Investment report for Teesside Pension Fund

Economic and political outlook

As the problems facing the world become greater the calibre of politicians seems to become poorer. Their jobs seem to be taken over by pressure groups such as David Attenborough with his educational approach to pollution and excess production of plastics and the damage it is doing to our environment and Greta Thunberg and her concerns on climate change and how it could be tackled. So the politicians have left it to a 93-year-old and a 16-year-old to be the leading protagonists of improvements in the world's environment and long-term sustainability. Politicians, it seems, do not have the insight or the commitment to take their various countries on a sustainable economic and social trajectory. If they are reluctant to do so there will be others who are unelected who will step into the vacuum to provide the answers which is not a particularly enticing thought.

The recent European elections have shown just how quickly larger established political parties can decline. The shape of the current European Parliament will make meaningful strategic decisions even more difficult given the number of seats falling to more populist parties.

In the United Kingdom Mrs May's successor is likely to have no more luck moving things forward on the Brexit front than Mrs May did so the Halloween deadline for exit looks untenable even at this stage. It is difficult to see how the impasse is to be broken given that there is little appetite for a general election and no sign that the European Community will consider a renegotiation of the exit agreement.

Globally politicians seem to be less inclined to seek resolutions to problems and more ready to up the ante which in general exacerbates the situation. Established rules and modus operandi which used to be challenged are now being broken and the results are unlikely to be positive for world order or economic growth and social development, it encourages totalitarianism and a decline in the democratic process.

Maybe I'm being just a little too gloomy!

World economic growth is slowing from an already modest level. The older developed economies are in the main slowing down in 2019 whilst the emerging markets will grow faster than they did in 2018.
The growth rate in the UK will halve from just under 2% to about 1% whilst inflation will rise modestly to just over 2%.
Growth rates in the European Community are likely to be flat with a gentle rise in inflation.
The United States will continue to grow but at a slower rate and inflation will remain stable at about 2%.
Both China and India will show strong growth of between 6 and 7% with stable consumer price inflation. Other developing economies are generally showing at improving growth trend In a benign inflationary environment.
Overall the economic picture is gently supportive for markets provided that interest rates do not rise significantly which looks unlikely in the near future. Clearly the environment is not as supportive as it has been in the period when interest rates were in secular decline but it is not so hostile that it would cause a substantial market setback in my opinion.

Markets

Yields remain exceptionally low in bond markets despite the reduced impact of quantitative easing. This is probably a reflection of weakening economic growth in the major developed markets and increasing uncertainty on a number of fronts. This environment is unlikely to change and there is little upward pressure on either short-term or long-term interest rates. Governments worldwide are acutely aware of the impact of interest rate management in an era of very fragile economic growth. The low interest rates will serve to support equity markets .
The US market has been the main driver of equity markets across the world, it's performance since 1981 has been nothing short of incredible. This has been driven by falling interest and inflation rates and a more than

doubling of the share of corporate profits in GDP which now stands at more than twice its historical average. In the past this has been a measure that has always reverted to the mean. This does not necessarily mean that the US market will halve in future but it does mean that the upward path of the market will be more difficult and more muted. It is likely that the market will rise at a very modest rate or flatline over the medium term. Other equity markets are likely to follow suit not because their profit share is unsustainably high but merely from the historical fact but where the US leads other markets follow.
Increasing uncertainty mentioned earlier could make the stock market ride more uncomfortable than the economic conditions suggest.
Having said that quoted equity markets are cheap when compared to fixed interest markets and could easily be priced on PE ratios markedly higher than current levels.

As quoted equity markets are unlikely to make rapid upward progress alternatives should give better returns over the medium term.
The property market has become extremely quiet in the UK in the face of Brexit uncertainty which is likely to continue over the foreseeable future.
The inefficiencies of the unquoted markets should be capitalised on to produce returns which should be higher than those available in the quoted marketplace.
Cash remains unattractive and should only be used park liquidity in readiness for investment in other assets.

Portfolio recommendations

The fund's current weighting towards fixed interest Is appropriate given expected returns.
The high weighting in equities should be maintained until appropriate alternative investments can be found as they are likely to give a small positive return which is likely to be greater than fixed interest and in line with property returns.

Property investment should be made when high quality, high return propositions can be found.
The move into alternatives should continue as and when investments can be found which give the right risk-return profiles. The resources available within the Investment team indicate that this is a medium term exercise.
Cash levels should be reduced to facilitate the build up of alternative investments before any further liquidation of quoted equity markets.

Peter Moon