

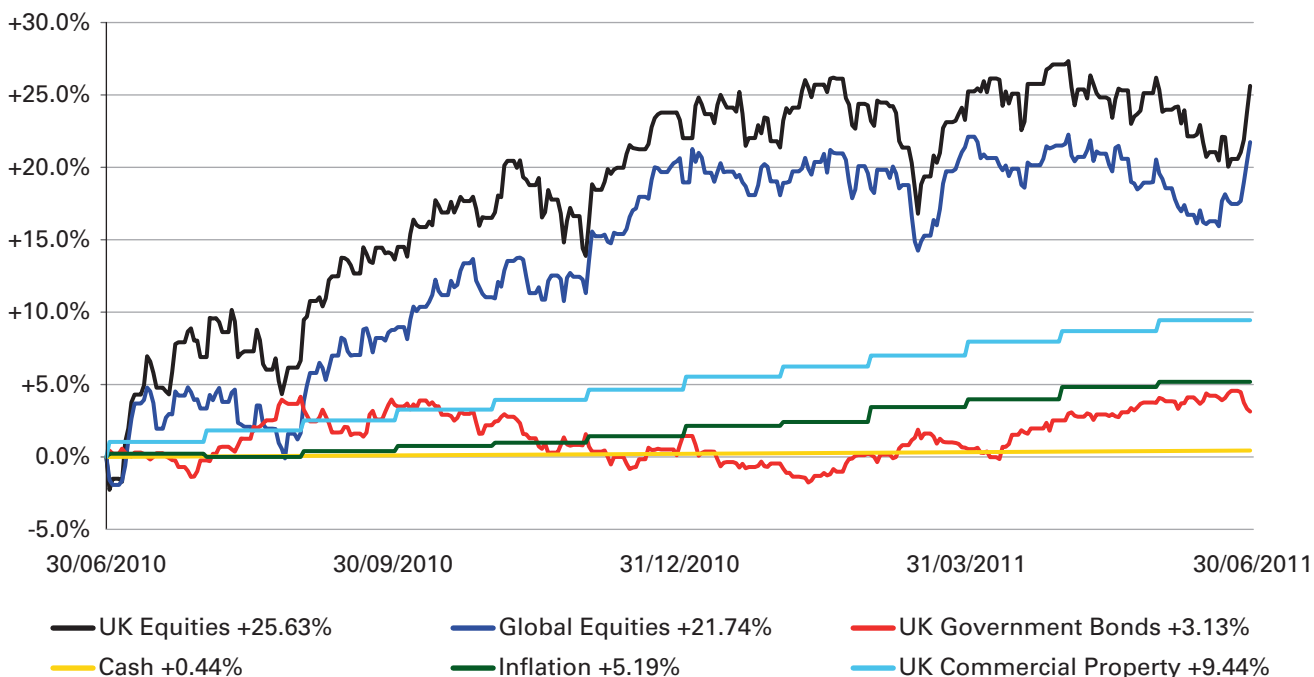
CCLA INVESTMENT MANAGEMENT LTD

MARKET REPORT JUNE 2011

Headlines

- Equity markets provided mixed returns in local currency terms but currency factors pushed international indices into positive territory for sterling based investors.
- Fixed interest markets overall eased lower, gilts performed better than corporate bonds, shorter dated stocks outperformed longer maturities.
- Property returns were positive, but only just. Activity levels declined again.
- Sterling fell as dull economic data caused investors to expect low interest rates for longer.

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

The pattern of returns for most global equity markets was sharp weakness early in the month, driven by disappointing economic data and concerns over Greece, followed by a rally as the latest episode of the crisis was resolved. The net result, after a volatile month's trading, was that indices were little changed. For UK based investors international returns were pushed into positive territory by currency weakness. The FTSE All-World Index in sterling terms gave a return of +0.99% to bring the change over 2011 to date to +2.34% and returns over the year to +21.74%. The best performing of the regional markets was Japan where sentiment was improved by data showing that manufacturing output was recovering from the shut downs and shortages caused by the earthquake. Europe returned +1.18%, the USA +0.76% and Asia +0.60%. Although individual market returns diverged substantially during the month, by the end of the period the disparity had narrowed substantially. Strong performances in Asia came from Indonesia and the Philippines which both rose by +4.89%, China, Taiwan and Hong Kong all fell. Ireland was Europe's strongest market (+6.27%) and Sweden the weakest (-2.81%). The most unlikely performance came from Greece, which ended the month slightly higher. The UK underperformed its peers with a negative return of -0.45%. All size and style cohorts were lower, but none substantially so. Despite this minor setback the UK equity market has returned +2.96% in the first half of 2011 and +25.63% over the past 12 months.

