

QUARTERLY BULLETIN

30 June 2011

Note from the Chief Executive of CCLA The outlook for interest rates

Cash is a critical part of many charity portfolios, indeed for many it is the only asset held. Battered by low interest rates for an extended period, many trustees are hoping for respite in the months ahead, but how realistic is this? I thought that I should set out our thoughts on this important topic.

Base rate has been at the present level of 0.5% since March 2009. The changing economic climate over this period has prompted occasional speculation about an imminent rise but each has proved false, despite a sharp increase in inflation. CPI inflation at 4.2% sits uneasily with a target of 2.0% and although the current high level has been blamed on transient factors beyond the Bank of England's control, the rate has been persistently above the target, so clearly we are experiencing something more substantial in nature. In fact the inflation rate is expected to get worse before it gets better, and is expected to exceed 5% at its peak in the Autumn. In these conditions, given the Bank's clear mandate, you would expect interest rates to increase, but there is no consensus within the Bank's Monetary Policy Committee that they should do so.

A key reason for this is the growth trend in the economy. Although prices are moving higher the effect on activity is actually deflationary as higher fuel and food prices erode the ability to spend on other items and act as a drag on growth. This is reflected in a decline in disposable income in the year to March, down by 2.7% under a twin attack of higher prices and higher taxes which is not being compensated by higher wages. Overall wage growth is just 2.5%, with no growth at all in public sector incomes. It can be no surprise that despite a fall in the savings rate there are clear difficulties on the High Street and the housing market outside London and the South-East is in broad decline.

The malaise in the consumer sector is reflected in the economy as a whole. Over the final quarter of 2010 and the first of 2011, activity showed no growth at all, and looking forward the prospects for growth are modest. Little improvement can be expected in consumer activity and increasingly the effects of expenditure cuts will be felt. The cuts, plus tax increases, will create a headwind for growth of more than 1% per annum, potentially offsetting much of the growth momentum achieved so far in the recovery.

In our view it is the weakness of the economy which is the dominant consideration in this debate. The policy imperative to reduce the deficit is based on three initiatives; spending cuts, tax increases and a level of economic growth. Raising interest rates in the current environment therefore risks making a difficult task much harder. This means that, whether or not there is a cosmetic adjustment to rates later this year or in the early months of 2012, they will remain at very low levels and importantly for those holding cash, far below the rate of inflation.

Of course there are institutions offering more than base rates for cash deposits. Some of these have low credit ratings and simply have to pay more for their finance. Others, in a changing world, are seeking term deposits in the hope that by paying a little more they can achieve certainty for themselves and transfer risks to lenders. A better way of improving returns is not to take risks with cash but to use assets efficiently, ensuring that only spending needs are matched by cash, with funds available for the longer term invested in an appropriate blend of long term assets. This will bring an immediate improvement in income, provide a defence against inflation and create a platform for long term growth in values.

