

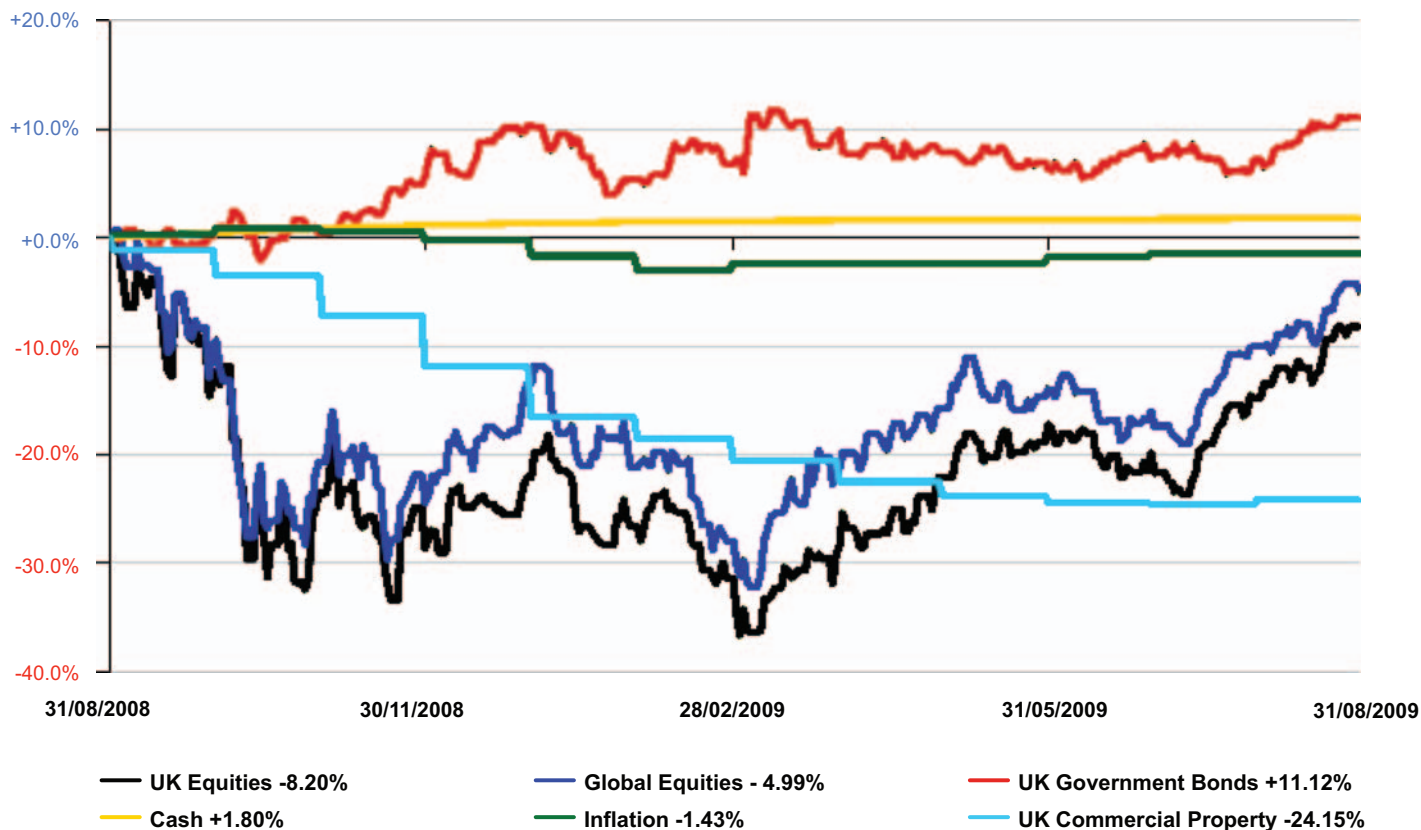
# CCLA INVESTMENT MANAGEMENT LTD

## MARKET REPORT AUGUST 2009

### Summary

- Global equity markets made good progress, boosted by improved economic data.
- UK government bonds and corporate bonds also moved ahead, with lower quality bonds most favoured by investors.
- Property values have stabilised after a long period of decline.
- Sterling has weakened on international currency exchanges, boosting the return from international investments.

