

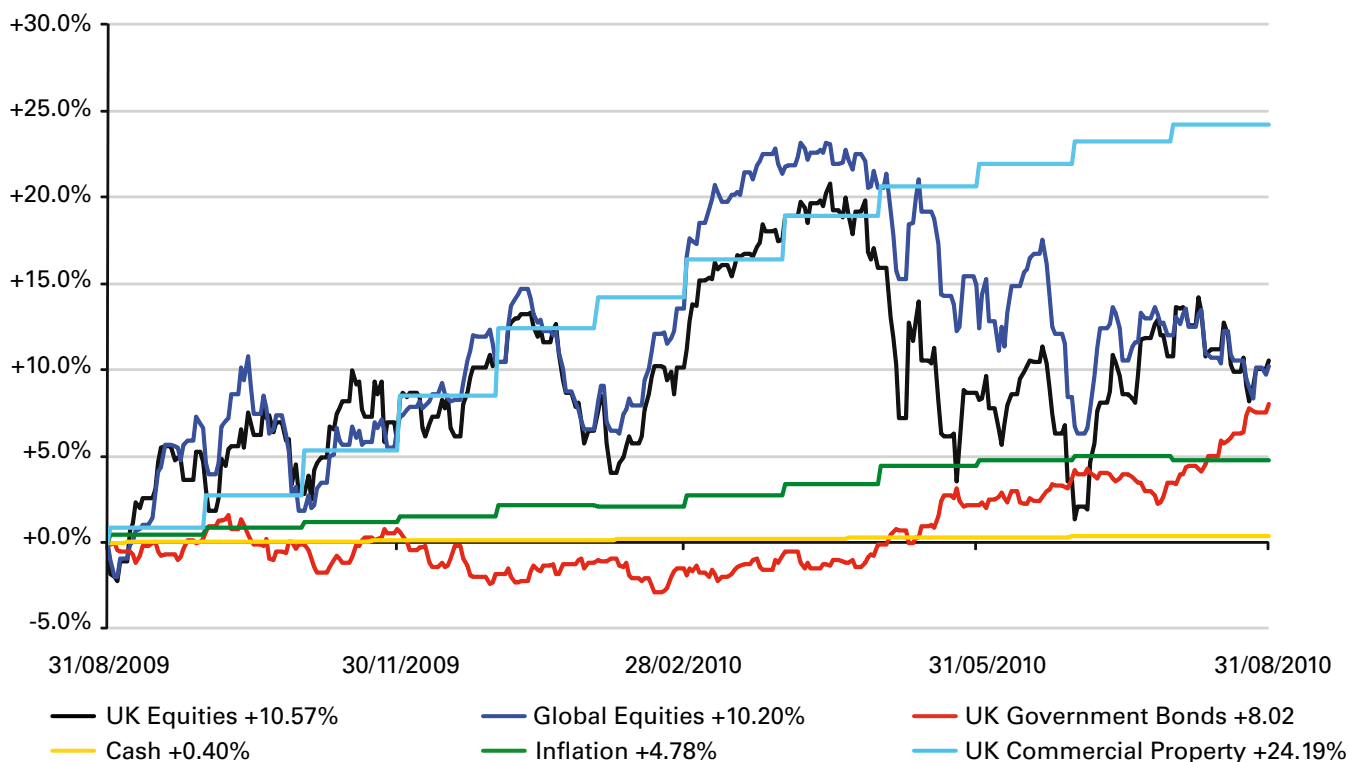
# CCLA INVESTMENT MANAGEMENT LTD

## MARKET REPORT AUGUST 2010

### Summary

- Equities were volatile on a day-to-day basis but ended the month only slightly lower.
- Bonds had a strong month with both gilts and corporate stocks moving sharply higher.
- Quiet property markets saw valuations hold steady.
- Sterling fell relative to both US dollar and yen but gained slightly against a weak euro.

### 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 a month to give a contemporaneous picture).

### Review

#### Markets

Over the month global equity markets have continued the trend evident over the past few months of high day-to-day volatility but little substantial overall change in level. On down days sentiment has been hit by fears that economic activity would decline again into another recessionary phase, on the up days progress has been based upon good corporate results, supportive economic data and a view that low valuations meant that the markets offered attractive long term value.

