

# QUARTERLY BULLETIN

## 30 June 2010

### Note from the Chief Executive of CCLA BP: an update

In a busy and volatile quarter for investment markets one corporate event stands out: the calamitous failure of BP's Macondo well in the Gulf of Mexico. Given the wide repercussions this has had I felt that we should take this opportunity to set out what we believe this means for investors.

The well was an attempt to access deep water oil reserves available only at the edge of current technology but it failed catastrophically, resulting in a massive oil spill which has had severe consequences for the ecology of the region and numerous local communities. BP's shares price subsequently collapsed, declining 51%, from 623p in April to 319p at the end of June. The fall contributed substantially to the poor market performance over the quarter.

BP has been forced to accept a complex financial arrangement to ensure that those who have suffered from the leak are adequately compensated. This has included the creation of a \$20 billion fund which will be available to pay legitimate claims. Any fines or penalties imposed by the US authorities however will be considered separately and will be in addition to the compensation. To bolster cash resources BP will sell \$10 billion of assets and cut capital expenditure this year and next. Importantly for investors, dividend payments for 2010 have been suspended.

As I write, much remains uncertain. Although BP has been able to capture a substantial amount of the oil and gas spilling from the well, oil continues to leak at high volumes. Plans to seal it with a relief well are still weeks from completion and although the company is using a proven approach to this, it is not simple or

straightforward; trying in effect to intercept a bore hole 10 inches in diameter from a ship 3.8 miles away.

It is clear that the financial consequences for the company will be significant but BP's resources are also great, and if the financial costs to it are based upon genuine compensation plus a level of punitive sanction, then, although it will be expensive, the business will still be sound and capable of generating attractive growth in the future. Currently, the uncertainties are such that we must expect the share price to remain volatile – investors are nervous and reasonably so and much still needs to be understood. Our expectation is that in time however the share price will be driven more by inherent value and less by fear and uncertainty and that this will lead to a substantial recovery.

A wider perspective of this unhappy event highlights an important issue for trustees, that of portfolio concentration. BP was not only the largest UK listed company by market capitalisation, it was also the most important source of dividend income, alone providing some 12% of the UK market's total dividend flow. Any charity heavily exposed to the share, or simply tracking the index, would therefore have suffered a fall in value but also a sharp drop in income. In our view equity portfolios must be widely diversified and increasingly that means a significant exposure to top quality companies in countries other than the UK.

Wide diversification in CCLA equity portfolios means that the loss of the BP dividend will not result in a reduction in the income payments to our investors.

