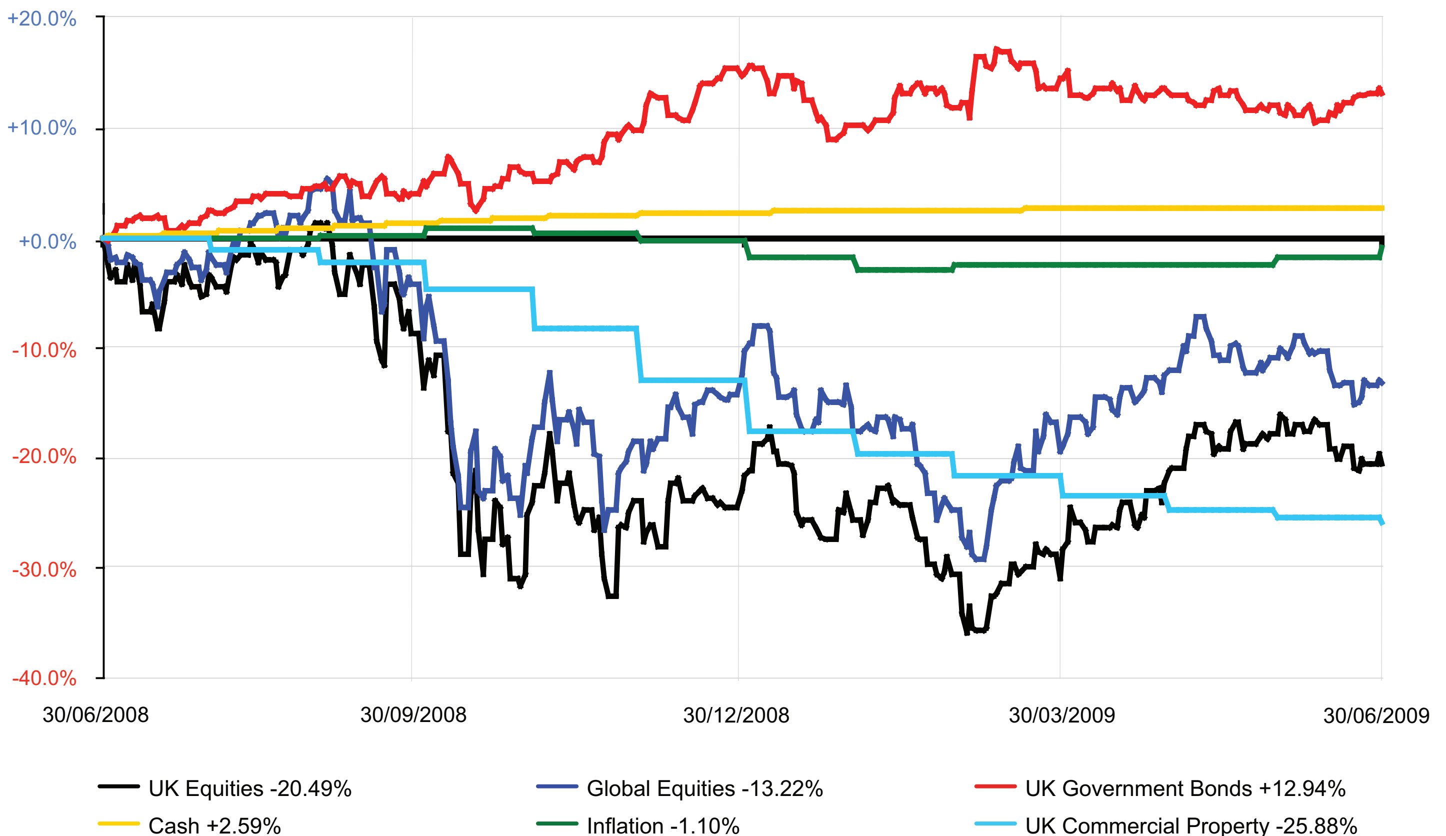
# CCLA INVESTMENT MANAGEMENT LTD
# MARKET REPORT JUNE 2009


## Summary

- Equity markets have eased back after a strong rally in recent months.
- Government securities have been stable but longer dated and lower quality corporate bonds have given positive returns.
- Property values have continued to ease but the pace of decline has moderated.
- Sterling has strengthened, with modest gains against dollar, yen and 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

After three months of rising prices global equity markets fell back slightly in June. Over the month sentiment was pulled between disappointing historic economic data, which reflected the severity of the downturn and more optimistic current surveys. On balance profit taking won the day but the overall declines were modest relative to those seen earlier in the year.