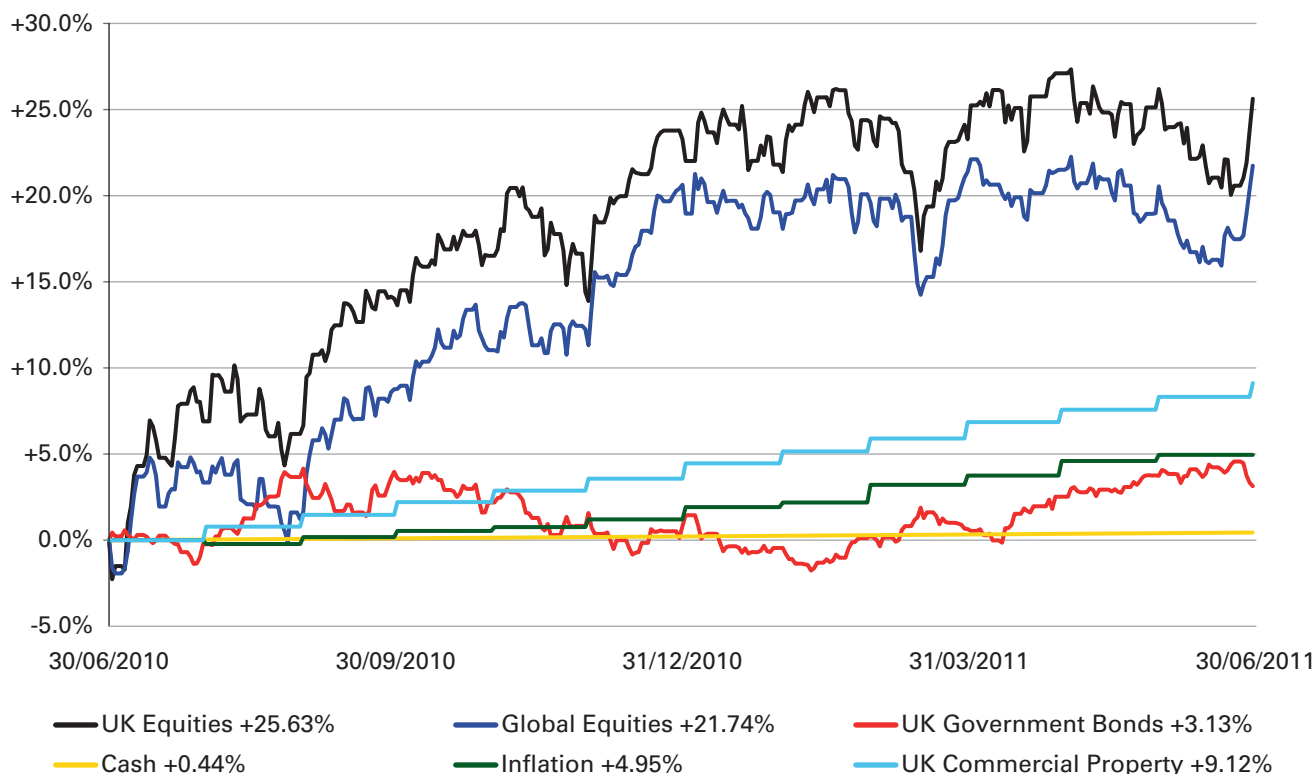
Michael Quicke



for the Church of England

Market Review & Outlook

Markets at a Glance - 12 Months to 30 June 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 (*Latest monthly return estimated by CCLA).

Market Review & Outlook

- Most international equity markets made headway over a quarter of volatile day to day returns. The FTSE All-World Index gave a return of +0.29% in sterling terms to bring the return for the year to date to +2.34% and for the past 12 months to +21.74%. Of the regional FTSE indices Europe performed best, with a gain of +3.18%, despite a sharp fall in the Greek indices (-16.75%). Returns from Japan were positive at +0.20% but were slightly lower in local currency terms. The US and Asian markets were fractionally lower, by -0.03% and -0.11% respectively. In Asia concerns of economic overheating saw profit taking in India and China, the region's weakest performers. The UK market returned +1.91%. Medium sized companies were the strongest size cohort. Value stocks outperformed growth but the differences were minor.
- Fixed interest returns were uniformly positive, supported by safe haven buying, as the Portuguese and Greek financial crises troubled sentiment and by economic data which suggested that growth rates were slowing. The gains were achieved despite poor inflation data which showed that price rises were continuing to increase at a pace far above the Bank of England's target rate.
- Commercial property returns were positive but gains were derived almost entirely from income. Overall capital values were little changed but this masked a divergence between the resilience of, good quality income secure properties and more secondary locations where there were clear signs of weakness. Occupier markets remained difficult in many areas.
- In currency markets sterling improved slightly against the dollar (+0.16%) but lost value more substantially against the euro (-2.22%) and yen (-2.93%).
- Economic growth continued in the developed economies but at a moderating pace, restrained by full stock pipelines, higher commodity prices and supply shortages resulting from the Japanese earthquake. Despite slower growth governments continued to normalise economic policy. Interest rates were increased in Europe, with another rise in early July. In the USA the quantitative easing programme (QEII) was allowed to conclude as planned. The quarter began and ended with a sovereign debt crisis. Portugal was granted a €78 billion support package on conditions of economic reform and austerity measures. Greece too sought assistance, as earlier expectations of a return to commercial borrowing were revealed as hugely optimistic. A conditional release of funds has relieved immediate liquidity fears but the scale of debt is such that market expectations are for a default in time.
- We expect economic output to continue to expand, but at a moderate pace. Inflation in the UK will remain high and is expected to exceed 5% at the peak in the Autumn. Despite this interest rates will stay low and negative in real terms by a significant margin. This is not a supportive environment for fixed interest stocks and so we expect bond yields to rise in the period ahead. It is premature to expect growth in commercial property values, these remain in the future, but in the meantime investors in the sector can expect a strong return from income. Our expectation for global equities is that they will move higher over time, supported by rising profits and higher dividends. Volatility however is expected to remain at high levels and there are clear risks of a short term shock to sentiment from a number of potential sources.

