Timeless principles, focused action
50 years of ethical investing
Annual Report 2010

Central Finance Board
of the Methodist Church

1 Our mission
2 Timeless principles, focused action
8 Chairman's statement
10 CFB Council
12 CFB staff
14 Investment review
20 Investment ethics
22 How our funds performed
25 Our funds in detail
25 – Managed Equity Fund
25 – Managed Fixed Interest Fund
25 – Managed Mixed Fund
26 – Deposit Fund
28 – UK Equity Fund
31 – Overseas Fund
32 – Gilt Fund
33 – Corporate Bond Fund
34 – Short Fixed Interest Fund
35 – Inflation Linked Fund
36 – Property Fund

50 years of ethical investing

1960
2010

Our mission, alongside the Church, is to seek practical solutions which combine Christian ethics and investment returns.

We therefore aim…

…to provide a high quality investment service seeking above average returns for investors

…to follow a discipline in which the ethical dimension is an integral part of all investment decisions

…to construct investment portfolios which are consistent with the moral stance and teachings of the Christian faith

…to encourage strategic thinking on the ethics of investment

…to be a Christian witness in the investment community.

Timeless principles, focused action
50 years of ethical investing

Ever since the Methodist Church Funds Act brought the CFB into existence fifty years ago we have striven to follow the timeless principles of the Christian faith in managing the assets entrusted to our care.

From the very beginning we recognised that our attempt to provide good investment returns could not ignore the way in which those returns were earned. Therefore, businesses mainly involved with alcohol, armaments, gambling, pornography and tobacco have always been excluded from our portfolios. As John Wesley said, "in worldly business we (should) attempt to gain all we can without hurting our neighbour… in his substance… mind or… body".

In the 1980s as the campaign to end apartheid in South Africa escalated, the attempt to integrate ethics into our investment process moved to a new level. We saw that if we were to remain true to biblical principles we could not profit from even legitimate businesses if their activities supported societies where injustice was endemic.

When apartheid came to an end in 1991, Roy Foulds, a former Secretary of the CFB, said with prophetic wisdom, "as the setting sun allows the stars to be seen so the end of apartheid will reveal many other ethical issues we need to address". As predicted the issues we now address have increased enormously. In the past year alone we have adopted three new policies relating to climate change, children's issues and prisons (see www.cfbmethodistchurch.org.uk/ethics).

Seeking change in the way companies behave is now seen as far more important than mere exclusion. Engagement focused on pornography, environmental issues and gambling have all been part of our recent witness to the business community.

No doubt there will be many more challenges in the years ahead, but as the CFB embarks on its next half century, we are committed to remain true to Christian principles as we seek to serve the Methodist Church.

Timeless principles, focused action

Protecting the environment

The clear biblical requirement to be good stewards should be reflected in all we do. This the CFB has always tried to do, both in relation to financial returns and in the environmental impact of the businesses in which we invest. Last year we adopted a climate change policy aimed at integrating investment decisions with the teaching of the Methodist Church on the environment, as expressed in its report, *Hope in God's Future*. We are committed to produce portfolios with carbon footprints that are relatively low and measurably declining. The expert services of Trucost and EIRIS have confirmed that our UK equity portfolio has a lower carbon footprint than the market as a whole, although we recognise that these are inexact measures.

As a signatory of the Carbon Disclosure Project we have long been active in encouraging companies to disclose and to reduce their carbon emissions. We have written to all those companies who did not participate in the Carbon Disclosure Project and in which we invest encouraging them to reconsider their position.

In the past year there has been rising concern over the impact of exploiting 'oil sands' in Canada. These deposits could add significantly to global oil supply, but are highly contentious in terms of their environmental impact in general and climate change in particular. The CFB therefore co-filed shareholder resolutions on the subject at both the BP and Royal Dutch Shell AGMs requesting more information justifying their investment in these projects and how the related risks are assessed. This has led to lengthy but useful dialogue, particularly with Shell, which responded by publishing a detailed report on their oil sands projects.

Timeless principles, focused action
Working for change

Part of our response to the Christian Gospel is to confront companies when we see examples of exploitation and injustice. Our witness has its greatest impact when it is exercised in partnership with other churches. BSkyB provides a good example of a successful outcome of this approach. The company had long been excluded on ethical grounds due to its ownership of a number of pornographic channels. A meeting was arranged between Jeremy Darroch, the company's chief executive and the Church Investors Group led by John Ellis, the Methodist Church Connexional Secretary for Team Operations. The result was a commitment from BSkyB to withdraw from this business. By early 2010 the final channel was closed and the Joint Advisory Committee on the Ethics of Investment felt able to advise that there was insufficient ethical objection to investment, although continued engagement relating to the company's small on-line gambling business should continue. Under the auspices of the Church Investors Group (CIG) several other company engagement meetings were held over the past year. Those with John Varley, the chief executive of Barclays, and Niels Christiansen, a senior Nestlé executive, which provided the opportunity to challenge their activities at the highest level, were particularly noteworthy.

As a shareholder the CFB believes that it should not only exercise its right to vote all its shares, but also to ensure that those votes are consistent with our ethical policy. In order to do this efficiently in the UK we devised a voting template. Recently we worked with partner churches on an amended version, which has been adopted as a voting standard by the CIG. We have also signed up to use a voting template for the rest of Europe, designed on behalf of the Church of England. These developments should enable the Church to demonstrate united action in our dealings with companies. One of the most contentious voting issues relates to executive pay. There is a widespread concern that remuneration packages at the highest level are excessive. CIG entered the debate by commissioning a report, *The Ethics of Remuneration: a Guide for Christian Investors*, examining the issue from a theological viewpoint. It concluded that injustice was apparent all too often, providing clear reasoning for the high proportion of votes cast against remuneration reports by the CFB. It has also provided us with a number of opportunities to speak out on the subject through the press, radio and TV.

Chairman's statement

Roger Smith
Chairman

A fragile recovery

Over the past year a fragile confidence has returned as the financial system has stabilised. In March 2009 bank rate was cut to 0.5%, where it has since remained. Deposit rates have gradually subsided from 2% to 0.5% as the risk premium demanded by investors has evaporated. The stimuli from low interest rates, quantitative easing and a huge public sector deficit have helped drag the economy out of the deepest recession since the war. However, the recovery cannot be described as robust and the country faces years of austerity if public sector debt is to be brought back to acceptable levels.

Good returns for investors

It was a good year for investors with positive returns in all asset classes and a particularly spectacular recovery in equity prices. The best absolute return came from the UK Equity Fund (+42.8%) but it lagged 3.9% behind its benchmark, the ethically adjusted index, which was a further 0.6% lower than the FTSE All Share Index. CFB performance often lags behind during strongly rising markets and this trend was especially marked last year as low quality cyclical stocks led the way forward. While they may have maximum recovery potential they tend to underperform over the longer term and consequently are underweighted in our portfolios. Similarly the returns on the Overseas (+41.6%), Corporate Bond (+11.2%), Inflation Linked (+11.2%) funds, all of which have exposure to corporate equity or debt, underperformed their benchmarks by 9.4%, 3.6% and 0.7% respectively. However, the Short Fixed Interest (+3.7%) and Gilt (+2.8%) funds both outperformed their benchmarks by 1.1% and 0.3% respectively.

Ethical pledge

The securities held by all CFB Funds will, to the best of our ability, be in line with the ethical policy of the Methodist Church.

Although total returns were positive, distributions on all the funds declined. The virtual disappearance of dividends from bank shares resulted in the payout of the whole UK equity market falling by around a quarter, with a similar decline overseas. This trend is now at an end and dividends are once again beginning to rise. Perhaps the decline in bond fund distributions was more of a surprise but this was an inevitable consequence of the ongoing interest rate decline. Although the Deposit Fund distribution also declined, the success in minimising the impact could be seen in the expansion of the Affirmative Deposit Fund which saw non CFB accounts approach 450 as deposits increased by over 90% in the past year.

New internet facility

The Deposit Fund also added a significant additional service through the introduction of an on-line function. Through the internet, depositors are now able to view their current balances and all activity on their accounts over the previous eighteen months. In addition they are able to send instructions to make payments and deliver secure messages to the CFB.

Active year for ethics

There has also been a great deal of activity in relation to ethics. We have adopted policy statements on three subjects: climate change; ethical issues involving children; and prisons. Analysis by two independent bodies enables us to state that the carbon footprint of our UK equity portfolio is lighter than that of the market as a whole. It is also very encouraging to be able to report a major step forward in ecumenical co-operation relating to voting. We revised our UK voting template, which has been adopted by the Church Investors Group as best practice, and signed up to use a European voting template developed on behalf of the Church of England. For the first time we decided to co-file corporate resolutions, which are to be placed before the BP and Royal Dutch Shell AGMs on the subject of their respective oil sands projects. These are part of an increased effort to raise the level of constructive engagement with the companies in which we invest. This is a time consuming activity and we have been fortunate to obtain the services of an experienced ethical consultant, Neville White, to assist us. We have also received considerable media interest through our involvement with the Church Investors Group report, *The Ethics of Executive Remuneration: a Guide for Christian Investors*. This is an important contribution to an issue that has commanded increasing attention over the past year.

50 years' service to Methodism

Finally, as I look back on the CFB's fifty years of service to the Methodist Church I must pay tribute to the efforts not only of those who share the responsibility today, but of those who had the courage first to establish the CFB and then to develop it into the respected organisation it is has become. I make particular mention of Dr John Kellaway who died during the past year and was Chairman during the period when the investment unit was developed. It would also be inappropriate to allow this anniversary to pass without honouring Charles Jacob who set up the unit, established an enviable investment record and persuaded Methodist organisations to put their trust in the CFB. I would also like to extend my appreciation for the selfless efforts of the current Council in overseeing the work of the unit and for the dedication and professionalism of our staff as they build on the inheritance we have been left. However, it is also important to look forward and we need to encourage those with the requisite skills within Methodism to take up the baton and offer themselves for service on our Council. I am confident that as we look to the future we can continue to integrate the ethical stance of the Methodist Church into a high quality service to provide the investment returns required by our clients.

Roger Smith
Chairman
April 2010

CFB Council

Roger Smith
Chairman
Chairman of family investment company, following a career in the oil and gas industry and motor industry. Chairman of Epworth Investment Management.

