

Quarterly Review Autumn 2011

The Economic and Market Background

This has been such a frenetic quarter that it is quite difficult to know where to start. Early in August attention shifted quite dramatically back to Europe, the apparent inability to agree some form of rescue package for Greece and the extent to which Portugal, Spain and Italy would follow in Greece's wake. This led rapidly to another round of banking problems for those (European) banks holding Greek debt, and stock markets swooned as the potential recessionary impact of all this became apparent.

Meanwhile, government bond markets soared (well, those where the government is trusted) as 'safe havens' were sought. America's loss of its 'triple A' rating was ignored (and widely ridiculed); US bonds have not looked back since.

Putting aside the eerie parallels between Greece and Argentina ten years ago, Europe's leaders have been given an unpleasant shock that is probably sufficient to break the political paralysis. I anticipate that a comprehensive package of support for the eurozone will emerge in the next few weeks, centred on a huge (costly) expansion of the European Financial Stability Fund (EFSF) and fresh capital for the region's banks. As Martin Wolf succinctly put it in *the Financial Times*: "The need for such a rescue may be viewed as the price of having entered hastily into an indissoluble monetary marriage, tolerating the emergence of huge imbalances, failing to discipline the banks and then dealing with the emerging crisis so incompetently."

Such a package should restore some calm to the region, and to world markets. I consider this to be the wrong solution to the problem; I fear that the eurozone may ultimately prove to be another monument to political folly, but we must see what is actually proposed. I find it hard to understand why the European Central Bank has maintained the increase in European rates imposed earlier in the year. As some might observe – what planet are they on?

America is sufficiently concerned with European matters that the Secretary of the Treasury, Timothy Geithner, has been dispatched to impress upon Europeans how crucial it all is (nothing like a foreign distraction from problems at home). The Federal Reserve is indulging in a variation on quantitative easing, 'operation twist' as it has been dubbed, in an effort to push longer-dated interest rates even lower. Though recent US economic statistics have actually been better than expected.

Back home, The Bank of England has just announced further quantitative easing in an attempt to boost the domestic economy. For those of us who remember the state of the nation in the early 1970s, the recent observation from the Governor, Mervyn King, that the crisis was the most serious since the 1930s "if not ever", sounds like hyperbole.

By the end of the quarter sentiment was so negative as to appear to be discounting the worst possible outcome. Attempting to stand back and take a longer-term view, I do worry about a number of the supposedly safe assets at current prices. The last time that UK government securities offered such low returns was post war; an investment then produced a negative real return of around 3% annually for the following thirty years including re-investment of untaxed income.

More prosaically, I felt that I should mention that the dividend payments from our equity funds (payable at the end of November) are higher than last year and we anticipate that this will also be the case in April.

James Mahon, October 2011

Regulation Corner and Risk Warnings

As always, I should remind you that investing in stock markets and other assets is risky (possibly this is not necessary at present). If you have any doubts about your portfolio or there are any changes in your circumstances that we should know about then do, please, get in touch. Please remember that:

The value of investments and the income you get from them may fall as well as rise and there is no certainty that you will get back the amount of your original investment. You should also be aware that past performance may not be a reliable guide to future performance.

Information on our funds is interspersed through this Review. Some, or all, of these funds feature in most portfolios and the warning above is pertinent to each of them as well as to investment portfolios generally. The main risks they face arise from market price and interest rate risk. They have no borrowings, or unlisted securities of a material nature, so there is little exposure to liquidity or cash-flow risk. We review the policies for managing these risks on a regular basis.

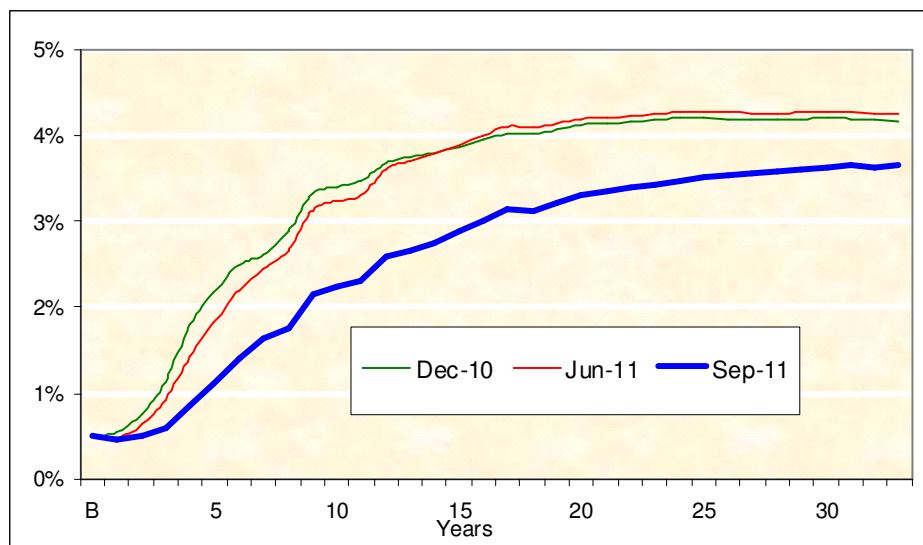
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The UK Economy and Interest Rates

Concerns over the fate of the eurozone and scaling-back in expectations for economic growth led to a rush for Government bonds (gilts) and interest rates moved lower again. The Monetary Policy Committee (MPC) of the Bank of England (the Bank) is now expected to hold the base rate at one half of one per cent into 2013. Our chart of the yield curve illustrates the fall in interest rates (rise in gilt prices) clearly: the ten-year rate having fallen sharply from 3.6% at the end of June to just 2.4% at the end of September:

UK (Government) Interest Rates 2011 - (The Yield Curve)



B = Base rate Source: Church House

Economic growth remains sluggish and is likely to struggle to remain in positive territory for the rest of the year. The unemployment figures make for uncomfortable reading: over the three months to August the headline rate rose to 8.1% and the number out of work rose to the highest level since 1996. Meanwhile, for those in work, pay is increasing slower than inflation so the squeeze on 'real' incomes continues.

Expect increasing pressure on the Chancellor and the Government to ease up on the 'fiscal austerity' and come up with a 'plan for growth'. The Chancellor is more likely to look to the Governor of the Bank and their quantitative easing (QE) programme. The Bank's own analysis of the first £200bn of QE suggests that it had a similar affect to a cut in interest rates of between 1.5% and 3%, so, possibly, we should be reflecting this in our charts to show negative interest rates.

The Bank has just announced the addition of a further £75bn to their 'asset purchase programme' (QE), continuing this period of negative interest rates. In their statement announcing the extension to QE, the Governor said that the deteriorating outlook (blamed squarely on Europe) made it more likely that inflation would fall below their 2% target "over the medium term" - so an injection of further monetary stimulus was required. We are inclined to agree with the section of their statement on inflation:

"CPI inflation rose to 4.5% in August. The present elevated rate of inflation primarily reflects the increase in the standard rate of VAT in January and the impact of higher energy and import prices. Inflation is likely to rise to above 5% in the next month or so, boosted by already announced increases in utility prices. But measures of domestically generated inflation remain contained and inflation is likely to fall back sharply next year as the influence of the factors temporarily raising inflation diminishes and downward pressure from unemployment and spare capacity persists."

Pensions

An unfortunate by-product of the steep fall in longer-term interest rates is an equally steep increase in pension liabilities. Any company, government or other public institution that has promised to pay pensions to employees in the future must (should) discount those future liabilities at an equivalent long-term interest rate.

So, as governments put pressure on long-term interest rates via quantitative easing, or the Federal Reserve's 'twist', they automatically pile on the current value of that future liability. In response, of course, companies, governments etc, should put aside more money for their pension funds - but then they wouldn't be able to invest that money in new productive projects, so the economic recovery will be hit again (cue more quantitative easing etc ...).

Reporting and Percentages

Stock markets (and risk assets generally) suffered a sharp setback at the beginning of August that was indeed worthy of news coverage: the FTSE 100 Index fell 13% over the first two weeks of August, reaching a (closing) low point on 10th of the month.. Since then, markets have been fractious and volatile but, quite possibly, the continued reporting has been somewhat extreme.

Over the subsequent eight weeks there were a number of bleak days: on 18th the Index fell 4.5%, over the weekend of 2nd to 5th September it fell 5.6%, over the following weekend it fell 4%; and finally on 22nd September it completed a two-day fall of 6%. Each occasion appeared to me to be reported with glee and yet, over that whole period from the close on 10th August to 30th September the Index actually *rose* by 2.4%. Perhaps I am just feeling jaded after the last few months.

The Eurozone

The crisis in the eurozone, and particularly in Greece, moves on apace. Whatever I write is likely to be overtaken by events, so this piece presents a longer-term view. I am expecting the Germans to broker a deal shortly that will provide some succour for the region over the next quarter, presumably involving some form of recapitalisation of European banks, support for Southern European debt markets (and the Greek economy) and promises as to future fiscal rectitude and harmonisation.

My thesis here is that this may well provide some breathing space for Europe (and world markets) in the short-term, but it is not a long-term solution. I consider the euro 'project' to be a failure and it is only a recognition of this that will lead to genuine long-term solutions.

Countries joining the eurozone agree to drop their own currency in favour of the euro and to cede control of monetary policy (essentially the setting of interest rates) to the European Central Bank (ECB). They agree to do lots of other things too, like keeping their budgets in balance, but these two are the important facts that cannot be avoided, the rest can be fudged (and are extensively). Fiscal policy (setting of tax rates and budgets) remains with individual countries.

The 'one size fits all' interest rate policy has been a major problem for a number of countries in the eurozone. Take Ireland and Spain as examples; during the period 2003/5 they had domestic inflation rates of 3%-5% but the ECB held interest rate at 2% (German inflation was running at 1%/1.5%). So, interest rates were too low for Ireland and Spain and, rather than build factories, it was much simpler to borrow cheap money and build housing estates. Marvellous for a while, until the merry-go-round stopped. Then Spanish and Irish banks were left with unsalable assets and their economies saddled with huge debts.

