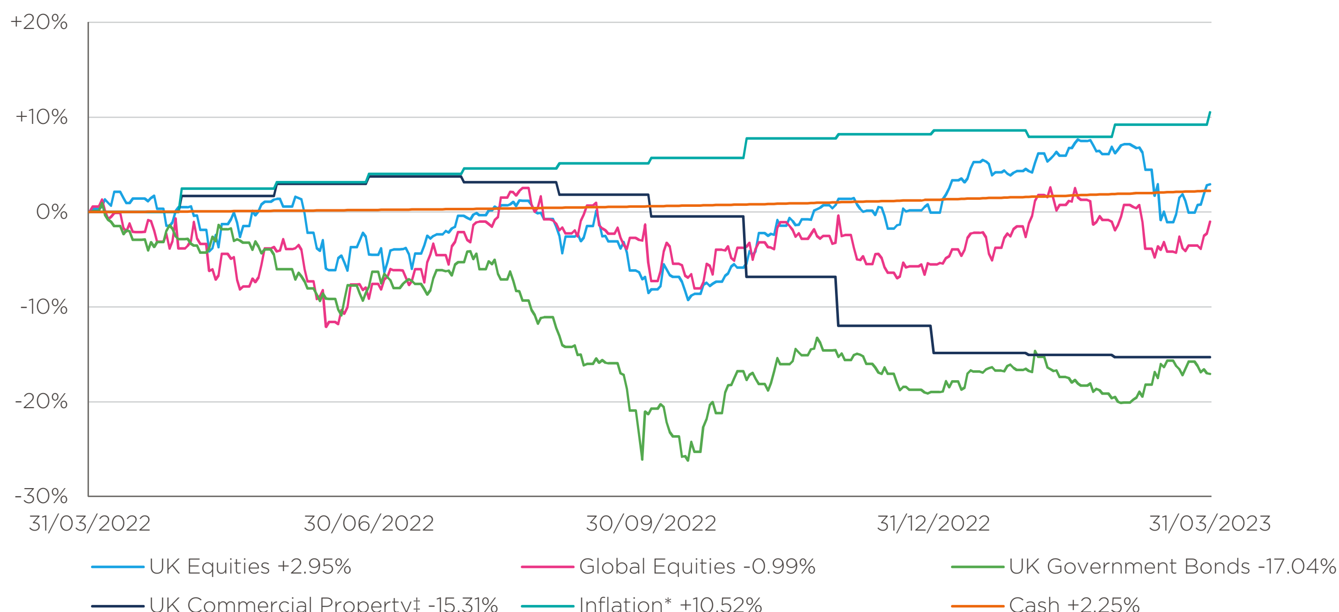
CCLA

QUARTERLY BULLETIN

31 March 2023

Market review and outlook



General Market Indices

	Current quarter (%)	Last twelve months (%)	Last three years annualised (%)	Last five years annualised (%)
UK Equities (MSCI UK Investable Markets Index)	+3.02	+2.95	+13.59	+4.70
Global Equities (MSCI World Index)	+4.81	-0.99	+16.51	+10.77
Global Equities ex UK (MSCI World ex UK Index)	+4.87	-1.28	+16.61	+11.07
UK Govt. Bonds (Markit iBoxx £ Gilts Index)	+2.38	-17.04	-9.53	-3.16
Sterling Bonds ex UK Govt, (Markit iBoxx £ Non-Gilts Index)	+2.39	-10.20	-3.07	-0.85
UK Commercial Property (AREF/MSCI™ All Prop Monthly) ‡	-0.52	-15.31	+2.50	+2.63
Inflation (CPI) *	+1.74	+10.52	+6.02	+4.27
Cash (SONIA) §	+0.94	+2.25	+0.78	+0.68

Source: Bloomberg (Data shown is daily except for Inflation and UK Commercial Property where data shown is monthly)

§ SONIA (Sterling Overnight Index Average) is estimated for the most recent month. From 1/1/21: SONIA. Prior to 1/1/21: 7-Day London Interbank Sterling Bid Rate (7-Day LIBID).
* CPI (Consumer Price Index) is estimated for the most recent month.
‡ MSCI UK Monthly Property is estimated for the most recent month.