Richard Reeves
Vice Chairman
Chartered accountant with many years' experience in the areas of governance and compliance as Company Secretary of a public listed company. He retired in 2005 as Company Secretary of Corus Group plc (formerly British Steel plc). A Director of Epworth Investment Management.

Ted Awty
A Senior Partner of international accounting firm KPMG LLP. He works with major corporate clients across a range of industries. A member of Sir Robert Smith's Committee which produced the Audit Committees Combined Code Guidance Report in 2002.

Peter Cussons
PricewaterhouseCoopers tax partner with considerable international expertise. Chair of Large Business and International Tax Committee of ICAEW Tax Faculty and Chair of other key groups. Member of the CBI's Main Committee and International Tax Committee, and Chair of the CFB Audit Committee. Nominated by *International Tax Review* as one of UK's top tax advisers. Has been listed in *Accountancy Age's* 'Financial Power List'.

John Gibbon
Adviser to a number of pension funds and member of the Investors Committee of the Property Income Trust for Charities.

Alan Groves
Retired Finance Director of Northern Electric plc, and member of the 100 Group of Finance Directors. Was non-executive Vice Chairman of the Universal Building Society. Currently a governor of Newcastle College Group and chairs their Audit Committee.

Sue Haworth
A qualified accountant with experience in tax and compliance. Previously, Compliance Officer and Company Secretary for Montagu Private Equity. Currently CFO for Advantage Capital Ltd.

Anne Hughes-Holmes
Chief Executive of Trustees for Methodist Church Purposes. Articled with Hodgson Impey, then specialised in personal tax at Ernst & Young. Subsequently partner in local practice, dedicated to small businesses and director within Charity Sector.

Sir Michael Partridge
Formerly Permanent Secretary of Department of Social Security, non-executive Director of Aviva and The Stationery Office and Chairman (now Pro-Chancellor) of Middlesex University. Currently Vice Chairman of Magdi Yacoub Research Institute, Chairman of Heathfield School and Director of Methodist Ministers' Pension Trust and Epworth Investment Management.

Colin Pearson
A qualified actuary and former investment manager with AXA Equity & Law. Director of Methodist Ministers' Pension Trust and Chair of Methodist Lay Employees' Pension Trust. A local preacher in the Ashford Circuit.

Revd Graham Thompson
Chair of East Anglia District. Trained in accountancy, member of the Connexional Allowances Committee and former Director of the Methodist Ministers' Pension Fund.

CFB staff

Bill Seddon
Chief Executive

Peter Forward
Chief Financial Officer

Russell Sparkes
Chief Investment Officer

Miles Askew
Senior Fund Manager

Stephen Beer
Senior Fund Manager

Chris Wigley
Senior Fund Manager

Christophe Borysiewicz
Fund Manager

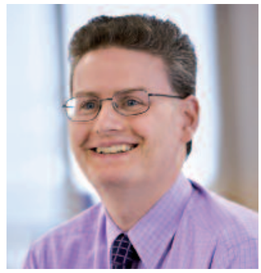
David Katimbo-Mugwanya
Assistant Fund Manager

Chris Gooding
Trainee Fund Manager

Tendai Hove
Analyst

Neville White
Ethics Consultant

Bill Lane
Client Relationship Manager



Chris Field
Operations Manager

Janice Thomson
Senior Deposit Fund Administrator

James Forward
Communications Officer and Senior Fund Administrator

Paul Berry
Fund Administrator

Victoria Daniels
Fund Administrator

Safiya Nelson
Fund Administrator

Elizabeth Sewell
Fund Administrator

Kate McNab
Secretary

Natalie Zahl
Secretary

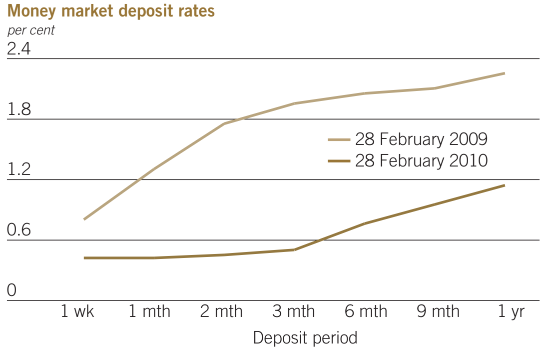
Investment review

Bill Seddon
Chief Executive

Market movements and performance

Money market

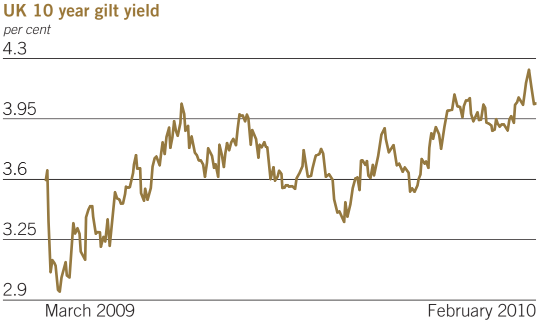
Money market deposit rates



- Base rate began the twelve months under review at 1% but the cut to 0.5% on 6 March 2009 was the only change during the year.
- The premium of 3 month deposit rates over the base rate began the year at 95bp and peaked at 140bp in March. As money markets normalised the premium gradually slid to a discount of 6bp in October before closing February at a nil premium.
- 3 month rates opened at 1.95% peaked at 2.00% in March touched the low of 0.44% in October before closing the year at 0.50%.
- 12 month rates opened at the high of 2.25% and closed at 1.10%, 8bp above the September low.
- The Deposit Fund's average life moved between 79 and 102 days closing down 10 at 85 days.
- An average rate of interest of 1.5% (aer) was paid out over the year compared to 0.1% (aer) for higher rate bank deposits.

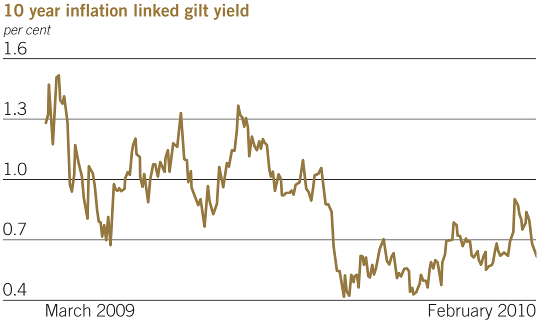
Fixed Income

UK 10 year gilt yield



- Global bond prices fell over the year. The 10 year US Treasury yield opened at 3.02%, touched 2.54% in March rising to 3.84% by October before closing at 3.62%.
- UK gilt prices followed a similar pattern. The 10 year yield opened at 3.63%, fell to 2.95% in March, rose to 4.23% in February before closing at 4.03%.
- The yield curve continued to steepen as the 2 year gilt yield fell by 50bp to 0.94% and the 30 year gilt yield rose by 24bp to 4.58%.
- The average spread of corporate bond yields over gilts fell by 251bp to close at +172bp having traded between +478bp and +163bp.
- The spread between AAA and BBB rated bonds declined by 528bp to +247bp having traded between +820bp and +237bp.

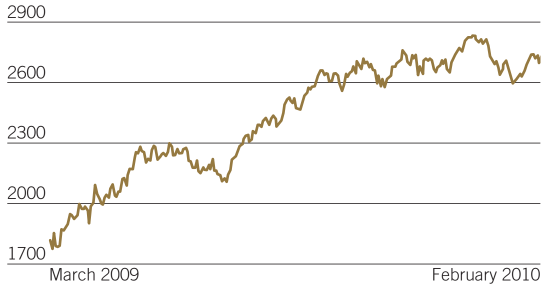
10 year inflation linked gilt yield



- Index linked gilt prices continued to rise. The 10 year yield opened at 134bp, traded between 152bp and 42bp, before closing at 61bp.
- Over the year corporate bonds outperformed index linked and conventional gilts: iBoxx Non Gilts Index (+17.0%); FTSE All Stocks Index Linked Index (+10.8%); FTSE All Stocks Gilts Index (+2.5%). Short dated issues outperformed long dates: Short Fixed Interest Fund Composite Index (+2.6%); Over 15 Year Gilts Index (+2.5%).
- The best return relative to benchmark came from the Short Fixed Fund (+1.1%) followed by the Gilt (+0.3%) and Managed Fixed Interest (+0.4%) funds. The Inflation Linked (-2.0%) and Corporate Bond (-3.6%) lagged due to the strength of lower quality corporate bonds.

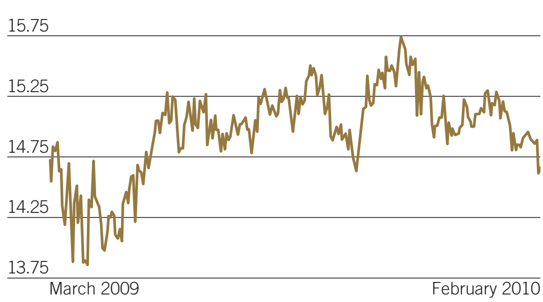
UK Equities

FTSE All Share Index

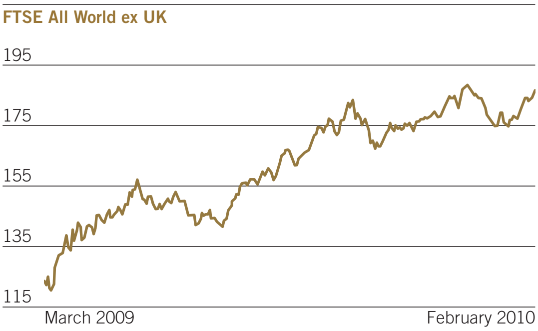


- The low point for UK equity prices occurred in early March but the subsequent rally saw the FTSE All Share Index rise 63% by mid January. It closed up 42% over the year, for a total return of 47.3%.
- Smaller more cyclical companies provided the best returns with The FTSE Mid 250 outperforming the FTSE 100 Index (+58.9% vs +45.5%).
- The main positive relative contributors to All Share returns were the Mining, Bank and Life Insurance sectors, while the main negative relative contributors were Oil & Gas Producers, Pharmaceuticals and Mobile Telecoms.
- The CFB ethically adjusted benchmark lagged behind the All Share Index over the year (-61bp). Excluded stocks, which account for 14.6% of the Index, rose 40.0% compared to 42.1% for the rest of the Index.
- Over the year the UK Equity Fund return (+42.8%) lagged the ethically adjusted benchmark by 3.9% and the FTSE All Share Index by 4.6% as the lower quality cyclical stocks that led the way down outperformed significantly. The Managed Equity (+42.7%) and Managed Mixed (+31.5%) lagged their benchmarks by 4.4% and 1.3%, respectively.
- The Property Fund produced an estimated return of +15.0% based on distributions to 31 December and the value on 28 February. The purchase yield based on the distribution in the final quarter of 2009 would be 8.0%.

