

**The Income Trust for Charities is one of our five Charity Commission authorised Common Investment Funds. As such, this fund adopts a structure that is similar to a unit trust but only charities in England, Wales, Scotland and Northern Ireland may invest in it.**

#### Purchase information

Minimum investment:	£10,000 and £1,000 thereafter
Annual management charge:	0.4%
Initial fee:	Nil
Exit fee:	Nil
Dealing:	12 noon every business day
Units:	Income class only
Currency:	Sterling
Sedol:	0169332
ISIN:	GB0001693323

#### Manager Information

Alexander Smitten joined Cazenove in 2000. He is a member of the Credit Team with specific responsibility for analysis of sovereigns and financial institutions. He is manager of the Cazenove UK Corporate Bond Fund and the Income Trust for Charities, a UK authorised Common Investment Fund, which are predominantly investment grade bond funds. After graduating from the City University with a degree in Banking and International Finance, Alex worked for 9 years at TSB/Hill Samuel followed by NatWest and Daiwa in the capital markets divisions. He has 27 years of investment experience.



#### Trust data

	At 31.12.11	At 30.09.11
Trust size (mid value) £	87,862,968	88,856,475
Bid price (pence)	62.85	60.99
Offer price (pence)	63.34	61.39

Source: CIFM

#### Investment objectives

The Income Trust for Charities aims to provide a high and steady level of income through investing mainly in UK government and other fixed interest securities, or derivatives thereof. The Manager aims to outperform the FTSE All Stocks Index on a total return basis after costs over rolling five year periods.

#### Performance

% change to 31.12.11	3 months	6 months	1 year	3 years % pa	5 years % pa
Trust (bid to bid) *†	4.4	9.4	11.8	6.0	6.5
FTSE Govt All Stocks Index	5.0	13.7	15.6	7.0	7.8
Relative	-0.6	-4.3	-3.8	-1.0	-1.2

	Dec 2010 to Dec 2011 %	Dec 2009 to Dec 2010 %	Dec 2008 to Dec 2009 %	Dec 2007 to Dec 2008 %	Dec 2006 to Dec 2007 %
Trust	11.8	6.8	-0.2	10.2	4.6
FTSE Govt All Stocks Index	15.6	7.2	-1.2	12.8	5.3
Relative	-3.6	-0.4	+1.0	-2.6	-0.7

\* Gross income reinvested.

† The Income Trust for Charities was launched on 31 October 1997

Source: Lipper

Past performance is not a guide to future performance. The value of investments and the income from them can go down as well as up and an investor may not get back the amount originally invested.

#### Income payments

The distribution yield is 5.0% p.a. based on the last four quarterly payments.

2011	Ex-distribution date	Payment date	Rate per unit
Final	31 October 2011	15 December 2011	0.79p (0.79p 2010)
Interim	31 July 2011	15 September 2011	0.79p (0.79p 2010)
Interim	30 April 2011	15 June 2011	0.79p (0.79p 2010)
Interim	31 January 2011	15 March 2011	0.79p (0.79p 2010)

**Trust allocation**

By asset class	Fund weighting 31.12.11 %	Fund weighting 30.09.11 %	FTSE All Stocks Index 31.12.11 %
UK Government Bonds	64.0	64.5	
Euro Sterling	32.4	31.4	
Cash	3.9	4.4	
Futures	-0.3	-0.4	
<b>By Maturity</b>			
0-5 years	10.4	10.2	32.0
5-10 years	40.2	39.5	24.7
10-15 years	3.7	3.6	6.0
15-20 years	15.5	14.4	8.8
20-25 years	11.3	14.5	8.3
25-30 years	3.8	3.5	7.8
> 30 years	11.5	10.4	12.3
Average Duration (years)	8.0	7.7	9.2

Source: CIFM

**Five largest holdings**

Stock	Holding %
UK Treasury 8.75% 2017	16.0
UK Treasury 4.25% 2036	10.7
UK Treasury 6.00% 2028	10.1
UK Treasury 8.00% 2021	9.7
UK Treasury 3.50% 2049	7.2

Source: CIFM

**Dividends**

The Fund paid a distribution of 0.79 pence per unit on 15 December 2011. The Fund's current yield of 5.0% is based on the last four distributions paid.

**Performance**

The Fund returned +4.4% over the quarter compared to +5.0% for the FTSE All Stock Gilt Index.

This underperformance can be attributed approximately equally to two main factors.

First, the Fund's holdings of corporate bonds underperformed gilts for the third quarter in a row, but produced positive returns. The underperformance was led by anything related to peripheral Europe with banks and some supranational issuers such as the European Investment Bank exhibiting pronounced weakness.

Second, the Fund's duration was shorter than the Index and so the value of its holdings rose less than the Index as yields fell.

**Fixed Interest review**

The economic outlook was again dominated by the on-going crisis of confidence in Europe as it stumbled from one summit to the next, with little sign of a permanent resolution to its fiscal problems. As you are all too aware, the process has been long, drawn out and predictably disappointing most of the time. In late October, agreement was reached in principle on most of the key issues we have discussed previously eg to leverage the European Financial Stability Facility and to facilitate bank recapitalisations. However, the lack of detail was clear to all and after a brief respite in markets, there was a dramatic turnaround in the wake of a threatened Greek referendum which saw gilt yields slump nearly 0.5% in two days and stock markets fell sharply. This essentially set the tone for markets into the end of the year.