The eurozone was supposed to promote a gradual coming together of economic performance and prosperity across the union, sadly this has not been the case. I am indebted to a paper by Christopher Smallwood for Lombard Street Research for some of the data in this piece. In his paper he notes:

“The great failure of the eurozone has been that instead of encouraging the economic performance of member states to converge, the opposite has taken place, with Club Med steadily losing competitiveness against stronger economies in the north, and most spectacularly against Germany. The loss of competitiveness in terms of unit labour costs between Club Med on the one hand and Germany on the other amounts to some 30% since 1999. Trade balances within the eurozone have steadily moved against the weaker economies, reflecting these differential cost movements, and it is clear that there can be little prospect of a sustainable return to growth in countries such as Greece and Portugal (and it can be equally argued Spain and Italy as well). If this does not happen, they are condemned to indefinite stagnation, and it is important to recognise that fiscal union will operate to reinforce this outlook.”

The solution apparently being proposed for the problems in the eurozone essentially amount to compelling the Mediterranean economies to be more like Germany. After first applying a huge sticking plaster in the form of a massive European Financial Stability Fund (EFSF) and fresh capital for those European banks who will have to write-off a large part of the value of their Greek (and other) debts. (I have a lot of sympathy for the Slovakian opposition spokesman who observed that a solution involving borrowing vast amounts of money to pay off debts was not a good solution).

There is a lot of talk around the idea of 'fiscal harmonisation'. The German Finance Minister, Wolfgang Schäuble, observed recently: "I am convinced that, with the escalation of the crisis, the time has come to accelerate the process of changing the political and institutional structures of the Union towards a political and fiscal union. Otherwise it will be extremely hard to convince markets of the eurozone's long-term sustainability". While this route appears to be the preferred option for Europe's political leaders it is fraught with difficulties.

Remember that Germany has spent vast sums (maybe €1.3 trillion) on bringing the former East Germany closer to West Germany, but this is widely perceived by Germans to have been a waste of money. If such a vast bail-out does not work so close to home it is hard to see a similar bail-out for Mediterranean countries gaining popular support; presumably that is why Chancellor Merkel's CDU party is suffering in local and regional elections. And viewed from the Greek/Portuguese/Spanish/Italian side of the fence one needs to be clear as to what fiscal harmonisation implies.

With the burden of huge debts, high unemployment and uncompetitive labour costs, re-balancing their budgets means severe cut-backs which, in turn, will depress their economies. Assuming compliant populations, this would take many years of hardship. But I find it hard to see why one would expect compliant populations. Spanish youth unemployment is already scarily high, imposing stringent budgets is surely a recipe for social and political unrest on a grand scale. At times of stress like this, I expect political nationalism to be on the increase and a recipe that essentially puts Germany in control of Europe's budget (and policy) seems likely to be most unwelcome. European history is just too big a hurdle.

Strong economic growth is the answer to their problem but this does not appear to be addressed in any sensible timescale. The only way out that makes sense to me is to face that other tenet of the eurozone, that one exchange rate works for all. The safety valve of varying exchange rates counterbalances the huge disparities in cultural values, economic and working practises that exist in the different countries of Europe. The solution is to recognise this and allow countries to leave the eurozone and re-establish their own currencies.

Of course this would need to be carefully handled, but the subsequent devaluation of Southern European currencies (and revaluation of the Northern euro) could provide exactly the boost to economic growth that is required.

Credit Ratings

After the downgrade of US Government debt and multiple downgrades of the debt of various European countries, credit ratings are frequently in the news. Several clients have asked me to set out what the various ratings mean so this is a brief 'starter' (those with a financial background please move on). The basic idea of a credit rating is to provide a view as to the credit worthiness of any particular company, institution or country, essentially their ability to repay their debt. Much as a bank manager is supposed to form a view as to the likelihood of an individual being able to repay a loan before advancing any money. There are a number of institutions carrying out such credit checks, for these purposes the best known are Standard & Poor's and Moody's (not Jerry's favourite institutions – see his Credit Market commentary below).

The other point to understand is that any particular institution might have different classes of debt and each class can have its own credit rating. So, for example, a bank may borrow (issue some debt securities) against a specified pool of assets that comfortably covers the value of the debt and repayment of the debt is separate from the fortunes of the rest of the bank – such a debt security will attract a high credit rating. But the same bank may also borrow unsecured with repayment subordinated behind other more senior debt of the bank – this will attract a significantly lower credit rating. The job of the credit rating agencies is to consider each borrower, and the nature of the particular debt they have issued, and so to form an opinion as to their ability to repay their debts in the future (and not to default on interest or capital payments). For simplicity and ease of comparison, the agencies then assign a rating, on a scale from AAA down to D, to each debt instrument. Technically, the ratings represent an assessment of default risk; here are the (slightly abbreviated) official definitions and comments from Standard & Poor's:

AAA An obligation rated 'AAA' has the highest rating assigned. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

AA An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.

A An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

BBB An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

Obligations rated 'BB', 'B', 'CCC', 'CC', and 'C' are regarded as having significant speculative characteristics. 'BB' indicates the least degree of speculation and 'C' the highest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.

BB An obligation rated 'BB' is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

B An obligation rated 'B' is more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.

CCC An obligation rated 'CCC' is currently vulnerable to nonpayment, and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation.

CC An obligation rated 'CC' is currently highly vulnerable to nonpayment.

C A 'C' rating is assigned to obligations that are currently highly vulnerable to nonpayment, obligations that have payment arrearages allowed by the terms of the documents, or obligations of an issuer that is the subject of a bankruptcy petition or similar action which have not experienced a payment default.

D An obligation rated 'D' is in payment default. The 'D' rating category is used when payments on an obligation, including a regulatory capital instrument, are not made on the date due even if the applicable grace period has not expired, unless Standard & Poor's believes that such payments will be made during such grace period.

The ratings from AA to CCC may be varied with the addition of a plus or minus sign to show relative standing within the rating categories.

The FTSE APCIMS Indices

The table below shows the performance of the Private Investors' Indices from the Association of Private Client Investment Managers and Stockbrokers (APCIMS) for the six months*, excluding income. These are based on long-term model portfolios of APCIMS members and are designed to give private investors a benchmark against which to judge their own portfolios.

Private Investors' Indices	30 September 2011	31 March 2011	% Change*
Income	2188.4	2307.7	-5.2%
Balanced	2735.1	2984.8	-8.4%
Growth	3041.8	3426.4	-11.2%

Source: FTSE Group in association with APCIMS

* All the statistics in this report show comparisons with 31 March to match with the accompanying portfolio valuations, unless specifically marked otherwise. The commentary largely relates to the third quarter of the year as we reported in July on the previous quarter.

Church House Investment Grade Fixed Interest Portfolio

	30 September 2011	31 March 2011	%
CH Investment Grade* -	102.8	102.9	-0.1%
iBoxx AA Corporate 5-15 year	81.9	83.3	-1.7%
FTSE 5-15 year Gilt	184.0	171.6	+7.2%
CH Investment Grade - Accum.	125.4	123.5	+1.5%
ML AA Corp 7-10 years**	229.9	223.7	+2.8%

*bid price to bid price, excluding income, Fees are split 50/50 capital/income. **Total Return Index.

The following four pages cover the Fixed Interest portfolio. This page looks at movements in the portfolio since the end of June. Jeremy's economic and credit market commentary follows overleaf; then there is the portfolio itself and some more analysis of the mix of investments within the portfolio.

Fixed Interest Portfolio Statistics – 30 September 2011

Short-dated Securities (less than 5 years)	27.5%
Medium-dated Securities (5 to 15 years)	54.9%
Long-dated Securities (over 15 years)	17.1%
Average Life of Holdings	9.7 years
Duration of Portfolio (Macaulay)	6.2 years
Number of Holdings	126
Gross Yield	4.5%
Net Yield	3.6%
Portfolio Value	£55.4m

This table shows the broad disposition of the portfolio at the end of the month: currently 126 investments, with an average life to maturity of just less than ten years. All of the fixed interest issues are denominated (and pay interest) in £ sterling. The 'running' income yield on the portfolio is currently 4.5% (3.6% net) a touch higher than it was three months ago, despite the fall in interest rates generally. This is a reflection of the widening of credit spreads over the period, i.e. the yield on corporate debt has risen while the yield on UK Government debt has been falling.

New additions to the portfolio over the quarter include three from utility companies: **Scottish Power Distribution**, **Eastern Power Networks** and **Southern Gas Networks**. Also new to the portfolio are the **Imperial Tobacco** 5.5% issue due 2026 and the **Barclays** floating rate note issue due 2017. Gone from the portfolio are the **Export Canada** 2015 holding, which had served its purpose, and the long-dated, 2031, **BAA** holding (we hold three other issues from the airport operator).

But this was a period when new issues were few and far between so we added to a number of existing holdings as credit spreads widened, including: the **Coventry Building Society** 4.625% 2018 issue, **Linde Finance** 8.125% 2016, **Barclays** 14% 2019, **BP Capital Markets** 4.325% 2018 and **BG Energy Capital** 5.125% 2025. Going the other way, we reduced the holding of **Goldman Sachs** 6.125% 2017.

