

to be a
TRUSTEE...

Inflation - The challenge for charity investors

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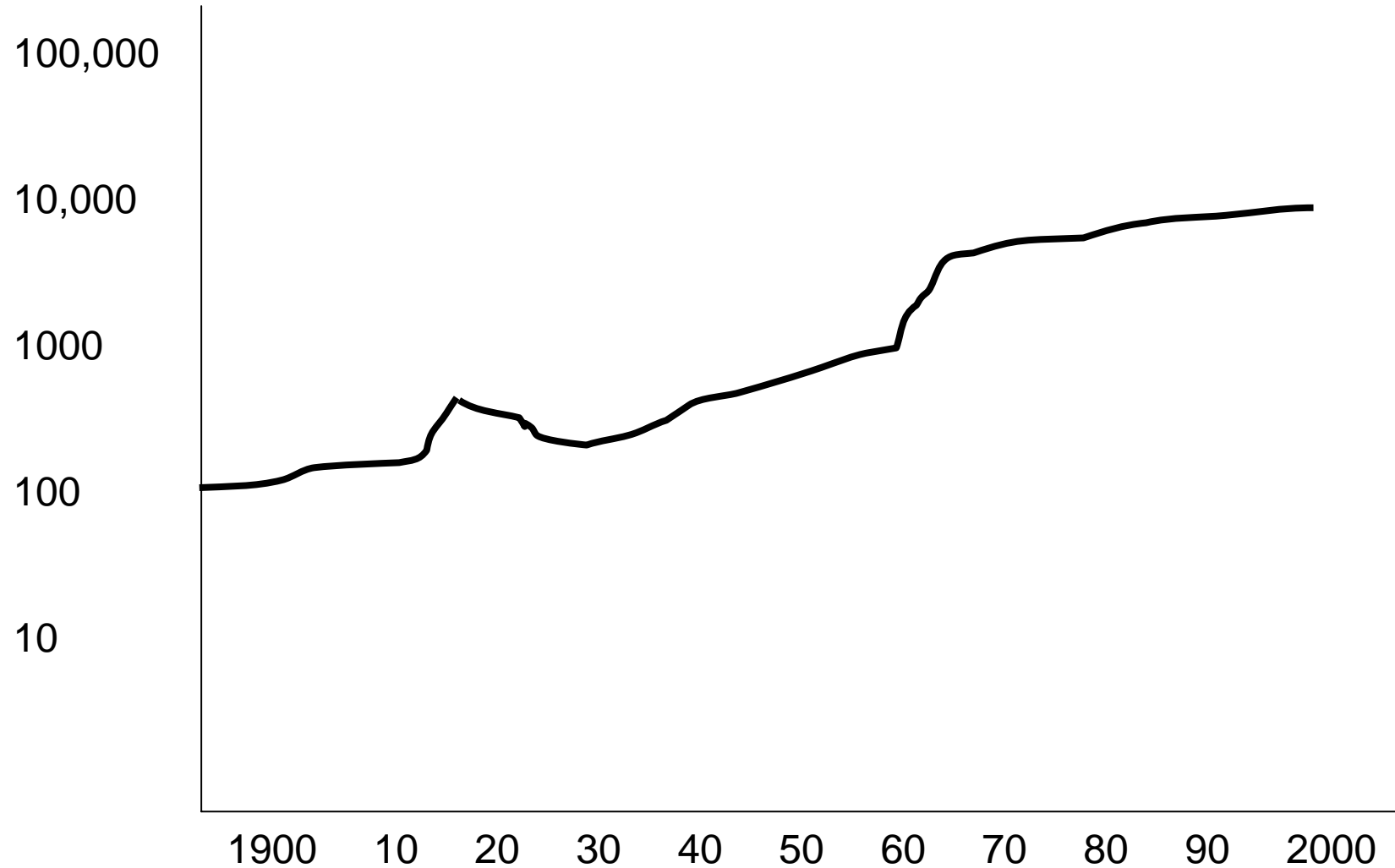
Programme

- About CCLA
- Background to the inflation challenge
- What inflation means for investors
- Question & Answers

