

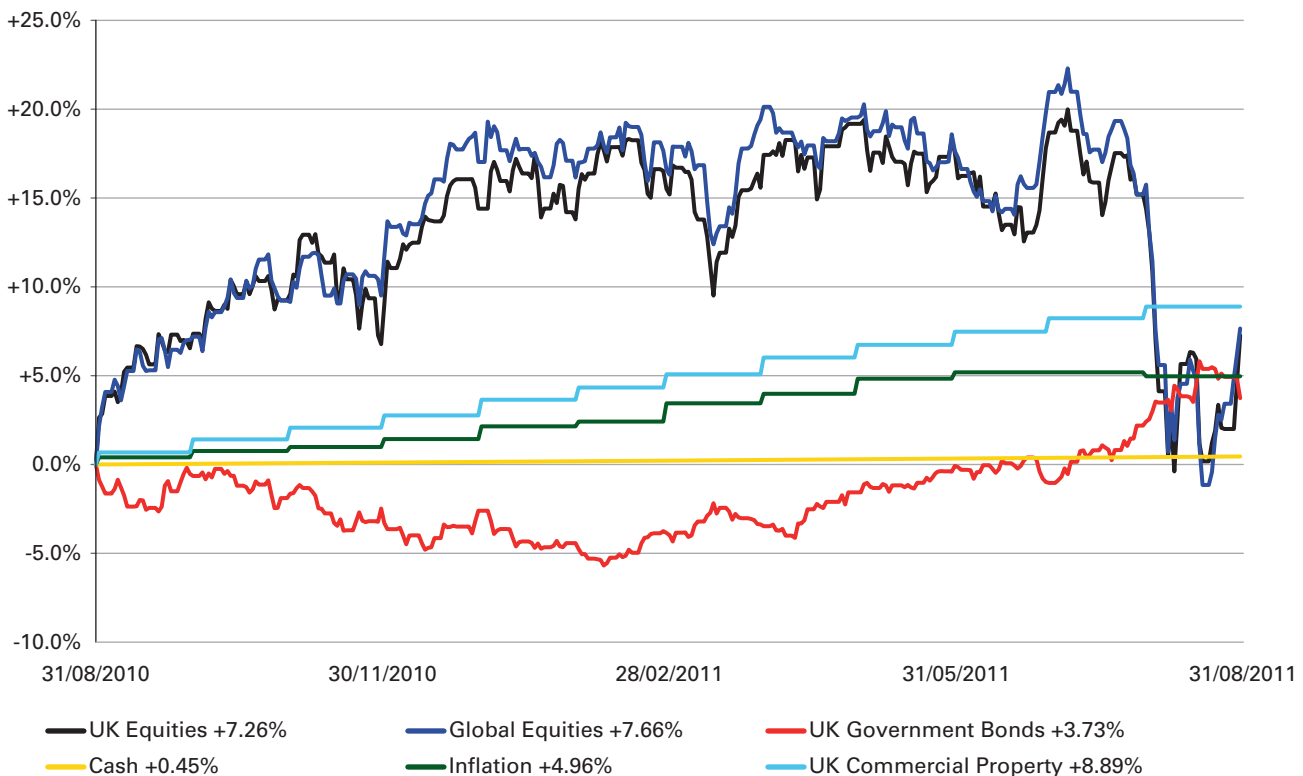
CCLA INVESTMENT MANAGEMENT LTD

MARKET REPORT AUGUST 2011

Headlines

- August was a second consecutive month of sharp falls for global equities with all of the markets we monitor down over the period.
- Fixed interest markets were mixed; gilts and top quality corporate bonds rose but lower rated issues fell back.
- Property data for July, the latest available, showed a positive return but one based upon the contribution from income.
- Sterling fell against all the major currencies.

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

Equity markets fell sharply over the month, extending the declines experienced in July. Investor sentiment, already fragile, was undermined by a steady flow of negative news with little in the way of positive developments to provide balance or support. The FTSE All-World Index fell by -6.55% to a sterling based investor to leave the return for the year to date in negative territory at -8.01%. Over the past 12 months however the returns remain positive at +7.66%. Of the regional markets, the US declined the least, down -4.73% to a sterling based investor. Japan (-7.23%) and Asia (-7.79%) fell more steeply but Europe was weaker still, with a fall of -10.76%. There were sharp falls in some of the individual Asian markets, with both India and South Korea down by more than 10% but the worst performances came from Europe. Seven national indices declined by more than 10% including a -18.07% fall from Germany and a remarkable -27.55% performance from Greece, as expectations of a default moved from 'if' to 'when'. The UK return was more or less in line with the peer group, a decline of -6.89% recorded on the FTSE All Share Index. The domestic equity market is down by -6.24% over 2011 to date but remains in positive territory over the past year with a total return of +7.26%.