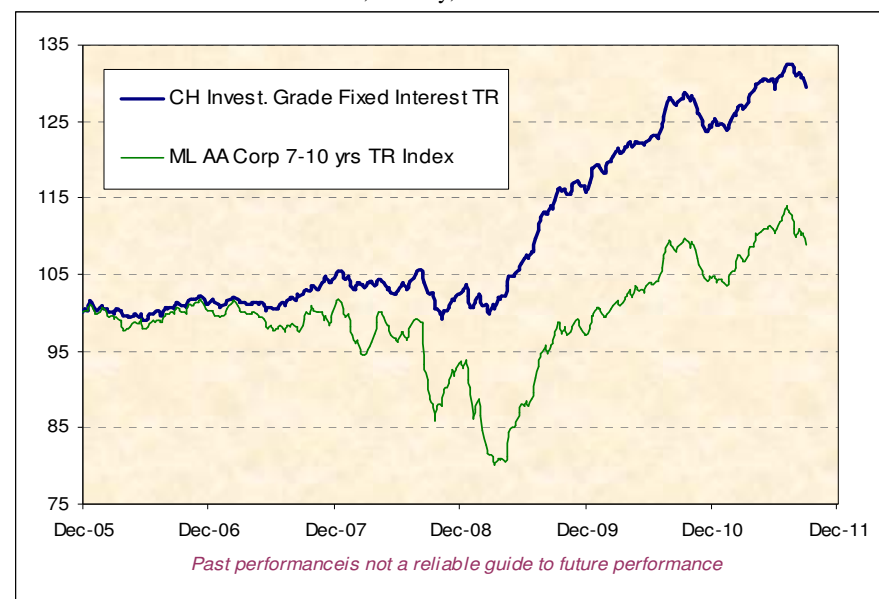
In recognition of the difficult conditions in (credit) markets and the paucity of new issues, we also purchased two significant gilt holdings during the period: **Treasury** 4.5% 2013 and **Treasury** 5% 2018. As and when credit market conditions assume more normality and the new issue market reopens we will sell these holdings down and re-invest in corporate debt for higher returns.

Calendar Year Performance

YTD	2010	2009	2008	2007
2.9%	7.1%	11.9%	-3.0%	2.4%

Source: Church House Investments, bid price to bid price, net income re-invested.

CH Invest. Grade Fixed Interest Portfolio v. AA rated Corporate Securities* Bid Prices, Weekly, Income Re-Invested



* Merrill Lynch 7-10 year AA Corporate Bond Index

Source: Church House

Credit Market Commentary – Jeremy Wharton

In Q3 the tsunami created by the 2008/9 credit crisis reached Eurozone Sovereigns and in turn their banking systems; early August saw a seizure in markets producing the worst quarter for credit since 2008. Systemic risk, in the form of forced exits and defaults from/within the Eurozone, potentially looms large. Bank capital structures felt these effects, widening significantly, whilst senior unsecured issuance dropped to zero. US money market funds withdrew funding from European banks, prompting a coordinated reinstatement of \$-swap lines by central banks.

When I began writing we had the monumentally absurd situation of twenty members of one party within the Slovakian coalition attempting to prevent the ratification of the EFSF. Hands up, I had to get a map out... If this former Soviet bloc country has to contribute 9% of its GDP to bailing-out the system from which it has benefited so much it seems like a tough, but fair, sacrifice. Having said that, you can see their point; they practised all the fiscal restraint and austerity needed to gain access to the system that Greece and others fudged to join and then openly flouted thereafter.

However, at this juncture the EFSF has become the only realistic chance the system has got, and it has now been ratified. Quite how it is to be funded remains to be seen, but it does need to be on a grand scale. The banking system needs a Euro TARP recapitalisation equivalent as well, ie every institution being forced to take new capital whether they want/need it or not. But where does this capital come from and who compels them to take it?

TARP did work in the States; the US banking system is in a much better state than this side of the Atlantic. Talk of such a system might not be entirely misplaced while the EFSF allows a managed default of Greece and ring-fencing of the rest of the PIIGS, although it is unclear how the latter might be achieved. What is clear is that the political will or cohesion that is paramount to achieve a resolution of this shambles might not necessarily be available. Systemic risk is in the hands of politicians and central bankers now.

We all politely ignore the fact that the ECB has only €10bn in capital and holds €130bn of Greek debt on their balance sheet - we see one reason here for lack of default and the difficulty of 50% haircuts....discussions are still on-going at the G20. There is no quick fix to this situation which resulted either from governments running-up unsustainable debts to create a false standard of living (via public sector non-jobs) or banking systems following reckless lending policies and requiring bailouts. The UK, uniquely, managed to run-up debts through both channels: remember that next time you hear opposition politicians sounding-off.

S&P did the dirty deed and downgraded the US to AA+. The SEC duly announced an investigation into the downgrade and US Treasuries have rallied significantly since. The US Justice Department continues its probe into the bonanza enjoyed by both Moody's and S&P as they over-rated mortgage-related securities in the lead up to the financial crisis which cost financial institutions \$2tn in losses. Quite why these institutions should still wield so much power, and be given so much credence, is beyond me. Latterly, rating agencies have acted aggressively against sovereigns and banks in an attempt to be ahead of the curve this time. However, the US downgrade came at an unfortunate time, converging with weeks of dreadful job numbers, weak GDP outcomes accompanied by universal reductions in economic forecasts, Spanish and Italian yields spiking, general worries over the weakness of global growth (and fears therefore of a double-dip back into recession), all conspiring to give risk assets the excuse to sell-off in a dramatic way, suffering severe dislocation over August and September. Many equity indices saw a retracement of nearly 20% as they priced-in a long period of reduced earnings.

Ignoring rating downgrades, yields on 'quality' and reserve currency sovereigns saw moves to record lows, especially further out on the curve, pushed down by safe-haven buying and the realisation that we really are in for the long low haul. Moves were also aided by direct language from the likes of Bernanke pushing out rate hikes to 2013. The US 10yr dipped below 2% and the Long Bond 3.3%, while 10yr and 30yr Gilts saw 2.2% and 3.6%.

Meanwhile, the ECB entered the market to buy up BONOS and BTIPS and successfully brought their 10yrs to sub 5% initially, although it will have to keep up the pressure and yields have since leaked wider to 5.25% and 5.73%. Eurozone collectivisation of debt looms ever closer despite squeals from Germany. Bunds are beginning to feel this effect already and German CDS are now trading outside the UK. Credit spreads pretty much doubled all round, with investment grade indices widening from 105 to 210. Spreads on financial paper took a pasting too, although we are now just beginning to see a turn, there is certainly some tremendous value on offer in selected credits and risk assets generally. However, we anticipate that the current volatility (and patchy liquidity) will persist for some time until we see a concrete and valid European policy response.

On the UK side of the fence the potential for more QE became a reality when a further £75bn was announced as hopes for decent growth become a fond memory, will it have any effect? Flattening yield curves will not help the profit forecasts of our own banking system. In the US, markets were disappointed by no QE3 announcement having to make do with Operation Twist, a plan to switch longer to promote further flattening. Latterly a new phrase of 'Japanisation' regarding Western economies has emerged and although one can frighten oneself with plenty of parallels I do not particularly agree with the theory – Western demographics are completely different.