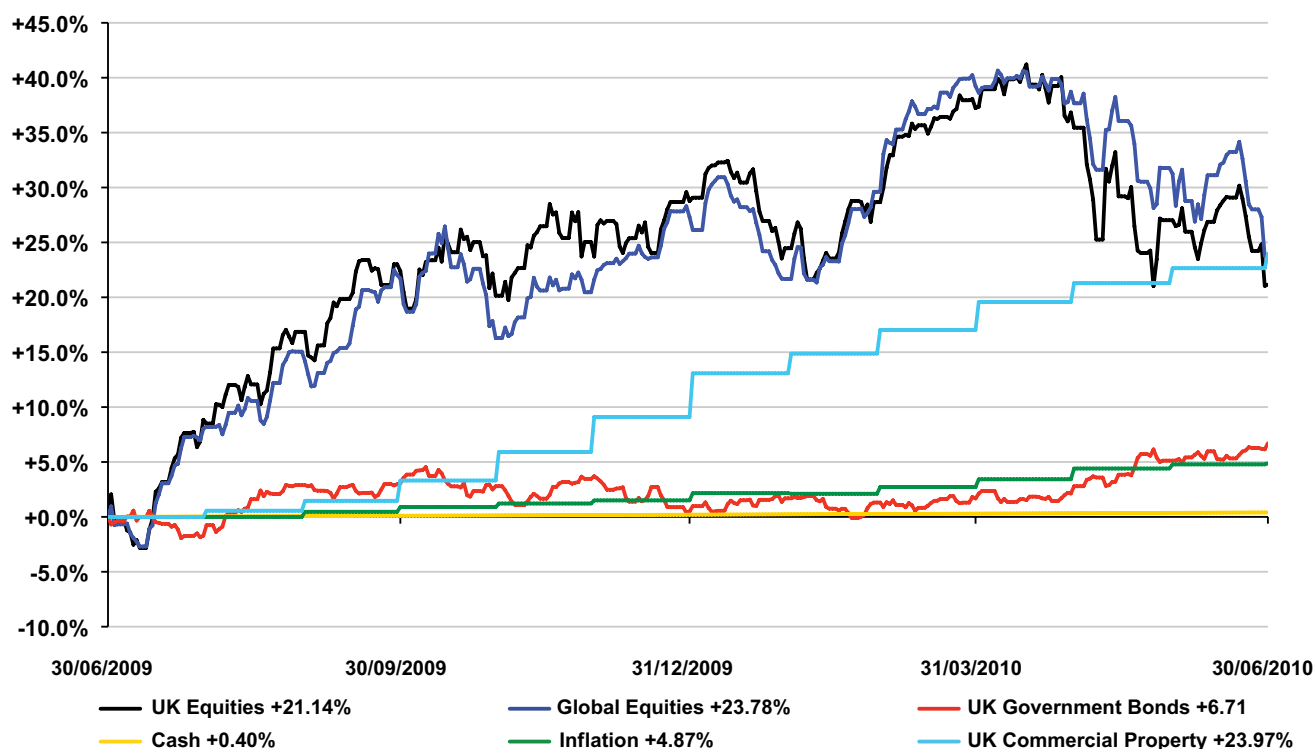
**Michael Quicke**



for Charities

# Market Review and Outlook

## Markets at a Glance - 12 Months to 30 June 2010



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).

## Market Review & Outlook

- Global equity markets fell back over the quarter as investors became more cautious on the prospects for economic growth. The return on the FTSE All-World Index to a UK based investor was -10.70%, effectively cancelling the gain earned in the first three months of the year. All the main regional indices moved lower, the US by -10.37%, Japan by -8.73%. In Asia the regional index declined by -6.86%, although a number of the national indices actually moved higher. In contrast Europe was uniformly weak, falling by -14.32% but with the average masking falls of over 20% in Austria and Finland and nearly 40% in Greece. The UK equity performance was in line with its international peers, the FTSE All-Share Index returned -11.80%. Over the past twelve months the UK equity return is still positive, at +21.14%.
- Fixed interest markets benefited from the more cautious mood with government bonds (gilts) in particular finding support after a Budget which promised a swifter deficit reduction programme and a reduced level of new gilt issuance. Government bonds gave a positive return of +4.49%, lower quality corporate bonds +0.98%.
- Commercial property valuations improved although at a slower pace to that experienced earlier in the year. Buyers for good quality assets remain but they have become reluctant to chase prices at the higher levels.
- In currency markets the main feature was the weakness of the euro, against which sterling improved by +8.68%. This strength was not maintained against either the US dollar or yen however, which rose against the pound by +1.57% and +6.88% respectively.
- The dominant concern over the period was the problem of debt, on two levels. The first related to the scale of borrowings outstanding relative to the ability to repay them. These fears came to the fore with the Greek crisis but swiftly became more widespread, affecting the ability of banks but also some countries to access capital markets. The second related to the effect debt reduction programmes could have on what has so far been a lacklustre recovery in economic activity. The worry was that an increased focus on cutting government activity will cause a weak upturn to slow – or even go into reverse.
- Looking forward, we expect continued near term support for fixed interest markets but also for this to fade later in the year. Property values can improve further from current levels but the main attraction of the sector is the high level of income it currently provides. Equities are very good long term value but volatility will stay high and the range of fluctuations could test sentiment over the summer when trading volumes are usually thin.
- Diversification is critical and we expect that a high and consistent income flow will be an important contributor to overall returns in a low growth environment.

