

QUARTERLY BULLETIN

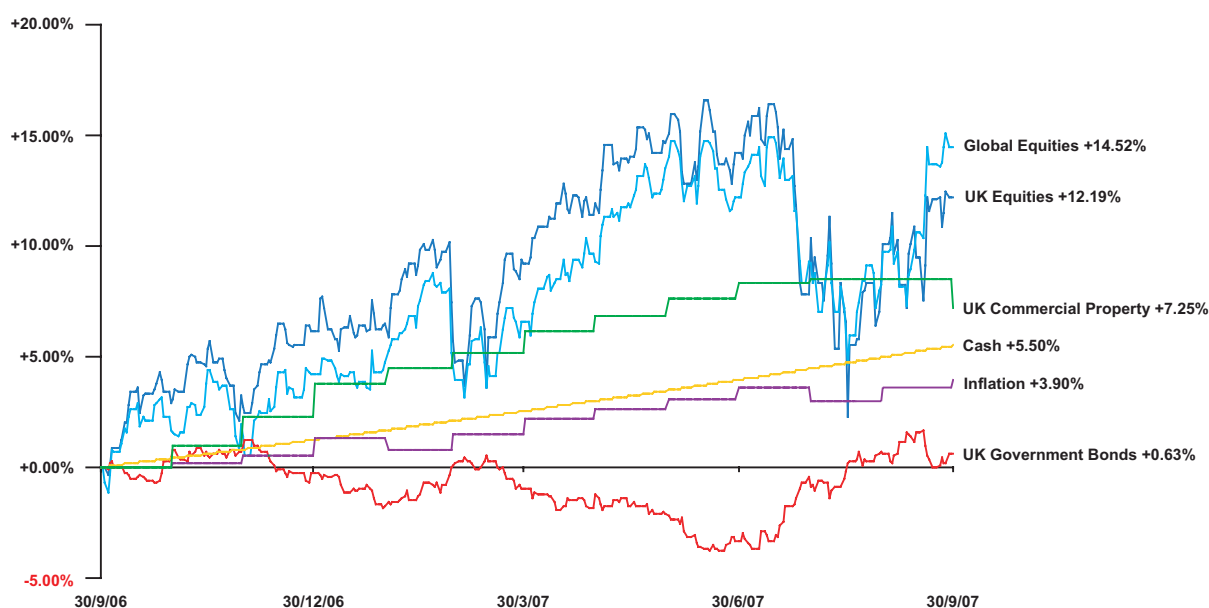
30th September 2007



for the Church of England

Markets Review and Outlook

Markets at a Glance - 12 Months to 30 September 2007



Sources: Bloomberg, Datastream, IPD: FTSE All-Share Total Return Index, FTSE All-World Total Return Index, UK Govt All-Stocks Total Return Index, IPD Monthly Total Return Index, 7 Day LIBID, Retail Price Index.

Market Review & Outlook

- For a number of years, global economic activity has been somewhat out of balance. Growth has been driven by rising consumption in developed economies such as the US and the UK on the one hand and rising production in developing economies such as China and India on the other.
- As a result of this imbalance, huge flows of money have gone to the developing economies of the world. Much of this has been invested internationally rather than spent in home markets with a large proportion finding its way into secure assets such as bonds. This has driven the price of bonds up to levels that may seem at odds with underlying economic fundamentals and a number of other markets have seen price distortions.
- The rise in bond prices has reduced the cost of borrowing. This has supported consumer spending, housing markets and the private equity industry. In the search for returns in a low interest rates environment both lenders and borrowers have been prepared to take risks that they might normally have declined.
- During the quarter, markets became aware of the adverse consequences of lax lending policies as declines in the over-extended US housing market exposed the frailty of 'sub-prime' mortgage loans in circumstances where some borrowers had so called 'ninja' mortgages - as in no income, no job, no assets.
- The problems from sub-prime loans were not confined to the companies which gave the mortgages because most of the loans were packaged up, often using innovative derivative based structures, and sold on to other financial institutions. As it was unclear where the exposure to potential sub-prime losses lay and because the scale of risk exposure was far higher than the loans themselves due to gearing and derivatives, a crisis of confidence developed in the entire financial sector. This made major banks and other institutions unwilling to lend to one another which effectively removed the daily liquidity which lubricates the financial system.
- Central banks, such as the US Federal Reserve, acted quickly by providing funds to the market and cutting interest rates. This certainly averted a crisis, although the near-failure of Northern Rock revealed how difficult conditions can turn.
- The immediate impact of the 'sub prime' crisis on investment markets was a sharp increase in turbulence and a 'flight to safety' with Government bonds moving higher. However when it became apparent that markets were to be bailed-out by central banks, confidence was largely restored and after a spike downwards, 'risky' assets such as equities began to recover.
- The underlying problems of economic imbalance remain, but look unlikely to trouble markets while central banks are able to provide support. Whether this benign set of circumstances can continue however remains to be seen; economic growth is robust and if inflation were to rise, the pressure to raise interest rates would be substantial.
- Looking forward, equity markets are not expensive in terms of historic valuations and should be supported by companies' earnings and cash flows. However as the global economy slows, we expect that there will be an increasing worldwide focus on the quality of companies and their ability to pay and sustain good dividends.
- For now bonds are buoyed by the prospect of lower interest rates but there are risks that inflationary pressures will rise, undermining returns.
- We expect that commercial property prices will fall back in the face of low transaction volumes, but that over time the prospect of attractive rental growth will support prices, with superior performance associated with higher yields and yield growth.

