CCLA INVESTMENT MANAGEMENT LTD

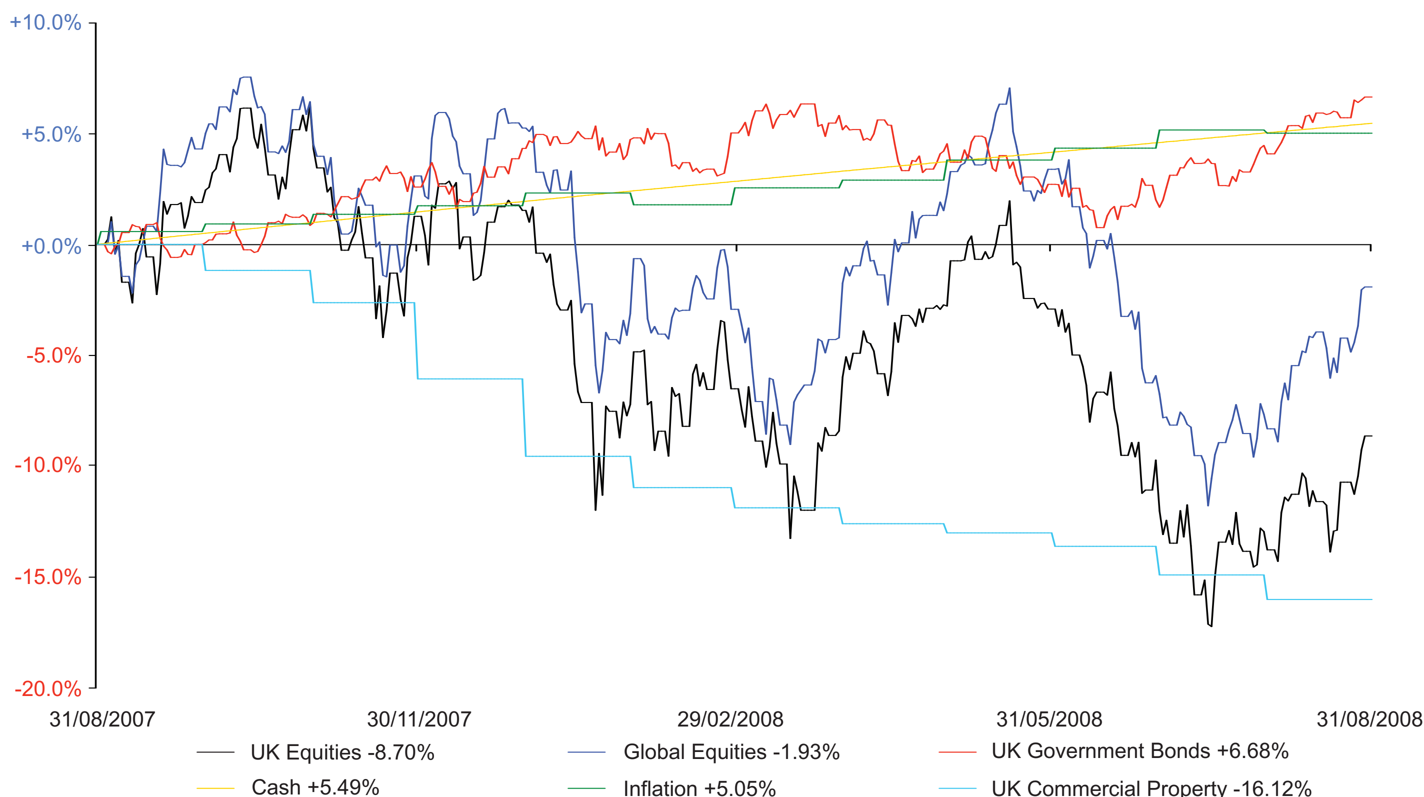
MARKET REPORT SEPTEMBER 2008

Summary

- Activity growth in the world economy continued to slow in most areas although the US showed surprising resilience.
- Equity markets rose modestly but returns for UK based investors were boosted by sterling weakness.
- The bond market continued to move ahead but commercial property remained weak.
- Sterling fell sharply on international currency markets.

Review

Market returns - 1 year



Source Bloomberg: FTSE All-Share Index, FTSE All-World Index, UK Govt All-Stocks Index, 7 Day Libid, RPI, IPD UK All Property Index

August was a month of positive returns for most markets with marked sterling weakness boosting the gains from international exposure. Economic indicators continued to suggest that growth in the world economy was slowing but rather than focus on this, investors took heart from sharp falls in commodity prices in the hope that these would lead to lower inflation and lower interest rates in the months ahead.