# Distributions for the Quarter

COIF Charities Fund	Distribution per Income Unit	Payment Date	
Investment Fund	10.23p	30/08/10	<ul style="list-style-type: none"> <li>The diversified portfolio structure and focus on quality has enabled us to maintain the income payment for the quarter. The payment is up by +3.11% over the past year.</li> <li>We expect to increase the distribution for 2010.</li> </ul>
Ethical Investment Fund	1.62p	30/08/10	<ul style="list-style-type: none"> <li>This is the second payment to investors since the launch of the Fund on 31st December 2009.</li> <li>The full year payment is estimated at 6.96p per unit.</li> </ul>
Global Equity Income Fund	1.60p	30/08/10	<ul style="list-style-type: none"> <li>The payment to investors is +2.56% on the previous quarter but is down over the past year due to differences in the timing of some receipts.</li> <li>The distribution for the full year is expected to show an increase.</li> </ul>
Property Fund	1.80p	30/08/10	<ul style="list-style-type: none"> <li>The payment has been maintained at the rate paid in the previous quarter, over the past 12 months the payment has risen by +3.06%.</li> <li>We expect to grow the income for the year as a whole.</li> </ul>
Fixed Interest Fund	1.80p	30/08/10	<ul style="list-style-type: none"> <li>The income payment to unit holders has again been maintained.</li> <li>Based on the price at the end of June and an annual distribution of 7.20p the income yield on the Fund is 5.59% and the gross redemption yield is 2.84%*.</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

