

# QUARTERLY BULLETIN

## 31 December 2011

### Note from the Chief Executive of CCLA Great Expectations

It may seem a long time ago now, but 2011 began with investors in an optimistic mood. The world economy was predicted to improve as recovery took hold in the developed economies and the emerging world continued to experience strong growth. Inflation was expected to remain low but interest rates were forecast to move higher because of the strengthening recovery. The debt crisis in Europe was a concern, but not a dominant one because it was considered a problem of the periphery and so readily contained. Investment markets soon reflected this benign consensus, with equities moving higher while fixed interest investments lagged. As the year developed, however, it became clear that events were not following the path expected. The pick-up in economic activity was hesitant at best and inflation, rather than edging lower, moved up, propelled by rising commodity costs. Furthermore the European debt crisis was revealed as being far more severe than just a liquidity problem in some of the smaller member states. In investment markets, the uncomfortable realisation that the world would be different caused some sharp and substantial adjustments in prices over the summer. Equities fell, with the emerging countries, where the optimism had been strongest, seeing some of the steepest declines. As concern replaced optimism so 'safe haven' investments came into favour. Gold rose and whilst some government bond markets saw strong investor inflows, others were friendless. In the final three months of the year share prices rallied but sentiment remained weak.

As we start 2012 once again we can see a strong consensus of views amongst investors. However, whereas 12 months ago expectations were buoyant, today the overwhelming mood is

cautious, if not pessimistic. This caution is reflected in the price of investments. International equities, despite good profits growth in 2011, and with more profit growth expected in 2012, are lower than they were a year ago. In contrast UK government bonds, which are seen as a safe haven, provide a lower income now than at any time in the last 60 years - since the early 1950s, a world of post-War austerity and economic damage.

What might this mean for the returns from investments in the year ahead and beyond? When we look forward to analyse the prospects we have to look past the consensus view of the immediate outlook - because that is already substantially reflected in share prices. Instead we should ask how those expectations might be challenged as they were in the year just passed and what the results could be. In our view, although near term caution is justified, these worries have so dominated that they have blinded investors to other considerations. History shows us that over the long term the main driver to investment returns is valuation, not sentiment, and at current levels valuations support equities, rather than fixed interest investments. This is not to say that there are no risks or that prices could not spike temporarily lower on some particular bad news. Furthermore it is very likely that the high levels of day to day volatility that have worried investors in recent months, continue. Gradually however we believe that investors will stop looking back at 2011 and start thinking about the prospects for 2012 and 2013 and as that happens we expect equity prices to strengthen.

