

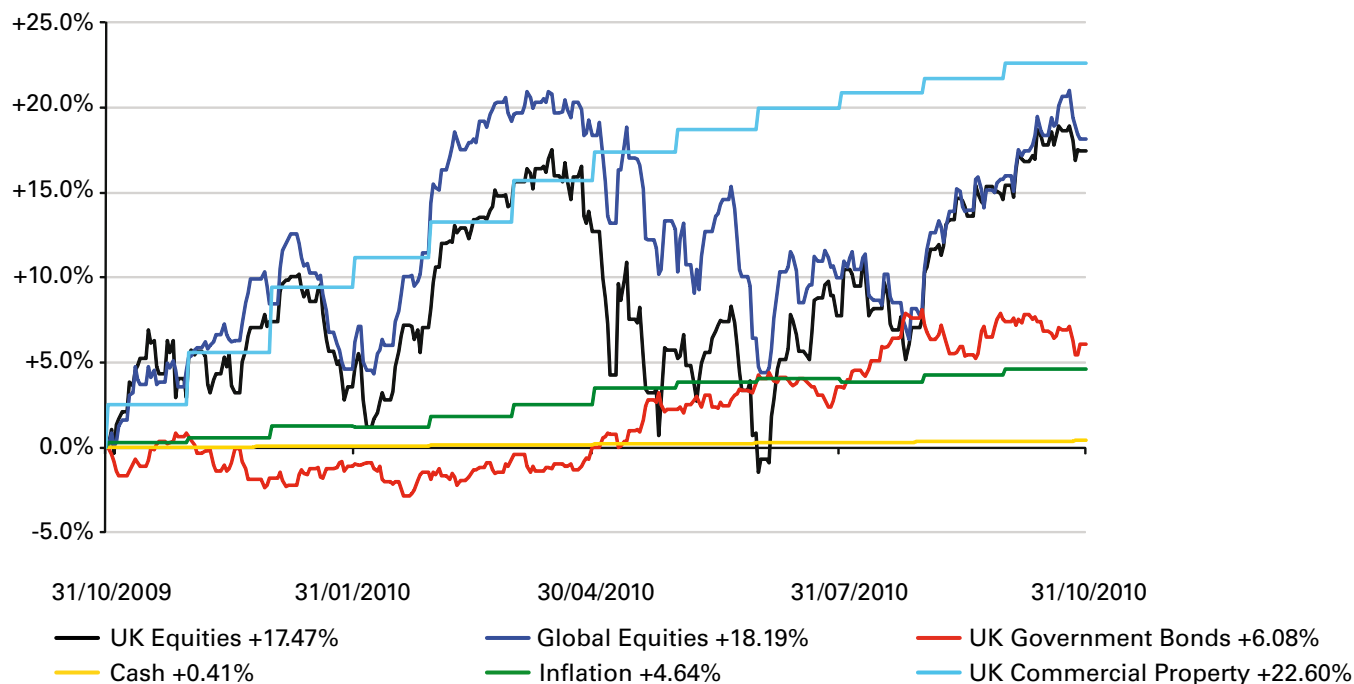
CCLA INVESTMENT MANAGEMENT LTD

MARKET REPORT OCTOBER 2010

Headlines

- Equities rose over the month but gave up some of the gains in the final few days.
- Governments stocks declined slightly, corporate bonds were flat, supported by their higher income flows.
- Commercial property edged higher but some sectors saw minor weakness.
- Sterling advanced relative to the dollar but fell relative to both the euro and 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).