Equity markets had mixed fortunes over the first quarter of 2023 but made progress overall. January was strongly positive, as investors began to anticipate a peak in the current monetary policy tightening cycle. The mood changed in February, however, amid signalling from the US Federal Reserve and other central banks that they regarded the fight against inflation as having some way to go.

Although headline inflation continued to fall, employment data indicated that jobs markets remained too tight for the regulators' liking, and core inflation measures which strip out volatility energy and food prices continued to rise. This reinforced expectations that interest rates would move higher and stay there for longer than had recently been priced in by markets.

Financial stocks were especially volatile in the month of March, as difficulties emerged at a handful of institutions including Credit Suisse and the specialist Silicon Valley Bank, making this one of the worst-performing sectors over the quarter. Swift action by regulators and the realisation that the turmoil was not systemic to the banking system as a whole brought some relief to financials as the period end approached. More broadly, signs in March that labour markets were finally beginning to soften and that the peak of interest rate tightening was approaching – seen as even more likely if central banks concluded that a rising yield environment had contributed to banks' woes – improved support for equities as a whole.

The global equity index delivered total returns for the latest quarterly period of +7.7%; although a weakening in the dollar meant that for sterling-based investors these gains were pared to +4.8%. In a further sign of improving sentiment, 'growth' stocks outperformed 'value' – with value also held back by the weakness of banks which fall within that category. In the dominant US market, for example, the value index was down -3.2% (sterling terms) while growth was well into positive territory at +15% for the quarter. Uncertainty in the banking sector and a lower oil price contributed to underperformance by the UK market relative to its global peers, as both these and other 'value' sectors are heavily represented in the UK index. Returns from UK equities were +3.0% over the first three months of the calendar year. Looking back further to the last 12 months, however, the UK market remains ahead with total returns of +2.95% compared to the world index return of -0.99%.

The year also got off to a positive start for fixed interest assets with yields falling (and hence, valuations rising) as markets anticipated less hawkish monetary policy than had previously been priced in. The UK government bond (gilts) market as a whole gave total returns of +2.4%, although still nursing losses of more than 17% over the last year; while non-government bonds were up 2.4% over the quarter, and down -10.2% for the latest 12-month period.

In UK commercial property there were modest further declines in capital values and transaction volumes remained low by historical standards. However, the market appeared to have regained some composure after the savage downturn in valuations in 2022, which as with other asset classes was prompted by the sharply rise in bond yields. Income returns from property, meanwhile, remained healthy, and rental growth was reported to be marginally positive.

Outlook

Many commentators are now forecasting modest growth, rather than recession, for the world's major economies in 2023 and 2024. Even the UK, widely regarded as being in a weaker position than its peers, has better prospects than was the case a few months ago: the Office for Budget Responsibility (OBR), in its report accompanying the recent government Budget, predicts that the UK will avoid a technical recession in 2023. The more optimistic tone stems from a variety of factors, including the impact on global demand and supply of China's post-Covid reopening, and the mild winter in Europe limiting the economic damage from higher energy prices.

Nevertheless a number of indicators suggest that there are significant headwinds to growth, with recession remaining a distinct possibility. The constraining effects of higher interest rates come some months after the related announcements by central banks, and have yet to be fully felt. Commercial bank lending standards were already tightening before the recent clutch of financial distress cases and may well tighten further, representing a further brake on spending and investment. Perhaps most compellingly, the US yield curve remains significantly inverted; historically this has been one of the most reliable indicators of a forthcoming recession. Given the US's dominant position as an economy and as an investment market, a slowdown or contraction there would have implications for investors around the world.

