

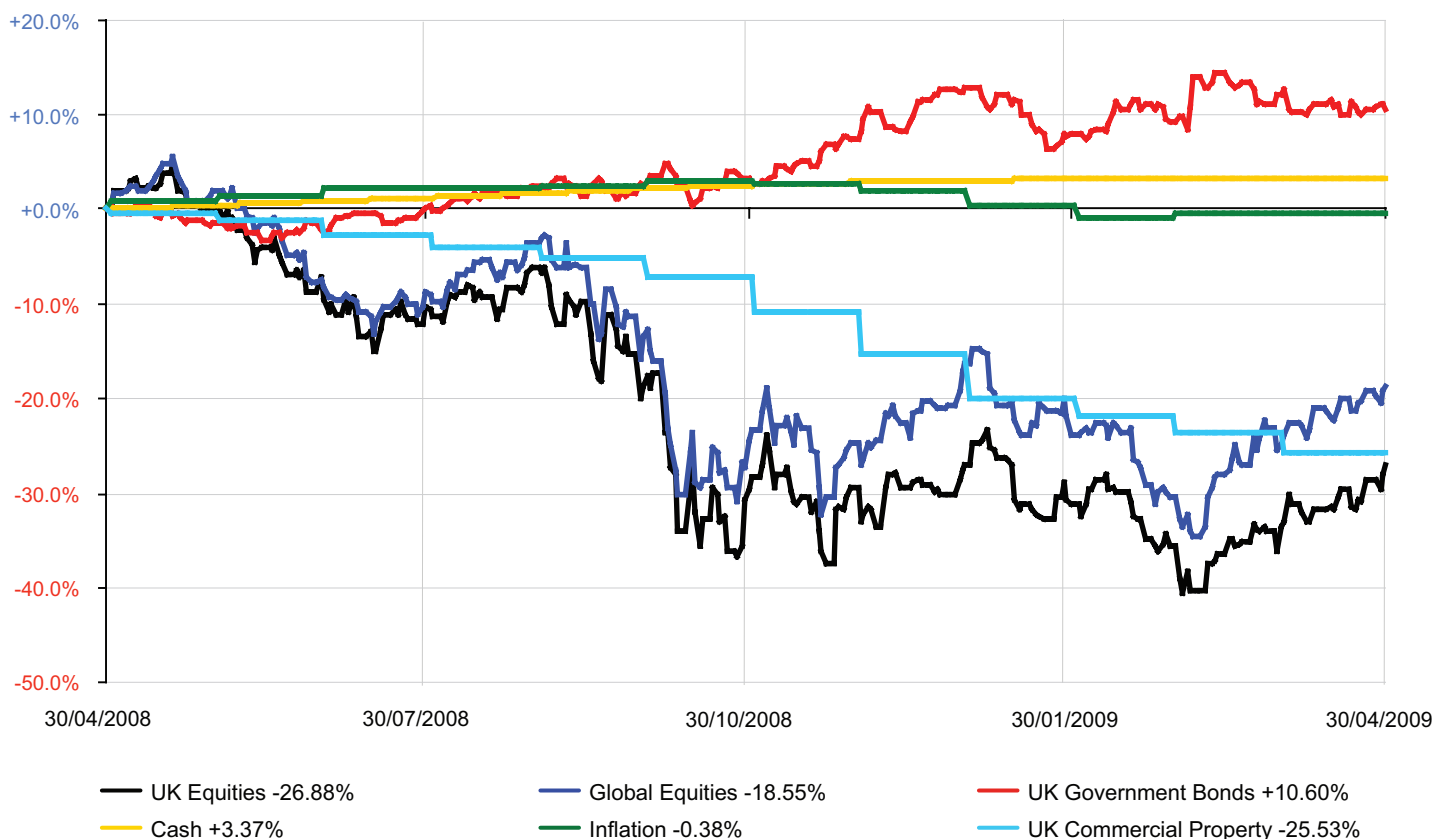
CCLA INVESTMENT MANAGEMENT LTD

MARKET REPORT APRIL 2009

Summary

- All major equity markets enjoyed a strong rally.
- In fixed income markets government securities retreated but corporate bonds performed better, with riskier bonds providing the best returns.
- Property remained weak as economic factors compounded the effect of the upward adjustment in yields.
- Sterling rose slightly on international currency exchanges.

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

In April, equity markets rose strongly, building on the gains made in March. The improved tone reflected expectations of eventual recovery to come rather than the news flow of the period, which was overwhelmingly poor.

