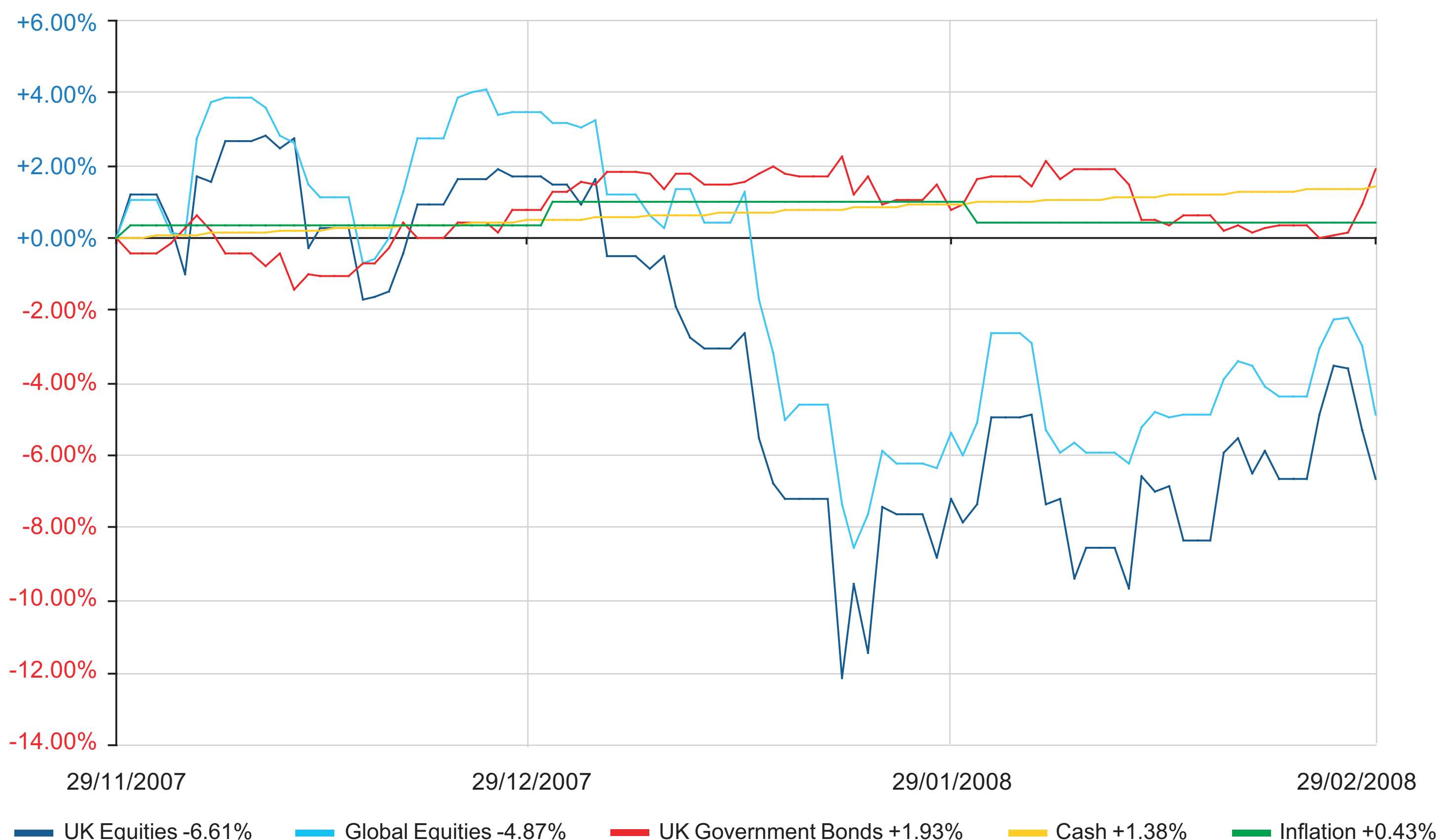
CCLA INVESTMENT MANAGEMENT LTD
MARKET REPORT MARCH 2008

Summary

- In February global equity markets stabilised after a poor start to the year.
- Fixed interest markets continued to favour safety – corporate bonds underperformed and short dated government stocks performed best.
- Commercial property markets remained weak.
- Economic expectations continued to moderate. In the US the discussion is on when recession will begin, elsewhere it is on how much growth will slow.
- Investors face two substantial unknowns at present: the extent of the slow down in world economic growth rates and the implications of the credit crunch. Until these are better understood uncertainty will hold back any sustained improvement in confidence. Looking beyond this, valuations in many markets are attractive and will provide support over time.