Fortunately a weak outlook for economic growth does not mean that investment markets cannot progress, although some businesses will be better placed than others to prosper in a low-growth environment. The widespread damage to valuations suffered in the face of rapidly rising yields is unlikely to be repeated now that policy tightening appears to be approaching its peak. However in the coming weeks investors will be scrutinising corporate earnings reports for signs of how inflation and interest rates are affecting revenues and margins. We can expect to see divergence between sectors and between individual stocks as results and guidance are published.

.

The market review, analysis and any projections contained in the document are the opinion of the owner only and should not be relied upon to form the basis of any investment decision.

Banks in the spotlight

Within the space of a few days in March 2023, two US regional banks and Europe's Credit Suisse failed, prompting regulators to intervene and dragging down equity prices across the banking sector. What happened – and should investors be concerned?

Conventionally, banks prosper by borrowing (i.e. taking deposits) at relatively low interest rates, and lending at higher rates, to businesses and individuals such as mortgagors. A general rise in interest rates wouldn't necessarily cause the sector any difficulty; in fact it would often be regarded as helpful for its potential to increase the margin between the rates at which banks can lend and borrow money.

In the current cycle, events have played out rather differently. The demand from borrowers looking to invest in business and property over the long term has not kept up with the volume of short-term cash deposits. Even whilst paying very modest rates to depositors, many banks have seen margins decline as they have struggled to put their balance sheet assets to sufficiently productive use. To enhance profitability, some have bought portfolios of slightly higher-yielding bonds.

If held to maturity, these bonds would present very little risk to nominal cash flows. However bonds may also be considered available to be sold prior to maturity if required to support a bank's liquidity. Because bond prices move inversely to yields, the steep rise in interest rates caused the market value of these bonds to decline sharply, and in the case of the now-defunct Silicon Valley Bank (SVB) sizeable losses were realised when bonds were sold in order to raise cash levels. Alerted to the state of its balance sheet, a large swathe of SVB's depositors took fright and sought to withdraw their cash, prompting the US regulator, the Federal Deposit Insurance Corporation (FDIC) to step in, brokering and underwriting the sale of its assets and liabilities to another bank. Meanwhile SVB's UK arm was sold to HSBC for £1.

The failure of SVB alarmed many customers of another specialist US, Signature, which had significant exposure to cryptocurrency and had already been weakened by 2022's slump in crypto asset prices and the collapse of crypto exchange FTX. Once again the FDIC intervened to forestall a run on Signature Bank and avert the risk of contagion to the wider banking sector.

A few days later, Credit Suisse finally succumbed to the pressure created over a number of years by a series of scandals, unstable governance and commercial mis-steps. A loss of investor confidence, highlighted by the bank's difficulty in attracting new funds to support liquidity, led the Swiss National Bank to step in with Credit Suisse being sold at a knock-down price to rival UBS.

Should investors be worried?

Fortunately, widespread failures among major banks are unlikely, for several reasons. Firstly, regulatory intervention worked as intended, and swiftly, including full protection for depositors and thus reducing the risk of 'contagion' in the shape of panicked bank runs by customers of other institutions. The affected banks also had risks and challenges, such as highly concentrated client bases and substantial exposure to volatile assets, that aren't characteristic of the sector's dominant players. Thanks to regulatory changes in the wake of the financial crisis of 2008-09, large banks now have much higher liquidity buffers than at that time; and regulation of the largest banks, which account for the majority of the sector's assets, is more stringent than the regime for the smaller US banks which collapsed.

Nevertheless, the recent failures have highlighted some important risks and put investors on alert.

Questions are being asked about oversight of risk exposure, especially at US mid-tier banks. The episode has served as a reminder of the commercial challenges facing banks in a low-growth environment, leaving markets wary of the sector's potential to deliver strong shareholder returns. More widely, economic activity is likely to be hampered as banks toughen up their already-tightening lending conditions in order to limit risk. A banking crisis may have been averted, but the impact of the recent turbulence could be felt for some time.

