

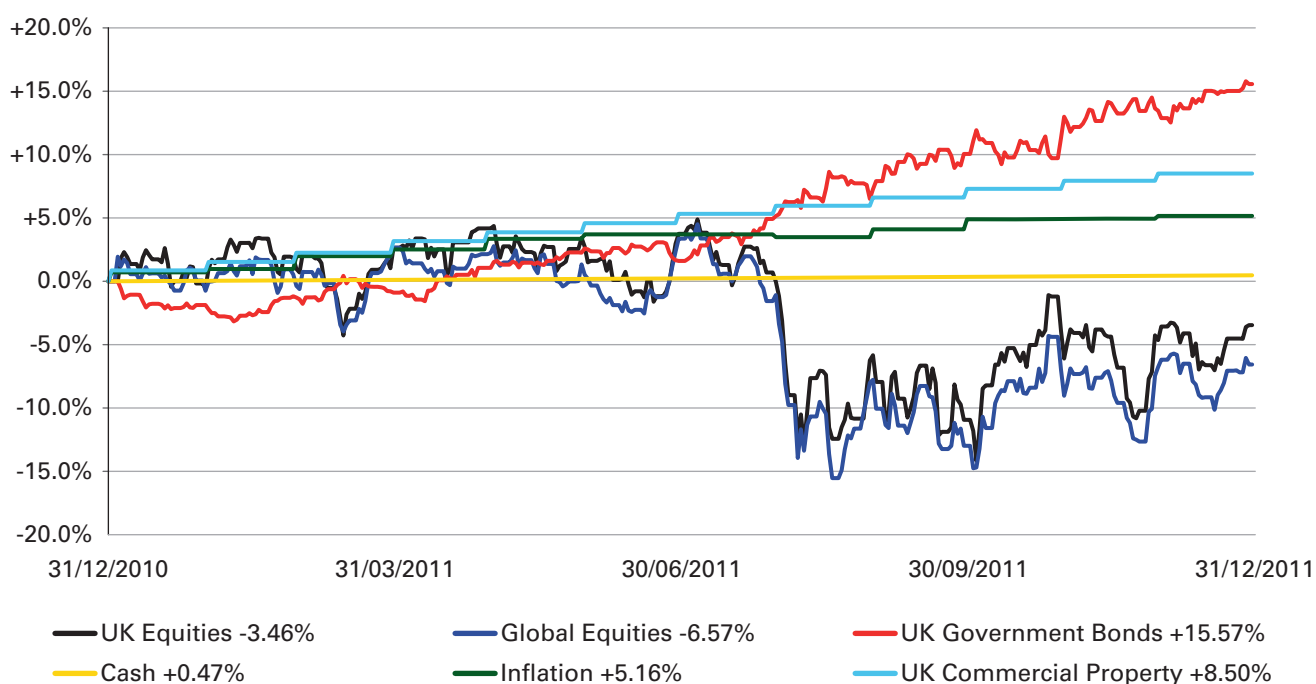
# CCLA INVESTMENT MANAGEMENT LTD

## MARKET SUMMARY OF 2011

### Headlines

- After a hesitant but positive start to the year global equities fell back in the summer and despite a late rally, ended the year down.
- In contrast, fixed interest markets lost ground early on but soon gathered strength and ended the year strongly. Government bonds were comfortably the best performers.
- In the Property Sector a two tier market developed. Good quality, income secure properties were in strong demand but secondary assets became increasingly friendless and saw lower valuations.
- Sterling gained against the euro, was little changed against the dollar but fell back against a strong yen.

### 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

Global equity markets promised much in the early months of 2011 but lost momentum in the spring and then fell sharply in July and the late summer. The indices rallied in the final months but not enough to make good the ground lost earlier. The FTSE All-World Index ended the year with a negative total return of -6.57%. Of the major regional indices, only the USA managed to achieve a gain to a sterling based investor, of +2.48%. Elsewhere the picture was negative. The Japanese market lost -12.91%, Europe -14.41% and Asia -14.84%. The range of returns between individual markets was wide, notwithstanding that relatively few were positive. In Asia, Indonesia was the best performer, rising by +10.11%, New Zealand, the Philippines, Malaysia and Thailand were also higher, albeit modestly. The worst performance came from a market tipped by some to do well at the start of the year, India, which ended the period -35.5% lower. Amongst the other significant fallers were China, -17.09%; Hong Kong, -16.74%; and Singapore, -17.13%. In Europe only one market enjoyed a positive return. This, perhaps surprisingly, was Ireland which ended the year up by +9.57% after evidence of an improving economy generated a strong rally in the final three months. Ten markets in Europe fell by more than 10%, of which five fell by more than 20% including Italy, -22.32% and Portugal, -23.19%. The worst performer was Greece, which ended the year -59.71% lower.