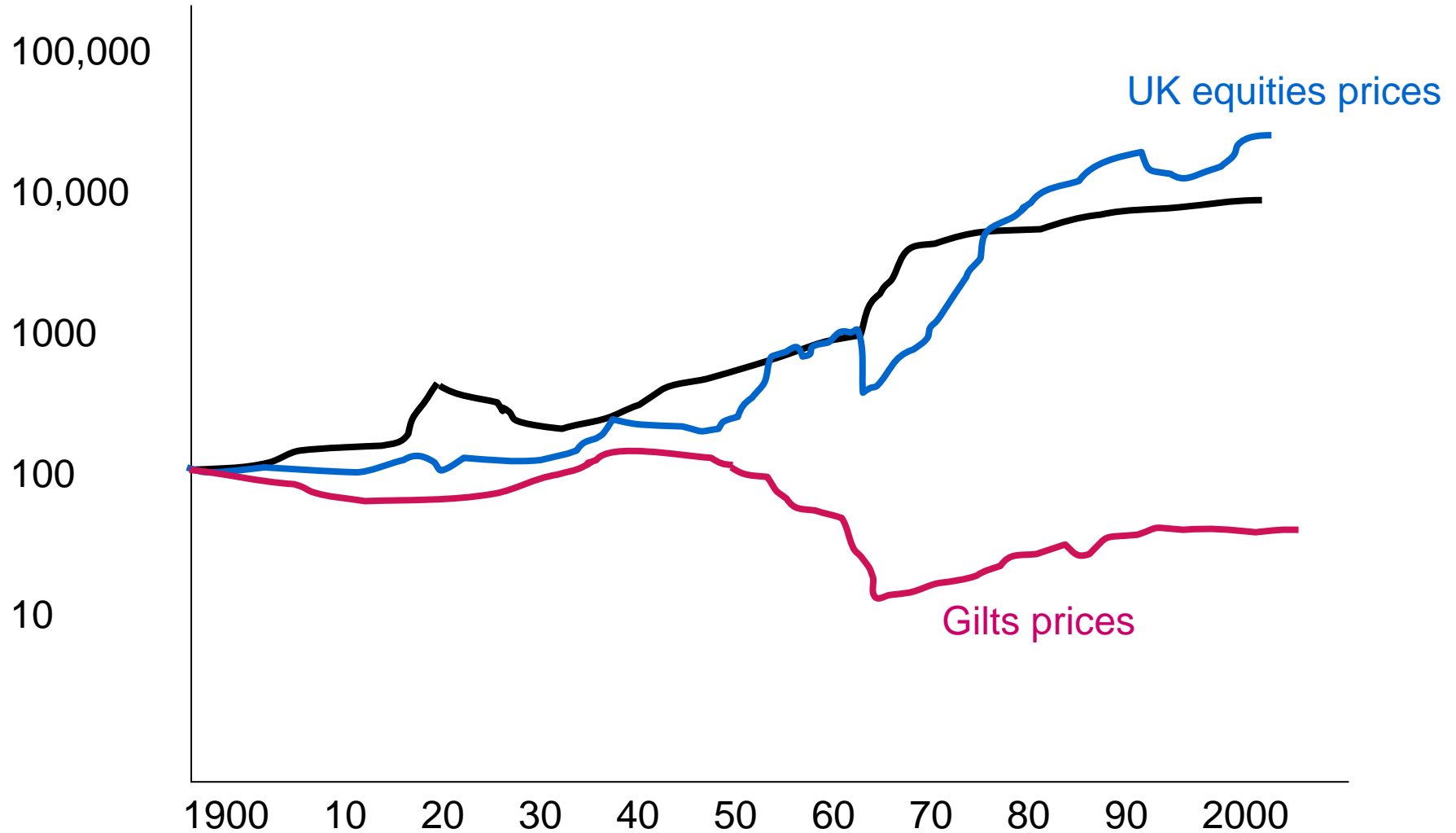
About CCLA

- CCLA is the leading manager of charity assets in the UK, managing some £5 billion on behalf of 43,000 clients.
- We are owned by our clients and so do not have to compromise our objectives, our standards or our principles.
- We specialise in the management of charity assets and apply all of our resources to the sector.
- CCLA has a history reaching back over 50 years.

Inflation is important for markets and investors



Inflation is important for markets and investors



Inflation is important for markets – we can see it but do we know why?

With cash and bonds, it's relatively straightforward:

The nominal return = the real return + inflation

So for any given real yield requirement, more inflation

- means higher yields
- means lower prices

Inflation is important for markets – we can see it but do we know why?

With equities, it's a bit more complex.

There's a popular perception that 'equities are a good hedge against inflation'.

But it matters

- as to what sort of inflation
- how investors capitalise future benefits

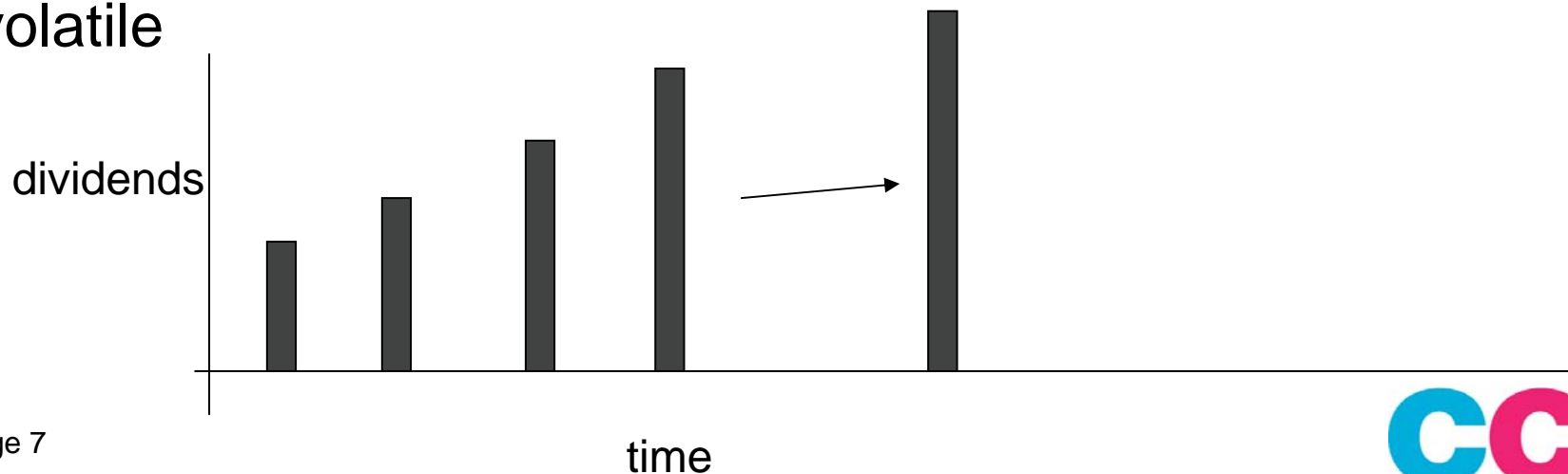
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With equities, the returns that investors receive can be considered as

Dividends – relatively certain in the near term, increasingly uncertain in the future

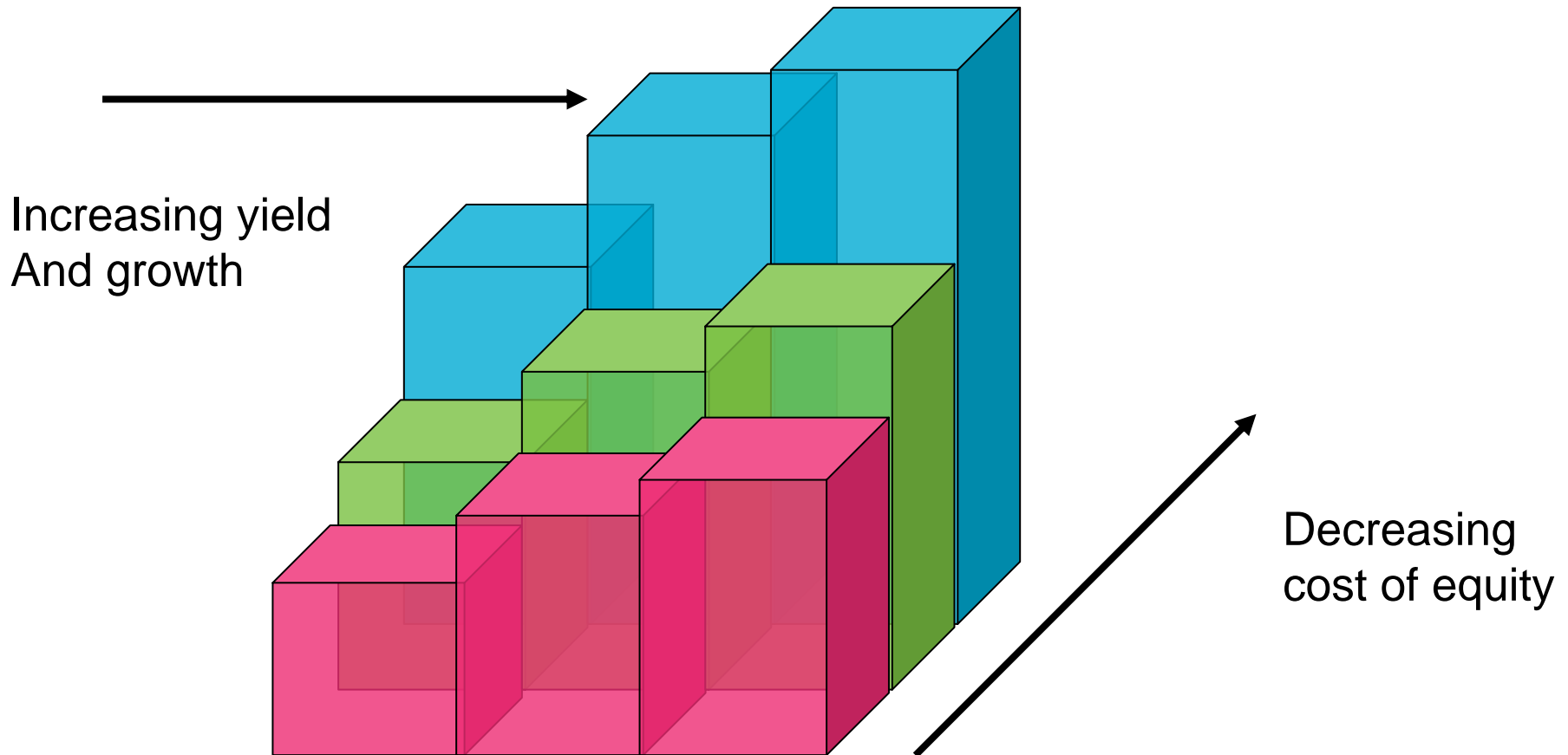
+ participation in growth – less and less certain as the time horizon extends

