

CCLA INVESTMENT MANAGEMENT LTD

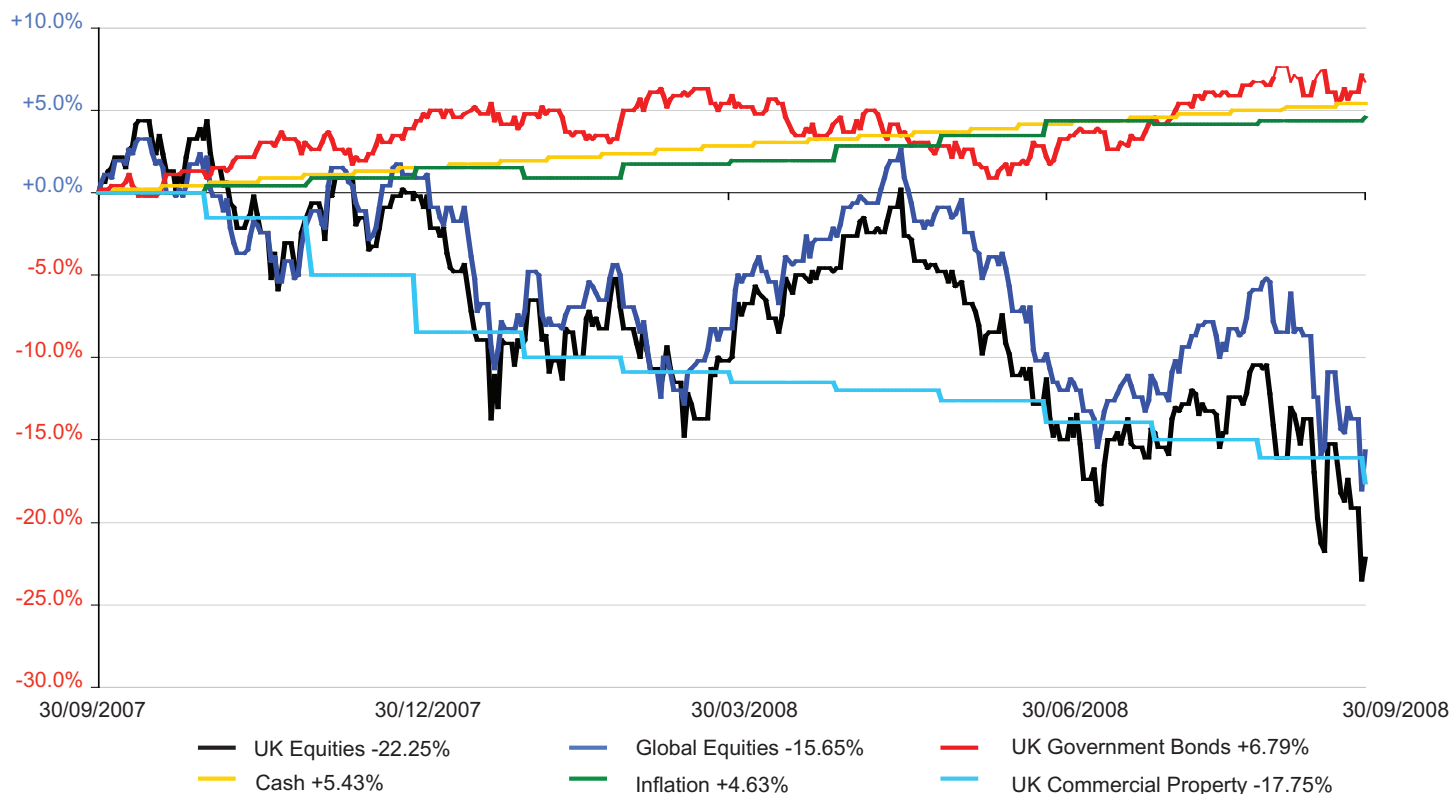
MARKET REPORT OCTOBER 2008

Summary

- Equity markets around the world fell sharply as fears grew for the stability of the banking system.
- In bond markets the most defensive areas produced the best returns.
- Economic activity weakened further with evidence of stagnation or recession in a growing number of countries.

Review

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* (*Latest monthly return estimated by CCLA).

September was a month of pronounced weakness in equities with all of the major markets registering a decline. The reason for the falls was a collapse in investor confidence as the credit crisis that has been developing for over a year intensified and brought into question the stability of the banking system. Economic news was dull and consistent with a weakening trend in activity but these developments were completely overshadowed by the moves in investment markets.