A lot was riding on the 9th December EU Summit but, once again, investors were left wanting as the resulting "fiscal compact" failed to impress key areas. Firstly, with notable veto from Britain, the compact would be accomplished by a series of intergovernmental treaties on fiscal rules. These may have the advantage of being quicker to set up but they may still take 6 to 9 months. The key will be whether governments enact the necessary domestic legislation as without this the treaties are worthless. Secondly, the agreement was purely for a rules based system, not for steps toward fiscal union. Looking at Italy's credit spread as a measure of success, the 5 year Credit Default Swap rate fell sharply ahead of the summit only to rise almost to the year's highs again afterwards. It is still higher, ie perceived as riskier, than immediately before the summit. The yield on 10 year Italian government bonds rose from

5.8% to 7% over the quarter. Gilts continued to act as a beacon of “safety” with further outperformance versus US equivalents. 10 year gilt yields hit a new all-time low of 1.93% towards the end of the year and closed 0.45% lower on the quarter at 1.98% (a fall of 1.4% over the year as a whole).

Central Banks did what they could to offset the destructive effects of the crisis with the Bank of England acting early in October by increasing its Quantitative Easing program by £75bn. In its first meeting under new President, Mario Draghi, the ECB cut the official repo rate from 1.5% to 1.25% in November and to 1% in December. The most interesting development was the introduction by the ECB of a new 3 year liquidity facility which provided €489bn to the banking system. It is too soon to judge whether this will be effective in supporting either the European economy or its bond markets. What is clear is that European banks are lending more and more of their money bank to the European Central bank even at extremely low rates of interest. The Bank of England surprised markets in October by acting earlier than expected in boosting the scale of its Quantitative Easing policy. This was set an extra £75bn of gilt purchases over the following six months. This was rationalised in the Bank of England’s very downbeat November Inflation Report which predicted that inflation would be below target at the 2 year horizon and that economic growth in 2012 would be around 1%. The OECD forecast an even lower 0.5% level.

As if the confidence sapping of European political failings wasn’t enough, it became clear that the European economy was actually weakening quite sharply. The OECD revised its forecast for 2012 real GDP growth all the way down to 0.2% from 2% in June.

Corporate bonds underperformed Gilts for the third quarter in a row but produced positive returns. The underperformance was led by anything related to peripheral Europe with banks and some supranational issuers such as the European Investment Bank exhibiting pronounced weakness.

#### Fund activity

The Fund’s duration increased modestly from 7.7 to 8.0.

Activity was generally low but one new issue we subscribed to was the Wales and West (Gas Distribution) bond. This is an A- rated, 2028 maturity corporate bond, yielding 1.95% above gilts.

#### Economic outlook

The Eurozone debt crisis will continue to dominate global markets in coming months. Of key importance will be the ability of the individual members to enact robust fiscal rule legislation so that the system is perceived to be on a

sound fiscal footing. Even here there is a risk that locking into a persistent bout of fiscal austerity will condemn the peripheral members to a vicious spiral of weak growth and worsening debt ratios. A major problem is the sheer scale of the necessary debt issuance. For example, France and Italy are both expected to have a gross financing need of nearly €400bn in 2012. Total Eurozone issuance will be in the region of €1.4 trillion. While the majority of this is replacing existing debt maturities, the key is whether investors will be happy to roll it over and at what price. It seems likely that the scale of the refunding will result in some periods of meaningful stress in the peripheral markets. Investors will be demanding the fullest commitment from the ECB and the EFSF given the lack of appetite from outside Europe.

On top of this huge sovereign funding need, there is a substantial refinancing requirement for Eurozone banks – anything up to €500 billion depending on whose figures you take. All of this is just part of a truly massive global refinancing requirement with G7 governments needing to roll \$7.6 trillion of maturing bonds before thinking about financing the budget deficits themselves.

The growth outlook is expected to be weak particularly in Europe, as austerity measures take full effect. While the US and emerging market economies seem to be performing much better than Europe currently, there is a danger that this will not persist.

The markets are almost certainly correct in assuming official interest rates will stay low for a considerable time as the authorities try and ease the pain of prolonged deleveraging by banks and governments. However what happens to yields further down the maturity spectrum is uncertain. Will the strain of the enormous funding requirements push yields higher or will central banks be able to keep yields low through expanding their own balance sheets and buying sufficient quantities of government bonds themselves? Will such policies inevitably result in uncomfortably high inflation down the road? So we know the questions to ask but the answers are harder than ever to arrive at. We think that the markets will be volatile as they visit the likely extreme outcomes from time to time. We do not believe inflation will be a problem this year although tensions in the Middle East could see another sharp rise in the oil price. We do believe that a permanent “solution” to the debt crisis in the developed world will be hard to come by as it is in effect a generational problem rooted in 25 years of excess debt creation. High quality corporate bonds should outperform Gilts given their significantly higher yields; particularly if the UK fiscal plan veers further off path as growth continues to disappoint.

Another difficult year is in prospect but with plenty of opportunities.

## Common Investment Funds

We offer five Common Investment Funds. In combination, they provide a unique pooled offering for charities and reflect our commitment to the sector. Charities can achieve their investment objectives by investing in one or a number of the following Common Investment Funds:

**The Growth Trust for Charities:** a UK equity fund  
**The Equity Income Trust for Charities:** a higher yielding UK equity fund  
**The Income Trust for Charities:** a fixed interest fund  
**The Absolute Return Trust for Charities:** a fund of hedge funds  
**The Multi-Strategy Property Trust for Charities:** a property fund

For further information:  
Telephone **020 3479 0109** and ask for **Edward Harley,**  
**John Gordon** or **Nurten Baykal.**  
[www.cazenovecapital.com](http://www.cazenovecapital.com)

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