Distributions for the Quarter to 31 August 2007

**The CBF
Church of
England Fund**

**Distribution
Per income
share Date**

Fund Income

Investment Fund	10.5p	28/09/07	<ul style="list-style-type: none"> A dividend of 10.5p per Income Share was declared for the three months to 31 August 2007. It is anticipated that the distribution for the full year will be at least 38.0p, and that the Fund income and distributions will be increased substantially on a sustained basis through 2008, whilst maintaining full focus on growing the underlying capital for the long term.
Fixed Interest Securities Fund	2.2p	31/10/07	<ul style="list-style-type: none"> A dividend of 2.2p per Income Share was declared for the three months to 31 August 2007. The Fund provides an income yield of 5.75%, based upon an Income Share price of 153.00p and an annual distribution rate of 8.8p. The corresponding gross redemption yield is 4.85%*.
Property Fund	1.8p	31/10/07	<ul style="list-style-type: none"> A dividend of 1.8p per Income Share was declared for the three months to 31 August 2007. The total distribution for the last twelve months rose to 7.05p per Income Share, representing an income return of 4.3%. The income reserve was utilised to support the increased dividend payment and to smooth dividend payments. Work is ongoing to improve Fund income whilst optimising total returns.
UK Equity Fund	1.1p	31/10/07	<ul style="list-style-type: none"> A dividend of 1.1p per Income Share was declared for the three months to 31 August 2007. It is anticipated that the distribution for the full year will be at least 4.1p, and that the Fund income and distributions will be increased substantially and on a sustained basis through 2008, whilst maintaining full focus on growing the underlying capital for the long term.

