TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 7

INVESTMENT PANEL REPORT

27 SEPTEMBER 2017

STRATEGIC DIRECTOR FINANCE, GOVERNANCE & SUPPORT – JAMES BROMILEY

INVESTMENT ADVISORS REPORT

1. PURPOSE OF THE REPORT

1.1 To update Members with the current capital market conditions, and set an appropriate short term asset allocation to best take advantage of these conditions.

2. RECOMMENDATIONS

2.1 That Members note the report and approve with the short term asset allocation.

3. FINANCIAL IMPLICATIONS

3.1 Decisions taken by Members, in light of information contained within this report, will have an impact on the performance of the Fund.

4. BACKGROUND

4.1 At each Investment Panel meeting, the Panel's Independent Investment Advisors (the Advisors) provide an update to Members on current global economic, political and market conditions, and recommend an appropriate short term asset allocation for the Fund given these conditions.

4.2 As Members are aware, a review of Advisors was carried out and as part of the tender exercise the previous Advisors' last Panel meeting was March 2017. Progress has not enabled new Advisors to be present for this meeting to provide advice to Members.

4.2 Attached as Appendix A is a report from the Head of Investments and Treasury Management. The report sets out the political, economic and market background since the previous meeting.

5. SHORT TERM ASSET ALLOCATION ADVICE

5.1 In light of no Advisors to provide advice, it is considered appropriate to continue with the previous short term asset allocation. The current political, economic and market conditions are similar to previous advice provided at meetings and do not suggest any need to make any major strategy changes. Currently, the key component when setting the short term asset allocation is the Bond yield levels. Most other asset classes are basing their market levels from Bond yields and with yields currently low, investors are seeking returns wherever they can find them so driving market levels up in other asset classes. Also, the only issue of note on the medium horizon is the ECB statement on cutting back its monetary stimulus. It is envisaged that this will be carried out very carefully so as not to spook the markets and so is worthy of watching but not requiring immediate attention or changes to the short term strategy at this time. In addition, market shocks may follow further escalation of the current missile crisis, however at present markets remain high at the current level of tension.

5.2 Therefore, it is proposed that the Fund continues to favour growth assets over protection assets. It is considered that in the long run, Bond yields will rise, but at present and while central bank continue to intervene in the Bond markets, yields do not meet the actuarial requirements for the Fund and should continue to be avoided at around these levels unless they are held as a short term alternative to cash.

5.3 Cash has built up as divestments from other asset classes have occurred, and is primed to be invested when opportunities allow. It is always preferential for cash to be invested in higher returning assets, but at this time high cash levels can assist in protecting the Fund, as a diversifier, from Equity market downturns. However, at the current level of approx. 13%, cash should not rise too much further in the short term to above the maximum short term level set at the customised benchmark for protection assets (15%). It is accepted that if the value of other asset classes fall, particularly Equities, there is a possibility that the short term cash level will rise over the maximum set below.

5.4 Equity markets have been volatile over the past few years, with additional volatility in currency markets, both of which have recently been beneficial to the Fund at current equity and currency market levels with the Fund's high weighting in equities. The short term allocation strategy and range provide flexibility to continue and either increase or decrease investments when market opportunities arise.

5.5 Investment in direct property to continue on the same basis as previously presented to the Panel; on an opportunistic basis where the property has a good covenant, yield and lease terms.

5.6 Investment in Alternatives, such as general and local infrastructure and private equity, offer the Fund diversification from equities and bonds. They come with additional risks of being illiquid, traditionally they have costly management fees and investment in the type of investment can be a slow process. However, the Fund is considerably underweight its customised benchmark and, providing suitable investment opportunities are available, the Fund should look to increase its allocation to this asset class up to the customised benchmark level.

5.7 The Fund's long and short term asset allocation strategies are summarised below, together with the short term asset allocation ranges for each asset class:

Asset Class	Customised Benchmark %	June Weighting %	LT Asset Allocation Strategy	ST Asset Allocation Strategy	ST Range %
GROWTH:					
UK Equities	30	31	Reduce	Market dependent	29 – 35
Overseas Equities	40	48	Reduce	Market dependent	45 – 51
Property	10	6	Increase	Opportunistic increase	7 – 9
Alternatives	5	2	Increase	Opportunistic increase	1.5 – 5
PROTECTION:					
Bonds	12	0	Increase	Hold	0 – 2
Cash	3	13	Reduce	Hold/Reduce	5 – 15

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APPENDIX A

Investment Report September 2017

Geopolitical Background

The major geopolitical news in the period since the last Panel meeting is North Korea continuing apace to increase its missile testing programme, heightening tensions between them and their neighbours, South Korea and Japan, and the US. Despite strong words, tougher UN Security Council sanctions and pleas to the Chinese and Russians to assist, the North Korean hierarchy are emboldened with confidence increasing the danger of this missile crisis escalating further.

In the UK, following the snap election and hung Parliament result, all eyes will be on the PM and the Conservative Party conference next month to see if she can unify the party or whether it becomes a beauty parade of successors. Brexit negotiations continued with scant progress with both sides holding back their strongest political cards for a later showdown. The size of the UK's "divorce bill" remains the biggest obstacle with the UK rejecting the EU's €100 million claim while the EU rebuffed the UK's attempts to steer discussions towards post-Brexit relations, arguing that the demands on the treatment of goods and the Northern Ireland's border amounted to the UK retaining single market rights even after it had left the EU.

The latest "Eurobarometer" survey, published by the European Commission, determined that popular support for the Euro area has risen to its highest level since 2004. The outcome is helped by economic growth across the region accelerating at its most rapid pace in over six years. Optimism levels are especially high in Germany, where Chancellor Merkel looks set to win her fourth term with elections this month.