The UK equity market performed relatively well in comparison but not sufficiently to achieve a positive outturn, the FTSE All-Share Index returned -3.46% for the period. Within the market large companies performed best and small companies fell much harder than the market as a whole, the FTSE-100 Index of large companies declined by -2.18%, the Small Capitalisation Index by -15.16%. In a hesitant market 'value' stocks comfortably outperformed the higher rated 'growth' alternatives, rising by +5.21% compared with a decline of -6.86%.

In an environment of falling investor confidence and with a growing appetite for assets perceived to offer some protection from weak growth and the troubling developments in Europe, UK fixed interest markets were well supported. Government bonds substantially outperformed the corporate alternatives despite the higher yields on offer. The FTSE Government All-Stocks Index returned +15.57%, the IBoxx Sterling non-gilts 7-10 year Index, +5.98%.

Commercial property gave positive returns to investors but this was due almost entirely to the contribution from income. Capital values overall were flat but this broad observation masks some good support for high quality income secure properties and a poor return from secondary assets. The best performing sector was central London offices, in contrast the retail sector began to weaken towards the close of the year as poor trading on the High Street was reflected in income expectations.

The prime trends in currency markets were the strength of the yen and weakness of the euro. The sterling/dollar exchange rate was little changed over the year.

## Economic developments

The main themes influencing markets related to inflation, growth and the debt crisis in Europe. Inflation in the UK rose steadily through the year to a peak of 5.2% in September. About half of the surge in the rate of price change came from higher energy and fuel prices – the price of a barrel of crude oil averaged about \$60 in 2009, \$80 in 2010 and exceeded \$100 in 2011. Prices were pulled higher by rising demand, particularly from China and the loss of Libyan production. The other main source of inflation was the increase in the rate of VAT, which accounted for about a quarter of the total. Although most developed economies other than the UK were able to control inflation, this was not the case everywhere and in economies as diverse as Korea, India, Hungary, Poland, Turkey, Brazil, Israel, China and Chile interest rates were raised or other actions taken to slow the pace of price increases.

Consensus growth forecasts for the UK economy were about 2% at the start of a year which was expected to see a steady expansion in the pace of activity growth. In the event however it quickly became clear that growth would be hard won in the face of dull international demand, poor credit conditions, the start of government spending cuts and, most important of all, a consumer sector that was under severe pressure. Disposable income was squeezed by price rises far above wage growth, higher taxes, rising unemployment and difficult credit conditions. Instead of gently improving, household expenditure declined by 0.6% in the first quarter of the year, an outcome associated with recession not recovery. Overall economic output did not grow at all in the second quarter and although the third quarter saw an improvement to a growth rate of +0.6%, the forward looking data suggested that the final three months would produce only meagre growth.

Of the international economies Europe experienced a similar dull outturn as early resilience from Germany was offset by flat conditions in France and Italy and recession in parts of the periphery. The performance of the United States however was noticeably better as greater commitment to growth supporting strategies rather than deficit reduction was rewarded by rising output levels. Growth in emerging economies slowed from peak levels but was still strong overall. It is likely that the world economy grew by about 3.0%-3.5% in 2011 with 80% of that growth coming from the new economies.

The European debt crisis evolved from a concern about a liquidity problem in some of the smaller Eurozone states to a recognition that structural imbalances in the flows and balances within the community posed significant threats to the stability of the single currency group. Governments met but produced little of practical value beyond a demand that the more exposed countries, including Spain and Italy, better balance their books to rebuild market confidence. Fortunately, in contrast to the lack of concrete action from governments, the ECB was very active. Huge sums were spent supporting the sovereign bond markets of the weaker economies to keep interest rates (just) at affordable levels. Towards the end of the year the ECB again acted decisively, this time to prevent a liquidity crisis caused by a reluctance of the banking sector to lend to other financial institutions. This hiatus in lending threatened a rapid dwindling of the day – to – day liquidity flows essential for a healthy banking system, putting at risk both economic activity and the viability of some of the major financial institutions. The ECB addressed the problem by making available € 490 billion of new liquidity in the form of loans lasting for up to three years – thus reducing the dependence on unpredictable short term borrowings. Approximately 500 banks took advantage of this facility to improve their balance sheets, either by accessing new lines of finance or by rolling over short term loans into more dependable, longer term resources. This action was the foundation for the improvement in sentiment evident in the final weeks of the year.

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