

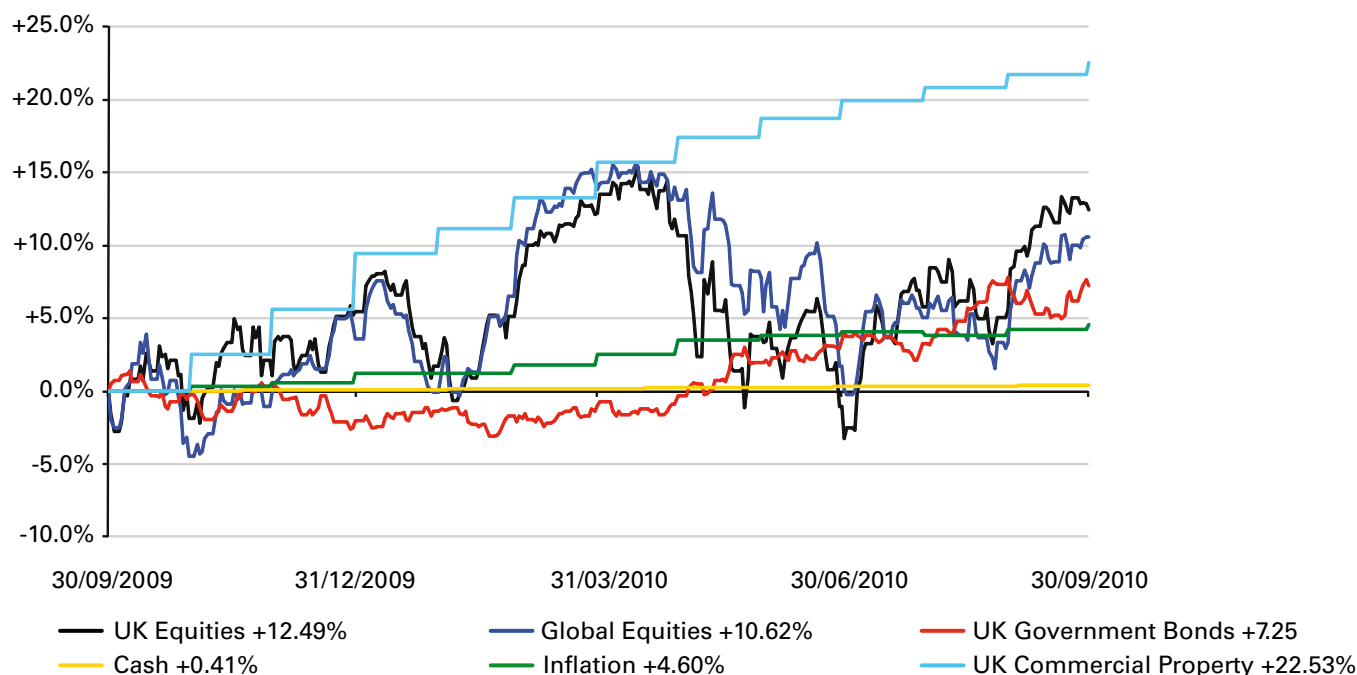
# CCLA INVESTMENT MANAGEMENT LTD

## MARKET REPORT SEPTEMBER 2010

### Headlines

- Equities moved smartly higher in most markets.
- Bonds eased back slightly despite a better trend towards the end of the month.
- Commercial property returns were positive but all the contribution came from income.
- Sterling continued to move in a narrow relative range, improving this month against the US dollar and yen, losing ground relative to the euro.

### 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

#### Markets

After a quiet and trendless couple of months, global equity markets rose strongly in September, moving back up to the top of their recent trading range. Wall Street in fact enjoyed its best September performance since 1939, albeit after the worst August in almost a decade.

The FTSE All-World Index gave a total return to a sterling based investor of +7.01% to bring the return for 2010 to date to +6.75% and +10.62% for the past 12 months. All of the major regional markets contributed to the gain with Europe and Asia the best performers, returning +9.49% and +9.24% respectively. The US improved by +6.35% and Japan by +1.85%; the local currency gain was higher but was reduced on conversion to sterling by the rally in the pound:yen exchange rate.

At the individual market level there were some very strong performances. In Europe, seven countries managed double digit gains, led by Sweden, which rose by +16.56%; only Greece was lower over the period. In Asia, five countries managed gains of more than +10% and only one was in negative territory. The UK participated in the better trend, the return on the FTSE All-Share Index emerging at +6.54%. The gains were evenly spread across all size cohorts and both value and growth sectors.

Fixed income markets were flat, pausing after the strong gains experienced in August. At the start of the month prices actually came under downward pressure, from valuation concerns and sticky inflation data that suggested that the above target pace of price increases was expected to persist well into next year. Towards the end of the month sentiment improved as expectations rose that a further round of quantitative easing (termed 'QEII') would be announced in November, alongside the next inflation report from the Bank of England.

Commercial property values held steady, bringing a quiet quarter to a close. Returns are positive for the period as a whole but this is due almost entirely to the contribution from income flows. Underlying occupier market conditions remained dull, a survey by Lloyds Bank suggested that the market was unlikely to improve significantly until Spring 2011.

In currency markets the main feature was the pull-back in the yen after intervention by the Japanese government to slow, if not reverse; the pace of appreciation in the currency. Sterling lost ground against a recovering euro (-4.80%) but improved relative to the dollar (+2.40%) and yen (+1.58%).

### Economies

The overall picture of a slow, reluctant recovery remained in place. Perversely, it was the continued pedestrian pace of improvement that was the source of some optimism for investors, as speculation grew that, in order to bolster growth, a further phase of economic stimulus was likely in the US and UK. As expectations of a new programme of support rose so bond prices also increased, in expectation that once again the Bank of England would be a large scale buyer of gilts. The need for some fresh initiatives is shown in the revised estimate of second quarter UK GDP growth. The headline expansion of +1.2% was attractive but too much of the improvement was due to one-off factors which, by definition, will not be present in the second half to off-set the negative effects of cuts in government spending.

In the weeks ahead an increasing focus will be placed on expenditure cuts and plans to reform benefit programmes. Over 4 million households in the UK have no members currently in work, over 800,000 have all working age members currently viewed as being unfit for work; the scale of the reform challenge, at a time of weak consumer demand and frail government finances, is therefore very considerable.

### Outlook

Encouraging as the equity market performance in September was it is too early to suggest that markets are breaking out of the narrow trading ranges that have held over the summer, too much remains uncertain for that. Looking forward, on the positive side of the debate is the fact that expectations for growth are so modest that almost any good news would have a supportive effect on sentiment; in addition, company profit announcements for the third quarter will begin soon and these should highlight the extent to which the corporate sector is doing better than the economy as a whole. The worry is that current dull growth is pushed into negative territory by aggressive spending cuts in an economic environment where central government activity has been a key factor in keeping the trend in activity positive.

Our view is that in time the question will be resolved in a positive way and that current prices in equity markets will prove to be excellent long term value. We are less sanguine about the fixed interest market where yields are just too low on any but the most defensive view. Commercial property prices are likely to stay near current levels at least for the near term, but for those investors in receipt of a high income flow, this is not a major hardship.



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