to reverse.

## Outlook

Global economic growth is likely to slow moderately during 2008 but we do not expect that the US will slide into recession as the Fed stands ready and able to take action to support growth if required. Overall global growth should be supported by the continued rapid expansion of developing economies such as China and India.

The immediate outlook for global markets remains uncertain. Given the huge imbalances in the world and the extent to which losses from irresponsible lending and over-leveraging are still in the system, volatility is likely to remain at elevated levels relative to the experience of recent years.

In this environment, we believe it is prudent for funds with a longer term investment horizon to focus on solid money inflows (such as reliable, growing dividends and property rents) sourced from a diversified, balanced pool of assets. It is not sensible to place a reliance on achieving short term capital gains.

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