The FTSE All World Index gave a total return to sterling based investors of -1.64%, the return over the past 12 months is +10.20%, over 2010 to date -0.25%. The UK performed in a similar vein, losing -0.22% in August as measured by the FTSE All Share Index. Within the market 'value' stocks were better performers than the 'growth' equivalents whilst the best area, as defined by capitalisation, was smaller companies, which actually managed a small positive return (+1.33%).

Of the international regions, all but Asia eased back. European markets declined by -2.87%, the US by -2.65% and Japan by -0.49%. Asia did buck this trend but only to a modest extent, with a gain of +0.63%. On an individual market level the best performances came from Asia. Thailand led the way higher, with a gain of +12.42%, Malaysia (+8.44%) and the Philippines (+7.54%) also rose strongly. The weakest returns came from Europe and in particular Ireland where the index declined by -13.33% after news that the country's credit rating had been lowered again. The situation was aggravated by the news that the banking sector was in need of additional capital support. These fears were felt too in the Greek market, which fell back by -9.26%.

In contrast to the dull trend in equities, fixed income markets moved higher across the range with longer dated bonds particularly in demand. The FTSE Government Securities All Stocks Index gave a return of +4.40%, the iBoxx non-Gilts over 10 years Index, of +6.59%. Gains such as these have pushed yields down to levels last seen at the peak of the credit crisis when the 'safe haven' characteristics of government bonds in particular were in massive demand. In part this reflects concerns that the economic recovery will falter but it is also a consequence of the huge increase in liquidity which has resulted from government efforts to stimulate economic activity. With investors unwilling to use this cash to buy long term assets such as equities or property but keen to earn more than is available on short term deposits, large sums have been allocated to fixed income markets. The resulting surge of new money has forced prices up and yields down.

Commercial property values have stabilised as transaction volumes have fallen to very low levels. The trend in the underlying occupier markets has continued to improve slowly with reduced downward pressure on rents (and growth in some areas) and some decline in void rates, although these are still uncomfortably high.

In currency markets sterling fell back against the dollar and the yen (-2.17% and -4.73% respectively) but improved a little against the euro (+0.64%).

## Economies

Economic activity in the leading developed economies continued to improve but only at a modest pace, indeed there are signs in some areas that the pace of improvement is now easing. The problem is that the beneficial effects of past government efforts to stimulate output are fading before other sources of growth make a large enough contribution to make the upturn self sustaining. As a result, plans to ease back on support for the economy have been put on hold and in some areas, notably the US and Japan, new initiatives are being discussed to help support growth once again. There are exceptions of course and Germany has proved to be one of them, seeing growth of over 2% in the second quarter due substantially to a surge in export orders. This is positive but looking forward there are doubts as to whether this rate of growth can be maintained in an environment where customer economies are seeing quieter conditions. Overall, this is an environment where interest rates will stay low for some time to come.

In the domestic economy inflation has eased back slightly but remains above target at 3.1% on a CPI basis, 4.8% on the RPI measure. Inflation in the UK is proving very sticky – and not just recently, the pace of price increases has averaged 0.5% more than the 2% target level since 2006 and is forecast by the Bank of England to stay at or near current levels until 2012. A positive development was an unexpected drop in government borrowing in July. This reflected not spending cuts, which have still to take effect, but rather a sharp pick-up in tax receipts.

## Outlook

Equity market investors entered the current quarter hopeful that economic recovery would expand and accelerate. As these hopes have been frustrated so markets have lost momentum and in most cases given back the gains achieved earlier in the year. In contrast bonds have made steady progress with yields on 10 year government bonds below 3% and thus below current levels of inflation. The low income on gilts compares with an average yield of 3.5% on equities in a market where one in four companies yields over 5%. This relative rating only makes sense if activity levels in the economy are expected to fall away again and for company profits and dividends to decline and stay under sustained pressure. We expect economic growth to be low but see no collapse. As a result we believe that equities, in their own right but particularly relative to fixed income stocks, offer very attractive long term value at current levels. Commercial property values are marking time and we expect them to continue to do so until transaction volumes increase again. The main attraction of the sector is the high and potentially growing income it provides, we expect income flows to constitute the main part of investment returns for the period ahead.



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)

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