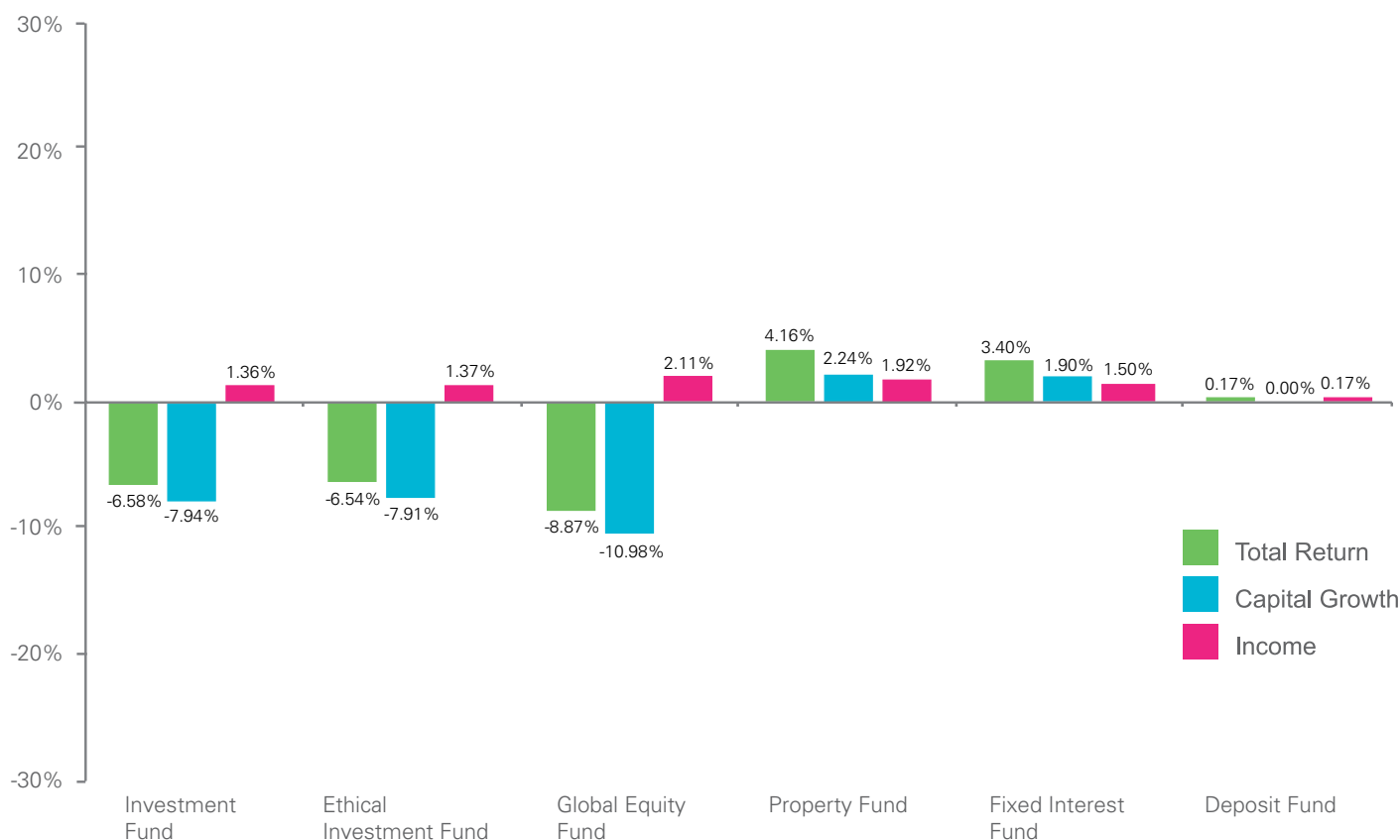
### COIF Charities Deposit Fund

Average interest rate over the quarter	0.50% (0.50% A.E.R.)**	<ul style="list-style-type: none"> <li>The interest rate payable on the Fund is ultimately dependent on the rates available in the money markets. Over the period these interest rates have been relatively stable.</li> </ul>
Interest rate at the quarter end	0.50% (0.50% A.E.R.)**	<ul style="list-style-type: none"> <li>The Fund is rated AAA/V1 by Fitch Ratings: this reflects the 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.

# Fund Performance

## COIF Charity Funds over the Quarter (gross)



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

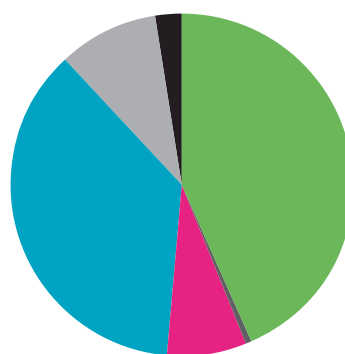
- Despite weakness in equity markets over the previous quarter, investment returns over the past year have been strongly positive with all major categories contributing to returns.
- Income flows have remained difficult however with low interest rates, falling property rental values and cuts in equity dividend payments in the UK and overseas. Despite this environment the distribution on the Fund has been maintained and is expected to increase for the year.
- Returns on the Fund have lagged those on the composite index over the past year, a continued echo of stock selection factors in 2009 and in particular a low relative exposure to recovery stocks in the mining sector. In the first half of 2010 returns are above those of the comparator.

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

	2010	2009	2008	2007	2006
Fund	+16.5%	-14.6%	-11.6%	+15.6%	+16.9%
Comparator	+20.5%	-16.1%	-10.5%	+15.0%	+16.8%

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

### Asset Allocation as at 30 June 2010



UK Equities 43.6%	Overseas Equities 36.7%
Fixed Interest 0.4%	Property 9.4%
Infrastructure 7.5%	Cash 2.4%

### Overseas Equities %

Europe	10.5
USA	11.3
Japan	3.4
Pacific Ex Jap	8.8
Other	<u>2.7</u>
	36.7

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 Ethical Investment Fund

- In the period since launch at the end of 2009 investment markets have been volatile but with overall returns slightly negative. Against this backcloth the returns on the Fund have exceeded those on the composite indicator.
- The Fund has announced its second income payment to investors and is on track to pay a distribution of 6.96p per Income Unit for 2010.

## COIF Charities Global Equity Income Fund

- A weak quarter for global equity markets has undone the progress made earlier in 2010, over the past 12 months however equities have shown strong positive returns.
- The income payment for the quarter has been increased but is lower on a 12 month comparison due to timing differences on receipts.
- Performance is below that of the comparator for the year, this reflects underperformance in 2009 predominantly by the high yielding companies which comprise the Fund's investment universe. Returns for 2010 to date are better than those on the comparator.

## COIF Charities Property Fund

The income payment has been maintained over the quarter but is +3.06% higher over the year.

- Property values have risen strongly from their lows 12 months ago although the pace of improvement has slowed in more recent months.
- The Benchmark return data is not available as we go to print but our expectation based on early estimates is that the portfolio has continued to outperform.

## COIF Charities Fixed Interest Fund

- The income payment on the Fund has again been maintained at 1.80p per Income Unit, we expect this to be true for the year as a whole.
- The overall trend in fixed income markets has been positive and although corporate bonds were strongest early in the period, more recently government bonds have rallied.
- The performance of the Fund has been in line with the Benchmark.