FTSE UK verses All World ex-UK



Overseas Equities



- The FTSE All World ex UK Index also rose strongly last year closing up 46% for a total return of +50.0%.
- Currency movements had little impact on relative returns over the past year although the FTSE World ex UK Index outperformed the FTSE All Share Index by 2.7%.
- Over the year sterling fell against the ¥ (-2.9%) and € (-1.1%), but rose relative to the $ (+6.4%).
- The best regional performer was the Rest of the World (+81.6%) followed by the Pacific (+78.7%) and Europe (+51.6%). Japan (+25.1%) brought up the rear, but North America (+45.4%) also lagged.
- The return on the Overseas Fund (+41.6%) was 8.4% behind the Index as investments in the US and Pacific lagged behind their local benchmarks due to relatively cautious strategies.

Economic overview

Global

In most countries industrial production and exports have recovered to more normal levels after the collapse in world trade seen early last year, although consumer confidence and consumer spending remain relatively muted. It is positive that the US economy seems to be entering a normal cyclical upturn, and the Federal Reserve's estimate of 3%-3.5% growth for the year may prove to be too conservative. Fourth quarter GDP growth was revised up slightly to an annual rate of 5.9%, although it is expected to drop back to around 3% in the current quarter. Employment data for February was better than expected, as job creation would have turned positive for the first time in over two years adjusting for the poor weather. It was also encouraging that February saw the first significant rise in the service sector Purchasing Managers' Index for nearly a year. However, there have been some negative signs. In January, new home sales dropped to a record low, the construction sector turned down, although this was probably weather related and leading indicators were disappointing. The US Federal Reserve was probably pleased that inflation actually fell back 0.1% to 2.6% despite the improving economic outlook.

On the other hand the Eurozone recovery seems to have 'stalled'. While the European Central Bank (ECB) has reaffirmed its estimate of 0.7% growth this year, it has warned that the risks lie to the downside. The European Commission's composite indicator of business and consumer activity unexpectedly fell back in February for the first time in over a year. Although there were signs that industrial production and export orders were picking up, particularly in core European states such as Germany, this was more than offset by falling consumer confidence and retail sales, especially in Portugal, Ireland, Greece and Spain. This is hardly surprising given that the Greek government is currently pushing through an austerity package to cut the budget deficit by 4% to 8.7% of GDP, and others may have to follow suit.

While most of the Pacific economies are experiencing rapid growth, there was an unexpected and sharp drop in the Chinese manufacturing Purchasing Managers' Index, which could be a sign that the government's tightening measures are beginning to take effect. However, a jump in Chinese inflation and in property prices in February suggest that further tightening may be required. India is also suffering from accelerating inflation, with politically sensitive food prices rising by 18% in February compared to the previous year. This resulted in the Reserve Bank of India unexpectedly increasing the key interest rate level.

The Japanese economy shrank by 1.2% in 2008 and a further 5.0% in 2009. However, a major fiscal stimulus package with large tax cuts on energy efficient cars and electrical goods seems to have worked, at least in the short term, with annualised fourth quarter growth of 3.8%. Although exports surged as expected, there was an encouraging rise in consumer spending and a modest increase in capital investment. Since then a drop in unemployment and an increase in wages for the first time in 20 months indicates the recovery looks fairly broadly based. However, while the IMF estimates that the Japanese economy will grow by 1.8% this year, consumer spending is expected to fall back in the fourth quarter once the tax cuts come to an end. There seems quite a high risk that the economy could then fall back into recession. Much will depend on continued growth in exports. As around 65% go to Asia, mostly China, Japan could be badly affected if China does experience a sharp slowdown. The Japanese economy is also suffering from price deflation, a negative factor absent elsewhere. Longer term, economic growth in Japan seems likely to be slower than most other developed economies due to adverse demographic factors. A major budget deficit crisis could also be looming. As the net public deficit is currently around 130% of GDP, a similar figure to that of Greece, the government could at some point be forced to cut back public spending aggressively.

UK

In January the UK experienced its coldest month since 1987, VAT was raised and the stamp duty holiday for low priced properties came to an end. It was not surprising, therefore, that some of the economic data for the month was not particularly encouraging. Retail sales fell sharply, mortgage approvals and housing transactions were substantially reduced, export growth remained modest, unemployment rose and industrial production fell for the first month since August. However, on balance it seems that the economy is on course for a recovery that may prove more buoyant, at least in the early stages, than official forecasts indicate. The Purchasing Managers' Index for February shows that both manufacturing and service sector surveys are above their long term averages and that the Composite Index for the first two months of the year is above its fourth quarter average. This would be consistent with annualised GDP growth of at least 3%, well above the Treasury forecast of 1.25% for 2010. However, there remains a significant discrepancy between official growth data and most other indicators of economic activity. Consequently, it was not unexpected that GDP growth for the fourth quarter has been revised from +0.1% to +0.3% and further increases cannot be ruled out. However, it is of concern that general government spending contributed more than household consumption, that the deterioration in the net trade balance reduced the growth figure by 0.2% and that the slowdown in the inventory reduction added only 0.4% to total growth.

It is also noticeable that the nominal growth rate of the UK economy in the fourth quarter was not far short of the 5% level that the Monetary Policy Committee has identified as its preferred rate of expansion. As the implied GDP price deflator was 3%, there would seem to be ample grounds for the suspension of the Quantitative Easing (QE) programme. Nonetheless, in his letter to Mr Darling following the Consumer Price Index overshoot of its target by 1.5%, the Governor of the Bank of England indicated that the problem was short term in nature resulting from the VAT increase, the rise in fuel price and the fall of sterling. He also expressed his confidence that these would be offset by the persistent margin of spare capacity in the economy and CPI would be back below target in the second half of the year. However, as even Mr King admits, the risk of inflation is now to the upside.

The media drew attention to the fact that the Public Borrowing Requirement grew in January despite it being the most favourable month for government revenues. Although this was not good news, the real story is that the government deficit is on track to undershoot the Treasury estimates that accompanied the Pre Budget statement. It was, therefore, no surprise that the Chancellor in his Budget was able to announce a reduction in the PBR. However, once the General Election is past, attention will revert to the long term fiscal imbalances. Having enjoyed higher growth than was naturally sustainable, financed by ever increasing levels of debt, we are facing an extended period of the reverse. Whichever party forms the new government, as an attempt is made to reduce debt to manageable levels, the future seems certain to hold a mixture of spending cuts, tax increases and inflation in the context of sub-par economic growth.

Market outlook

Money markets

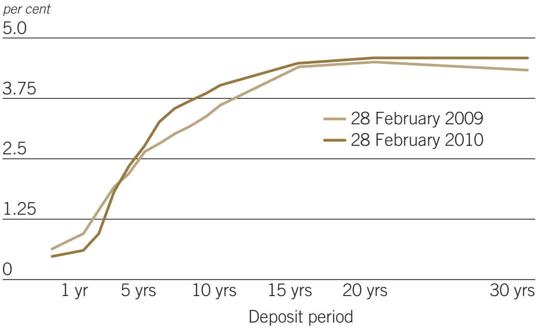
The US Federal Reserve surprised the money markets recently by unexpectedly increasing the discount rate by 25bp to 0.75%. This is the rate at which the Fed lends to banks at times of market distress and while most analysts believe the move to be just part of the 'normalisation' of US monetary policy, historically a rise has often been the precursor to an increase in the Federal funds rate.

In February the Monetary Policy Committee of the Bank of England also gave the first hint of its desire to tighten monetary policy by putting the QE programme on hold. However, concerns that economic recovery may be less robust than some had previously thought likely has led to the consensus view for the first increase in the base rate being pushed back from the third to the fourth quarter of the year. The prospect that rates may remain lower for longer than expected, combined with the current steepness of the money market yield curve, indicates that there is still some value in longer term deposits. There are also signs that some banks wish to establish direct relationships with depositors and are increasingly bypassing brokers and offering premium rates by way of inducement.

Fixed interest

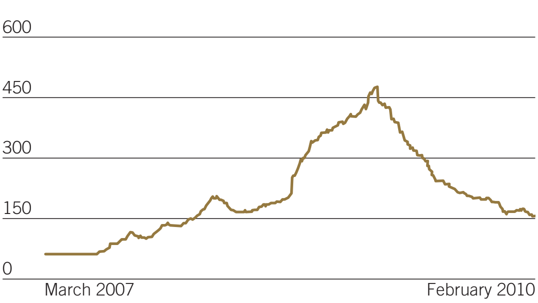
Bond markets began 2010 in dramatic fashion with 10 year US Treasury yields jumping from 2.5% to 4% before setting back to around 3.7%. The catalyst for these moves was concern over the risk of holding bonds issued by countries such as Greece and Portugal. Bond investors were shocked last November when the European Commission revealed that the Greek government had concealed the true size of its budget deficit, which at over 12% of GDP was double its previously stated level. Although core European bonds have been resilient, with the yield on the German 10 year Bund trading around 3.1%, yields on peripheral European bonds have soared. In response Greece introduced a €4.8bn austerity package and was then able to sell €5bn of a new 10 year bond, although the coupon at 6.25% was nearly double that of its previous issue. For the moment calm has returned, the Euro has rallied in response and the safe-haven attractions of US Treasury bonds have diminished. However it is doubtful whether the problem has been finally resolved and concerns may remerge in April/May when Greece has to refinance €20bn of maturing bonds.

Gilt yield curve



The gilt market has also suffered as 10 year yields jumped from less than 3.4% last October to a February peak of 4.2% in the face of Sterling weakness, contagion from Greece, and renewed threats to the UK's AAA credit rating. However, the bad news may already be discounted, at least on a short term basis. The consumer price index seems to have peaked at 3.5% in January, the Budget deficit is likely to undershoot previous estimates whilst higher than forecast economic growth will further improve the situation. Gilt prices could easily rally in response to such news. There may also be help from increased demand for gilts from the banks. The FSA intends to force them to hold a much larger buffer of liquid assets on their balance sheets. This could amount to as much as £600 billion, much of which is likely to be in the form of gilts and would go a considerable way to plug the gap in demand for gilts left by the end of QE. Therefore, despite the poor underlying fundamentals and the huge ongoing government funding requirement, conventional gilt prices may stabilise or even rally in the short term. Longer term there seems little reason not to remain underweight in conventional fixed interest securities. Indeed the Barclays' Equity Gilt Study 2010 states that "the chances of a real return over the next ten years are extremely low". Although inflation linked yields have risen from the recent 49bp low, at 80bp they still do not look good long term value.