Distributions for the Quarter to 31 May 2011

The CBF Church of England Fund	Distribution per Income Share	Payment Date	
Investment Fund	13.00p	30/06/11	<ul style="list-style-type: none"> This distribution is at a similar rate to that paid at the equivalent period last year. The payment for the past 12 months is 3.00% higher. At the end of the quarter the yield on the Fund was 4.27%, this compares with a yield of 2.99% on the FTSE All-Share Index.
Global Equity Income Fund	1.70p	29/07/11	<ul style="list-style-type: none"> The payment for this quarter is unchanged, over the past 12 months the payment is 2.91% higher. As at the quarter end the income yield on the portfolio was 4.78%, this compares with a yield of 2.99% on the FTSE All-Share Index.
UK Equity Fund	1.37p	29/07/11	<ul style="list-style-type: none"> There is no change to the income payment for this quarter. The income for the past 12 months is 2.97% above that for the equivalent payment in 2010. As at 30th June the income yield on the portfolio was 4.30%. The comparable yield on the FTSE All-Share Index was 2.99%.
Property Fund	2.00p	29/07/11	<ul style="list-style-type: none"> The income payment is unchanged on that for the equivalent period last year. Over the past 12 months the income payment is 2.00% higher. At the quarter end the income yield on the Fund was 6.67%, the equivalent yield on the IPD Balanced Property Unit Trust Index was 4.50% as at 31 March.
Fixed Interest Securities Fund	2.20p	29/07/11	<ul style="list-style-type: none"> There is no change in the income payment on the Fund. Based on the price as at 30th June the income yield on the Fund was 5.70%, the gross redemption yield 2.82%*.

*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.

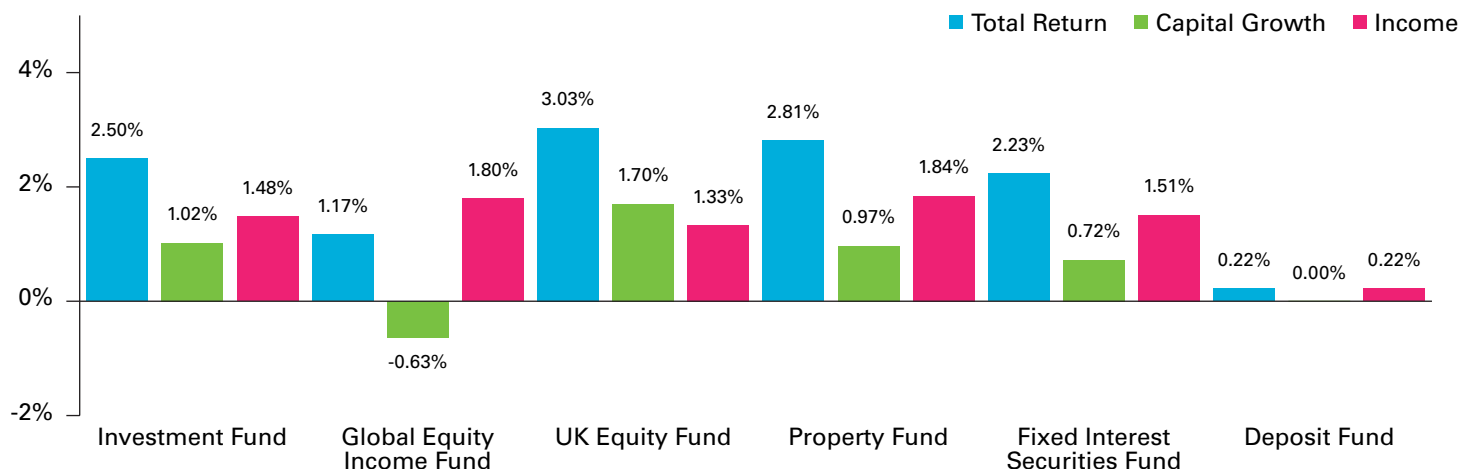
Interest for the Calendar Quarter to 30 June 2011