+/- changes in the valuation of that growth – inherently very volatile



Inflation is important for markets – we can see it but do we know why?

The 'fair' price that investors should be prepared to pay is dependent on dividends, growth and the cost of equity:



Inflation is important for markets – and the type of inflation is important too

‘Inflation’ simply refers to a hike or hikes in prices, and to understand what’s going on, and what we can and should do, requires us to think about

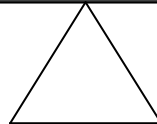
- Where the inflation comes from
- What sort of inflation we face
- What the detailed implications are for costs and markets

Stepping back: what the last few years have involved

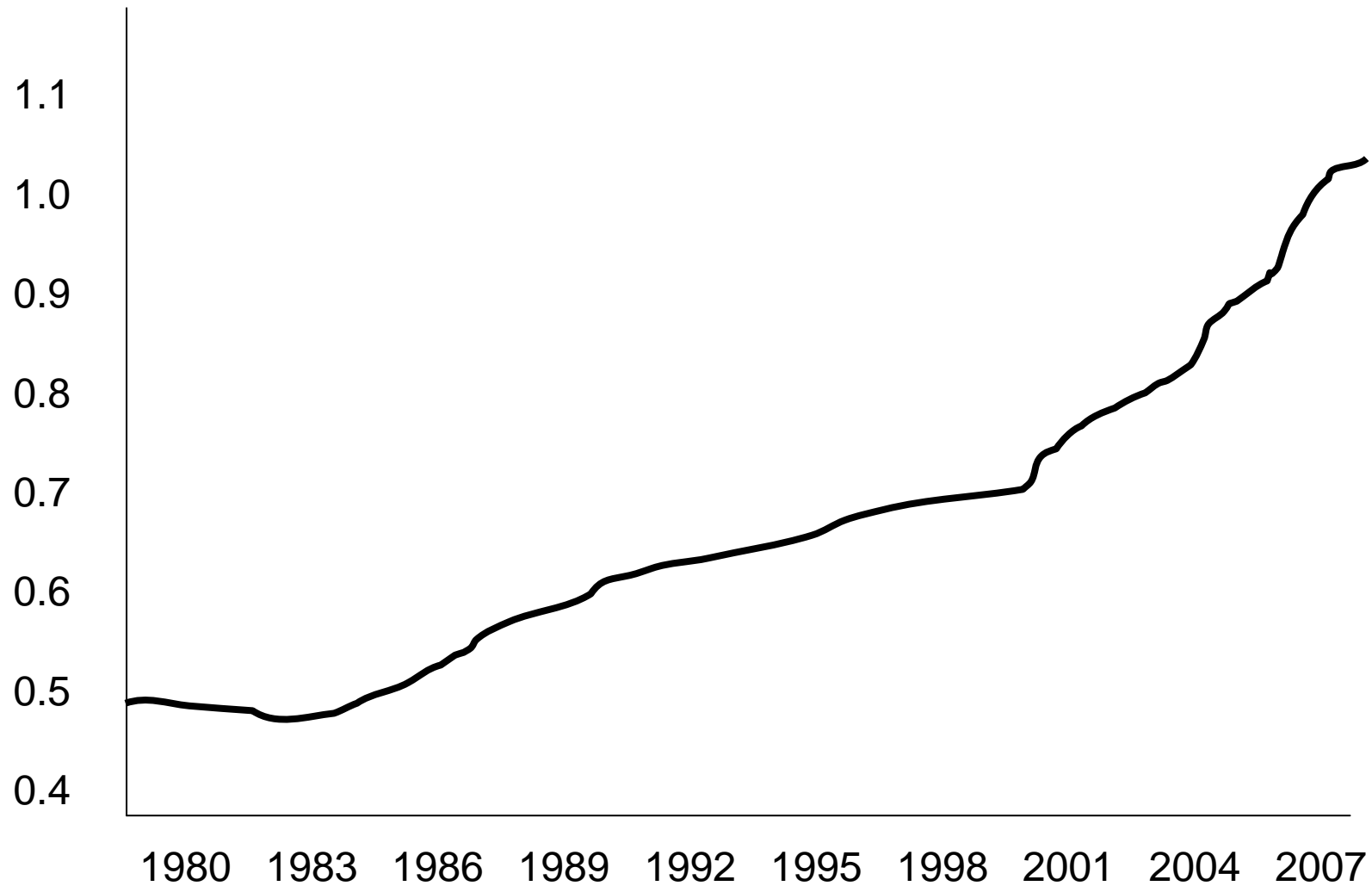
In recent years, markets have been grappling with substantial imbalances – which have persisted at least in part because it's suited the key participants

China and India:
-over producing
-under consuming
-excess savings
-exporting
 -goods,
 -services and
-capital

