

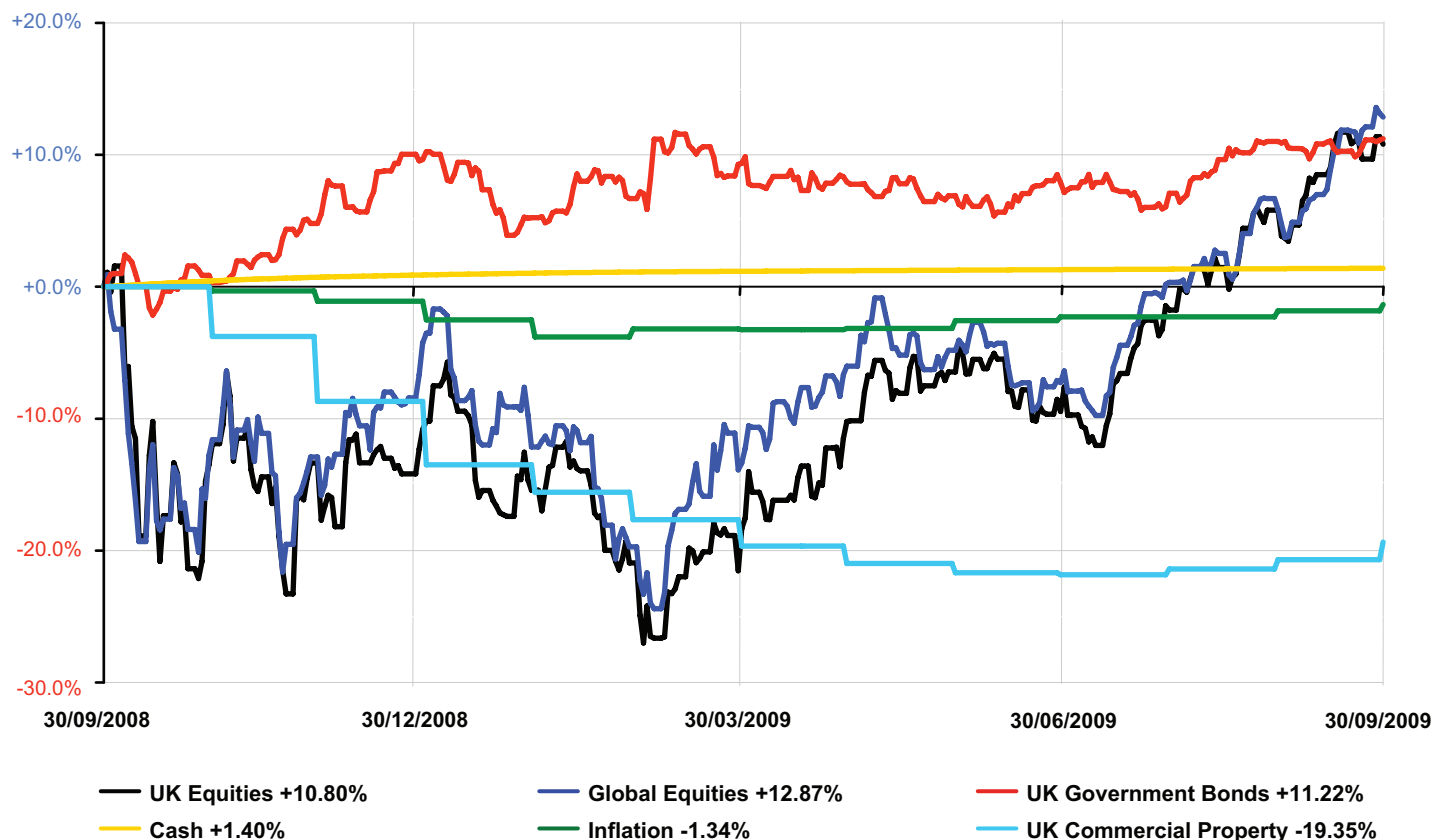
CCLA INVESTMENT MANAGEMENT LTD

MARKET REPORT SEPTEMBER 2009

Summary

- Global equity markets overall continued to advance, supported by hopes of economic recovery and profits which emerged above expectations.
- UK government bonds have been stable and corporate bonds have edged higher as the income premia over gilts has narrowed further.
- Property prices have risen despite continued downward pressure on rents.
- Sterling has weakened against the major currencies.

