Investment report for Teesside Pension Fund

Economic and political outlook

I know it's not just me but everybody must be getting a feeling of deja vu over the course of UK politics. MPs quitting the Labour Party because it has become too left wing, others quitting the Conservative Party because it has become too right wing is reminiscent of the formation of the SDP back in the 1980s. This time around though it could have a lasting effect on UK politics due to the disaffection caused by globalisation and the poor quality of the current crop of politicians. What has been more surprising is that the Liberal Party has not made more of a showing in this grab for the middle ground. Furthermore given the prime minister's inflexible approach it is unlikely to leave the EU receptive to any proposals of any kind from the left or right. Like the rest of us the European negotiators must be astonished at the lack of professionalism from the UK side. All this makes it unlikely that the EU will be inclined to make any progress towards easing the UK's exit from the Customs Union and you've got to ask why would they? So it's no wonder that the odds have moved towards a no
deal Brexit.

Meanwhile across the pond there is the same feeling of deja vu. President Trump seems oblivious to any outside influences which might bring some coherence to his policies. Bernie Sanders enters the race to become the Democratic contender for president. If Sanders is elected to run for the Democrats this will just reinforce the left / right divide in the United States which appears to be running a few years behind the UK in potentially creating a party of the centre. As in the UK though the differences between the two main parties is becoming more marked.

The economic situation has not changed much since the last meeting, continuing slow growth , a low inflationary environment and gently rising or stable interest rates. Given the fragility of the economic recovery the prospects for significantly higher interest rates is low but recent consumer

expenditure figures in the UK, where there is a high level of uncertainty, indicate that the fragility could well be receding.
Indicators from the European economies have shown very little improvement at all and Germany and Italy are looking softer than they have for some time. Europe could well be entering into another another period of extremely slow growth and given the levels of uncertainty worldwide it is unsurprising that forecasters are becoming more gloomy. One relative brightspot is that the talks on tariffs between China and the USA have been progressing more satisfactorily than could have been expected. Any escalation of tariffs is unlikely to change the fortune's of the US economy and its trade deficit but China desperately wants the issue settled amicably so sense might well prevail. Fiscal stimulus in China is also a positive sign for slightly stronger economic growth some time in 2019.

Markets
It is difficult to see fixed interest markets making much progress in an era of reduced quantitative easing. However interest rates are unlikely to rise much given the sluggish rate of economic growth. Fixed interest markets are likely therefore to remain in a fairly tight trading range where returns will be extremely modest. Additionally credit spreads could come under pressure as the quality of the corporate bond market deteriorates. The present portfolio stance is therefore appropriate.
Equity markets are fair value despite their recent rise and despite the uncertainties in the world economy. Equity markets in particular do not like uncertainty and two big issues will have been resolved in all likelihood by the middle of the year, Brexit and Tariff negotiations between the USA and China and markets could well be at higher levels than now as a result. Monetary tightening and fiscal easing could also potentially help markets as fixed interest markets come under pressure and the headwinds corporate profits are facing at the moment ease.

UK property market will continue to face challenging conditions especially in the retail space despite a stronger performance by UK consumers in January.

In alternative investments attractively priced investment opportunities remain difficult to find especially in the large project area. Smaller projects are attracting less attention and this is where the higher returning opportunities are likely to lie in the future. There are other less correlated strategies available and, when resources permit, maybe these should be investigated.

Cash remains an unattractive investment except when it is parked awaiting better investment opportunities.

Portfolio Recommendations

The current positioning of the fund in fixed interest, despite being extreme, is appropriate. Long term investment should be dictated by valuations not by peer groups or by benchmarks.

Equity markets are still good value despite the long bull run they have had. However given the strong funding position consideration should be given to taking out protection to cover potential falls in the market but only when the executive feel comfortable in doing so. Alternatively the fund should remain invested until equities have reached a valuation level that is uncomfortable. This is not an ideal position but it is the best option whilst we search out attractive alternative investments. Regarding individual regions Emerging markets look substantially better value than the US and better value than the European markets.

During the Brexit turmoil opportunity should be taken to invest in selected good covenant properties away from the retail sector and the high street.

The cash position should be utilised to make investments in attractive alternative investments when they become available.

Peter Moon