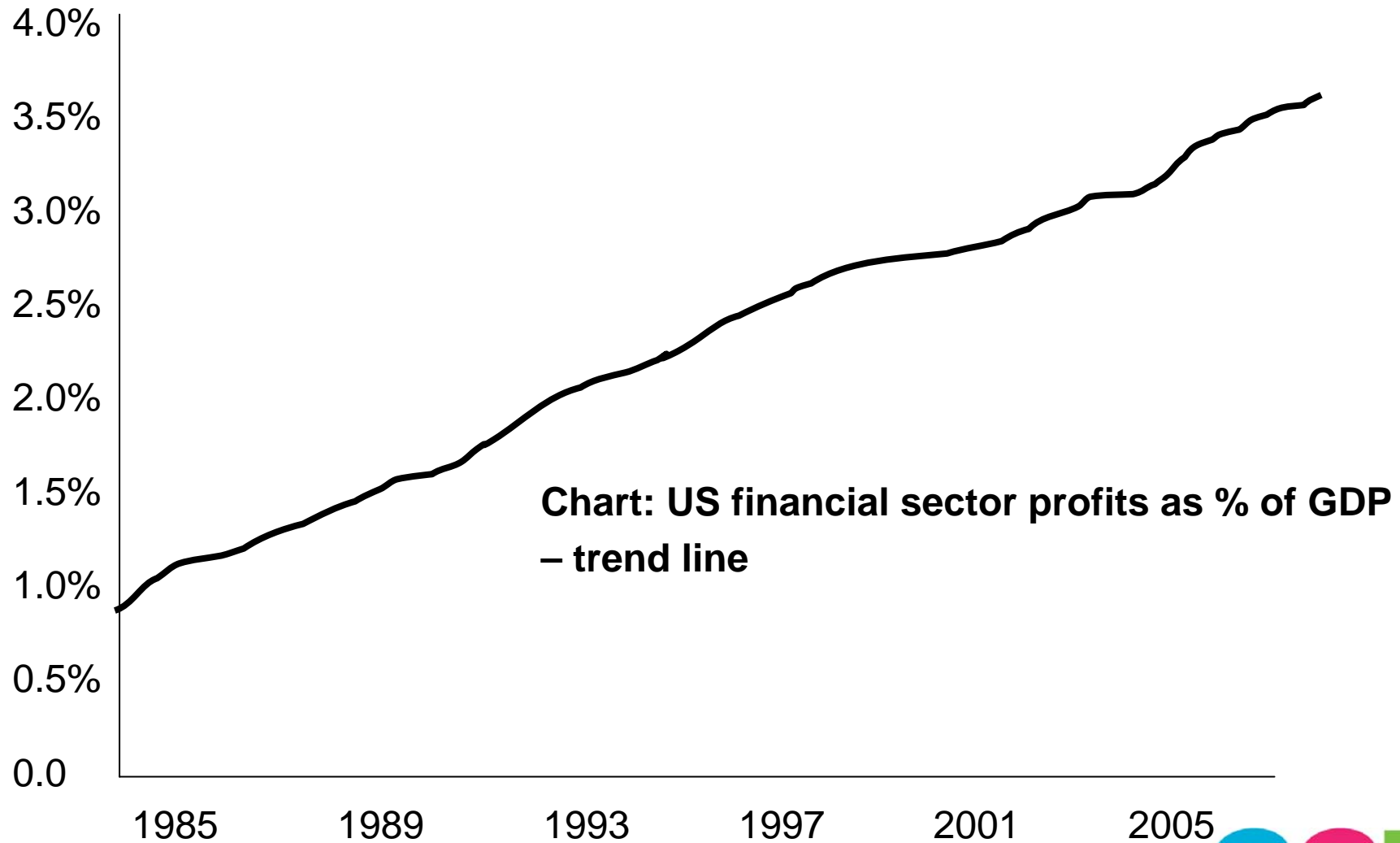
US:
-under producing
-over consuming
-no savings
-importing
 -goods,
 -services and
-capital



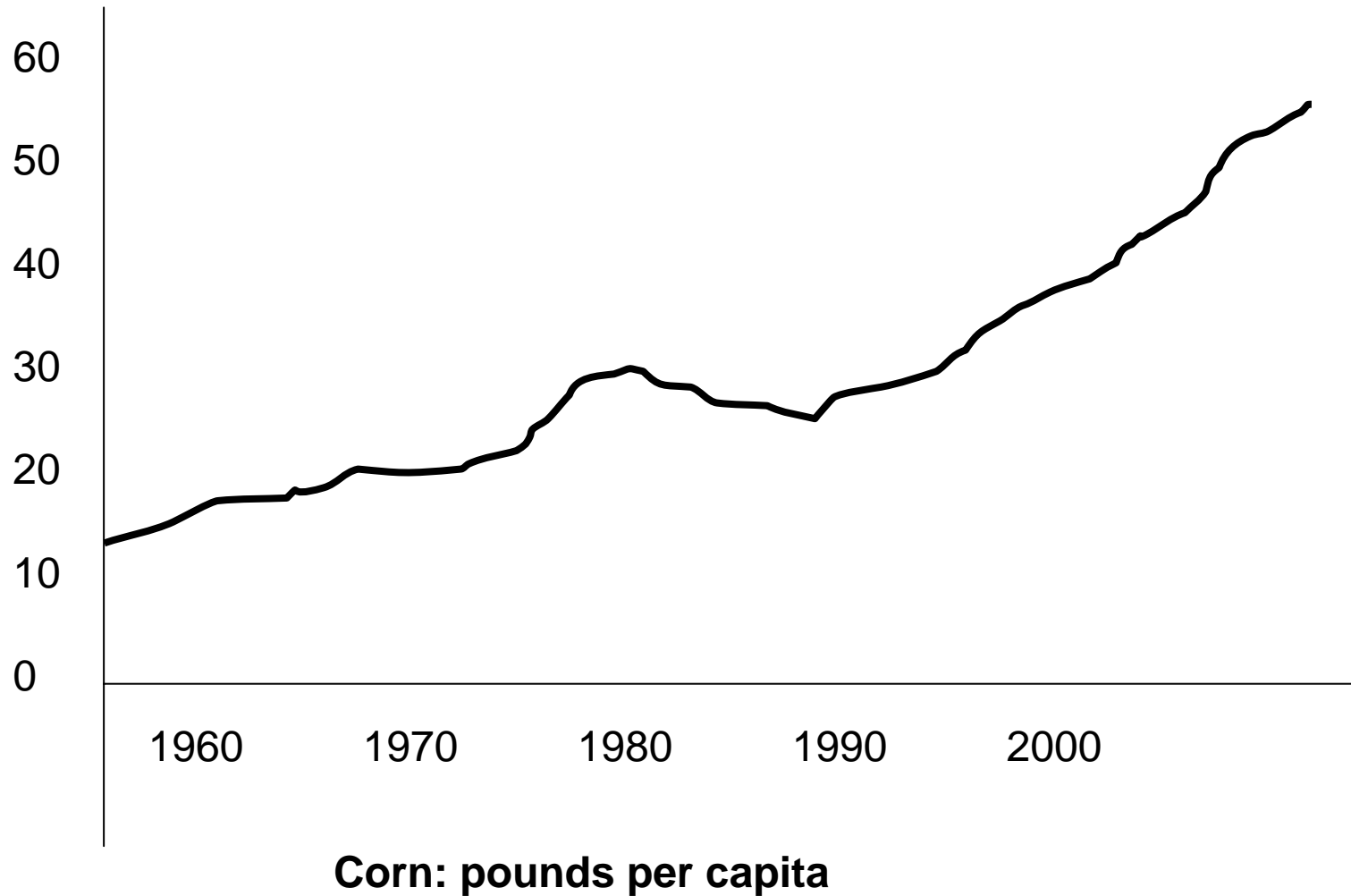
These imbalances have been growing over the years – Table: the ratio of US household debt/GDP