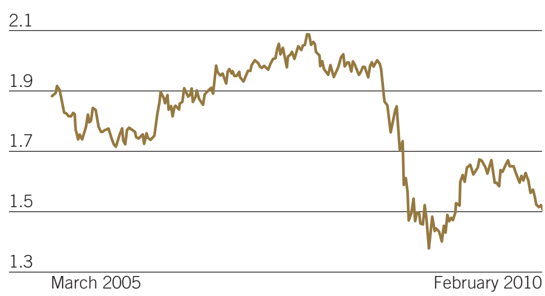
Average spread of corporates over gilts



Corporate bond spreads soared following the collapse of Lehman Bros in September 2008, and reached a peak in March last year. Since then they have fallen back with the spread on the Merrill Lynch non-Gilt sterling index compared to gilts declining from a peak 478bp to a more normal 158bp. Yield spreads on lower quality corporate bonds rose quite sharply at the height of the concerns over Greece, but as calm has returned spreads have started to tighten again. In the UK this trend has been strengthened by the dearth of new sterling issues, in contrast to the steady flow of US dollar and euro corporate bond issuance. Although spreads no longer look outstanding value compared to gilts, they continue to offer reasonable long term value and positions should be increased on any setback.

Overseas Equities

Sterling/dollar exchange rate



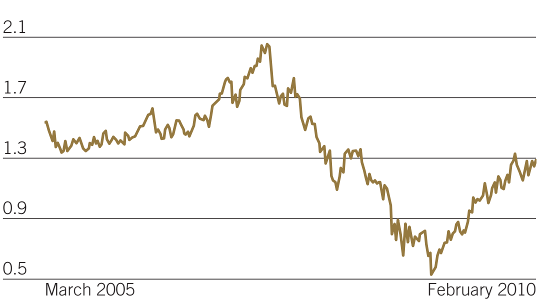
Global equity markets have had a good year with the FTSE All World ex UK £ Index up nearly 70% from the March 2009 low. It has now recovered all the ground lost in the 2007/9 bear market and is within 10% of the all-time high reached in September 2000, although in dollars it is still over 25% from its 2007 peak. Sterling enjoyed a reasonable recovery following its sharp fall in the winter of 2008-09, but since August most of these gains have been lost. Pressure on it is unlikely to diminish until uncertainty over the forthcoming General Election and the possibility of a hung Parliament is resolved. However, the currency is also sensitive to swings in the UK housing market as seen by the recent drop following a weaker than expected Royal Institution of Chartered Surveyors survey. This showed continued growth in the number of houses being put up for sale, but a sharp reduction in the number of new buying enquiries and newly agreed sales. Although the medium term risk of persistently lower house prices is low, with building likely to be less than the creation of new households, the lack of mortgage availability will constrain demand and offers little hope of support for Sterling from a robust housing market. However, given the extent of the recent fall, the possibility of a short term rally cannot be ruled out.

Quantitative analysis shows that the equity rally fell into two distinct parts. From the March low point until November, investor demand for risk assets led to an unusually high correlation between normally uncorrelated markets such as commodities, corporate bonds, and foreign exchange. Subsequently, these unusual relationships have broken down and a more normal type of correlation has returned. The same type of 'sea-change' has also been true within equity markets. During the nine month 'dash for trash', equity performance was dominated by companies with weak balance sheets, low profit margins, and sluggish sales growth. Such poor fundamentals might be expected to lead to underperformance over most time periods. However, investors were not looking for value investments, but operational gearing to take advantage of eventual economic recovery and outperformance was concentrated in shares whose price was high compared to their expected long term growth rate. Since November investors have started to pay greater attention to the fundamentals, with companies that show steady earnings growth and reasonable valuations coming back into relative favour.

It is difficult to believe that global equities will continue to surge upward without some kind of correction and prices currently seem vulnerable to bad news. The Overseas Fund is underweight in the Pacific and the Rest of the World, which look particularly vulnerable to a setback, and overweight in Japan which has defensive merits. The Fund continues to be overweight in North America and underweight in Europe, but it has reduced the relative risk positions following Europe's sharp underperformance. Since their recent relative peak last November, UK equities have fallen by nearly 10% compared to other markets. While this relative decline may still have a little further to go, particularly if a hung Parliament emerges, it appears timely to reduce underweight UK equity positions.

UK Equities

10 year gilt yield relative to All Share yield



It has also been a strong year for UK equities with the FTSE All Share index currently almost 65% above its low point of March last year, although it is still over 15% below the all-time high reached in June 2007. Although there may be significant question marks over the pace of any UK economic recovery, corporate profits have been consistently better than expected since last summer. Earnings upgrades have now exceeded downgrades for seven consecutive months and the proportion of positive earnings surprises is at a five year high. Profits for 2009 are now thought to have dropped by around 38% and although a recovery of over 40% is the consensus view for 2010, this would still leave profits down 12% on 2008. However, excluding financials and resource companies, the swings become far more modest with a decline of 7% followed by a recovery of 8% pa for the foreseeable future. Whilst profits can be expected to rally strongly during the first phase of recovery, there should be more concern over assumptions that this can continue indefinitely when a below par economic expansion is anticipated. Nonetheless, despite the surge in equity prices valuation levels still appear modest with price earnings multiples, both trailing 10 year and the forecast for 2010, well below the average of the past twenty years. Longer term, expectations should be for absolute returns consistent with the nominal growth in GDP rather than the optimistic forecasts for profits.

Equities continue to appear cheap relative to gilts with the gilt yield premium still under 20%. However, with the average equity dividend yield 60bp below its twenty year average, this has more to do with bonds being expensive. Bond yields have probably passed their cyclical low point at a time when sovereign risk is perceived to have risen sharply. Historically, in the year following the low point, gilt yields have risen on average by around 20%. In current circumstances this would indicate a far from improbable level of 4.6%. Such a move would create a significant headwind for equities pointing to a de-rating approaching 15%. The equity rally has also been supported by unprecedented central bank intervention on a global scale. If as seems likely, these measures are now gradually withdrawn, there is a considerable risk of profit taking.

Valuations are likely to be increasingly influenced by the ageing of the baby boomers who have now passed the peak savings age as they move into retirement. This is likely to exacerbate a more capital scarce environment and reduce likely returns as equity ratings struggle to rebound to levels previously considered fair value. Modest overweight equity positions still seem appropriate but exposure should only be further increased on setbacks, which could occur, for example, on worries that the recovery has stalled or renewed financial panics.

Investment ethics

Russell Sparkes
Chief Investment Officer

Stephen Beer
Senior Fund Manager

An integrated approach
Over the past 50 years ethics has always been at the heart of our approach to investment. In particular we adopt an integrated system whereby all members of the investment team are required to look at ethical issues when they analyse companies. We also believe it essential to have a structure that looks at specific issues in some depth. The result has been a series of detailed position papers with a strong theological basis underpinning the work. These position papers are ultimately approved by JACEI, the Joint Advisory Committee on the Ethics of Investment, and form the basis of policy statements to guide the CFB's decision making. In the past year this process has resulted in the adoption of new policies on climate change, prisons and children's issues.

Climate change policy and engagement
The clear biblical requirement to be good stewards needs to be reflected in all we do, and nowhere is this more pressing than in our response to the threat of climate change. A significant amount of time was given by JACEI to refining our thinking in this complex area. The result was the publication of both a position paper and a policy statement, which set out our aim to "create and manage portfolios with a carbon footprint that is relatively low and measurably declining". Our first act in carrying out this policy was to employ the expert services of Trucost and EIRIS to review our UK equity portfolio. Using very different methodologies both concluded that we had a lower carbon footprint than the UK equity market as a whole.

A strong feature of the CFB's policy is to encourage companies to disclose and reduce their carbon emissions. We have long been active in this but in the past year have increased our level of engagement, encouraging those companies in which we invest that do not participate in the Carbon Disclosure Project to reconsider their position. Our membership of the Institutional Investors Group on Climate Change provides collaborative opportunities with other investors to lobby policy makers and companies to take action.

Ethical investment and children's issues
Last year we noted that JACEI had approved the position paper: *Ethical Investment Issues Involving Children*. A policy statement was subsequently produced that emphasised the need to bring an extra ethical dimension to bear on issues such as children's rights that transcend traditional company or sector based ethical frameworks. The policy seeks to ensure that proactive engagement brings ethical issues affecting children to the attention of any company involved. For instance we began engagement with leading High Street retailers on possible exploitation of children by their overseas manufacturers and inappropriate clothing ranges targeted at young children.

Prisons and detention centres
The CFB through its close collaboration with the Methodist Connexional team can become involved in work that is distinct from mainstream ethical initiatives. Our new policy statement: *Prisons and other Detention Centres* falls into this category. We began by examining the distinction between prisons, juvenile detention

facilities, and centres for the detention of asylum seekers, highlighting that children who had not broken any criminal law might be detained as asylum seekers. The policy accepts that investment in companies operating prisons is ethically acceptable in principle, except where the death penalty is used, but commits the CFB to examine with particular care any company operating or owning prisons in which children are detained.

Caste discrimination

The injustice of the caste system was another distinctive issue that was addressed by JACEI through a position paper focused initially on the Dalits in India. A CFB policy paper and further examination of human rights issues are tasks for the coming year.

Ecumenical dialogue

Our witness has greater impact when exercised in partnership with other churches. For the CFB, this is normally conducted through our involvement with the Church Investors Group (CIG). A good example of the success of this approach was the closure of BSkyB's seven wholly owned pornography channels. This followed a long period of engagement with the company, culminating in a meeting with Chief Executive, Jeremy Darroch. CIG also held meetings with John Varley, Chief Executive of Barclays, and Niels Christiansen, a senior Nestlé executive, which provided the opportunity to challenge their activities at the highest level. In the case of Nestlé, the CIG was able to bring together many denominations for an open and frank dialogue which proved particularly beneficial for all concerned.