Promoting Healthier Markets

Investment markets will only be as healthy as the environment and communities that support them. From tackling obesity to addressing workplace ill-health, investors can play a key role in driving positive change.

Why health?

The private sector undertakes many activities that affect people's health, both positively and negatively. Within a company's immediate sphere of influence, its approach to the health, safety and welfare of its own workforce can have a direct impact on its profitability. More broadly, the products or services that a company offers come with consequences for customers and society.

Nutrition and the obesity crisis

Worldwide, obesity has nearly tripled since 1975 (WHO). The World Obesity Federation estimates that by 2020 around 770 million adults globally were affected by obesity; that figure is anticipated to exceed one billion by 2030. Obesity is closely linked to several health conditions, which are estimated to cost $2 trillion annually.

Companies that produce or sell unhealthy food and drinks rightly come under fire for the role they play in fuelling the obesity crisis. Yet some of the largest manufacturers of 'bad food' also produce a great deal of 'good food' as well. For instance, while Nestlé owns brands such as Häagen-Dazs, KitKat and Quality Street, it also owns three pure water brands, four baby food brands, and produces a wide range of vitamins, minerals and supplements via its Nestlé Health Science business.

Engaging with Big Food

Recent engagement with Unilever, PepsiCo, Nestlé and Coca-Cola aims to persuade these companies to commit to producing healthier products and to make these products more accessible, more affordable and more available. Our specific asks relate to disclosure, target setting, and reporting on progress against those targets.

On the back of prolonged engagement, Unilever pledged last year to set a new industry-leading standard on transparency around sales of healthy foods. It has now disclosed the 'healthiness' of its global portfolio against six government-endorsed nutrient profiling models, in both sales volume and revenue.

We have had similar discussions with Nestlé over the past two years as part of our support for ShareAction's Healthy Markets Coalition and the Access to Nutrition Foundation.

There was notable success in 2022. On increased shareholder pressure, Nestlé agreed a set of new nutritional commitments. These require the company to (among other things):

- Benchmark and disclose the nutritional information of its products in 14 countries (now published).
- Raise the target age of marketing of unhealthy foods.
- Cease marketing on gaming platforms where the user base is significantly comprised of under 16s.
- Cease the marketing of infant formula milk from 1st January 2023.

After an initial reluctance to set targets on sales of healthy foods, we escalated the engagement and considered co-filing a shareholder resolution. The company eventually agreed to set targets on absolute sales of healthy products. While this falls short of the proportional targets we were seeking, we will continue to ask for further commitments in 2023.

Investor Coalition on Food Policy

In 2021, the UK government-commissioned National Food Strategy was published. The review includes 16 recommendations to build a more sustainable food system, for both health and environment.

In 2021, we signed a letter to the Prime Minister, along with 17 other institutional investors, urging the Government to act on the Strategy's recommendations. We subsequently met the Minister of State for Farming, Fisheries and Food at the Department for Environment, Food and Rural Affairs (DEFRA), and representatives from the Department of Health and Social Care. We discussed why mandatory nutritional reporting is important for investors, the role that investors could play, and how it could work in practice. The meeting was positive but non-committal.

In Q1 2023, following several months of significant change in the government, we co-signed letters to the Secretary of State for Environment, Food and Rural Affairs and the Secretary of State for Health and Social Care. The letters reiterate the investor case for mandatory reporting and our support for the Food Data Transparency Partnership. We await a response.

Ethical and responsible investment report

Our work has four 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 in line with the faith consistent investment policy, informed by a dedicated Faith-Consistent Investment Committee.
3. Proxy voting on corporate governance issues to protect shareholder value and address excessive remuneration.
4. Responsibilities under the UK Stewardship Code and the UN Principles for Responsible Investment (PRI).

