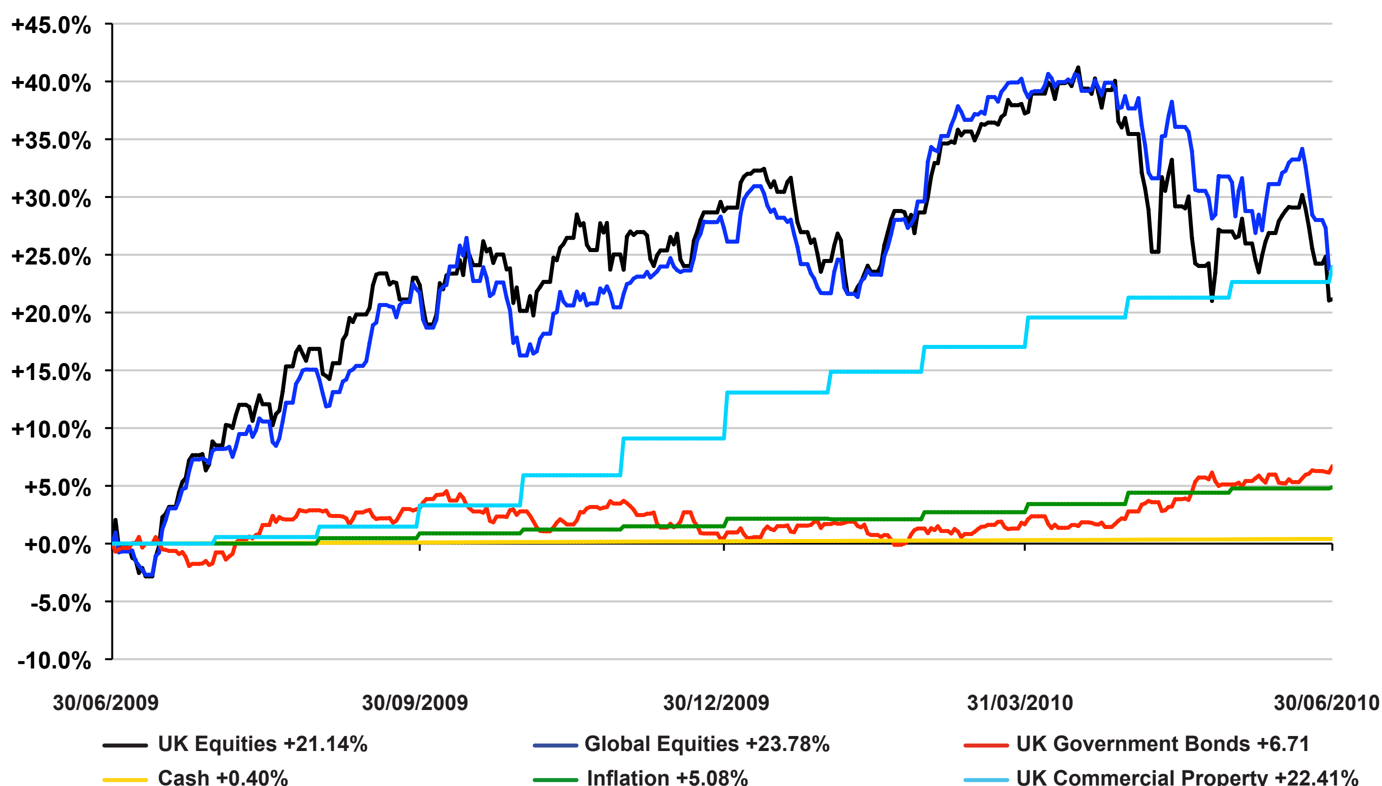
CCLA INVESTMENT MANAGEMENT LTD
MARKET REPORT JUNE 2010

Summary

- Another month of declines in equity markets.
- Bonds edge higher, lower risk issues are the best performers.
- Commercial property prices improved slightly.
- Sterling rallied against euro and dollar but lost ground relative to the 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 a month to give a contemporaneous picture).