The CBF Church of England Deposit Fund

Average interest rate 5.66% over the calendar (5.78% A.E.R.)** quarter

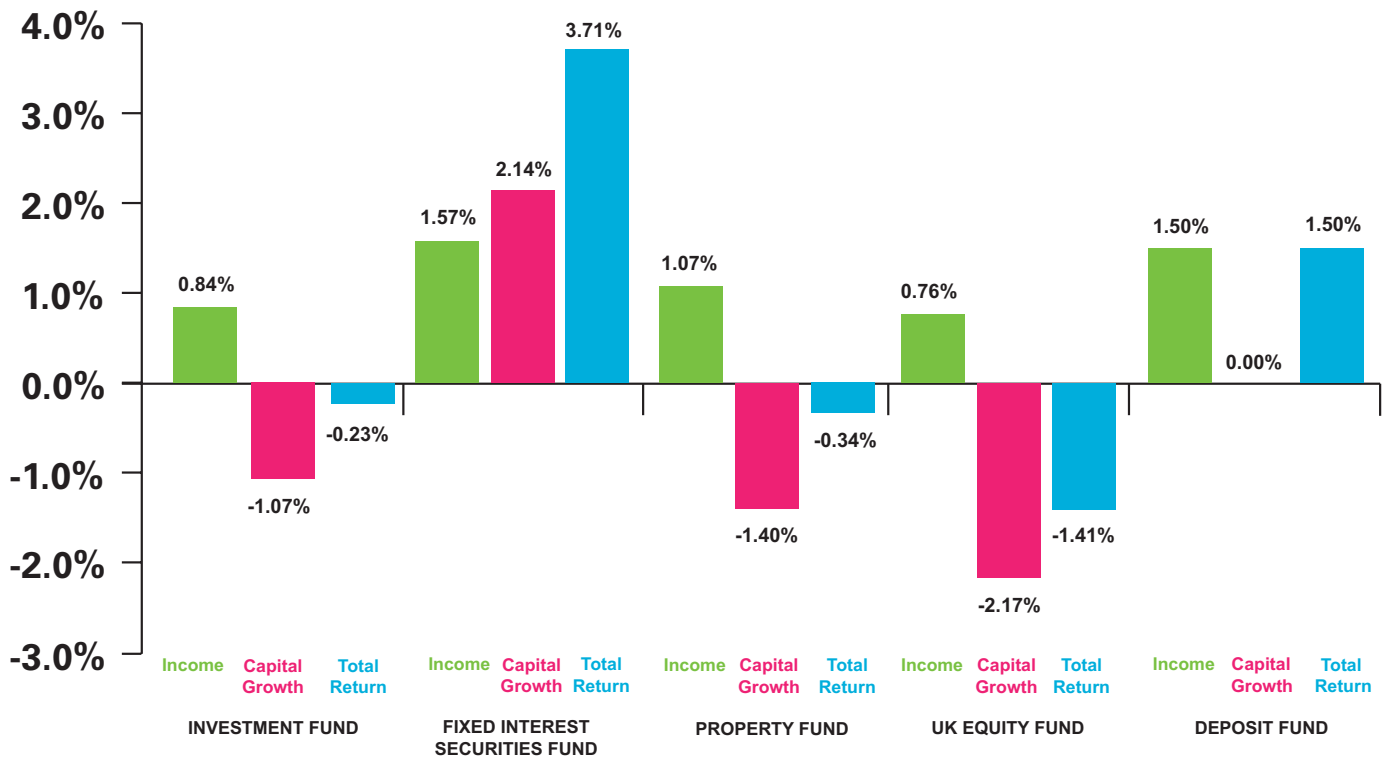
Interest rate at 5.88% the calendar quarter (6.01% A.E.R.)** end

- The declared interest rate on the Fund at the 30 September was 5.88%, 6.01% A.E.R.**.

* 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.

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

Fund Performance The CBF Church of England - 3 months to 30th September 2007 (gross)



Performance Comment

The CBF Church of England Investment Fund

- The Fund's distribution met forecasts, with the increased payout supported by underlying earnings coming in at least in line with expectations.
- In terms of capital value movements and total returns, the only parts of the global investment markets providing strong positive returns were emerging market equities and Government bonds, with the latter reversing losses made in prior months rather than making sustained forward progress.
- The Fund fell back slightly over the quarter as a result of the market turbulence but encouragingly the Fund's UK equities, non-UK equities, real estate and gilts all outperformed their respective market benchmark indices.

The CBF Church of England Fixed Interest Securities Fund

- As a consequence of the financial turmoil, total returns from gilts were positive across all maturity sectors this quarter, whilst the returns from corporate bonds which had been strong, fell back due to a demand for increased risk margins relative to government securities.
- Over the three month period to end September, the Fund has outperformed shorter dated gilts (3.71% for the Fund vs 2.99% for the FTSE Under 5 Year Index), but with long dated stocks bounding ahead (FTSE Over 15 Year Index up 4.57%) despite offering lower yields and more risk against inflation, the Fund marginally underperformed the FTSE UK Government All Stocks Index, which returned 4.07%.

The CBF Church of England Property Fund

- Whilst property as an asset class fell back by some 1.73%, as measured by IPD based on their monthly valued funds universe, the CBF Fund fell rather less, down 0.34% before charges.
- The CBF Fund escaped the worst of the markdown due to the focus on rental value growth, and the Fund benefited from its overweight position in Central London office property particularly in the West End, the strongest sub-sector of the market.
- The retail warehouse holdings also held up well in a more difficult performance environment.