Quarterly highlights

In Q1, we sent letters to four companies asking them to become Living Wage accredited: Greggs, Watches of Switzerland, Admiral Group and Safestore Holdings. Admiral responded and Greggs agreed to a meeting. The discussion was positive but non-committal. We are now considering contacting The Bakers, Food and Allied Workers' Union for further insight.

In Q3 last year, we wrote to the 100 largest UK-listed employers, asking for details of what they are doing to support their workers through the cost-of-living crisis. In Q1, we wrote to these companies again, and have now had responses from 61 of them.

Late last year, we co-filed climate-related shareholder resolutions at JP Morgan Chase and Bank of America. In Q1, we met JP Morgan to discuss the company's climate transition plans. We are asking it to report on annual progress towards decarbonisation and to forecast in more detail its emissions reduction journey (annual projection vs achieved).

In Q1, we signed a letter to c.400 FTSE All Share companies asking for a 'Say on Climate' vote. This requires companies to put their carbon reduction strategy to shareholders for approval. We have received 44 responses to date.

Our focussed engagement on nutrition and obesity continues and during the quarter, we met Coca-Cola, PepsiCo and Nestlé. In Q1 we also co-signed letters to ministers at DEFRA and the DHSC on food policy in UK. We reiterated the investor case for mandatory nutrition reporting, as recommended in the National Food Strategy.

Assessments for the 2023 CCLA Corporate Mental Health Benchmark - UK 100 took place in March. The benchmark findings will be published in early June.

By the end of March, CCLA had reached a landmark 100 organisations signed to our sustainability initiatives, with a combined £17 trillion in assets under advice or management.

Quarter one voting in detail

CCLA aims to vote at all company meetings where we have portfolio holdings. The Catholic Investment Fund did not support 18% of the resolutions proposed by management at our investee companies this quarter.

We aim to support all pro-active shareholder proposals, particularly where a proposal complements one of our existing engagement priorities. Within our 'Better Work' engagement theme, we have been focussing on freedom of association and collective bargaining rights as a growing salient and material risk, relevant to several companies in which we own shares.

One of these companies is Starbucks. In Q1, we supported a shareholder resolution at the company, asking it to commission a third party assessment of its commitment to freedom of association and collective bargaining rights. While the company has made a commitment to freedom of association in policy, there has been repeated evidence that it is not upholding its workers' rights to organise.

Changes to 2023 vote guidelines: gender and cost-of-living

To generate 'healthy' long-term returns for our clients, we must push for progress at the companies in which we invest. Voting is one tool in the armoury and when used well, it can be a powerful driver of change.

Our vote guidelines are reviewed and updated every year. We aim to be nimble in our approach and seek to step in where we believe corporate practice may be unjust or detrimental to shareholder value.

Accordingly, there are two significant updates to our 2023 vote guidelines. We have expanded our approach to women in the boardroom beyond the UK; our 40% female rule now applies also to Northern Europe, North America and Australia.

In addition, we see the coming proxy season as an opportunity to accelerate corporate efforts to address the rising the cost-of-living crisis in the UK. We will no longer approve remuneration-related proposals where a company's response to our cost-of-living engagement is considered poor (see opposite).

CCLA's 2023 vote guidelines and full voting records by quarter are available at www.ccla.co.uk.

Ethical constraints

We confirm that the Catholic Investment Fund has been managed in accordance with its faith consistent investment policy this quarter.

Catholic Investment Fund

Performance comment

Global equity markets fared well in the first few weeks of 2023 before fading on signs that economies were not yet slowing down as policy makers intended, leading investors to anticipate that monetary policy tightening had some way to go. News of three bank failures also unsettled markets. Over the quarter as a whole, equity returns were positive but with significant divergence between sectors. Not surprisingly, banks fared poorly, as did energy and the traditional 'defensive' sectors of healthcare and consumer staples. Technology, communications services and consumer discretionary all performed well at the sector level, with some outstanding results from individual companies.