Expectations of economic growth in 2009 have again been subject to downward adjustment. The IMF is now forecasting an overall decline in activity in the world economy this year, the first since the aftermath of World War II. All of the developed economies face the prospect of recession, but it is those most exposed to exports, such as Germany and Japan, rather than those involved most deeply with the financial crisis, such as the UK and US, that will suffer the most severe downturn. World trade is expected to decline by 13.2% as inventories are cut back to reduce costs and liberate scarce cash resources.

Over the month the FTSE All World Index gave a return of +8.46% to a sterling based investor and +11.73% to one with a US dollar base, a reflection of a strengthened sterling exchange rate. In the domestic market the return on the FTSE All Share Index was +9.94%, but the real feature of the period was the strength in medium and smaller companies. The FTSE 250 Index returned +19.88% whilst the Small Capitalisation Index returned an extraordinary +31.88% as buyers returned to an area of the market notorious for poor liquidity and in so doing, forced prices higher. The positive picture was continued overseas. European markets improved by +11.47%, Asia by +11.88%, the USA by +6.10% and Japan by +5.84%. No major market gave a negative return but the range of increases was wide; in Europe, Finland rose by +26.09%, Switzerland by +4.53%. In Asia, Indonesia was up by +27.71%, New Zealand by +3.57%.

This improved performance was not evident in the commercial property market. The recent trend of valuations being reduced to reflect the depressed levels at which transactions were being achieved in a difficult market place continued, with the effects compounded by some direct effects of the economic cycle, such as falling rents and increased levels of property voids. Dealing volumes remained low but there were early signs of interest from overseas buyers and from investors attracted by the high income yields offered by the sector.

Government securities gave a negative total return of -1.28%. Two factors influenced this outcome, firstly investors were distracted by the strength of equities but also there were growing concerns about the potential influence of the huge issuance programme made necessary by the government's revenue shortfall. Corporate bonds performed better, with most strength enjoyed amongst the longer dated and higher risk stocks - a clear reflection of greater optimism amongst investors. The iBoxx Sterling non-gilt BBB Index gave a return of +2.32%, the iBoxx 7-10 year maturity index +2.98%.

A review of economic data released over the month showed various reflections of the reduced level of activity. Unemployment continued to increase in all areas, exceeding 2.1 million in the UK but rising to over 8% of the workforce in the USA and 17% in Spain, the worst hit of the European economies. Inflationary pressures eased but in the UK, although the RPI adjustment was negative, CPI remained above expectations at +2.9%, as the weakness of sterling was reflected in imported goods prices.

The UK budget announcement revealed the extraordinary deterioration in the financial position. Public borrowing is set to rise on a sustained basis and will reach £175 billion this year, compared to a forecast of borrowing needs made last year of £38 billion. Even on very optimistic assumptions of economic recovery, outstanding debt will still be the equivalent of 80% of GDP in five years time - after various and substantial cuts in services and tax increases. Public expenditure is set to fall from 48% of economic output to 39%, the hardest cuts for 30 years. Where these cuts will fall has yet to be identified but the scale of the cutback is such that all programmes are likely to be affected.

Outlook

The sharp fall in markets seen at the start of this year and the recent rapid rise in prices illustrate that, over short time periods in particular, the prime force moving markets is often emotion. The increased confidence currently evident reflects a number of changed assumptions. The most important is that the main period of risk in the financial sector has passed and that those banks still standing will either slowly strengthen themselves or be strengthened by the relevant authorities. A second assumption is that the rate of deterioration in the world economy will soon moderate as the stock reduction phase comes to an end and as government efforts to improve liquidity and boost activity take effect.

The improved mood is clearly welcome, removing some of the dark pessimism evident earlier in the year and allowing securities prices to move up from pessimistic to more realistic levels. There is though a danger that expectations for recovery become too optimistic too soon. Clearly within the economy stock reduction must come to an end at some point and when that happens a resumption of order flow will help to stimulate activity again. Similarly government sponsored stimulus programmes will boost output, but unless they are repeated (and in the UK the financial position does not permit this) then the effect will be transitory. When the boost fades growth in activity will ease, as over borrowed consumers and stretched banks continue the long term adjustment to lower borrowings and higher savings rates / stronger balance sheets.

We remain optimistic on equity markets for the longer term but have some near term caution given the pace of the recent rally. We expect the downward pressure on property prices to continue in the near term but then to moderate as the yield adjustment process is completed. There are attractions now for long term investors who wish to secure the high levels of income currently available. In bond markets government bonds are fully valued and this consideration will increasingly counterbalance the safe haven merits which have supported the sector over the past year. Corporate bonds are more attractive with high yields reflecting a level of default and damage which is increasingly unlikely to occur.

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