The CBF Church of England UK Equity Fund

- The Fund outperformed the FTSE All-Share Index during the quarter, but by falling by less than equities overall rather than by making additional forward progress.
- The principal source of outperformance was stock selection rather than sector selection, and most notably in diverse areas such as banks, travel and leisure and household goods. This was a period when ethically excluded stocks would have assisted performance.

The CBF Church of England Deposit Fund

- The Fund returned 1.5% over the quarter which was slightly ahead of the inter-bank wholesale benchmark rate.
- The Fund's daily declared interest rate rose by 0.46% during the quarter, and this compares with the 0.25% interest rate increase delivered by the Bank of England in July.

Longer term performance (gross) – 12 months to end September:

	2003	2004	2005	2006	2007
Fund	15.9%	11.7%	21.7%	13.5%	11.0%
Benchmark	14.9%	12.1%	21.9%	12.0%	11.7%

Benchmark - WM Co. CFS Universe, Total Assets (Current Quarter Estimate)

Longer term performance (gross) – 12 months to end September:

	2003	2004	2005	2006	2007
Fund	4.2%	3.9%	8.3%	3.8%	0.8%
Benchmark	3.8%	3.8%	8.6%	3.4%	1.8%

Benchmark – WM Co. CFS Universe, UK Bonds (Current Quarter Estimate)

Longer term performance (net) – 12 months to end September:

	2003	2004	2005	2006	2007
Fund	10.5%	17.1%	16.1%	21.4%	9.6%
Benchmark	8.9%	16.6%	16.9%	22.5%	7.3%

Benchmark - HSBC/AREF/IPD Balanced Property Unit Trust Index

Longer term performance (gross) – 12 months to end September:

	2003	2004	2005	2006	2007
Fund	n/a	n/a	n/a	14.8%	11.5%
Benchmark	n/a	n/a	n/a	14.6%	11.1%

Benchmark - FTSE All-Share Index Adjusted for Ethical Restrictions

Longer term performance (gross) – 12 months to end September:

	2003	2004	2005	2006	2007
Fund	3.8%	4.2%	4.9%	4.7%	5.6%
Benchmark	3.6%	4.1%	4.8%	4.6%	5.5%

Benchmark – 7 Day LIBID

Source: CCLA. Performance shown before management fees and expenses: net returns will differ after the deduction of fees, commissions and charges, except the Property Fund which is shown at net. 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.

Strategy and Outlook

Investment Fund

- In recognition of the longer term prospects for asset returns and economic variables, the Investment Fund has maintained high weightings to equities, which remain the dominant asset class.
- The Fund has had a significant reliance on UK equities, as a reflection of the historic attractions of the home market in terms of valuations and dividend policy.
- Going forwards, and reflecting the development of global markets and the global economy, we expect to take advantage of attractive opportunities to achieve high and rising dividend flows from both UK and non-UK equities.
- Taking account of the risks to the global economy, we will focus significantly on companies with strong free cash flow, robust sales and secure balance sheets. We anticipate that this will permit the Fund to offer both a higher immediate yield but also good long term growth in dividends and underlying capital.
- With a view to adding value and controlling overall long term risks, we will complement the equity exposure with real estate, infrastructure and fixed interest investments.
- With property and infrastructure, we will focus on attractive income flows underpinned by sound long term growth prospects, accepting that there may be short term volatility. With fixed interest we will be largely focused on shorter dated securities, reflecting the higher yields available and the reduced risks associated with any move-up in inflation.

Fixed Interest Fund

- We maintain our view that long term bonds offer poor value relative to shorter dated alternatives, and that long dated yields will likely rise in due course. This reflects our assessment that too little focus is on the risk that inflation could rise in the longer term, and that in a global context the buyers of bonds have been more concerned with re-cycling capital trade surpluses (the so called Sovereign Wealth Funds) rather than investment fundamentals.
- In reaction to the turmoil in the fixed interest market the yield difference between corporate bonds and gilts has widened. This is a healthy correction in relative values which makes the credit sector more attractive.
- However, for now and reflecting the overall outlook for the economy and markets, we expect to be positioned more at the short end of the bond market than the long end, and more towards gilts rather than corporate loans.

Property Fund

- The Fund has benefited from a continued focus on growth sectors, investment quality buildings and active management opportunities, delivering an attractive total return performance and a good dividend yield.