The CBF Church of England Deposit Fund

Average interest rate over the calendar quarter	0.70% (0.70% A.E.R.)**	<ul style="list-style-type: none"> The interest rate payable on the Fund will ultimately reflect the rates available from top quality borrowers in the money market. Over the period it has been possible to increase the rate payable to investors.
Interest rate at the calendar quarter end	0.70% (0.70% A.E.R.)**	<ul style="list-style-type: none"> The Fund is rated AAA/V1 by Fitch Ratings. This reflects the quality of the lending portfolio and its low volatility.

**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

The CBF Church of England Investment Fund

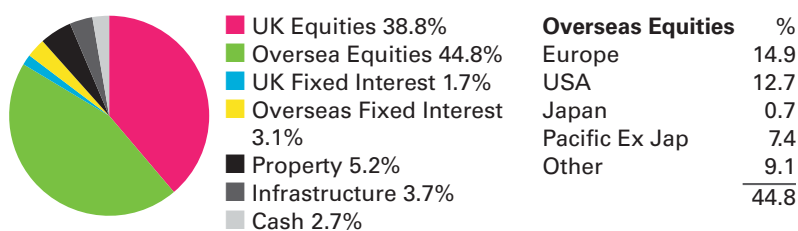
- Investment markets rose over the quarter with equities, bonds and property all contributing to the rise in value of the Fund. Over the past twelve months returns have been very good indeed and substantially above inflation.
- Low interest rates and bond yields contributed to continued challenges in investment income generation. The payment to investors has nevertheless been maintained and is up over the past year.
- Fund returns have been in line with, but a little below the comparator index over the 12 month period, they are stronger over the most recent quarter.

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

	2011	2010	2009	2008	2007
Fund	+19.8%	+17.2%	-14.9%	-11.0%	+15.3%
Comparator	+20.9%	+20.4%	-16.1%	-10.5%	+15.0%

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 2011



Overseas Equities	%
Europe	14.9
USA	12.7
Japan	0.7
Pacific Ex Jap	7.4
Other	9.1
	44.8

The CBF Church of England Global Equity Income Fund

- Global equity markets were mixed over the quarter with returns for a UK investor pushed into positive territory by currency translation factors. Returns over the past year have been very strong with only Japan failing to provide gains comfortably in double figures.
- Dividends have remained under pressure; the income distribution on the Fund however has been maintained.
- Fund returns have been in line with the comparator over the past year and ahead of the FTSE All-World Index.

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

	2011	2010	2009	2008	2007
Fund	+24.2%	+16.3%	-13.4%	n/a	n/a
Comparator	+25.6%	+21.1%	-20.5%	n/a	n/a

Comparator – FTSE All-Share Index.

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)

The CBF Church of England UK Equity Fund

- The UK equity market has moved slightly higher over the quarter but has shown strong growth over the past year, at a pace substantially above the inflation rate.
- The most severe pressures on dividend flows have eased but growth is still hard to find. The payment on the Fund has been maintained.
- Relative performance of the Fund has been strong over the quarter and over the past year.

The CBF Church of England Property Fund

- Sector returns have been positive over the quarter but overwhelmingly this has been due to income payments, capital values are little changed.
- Rental trends have shown a strong divergence between prime areas, which have been resilient and secondary locations where levels have been falling.
- At the time of writing the returns on the benchmark are not available.

The CBF Church of England Fixed Interest Securities Fund

- Returns from the fixed interest markets have been positive over both the past quarter and year. Support has come from investors seeking to boost income and from those seeking a safe haven in a challenging environment.
- Income payments have been maintained, we expect the payment for the year as a whole to match that for 2010.
- The returns on the Fund are in line with those of the benchmark over both the latest quarter and the past year.