The US and Caribbean were hit by Hurricanes Harvey, Irma and Jose in fairly rapid succession. As Gulf Coast refineries were damaged, gasoline prices rose sharply, while, bizarrely, crude oil prices initially fell.

Economic Background

The recent inflation figures in the UK are putting pressure on the Bank of England's Monetary Policy Committee to consider again the first increase in interest rates since the financial crisis ten years ago. With CPI at 2.9%, well ahead of the target rate of 2%, the Governor of Bank of the England's statement and the voting result indicated a rise is imminent. This rhetoric may have done the same job as a rate rise, in lowering the inflation rate as some of the increase was caused by the weakness of the GB Pound, making imports more expensive; the GB Pound strengthened on the back of the statement.

In the Euro region, monetary policy makers are pulled in two directions with the temptation of slowly drawing back monetary stimulus whilst worrying about the strength of the Euro to other major currencies (three year high against the US Dollar and eight year high against the GB Pound) and the effect this strength may have on the recent economic recovery over the longer term.

At the previous Panel meeting, the headline economic news was the increase in interest rates in the US, raising its headline interest rate by 0.25%, keeping rate at between 1% and 1.25%, with many market commentators suggesting a third rise by the year's end. However, since then inflation rates have stubbornly refused to rise significantly towards the Fed's target of 2% prompting a more cautious approach ahead of a third interest rate rise.

The Fed's Jackson Hole symposium failed to live up to the fanfare during the run-up. Market participants were on tenterhooks in the preceding days, prepared to hang on every word of the most influential monetary policymakers in the world. In the end, the Fed's Chair provided little insight on monetary policy strategy, focussing more on the regulatory environment. The ECB's Chief also gave little away, reiterating a mildly dovish outlook on inflation.

Market Background

Equity markets, in general, have performed positively again since both the start of this quarter (to 11 September 2017) and the beginning of 2017 (to 11 September 2017), as shown in the table below:

	YTD %	**QTD %**
FTSE All-Share (UK)	8.12%	2.56%
S & P 500 (US)	5.57%	1.75%
Euro Stoxx 600 Ex UK (Europe)	17.41%	4.78%
Topix 500 (Japan)	6.94%	1.60%
MSCI Asia Pacific Ex Japan	23.94%	6.34%

The above returns are all rebased back to GB Pounds, and take into effect both the currency and index moves. The strength of the Euro has assisted the European market's total returns, which contrasts with the weakness of the US Dollar over the above periods and acted as a drag on performance of US markets.

In the past it has been reported to the Panel that Bond yields are not sufficient to meet the actuarial rate of return, as calculated by the Fund's Actuary. The table below sets out the yields of the major market's 10 year bond yields for the 31 December 2016, 30 June 2017 and 11 September 2017:

10 Year Bond Yields	**31/12/2016**	**30/06/17**	**11/09/2017**
UK	1.235	1.256	1.043
US	2.445	2.305	2.131

Germany	0.204	0.465	0.334
France	0.681	0.813	0.632
Switzerland	-0.224	-0.049	-0.161
Japan	0.041	0.079	-0.005
Australia	2.765	2.598	2.604

As seen from the levels shown, European yields widened in the first half of the year, but have subsequently tightened. All markets are not close to the required rate of return of 4.7%.

Short Term Asset Allocation Advice

In light of no Advisors to provide advice, it is considered appropriate to continue with the previous short term asset allocation. The current political, economic and market conditions are similar to previous advice provided at meetings and do not suggest any need to make any major strategy changes. Currently, the key component when setting the short term asset allocation is the Bond yield level. Most other asset classes are basing their levels from this yield and with yields currently low, investors are seeking returns wherever they can find them. Also, the only issues of note on the medium horizon is the ECB statement on cutting back its monetary stimulus and German election. It is envisaged that any changes announced by the EBC will be carried out very carefully so as not to spook markets and so is worthy of watching but not requiring immediate attention or changes to the short term strategy at this time.

Therefore, it is proposed that the Fund continues to favour growth assets over protection assets. It is considered that in the long run, Bond yields will rise, but at present and while central banks intervene in the Bond markets, through quantitative easing, yields do not meet the actuarial requirements for the Fund and should continue to be avoided at around these levels unless they are held as a short term alternative to cash.

Cash has built up as divestments from other asset classes have occurred, and is primed to be invested when opportunities allow. It is always preferential for cash to be invested in higher returning assets, but at this time high cash levels can assist in protecting the Fund, as a diversifier, from Equity market downturns. However, at the current level of 13%, cash should not rise too much further in the short term to above the maximum short term level set at the customised benchmark for protection assets (15%). It is accepted that if the value of other asset classes fall, particularly Equities, there is a possibility that the short term cash level will rose over the maximum set below.

Equity markets have been volatile over the past few years, with additional volatility in currency markets, both of which have recently been beneficial to the Fund at current equity and currency market levels with the Fund’s high weighting in equities. The short term allocation strategy and range provide flexibility to continue and either increase or decrease investments when market opportunities arise.

Investment in direct property to continue on the same basis as previously presented to the Panel; make purchases on an opportunistic basis where the property has a good covenant, yield and lease terms.

Investment in Alternatives, such as general and local infrastructure and private equity, offer the Fund diversification from equities and bonds. They come with additional risks of being illiquid, traditionally they have costly management fees and investment in the type of investment can be a slow process. However, the Fund is considerably underweight its customised benchmark and, providing suitable investment opportunities are available, the Fund should look to increase its allocation to this asset class up to the customised benchmark level.

Paul Campbell – Head of Investments & Treasury Management

14 September 2017