- In a more hostile environment, with reduced transaction volumes and rising yields, we believe these characteristics will be key to achieving strong medium term returns.
- We maintain a clear emphasis on sectors and individual properties with good tenants, good covenants and good prospects for rental growth. In the current climate we will not be seeking exposure to secondary quality opportunities, even though these can provide the strongest returns in robust market conditions.
- We expect that income will become a critical component of total returns from the asset class. We are therefore focusing on properties with good rental income and rental growth prospects as we believe these characteristics will drive capital returns.

UK Equity Fund

- During the quarter we increased the Fund's focus on good quality non-cyclical stocks with strong balance sheets and resilient earnings streams.
- Valuations of UK equities, particularly those of larger companies, remain very modest by historic standards, and we expect this to provide continued support to the Fund's prospects as we move into a period of slightly slower economic growth.
- Over the months ahead we will be increasing the dividend yield on the Fund, taking advantage of the apparent mis-valuations available in the market and the high levels of yield becoming available from high quality companies with strong long term prospects.

Deposit Fund

- Our strategy with Deposit Fund has been to maintain a well diversified exposure to high quality borrowers, with a focus on securing high current yields whilst protecting capital.
- The high current yield has been achieved through blending deposits made in the wholesale markets, seeking to add value against inter-bank benchmark rates. Given the need to preserve liquidity, the overwhelming majority of deposits are very short dated, but opportunities are and will be taken to secure added value by having some longer dated loans where we anticipate that the rates available are an attractive option.
- Capital protection has been pursued through diversification and a focus on borrower quality and covenant.
- The Fund's 'triple A' rating is unmatched by any British bank or deposit taker.
- In terms of interest rates, we expect UK base to remain unchanged over the months ahead, caught between the evidence of rising inflationary pressures and the more difficult economic climate.

Responsible Investment Report

Our work has three strands -

- 1 Engagement on issues of corporate social responsibility with a view to optimising long term economic returns in the context of Christian mission and witness.
- 2 Engagement on corporate governance to protect and enhance shareholder value.
- 3 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 Board.

1. Corporate Social Responsibility (CSR)

Key issues that we have covered over the last three months include

- Pharmaceutical drug testing in the developing world. (Over the quarter we engaged with AstraZeneca and GSK).
- Sustainable timber and logging. (Over the period we corresponded with Wolseley following accusations by Friends of the Earth that the company had been selling an endangered variety of timber. The company provided a comprehensive response, confirming that the accusations were based on old information and the company had taken steps in May 2006 to cease the sourcing and sale of this timber).
- Financial exclusion. (We met with Standard Chartered to discuss the company's approach to financial exclusion in the developing world. The company had contacted the SRI Unit to understand CCLA's views on financial exclusion based on its work for the Church).
- Human rights abuses. (We wrote to two Chinese companies, PetroChina and Sinopec both with operations in Sudan, following engagement with campaigners about human rights abuses in Sudan. This engagement is ongoing).
- Fair trade. (A report written by the SRI Unit on the relationship between farmers and supermarkets in the UK, based on visits to farmers around the country was sent confidentially to the Competition Commission as part of its enquiry into the groceries market, and subsequently to major UK supermarkets for comment).

2. Corporate Governance

- We view engagement on corporate governance to be an essential part of shareholder stewardship.
- CCLA actively engages with companies on corporate governance issues, and seven were contacted during the quarter. Dialogue is ongoing. For the year to date CCLA has been in touch with 41 companies with a view to raising governance issues, and separate to other engagement work detailed in this report.
- In summary, over the quarter the Funds opposed five company remuneration reports for reasons including potential excess, unstretching performance conditions or schemes tiered towards median performance.
- CCLA also abstained from voting on one remuneration report (BT Group) and a long-term incentive scheme at National Grid, where we had some residual concerns.
- Four shareholder resolutions put by a small activist investor, Efficient Capital Structures, to Vodafone proposed changes to the holding in Verizon and were opposed (in support of the Board) as not being in the long-term interests of shareholders. All four resolutions were heavily defeated.

3. Ethical constraints

- We confirm that the funds are managed in accordance with the constraints and restrictions proposed by the EIAG and as endorsed by the CBF Board.



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