AGENDA ITEM 8

APPENDIX B

Investment report for Teesside Pension Fund

Economic and political outlook

I will first address the political outlook across the world. Globalisation has brought with it many positives but the reluctance of governments to address the inequalities caused by free trade has brought about a lack of confidence in politicians and the political system in the Western world. This in turn has created a tribal and insular environment in the voters in many countries: the United Kingdom, the United States, Italy and Poland to mention just a few.

The unpredictability of the president of the United States is causing uncertainty in world economics and politics which in turn is causing a major shift in direction of other major economies such as Japan and South Korea where both countries are contemplating an increase in defence expenditure to counteract the uncertainty of reliability of the United States. The importance of China in this equation cannot be underestimated and the approach of President Trump to China and South Korea is exacerbating the situation. Trump is also making promises to his own electorate which will be impossible to fulfil whether this causes an increase in his popularity because of the fear factor or a falling off in support is difficult to predict. Either way the United States standing in the world is likely to fall further.

Predicting the course of Brexit is not much easier. The Commons vote will make for a very marginally clearer picture but with added uncertainty. On current expectations Mrs May will have lost the vote in Parliament but whether this will lead to a hard Brexit, no Brexit or another referendum is anyone's guess. What is entirely sure is that whatever the outcome our relationship with our largest trading partner is unlikely to be as good as it is now. The impact on Europe and on the UK will be negative both politically and economically.

The economic situation currently is reasonably benign with slow GDP growth, a low inflation environment and low and gently rising interest rates. However given the lack of policy options in the majority of Western countries excluding the United States and the rising level of uncertainty the outlook is murky to say the least. The protectionist trading model beginning to emerge as the modus operandi will impact negatively on economic wealth in the future. A balance however must be must be sought so that protectionism does not become the order of the day and this will require a substantially different approach to welfare by Western governments in an ever tightening fiscal environment. Clearly the UK economy is extremely vulnerable during the Brexit negotiations and does not have much room for manoeuvre . The lack of investment and rising uncertainty is likely to impact adversely of corporate profitability even with a Sterling devaluation. The other economic area at risk is the Far East where a rising dollar and potentially a deteriorating economic situation in China is likely to take its toll. Europe despite it's protectionist economic regime will struggle along with modest economic growth rates.

Markets

The outlook for fixed interest markets continues to look disappointing in any area.
Equity markets after recent falls look about fairly valued despite the uncertainties compared to the alternatives. The risks to the UK market however are higher than in most other equity markets.
Property markets in the UK in particular are likely to go through a difficult time as uncertainty is neither good for economic growth rates, investment or consumer confidence.
Alternative assets potentially could give some attractive returns and diversification benefits.
Cash continues to be unattractive as a long-term investments but has his place in the portfolio for short time periods.

Portfolio

Despite being extremely underweight in fixed interest this is the appropriate position given the prospects for rising interest rates. There continues to be no value in fixed interest stocks and to enter the market at this point would most likely cause substantial losses for the fund.
The funding level of the fund will have slipped a little given the recent market movements however the funding level remains strong. Given the prospects for equity markets and their current valuations there is no strong reason currently to take out equity protection until the funding level moves up to over 100% (which is where it might well still be). So although the percentage in equities is way higher than the benchmarks it is appropriate to continue to hold this level and take out protection cover if the market rise sufficiently to give an adequate surplus.
Property looks less attractive than it did before the a true level of difficulties of exiting the European Union became apparent but there will be opportunities to make investments at higher levels of yields than are currently available, this opportunity should be taken.
Cash should be reduced by investment into higher yielding alternatives as they become available and if they can be managed effectively, this portfolio distribution should help the overall efficiency of the fund.
The move towards the new benchmark should only progress where an economic case can be made for the migration, this is likely to be a long-term exercise.

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