Corporate governance and responsible compensation

Perhaps the most contentious voting issue for shareholders is executive compensation, with a wide spread concern that remuneration packages at the highest level are excessive. The Church Investors Group entered the debate by commissioning a report, *The Ethics of Remuneration: a Guide for Christian Investors,* that examined the issue from a theologically reflective viewpoint. It concluded that injustice was apparent all too often, thus providing ample justification for the high proportion of votes cast by the CFB against remuneration reports. The report and our rigorous approach to challenging compensation packages provided us with a number of opportunities to speak out on the subject through the press, radio and TV.

As responsible shareholders we continue to take action where we believe remuneration has been excessive, rewarded failure, or been related to 'takeovers'. In 2009 we voted against 62 remuneration reports and abstained on a further 31 out of a total of 107 resolutions on executive remuneration. We also voted against 14 resolutions for the appointment or re-appointment of auditors. During the year, the CFB worked with other members of CIG to adapt the CFB model to produce an agreed CIG voting template for UK companies. We have also agreed to a collaborative voting template for our European portfolio designed originally for the investment bodies of the Church of England. These developments will go some way in enabling the Church to demonstrate united action in our dealings with companies.

Neville White
Ethics Consultant

How our funds performed

Unit price and distribution history

Schedule of valuations and distributions – Equity and Property Funds

	UK Equity Fund		Overseas Fund		Property Fund	
	Valuation p	Annual Distribution p	Valuation p	Annual Distribution p	Valuation p	Annual Distribution p
28 Feb 2006	1460.5	40.60	251.2	3.71	103.9	1.56
28 Feb 2007	1580.9	44.08	255.9	3.92	118.8	6.77
29 Feb 2008	1491.8	49.82	258.1	3.48	99.4	7.71
28 Feb 2009	978.5	58.27	193.9	4.24	59.2	7.66
28 Feb 2010	1348.5	42.67	270.9	3.14	61.9	6.57

Property Fund launched 1 December 2005

Schedule of valuations and distributions – Managed Funds

	Managed Equity Fund		Managed Fixed Interest Fund		Managed Mixed Fund	
	Valuation p	Annual Distribution p	Valuation p	Annual Distribution p	Valuation p	Annual Distribution p
28 Feb 2006	1703.7	43.81	169.3	7.90	316.5	9.54
28 Feb 2007	1829.2	47.50	163.0	7.59	332.5	10.53
29 Feb 2008	1745.0	52.52	165.1	7.53	320.7	11.54
28 Feb 2009	1171.0	62.23	172.8	7.48	239.7	12.70
28 Feb 2010	1619.0	46.13	173.5	6.82	303.9	10.12

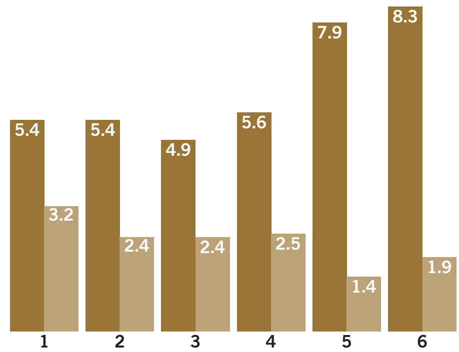
Schedule of valuations and distributions – Fixed Interest Funds

	Gilt Fund		Corporate Bond Fund		Short Fixed Interest Fund		Inflation Linked Fund	
	Valuation p	Annual Distribution p	Valuation p	Annual Distribution p	Valuation p	Annual Distribution p	Valuation p	Annual Distribution p
28 Feb 2006	131.3	5.82	119.4	6.02	102.9	4.91	220.3	4.80
28 Feb 2007	125.6	5.68	114.2	5.84	99.6	4.67	220.5	4.75
29 Feb 2008	126.8	5.62	110.2	5.82	102.1	4.66	236.1	4.80
28 Feb 2009	132.1	5.57	109.5	5.87	108.5	4.53	225.1	4.63
28 Feb 2010	130.8	4.97	115.9	5.59	108.4	4.10	243.7	4.09

Long term returns: internal assessment
for the periods to 28 February 2010

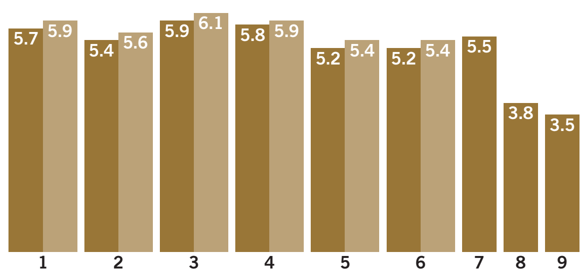
Equity and Convertibles

1 CFB Managed Mixed Fund
2 CFB Managed Equity Fund
3 CFB UK Equity Fund
4 FTSE All Share Index
5 CFB Overseas Fund
6 FTSE All World Index (ex UK)



Fixed Interest

1 CFB Managed Fixed Interest Fund
2 Managed Fixed Interest Composite
3 CFB Short Fixed Interest Fund
4 FTSE Short Gilt Index Composite
5 CFB Gilt Fund*
6 FTSE All Stock Gilt Index
7 CFB Corporate Bond Fund#
8 iBoxx Non Gilts Index#
9 Corporate Bond Index Composite

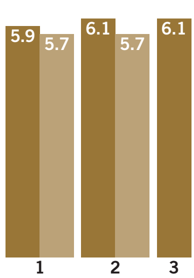


*Figures prior to 01/11/02 relate to CFB Long Fixed Interest Fund

#10 year data unavailable

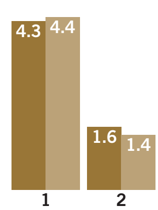
Inflation Linked

1 CFB Inflation Linked Fund
2 FTSE All Stock Index Linked Index
3 FTSE Inflation Linked Index Composite



Cash

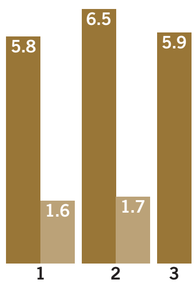
1 CFB Deposit Fund
2 Higher Rate Bank Deposits (over £10,000)



5 years % pa
10 years % pa

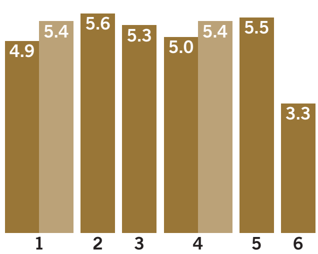
Long term returns: external assessment
for the periods to 31 December 2009

UK Equity
1 CFB
2 FTSE All Share Index
3 FTSE All Share Ethically Adjusted Index



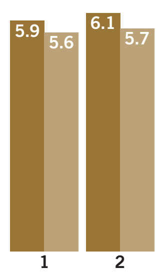
Overseas Equities
1 CFB
2 FTSE All World Index (ex UK)

UK Fixed Interest
1 CFB – Gilt
2 CFB – Short#
3 CFB – Corporate Bond#
4 FTSE All Stock Gilt Index
5 Short Fixed Composite#
6 iBoxx Non Gilts Index#



#10 year data unavailable

UK Inflation Linked
1 CFB
2 FTSE All Stock Index Linked Gilt Index



5 years % pa
10 years % pa
Source: Portfolio Evaluation

Our funds in detail

MANAGED EQUITY FUND

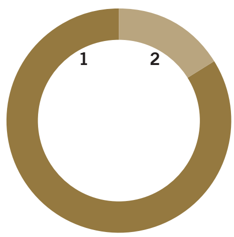
Investment objective
Over rolling five year periods, to achieve through holdings in the CFB UK Equity and Overseas funds, a total return equal to or in excess of the composite index measuring the constituent asset classes.

Investment parameters (reviewed annually)	
CFB UK Equity Fund	80-90%
CFB Overseas Fund	10-20%
Dealing surcharge	0.30% of unit value

Summary of investments and other assets
as at 28 February 2010

1 UK Equity Fund 83.7%

2 Overseas Fund 16.3%



MANAGED FIXED INTEREST FUND

Investment objective
Over rolling five year periods, to achieve through holdings in the CFB Gilt, Corporate Bond and Short fixed interest funds, a total return equal to or in excess of the UK Government fixed interest market.

Investment parameters (reviewed annually)	
CFB Gilt Fund	30-50%
CFB Corporate Bond Fund	5-15%
CFB Short Fixed Interest Fund	40-60%
Modified duration	4.7-7.8 years
Dealing surcharge	0.10% of unit value

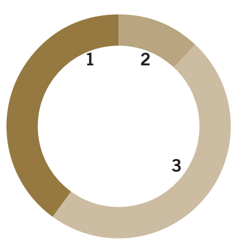
Summary of investments and other assets
as at 28 February 2010

1 Gilt Fund 40.0%

2 Corporate Bond Fund 12.0%

3 Short Fixed Interest Fund 48.0%

Modified duration of fund 6.4 years



MANAGED MIXED FUND

Investment objective
Over rolling five year periods, to achieve through holdings in the CFB UK Equity, Overseas, Gilt, Corporate Bond, Short Fixed Interest, Inflation Linked and Property funds, a total return equal to or in excess of a composite index measuring the constituent asset classes.

Investment parameters (reviewed annually)	
Equities and Inflation Linked Securities	60-80%
– CFB UK Equity Fund	(50-70)%
– CFB Overseas Fund	(5-15)%
– CFB Inflation Linked Fund	(0-5)%
Fixed Interest Securities	15-35%
– CFB Gilt Fund	(10-20)%
– CFB Corporate Bond Fund	(0-5)%
– Short Fixed Interest Fund	(5-15)%
Property Fund	0-10%
Dealing surcharge	0.35% of unit value

Summary of investments and other assets
as at 28 February 2010

1 UK Equity Fund 60.7%

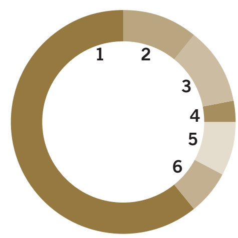
2 Overseas Fund 10.9%

3 Gilt Fund 11.3%

4 Corporate Bond Fund 2.9%

5 Short Fixed Interest Fund 7.9%

6 Property Fund 6.3%



Risk warning

CFB Funds are designed for long term investors. While we hope that unit values will rise, prices can and do fall. They are not suitable for you to use if you cannot accept the possibility of capital losses.