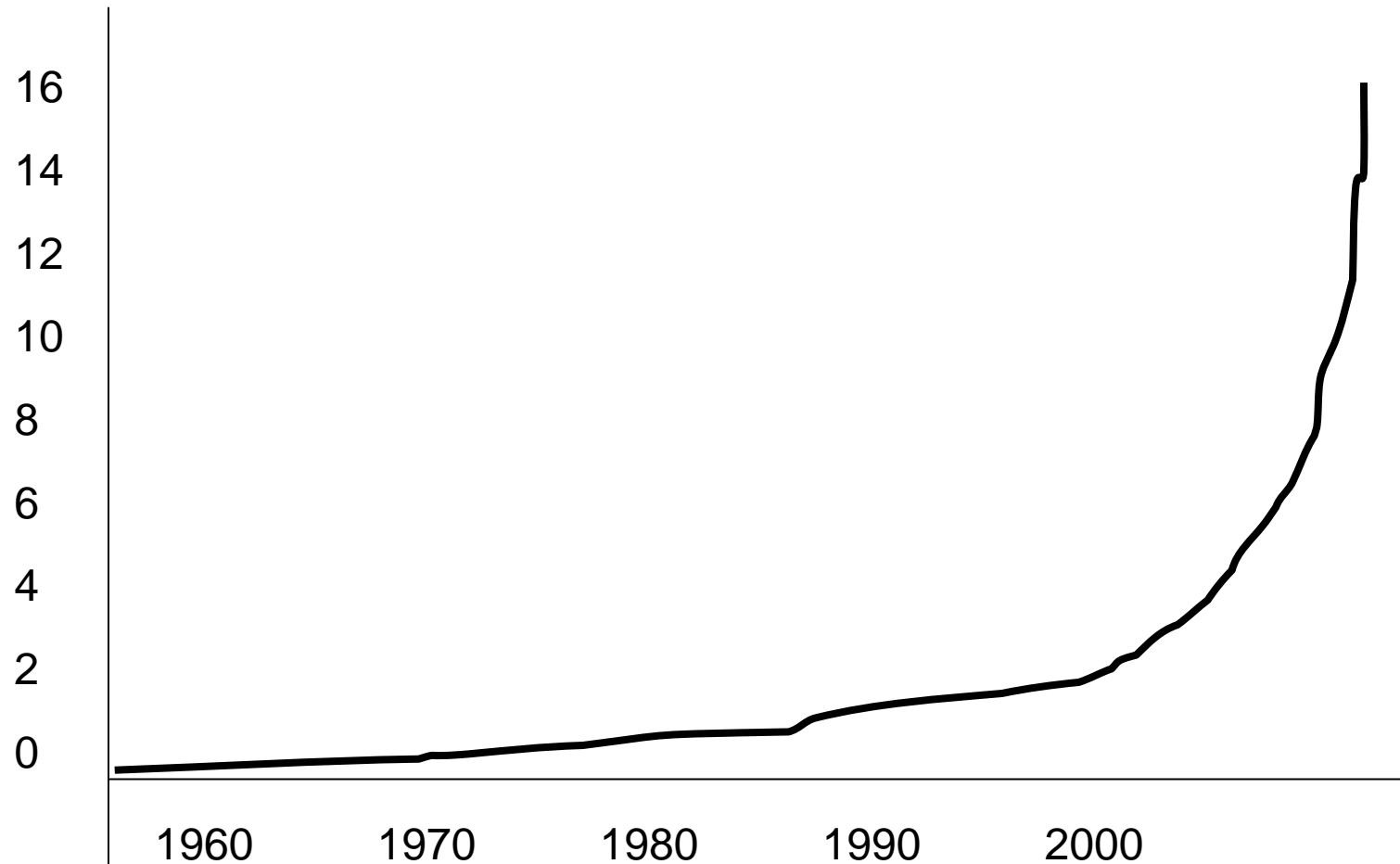
And fuelled by cheap borrowing costs and ample demand for borrowing, banks prospered:



Meanwhile, China's growth has involved a shift up in commodity consumption

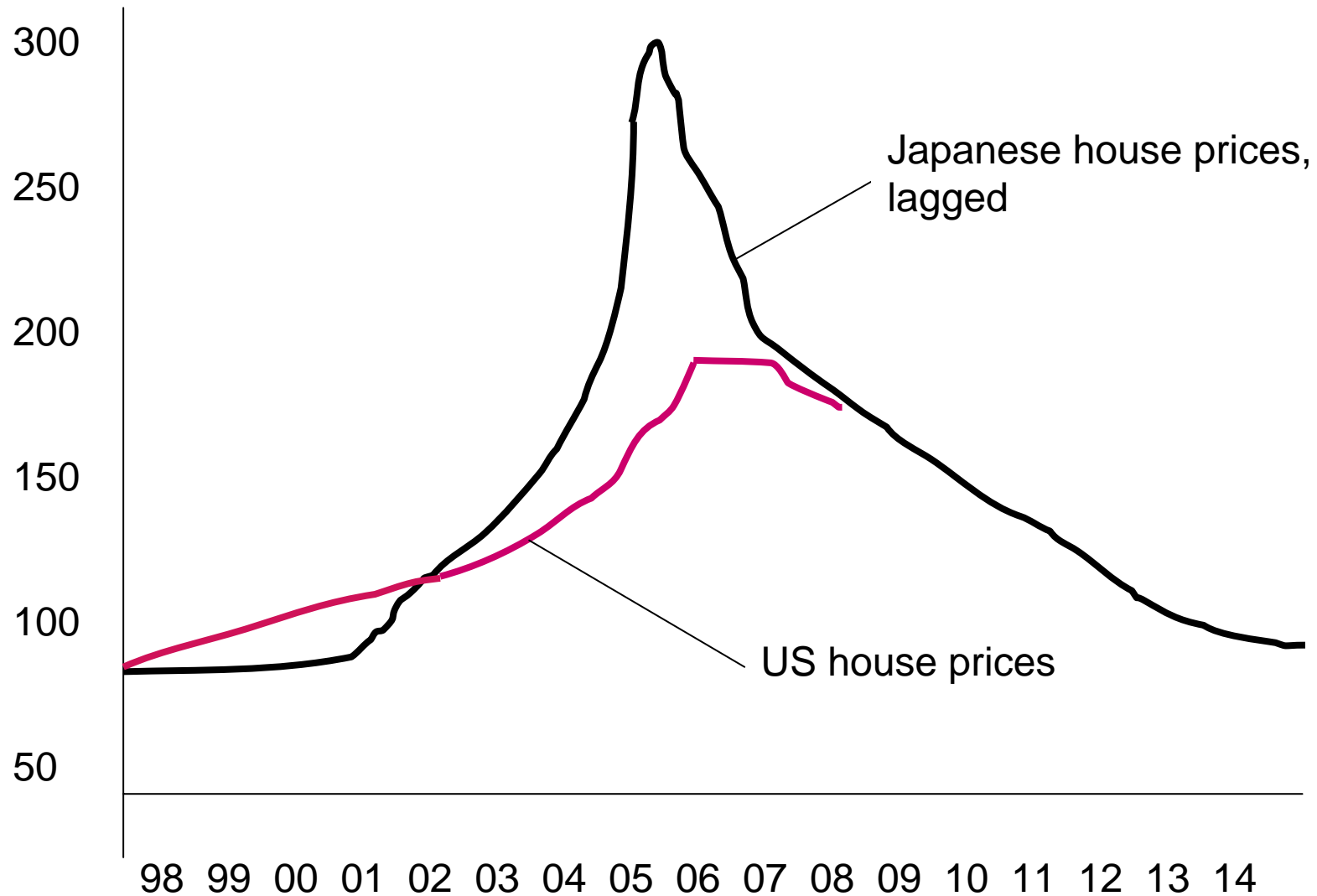


And the pick up in demand in a global context has been important

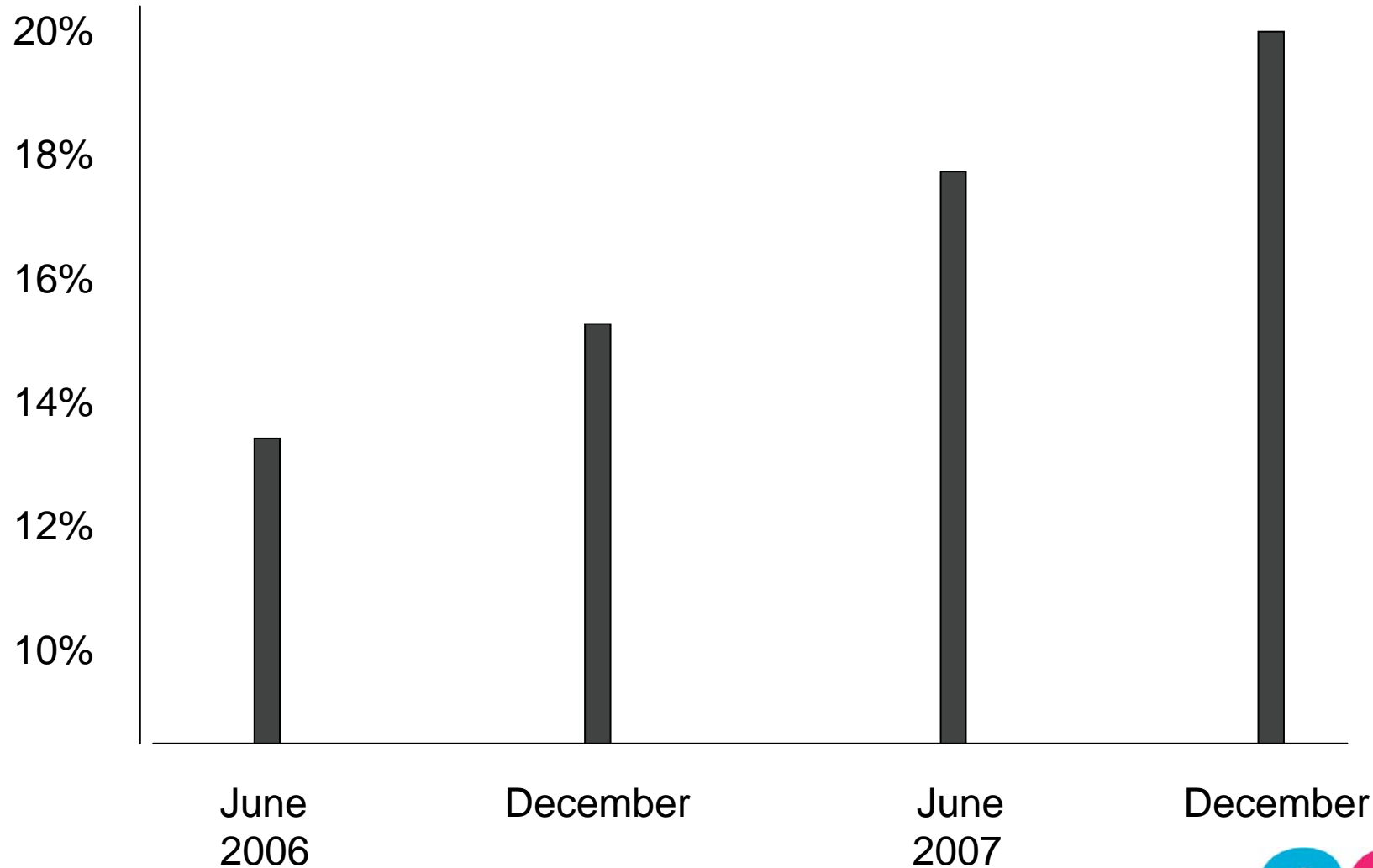


China's consumption: aluminium: kg per capita