Church House Investment Grade Fixed Interest Portfolio - 30 September 2011

Rating	Security	Weight	Rating	Security	Weight	Rating	Security	Weight
	<i>Floating Rate Notes</i>		A-	Close Bros 6.5% 2017	1.4%	BBB+	Aviva 6.625% 2021	0.7%
BBB	Standard Chartered FRN	0.5%	BBB	Yorks Water 6% 2017	1.0%	BBB-	Old Mutual 8% 2021	0.8%
A+	Barclays Bank FRN	0.3%	A-	A T&T Inc 5.875% 2017	0.5%	AAA	EIB 5.375% 2021	0.6%
A	Bank of America FRN	0.9%	A	Goldman Sachs 6.125% 2017	0.4%	A-	Legal & Gen. 10.125% 2021	0.6%
A+	JPMorgan FRN 2012	1.0%	BBB	Thames Water 5.375% 2017	0.5%	A	CNP Assurances 7.375% 2021	1.0%
AA+	Dexia Credit GG FRN	0.9%	BBB+	Anheuser Busch 6.5% 2017	0.5%	BBB+	Eastern Power 4.75% 2021	0.2%
AAA	EIB FRN 2014	0.8%	AAA	KFW 5.625% 2017	1.4%	AA	Nat Australia Bk 5.125% 2021	0.9%
AAA	Rabobank FRN 2014	1.8%	AAA	EIB 8.75% 2017	1.5%	BBB	Friends Provident 8.25% 2022	0.8%
AAA	KFW FRN 2016	1.8%	A	BG Energy 5.125% 2017	0.5%	AAA	Temasek Financial 4.625% '22	0.5%
AAA	IBRD FRN 2016	0.9%	AAA	GE Capital 4.125% 2017	0.9%	BBB	Thames Water 5.75% 2022	0.2%
A+	Barclays Collared FRN 2017	0.4%	AAA	Rabobank 3.25% 2017	0.9%	A	Coventry 5.875% 2022	0.9%
	<i>Short dated (less than 5 years)</i>		AA	Nat Australia Bk. 3.625% 2017	0.9%	A-	Aviva 6.125% 2022	0.5%
U/R	Asda Prop 10.31% Deb 2011	0.2%	BBB	Telecom Italia 7.375% 2017	0.5%	A-	Nat. Grid 4.188% I-L 2022	1.0%
A	Bank of Ireland LTII	0.2%	U/R	Temple Bar 9.875% Deb. 2017	0.2%	BBB+	Northumbrian 6.875% 2023	1.1%
A	RWE 6.375% 2013	0.5%	A+	HSBC 5% 2018/23	0.9%	A-	BAA 5.225% 2023	0.9%
U/R	Severn River 6.125% I-L 2013	0.5%	AAA	Coventry B/S 4.625% 2018	1.5%	A-	London Power 5.125% 2023	1.0%
A	RBS Capital 6.375% 2014	0.7%	AA-	RBS 6.625% 2018	0.9%	AAA	GE Capital 5.125% 2023	1.1%
A+	Santander 7.3% 2014/19	0.7%	AAA	EIB 4.75% 2018	1.0%	BBB	S Gas Networks 4.875% 2023	0.5%
AAA	New York Life 5.125% 2015	1.2%	A	BP Capital 4.325% 2018	0.9%	A-	Segro 6.75% 2024	0.2%
AA-	Roche 5.5% 2015	0.5%	AAA	Leeds B/S 4.25% 2018	0.9%	A-	ENEL 5.625% 2024	0.8%
AA-	Heineken 7.25% 2015	0.4%	A-	Southern Water 6.125% 2019	0.5%	U/R	John Lewis 6.125% 2025	0.7%
A	Lloyds 6.9625% 2015/20	1.2%	A-	Rolls Royce 6.75% 2019	0.1%	BBB+	BT Group 3.5% I-L 2025	0.7%
BBB	SSE 5.435% 2015 Hybrid	0.9%	U/R	John Lewis 8.375% 2019	1.1%	A	Central Nets. 5.5% 2025	1.0%
A	Soc. of Lloyds 6.875% 2015	1.0%	BBB	Royal Sun All. 9.375% 2019	1.2%	A	BG Energy 5.125% 2025	1.5%
A-	Portman 5.25% 2015	0.4%	A-	Barclays 14% 2019	1.4%	AAA	Nationwide 5.625% 2026	0.8%
A-	United Utilities 6.125% 2015	0.7%	BBB	Imperial 7.75% 2019	0.5%	BBB	Gatwick Funding 6.125% 2026	0.2%
U/R	Henderson Group 7.25% 2016	1.5%	A-	Yorkshire Water 6% 2019	0.7%	A-	Scot. Power 5.875% 2026	0.5%
BBB+	Akzo Nobel 8% 2016	0.4%	AA	Westpac 5% 2019	0.5%	BBB-	Imperial Tobacco 5.5% 2026	0.9%
U/R	Resolution 6.586% 2016	0.4%	BBB-	M & S 6.125% 2019	0.5%		<i>Long dated (over 15 years)</i>	
U/R	SVG 8.25% conv. 2016	0.4%	BBB+	Elec Supply Board 6.5% 2020	0.4%	AAA	Network Rail 1.75% I-L 2027	0.7%
BBB	LSE 5.875% 2016	0.6%	BBB	BUPA Finance 6.125% 2020	0.4%	A-	United Utilities 5.625% 2027	0.6%
BBB	Linde 8.125% 2016	1.0%	AAA	GE 5.875% 2020	0.5%	A	Bank of America 7% 2028	1.3%
A-	Siemens 6.125% 2016	1.0%	BBB	Eversholt 5.831% 2020	1.0%	A	Scot. & Southern 8.375% 2028	0.6%
	<i>Medium dated (5 to 15 years)</i>		AAA	Rabobank 4.625% 2021	1.0%	AAA	Lloyds C'vd 6% 2029	1.0%
AA+	Witan 8.5% Deb. 2016	0.2%	AAA	Abbey Nat 5.125% 2021	1.4%	AA-	Statoil Hydro 6.875% 2031	0.6%
BBB	Old Mutual 7.125% 2016	1.0%	BBB+	Lloyds 9.375% 2021	0.9%	A-	Centrica 7% 2033	0.6%
A-	Morrisons 6% 2017	0.6%	AAA	Wellcome Trust 4.75% 2021	1.0%	BBB+	BAT Intl. Fin. 6% 2034	0.5%

Church House Investment Grade Fixed Interest Portfolio (Cont.)

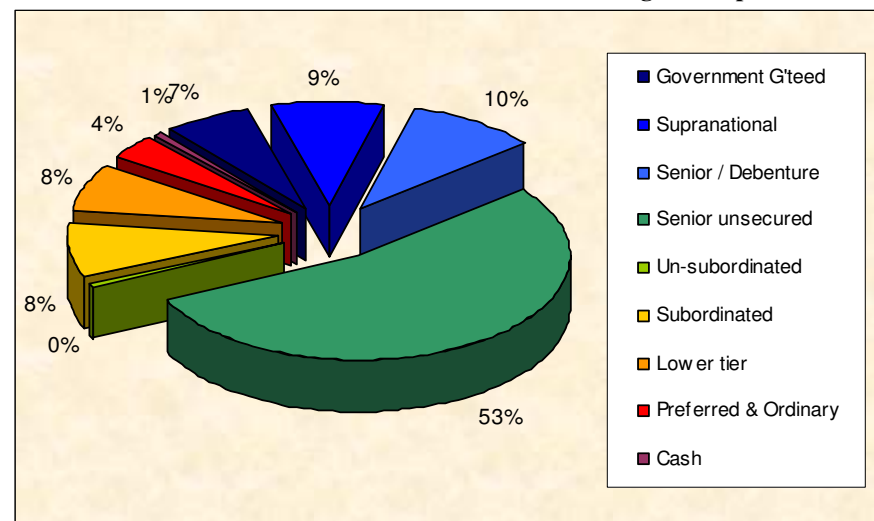
Rating	Security	Weight
	<i>Long dated (cont.)</i>	
A-	Tesco 1.982% I-L 2036	0.7%
AAA	GE Capital 8% 2039	0.6%
A	E.ON Intl Fin. 6.75% 2039	0.6%
A-	Tesco CMBS 6.052% 2039	1.0%
BBB	Scotland Gas 2.317% 2039	1.0%
A-	BAA 3.334% I-L 2039	0.8%
A-	Aegon NV 6.625% 2039	0.4%
AA-	London Quadrant 5.5% 2040	0.2%
BBB+	Northern Gas 5.625% 2040	0.6%
A-	Tesco CMBS 5.744% 2040	0.4%
A+	Lloyds 6.5% 2040	0.3%
A-	BAA 5.875% 2041	0.8%
	<i>Infrastructure Investments</i>	
U/R	International Public Part.	1.2%
U/R	GCP Infrastructure	0.5%
U/R	HSBC Infrastructure Co.	1.6%
U/R	John Laing Infrastructure	0.7%
	<i>Govt. Guaranteed Issues</i>	
AAA	Treasury 4.5% 2013	3.8%
AAA	Treasury 5% 2018	2.2%
	<i>Cash deposits</i>	0.5%

Pie Charts: The pie charts opposite provide some further analysis of the fixed interest portfolio shown on the previous page (and overflowing onto this page).

The top chart shows a breakdown by ranking of the securities that we hold, showing that more than three-quarters of the portfolio is invested in those ranked as 'senior' and above; we do not hold any 'peripheral' European sovereign issues.

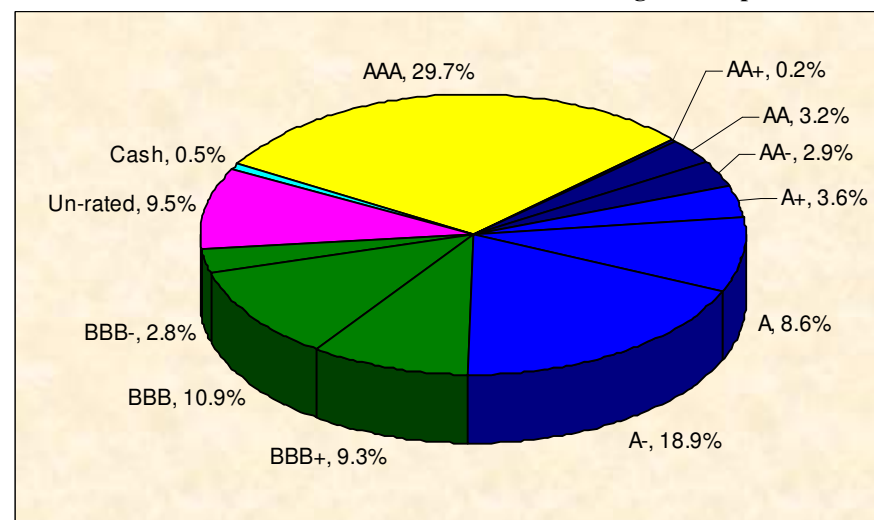
The second chart shows the breakdown by credit rating, (see earlier article). The major rating agencies use slightly different terminology – a security that Standard & Poors describes as AAA, Moodys will denote as Aaa while S&P's BBB+ broadly equates to Moody's Baa1 – for simplicity we just show the Standard & Poors terms.

CH Invest. Grade Fixed Interest Portfolio – Debt Ranking – 30 September 2011



Source: Church House Investments

CH Invest. Grade Fixed Interest Portfolio – Credit Ratings – 30 September 2011



Source: Church House Investments

UK Equity Indices

	30 September 2011	30 June 2011	Change
FTSE All-Share	2654.4	3096.7	-14.3%
FTSE 100	5128.5	5945.7	-13.7%
FTSE Mid 250	9819.4	11934	-17.7%
FTSE Higher Yield	2844.2	3133.4	-9.2%
FTSE Small Cap	2805.3	3272.9	-14.3%
FTSE AIM All-Share	700.3	858.0	-18.4%

The first two weeks of August saw a dramatic turnaround in the equity market's fortunes as the FTSE 100 Index fell sharply; to be followed by six weeks of highly volatile conditions - *The Economist* rather delightfully observed that "Financial markets have recently been as emotional as Kate Winslett at an awards ceremony".

