

# QUARTERLY BULLETIN

31 March 2009

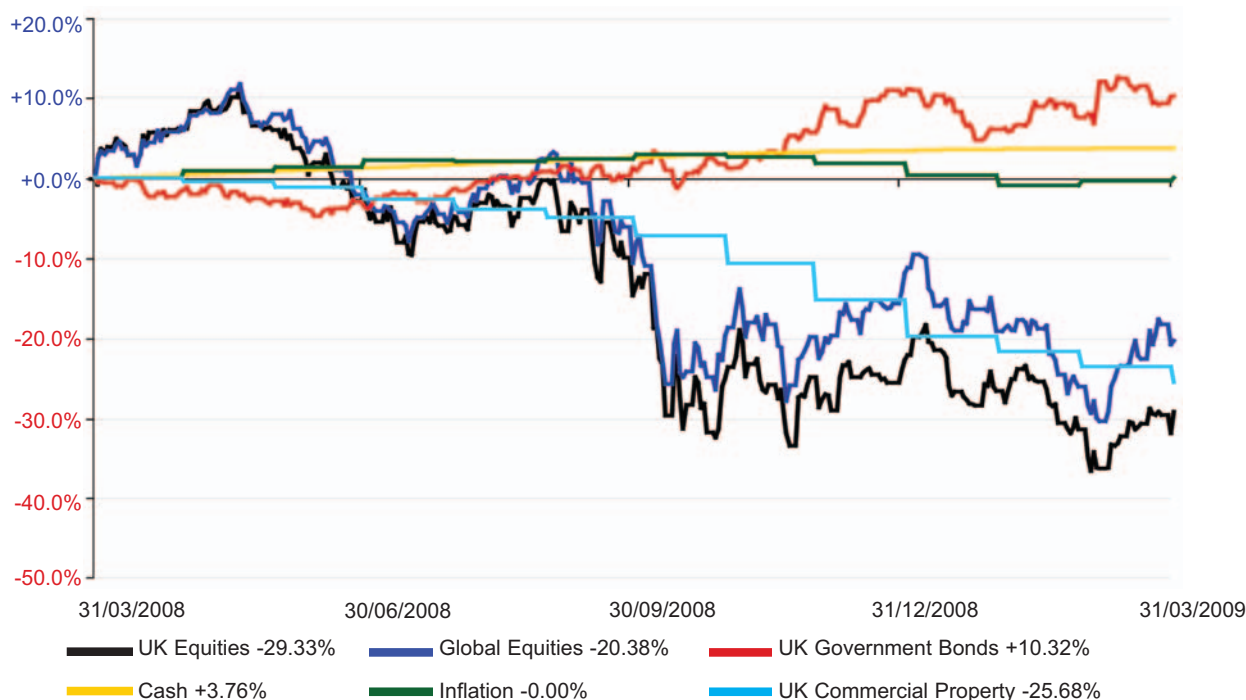


for the Church of England

# Market Review and Outlook

## Markets at a Glance - 12 Months to 31 March 2009

Equities, bonds, cash and property - 1 year returns



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

- In the opening quarter of 2009 most major equity markets have exhibited the weakness that characterised much of 2008.
- Over the period the FTSE All-World Index returned -10.20% to a sterling based investor, this despite a strong rally in the final few weeks. The UK market mirrored this performance as the FTSE All-Share Index fell by -9.08%, the market pulled lower by continuing weakness in financial stocks and selling of traditionally defensive sectors which had previously held up well in the downturn.
- Of the major international markets the return from the US was -10.27%, from Europe -16.04% and Japan -16.10%. Asian markets performed better and were all but unchanged with a return of -0.05%.
- In fixed income markets prices did not suffer the same weakness but neither did they enjoy the support that was evident previously. UK government securities produced a slightly negative overall return (-0.81%) but corporate issues were weaker, pulled back by economic concerns and worries of an increased risk of default.
- Property values retreated. Falling rents were a negative but the main cause was the move by valuers to bring valuations more closely into line with the prices actually being achieved in the market. The IPD Monthly Index of commercial property values is estimated to have declined by -7.31% in the first quarter.
- The economic news flow during the period was uniformly poor. A feature of this downturn has been the pace at which conditions have deteriorated. So swift has this been that forecasters have been taken by surprise, thus although expectations have been changed, too often the adjustment has been late and reactive, leaving expectations exposed to later negative news flows.
- Against this gloomy backcloth governments have continued to create initiatives to promote recovery. In the UK this has involved the Bank of England beginning a programme of quantitative easing – effectively a strategy designed to push money into the economy by the Bank buying bonds from commercial banks and other holders. The hope is that this activity improves liquidity and forces long term interest rates lower.
- In time these actions, together with the contribution to growth from lower interest rates and a weaker currency, will help build a recovery, an improvement however is unlikely before 2010.
- Investment markets of course discount economic moves and so will anticipate an upturn before it is underway. It may be therefore that the recent steadier trend in markets reflects some early hopes that the worst phase of the downturn is passing. We see good long term value in many areas of the investment universe but remain aware that risks are at elevated levels and it may be that further squalls come along to test sentiment before recovery becomes fully established.