The CBF Church of England Deposit Fund

- Official base rates have been held at 0.5% since May 2009, over the period expectations for when rates will rise have been pushed into the future.
- The Fund has maintained a slight premium income over official rates by lengthening the term of the deposits. There has been no reduction in the focus on the quality of the portfolio.
- Interest rates are expected to be unchanged in the period ahead.

Longer term total return performance (gross)

12 months to end June:

	2011	2010	2009	2008	2007
Fund	+28.6%	+21.5%	-24.1%	-12.1%	+17.1%
Benchmark	+26.0%	+20.1%	-22.0%	-13.5%	+17.6%

Benchmark – FTSE All-Share Index Adjusted for Ethical Restrictions.

Longer term total return performance (net)

12 months to end June:

	2011	2010	2009	2008	2007
Fund	+7.1%	+26.2%	-23.9%	-13.0%	+14.8%
Benchmark	n/a	+18.8%	-29.5%	-17.2%	+13.8%

Benchmark – IPD Balanced Property Unit Trust Index (Current Quarter not yet available).

Longer term total return performance (gross)

12 months to end June:

	2011	2010	2009	2008	2007
Fund	+3.6%	+8.5%	+10.1%	+5.3%	-0.2%
Benchmark	+3.7%	+8.7%	+11.1%	+5.1%	-0.8%

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

Longer term total return performance (gross)

12 months to end June:

	2011	2010	2009	2008	2007
Fund	+0.8%	+0.7%	+4.0%	+6.1%	+5.3%
Benchmark	+0.5%	+0.5%	+2.5%	+5.7%	+5.2%

Benchmark – 7 Day LIBID.

Strategy and Outlook

The CBF Church of England Investment Fund

- Our central expectation is that the world economy will continue to grow although for the developed nations the rate of growth will be modest.
- We consider equities to be good value against a backdrop of economic expansion and rising profits and it is this asset class which constitutes the main part of the portfolio. We have a high representation in economies which we expect to perform more strongly than the UK.
- An environment of high and sticky inflation and low bond yields is not supportive of fixed interest investments and so we have adopted a cautious stance to this sector, concentrating on high yielding specialist parts of the market.
- The background to investment is one where relatively high levels of day to day volatility must be expected in the near term, however, looking beyond current headlines, we expect investment markets to make further progress.

The CBF Church of England Global Equity Income Fund

- The focus on income will mean that the portfolio has a shape and structure which, in terms of the companies held and the sector and country weightings will differ substantially from those of conventional capitalisation based investment market indices.
- Within the portfolio there were weightings greater than those in the main market indices in sectors including pharmaceuticals and financials including non-life insurance and property. There were lower weightings in mining and oil and gas and in consumer related sectors such as automobile manufacture.
- In geographical terms the Fund has a relatively high exposure to the UK, Europe and emerging markets balanced by below index exposures to the United States and Japan.

The CBF Church of England UK Equity Fund

- The Fund invests in good quality UK equities able to provide capital growth and a rising income over time. There is no pre set allocation to stocks or sectors beyond that from a prudent adherence to risk control. In current conditions the portfolio is biased towards companies with strong franchises and good cash flows from which to invest and pay income to investors.
- Within the portfolio the exposure to mining and oil and gas is below that of the broad market, there are above average weightings to financials, utilities and, within the consumer sectors, to media companies.
- We expect the UK equity market to progress in the period ahead, supported by profit growth and by current low valuations. Given the uncertainties in the world economy however the path is unlikely to be smooth.

The CBF Church of England Property Fund

- The Fund provides investors with an exposure to the commercial property sector which is diversified by both market sector and geographical region, within the UK. The portfolio is invested in good quality assets which can provide investors with a high income, growing over time, and capital growth.
- The portfolio is actively managed in that the managers seek to add value by lease management and site and structural improvements. We look for good quality assets which can be bought at a discount to long term value and which can provide a secure flow of income.
- In order to protect the income on the Fund from the effect of low interest rates, cash weightings are typically kept at low levels.