Valuation

This is more technical, but hopefully worth setting out after the recent falls. At these levels, the valuation of leading companies appears to be quite compelling, subject to a more serious recession than appears to be being discounted already. Looking at the FTSE 100 as a whole at the end of September, Bloomberg gives me the following figures:

FTSE 100	Actual	2012 Est.
Earnings per Share	516	603
Price / Earnings Ratio	9.9X	8.5X
Earnings Yield	10.1%	11.8%
Dividends per Share	203	240
Dividend Yield	4.0%	4.7%
Dividend Cover	2.5X	2.5X

Source: Bloomberg

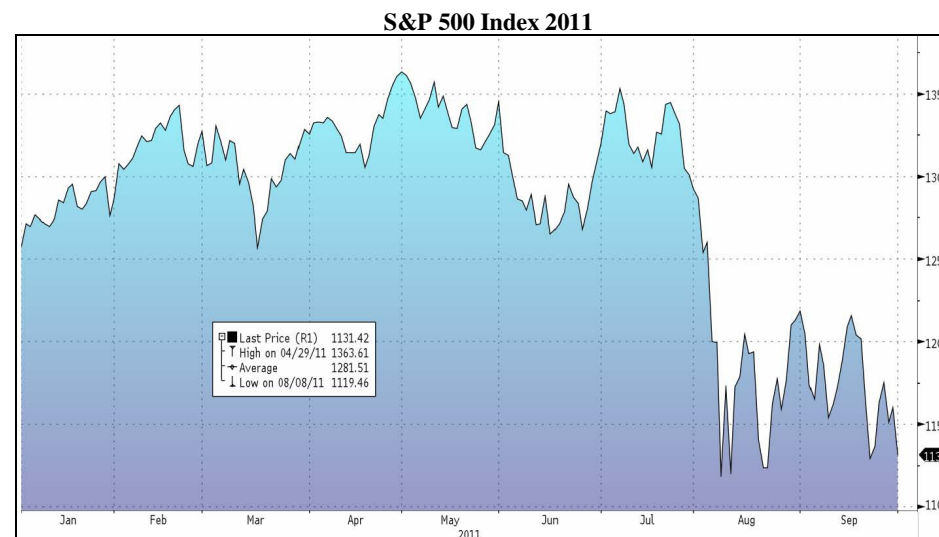
In other words, the FTSE 100 Index is trading on a multiple (P/E ratio) of ten times the actual earnings (after tax) of all the companies that make up the Index. I prefer to think of it in terms of a 10.1% earnings yield (the inverse of the P/E ratio) which is simpler to compare to other returns. These companies are currently paying out 39% of their earnings in the form of dividends to shareholders to give a dividend yield of 4%, or, in other words, their dividend payments are covered 2.5 times by their earnings after tax.

Looking at the forecasts for next year, the figures look even more interesting. But these should be treated with caution as we expect forecasts to come down, along with economic forecasts. (Possibly I should point out that, while it is interesting to look at the valuation statistics for indices, we actually concentrate on the figures for individual companies.)

International Equity Indices

	30 September 2011	30 June 2011	% Change
US - S&P 500	1131.4	1320.6	-14.3%
US - NASDAQ	2415.4	2773.5	-12.9%
UK - FTSE All-Share	2654.4	3096.7	-14.3%
Germany - DAX	5502.0	7376.2	-25.4%
France - CAC 40	2982.0	3982.2	-25.1%
Japan - TOPIX	761.2	849.2	-10.4%
Brazil - Bovespa	52324	62403	-16.2%
China - Shanghai Comp.	2359.2	2762.1	-14.6%
Hong Kong - Hang Seng	17592	22398	-21.5%
Australia - ASX 200	4009	4608	-13.0%

The direction was the same across world equity markets with the leading European bourses falling by a quarter. Emerging market equities have proved a disappointment; these markets were tipped to do well this year as their economies showed considerably more resilience than those in the debt-burdened developed economies. This has not been the case, emerging market indices are down around 25% on the year as compared to a 10% fall for the US S&P 500 share Index. Conditions have been volatile everywhere:



Source: Bloomberg

International Investment Trusts

In early 2009 we took the strategic decision to reduce European equity exposure in favour of North America. Principally this involved the purchase of **JP Morgan American Investment Trust** and sale of **Fidelity European Values**. I am pleased to say that the strategic switch has worked well, but this is not intended to be a self-congratulatory piece rather to give more colour on JPMorgan American.

This trust is managed by Garret Fish at JP Morgan in New York where, unsurprisingly, they have considerable resource. The objective is simply capital growth from North American investments with a benchmark of the S&P 500 share Index. In contrast to some of the other trusts that we have looked at in this section, most of the investments are immediately recognizable (this was quite deliberate; we wanted to be invested in major companies with the balance sheet strength and resources to weather a difficult period). Accordingly I am just showing the top ten holdings this time without any ‘thumb-nail’ sketches:

JP Morgan American IT

Top Ten Holdings 31/8/11	% NAV
Exxon Mobil	4.0%
Apple	3.1%
IBM	3.0%
Microsoft	2.7%
Chevron	2.2%
Merck & Co.	2.0%
Pfizer	1.9%
Procter & Gamble	1.9%
United Technologies	1.9%
Philip Morris International	1.8%

On a recent call Garret Fish expressed the view that slow growth in Western economies is here to stay and that the American economy has shown an unusually weak recovery. Domestic employment recovery has been slow, especially when compared to previous recoveries. Consequently he expects the economic outlook to remain muted. He went on to say that politics has become a major factor in the recovery with both Presidential and Congressional approval ratings low and a growing polarization of politics in Washington. Combined with high government debt, he sees these political factors as providing strong headwinds to growth.

On corporate America, Garret Fish is rather more positive. He says that weaker corporates have been thinned-out since 2008, while those remaining have cut costs and strengthened their balance sheets – corporate cash as a percentage of current assets of S&P 500 companies is now as high as 20%. He views the equity market as inexpensive with attractive valuations, highlighting Merck, Microsoft, Time Warner and United Technologies as compelling opportunities. But he does acknowledge that earnings expectations are vulnerable to greater disappointment in economic growth.

Europe

The European stock that we have retained is **Henderson Eurotrust**, managed by Tim Stevenson, which we looked at in detail in July. Contrarily we feel that this trust is now looking good value again as European concerns have pushed their share price to a significant discount to the value of the underlying assets. His major holdings are currently:

Henderson Eurotrust

Top Ten Holdings	% NAV
Deutsche Post	4.0%
Fresenius	3.8%
BIC	3.1%
Swedish Match	2.9%
Ericsson	2.8%
Amadeus	2.8%
Roche	2.7%
Essilor	2.5%
Linde	2.5%
Brenntag	2.4%

The list includes a few names that were not there in July: telecommunications company **Ericsson** (known best here for the Sony Ericsson joint venture), **Roche** the Swiss pharmaceutical company (I was pleased to see this as we have also been adding to this holding), **Essilor** who produce ophthalmic lenses and **Brenntag** which is a German chemical company.

It is possibly worth just pointing out again that Tim Stevenson is really focussed on the major European markets with this trust, not the ‘periphery’. German investments account for 29% of the total, French 23%, Swiss 21% and Swedish 11%.

Currencies:

	30 September 2011	30 June 2011	% Change
£/\$	1.558	1.605	-2.9%
£/euro	1.161	1.107	+4.9%
£ Exchange Rate Index	79.8	77.8	+2.6%
\$/euro	1.34	1.45	+7.4%
\$/yen	77.1	80.8	-4.6%
\$ Exchange Rate Index	79.8	77.0	+3.6%

A fascinating three months in the foreign exchange markets has seen a marked recovery in the US\$ and fall in the euro. We remarked in July that “it is difficult to see what might reverse the fortunes of the US\$” and then it quickly became obvious as the crisis in the eurozone unfolded.

Pressure is building on the Chinese authorities again as the US Senate is advancing a bill putting pressure on China to stop undervaluing its currency - with uncomfortable echoes of the Smoot-Hawley Tariff Act of 1930. The Chinese are not pleased, urging the US to abandon protectionism; presumably the bill will not make it to law, but the message is clear.

Similarly we observed that the steep rise in the Swiss franc was giving the “Swiss authorities something of a headache” to be followed in early September by the announcement:

“The current massive overvaluation of the Swiss franc poses an acute threat to the Swiss economy .. The Swiss National Bank (SNB) is therefore aiming for a substantial and sustained weakening of the Swiss franc. With immediate effect, it will no longer tolerate a EUR/CHF exchange rate below the minimum rate of CHF1.20. The SNB will enforce this minimum rate with the utmost determination and is prepared to buy foreign currency in unlimited quantities.”

Strong stuff, that had the desired effect and the Swiss franc has duly weakened since.

The £ sterling usually reacts somewhere between the major currencies and this time has been no different; it has rallied against the euro but fallen against the resurgent US\$, overall it has improved by around 2½% on its ‘trade weighted’ index. It remains to be seen whether the latest round of quantitative easing that the Bank has just announced will serve to weaken the pound again.

The big fall in the pound occurred in late 2007 and 2008, since then it has been remarkably steady. Looking at the past ten years of the pound’s performance on the chart opposite gives me the impression that a move might well be imminent.

Commodities:

	30 September 2011	30 June 2011	% Change
Oil (Brent)	\$104.0	\$112.5	-7.6%
Gold	\$1615	\$1512	+6.8%
Copper	\$7019	\$9430	-25.6%
Commodity Price Index	298.2	338.1	-11.8%

As world equity markets took fright in August, the fear rapidly moved to other ‘risk assets’ and commodity prices fell sharply. Base metal prices moved quickly to reflect downgrades to global growth expectations, notably the copper price which, as the table shows, has fallen by a quarter since the end of June.

Among the precious metals, the price of gold initially surged from \$1500 to \$1900 before succumbing to the general pressure and falling back again. Gold though is virtually alone in still showing an increase over the period; silver and platinum are both down in price

The price of oil has also fallen back but, unfortunately, not to the levels of 2009/10, and for us in the UK, by less in £ sterling terms. More encouragingly, the price of most foodstuffs has fallen and this, combined with the fall in commodity prices generally, will help to reduce the input-price push to inflation that has been prevalent for some while.