# Distributions for the Quarter to 28 February 2009

| The CBF Church of England Fund | Distribution per Income Share | Payment Date |   |
|--------------------------------|-------------------------------|--------------|---|
| Investment Fund                | 6.00p                         | 31/03/09     | <ul style="list-style-type: none"> <li>The payment for this quarter has been maintained at the level achieved in 2008.</li> <li>The payments over the past four quarters amount to 45.00p, this is 9.76% higher than the payment made for the previous equivalent period.</li> </ul>                                |
| Global Equity Income Fund      | 1.00p                         | 30/04/09     | <ul style="list-style-type: none"> <li>The payment to investors has been maintained at the level achieved at this stage in 2008.</li> </ul>   |
| UK Equity Fund                 | 0.70p                         | 30/04/09     | <ul style="list-style-type: none"> <li>The dividend payment is unchanged on the payment for the comparable period in 2008.</li> <li>The payment for the past four quarters amounts to 4.90p per Income Share, an 8.89% increase on the payment at this stage of the previous year.</li> </ul>                       |
| Property Fund                  | 1.90p                         | 30/04/09     | <ul style="list-style-type: none"> <li>The payment to investors has been increased by 2.70% over the comparable period in 2008.</li> <li>The payments for the past four quarters is 6.90% higher than those for the previous equivalent period.</li> </ul>  |
| Fixed Interest Securities Fund | 2.20p                         | 30/04/09     | <ul style="list-style-type: none"> <li>The quarterly distribution has been maintained at the same level as the 2008 payment.</li> <li>Based on the price of the Fund at the end of March 2009 and an annual income payment of 8.80p, the income yield is 5.68% and the gross redemption yield is 4.02%*.</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.

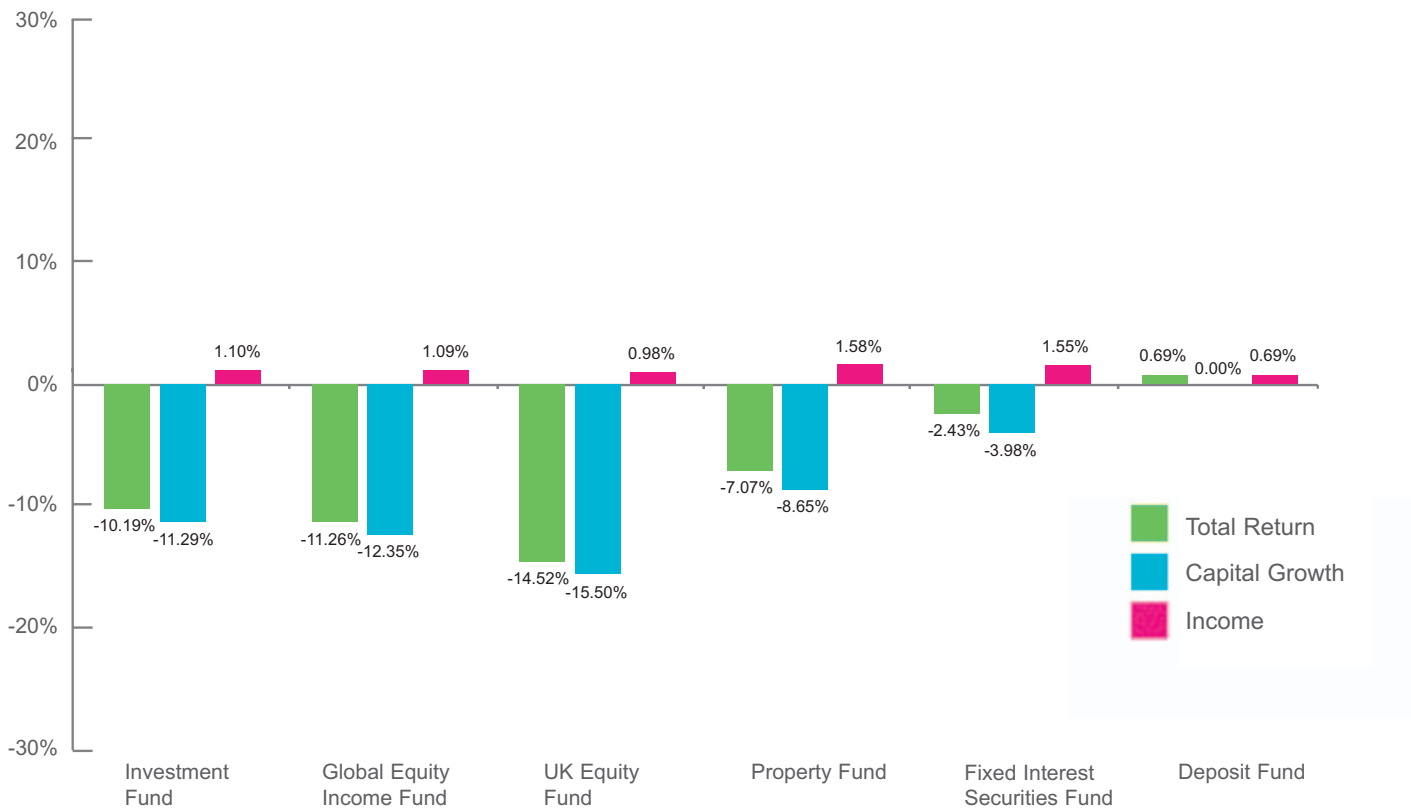
## Interest for the Calendar Quarter to 31 March 2009