## COIF Charities Deposit Fund

- Short term interest rates have remained low with Base Rates held at 0.5% since March 2009.
- We expect this trend to continue to help stimulate economic activity at a time of cuts in government spending.
- There are occasional offers of premium interest rates from various institutions but our focus on capital security means that often these do not meet our lending criteria.

Past performance data will be shown once the Fund has existed for 12 months.

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

	2010	2009	2008	2007	2006
Fund	+15.2%	-14.3%	n/a	n/a	n/a
Comparator	+21.1%	-20.5%	n/a	n/a	n/a

Comparator – FTSE All-Share Index

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

	2010	2009	2008	2007	2006
Fund	+30.9%	-25.5%	-14.2%	+15.9%	+19.7%
Benchmark	n/a	-25.0%	-13.8%	+13.0%	+21.3%

Benchmark – IPD Monthly & Quarterly Valued Funds Excluding the Smallest & Largest 5% (Current Quarter Not Yet Available)

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

	2010	2009	2008	2007	2006
Fund	+8.6%	+10.9%	+5.9%	-0.4%	+1.7%
Benchmark	+8.7%	+11.1%	+5.1%	-0.8%	+1.3%

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

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

	2010	2009	2008	2007	2006
Fund	+0.7%	+3.9%	+6.1%	+5.3%	+4.7%
Benchmark	+0.5%	+2.5%	+5.7%	+5.2%	+4.6%

Benchmark – 7 Day LIBID

# Strategy and Outlook

## COIF Charities Investment Fund and the COIF Charities Ethical Investment Fund

These two funds have similar objectives and follow similar strategies, they differ in the ethical and responsible policies followed which will create some differences in the portfolios of stocks held.

- The investment objective of the Funds is to provide investors, over the course of the business cycle, with an average annual total return of inflation +5%, whilst maintaining the real value of the income paid.
- The Funds' portfolio has a high weighting to those assets which over time are most likely to provide strong returns and a rising income. These include equities, at home and overseas, property and infrastructure.
- A feature of the portfolios is a relatively high exposure to international markets. This increases significantly the range and number of investment opportunities and gives exposure to economies enjoying faster rates of growth than the UK. Currency techniques are used to moderate the effects of changes in exchange rates.
- The Funds have a low exposure to fixed income markets; this reflects concerns that current yields are unattractive on a longer term view.
- Our expectation is that we will increase the income payment to investors for the current year for the Investment Fund. We expect the payment on the Ethical Investment Fund to match the forecast amount.

## COIF Charities Global Equity Income Fund

- The investment objective of the Fund is to provide investors with a high and growing income from a portfolio of global equities.
- The portfolio is constructed on the basis of the appeal of the individual equities under consideration and is not limited by any pre-determined allocation to any country or industry. This means that the portfolio construction will usually differ significantly from the major stock market indices, typically with a bias towards stocks and sectors which are currently out of fashion.
- Equity markets have eased back and are not expensive on a medium to long term view, we expect to keep cash holdings low and maintain a fully invested position.
- We expect to increase the income payment to investors for the current year.

## COIF Charities Property Fund

- The Fund seeks to provide investors with a high income, growing over time and some capital growth.
- Although the pace of valuation improvement has slowed this year after the swift recovery in the later months of 2009, we expect growth to continue a little longer. A sustained upturn however will need support from stronger occupier markets.
- The main attraction of the sector currently is therefore the high income it can provide from secure assets let to good quality tenants. We currently favour the industrial and retail warehouse segments of the market.
- We expect to increase the income payment to holders this year.

## COIF Charities Fixed Interest Fund

- The Fund aims to provide investors with a high and secure income from a portfolio comprising of UK government and corporate bonds.
- Bond markets have rallied in recent weeks following a Budget which promised a swifter reduction of government debt and a smaller flow of new bonds on to the market. Another positive factor has been fallout from the problems in the Euro zone as investors, cautious of those markets, have increased their allocations to the UK.
- We expect these factors to continue to support the market in the near term but then for prices to ease under the pressure of a reduced, but still very substantial, new issuance programme.
- We expect to adopt a slightly defensive strategy and maintain the current exposure to the higher yielding corporate bond sector.