Fixed interest markets gave slightly negative returns due mainly to an unexpectedly large issue of new long dated gilt - edged stock at the close of the period. Short dated issues edged into positive territory but most corporate bonds, in an atmosphere of caution due to the Greek crisis, saw yields rise.

Commercial property activity levels fell back from already quiet levels. Valuations were flat in most areas although Central London maintained positive momentum. Returns to investors were positive but once again this was due overwhelmingly to the contribution from income. The weakness of underlying occupier markets was highlighted by the problems of several retailers who announced store closures due to poor trading conditions.

Sterling fell on currency exchange markets due to dull economic data which pushed expectations of interest rate increases far into the future. The pound fell by -2.40% against the dollar, -3.11% against the euro and -3.54% against the yen.

Economic developments

Economic data over the period suggested that growth rates, in the UK and more widely, were slowing down. Manufacturing output declined in the US and Europe and in the home economy with forward looking indicators suggesting further weakness ahead. Part of this has been blamed on the end of inventory building but the effect of higher commodity and oil prices on modest demand levels has also come under scrutiny. Western governments lobbied OPEC hard for increased oil production to bring prices down and when this was not forthcoming announced a co-ordinated sale of 60 million barrels from stockpiles, officially to compensate for lost Libyan production but possibly aimed at shaking out speculators and getting the price down to less damaging levels.

UK specific news echoed past trends. Inflation stayed high at + 4.5% and it became increasingly likely that the peak rate will be over +5% as the scale of energy price rises proposed for the autumn became clear. Disposable incomes measured over the year to March declined by - 2.7% as wage growth lagged far behind the pace of price and tax increases. The latest data suggests that overall wage growth has averaged 2.5% but that public sector wages have shown no growth at all.

The main economic news however, and the dominant influence on markets, was the latest episode in the odyssey that is the Greek financial crisis. The recent problem was triggered by debt repayment obligations which required a flow of cash Greece simply didn't have. With no access to conventional borrowing sources, the risk was default if ECB/IMF support was not forthcoming. Following the adoption of fresh austerity measures the immediate cash crisis has now passed but future support is dependent on progress on tax increases, privatisations and spending cuts which, before the programme really bites, are facing significant popular and political resistance. More drama is therefore inevitable and it is far from certain that the conditions will be met or indeed can be met given the complexities of the situation. Despite the latest 'success' investment markets are still expecting Greek default, the debate is over when and how orderly the process will be. European banks remain heavily exposed to Greek debt particularly those in France (€57 billion) and Germany (€34 billion) but Credit Default Swaps – effectively anti-default insurance issued by the banks on Greek bonds - would take the total potential losses far higher. For a banking sector still recovering only slowly from the credit crisis, losses on this scale would be immensely damaging and could force some back into the arms of state protection.

Outlook

We continue to expect the UK economy to experience a slow improvement in activity levels in the period ahead. Inflation will stay high and is expected to top 5% at its peak, sometime this autumn. Despite this, interest rates will stay at or near to current levels for some time to come and for the entire period be negative in real terms.

The high available income remains the main attraction of the property sector. Capital values are unlikely to make near term progress and it may be that recent difficulties on the High Street cause valuers to adopt a more cautious approach near term. We see bonds as offering very poor value in an environment of high inflation and some economic growth. We expect to see yields move higher in time and have adopted defensive strategies against that. Equity markets offer good long term potential, on modest valuations and with the capacity to provide a rising income. Volatility however must be expected to remain high and there is still a real risk that disorderly events in Greece cause a crisis in confidence. We would see that as a buying opportunity.



CCLA INVESTMENT MANAGEMENT LTD
80 Cheapside, London EC2V 6DZ

Client Service T: 0800 022 3505 F: 0844 561 5126
www.ccla.co.uk

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