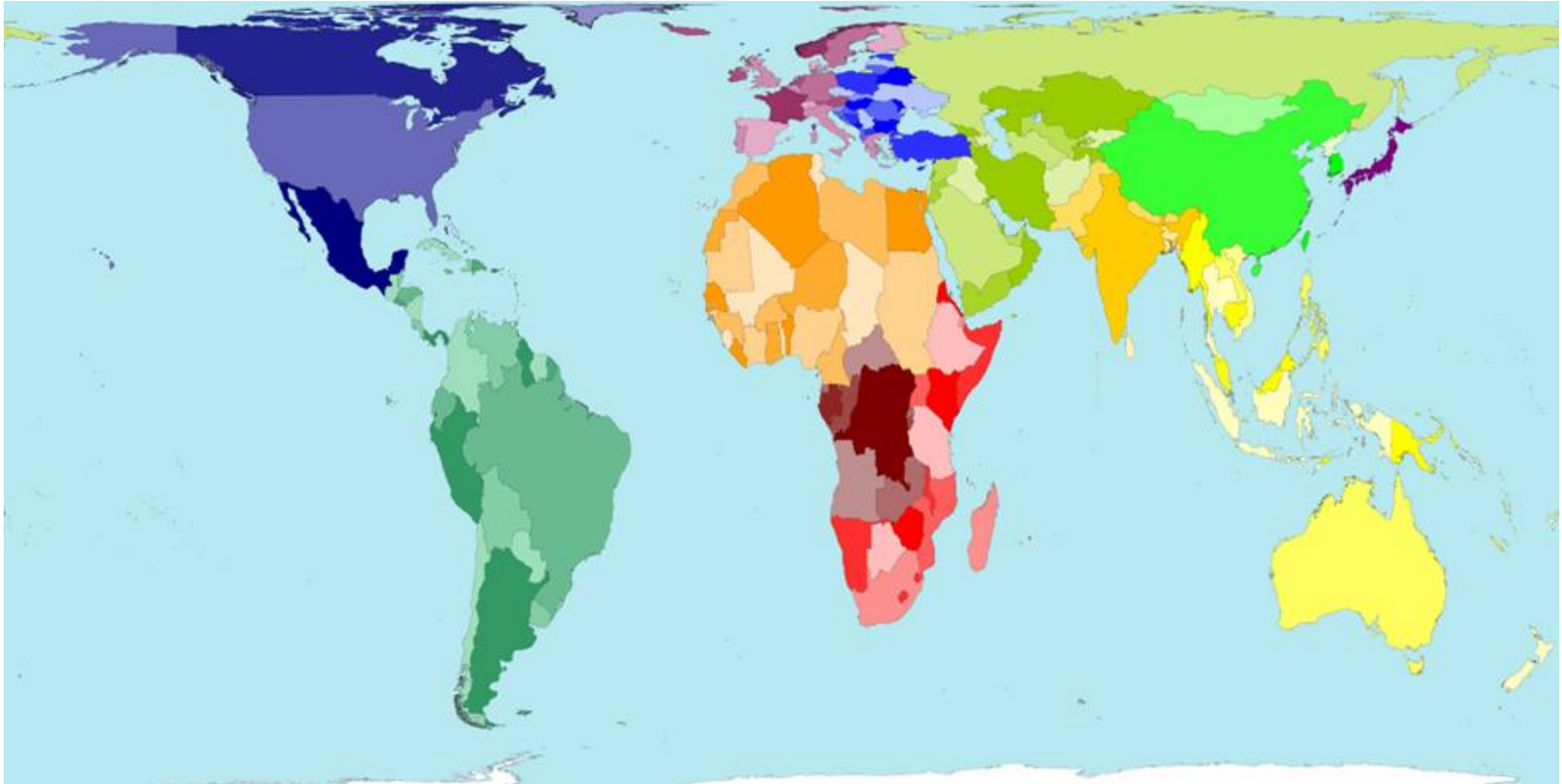
Cheap liquidity created some asset inflation problems which will take time to resolve



And some inflation pressures are only just beginning to emerge – here's the picture for China's wage inflation