### The CBF Church of England Deposit Fund

|   |                        |  |
|---|------------------------|--|
| Average interest rate over the calendar quarter | 2.22% (2.24% 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 interest rates have continued to decline.</li> </ul>   |
| Interest rate at the calendar quarter end       | 1.50% (1.51% A.E.R.)** | <ul style="list-style-type: none"> <li>The high demand for credit has meant that money market rates have been at a premium to official rates. This premium is expected to continue but at a lower level.</li> <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 The CBF Church of England 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

### The CBF Church of England Investment Fund

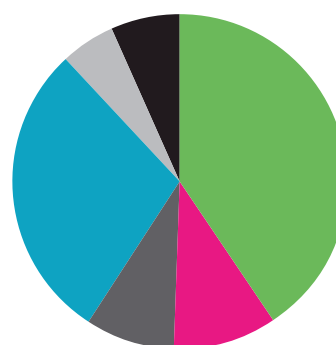
- Despite an increasingly difficult environment for income we have been able to maintain the payment to investors at a rate of 6.0p. The payment for the past four quarters is 9.76% above that for the comparable period last year.
- Investment markets have remained weak over the quarter. Equities in particular have lost ground but property values also eased and government securities (gilts) gave flat returns.
- Over the past 12 months the Fund has fallen in value by -24.1%, a decline similar to, but slightly greater than the decline in the Comparator Index. The main factor was the bias of the portfolio towards higher yielding stocks which lagged the equity market as a whole.

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

|            | 2009   | 2008  | 2007  | 2006   | 2005   |
|------------|--------|-------|-------|--------|--------|
| Fund       | -24.1% | -4.0% | +8.9% | +25.1% | +14.3% |
| Comparator | -23.2% | -5.3% | +8.7% | +25.8% | +13.1% |

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

### Asset Allocation as at 31 March 2009



|                      |                         |
|----------------------|-------------------------|
| UK Equities 40.7%    | Overseas Equities 28.9% |
| Fixed Interest 10.0% | Property 5.3%           |
| Infrastructure 8.7%  | Cash 6.4%               |

### Overseas Equities %

|                |             |
|----------------|-------------|
| Europe         | 9.0         |
| USA            | 10.3        |
| Japan          | 2.8         |
| Pacific Ex Jap | 5.1         |
| Other          | 1.7         |
| <b>Total</b>   | <b>28.9</b> |

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 Global Equity Income Fund

- The income distribution to investors is at a rate of 1.0p per Income Share. This is unchanged on the comparable payment in 2008.
- Investment markets have remained under downward pressure as concerns have increased over the financial crisis and the scale of the economic downturn.
- Against this backdrop the Fund has produced a negative return of -25.1%. This compares with a return of -29.3% for the performance comparator, the FTSE All-Share Index.