Bond markets also had a period of mixed fortunes but were positive for the quarter overall. In commercial property, valuations were much steadier than in the previous quarter, when valuations were savaged by 2022's steep climb in bond yields. Declining valuations continued to beset some infrastructure assets, notably in social and healthcare property; but elsewhere in infrastructure, clean power assets fared better as power prices remained solid.

Security selection in the equities portfolio was the main contributor to relative returns.

Fund update

The investment objective of the Fund is real long-term growth in capital values and a reliable income distribution within a clear risk control framework. There is a bias towards real assets, predominantly global equities but also property and infrastructure. Individual stocks are selected on businesses' fundamental characteristics including environmental, social and governance risks. We favour companies with the potential to grow more predictably than the general economy, resulting in relatively high weightings to sectors such as information technology. During the quarter we reduced the Fund's cash balance, which had been elevated throughout 2022 to give the portfolio a tactically defensive bias, by adding selectively to equity holdings.

Income

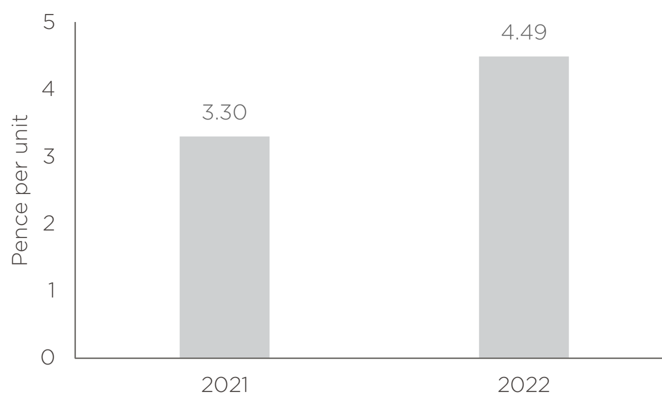
Gross dividend yield 3.02%*

MSCI $ UK IMI dividend yield 3.69%

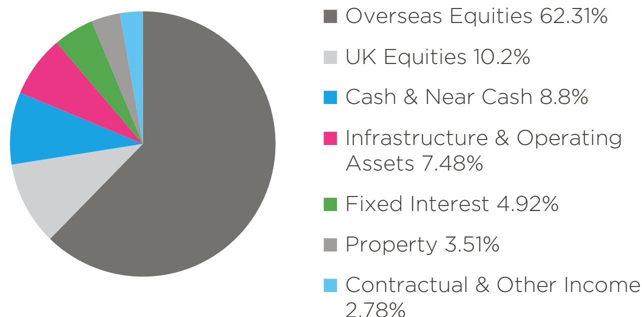
MSCI $ World ex UK dividend yield 2.04%

* Based upon the net asset value and an estimated annual dividend of 4.49p.