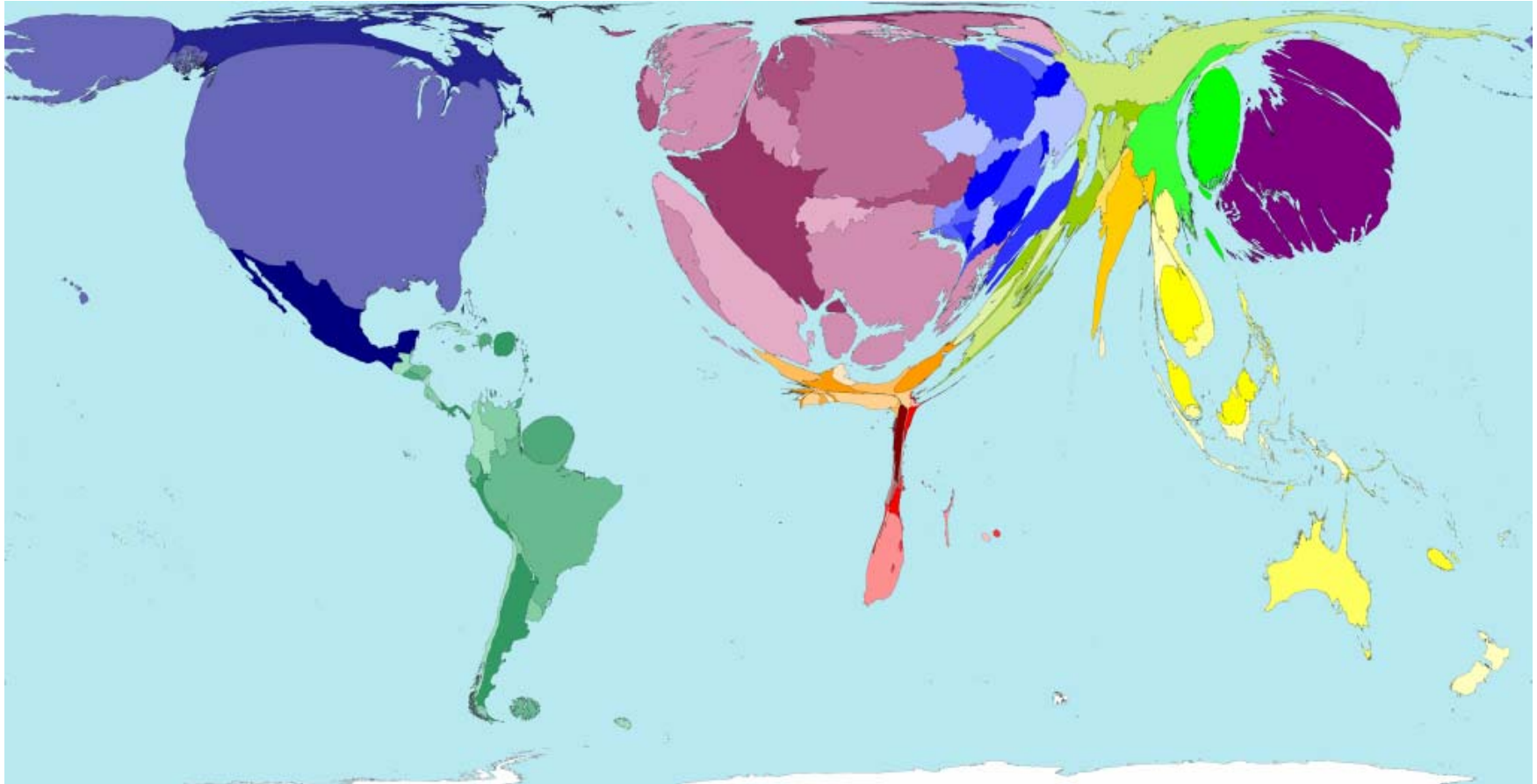


We can think about the world in terms of physical and political geography

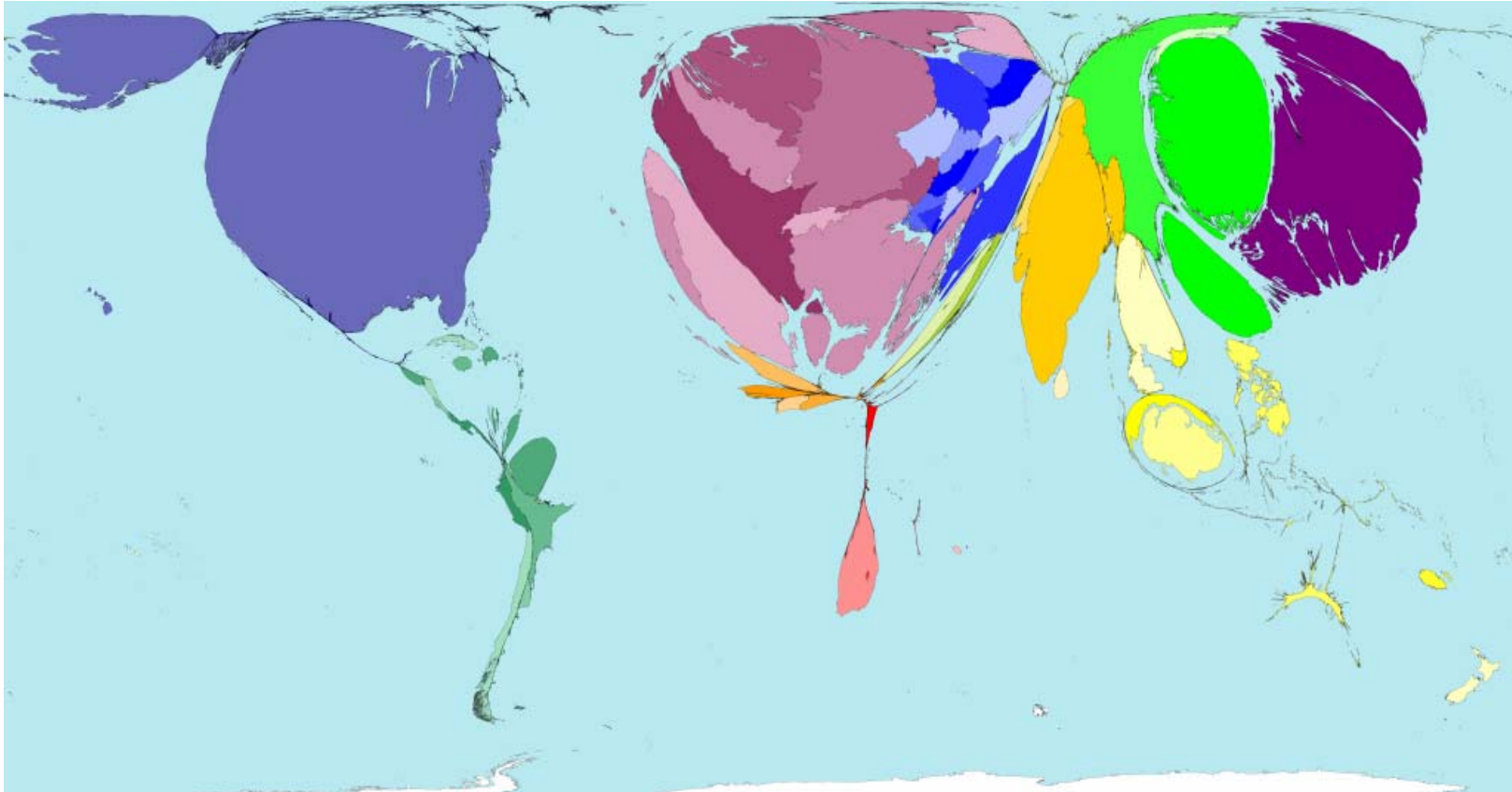


But for investment for need to consider other cuts

Here's the global picture of car ownership. A hike in one cost – wages – can have significant knock on effects



Car ownership patterns are connected to crude oil imports



- changes in supply and demand at the margin can create big price moves

But in plotting the outlook for inflation, we shouldn't forget the importance of exports and where the revenue goes



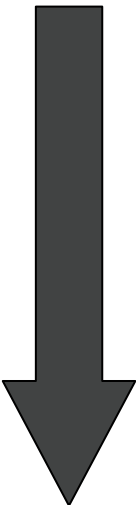
- How surpluses are 'spent' is very significant for the global economy and markets

So what might lie ahead?

Scenario	Growth	Inflation – Commodities	Finished Goods	Wages
Goldilocks	✓	x	x	x
Fast growth	✓	✓	x/✓	x
Overheating	✓	✓	✓	✓
Stagflation	x	✓	✓	✓
Recession	x	✓	x	✓
Recovery	✓	✓	x/✓	x/✓

We enjoyed years of benign growth:

Scenario	Growth	Inflation – Commodities	Finished Goods	Wages
Goldilocks	✓	x	x	x
	Growth supported by the global imbalances	Commodity prices primarily driven by developing economies	Finished goods prices affected by source, brand and margins	Developed economy wages held down by outsourcing
Fast growth	✓	✓	x/✓	x



But growth is now under significant threat... what might lie ahead?

Scenario	Growth	Inflation – Commodities	Finished Goods	Wages
Fast growth	✓	✓	x/✓	x

- The 'credit crunch' threatens a huge slowdown in growth, but
- Developing economy growth continues to drive commodity prices.
- Inflationary pressures rise and recorded inflation may accelerate.



?

Stagflation



?

Recession



?

Recovery

Where we came from was good for assets

Scenario	Growth	Inflation – Commodities	Finished Goods	Wages
Goldilocks	✓	x	x	x

- Potentially good for all assets!

Fast growth	✓	✓	x/✓	x
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- Problems can emerge for Fixed Interest, as policymakers seek to constrain growth with higher interest rates

Where we may go affects the returns from assets: 1:

Scenario	Growth	Inflation – Commodities	Finished Goods	Wages
Stagflation	x	✓	✓	✓

- Bad for most assets,
- but diversification towards more robust economies and across assets can help, whilst
- Fixed Interest losses are irrecoverable

Where we may go affects the returns from assets: 2:

Scenario	Growth	Inflation – Commodities	Finished Goods	Wages
Recession	x	✓	x	✓

- Bad for consumer-focused equities,
- but the risks of accelerating wage inflation make Fixed interest high risk.
- Best to focus on dividends and dividend growth.

Where we may go affects the returns from assets: 3:

Scenario	Growth	Inflation – Commodities	Finished Goods	Wages
Recovery	✓	✓	x/✓	x/✓

- Good for most assets, but
- especially good for
 - equities and
 - real estate

What does this mean for assets?

1. Uncertainties mean that markets will likely remain turbulent for the foreseeable future
2. Equities with strong free cash flows, robust balance sheets and able to pay growing dividends, and First class properties, with rising rental streams
Are the right points of focus for trustees
3. Infrastructure may also merit detailed consideration as part of a well-diversified portfolio
4. Fixed Interest – particularly long dated government issues – look risky
5. For trustees unable or unwilling to accept a bumpy ride, the returns from cash remain attractive

Questions

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