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

Global equity markets moved higher in September. Support came from hopes of economic recovery and from above expectation profits announcements.

In sterling terms the FTSE All-World Index gave a total return of +6.61% and although this rise owes something to the weakness of sterling, the gain to a dollar based investor is still attractive at +4.62%. The domestic equity market also moved higher, the FTSE All-Share Index giving a return of +4.72%. Within the broad index smaller companies continued to perform well, returning +7.38% to bring the increase in value from this segment of the market to +35.20% for the quarter. Large companies performed in line with the market average but those occupying the middle tiers of capitalisation were relative laggards. Growth stocks, having underperformed value biased companies for some months, rallied but remain behind in terms of relative performance on both three month and twelve month timeframes. Almost all the international markets produced positive returns. Asia rose by +11.51%, Europe by +7.56% and the USA by 5.75%. The exception to the positive picture was Japan where the index was all but unchanged for a sterling based investor (-0.10%) but declined more substantially in local terms (-5.39%). The best performing individual markets were Ireland (+14.40%) and Thailand (+14.92%). The laggards were Sweden (+2.76%) and Philippines (+1.20%).

The UK government bond market was flat (+0.18%) but corporate bonds continued to improve. The iBoxx Sterling BBB Index gave a return of +2.52%, the 7-10 year maturity index +2.58%. Corporate bonds are outperforming as more confident investors buy into the market to lock-in income yields which remain above those of gilts.

Commercial property prices rose over the month, despite further weakness in rental values. After a bear phase extending back to June 2007, prices are being supported by value orientated investors looking to secure the high yields available on excellent properties on strong covenants. Just as marginal selling caused disproportionate falls in value in the down period, so moderate buying pressure in an illiquid market, with few sellers, has stabilised prices and is now pushing them higher.

Sterling continued to weaken against the major currencies and fell by -1.87% relative to the dollar, -3.93% relative to the euro and -5.48% relative to the yen. Over the past year the relative declines in value has been -10.24%, -13.64% and 24.1% respectively.

In economic news although the G20 nations began to debate the withdrawal of economic stimulus programmes, there was broad agreement that any early action by governments would be premature, given the weak and inconsistent nature of the upturn so far. There were positive signs from data on manufacturing output and consumer confidence but the not all the news was positive and doubts remained as to whether in 2010 the improvement in activity would be sufficiently strong to reverse the upward trend in unemployment.

A feature of this downturn has been the collapse in takeover activity, a reflection of the difficult economic environment and the problems of raising finance in credit markets or through equity issuance. It was interesting therefore to see a spate of large potential deals announced, including the Kraft bid for Cadbury but also Xerox and Abbot Laboratories both proposing multi-billion dollar transactions. This seems to be another indication that conditions have become much more stable.

Outlook

The outlook for global growth has improved in recent weeks as more economies pass the low point in activity for the cycle and begin to expand again. This is important because investment markets have moved higher in anticipation of this recovery and the improvement in corporate profits which is expected to accompany it. Another important support to prices is coming from monetary conditions. With governments creating liquidity to stimulate activity and keeping interest rates low, cash is flowing in to financial markets in the search for higher returns. This combination of economic growth and 'easy money' will continue to support prices over the medium term but will not protect the indices from short term setbacks triggered by weak data or simply profit taking after the strong recent run. As the uptrend in the indices becomes more extended, so a period of consolidation becomes more likely, we would see this as a buying opportunity.

We expect corporate bonds to continue to outperform government stock but for both to be relatively dull performers. The upturn in property prices is welcome and overdue, we expect this to continue to build in the months ahead, the problem for investors, in a market where transactional activity has been very thin, will be to find suitable investments at or near current prices.

We expect sterling to remain relatively weak.

James Bevan

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