DEPOSIT FUND

Investment objective
To achieve mainly through a portfolio of bank deposits and with minimal risk of capital loss, the higher rates of interest usually available in the London Money Market whilst maintaining the ability to make withdrawals at short notice and with minimal risk of capital loss.

Investment parameters

On call or repayable within 5 business days	Minimum 10%
Maximum period of redemption (other than floating rate securities)	24 months
Maximum period between coupon changes on floating rate securities	6 months
Maximum average life (excluding fixed term arrangements made by specific clients)	150 days
Total expense ratio	0.19%

Summary of investments by credit rating
as at 28 February 2010

1 Aaa 2.2%

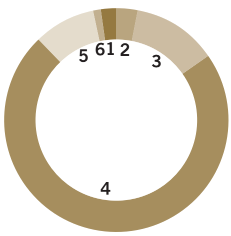
2 Aa1 3.1%

3 Aa2 12.4%

4 Aa3 72.3%

5 A1 8.9%

6 A2 1.1%



Average life of fund 85 days

Percentage of fund deposited with banks participating in UK Government credit guarantee scheme 72.5%

Fund description
What is the Deposit Fund?
The CFB Deposit Fund is a common deposit fund designed specifically for Methodist churches and charities. Monies received are pooled together and invested through the Affirmative Deposit Fund for Charities mainly in the London Money Market.

Security
Monies are placed on deposit with banks which meet rigorous criteria based on independent credit ratings and size. We further minimise risk by limiting the proportion of the fund deposited with any single bank.

Who can invest in the Deposit Fund?
All churches and charities in Great Britain responsible to the Methodist Conference are allowed to invest. This would normally include other organisations under the control of the Church Council, eg Sunday school, youth club etc.

What services do we provide?
- Accounts may be opened on any business day.
- Deposits may be made via a local bank, using a CFB paying-in book, or by post.
- Withdrawals to your nominated bank account are processed on day of request (up to £50,000). Notice of up to seven days may be required for larger sums.
- Automatic transfers can be set up to:
  – pay stipends
  – Circuit, District and other Deposit Fund accounts
  – fund local bank accounts
  – receive tax refunds
  – credit income distributions via TMCP.
- CFB Online allows you to access your CFB accounts via the internet. For further information and to register for this service, go to the CFB website at www.cfbmethodistchurch.org.uk

Dealing and interest
- Dealing date: every business day.
- Interest is earned immediately an account is credited.
- Interest is paid monthly by credit to the account.
- No transaction charges are levied.

More information
For more information about the CFB Deposit Fund and its services, contact us on 020 7496 3600.

Model trust money and property schemes
Model trust monies maintained in cash cannot be held directly in the Deposit Fund, but should be forwarded to the Trustees for Methodist Church Purposes (TMCP) in Manchester. You will, however, still benefit from the professional management of the CFB team, as such monies will be invested in the TMCP Trustees Interest Fund, which is itself managed on behalf of TMCP by the CFB. Further information on this fund can be obtained direct from TMCP on 0161 235 6770.

Balance Sheet
as at 28 February 2010

	28/2/10 £'000s	28/2/09 £'000s
Portfolio of investments	**398,691**	**421,839**
Current assets		
Debtors	5	191
Bank balances	–	3
	5	194
Current liabilities		
Creditors	49	47
Bank overdrafts	37	–
	86	47
Net current assets	**(81)**	**147**
Liabilities falling due in more than one year		
Income reserve	168	328
Net assets	**398,442**	**421,658**
Represented by:		
Current deposits	307,392	320,658
Term deposits	91,050	101,000
Unitholders' funds	**398,442**	**421,658**

Statement of total return
for the year ended 28 February 2010

	28/2/10 £'000s	28/2/09 £'000s
Gross income	8,306	22,668
Expenses	(562)	(539)
Net income & total return for the period	**7,744**	**22,129**
Finance costs: Distributions	(7,904)	(21,885)
Net increase/(decrease) in undistributed income	**(160)**	**244**

Summary of deposts by maturity
as at 28 February 2010

	28/2/10 £'000s	28/2/09 £'000s
Repayable within		
On call	307,641	325,839
5 business days	8,000	6,000
1 month	10,000	10,000
2 months	12,000	14,000
3 months	13,000	10,000
6 months	21,000	18,000
1 year	21,050	34,000
2 years	6,000	4,000
Total deposits	**398,691**	**421,839**

Net asset value (NAV)/fund size

Date	Net asset value £m
28 February 2006	374.6
28 February 2007	398.6
29 February 2008	421.9
28 February 2009	421.7
28 February 2010	398.4

Income distribution history

Year to 28 February	Average rate %	Average CAR %
2006	4.52	4.61
2007	4.61	4.71
2008	5.56	5.71
2009	4.96	5.08
2010	1.45	1.46

Notes to the accounts

Year to 28 February 2009

1 Accounting policies

(a) Basis of accounting

The accounts have been prepared under the historic cost convention, as modified by the revaluation of investments, and in accordance with the Statement of Recommended Practice issued by the Investment Management Association in 2008, and the requirements of the Methodist Church Funds Act 1960.

(b) Recognition of income

Interest on term and call deposits is accrued on a day-to-day basis.

(c) Management expenses

All administrative expenses in relation to the management of the Fund, including audit, legal, safe custody and transaction charges, are recovered by deduction from income before a distribution is declared. No other management charges are levied. Audited financial statements for the CFB Management Account detailing the total costs incurred in the management of all CFB funds are presented to the Board annually.

(d) Distribution policy

All income of the Fund, after deduction of management and other expenses is distributed to account holders. The Fund maintains an income reserve to facilitate the payment of interest to depositors.

(e) Basis of valuation

The Fund does not invest directly with the Money Market following a decision by the CFB Council to invest entirely through the Affirmative Deposit Fund for Charities, a Charity Commission established Common Deposit Fund managed by Epworth Investment Management Limited. All deposits with the Affirmative Deposit Fund for Charities are valued at cost.

2 Income reserve

The Fund operates an income reserve which is accumulated out of income and held on trust for depositors for the time being. The income reserve is maintained to ensure payment of interest to depositors each month even though a proportion of the income earned by the Fund will not be received until maturity of individual deposits. The reserve is also available to augment the Fund's deposit rate and to provide against potential default of counterparties.

	28/2/2010 £'000s	*28/2/2009 £'000s*
Balance at start of period	328	84
Transfer (from)/to reserve	(160)	244
Balance at 28 February 2010	168	328

3 Taxation

The Fund is exempt from UK income tax and capital gains tax due to its charitable status pursuant to Sections 505 and 506 of the Income and Corporation Taxes Act 1988. Distributions are paid on the basis that all recoverable UK taxation has been reclaimed. Withholding tax is credited to income when it is recovered.

Statement of the Council's responsibilities

The Methodist Church Funds Act 1960 requires the council, for each financial year, to prepare financial statements which give a true and fair view of the state of affairs of the board's funds and of the return of the board's funds for that period. In preparing those financial statements, the council is required to:

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the board will continue in business.

The council is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the board's funds and to enable them to ensure that the financial statements comply with the Methodist Church Funds Act 1960. The council is also responsible for safeguarding the assets of the board's funds and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Approved on behalf of Central Finance Board of the Methodist Church

Roger Smith
Chairman

8 April 2010

Independent Auditors' Report to the Members of the Central Finance Board of the Methodist Church

We have audited the financial statements of the Deposit Fund of the Central Finance Board of the Methodist Church for the year ended 28 February 2010 which comprise the Balance Sheet, Distribution Table, Statement of Total Return, Summary of Deposits by Maturity, the Net Asset Value Table, Income Distribution History and related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Board's members, as a body. Our audit work has been undertaken so that we might state to the Board's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Board and the Board's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the council and auditors

As described in the Statement of the Council's Responsibilities the Council is responsible for the preparation of financial statements in accordance with applicable law and which give a true and fair view of the state of affairs of the board's funds and of the return of the board's funds for that period.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the accounting and disclosure requirements of the Statement of Recommended Practice for Authorised Funds issued by the Investment Management Association in November 2008 and the Methodist Church Funds Act 1960. We also report to you if, in our opinion, the board has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This information comprises only the Statement of the Council's Responsibilities. We consider the implications for our report if we become aware of any apparent misstatement or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Board's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view of the financial position of the Deposit Fund as at 28 February 2010 and of the total return of the property of the fund for the year then ended;
- the financial statements have been properly prepared in accordance with the Statement of Recommended Practice for Authorised Funds issued by the Investment Management Association in November 2008 and the Methodist Church Funds Act 1960.

Mazars LLP
Chartered Accountants and Registered Auditors
Tower Bridge House, St. Katharine's Way, London E1W 1DD

19 April 2010

UK EQUITY FUND

Investment objective

Over rolling five year periods, to achieve mainly through a portfolio of UK equities, a total return equal to or in excess of the UK equity market.