Past distributions



Asset allocation as at 31 March 2023



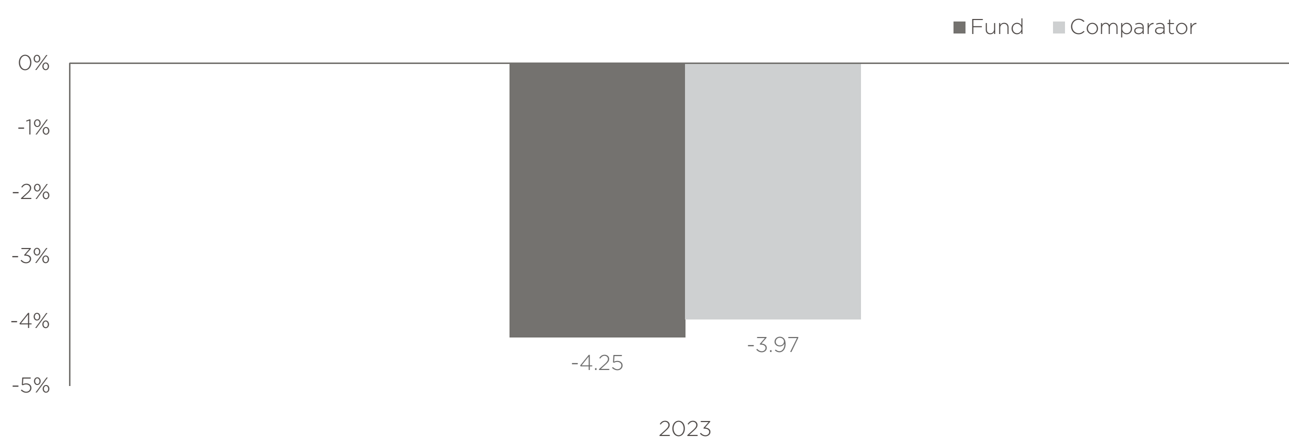
Total return performance

Performance* to 31 March 2023	3 months	1 year
Investment	+2.91%	-4.25%
Comparator ‡	+3.99%	-3.97%

‡ Target benchmark is CPI +5%.

Discrete year total return performance

12 months to 31 March	2023
Investment	-4.25%
Benchmark	-3.97%



Comparator - composite: From 01/04/21, MSCI World 75%, MSCI UK Monthly Property 5%, iBoxx £ Gilts 15% & SONIA 5%. Source: CCLA

Top 10 holdings as at 31 March 2023

Holding	%
COIF Charities Property Fund (Sub-Holding)	2.9%
UK Treasury 4.25% 07/06/2032	2.7%
Microsoft Com NPV	2.3%
Greencoat UK Wind Plc Fund	1.5%
United Kingdom Gilt 0.875% 31/07/2033	1.3%
Adobe Inc Com USD0.0001	1.3%
Pernod-Ricard EUR 1.55	1.3%
LVMH EUR0.30	1.2%
Humana Com USD0.166	1.2%
ICON Plc Com NPV	1.2%

* Performance of the funds is shown net of management fees and other expenses with income reinvested. Comparator performance is based on market indices which are not adjusted for any management fees or investment expenses. Past performance is not a reliable indicator of future results.

IMPORTANT INFORMATION

This document is issued for information purposes only. It does not constitute the provision of financial, investment or other professional advice. To ensure you understand whether a CCLA product is suitable, please read the key information document (KID) and prospectus. CCLA strongly recommends you seek independent professional advice prior to investing. Investors should consider the risk factors identified in the prospectus.

Past performance is not a reliable indicator of future results. The value of investments and the income derived from them may fall as well as rise. Investors may not get back the amount originally invested and may lose money. The fund can be exposed to different currencies and movements in currency exchange rates may adversely affect the value of your investment. Investing in emerging markets involves a greater risk of loss due to greater political, tax, economic, foreign exchange, liquidity, and regulatory risks, among other factors. There may be difficulties in buying, selling, safekeeping or valuing investments in such countries. The Annual Management Charge is paid from capital. Where charges are taken from capital rather than income, capital growth will be constrained and capital may be eroded.

Any forward-looking statements are based upon our current opinions, expectations and projections. We undertake no obligations to update or revise these. Actual results could differ materially from those anticipated. Investment in this fund is only available to charities within the meaning of section 1(1) of the Charities Act 2011.

CCLA Investment Management Limited (registered in England and Wales, number 02183088, at One Angel Lane, London, EC4R 3AB) is authorised and regulated by the Financial Conduct Authority.

All names, logos and brands shown in this document are the property of their respective owners and do not imply endorsement. These have been used for the purposes of this presentation only and its intended audience, and are not for wider distribution.
For information about how we obtain and use your personal data please see our privacy our privacy policy at www.ccla.co.uk/privacy-policy
.

CCLA Investment Management Limited
One Angel Lane, London, EC4R 3AB
Client Service, Freephone: 0800 022 3505
www.ccla.co.uk