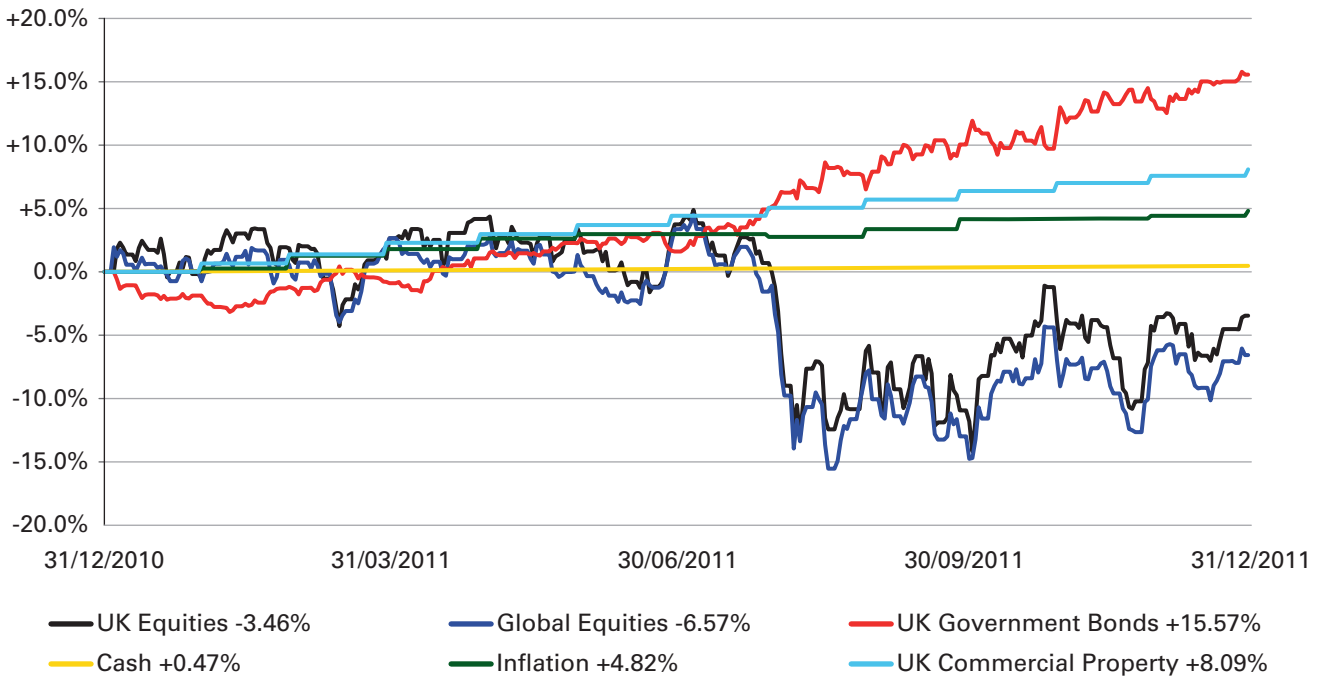
**Michael Quicke**



for Charities

# Market Review & Outlook

## Markets at a Glance - 12 Months to 31 December 2011



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.

## Market Review & Outlook

- In the final quarter of 2011 investment markets overall moved higher as global equities began a recovery from late Summer weakness and bonds continued to enjoy strong money inflows.
- In global equity markets improved investor sentiment saw prices move higher. The FTSE All-World Index gave a return of +7.37%, reflecting rising indices in all the major equity markets with the exception of Japan, which declined by -3.58%. The best performer was the US, which rose by +11.91% but Europe, +3.63% and Asia, +4.38% also rose. The UK fully participated in the recovery and provided investors with a total return of +8.39%. In the prevailing volatile conditions there were wide divergences between the returns of individual markets. In Europe, Ireland returned +17.70%, Greece -24.37%, in Asia, Malaysia rose by +12.12% whilst India fell by -14.34%.
- Fixed interest sector returns were also positive. In a risk-averse environment UK government bonds were the best performers, supported by an additional quantitative easing programme by the Bank of England, but corporate bonds also rose. The FTSE Government All Stocks Index returned +5.01%, the iBoxx Sterling Non-Gilt Index +2.30%.
- Commercial property again gave positive returns but with little overall improvement in values, these were sourced almost entirely from income. Within the sector, good quality, income secure properties remained in demand but secondary assets and those with short leases - and thus some income risk - saw values weaken.
- In currency markets the main trend was weakness in the euro which declined by -2.98% against sterling. Against the US dollar and yen the pound fell slightly, by -0.26% and -0.45% respectively.
- Investment markets are currently taking a pessimistic view of economic prospects and are concerned that there could be a deterioration in the debt and credit crisis in the Euro zone. This has resulted in government bond (gilt) yields being pushed down to very low levels and, despite good growth in profits, equities being lower at the end of 2011 than they were at the start. We recognise the threats to economic activity but still expect growth overall, due to the continued buoyancy of emerging economies. We expect inflation to ease back and for interest rates to stay at very low levels. As the uncertainties ease so there is scope for global equity prices to move higher, the path however will not be a smooth one and the day to day volatility which has been such a feature of 2011 is likely to continue to unsettle investors in the period ahead.