## COIF Charities Deposit Fund

- The prime objective of the Fund is capital safety and security. The portfolio is invested only in bank deposits and does not hold securities or derivatives. The deposits are made to an approved list of high quality borrowers and on any typical day investments will be spread between 20-30 names to boost security even further.
- We expect official rates to stay at very low levels for the near term and this will be the dominant influence on the rate paid to depositors. From time to time higher rates are on offer in the market place but too often these are from borrowers which do not meet our credit standards.

# 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 based on our 2008 client survey.
- 3 Proxy voting on corporate governance issues to protect shareholder value.
- 4 Selecting some investments that deliver social or environmental benefits plus market-level risk-adjusted returns.
- 5 Integrating appropriate risk factors into stock selection.

## Quarterly Highlights

- In early April 15% of BP's shareholders abstained or voted against management in relation to the Canadian tar sands resolution that was co-filed by church, charity and co-operative investors (including the COIF Funds) to highlight risks to long-term shareholder value of unconventional oil. An engagement meeting with BP board representatives has been arranged for the autumn.
- We decided to abstain at the Shell AGM, despite having co-filed the tar sands resolution. Shell's scenario work and practice of building a strategy that is resilient to plausible energy futures underpinned this decision. We would, however, welcome a move to collaborative scenario work undertaken with major investors.

## Voting in more detail

- Historically CCLA has only voted at UK company meetings. Given that equity portfolios have become more global in recent years this domestic focus is no longer satisfactory from a stewardship perspective.
- We have worked with other like-minded investors to develop a cost effective way of working together through two proxy voting providers. This has allowed us to continue to reflect charity-specific concerns about corporate governance and executive remuneration, whilst following global best practice in other areas.
- Global voting started in May. CCLA's quarterly record for the 1,187 UK resolutions voted was 14% abstentions or votes against management (mainly remuneration related).

## Ethical constraints

- We confirm that the funds have been managed to the new client-driven policies this quarter.
- 8.7% of the FTSE All-World Developed Index by market capitalisation was excluded from the new Ethical Fund, and only 2.8% for the other COIF Funds with exposure to corporate securities. In the latter case this is almost entirely driven by company involvement in weapons banned by international treaties or the tobacco screen.

## Focus on the new UK Stewardship Code for Institutional Investors

### In Summary:

- The UK Stewardship Code is the investor equivalent of the UK Corporate Governance Code for listed companies.
- Both codes are applied on a "comply or explain" basis.
- The stated purpose of the new code is to "improve the quality of corporate governance through promoting better dialogue between shareholders and company boards, and more transparency about the way in which investors oversee the companies they own".

## The Seven Principles in the UK Stewardship Code

"Institutional Investors should:

- 1 Publicly disclose their policy on how they will discharge their stewardship responsibilities.
- 2 Have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
- 3 Monitor their investee companies.
- 4 Establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.
- 5 Be willing to act collectively with other investors where appropriate.
- 6 Have a clear policy on voting and disclosure of voting activity.
- 7 Report periodically on their stewardship and voting activities".

## Background:

- The new code was one of the recommendations made by the Walker Review of corporate governance of UK banks. This 2009 review was commissioned by HM Treasury following the recent financial crisis.
- Sir David Walker noted that "institutional investors should be less passive and prepared to engage earlier if they suspect weaknesses in governance. They enjoy the privilege of limited liability whereas taxpayers have ended up assuming unlimited liability in respect of the big banks. Early preventive medicine through shareholder engagement can save everyone substantial time and money later on."
- The programme underpinning the new client-driven COIF Funds' responsible investment policies was designed in anticipation that a Stewardship Code would be introduced this year. Examples include our focus on systemic risks to shareholder value like climate change, the shift to global voting, and our strong support for carefully prioritised collaborative engagement.

## What next?

- In line with the Financial Reporting Council's timeline our statement outlining the extent to which we comply with the code will be available by the end of September.
- For further details about the new UK Stewardship Code, which was launched on 2nd July, see [www.frc.org.uk](http://www.frc.org.uk).



for Charities

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