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 August global equity markets built on the positive momentum evident in July and moved higher, supported by better investor sentiment and evidence that the economic recession may be over.

The FTSE All-World Index gave a return of +5.53% for a sterling based investor, over the past year the return is still negative at -4.99%. The domestic equity market was stronger than the international average and returned +7.70% as measured by the FTSE All Share Index. Small companies were particularly strong (+17.07%) and lower rated 'value' stocks (+11.07%) comfortably outperformed the growth sectors (+3.73%). These returns were consistent with increased investor confidence and a greater appetite for risk. In overseas markets returns were also encouraging. Europe led the way, with returns of +8.94%, but all the regional returns were positive. Japan produced +5.81%, the USA +5.42% and Asia +1.37%. The range of returns from individual markets was wide. In Europe, Austria produced the highest gains (+20.88%) but even from Norway, the laggard of this group, returns were usefully positive (+4.99%). Asian markets, having rallied earlier and more strongly than the international alternatives, saw more muted gains over the month and whilst the gain from Pakistan was very impressive (+23.33%), Singapore, Taiwan, Hong Kong and China lost ground, with the latter two each losing more than 5%.

Fixed income markets rose, supported by a growing conviction that although economic conditions were improving, interest rates would remain low for the foreseeable future. The FTSE Government All-Stocks Index gave a return of +3.67%.

Corporate bonds were stronger, particularly lower rated bonds and those with longer maturities. The iBoxx Sterling Non-Gilt Index of BBB rated bonds returned +6.01%, the index of bonds with an outstanding life of more than 10 years returned +7.08%.

There was encouraging news on commercial property values which stabilised after a long period of decline. Downward pressure on rents also moderated, particularly on good quality properties. On a sector basis the strongest performances came from retail warehouses where increased level of investor interest has been reflected in some improvements in valuations.

Sterling weakened over the month, falling by -2.55% against the dollar, -3.06% against the euro and -4.13% against the yen. The domestic currency lost ground as it became clear that the UK's economic performance was likely to be weaker than that of its peers.

Economic news was positive and a major factor behind the improved market trend. The key development was data from Europe which suggested that Germany and France has returned to growth in the second quarter of the year. The Japanese economic performance was also positive and whilst the US continued to shrink, the pace of decline was less than earlier thought. In the UK the Bank of England forecast a stronger bounce in output for 2010 but also suggested that 2009 would suffer more than had been predicted earlier in the year. A concern for the Bank has been the reduction in outstanding loans to industry and individuals suggesting that although the cost of credit has fallen, availability remains a problem. This was an important factor behind the decision to extend the quantitative easing programme by £50 billion.

UK companies reduced overall dividend payments by 9% in the first half of 2009 relative to the equivalent period in 2008; the trend to reduce payments is expected to continue in the second half of the year. For the first time in many years new money raised by the corporate sector by way of rights issues, exceeded the sums paid out as dividends.

## Outlook

The key question for investors relates to the prospects for recovery. Data has certainly improved and forward looking surveys are more hopeful but it is not clear yet to what extent this rise in activity is due to the contribution from government stimulus measures and the end to de-stocking by the corporate sector. These two factors can provide a powerful boost to output but they are essentially temporary and not a source of consistent and continuing growth, there is a risk therefore that, as their contribution fades so the recovery loses momentum and investor hopes of recovery are disappointed. Our concern is that whilst long term valuations are still supportive, near term expectations have moved ahead of fundamentals, leaving equity markets exposed to a risk of profit taking and consolidation.

In fixed income markets, there is still scope for corporate bonds to outperform gilts. The stability in commercial property prices is encouraging and may be a signal that valuations are at last bottoming out. The sector is certainly attractive on a current income perspective but there are risks too – particularly away from the prime areas. The relative weakness of the domestic economy suggests that sterling values will remain under pressure.

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