The return on the FTSE All World Index was -2.57% to a sterling based investor, this left the three month gain to +7.03% but the return over the past year at -13.22%. The change in the UK market, as measured by the FTSE All Share Index, was -3.21% and once again smaller companies (-1.11%) performed slightly better than large ones (-3.42%). In overseas markets Europe was the weakest performer, declining by 4.31%. Other markets were stronger and although the returns from the US (-1.87%), Japan (-0.24%) and Asia (-1.08%) were all negative in sterling terms, in local currency the outcomes were positive, albeit on a similar modest scale. Recent months have produced a wide range of returns from individual markets but even these were muted in June. The best performing European market was Spain (+1.31%), the worst Norway (-9.55%). Asia returns were generally stronger and Thailand headed that list with a gain of +7.37%. Taiwan gave the worst return at -9.26%.

Commercial property values remained under a cloud although the rate of decline moderated. Downward pressure on valuations continued to be exerted by falling rental values and fears of forced disposals by highly borrowed developers brought into difficulty by the severe credit shortage. Balancing (almost) these negative forces has been the low level of transactions and the support to prices from high income yields.

Government securities have given modest positive returns, an improvement after a couple of dull months. Corporate bonds have done better and a reflection of the increased risk appetite shown by investors is the relative performances within the corporate bond sector. The areas which have performed best are the longer dated and lower quality issues, those which suffered most in the downturn. The return from the iBoxx non-gilt BBB index – the lowest investment grade cohort of the corporate bond market, is + 4.94% compared with + 0.95% from gilts. Over the past 12 months however the position is reversed with a return of +0.51% on the corporate bonds and +12.94% on gilts.

Economic news has fallen into two distinct types: older data have been bleak, more recent data have shown signs of underlying improvement - indeed some forward looking surveys have suggested a recovery could be in prospect.

The depth of the slowdown in activity in the final months of 2008 and the first quarter of the current year has been substantially covered in past monthly notes and of course in many other places and so we do not propose to cover the latest releases in any detail but we will note the latest revision to the estimates of UK economic performance in the first quarter which show a fall in activity of -2.4%, the worst performance in some 50 years.

Recent evidence has been better. As the run - down in company stocks has been completed so underlying demand has again begun to feed through to manufacturers, prompting production to start again. This bounce in output has helped moderate the downturn and in so doing brought hopes that the low point for the economic cycle had been reached. The number of areas signalling an improvement is broad and includes China, the USA, Japan and the UK, with the OECD leading indicators of economic activity also suggesting better times ahead. On this basis we would expect to see further improvements in the data through the year and particularly in the final quarter when the comparisons will be with a weak period in 2008. Tempting though it is to focus on these green shoots, the more important questions of course relate to how robust any recovery can be in a world where consumers are still heavily borrowed, the banks frail and credit availability heavily reduced. Certainly for the UK it will be some time (2011?) before there is a return to long term trend rates of growth.

## Outlook

Equity markets have risen to levels which reflect the growing consensus that the worst has passed. Ratings are not stretched but neither are they as cheap as they were and there is certainly scope for disappointment if the news flow turns negative or if an unanticipated crisis flares up – particularly if the trouble spot is in the financial sector. Whilst there are sensible grounds for caution, our central expectation is for further progress to be made, recognising that the path will not be a smooth one and that volatility will remain high. The same developments will support corporate bonds, which remain cheap relative to government issues. For property the high yields available suggest fears of falling rents in the future. In the present environment some properties are clearly at risk – but that does not mean that all are at risk. Strong covenants and long agreements are increasingly attractive on income grounds – with the recognition that capital values can still decline from current levels.

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