£ Sterling Effective Exchange Rate Index - 2001 to 2011



Source: Bloomberg, the Bank of England

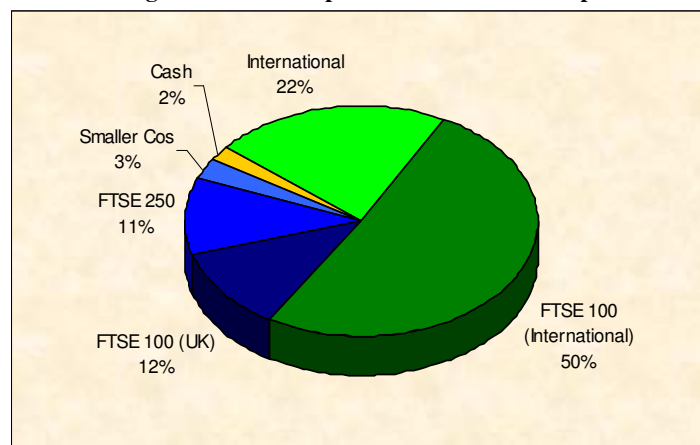
Church House UK Managed Growth Portfolio

	30 September 2011	31 March 2011	% Change
CH UK Managed Growth*	92.4	106.3	-13.0%
FTSE 100	5128.5	5908.7	-13.2%
FTSE All-Share	2654.4	3067.7	-13.5%

*bid price to bid price, excluding distributions of income. The management fee is charged to income.

At the 'sharp end' of exposure to equity markets the Managed Growth portfolio has had the most difficult period of all. Despite a relatively low beta (currently 0.93) and underweight positions in the mining and financial sectors it has still been tough. The full portfolio is shown overleaf, the pie chart below shows the broad disposition of the portfolio at the end of the quarter. Not a lot of change at this level, though exposure to small and mid-cap companies is a touch lower than at the end of June:

CH UK Managed Growth – Disposition of Assets – 30 September 2011



Source: Church House Investments

FTSE 100 (International) – our definition: FTSE 100 companies with more than 75% of sales overseas.

By value, the greatest change to the portfolio is in the *Oil & Gas* sector. We have sold the entire holding of **BP**, switching principally to **Royal Dutch Shell** but also to **Tullow Oil**. I was not impressed by BP's shenanigans in Russia and loss of the deal with Rosneft to explore for oil in the Russian Arctic (a prize now claimed by Exxon Mobil). Shell meanwhile is moving from a period of heavy investment to one where their (already prodigious) cash flow should blossom. Tullow Oil has had considerable success exploring for oil off the West coast of Africa with good prospects to come in the area. There is also the possibility that the opposite side of the Atlantic, where they also have acreage, could be exciting and a recent find off French Guiana supports this.

Sticking with the *Oil & Gas* sector, Vallares has announced the intention to merge with Genel Energy, a Turkish company with major oil producing assets in the Kurdistan region of Iraq. This transaction should complete by the end of October and Vallares shares will be relisted as Genel Energy Plc with Tony Hayward as Chief Executive.

The Swiss National Bank's move to weaken the Swiss Franc gave us the opportunity to add to our holding of **Roche** in the *Pharmaceuticals* sector, it is hard to see why a company of this quality should be so lowly rated. In the related *Healthcare* sector we have also built up a holding in **Smith & Nephew**; following the sale of our holding in the medical devices company **Synthes** earlier in the year, we were looking for an opportunity to re-invest in the area. Other changes over the quarter include a reduction in our holding of **Montanaro UK Smaller Companies** (an excellent trust, we simply wished to reduce our smaller companies exposure) and additions to our holdings in **Microsoft** and **Spectris**. Against the trend, we have recently reduced our exposure to **Unilever**, which has been just the right place to be invested in such times, but we are concerned that weakness in emerging market companies of late could lead to downgrades.

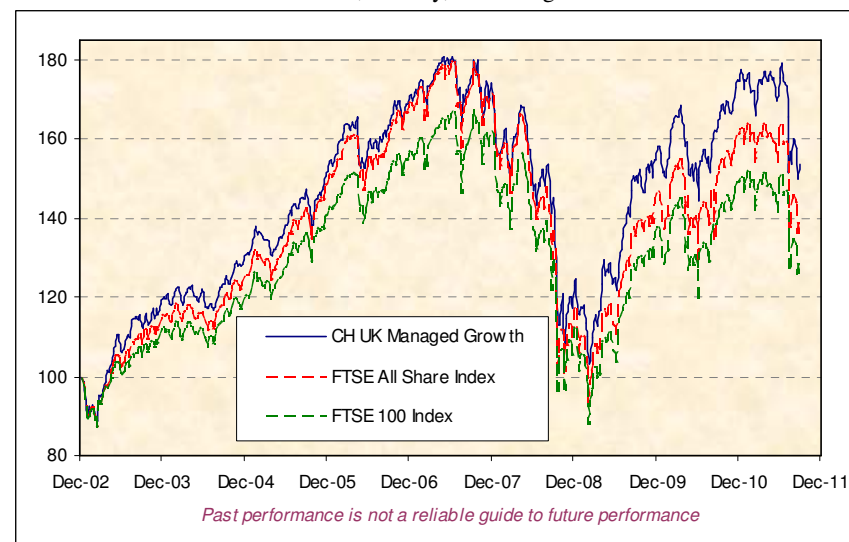
Calendar Year Performance

YTD	2010	2009	2008	2007
-12.3%	13.4%	28.8%	-27.2%	3.9%

Source: Church House Investments, bid price to bid price, net income re-invested.

CH UK Managed Growth v. FTSE Equity Indices

Bid Prices, Weekly, Excluding Income



Source: Church House Investments

Church House UK Managed Growth Portfolio – 30 September 2011

Sector	Shareholding	Weight	Sector	Shareholding	Weight	Sector	Shareholding	Weight
Oil & Gas		13.5%	Consumer Goods(cont.)			Financials		15.3%
Oil & Gas Producers	Royal Dutch Shell	4.7%	Food Producers	Unilever	1.5%	Banks	HSBC	5.5%
	BG Group	4.1%	Tobacco	BAT	3.4%		Standard Chartered	2.3%
	Exxon Mobil	3.5%					Barclays	1.2%
	Tullow Oil	1.2%	Health Care		8.9%	Insurance	Berkshire Hathaway	2.4%
Oil Equipment		-	Healthcare Equipment	Smith & Nephew	1.0%	Life Assurance	Prudential Corp	1.1%
			Pharmaceuticals	Astra Zeneca	2.7%		Legal & General	1.4%
				Roche Holding	4.0%	Real Estate	Shaftesbury	1.4%
Basic Materials		10.0%		Johnson & Johnson	1.2%	General Financial	Terra Catalyst	0.9%
Chemicals	Johnson Matthey	1.2%					Aberdeen Asset Man	0.9%
Mining	BHP Billiton	3.1%	Consumer Services		8.9%		Marwyn Manage.	0.5%
	Rio Tinto	3.4%	Food & Drug Retail			Technology		2.0%
	Xstrata	2.4%		Tesco	2.5%	Software/Computers	Microsoft	1.7%
				Greggs	1.1%	Hardware & Equipment	First Solar	0.3%
Industrials		5.4%	General Retailers					
Construct. & Build.	Balfour Beatty	1.1%	Media	Reed Elsevier	1.3%			
Aerospace & Defence		-	Travel & Leisure	Whitbread	1.9%			
Electronic Equipment	Halma	1.2%		Greene King	1.1%	Investment Companies		9.7%
	Spectris	0.7%				International	Investor AB	2.3%
Industrial Engineering	Spirax Sarco	1.3%	Telecommunications		5.1%		Scottish Mortgage	1.4%
Support Services	Babcock Intl.	1.2%	Mobile	Vodafone	5.1%		Impax Asian	0.8%
							Eredene Capital	0.9%
Consumer Goods		14.2%	Utilities		2.3%		Vallares	2.2%
Beverages	SAB Miller	2.8%	Electricity	Scottish & Southern	1.1%	Private Equity	Candover	1.0%
	Pepsico	1.8%	Gas, Water	Centrica	1.2%		Electra	0.4%
	Diageo	1.8%				UK Smaller Cos.	Montanaro UK	0.7%
	Britvic	0.8%						
Household Goods	Reckitt Benckiser	2.2%						
Personal Goods		-				Cash Deposits		2.2%

*see text

FTSE 100 (UK)*	11.7%	FTSE 100 (Intl.)*	50.6%	No. of	Portfolio
FTSE Mid 250	10.8%	International Equity	21.8%	Holdings	Value
UK Smaller Cos.	2.9%	Portfolio Beta	0.93	53	£34.1m

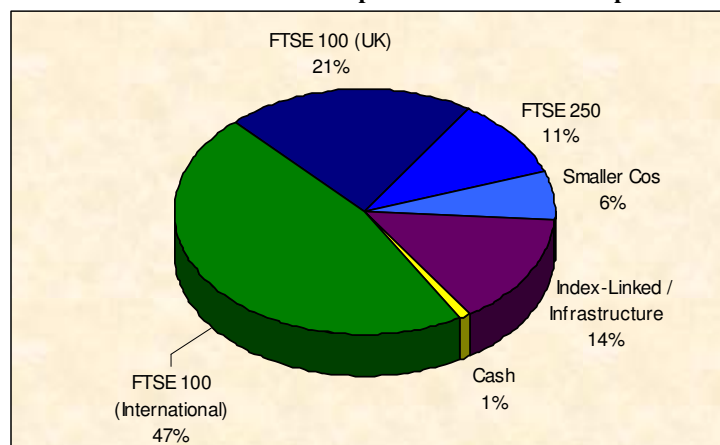
Church House Balanced Value & Income Portfolio

	30 September 2011	31 March 2011	% Change
CH Balanced Value & Inc*	132.0	142.0	-7.0%
FTSE Higher Yield Index	2844.2	3090.4	-8.0%
FTSE All-Share	2654.4	3067.7	-13.5%
FTSE Index-Linked All Stocks	418.3	380.9	+9.8%

*bid price to bid price, excluding distributions of income. The management fee charged is split 50/50 between capital and income.