For a UK based equity investor the FTSE World Index returned +6.62% to bring the return over the past 12 months to -1.93%. The UK market rose with the FTSE All Share Index up by +5.00%. The FTSE 100 Index returned +4.86% and the Small Capitalisation index +4.85% showing that for this period at least size has not been a factor. If we turn the clock back over the past year however we see a very different picture, one of substantial relative weakness by the small company sector. Whilst the FTSE 100 Index has given a disappointing negative return of -8.70%, the small company return has been -30.20%. The trends in international markets were mixed in local currency terms with the US and Europe rising and Japan and Asia easing back. After conversion into sterling however they were uniformly positive. Leading the pack was the US which returned +10.25% but there were good gains from Japan (+4.32%) and Europe (+3.96%) with Asia also in positive territory (+1.82%). Of course individual returns varied substantially. In Europe, the best returns came from The Netherlands and Belgium which returned +9.70% and +8.91% respectively, while the Greek market fell back over the period. In Asia, the Philippines (+11.97%) and Thailand (+10.21%) were strongest whilst Pakistan continued a dull run to fall by -12.43% in August, -25.68% over the past three months.

UK bonds made steady progress with positive returns from across the sector. Government securities performed a little better than corporate stocks and longer dated stocks did better than those with a shorter time to maturity. Commercial property values fell once more but in an environment of very low transactional activity.

In currency markets the main news was the sudden weakness of sterling which fell by -8.22% relative to the dollar and by -7.47% against the yen, to take the pound to an eleven year low on a trade weighted basis.

Economic news from the UK, Eurozone and Japan showed that activity was either flat or had declined during the second quarter. In the UK, the economy stopped growing for the first time since 1992 as lower consumer spending and a sharp fall in investment from an increasingly cautious business community, hit overall activity. In Europe, output fell by -0.2% but the major contributors to the regional economy fared worse. Germany experienced a -0.5% decline as exports were squeezed and consumer and business confidence fell away. Activity in Japan fell by -0.6%. Against this background the US was the cause of great surprise when estimates of the growth achieved in the three months to end June were revised up, from +1.9% to +3.3%. This remarkable result owed something to the benefits to consumer spending from the tax rebates given in the Spring but the main source of improvement came from changing patterns of trade: slowing growth brought a sharp fall in imports whilst weakness of the dollar was reflected in export growth. This rate of expansion in this phase of the cycle is unsustainable and growth rates will reduce in the months ahead. Nevertheless the US does seem to be coping with current conditions rather better than either Europe or Japan and it was consideration of this that sparked the sharp rally in the dollar.

Although growth rates slowed, past increases in fuel, food and commodity prices continued to be reflected in inflation. In the UK, RPI rose by +5.0% year on year in July, the CPI by +4.4%. These rates are likely to rise further in the near term but should peak in September or October and then decline gradually into the early months of 2009. Once this trend is established then interest rates will be reduced, something we are pencilling in for the end of 2008 or, more likely, early in the New Year. Lower base rates will help stimulate the economy over time but the rate of recovery, when it comes, could be disappointing. This is because the real problem is the not the cost of credit but its availability. Banks, hit by huge losses, are unable to maintain their lending programmes, and the market in loans has closed. What this means is that when a more buoyant economy requires access to funds they will be very difficult to provide almost regardless of rate, thereby holding back the upswing.

Within markets, in a period traditionally quiet for company news, the headlines have once again been stolen by the problems of the financial sector. Speculation has continued as to whether the US authorities will have to provide support for the two troubled mortgage companies, Fannie Mae and Freddie Mac. These two companies are pivotal to the recovery in the US housing sector and if they need to be supported they will be. Less essential was The Columbian Bank of Trust, a Kansas-based bank which became the 9th regional bank to be forced to close this year. Not all the troubles were in the US and in Denmark a difficult housing market meant that Roskilde, the 8th largest bank, had to be rescued.

Outlook

Economic news will remain dull for some time and whether or not individual economies trigger the technical definition of a recession, the environment will be one of slow expansion. In time this will lead to lower interest rates, but with inflation still to peak and geo-political issues keeping oil a wild card in any assessment of the situation, we should expect cuts to be gradual.

This is not a time for investors to take substantial bets away from their natural long term strategy. Our overall view of equity markets is that they have probably begun the process of bottoming out but have yet to hit the lows for the cycle.

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).