## The CBF Church of England UK Equity Fund

- The income payment to investors is at the rate of 0.7p per Income Share. The payment for the past four quarters amounts to 4.90p, an 8.89% increase on the comparable period.
- The domestic equity market declined sharply over the period as investors reacted to the crisis in the banking sector and the severe downturn in economic activity.
- Against this background the Fund has produced a significant negative return of -32.8%. This is more than the decline in the benchmark (-30.5%) and reflects the bias towards higher income stocks in the portfolio.

## The CBF Church of England Property Fund

- The income payment to investors has been increased by 2.70%. Over the year the increase is 6.90%.
- Commercial property values fell over the period as valuations were reduced to reflect prices being achieved in transactions.
- In this difficult environment the Fund declined in value by -21.6%. This compares with an estimated decline in the benchmark of -29.2%.

## The CBF Church of England Fixed Interest Securities Fund

- The income payment to investors has been maintained at 2.20p per Income Share.
- Over the period government securities have been supported by investors seeking respite from volatile markets. Corporate bonds have performed less well due to default concerns.
- The Fund has produced a return of +5.9% compared to an estimated +3.5% return on the benchmark.

## The CBF Church of England Deposit Fund

- At the end of the quarter the rate paid to investors was 1.50% (1.51% AER\*). Interest rates continued to decline over the period as economic activity weakened and inflation fears retreated.
- The Fund has been able to provide an interest rate above official rates because of credit shortages in the money markets.
- Interest rates are very low by historic standards but there is scope for further declines in the months ahead. Although rates are lower, risks remain and the focus on safety and security will continue.

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

|            | 2009   | 2008 | 2007 | 2006 | 2005 |
|------------|--------|------|------|------|------|
| Fund       | -25.1% | n/a  | n/a  | n/a  | n/a  |
| Comparator | -29.3% | n/a  | n/a  | n/a  | n/a  |

Comparator - FTSE All-Share Index

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

|           | 2009   | 2008  | 2007   | 2006   | 2005 |
|-----------|--------|-------|--------|--------|------|
| Fund      | -32.8% | -6.2% | +10.9% | +26.2% | n/a  |
| Benchmark | -30.5% | -8.6% | +10.5% | +27.5% | n/a  |

Benchmark - FTSE All-Share Index Adjusted for Ethical Restrictions

## Longer term total return performance (net) 12 months to end March:

|           | 2009   | 2008   | 2007   | 2006   | 2005   |
|-----------|--------|--------|--------|--------|--------|
| Fund      | -21.6% | -9.7%  | +18.3% | +19.2% | +17.4% |
| Benchmark | -29.2% | -11.3% | +17.3% | +21.5% | +17.5% |

Benchmark - HSBC/AREF/IPD Balanced Property Unit Trust Index (Current Quarter Estimated)

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

|           | 2009  | 2008  | 2007  | 2006  | 2005  |
|-----------|-------|-------|-------|-------|-------|
| Fund      | +5.9% | +6.2% | +1.0% | +7.1% | +5.3% |
| Benchmark | +3.5% | +5.0% | +1.4% | +6.9% | +5.5% |

Benchmark - WM Co. CFS Universe, UK Bonds (Current Quarter Estimated)

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

|           | 2009  | 2008  | 2007  | 2006  | 2005  |
|-----------|-------|-------|-------|-------|-------|
| Fund      | +5.0% | +6.1% | +5.0% | +4.7% | +4.7% |
| Benchmark | +3.6% | +5.8% | +4.9% | +4.6% | +4.6% |

Benchmark - 7 Day LIBID

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

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

## The CBF Church of England Investment Fund

- The strategy of the Fund is to provide investors with a total return over a business cycle at a level equivalent to inflation +5% p.a. whilst at the same time maintaining the value of the income paid in real terms.
- The portfolio has a bias towards those asset classes which we believe will provide strong long term returns and a rising stream of income. This means an emphasis on assets which can benefit from the growth over time of the economy such as equities, property and infrastructure.
- The Fund has a substantial exposure to international markets so as to benefit from stronger economic growth and to exploit the increased choice of individual companies this brings.
- Exposure to currencies other than sterling has been a positive contribution to performance.
- The pronounced weakness in investment markets over recent months reflects a coming to terms with the sharp downturn in the global economy. At current levels the value on offer to long term investors is substantial, near term however there is a risk of a further setback whilst volatility is likely to remain elevated for some time.