The Balanced Value & Income portfolio is shown in full overleaf. The pie chart below shows a continuation of the pattern for this portfolio of a reduction in holdings in smaller companies in favour of larger. The general objective being to grow the dividend yield from the portfolio while, hopefully, providing greater stability to capital and to the income stream.

CH Balanced Value & Income – Disposition of Assets – 30 September 2011



Source: Church House Investments

Reductions in smaller company holdings during the quarter included: **Filtronic**, **M J Gleeson**, **Ambrian Capital**, **Amino Technologies** and the unquoted **Ceravision**; while additions to larger company holdings included: **Johnson Matthey**, **HSBC**, **BAE Systems**, **Astra Zeneca**, **Smith & Nephew** and **Sage Group**. In the mid-cap area we added to positions in **Balfour Beatty**, **Segro**, **Britvic** and **Dairy Crest**. Returning to the portfolio is **Marks & Spencer**, a stock we have not held for a while; at current levels their shares are attractive with a dividend yield over 5%. Of course, I recognise that conditions on the high street are not going to improve in a hurry but consider that Marks will be one of the survivors and new Chief Executive, Marc Bolland, appears to be making a good start.

Rather more opportunistically, we sold the remaining holding of **Treasury 4.125% Index-Linked** stock to add further to equities during the pit (I hope) of the gloom in early August. These funds were used to add to positions in **Reed Elsevier**, **Legal & General**, **Smith & Nephew**, **Unilever** (later sold) and **Babcock**. The changes outlined in this and the preceding paragraph have served to increase the dividend yield on the portfolio quite significantly. This should, in turn, show up in improved income in clients' portfolios over the next twelve months.

The 'portfolio within a portfolio' of index linked issues and infrastructure investments did provide stability for the whole over the last six months as all the index-linked issues rose in value over the period. The sale of our Treasury index-linked holding has already been mentioned, the only other change to this part of the portfolio was the addition of a more conventional holding in **Royal Sun Alliance 6.701% stock** offering an attractive high yield.

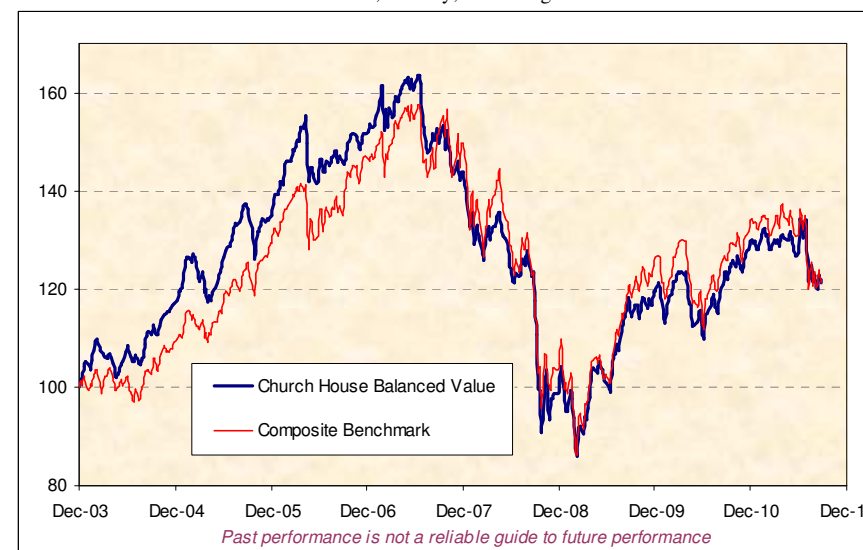
Calendar Year Performance

YTD	2010	2009	2008	2007
-4.5%	11.0%	20.8%	-26.2%	-3.2%

Source: Church House Investments, bid price to bid price, net income re-invested.

CH Balanced Value & Income v. Composite Index*

Bid Prices, Weekly, Excluding Income



*Benchmark was FTSE All-Share to 31/12/2007 then 50% FTSE Higher Yield, 40% FTSE All-Share and 10% FTSE Index-Linked All Stocks Index. Source: Church House Investments

Church House Balanced Value & Income Portfolio – 30 September 2011

Sector	Shareholding	Weight	Sector	Shareholding	Weight	Sector	Shareholding	Weight
<i>Oil & Gas</i>		11.5%	<i>Tobacco</i>	BAT	2.5%	<i>Financials</i>		13.3%
<i>Oil & Gas Producers</i>	BP	3.6%		Imperial	1.6%	<i>Banks</i>	HSBC	5.1%
	Royal Dutch Shell	6.0%					Barclays	0.8%
	BG Group	1.9%	<i>Health Care</i>		8.5%	<i>Non-life Insurance</i>	Amlin	0.9%
<i>Oil Equipment</i>		-	<i>Healthcare Equipment</i>	Smith & Nephew	1.4%		Royal & Sun All.	1.0%
<i>Basic Materials</i>		5.4%	<i>Pharmaceuticals</i>	GlaxoSmithkline	4.4%	<i>Life Assurance</i>	Aviva	1.4%
<i>Chemicals</i>	Johnson Matthey	0.9%		Astra Zeneca	2.7%		Legal & General	1.3%
<i>Mining</i>	BHP Billiton	2.3%	<i>Consumer Services</i>		9.0%	<i>Real Estate</i>	British Land	0.9%
	Xstrata	1.1%	<i>Food & Drug Retail</i>	Tesco	2.0%	<i>General Financials</i>	Segro	0.8%
	Rio Tinto	1.1%		Greggs	0.9%		Ambrian	0.4%
<i>Industrials</i>		9.9%	<i>General Retailers</i>	Alexon	0.2%		Close Bros.	0.7%
<i>Construct. & Build.</i>	Balfour Beatty	0.9%		Marks & Spencer	1.2%	<i>Investment Cos.</i>		2.6%
<i>Aerospace & Defence</i>	BAE Systems	1.0%		Mallett	0.8%		Law Debenture	1.1%
<i>General Industrial</i>		-	<i>Media</i>	Reed Elsevier	1.5%		Aberforth Geared Inc	0.6%
<i>Electronic & Electrical</i>	Ceravision	2.5%	<i>Travel & Leisure</i>	Whitbread	1.8%		SVG 8.25% Conv.	0.9%
	Halma	0.9%		Greene King	0.5%			
	Amino Technologies	0.4%		ULTra PRT	0.1%	<i>Index-Linked & Other Fixed Interest</i>		14.4%
<i>Industrial Engineering</i>		-	<i>Telecommunications</i>		4.9%	<i>Index Linked Securities</i>	Severn Riv. I-L 2013	0.4%
<i>Support Services</i>	Bunzl	1.4%	<i>Mobile</i>	Vodafone	4.9%		Bk. Scot. I-L 2016	1.3%
	Babcock Intl.	1.2%					Tesco 4% I-L 2016	1.2%
	Waterman Group	0.5%	<i>Utilities</i>		8.6%		Nat.Grid I-L 2020	1.2%
<i>Consumer Goods</i>		10.9%	<i>Electricity</i>	Scottish & Southern	1.2%		Anglian I-L 2020	1.3%
<i>Beverages</i>	Diageo	2.1%	<i>Gas, Water</i>	Centrica	2.2%		Nat. Grid I-L 2022	1.4%
	Britvic	0.9%		National Grid	1.7%		BT 3.5% I-L 2025	1.5%
<i>Household Goods</i>	Reckitt Benckiser	1.2%		Pennon Group	1.3%	<i>Other Fixed</i>	BAA I-L 2039	1.0%
	M J Gleeson	0.4%		United Utilities	1.7%		RSA 6.7% 2017	0.7%
<i>Food Producers</i>	Unilever	1.5%		Premier Energy	0.5%	<i>Infrastructure Cos.</i>	HSBC Infrastructure	1.3%
	Dairy Crest	0.7%	<i>Technology</i>		1.2%		International PP	1.3%
			<i>Software/Computers</i>	Sage Group	1.2%		GCP Infrastructure	0.6%
							John Laing Infra.	1.1%
						<i>Cash Deposits</i>		1.1%

FTSE 100 (UK)	21.3%	FTSE 100 (Intl.)	46.3%	No. of	Portfolio:
FTSE Mid 250	10.6%	Index-Linked / Other	14.4%	Holdings	Value £27.0m
UK Smaller Cos.	3.8%	Un-quoted Invests.	2.6%	69	Beta 0.79

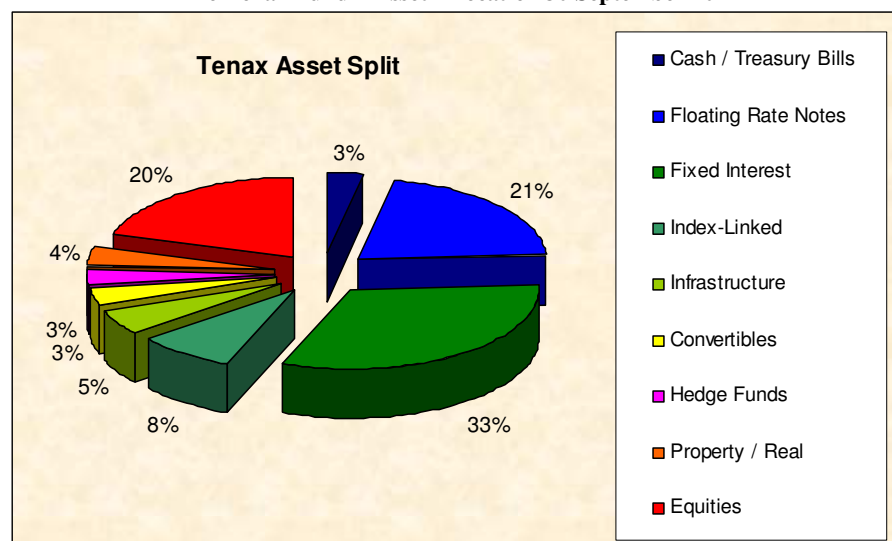
The Tenax Fund

	30 September 2011	31 March 2011	% Change
The Tenax Fund*	115.6	119.4	-3.2%

*bid price to bid price, 'A' accumulation shares.
The management fee in Tenax is charged to income.