Review



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

After very weak trading at the start of the year, global equity markets stabilised in February. Over the month the FTSE All World index, in sterling terms, inched higher by +0.02%. However the index was 6.24% lower than it was just three months ago. This pattern of a modest improvement on the month, but weakness over the past three months, was repeated in most developed markets. In the UK the FTSE All Share index rose by +0.77% in February but was down -7.72% on the extended view. The returns from Europe (+2.16%, -7.35%) and from Japan (+0.43%, -4.62%) followed a similar pattern. The US was an exception to this pattern of a gentle rally in prices. Here, despite the news of sharp cuts in interest, the index level remained under pressure and returns fell by 3.27% to a point 6.52% below the level of three months ago. A happier contrast was with the markets of South East Asia where the regional index managed a modest rally over the month (+4.54%) but where some of the individual markets moved sharply higher – Thailand rose by +13.63%, China by +10.75%, Taiwan by +14.11%.

Commercial property remained under pressure. In December the IPD recorded a return of -2.0% in capital terms, -1.60% after income has been taken into account.

Although most markets stabilised over the month, day to day volatility remained high. This was despite a cut in US interest rates at the very end of January, a move which was accompanied by a statement by the Federal Reserve which indicated that they were fully aware of the risks to the economy and were prepared to act to support activity.

The period has in fact seen a number of signs that activity in the US has been slowing sharply. Housing remains depressed with year on year price falls averaging over 9%. New building activity picked up in January after a weather hit December, but the increase was modest and the number of new-build permits issued over the period fell again, indicating lower activity in the months ahead. Even this will not help the over-supply problem in the short term however as sales fell further behind new-build completions.

Consumer confidence has been very badly hit by the housing crisis and weakness in security markets. Survey results show readings at the level recorded in the aftermath of Hurricane Katrina but where forward looking indications are lower again, and hitting 17 year lows.

The actual readings are not at the level that signal the arrival of a recession, but they are closing in on that level very quickly. With new manufacturing orders falling, despite the support of a weak currency, employment faltering, consumer spending flat and the housing market in significant decline, the US seems to be heading for a period of negative economic growth.

Consumer sentiment is poor in almost all the major economies, with only Germany showing a positive signal. The difference with the US is that underlying economic activity is stronger and this gives the central banks more of a dilemma on interest rates; although the prospects for future growth are less attractive, current rates of expansion are near to trend levels whilst inflation is moving higher and threatens to be sticky. Inflation is a problem for the US – the CPI has been above 4% for the past three months – but is not seen to be as critical problem as a sharply contracting economy.

Outlook

Investors now expect further falls in interest rates over the balance of the year in the US, the UK and in Euroland. The problem is that these cuts are being offset in the real economy by higher rates and by credit rationing by the banks; in effect and despite the best efforts of the Central Banks credit conditions continue to constrain economic activity.

Recent company results have met expectations but commentators are reviewing earnings forecasts for the year ahead. Certainly there is scope for some sharp reductions given that costs are rising, activity falling, finance more expensive and profits share of the economy as a whole at record highs. Equity markets are far from expensive – p/e ratios are only about half what they were at the peak of the dot com boom – but lower earnings forecasts will certainly hit sentiment in the near term.

In fixed interest markets the dominant factor has been investors seeking a safe haven and this will continue in the near term. Looking beyond this however yields are unattractive given the inflationary threat and the likely increase in default rates (currently at a 27 year low). We prefer a cautious position, favouring government securities against corporate bonds and shorter dated maturities for both.

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

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, 1046249, 1093084 and 1121433).