## The CBF Church of England Global Equity Income Fund

- The Fund's portfolio is comprised of companies which have a high current yield but which can also provide growing income in the future. Companies are bought on their own merit and there is no pre-determined requirement to have a set weighting to any sector or geographical region.
- The advantage of the global reach of the Fund is that it is able to consider companies from any of the world's markets, some of these are in sectors which are only poorly represented in the UK market.
- Equity markets have fallen sharply in reaction to both the credit crunch and the slowdown being experienced in economic activity. At current levels the long term attractions of good quality international equities are strong, in the near term however day to day volatility is likely to remain elevated and there are risks that further periods of weakness could occur.

## The CBF Church of England UK Equity Fund

- The strategy of the Fund is to provide investors with a relatively high income yield which will rise over time. This is achieved from a diversified portfolio of good quality domestic securities.
- Whilst recent weakness in equity prices has disconcerted some investors, one result is a substantial increase in the number of companies which have excellent prospects and which can be bought on attractive income yields.
- At and around current levels the valuation of the domestic equity market is very attractive on a longer term view.

Near term risks remain however and it is likely that volatility will stay at the higher levels recently experienced.

## The CBF Church of England Property Fund

- Commercial property values declined again as valuers continued the process of adjusting valuations down to reflect prices actually being achieved in transactions. Activity remained at low levels but there are signs of buying interest for prime properties with sound tenants.
- Our policy continues to be one of seeking improved returns by a programme of refurbishment and improvement and by keeping voids to as low a level as possible.
- The Fund has benefited from having a large cash balance but with earnings on cash deposits low, this could have a negative effect on income. We intend to reduce liquidity substantially in the near term.
- Yields seem to be stabilising for good quality properties at around current levels and so the focus is on how severe the weakness in rents becomes. There is a clear downtrend in parts of the market – offices and retail shops – which is spreading geographically. If the dip is shallow then we expect to see much more stable conditions later in the year.

## The CBF Church of England Fixed Interest Securities Fund

- Government securities (gilts) are little changed over the quarter as investor enthusiasm has been blunted by contemplation of the reduced yields on offer and the prospect of a huge wave of new issues.
- Corporate bonds have performed less well, with bonds issued by banks in particular falling sharply. This was due to fresh concerns over the financial security of the sector and increased risk of default.
- We have used the weaker trend in the corporate bond sector to increase our exposure, locking-in attractive yields but always with a focus on quality and risk control.
- The government securities segment of the Fund is structured to be relatively cautious whilst the government's new issuance programme gathers steam and whilst the full practical implications of quantitative easing become understood.

## The CBF Church of England Deposit Fund

- The prime focus of the Fund is on the safety and security of the investments. The portfolio is deposited with a diversified list of high quality borrowers which is kept under constant review to ensure that there is no deterioration in status or standing.
- The Fund has been awarded a AAA/V1 rating by Fitch Ratings, the leading credit rating agency. AAA ('Triple A') is the highest credit rating available.
- Interest rates have continued to decline and this has meant a reduction in the income paid by the Fund, longer term deposits made at higher rates have helped to cushion the decline.
- Market interest rates may ease further in the months ahead, any increase is still many months away.

# 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 including proxy voting on issues 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 Funds Trustee.

## 1. Corporate Social Responsibility (CSR)

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

- Members of the Church Investors Group met the Chief Executive of BSkyB to relay concerns about the continuing ownership of pornographic channels.
- The CBF Church of England Investment Fund has invested £2.5m in micro-finance through Triodos. We believe this approach offers a combination of excellent financial returns, strong and persistent diversification advantages, and significant social benefits.
- Edward Mason, the new Secretary to the Church of England's Ethical Investment Advisory Group joined the team at Church House in March. Reviews of the defence and alcohol policies have now commenced. If you have comments on these please contact Edward on [edward.mason@c-of-e.org.uk](mailto:edward.mason@c-of-e.org.uk)

## 2. Corporate Governance

- The CBF Investment Fund voted at eight UK company meetings during the quarter, and the CBF UK Equity Fund at five meetings.
- Proxy voting statistics can be found at [www.ccla.co.uk](http://www.ccla.co.uk).
- During the quarter, CCLA voted against executive remuneration at BP, and abstained from supporting amendment to the Performance Share Plan Rules at Sage Group.
- At the former we have continuing concerns at the narrowness of the peer group for the award of long-term incentives, and discretion used by the Remuneration Committee to make an award in the past year even though performance conditions were not met.
- In volatile markets where corporate performance may be under pressure, investors will be closely monitoring the decisions taken by remuneration committees to ensure executive awards remain appropriate, stretching and linked to the delivery of superior performance. To that extent it may be noted that already in 2009 two companies have had their remuneration reports defeated by investor action (Royal Bank of Scotland and Bellway).

## 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 Funds Trustee.



for the Church of England

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