The disposition in our 'multi asset class' portfolio, the Tenax Fund, is shown on the pie chart below. This shows only modest change from the position at the end of June, exposure to Fixed Interest is a couple of percentage points higher and Equities correspondingly lower. The full portfolio, broken down by the respective asset class, is shown overleaf.

The Tenax Fund – Asset Allocation 30 September 2011



Source: Church House Investments

We have not been active in Tenax over the quarter, preferring to maintain its lower-risk posture for the time being. Our objective with this portfolio is to preserve capital where possible so will always be inclined to patience.

There have been some transactions. In the equity portion, clearly the area that has given us the greatest problems over the period, we have twice added to the holding in **Caledonia Investments**. It is not clear to us why shares in this international trust with a long-term record of growth in dividend and assets should trade on such a wide discount to the value of their underlying assets. We also added modestly to the holding in **RIT Capital Partners**, another trust with broad international interests.

In the more specialist areas of fixed interest we added to three of the zero dividend preference issues in the portfolio: **Utilico Finance ZDP 2014**, **JP Morgan Private Equity ZDP 2014** and **Electra ZDP 2016**. The returns to redemption of these issues looked attractive, particularly when compared to other short-dated fixed interest returns. A new floating rate holding in the portfolio is the **Barclays FRN due 2017** which pays interest of 3.25% or LIBOR plus one half of a per cent, whichever is the higher – a floating rate note with a 'floor'. We have also added to the holding of **Royal Sun Alliance 6.701% 'Fix-to-Float'** in the portfolio, this pays interest at 6.701% until July 2017 and thereafter at LIBOR plus 2.5% if the company does not redeem the issue then.

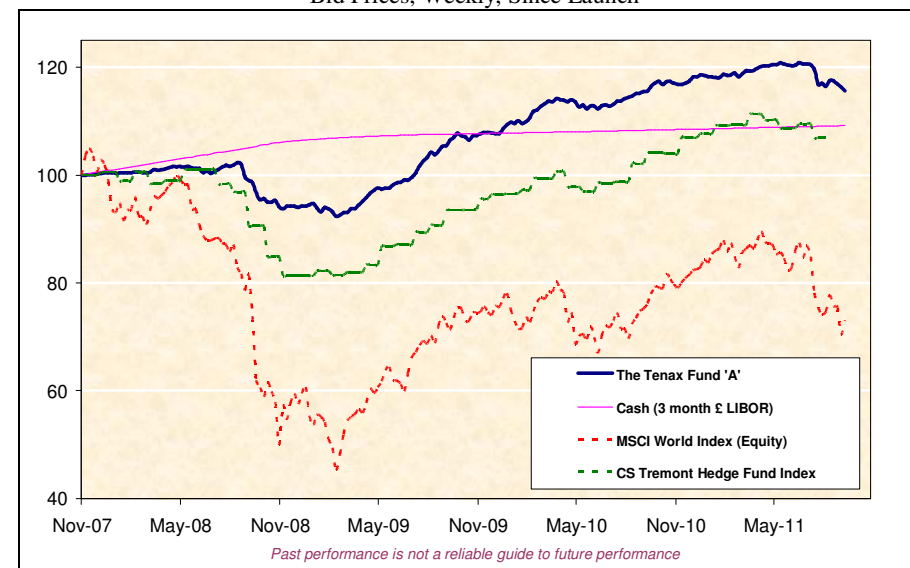
Finally, we took up the offer of further equity in Duet Real Estate Finance. This company invests in loans secured against commercial property, principally in the UK and Germany. Duet has a fixed life to December 2014. Once it is fully invested, probably within the next twelve months, it will cease to make new investments and aims to pay a high dividend and return capital as loans are repaid.

Calendar Year Performance

YTD	2010	2009	2008	2007 (part)
-2.2%	9.8%	14.2%	-6.0%	0.3%

Source: Church House Investments, bid price to bid price, 'A' accumulation shares.

The Tenax Fund 'A' Shares v. Cash & other Indices Bid Prices, Weekly, Since Launch



Source: Church House Investments

The Tenax Fund – 30 September 2011

Asset Class / Holding	Weight	Asset Class / Holding	Weight	Asset Class / Holding	Weight
Fixed Interest	31.6%	<i>Structured Credit / Distressed Debt:</i>	<i>3.0%</i>	<i>Equity Long/Short:</i>	<i>1.5%</i>
<i>Government (& supranational):</i>	<i>0%</i>	Harbourvest Senior Loans Europe	1.5%	S&W Enterprise	1.5%
<i>Corporate:</i>	<i>21.1%</i>	NB Distressed Debt	1.5%	<i>International Equity:</i>	<i>12.1%</i>
Novae 8.375% 2012/17	0.9%	Fixed Interest – Index-Linked	8.4%	RIT Capital Partners	1.4%
Lloyds 6.9625% 2015/20	0.8%	<i>Government (& supranational):</i>	<i>2.8%</i>	Senhouse European Focus	1.5%
Soc. of Lloyds 6.875% 2015/25	0.9%	Network Rail Index-Linked 1.75% 2027	2.8%	Caledonia Investments	2.1%
Scottish & Southern 5.453% 2015 Hybrid	0.9%	<i>Corporate:</i>	<i>5.7%</i>	Scottish Mortgage	1.1%
Akzo Nobel 8% 2016	1.1%	Severn River 6.125% Index-Linked 2013	0.2%	Berkshire Hathaway 'B'	1.1%
Old Mutual 7.125% 2016	1.0%	HBOS 1.835% Index-Linked 2016	0.5%	Findlay Park American Smaller Cos	0.6%
Amlin 6.25% 2016 Var.	0.9%	Tesco 4% Index-Linked 2016	1.1%	Impax Asia Environment Technology	0.7%
Linde 8.125% Var. 2016	1.0%	National Grid 2.983% Index-Linked 2018	0.7%	Ecofin Water & Power	1.1%
Siemens 6.125% Var. 2016	1.0%	National Grid 4.1875% Index-Linked 2022	0.9%	Eredene Capital	1.4%
Henderson Group 7.25% 2016	1.4%	British Telecom 3.5% Index-Linked 2025	0.7%	Schroder Japan	1.2%
BAA 7.125% 2017	1.1%	Wales & West 2.496% Index-Linked 2035	1.0%	Vallares	0.7%
RBS 5.6457% Var. (2017)	0.5%	BAA 3.334% Index-Linked 2039	0.5%	<i>Private Equity:</i>	<i>2.0%</i>
RSA 6.701% Var. (2017)	1.1%	Infrastructure Assets	5.1%	Neuberger Berman Private Equity	1.0%
Lafarge 8.75% 2017	0.5%	International Public Partnerships	1.6%	KKR & Co.	0.6%
Segro 5.5% 2018	1.2%	HSBC Infrastructure Co.	1.7%	Marwyn Management	0.4%
Anglian Water 7% 2018	0.4%	GCP Infrastructure Investments	0.7%		
John Lewis 8.375% 2019	1.3%	John Laing Infrastructure	1.2%		
RSA 9.375% Var. 2019	0.5%	Convertible Fixed Interest	3.4%	Cash / Near Cash	24.2%
LSE 9.125% 2019	0.6%	Aberdeen 3.5% Conv. 2014	1.0%	<i>Floating Rate Notes (senior):</i>	<i>21.1%</i>
Barclays 14% 2019	1.0%	Petropavlosk 4% Conv. 2015	0.8%	Lehman Bros FRN Jun 2009	0.4%
Standard Chartered FRN	0.5%	SVG Capital 8.25% Conv. 2016	0.7%	SNS Bank FRN GG Apr 2012	1.1%
Investec Bank 9.625% 2022	1.3%	Electra 5% Conv. 2017	1.0%	J P Morgan FRN Jun 2012	1.6%
CH Invest Grade Fixed Interest Fund	1.3%	Absolute Return / Hedge Fund	3.0%	Bank of America FRN Jun 2012	1.3%
<i>Zero Dividend Preference:</i>	<i>7.6%</i>	Brevan Howard Global	3.0%	Santander FRN Aug 2012	1.4%
J P Morgan Private Equity ZDP 2013	0.9%	Property / Real Assets	4.0%	Dexia Govt Gteed FRN Jan 2013	2.3%
Utilico ZDP 2014	1.1%	Segro	1.0%	Commonwealth Bk Australia FRN Jan 2014	2.3%
F&C PE ZDP 2014	1.1%	Duet Real Estate	1.6%	Rabobank FRN Jun 2014	1.4%
J P Morgan Private Equity ZDP 2015	0.9%	Terra Catalyst Fund	0.8%	EIB FRN Feb 2015	4.6%
Ecofin Water & Power ZDP	0.4%	Blackrock World Mining	0.6%	KFW FRN Mar 2015	2.3%
Electra ZDP 2016	1.1%	Equity	20.2%	IBRD FRN Jan 2016	1.4%
Neuberger Berman PE ZDP 2017	1.1%	<i>UK Equity:</i>	<i>3.9%</i>	Barclays Collared FRN Jul 2017	1.1%
Aberforth Geared Income ZDP 2017	0.8%	Barclays FTSE Synthetic 2012	1.5%	<i>Treasury Bills:</i>	<i>0%</i>
		Barclays Financials Synthetic 2013	0.5%	<i>Cash Deposits:</i>	<i>3.1%</i>
		CH Deep Value	1.9%		

