

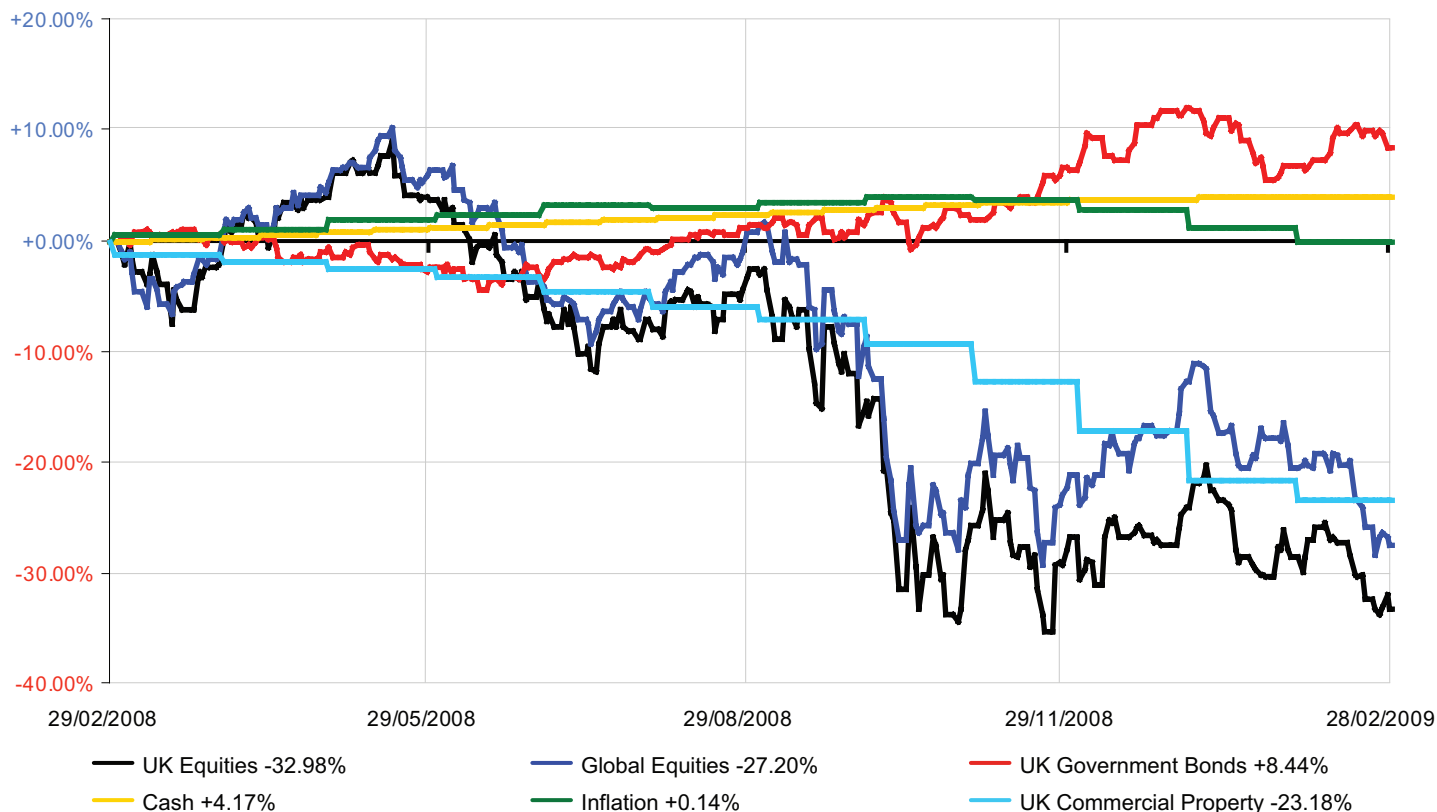
CCLA INVESTMENT MANAGEMENT LTD

MARKET REPORT FEBRUARY 2009

Summary

- The weakness in equity markets evident in January continued in February.
- In bond markets government stocks enjoyed some support but corporate issues declined.
- Property declined again on financing fears and concerns over the weaker outlook for rents.
- Sterling was little changed relative to the euro but rallied modestly against the dollar and by more against the yen.

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

The weak trend evident at the start of the year continued in February. The principal causes remained the same, a high level of concern over the frailty of the financial sector and the remorseless flow of evidence showing the extent of the decline of activity in the world economy. The tone in the commentary on the economic situation remained profoundly negative as comparisons with recent downturns, either the relatively shallow set-back in the early 1990s or the more substantial decline in the 1980s, gave way to a fear that this downturn could be worse than either in terms of extent, duration and breadth. In a sensitive environment the activities of governments have not helped sentiment. The US published a plan to re-stimulate the economy by spending on a titanic scale but it failed to find favour because the lack of detail in the proposals meant that it was viewed as aspiration rather than a firm plan. In Japan, the government professed the view that high deficits and zero interest rates mean that it is relatively powerless to act in the face of a sharp fall in activity, whilst the Eurozone has as yet failed to show a coordinated response to a crisis which is hitting some members very hard. In particular the European Central Bank has been thought to be slow and reactive in its interest rate policy. In the UK aggressive remedial action is on the cards but the scale of what is proposed is stretching for the economy, with no guarantee of success.