The CBF Church of England Fixed Interest Securities Fund

- The prime objective of the Fund is to provide a high and consistent income flow from a portfolio of good quality government and corporate bonds.
- The portfolio has a relatively defensive structure at the moment, reflecting our cautious view of the prospects for this sector of the market. We favour shorter dated bonds which are less exposed to changes in investor sentiment. Corporate bonds, which account for over 30% of the invested assets, are a source of premium income.

The CBF Church of England Deposit Fund

- The prime objective of the Fund is to provide a high level of security for cash investments, one with a competitive rate of interest and from which customers can enjoy easy access to their investment cash. Investments are made only with an approved list of high quality borrowers and we use only bank deposits and call accounts. We avoid taking risks in exchange for a modest improvement in income flows.
- Interest rates are expected to remain at very low levels - and below the level of inflation - in the period ahead.

Responsible Investment Report

Our work has five strands:

- 1 Engagement, focused on social and environmental issues in the context of Christian mission and witness.
- 2 Setting appropriate constraints on investment and exposure to activities considered unacceptable by the Church of England's Ethical Investment Advisory Group (EIAG) and the CBF Funds Trustee.
- 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

- The EIAG ratified the appointment of James Featherby, author of "The White Swan Formula: Rebuilding business and finance for the common good", as its new Chair (from January 2012). Until recently James was a partner of one of the City's leading law firms.
- The EIAG's 2010/11 annual review has been distributed to General Synod, and the Church's new alcohol policy has also been announced.

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 2,371 resolutions voted across all markets was 15.7% abstentions or votes against management (mainly remuneration related).
- This quarter we sent 87 letters to companies outlining our concerns, with 23 responses to date.
- We joined 34% of Reckitt Benckiser's shareholders in not supporting the remuneration report. We have several concerns about how bonuses are rewarded.
- At Johnson & Johnson we opposed the re-election of five directors for several reasons, including lack of board independence and a combined chair and chief executive.
- The EIAG has triggered a review of its corporate governance and executive remuneration policies.

Ethical constraints

- The EIAG is currently undertaking a comprehensive review of some of the restricted investment categories (currently high interest rate lending and pornography). This process is supported by the CBF Funds Trustee, and clients are invited to send comments to the Secretary (edward.mason@churchofengland.org)
- 5.4% of the FTSE All-World Developed Index by market capitalisation was restricted from investment this quarter.

Focus on the Church's new Alcohol Investment Policy

Background and summary:

- 1 Since 1998 investment has been permitted in some companies that have diversified away from brewing into catering, accommodation etc, but any company generating more than 25% of its turnover from the production or sale of alcoholic drinks has remained restricted.
- 2 The new policy is based on alcohol being a gift of God in creation to be enjoyed in moderation but not abused.
- 3 The focus of the new policy will be corporate complicity in alcohol abuse, and supermarkets not reaching minimum standards could also be restricted in future.
- 4 The EIAG expects to make its first recommendations on which companies to exclude from investment under the new policy in 2013.

Extracts from the June press release:

- A new ethical investment policy on alcohol has been adopted by the Church of England investing bodies following advice from the EIAG.
- The EIAG - concerned about the continuing negative health and social consequences of the misuse of alcohol - recommended continued restrictions on investment in companies involved in the production and sale of alcoholic drinks.
- General retailers such as supermarkets have been brought within the scope of the policy for the first time.
- John Reynolds, Chair of the EIAG, said "we are concerned about corporate complicity in the misuse of alcohol, including through inappropriate pricing and promotions. Institutional investors don't talk to the supermarkets about this and our old policy had no teeth because we couldn't divest from a supermarket. We want to use our influence to bear down hard on poor corporate practice and to encourage good practice."
- The new approach will involve the EIAG defining minimum standards of corporate responsibility that it expects from companies deriving more than 5% of their revenues from alcoholic drinks.
- The policy will be implemented in partnership with CCLA because it is based on a policy developed for the charity funds we manage following a 2007/8 client survey.
- Policy implementation will be supported by an advisory group whose members will include experts associated with health, youth, and law and order charities.

Further detail and future reviews:

- EIAG recommended policies that have been accepted by the national investing bodies are available at: www.churchofengland.org/about-us/structure/eiag



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