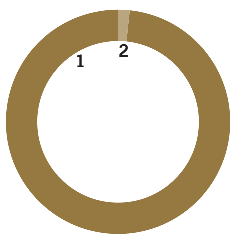
Investment parameters
(reviewed annually)

UK equities	95-100%
Cash	0-5%
Total expense ratio	0.255%
Dealing surcharge	0.30% of unit value

Valuation of UK Equity Fund
as at 28 February 2010

1 Equities 98.3%

2 Cash 1.7%



Summary of investments and other assets
as at 28 February 2010

	Market value £'000s	*CFB %*	*Benchmark %*
Oil & Gas Producers	65,878	19.9	19.7
Oil Equipment & Services	1,693	0.5	0.2
Chemicals	3,055	0.9	0.5
Forestry & Paper	–	–	0.1
Mining	30,437	9.2	9.3
Construction & Materials	712	0.2	0.3
General Industrials	3,751	1.1	0.8
Electronic & Electrical Equipment	2,077	0.6	0.3
Industrial Engineering	760	0.2	0.6
Industrial Transportation	1,184	0.4	0.2
Support Services	8,107	2.5	3.4
Beverages	851	0.3	0.1
Food Producers	7,779	2.4	2.7
Household Goods	7,989	2.4	2.7
Personal Goods	–	–	0.4
Healthcare Equipment & Services	2,482	0.8	0.6
Pharmaceuticals & Biotechnology	31,188	9.4	9.5
Food & Drug Retailers	13,313	4.0	3.9
General Retailers	7,127	2.2	2.1
Media	9,032	2.7	2.6
Travel & Leisure	10,440	3.2	2.8
Fixed-Line Telecommunications	3,779	1.1	1.2
Mobile Telecommunications	20,440	6.2	6.1
Electricity	4,591	1.4	1.4
Gas, Water & Multi-Utilities	11,023	3.2	3.2
Banks	45,214	13.7	13.8
Non- Life Insurance	2,514	0.8	0.9
Life Insurance	9,147	2.8	2.8
Real Estate Investment Trusts	5,263	1.6	1.6
General Financial	4,366	1.3	1.4
Equity Investment Instruments	13,194	4.0	2.8
Software & Computer Services	3,001	0.9	1.5
Technology Hardware & Equipment	468	0.1	0.5
Total investments	**330,855**	**100.0**	**100.0**
Net cash	**5,642**		
Total value of fund	**336,497**		

Portfolio valuation
as at 28 February 2010

	Holding 000s	*Market value £'000s*
Oil & Gas Producers		
BG Group	992	11,352
BP	3,580	20,714
Cairn Energy	600	2,006
Chevron	81	3,843
iShares S&P Global Energy	245	5,435
Premier Oil	100	1,091
Royal Dutch Shell B	1,180	20,249
Tullow Oil	100	1,188
		65,878
Oil Equipment & Services		
Wellstream Holdings	145	723
Wood Group (John)	270	970
		1,693
Chemicals		
Croda International	140	1,260
Johnson Matthey	87	1,380
Treatt	150	415
		3,055
Mining		
Anglo American	321	7,667
BHP Billiton	505	10,133
Lonmin	33	596
Rio Tinto	358	12,041
		30,437
Construction & Materials		
Gleeson (MJ) Group	145	213
Morgan Sindall	90	499
		712
General Industrials		
Cookson Group	150	689
Rexam	465	1,297
Smiths Group	170	1,765
		3,751
Electronic & Electrical Equipment		
Halma	300	745
Laird	150	190
Spectris	145	1,142
		2,077
Industrial Engineering		
Spirax-Sarco	60	760
		760
Industrial Transportation		
Forth Ports	40	426
Wincanton	395	758
		1,184
Support Services		
Bunzl	155	1,055
Capita Group	300	2,148
Connaught	130	391
Experian	176	1,065
Mouchel Group	125	259
RPS Group	180	323
RWS Holdings	54	180
Shanks Group	875	1,022
Spice	700	270
Wolseley	90	1,394
		8,107

Portfolio valuation
as at 28 February 2010

	Holding 000s	*Market value £'000s*
Beverages		
Britvic	200	851
		851
Food Producers		
Associated British Foods	110	1,045
Unilever (UK)	350	6,734
		7,779
Household Goods & Home Construction		
Bellway	70	465
Berkeley Group	85	630
Reckitt Benckiser Group	200	6,894
		7,989
Healthcare Equipment & Services		
Care UK	200	834
Smith & Nephew	245	1,648
		2,482
Pharmaceuticals & Biotechnoloy		
Astrazeneca	404	11,649
Glaxosmithkline	1,460	17,725
iShares S&P Global Health	10	337
Shire	105	1,477
		31,188
Food & Drug Retailers		
Greggs	120	493
Morrison (Wm)	760	2,269
Sainsbury (J)	475	1,569
Tesco	2,140	8,982
		13,313
General Retailers		
ASOS	150	703
Dignity	90	603
Halfords Group	210	954
Home Retail Group	200	510
Inchcape	1,200	305
Kingfisher	235	505
Marks & Spencer Group	375	1,238
Next	90	1,686
W H Smith	136	623
		7,127
Media		
Centaur Media	500	245
Daily Mail	105	467
ITV	500	270
Lion Hudson	152	82
Next Fifteen Comms	1,035	631
Pearson	235	2,143
Reed Elsevier	410	2,017
United Business Media	105	459
WPP Group	450	2,718
		9,032

Portfolio valuation
as at 28 February 2010

	Holding 000s	Market value £'000s
Travel & Leisure		
British Airways	255	538
Carnival	50	1,241
Cineworld Group	550	869
Compass Group	605	2,950
First Group	250	888
Go-Ahead Group	31	420
Intercontinental Hotels	60	551
National Express	500	1,015
Restaurant Group	245	502
Tui Travel	250	685
Whitbread	55	781
		10,440
Fixed Line Telecommunications		
BT Group	2,400	2,758
Cable & Wireless	750	1,021
		3,779
Mobile Telecommunications		
Vodafone Group	14,450	20,440
		20,440
Electricity		
International Power	465	1,508
Scottish & Southern Energy	275	3,083
		4,591
Gas, Water & Multiutilities		
Centrica	1,500	4,195
National Grid	725	4,727
Severn Trent	80	932
United Utilities Group	215	1,169
		11,023
Banks		
Barclays	2,608	8,142
HSBC Holdings	2,875	20,689
iShares S&P Global Finl	91	2,624
Lloyds Banking Group	7,207	3,784
Royal Bank Of Scotland	3,700	1,394
SPDR Financial Sector	80	771
Standard Chartered	500	7,810
		45,214
Nonlife Insurance		
Admiral Group	80	992
Royal and Sun Alliance	1,175	1,522
		2,514
Life Insurance		
Aviva	695	2,712
Legal & General	1,975	1,524
Prudential	610	3,675
Resolution	608	437
Standard Life	409	799
		9,147

Portfolio valuation
as at 28 February 2010

	Holding 000s	Market value £'000s
Real Estate Investment Trusts		
British Land	192	843
Hammerson	200	765
Land Securities Group	175	1,106
Primary Health Properties	376	1,128
Shaftesbury	133	501
		4,343
Real Estate Investment Services		
Quintain Estates	715	436
St Modwen Properties	250	484
		920
Financial Services		
Aberdeen Asset Mgt	500	574
F&C Asset Management	1,250	693
Icap	185	603
Man Group	357	803
Rathbone Brothers	90	736
Schroders	80	957
		4,366
Equity Investment Instruments		
Blackrock World Mining	310	1,700
Herald Investment Trust	400	1,388
Herald Ventures II		535
Herald Ventures		325
HG Capital Trust	50	417
iShares FTSE 100	155	829
iShares FTSE 250	357	3,284
Liontrust First Growth	219	399
Liontrust Intellectual	188	630
North Atlantic Smaller Cos	255	1,979
Oryx International Growth	525	877
TR Property IT	540	831
		13,194
Software & Computer Services		
Alterian	435	622
Aveva Group	50	515
Micro Focus International	170	799
Sage Group	450	1,065
		3,001
Technology Hardware & Equipment		
Spirent Communications	450	468
		468
Total investments		**330,855**
Net current assets		**5,642**
Total value of Fund		**336,497**

OVERSEAS FUND

Investment objective

Over rolling five year periods, to achieve mainly through a portfolio of overseas equities and inflation linked securities, a total return equal to or in excess of non-UK equity markets.

Investment parameters

(reviewed annually)

Overseas equities	90-100%
– North America	(29.8-59.8)%
– Europe (ex UK)	(11.2-31.2)%
– Japan	(4.2-14.2)%
– Asia Pacific (ex Japan)	(9.5-19.5)%
Rest of World	(2.3-8.3)%
Inflation Linked Securities	0-5%
Cash	0-5%
Total expense ratio	0.80%
Dealing surcharge	0.15% of unit value

Summary of investments and other assets

as at 28 February 2010

1 North America 51.8%

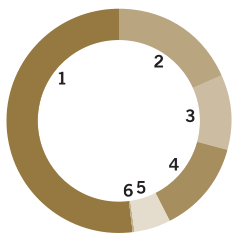
2 Europe 18.5%

3 Japan 10.9%

4 Pacific Basin ex-Japan 13.1%

5 Emerging Markets 5.4%

6 Cash 0.3%



Portfolio valuation

as at 28 February 2010

	Holding 000s	*Market value £'000s*
North America		
Canada		
iShares Canada S&P 60 Index	507	5,397
		5,397
United States		
Consumer Discretionary SPDR	83	1,662
General Board Domestic Stock Fund	5,709	55,143
Health Care Sector SPDR	72	1,485
iShares S&P 100	174	5,811
Powershares QQQ Trust	30	882
Industrials Sector SPDR	20	379
Financials Sector SPDR	165	1,591
Utilities Sector SPDR	27	516
Consumer Staples Sector SPDR	85	1,508
Technology Sector SPDR	78	1,110
Basic Industries Sector SPDR	25	516
Energy Sector SPDR	38	1,400
		72,003
European Composite		
Baring Emerging Europe	100	740
Central Europe & Russia Fund	13	273
European Fund CFB Units	28,721	23,933
iShares MSCI Europe Ex-UK	115	2,022
JPMorgan European Fledgeling	100	650
		27,618
Japan		
Atlantis Japan Growth	65	421
Baillie Gifford Shin Nippon	330	427
Blackrock Japan Index Sub-Fund	2,324	14,974
iShares MSCI Japan	76	496
		16,318
Pacific Basin ex-Japan		
Australia		
Glebe Equities Trust	5,403	2,144
iShares MSCI Australia	68	989
		3,133
Other Asian		
Aberdeen New Dawn IT	100	654
JPMorgan Indian IT	150	568
		1,222
Pacific Basin Composite		
First State Asia Pac Sustain	1,609	3,030
First State Asia Pacific	1,823	10,701
First State Asia Pac Leaders	452	1,341
iShares MSCI Pac ex Japan	5	118
		15,190
Rest of the World		
First State Emerging Markets	779	3,402
Blackrock World Mining	210	1,152
iShares MSCI South Africa	8	262
iShares S&P Latin American 40	100	2,949
Templeton Emerging Markets	50	259
		8,024
Total investments		**148,905**
Net cash		**651**
Total value of fund		**149,556**

GILT FUND

Investment objective
Over rolling five year periods, to achieve mainly through a portfolio of long-dated sterling denominated UK Government securities with an income yield close to the redemption yield prevailing on UK Government securities, a total return equal to or in excess of the UK Government fixed interest market.