# Distributions for the Quarter

COIF Charities Fund	Distribution per Income Unit	Payment Date	
Investment Fund	15.41p	29/02/12	<ul style="list-style-type: none"><li>Despite low interest rates and falling bond yields the income distribution to investors has again been increased. The payment for the quarter is +1.45% higher and that for the year as a whole +0.49% greater than that for the previous year.</li></ul>
Ethical Investment Fund	2.43p	29/02/12	<ul style="list-style-type: none"><li>Despite low interest rates and falling bond yields the income distribution to investors has again been increased. The payment for the quarter is +1.67% higher and that for the year as a whole +0.57% greater than that for the previous year.</li></ul>
Global Equity Income Fund	2.22p	29/02/12	<ul style="list-style-type: none"><li>The payment for the quarter and for the year has been maintained.</li></ul>
Property Fund	2.17p	29/02/12	<ul style="list-style-type: none"><li>The income payment on the Fund has been maintained and so is unchanged on a quarterly and annual basis.</li></ul>
Fixed Interest Fund	1.80p	29/02/12	<ul style="list-style-type: none"><li>The income payment has again been maintained at a rate of 1.80p. Based on the price at the end of the year the income yield on the Fund is 5.39%, the gross redemption yield is 2.11%*.</li></ul>

\*The gross redemption yield indicates what the total return would be if the Fund's investments were held to maturity, in other words, the aggregate of gross interest received and the capital gain or loss at redemption, annualised. Please note that forecast annual income and income yields are not guaranteed and will change over time due to changes in interest rates and the securities held by a fund.

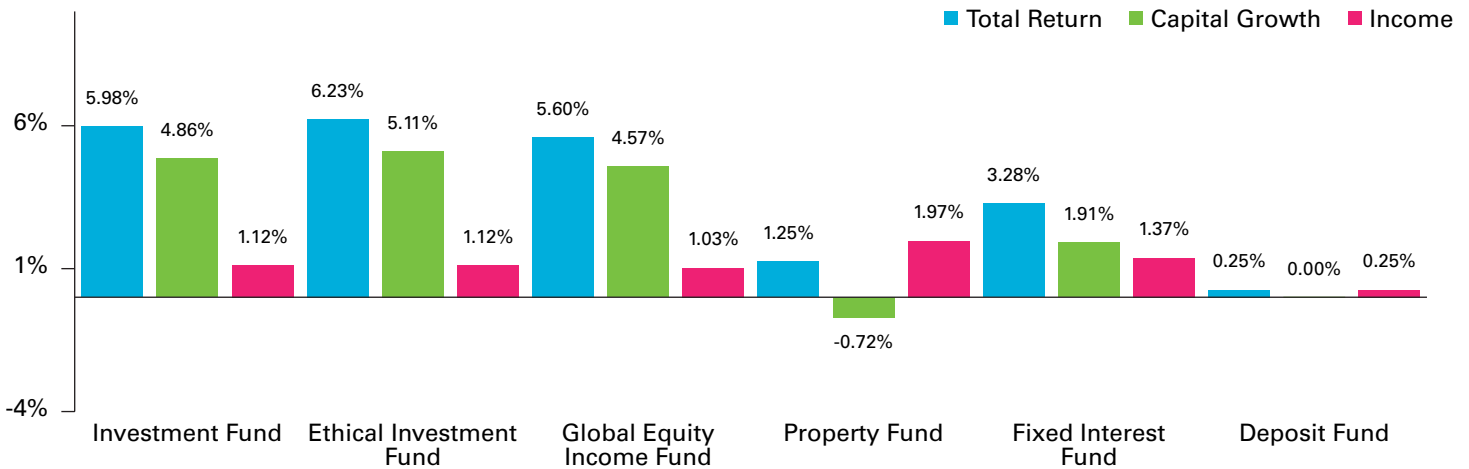
## Interest for the Quarter

### COIF Charities Deposit Fund

Average interest rate over the quarter	0.76% (0.76% A.E.R.)**	<ul style="list-style-type: none"><li>The interest rate payable on the Fund will ultimately reflect the rates available from top quality borrowers in the money market.</li></ul>
Interest rate at the quarter end	0.80% (0.80% A.E.R.)**	<ul style="list-style-type: none"><li>Despite flat base rates the interest paid on the Fund has increased over the quarter.</li><li>The Fund is rated AAA/V1 by Fitch Ratings. This reflects the high quality of the lending portfolio and its low volatility.</li></ul>

\*\*A.E.R. = Annual Equivalent Rate, which illustrates what the annual interest rate would be if the quarterly interest payments were compounded.

# Performance Comment



Source: CCLA. Gross returns before management fees and expenses. Please note that past performance is no guarantee of future returns. Investments in long term funds can go up and down in value and you may not get back the amount originally invested.