The search for safe haven investments saw support increase for UK government bonds (gilts), prices here rose to give a positive return of +1.51%. Top quality corporate bonds enjoyed similar support but those with any but the strongest quality credit ratings fell back; the declines however were not on the same scale as those experienced in the equity sector.

Property markets continued to see low levels of transaction flows. Returns remained positive but the overall upward momentum weakened. City office valuations were unchanged leaving only London West End offices producing consistent gains. Lower quality, secondary stock saw prices falling back, voids remained a problem in this area.

It was a poor month for sterling which declined against the major alternative currencies; by -1.27% relative to the yen; -1.07% against the dollar and by -0.88% relative to the euro.

Economic developments

August proved to be thin in terms of hard news but what did emerge was unhelpful and overall had a sharply negative effect on sentiment. As in July, the concerns related primarily to the debt crisis in Europe and the prospects for world economic growth. Both problems are linked of course.

In Europe the lack of commitment, of the indebted countries to embrace austerity and the stronger to support the emergency funding programmes, has heightened concerns that neglect will allow the current crisis to spiral out of control. Greece has remained at the centre of concerns but worries have also risen on Italy, where an unpopular and dysfunctional government has failed to convince investors that they are capable of putting in place necessary policies to stimulate growth and cut debt. The ECB has been aggressively buying Italian and Spanish government bonds to hold down interest rates but actions such as these are only palliatives and not a cure. Whether a cure is actually achievable is increasingly what investors are doubting. Governments are reacting to events rather than leading them - and even then reluctantly and there is a clear lack of any shared vision.

Economic news has been dull. Throughout this upturn the recovery has been feeble in the developed economies, lacking the natural strength of past upturns because of the weakness of underlying demand. Growth has therefore been significantly dependent on various stimulatory policies put in place by governments, including running substantial budget deficits, quantitative easing programmes and by keeping interest rates low. In recent months, driven partly by the view that the upturn, if weak, was established and partly by the costs of carrying on, these policies have gradually been reversed. The ECB has raised interest rates, in the US the quantitative easing programme has lapsed, the UK has begun to cut back government spending. Emerging economies too have been deliberately slowing growth, in their case to fight inflation. These policies make sense at the individual country level but overall have combined to slow growth to a point where momentum is barely positive and where the forward indicators are suggesting that the modest headway currently enjoyed is under threat. UK growth in the second quarter has been confirmed at +0.2%, Germany grew by +0.1%, France did not grow at all. Growth is important because it is the preferred way to cut deficits and stabilise government finances – in the UK of the £150 billion of deficit reduction promised, approximately £30 billion is from tax increases, £40 billion from cuts and £80 billion from the dividends of future growth. If that growth is not forthcoming then either deficits are higher for longer or tax increases and/or cuts have to be more severe. Given the choices we expect quantitative easing to be back on the agenda soon, in the UK, the US and in Europe, where the interest rate increases imposed earlier this year look to be premature at the very least.

Outlook

We continue to expect the domestic economy to expand but at a pedestrian pace. The Bank of England growth forecast, of +1.7%, looks increasingly isolated in an environment where consensus expectations, currently at about +1.3%, are falling still. Inflation will rise above 5% this year and then gradually fall back. Unemployment is likely to rise as growth is insufficient for the economy to absorb public sector job losses. Interest rates will stay at or near current levels for the foreseeable future.

Equity markets are supported by valuations which suggest that they are very cheap by historic standards. This will support long term returns but is no shield against the swings in sentiment currently being experienced. Reasonably, given the huge uncertainties, investors with cash will stand back from markets, preferring to pay more to gain certainty. We expect volatility to stay high and this means that markets could move lower still, longer term value however looks attractive.

We see fixed interest markets as being substantially over valued. 10 year government bonds yield only about half the inflation rate and will give guaranteed capital losses as they move to repayment.

Good quality commercial property offers a substantial premium income which is attractive to some investors. Capital growth will require a more resilient economic background.

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