Review

Global equity markets continued to fall back in June, pulled lower by fears over sovereign debt levels and increasing worries that economic recovery would fade into another period of weakness and perhaps recession. The FTSE All-World Index gave a return of -5.70% to a sterling based investor, a total made slightly worse by currency effects. The US was the weakest performer of the major international markets, with a negative return of -7.98%, but the downward trend was all pervading at the regional level with declines of -4.79% from Japan, -2.93% from Europe and -1.81% from Asia. In fact, several individual Asian markets moved ahead but the overall position was one of decline due to falls in China, New Zealand and particularly Australia. In Europe, Greece once again was the worst performer. The local index gave a return of -12.01% on the month to bring the total return over the past year to -43.25%, compared to a gain over the same period from the FTSE All-World Index of +23.78%. The UK performance was in line with its peers overseas. The FTSE All-Share Index returned -4.62%, large companies declined more, substantially due to weakness from BP, while smaller companies held up better, a reflection more of their illiquidity than any particular support for the sector.

Fixed income markets benefited from fears of weakening growth but, in an increasingly risk averse environment, it was the lowest risk segments of the sector that were most in favour. UK government bonds (gilts) gave a positive return of +1.50%, lower rated corporate bonds also rose, but by a lesser extent; the iBoxx BBB Index rising by 0.62%.

Commercial property values improved but the pace of improvement fell as transaction volumes reduced. There is still a good number of potential buyers ready to support the sector but their urgency has been reduced by the increase in valuations already seen and by continued signs of weakness amongst occupiers.

In currency markets, sterling rallied against both the euro and dollar following a budget that promised earlier spending cuts and, importantly, a reduced volume of gilt sales.

The international economy once again provided patchy evidence of growth, but at lacklustre rates. Retail sales improved in the US and manufacturing output increased, but not at a rate sufficient to trigger a sustained fall in unemployment. This is disappointing given the still - lingering effects of stimulus programmes and corporate re stocking. In Europe, a weaker euro helped German exports but activity levels in many peripheral economies remained weak. There were particular concerns about the viability of financial institutions in Greece and Spain as credit quality issues and fears of default effectively excluded them from commercial lending sources. The fears that pervaded the international banking industry in the aftermath of the Lehman Brothers default are present still in Europe. Bankers are again more interested in the return of their money than the return on it, deposits with the ECB amount to €305 billion despite earning an interest rate of 0.25%, pre crisis the typical balance in these accounts was €10 billion.

In the UK the main development was the first Budget from the new coalition government. The broad thrust was similar in direction to the proposals from Labour but went further and faster to cut the deficit by means of an unprecedented level of spending cuts, extending over several years. Reactions to the package from financial markets were mixed; sterling strengthened and gilts improved on the prospect of lower debt, but equity investors were more cautious, concerned that the effect of spending cuts and tax increases could be sufficient to stop and possibly reverse the modest uptrend in economic activity. Official forecasts, although reduced, still predicted growth post the Budget with an expansion rate of 1.2% in the current year, 2.3% in 2011 and 2.8% in 2012. Much will depend on the level of unemployment, currently at 2.74 million, with a similar number reluctantly under employed in part-time or temporary work. Estimates of how many public sector jobs will be lost in the spending cuts range from a little over 600,000 to 800,000, the question is how many of the displaced workers will be hired again in the private sector. The government is optimistic and expects overall jobless totals to decline, even if this proves to be the case over time there are likely to be periods when mismatches cause the unemployment rate to rise, if on a temporary basis.

Company news featured two main stories. At the start of the month Prudential held the headlines as its transforming bid for the Asian assets of AIG foundered after failing to achieve shareholder support. The dominant story however was BP, which, under huge pressure from the US authorities, agreed to create a $20 billion fund from which to make compensation payments to those affected by the oil spill at its Macondo well. Any penalties levied by the US authorities will be in addition to and separate from claims for compensation. To bolster cash resources the company announced that it would sell $10 billion of assets and reduce capital expenditure for two years. Despite however apparent increased certainty on a difficult situation, the BP share price continued to weaken, as fresh speculation arose that the scale of compensation claims could be greater than the provision and that government penalties would also be severe. The effect on the share price has been calamitous, since April, before the well failed, to the end of June, BP has fallen by over 50%.

Outlook

The continued weakness in equity markets reflects renewed concerns over the sustainability of recovery and the threat from excess debt in various parts of the economy. These risks are real and the fears they produce will only be eased by data that is likely to emerge over time; for that reason volatility should be expected to remain high, possibly exacerbated by thin summer trading conditions.

Against this background a longer term view perspective needs to be taken. We expect fixed interest markets to remain resilient in the near term as safe haven attributes come to the fore but after that for prices to ease as the volume of issuance becomes a factor and as other assets are seen as attractive once more. Equity ratings are modest but these provide little support against short term swings in sentiment. Commercial property remains attractive for income investors but further significant improvements in valuations will need some evidence of stronger occupier markets.

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, 1121433 and 1132054).