Market review

Global equity markets advanced again in October, extending the rally which began in the previous month despite some late profit taking as the period drew to a close. The FTSE All-World Index gave a total return to +2.07% to bring the year-to-date return to +8.96% and that for the past 12 months to +18.19%. Once again all of the major regional markets participated in the rally but, unlike in September, the range of returns was relatively narrow. The return from Europe was +3.08%, that from the USA +2.40%, Asia returned +1.13% and Japan +0.42%. The UK performed in line with this broad trend and the FTSE All-Share Index returned +2.53%. In the UK there was little variation in returns across the various capitalisation cohorts but overall small companies performed slightly more strongly than large ones; in a similarly tight race, value stocks gave returns slightly better than those on growth companies. In contrast to recent trends the variation in returns from individual markets was modest. In Europe, Greece gave the best returns (+7.22%) continuing a series of wide swings in investor mood in that market; Sweden and the Netherlands lost ground over the month. In Asia Pacific, New Zealand was the strongest performer (+6.64%); Thailand, India, Hong Kong and South Korea were all in negative territory but only to a minor extent.

In fixed income markets, government bonds (gilts) lost value. Prices had moved higher in expectation of an announcement of a further programme of quantitative easing by the Bank of England, a process which previously involved buying large quantities of government bonds. However, stronger than expected economic growth in the third quarter was seen as making this less likely and so profit taking set in. Corporate bonds followed a similar path but with returns staying positive in parts of the market due to the higher income flows they provide.

In the commercial property sector valuation growth continued but only modestly. IPD, a monitor of sector trends, estimated that values rose by 0.2% in September with a further +0.6% return coming from income. Total returns over the past 12 months are estimated at +14.2%.

In currency markets sterling improved against a weak US dollar but fell slightly against the euro and more substantially against a strengthening yen.

Economic developments

Economic news provided further evidence that developed economies were continuing to recover but at a pedestrian and lacklustre rate. Estimates of third quarter growth in the US emerged at +0.50% on the quarter to give +3.00% growth over the past year. Growth at this pace is too low to make any significant dent in unemployment levels, which have been stuck at around 10% of the labour force despite a year of rising activity levels. In an attempt to improve the growth rate to a higher level the Federal Reserve has announced a second phase of quantitative easing (QEII) whereby it will purchase \$600 billion of bonds, effectively injecting this cash into the economy.

The news from the UK economy was slightly better with third quarter growth of +0.8%, above most estimates which were centred in the +0.4% to +0.5% area. The expansion rate over the past year is now +2.8%, in line with past recoveries despite the lingering effects of the credit crisis. The quarterly data is still benefiting from pre-election spending and a related recovery in construction, but even stripping this out growth is about +0.55%, enough both to reduce the risk of a double dip in activity but also reduce the prospect of an extension of the UK's quantitative easing programme.

Staying with the UK, the results of the Comprehensive Spending Review was much as expected. The detail is still outstanding in many areas and the timing of cuts will be important, but the overall effect is expected to be a reduction in the future growth rate of the economy of about 0.5% p.a.

At a micro level, the UK housing market remained resolutely dull. Mortgage lending in September totalled just £112 million, compared with £1.1 billion in September 2009 and £10 billion in September 2007. Although the various market surveys differ on the scale of recent price moves, they agree on the direction, which is downwards for almost all areas of the country. Over the long term house prices have averaged about 4 x average earnings; despite recent weakness they are still above this and so there must be a reasonable expectation of further weakness in the period ahead.

Outlook

The background of hard won but modest improvements in economies will continue to influence investment markets in the months ahead. We expect interest rates to stay low but expect inflation to stay above target, boosted by currency related factors in 2010 and by VAT increases and rising central and local government costs in the new year.

Bond prices look to be too high at the moment, pushed far above fair long term value by the press of money available for investment and by hopes of a renewed quantitative easing programme. These are technical rather than fundamental factors and as their influence fades so prices could move significantly lower. Property values will consolidate for the next few months but should not suffer significant weakness; the main attraction of the sector remains the high income available from good quality portfolios. Equity prices have rallied again but part of this at least is due to hopes of additional monetary easing rather than recognition of improved economic and corporate sector prospects. We see equities as offering excellent long term value but also expect volatility to stay high for the immediate and medium term futures.



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