## Performance Comment

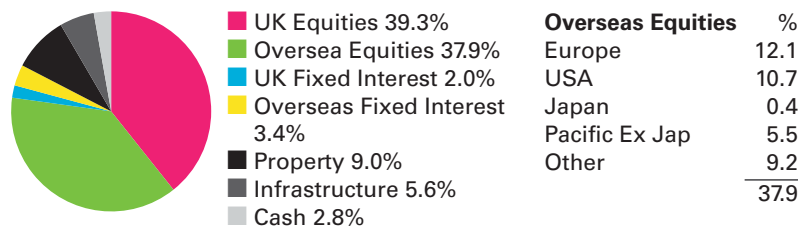
### COIF Charities Investment Fund COIF Charities Ethical Investment Fund

- The Funds produced positive returns over the quarter due mainly to a recovery in global equity markets and also positive returns in fixed interest and property.
- Despite a challenging environment the income payment to investors was increased slightly for the quarter and the year.
- Over a year of volatile quarterly movements the Funds have performed in line with the comparator index. Over the most recent quarter returns are below those of the comparator.
- The two funds have the same long term objectives and try to achieve them by following very similar strategies. Our expectation is that they will produce very similar returns over longer term periods, any short term variations will reflect detailed differences in the individual companies held.

### Longer term total return performance (gross) 12 months to end December:

	2011	2010	2009	2008	2007
Fund	-0.8%	+12.1%	+14.9%	-22.0%	+5.8%
Comparator*	-0.8%	+14.4%	+21.2%	-22.6%	+4.9%

### Asset Allocation as at 31 December 2011



Overseas Equities	%
Europe	12.1
USA	10.7
Japan	0.4
Pacific Ex Jap	5.5
Other	9.2
<b>Total</b>	<b>37.9</b>

### Longer term total return performance (gross) 12 months to end December:

	2011	2010	2009	2008	2007
Fund	-1.0%	+11.1%	n/a	n/a	n/a
Comparator*	-0.8%	+14.4%	n/a	n/a	n/a

### Asset Allocation as at 31 December 2011



Overseas Equities	%
Europe	12.4
USA	10.7
Japan	0.5
Pacific Ex Jap	6.3
Other	8.8
<b>Total</b>	<b>38.7</b>

\*Comparator – Composite: FTSE All-Share 60%, FTSE World ex UK 20%, IPD All Properties 10% & FTSE UK Government All Stocks 10%.

Source: CCLA. Performance shown before management fees and expenses: net returns will differ after the deduction of fees and charges. Please note that past performance is no guarantee of future returns. Investments in long term funds can go up and down in value and you may not get back the amount originally invested.

# Performance Comment (cont)

## COIF Charities Global Equity Income Fund

- Global equity markets rallied over the period recovering some of the ground lost in the third quarter but not sufficiently so to make the returns for the full year positive.
- Despite the high starting yield on the portfolio and difficult income conditions in some equity markets it has been possible to increase modestly the income payment to investors.
- Over the year the Fund has produced a return in line with that of the FTSE All-Share Index and better than that on FTSE All-World Index. Returns over the quarter were below those of these indices as high income investments lagged the equity markets as a whole.

## COIF Charities Property Fund

- Once again in this quarter the returns from the property sector have come from income, capital values have been little changed.
- Despite challenging conditions in parts of the industry, with downward pressure on some rents, the income payment to investors has been maintained.
- The returns on the Fund's benchmark indices are not yet available. Our expectation is that the Fund has produced returns similar to those for the sector as a whole.

## COIF Charities Fixed Interest Fund

- Fixed interest markets continued their positive performance over the quarter. Corporate bonds rose but government securities were stronger as investors maintained their preference for low risk assets.
- The income payment on the Fund has been maintained. We expect to maintain the payment for 2012.
- Our long term view is that Fixed Interest securities are expensive and so we have adopted a cautious portfolio strategy. Against a backdrop of rising markets this has resulted in underperformance of the benchmark during the year.

## COIF Charities Deposit Fund

- The Official Bank Rate has remained unchanged at 0.5% but credit shortages have meant that some market interest rates have edged higher.
- The Manager took advantage of these opportunities to increase the interest rate payment on the Fund. Our expectation is that the rate will increase again in the next few months.
- Our priority with the portfolio is capital security which means that we exclude the many potential counterparties which do not meet our credit quality criteria.