Over the month the return on the FTSE All World Index to a sterling based investor was -8.62%, the decline in dollar terms was -9.65%.

In the UK market the FTSE All Share Index returned -6.52% with small companies performing better than the market leaders and growth stocks performing better than their value counterparts. The pattern of falling equity indices was repeated in all the major markets. In Europe the indices retreated by -9.98% but this overall figure masks a wide range of

returns from individual countries. Sweden was only slightly down (-1.55%) but Finland, Austria and Greece all lower by more than -17.00%. In the United States the return was -9.25% whilst Japan lost only -4.37% to a local investor but -11.22% to one based in the UK, due to the effect of sterling's rally. The Asian return was -4.80% with South Korea (-16.69%) the worst performer in the region and Pakistan (+14.79%) the best.

UK government securities held their ground in the difficult environment but corporate bonds eased as fears of defaults rose to the surface again. As would be expected, longer dated securities were those most affected by the more sombre tone.

Anecdotal evidence from the property market suggested that the downtrend continued and prices fell again as valuers pushed estimated values down nearer to those being achieved in the market. Rental conditions deteriorated and there was further evidence of declines in rental levels, particularly in the retail sector. In the difficult prevailing conditions the industrial sector has remained relatively robust, reflecting the scarcity of properties in the South East and the high initial yields.

Economic news over the month was uniformly bad and consistent with a global economy moving swiftly into recession.

In Asia, the IMF cut estimates of regional growth from +4.9%, made at the end of 2008, to +2.7%. The reason for the downgrade was the contraction in regional trade which hit the exporting economies of the region particularly hard. South Korea was now expected to see a - 4% contraction in activity in 2009 and whilst the Chinese economy was expected to expand, it was of rates of +6% rather than double digit growth seen in the recent past. An indication of the headwinds the Chinese are now experiencing is that exports have fallen by -17.5% and imports by 43.0% in recent months. It is estimated that factory closures have cost the jobs of 20 million migrant workers. Falling exports have also hit Japan with overall trade down 4.4% in January. In the final quarter of 2008 the Japanese economy contracted by 3.3%, the worst performance for 35 years.

A similar flow of gloomy data emerged in Europe and the United States. A feature of this slow down in the US has been the speed at which lower activity levels have generated job cuts. Unemployment numbers have yet to reach the levels seen in 1980 but the rate of increase is such that that low water mark will be passed later this year.

In the UK, NIESR published an economic report which suggested that the recession will be the most serious for 60 years and that the recovery would be at best insipid. With inflation not thought to be a threat, Base Rate was cut again, to 1%. Estimates of government spending suggested a borrowing requirement rising from £89 bn in 2008 to £149 bn in 2009, peaking at £170 bn in 2010. These vast sums reflect huge increases in planned expenditure, the support to the financial sector and lost tax revenue. The financial sector previously provided c.27% of corporate tax revenues and the plunge from profit to loss in this segment of the economy has been a major contributor to a drop of £10 billion in government tax receipts.

Conditions have remained very poor in the financial sector. As part of a continuing programme of support the government has announced a scheme by which it will insure the risk of losses from the UK banks' loan books in exchange for a fee. Royal Bank of Scotland has joined the arrangement for over £300 billion of loans, Lloyds and Barclays are reviewing the commercial attractions of what is on offer.

Outlook

A feature of the fall in activity has been the move to cut stock levels across the global economy. Partly this reflects the shortage of credit, partly current and anticipated future falls in demand, but whatever the cause it is not a process that can go on for ever. Once stock levels reach minimum operating levels then demand will stabilise and some level of order flow resume. Activity can decline further from this point, but the pace of slowdown reduces and becomes more orderly. The current indication is that this will occur some time in the second quarter of the year. This is probably too soon to coincide with any boost to the economy from government action to increase spending and cut VAT or indeed from lower interest rates and a weaker currency, but all of these factors will make an increasing contribution over the balance of the year.

Investment markets remain friendless and investor confidence is all but entirely absent. Clearly UK profits will fall sharply this year – probably by 25%-30% but this cannot be new news to an investor population that has been focused on the financial crisis and recession for much of the past year. Valuations are at attractive levels for long term investors but this is irrelevant when the dominant emotion is fear. We must expect volatility to remain at high levels for the near term and prices may establish new lows before a base is built. In time value will be recognised.

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