Investment parameters
(reviewed annually)

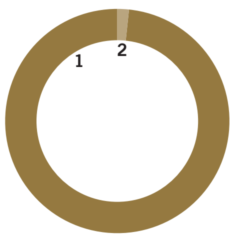
Government Securities	95-100%
Cash	0-5%
Modified duration	6.2-10.3 years
Total expense ratio	0.15%
Dealing surcharge	0.05% of unit value

Summary of investments and other assets
as at 28 February 2010

1 British Government 98.3%

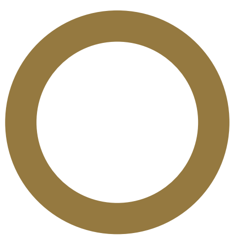
2 Cash 1.7%

Modified duration of fund 8.5 years



Summary of investments by credit rating
as at 28 February 2010

AAA 100%



Portfolio valuation
as at 28 February 2010

	Holding 000s	*Market value £'000s*
Treasury 4¼% 2011	1,000	1,037
Treasury 5% 2012	40	43
Treasury 5¼% 2012	1,000	1,086
Treasury 4½% 2013	4,500	4,851
Treasury 2¼% 2014	1,250	1,245
Treasury 5% 2014	3,283	3,630
Treasury 4¾% 2015	3,800	4,165
Treasury 4% 2016	3,750	3,909
Treasury 5% 2018	1,500	1,634
Treasury 4½% 2019	1,000	1,043
Treasury 4½% 2019	1,500	1,585
Treasury 4% 2022	3,500	3,409
Treasury 5% 2025	750	793
Treasury 4¼% 2027	4,750	4,593
Treasury 4¼% 2032	2,250	2,146
Treasury 4¼% 2036	1,250	1,184
Treasury 4¾% 2038	875	900
Treasury 4¼% 2039	2,250	2,129
Treasury 4½% 2042	1,250	1,239
Treasury 4¼% 2046	1,000	952
Treasury 4¼% 2055	1,750	1,674
Total investments		**43,247**
Net current assets		**737**
Total value of fund		**43,984**

CORPORATE BOND FUND

Investment objective
Over rolling five year periods, to achieve mainly through a portfolio of sterling denominated corporate and sub-sovereign fixed interest securities, a total return equal to or in excess of the UK corporate bond market.

Investment parameters (reviewed annually)	
Credit rating AAA and AA	55-85%
Other investment grade or secured issues	15-45%
Cash and bonds under 1 year to maturity	0-5%
Modified duration	5.2-8.6 years
Total expense ratio	0.195%
Dealing surcharge	0.45% of unit value

Summary of investments and other assets
as at 28 February 2010

1 Debentures 4.4%

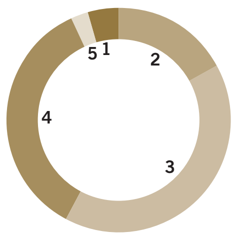
2 Supranational 17.2%

3 Corporate Unsecured – Financial 40.6%

4 Corporate Unsecured – Non Financial 35.4%

5 Cash 2.4%

Modified duration of fund 6.9 years



Summary of investments by credit rating
as at 28 February 2010

1 AAA 20.6%

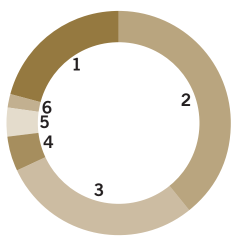
2 AA 39.3%

3 A 28.9%

4 BBB 5.0%

5 Debentures – not rated 4.2%

6 Cash 2.0%



SHORT FIXED INTEREST FUND

Investment objective

Over rolling five year periods, to achieve mainly through a portfolio of short-dated sterling denominated fixed interest securities with an income yield close to the redemption yield prevailing on short-dated UK Government securities, a total return equal to or in excess of the short-dated UK Government fixed interest market.

Investment parameters
(reviewed annually)

Government Securities	70-90%
Debentures and Unsecured Loans	10-9%
Cash	0-5%
Modified duration	3.3-5.5 years
Total expense ratio	0.15%
Dealing surcharge	0.05% of unit value

Summary of investments and other assets
as at 28 February 2010

1 British Government 77.8%

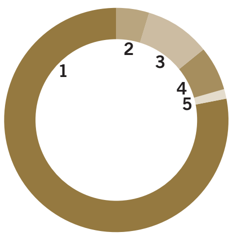
2 Supranational 4.8%

3 Corporate Unsecured – Financial 9.5%

4 Corporate Unsecured – Non Financial 6.4%

5 Cash 1.5%

Modified duration of fund 4.4 years



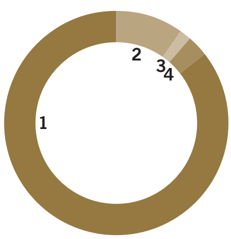
Summary of investments by credit rating
as at 28 February 2010

1 AAA 85.4%

2 AA 9.8%

3 A 1.6%

4 BBB 3.2%



Portfolio valuation
as at 28 February 2010

	Holding 000s	*Market value £'000s*
British Government Stock		
Treasury 5% 2012	1,000	1,076
Treasury 5¼% 2012	1,750	1,901
Treasury 4½% 2014	2,600	2,803
Treasury 5% 2014	1,250	1,382
Treasury 4¾% 2015	250	274
Treasury 4% 2016	500	521
Treasury 5% 2018	2,750	2,996
Treasury 4½% 2019	1,750	1,825
		12,778
Supranational		
International Finance Facility for Immunisation 3⁵⁄₈% 2014	500	511
Network Rail 4⁷⁄₈% 2015	250	270
		781
Corporate Unsecured – Financial		
Bank of America 6⁷⁄₈% 2010	250	253
Abbey National 5½% 2014	250	266
National Australia Bank 5% 2014	250	269
Rabobank 4% 2015	250	256
Svenska HandelsBanken 5½% 2016	250	263
Nationwide 5⁵⁄₈% 2019	250	252
		1,559
Corporate Unsecured – Non Financial		
Vodafone 4⁵⁄₈% 2014	250	259
General Electric 5⁵⁄₈% 2014	500	537
Tele Emisiones 5³⁄₈% 2018	250	253
		1,049
Total investments		**16,167**
Net current assets		**255**
Total value of fund		**16,422**

INFLATION LINKED FUND

Investment objective

Over rolling five year periods, to achieve mainly through a portfolio of sterling denominated securities linked to the Retail Price Index or similar measure of inflation, a total return equal to or in excess of the UK Government Index-Linked market.

Investment parameters

(reviewed annually)

Government Securities	80-100%
Debentures and Unsecured Loans	0-19%
Cash	0-5%
Modified duration	10.5-17.5 years
Total expense ratio	0.17%
Dealing surcharge	0.30% of unit value

Summary of investments and other assets

as at 28 February 2010

1 British Government 83.9%

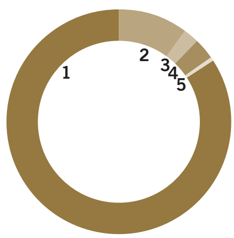
2 Supranational 10.2%

3 Corporate Unsecured – Financial 2.1%

4 Corporate Unsecured – Non Financial 3.1%

5 Cash 0.7%

Modified duration of fund 14.1 years



Summary of investments by credit rating

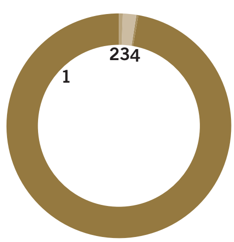
as at 28 February 2010

1 AAA 97.1%

2 AA 0.8%

3 A 1.7%

4 BBB 0.4%



Portfolio valuation

as at 28 February 2010

	Holding 000s	*Market value £'000s*
British Government Stock		
Treasury 2½% 2013	500	1,337
Treasury 2½% 2016	300	894
Treasury 1¼% 2017	200	235
Treasury 2½% 2020	2,000	5,959
Treasury 1⅞% 2022	11,600	13,526
Treasury 2½% 2024	3,100	8,067
Treasury 1¼% 2027	2,900	3,360
Treasury 2% 2035	6,000	9,200
Treasury 1⅛% 2037	8,300	9,625
Treasury ⅝% 2042	600	597
Treasury 1¼% 2055	200	252
		53,052
Supranational		
Ned Waterschapsbank 3% 2011	700	932
EIB 2.6% 2013	1,500	2,012
Network Rail 1.9618% 2025	2,000	2,490
EIB 2.40% 2030	700	1,022
		6,456
Corporate Unsecured – Financial		
Rabobank 2.324% 2013	650	814
Nationwide 4¼% 2024	250	525
		1,339
Corporate Unsecured – Non Financial		
Tesco 4% 2016	150	221
BG 4.1875% 2022	500	780
Severn Trent 3.86% 2028	500	737
SE Water 2.5329% 2041	250	246
		1,984
Total investments		**62,831**
Net current assets		**369**
Total value of fund		**63,200**

PROPERTY FUND

Investment objective
To provide capital growth linked to the value of commercial property and to provide a high and growing yield.

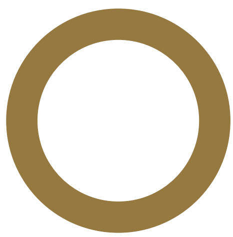
Dealing purchases
On first working day of month.

Sales
Quarterly on first working day of calendar quarter

For an information pack, please contact Bill Lane, Client Relationship Manager, on 020 7496 3630 or email bill.lane@cfbmethodistchurch.org.uk

Summary of investments and other assets
as at 28 February 2010

Property Income Fund
for Charities 100.0%



Summary of investments and other assets
as at 28 February 2010

	Holding 000s	*28/2/09 £'000s*
Property Income Fund for Charities	6,960	4,997
		4,997
Net current assets		**2**
Total value of fund		**4,999**

Chairman & senior officers
Chairman **Roger Smith**
Vice Chairman **Richard Reeves** FCA
Chief Executive **Bill Seddon** BSc (Econ) ASIP
Chief Financial Officer **Peter Forward** FCA
Chief Investment Officer **Russell Sparkes** MA ASIP
Senior Fund Manager **Miles Askew** BA MSc ASIP
Senior Fund Manager **Stephen Beer** BA ASIP
Senior Fund Manager **Chris Wigley** BA
Relationship Manager **Bill Lane** MSc ASIP

Council members
Ted Awty FCA
Peter Cussons MA ACA ATII
John Gibbon
Alan Groves FCCA J Dip MA
Sue Haworth FCCA ATII
Anne Hughes-Holmes BSc (Econ)
Sir Michael Partridge KCB
Colin Pearson MA FIA
Richard Reeves FCA
Roger Smith
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