## Longer term total return performance (gross)

### 12 months to end December:

	2011	2010	2009	2008	2007
Fund	-3.2%	+14.6%	+17.6%	-24.2%	n/a
Comparator	-3.5%	+14.5%	+30.1%	-29.9%	n/a

Comparator – FTSE All-Share Index.

## Longer term total return performance (gross)

### 12 months to end December:

	2011	2010	2009	2008	2007
Fund	+7.5%	+15.2%	+6.9%	-22.6%	-3.1%
Comparator	n/a	+15.1%	+3.1%	-22.4%	-3.6%

Comparator - IPD Quarterly Universe (Current Quarter not yet available).

## Longer term total return performance (gross)

### 12 months to end December:

	2011	2010	2009	2008	2007
Fund	+11.4%	+6.6%	+2.3%	+9.9%	+5.1%
Benchmark	+14.8%	+7.7%	+1.2%	+9.3%	+4.7%

Benchmark – Composite: Barcap £ Gilt 80% and £ Agg 100mm Non Gilt 20%.

## Longer term total return performance (gross)

### 12 months to end December:

	2011	2010	2009	2008	2007
Fund	+0.9%	+0.7%	+1.5%	+5.8%	+5.9%
Benchmark	+0.5%	+0.5%	+0.6%	+4.8%	+5.8%

Benchmark – 7 Day LIBID.

# Strategy and Outlook

## COIF Charities Investment Fund

### COIF Charities Ethical Investment Fund

- These two Funds have shared objectives of providing real capital growth and a strong income flow over time. They differ in the ethical and responsible policies they follow which will cause some differences between the portfolios of stocks held.
- The objective for these Funds is to provide investors with strong, long term returns and a rising income. To achieve this these portfolios will normally have a high weighting to assets such as equities and property which can provide capital growth and are a reliable source of rising income.
- We are attracted to equity markets at current levels seeing good long term value and the prospect of higher dividends. We favour a high allocation to faster growing economies overseas.
- We remain underweighted towards the fixed income sector. UK gilt yields are at levels not seen for nearly 60 years; we see little upside for valuations.
- Although there are clear reasons for near term caution we think that investment markets are already discounting a difficult environment and that there is scope for positive trends later in the year.

### COIF Charities Global Equity Income Fund

- Our strategy with the fund is to build a portfolio of good quality companies which can pay a high level of income which will grow over time.
- The portfolio does not have any pre-determined allocations to any country or sector, the shape is primarily determined by the availability of good quality investments. This approach will mean that the construction will often vary considerably from those of conventional market capitalisation based indices.
- The portfolio has increased weightings to companies exposed to consumer spending in emerging economies and to resources, where share prices have weakened. We have little exposure to Japan at present.
- Overall we are optimistic that global equity markets will make headway over the year ahead but expect markets to remain volatile.

## COIF Charities Property Fund

- The objective of the Fund is to provide a high income and capital growth over time from a diversified portfolio of property assets. There is an active approach to asset selection by which the managers seek opportunities to add value by activities such as lease restructuring and refurbishment.
- The focus at the present time is on good quality assets with a secure income flow - we expect income to contribute most of the return from the sector in the immediate future.
- At present there is a divergence in performance between good quality, income secure properties and more secondary assets, we expect this to continue. At current valuations we see attractions in the Industrial and, after recent weakness, Retail sectors.

## COIF Charities Fixed Interest Fund

- The objective for the Fund is to provide a high and consistent income. Risks are kept at a relatively low level by maintaining a substantial exposure to government securities.
- The fixed interest sector has performed very well this year, particularly government bonds which have been sought particularly by foreign investors seeking some protection from current uncertainties. We believe that this strength in prices has pushed valuations further into overvalued territory and so have put in place a defensive strategy.
- We expect to maintain the income payment to investors in the year ahead.

## COIF Charities Deposit Fund

- The prime focus of the investment strategy is to provide capital security from a fund offering easy access and competitive rate of interest.
- The focus on quality and security has meant that a number of counterparties have been removed from our approved list and some higher interest rate, but higher risk, offers declined.
- We expect interest rates to remain at very low levels, far below the rate of inflation. There is some scope to increase the payment to investors from current levels in the period ahead.