Over the month, for a UK based investor, the FTSE World Index returned -10.26%, a sharp decline despite being cushioned by a fall in the sterling exchange rate. In the UK the FTSE All Share index fell by -13.24% but this masks relative strength from the largest companies, as the FTSE 100 index returned -7.56%, and weakness elsewhere, with medium sized companies giving -15.81% and small companies -14.99%. With investors in defensive mood 'value' stocks, those with higher yields and stronger asset backing, performed best, a trend reflected in a number of other markets around the world.

International markets were uniformly weak. In the United States, the market most helped by currency factors, returns were -6.76%, a weak performance but one substantially better than those achieved from Europe (-13.04%); Japan (-8.91%) and Asia (-14.70%). The range of returns from individual markets was particularly wide. Europe's best performer was Spain (-7.79%); its worst Austria (-29.63%), although Norway (-28.62%), ran a close second. In Asia, the Philippines fell back -3.61%, China -19.29%.

Bond markets were not immune from the loss of confidence and although UK government stocks (gilts) just managed to produce positive returns (+0.10%) corporate bond returns were negative with the downturns most severe for the lowest rated parts of the market and for the longest dated bonds. Commercial property values fell, transactional activity remained at very low levels.

The prime cause of the weakness in investment markets was the growing crisis in the financial sector. As confidence ebbed, so the major banks became increasingly reluctant to lend to each other, drying up essential liquidity and forcing a growing reliance on the emergency facilities provided by central banks. Falling valuations of assets held weakened balance sheets and lower share prices undermined confidence and reduced the ability to raise new capital. The result was an extraordinary series of forced mergers, fund raisings and state interventions which transformed the financial landscape. Past reputation or even size was no guarantee of survival. In the UK at the start of the month the Derbyshire and Cheshire Building Societies sought a merger with Nationwide. By the end Bradford and Bingley had passed into state ownership and HBOS had agreed a rescue merger with Lloyds TSB. In the US the list of casualties was longer and more diverse. AIG, the giant insurance company, and Fannie Mae and Freddie Mac, the two cornerstones of the US mortgage system, needed government assistance, Merrill Lynch was sold to Bank of America and Lehman Brothers was allowed to go under. Rescue deals were required too for Washington Mutual and Wachovia. Although most of the problems surfaced in the US and UK, Europe too had important casualties.

In reaction to the crisis central banks provided huge amounts of liquidity to enable financial markets to continue to function on a day to day basis. Short selling of financial company shares was also banned. The problem was that the piecemeal approach, although substantial in scale, was seen to be responding to problems rather than solving the causes. For this reason the reaction by investors to the proposal by the US government to create a \$700 billion support scheme was very positive. By the end of the month it had still to be approved by Congress, tempering the initial hope.

Economic events were completely overshadowed by events in securities markets. The developments seen were all consistent with the established trends of slowing growth or stagnating activity. In the UK, the IMF forecast a recession in the second half of the current year. The causes were expected to be squeezed consumer activity and a weak housing market. The inflation picture was mixed, with domestic RPI growth slowing but CPI pressures getting worse. This phasing is consistent with lower inflation in the months ahead and helped to raise expectations that UK interest rates will fall soon and into next year. Activity in Europe followed a similar pattern of slower growth and reduced inflation rates. The rate of increase in costs remains well above target but despite this there are signs that interest rates here could also be on a downward path soon. The news from Japan was uniformly dull as the economy slowed and unemployment rose to 4.2% of the workforce. Oil prices weakened to around \$100 per barrel, supported against a backcloth of weaker demand by OPEC supply reductions and by hurricane damage to production and refining facilities in the Gulf of Mexico.

Outlook

Economic conditions have deteriorated and there is a clear risk that financial sector problems further weaken overall activity. Inflation looks to have peaked and could decline sharply from here. In the UK interest rates will be cut soon and for much of 2009. This has considerable implications for those relying on deposits to provide income.

For equity investors able to take a longer term view, and who can withstand current high levels of volatility, then current price levels are attractive. Equity yields are above those on government stocks, the authorities around the world are increasingly searching for a systemic cure to the problem rather than a solution on a case by case basis and investor sentiment is very negative. It is far too early to say that the bottom has been seen for this cycle but it is our view that it is increasingly likely that the bottoming out process has begun.

James Bevan

Chief Investment Officer CCLA



CCLA INVESTMENT MANAGEMENT LTD
80 Cheapside, London EC2V 6DZ

Client Service T: 0800 022 3505 F: 0844 561 5126
www.ccla.co.uk

Please note that the content of this report should not be interpreted as investment advice.

CCLA Investment Management Limited (registered in England No. 2183088 at 80 Cheapside, London EC2V 6DZ) is authorised and regulated by the Financial Services Authority and is the manager of the COIF Charity Funds (Registered Charity Nos. 218873, 803610, 1046249, 1093084 and 1121433).