# Ethical and Responsible Investment Report

## Our work has five strands:

- 1 Engagement, focused on social and environmental issues that are a priority for our clients.
- 2 Setting constraints on investment and exposure to activities considered unacceptable by our clients.
- 3 Proxy voting on corporate governance issues to protect shareholder value and address excessive remuneration.
- 4 Selecting some investments that deliver social or environmental benefits plus market-level risk-adjusted returns.
- 5 Responsibilities under the UK Stewardship Code and the UN Principles for Responsible Investment.

## Quarterly highlights

- We hosted the launch of the first National Ethical Investment Week "Action Guide for Charities". It was produced in association with the Charity Finance Directors Group (see [www.neiw.org/charities\\_guide](http://www.neiw.org/charities_guide))
- On behalf of our Ethical Investment Fund clients, we commissioned the Ecumenical Council for Corporate Responsibility to write "Hotels, sex trafficking and London 2012" (see [www.eccr.org.uk](http://www.eccr.org.uk)). It will guide the Church Investors Group's engagement on this topic.
- See our latest work on climate change.

## Voting in more detail

- CCLA aims to vote at all UK and overseas company meetings where we have portfolio holdings.
- Our quarterly record for the 461 resolutions voted across all markets was 13% abstentions or votes against management (mainly related to concerns about board composition or remuneration).
- We voted against three board directors at BSkyB due to concerns about independent representation. We also voted against the remuneration report and three remuneration committee members.
- We also had concerns about board composition at MMI Holdings and at Eutelsat Communications.

## Ethical constraints

- We confirm that the funds have been managed to the client-driven policies this quarter.
- 9.6% of the FTSE All-World Developed index by market capitalisation was excluded from the Ethical Fund, and only 3.0% for the other COIF Funds with exposure to corporate securities. In the latter case this was entirely driven by company involvement in weapons banned by international treaties or the tobacco screen.

## Background and summary:

- Our 2008 survey indicated that climate change was a priority responsible investment issue for most of our charity clients.
- Investment consultants Mercer have indicated that climate change (primarily policy uncertainty) could contribute as much as 10% to portfolio risk over the next twenty years.
- In 2011 we prioritised engagement with companies and policy makers (two of the Mercer report recommendations).
- We are part of the \$70tn Carbon Disclosure Project's (CDP's) carbon catalyst group that helped launch Carbon Action in 2011. The FTSE350 engagement work Victoria Barron undertakes for the Church Investors Group (CIG) is now a CDP case study (CCLA provides the CIG secretariat).

## Church Investor Group's 2011 Climate Change Work

- CIG now engages with fifty climate change laggards in the FTSE350 each year to fit with CDP's annual cycle.
- In 2011 40% of the companies contacted responded to CIG, 14% went from not responding to the 2010 CDP questionnaire to responding in 2011, and 6% went from not having emissions reduction targets to having targets.
- The Church Investors Group and St Paul's Institute hosted "Beyond Hot Air: Protecting Value in a Changing Climate" during National Ethical Investment Week.

## CCLA's 2011 Engagement Work:

- In 2011 we engaged with policy makers and climate negotiators in London, Brussels and Durban. We also signed the \$20tn global investor statement calling for investment grade climate and energy policies at both the domestic and international levels.
- In addition to the engagement work we undertake for the CIG, we have also focussed on Global 500 companies in carbon intensive sectors that do not have emission reduction targets. We have now received detailed responses from all the relevant overseas companies we are invested in. Engagement will continue in 2012.
- James Bevan, our Chief Investment Officer, took part in CDP's 2011 Global Forum, highlights of which are available through CDP Web TV at [www.cdproject.net](http://www.cdproject.net).

## What next?

- In 2012/3 we will also be focusing on the major UK-listed utilities and extractives companies in collaboration with other investors (including the £100bn Local Authority Pension Fund Forum). We will be encouraging these companies to aim for an "A" performance band from CDP.
- We are hosting the Institutional Investors Group on Climate Change's next public policy meeting.



for Charities

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