

Investment report for Teesside Pension Fund

Economic and political outlook

Generally these investment reports are at their best when the economic and financial climate is in a mode of flux. If it weren't for the machinations of some of the world's leaders, in the absence of said flux which exists now, this would be a pretty stolid read. So although the world's central bankers seem to be behaving in a rational and sensible manner their endeavours are being undermined by some of their countries leaders. The Central Banks have so little firepower that we should really be in a period of very little excitement in terms of policy options, there is very little left in the war chest if economies do begin to deteriorate significantly. Life would be so much more predictable without our current crop of politicians. But maybe a little bit of uncertainty makes an investment report a little more entertaining, I hope so.

I'm writing this report a little earlier than usual and unfortunately won't be able to attend the meeting, many apologies.

Exciting times, the government just been defeated and Parliament has taken over control of lawmaking, Something not seen in over 100 years. The Politics of the UK enter new uncharted waters. The Prime Minister is about to, and by the time you read this, is likely to have called a general election the outcome of which must be uncertain to even the most seasoned commentators. The election will either bring an end to the the Brexit uncertainty and enable the government to resolve the issue or it will end in an inconclusive result leading to further uncertainty and an extended time scale.

Talking of uncertainty pundits have been predicting an economic recession (which as I said earlier, central banks could do very little about apart from more of the same which increases imbalances within the economy) because yield curves have inverted. In my view this is a little premature

given the flatness of the inverted yield curve and the negative real interest rates at the longer end of the curve, itself an unsustainable state of affairs. The developed world's economies were in a parlously delicate state before this minor issue of the minor inversion. This is still the hangover from the global financial crisis which has been exacerbated by trade wars and the impact of Brexit on the European economy. This does not look like a backcloth for central bankers to take any chances with their economies and policies are likely to be followed which should be supportive to economic growth.

My predictions that the trade War between China and the USA would be resolved during the summer looks rather optimistic to say the least. In fact, the situation is becoming worse month by month and is likely to have a significant impact on the Far Eastern economies which could be telling as these have been the economies that have been the growth engine of the world economy. As a result World trade is set to become increasingly sluggish, impacted by politically motivated tariff regimes and a more difficult economic environment.

The United States will continue to grow at about 2% and the Euro area at about 1%. In contrast, India and China will grow at about 6% with the smaller Far Eastern economies growing between 3 and 5%. Resource based economies, given the economic uncertainties, are likely to show modest growth of 1 or 2% .

Consumer price inflation remains under control at about 2% and slightly less in the Euro area. Despite increasing trade barriers inflation look set to remain low aided by the deteriorating economic outlook. With this outlook fiscal and monetary policy is likely to remain loose and supportive of economies and markets alike.

Markets

It's hard not to become increasingly concerned about markets. Stock markets don't like uncertainty and that is something that we have in Spades at the moment.

Since our last meeting the level of uncertainty in the UK has risen significantly.

First, Brexit ; the resolution of the shape our exit from the European Community has become even murkier and indeed the exit path may become so difficult that it doesn't occur at all.

Second, a general election in the near term seems racing certainty and predicting its outcome is an impossibility. If there is no majority party then the prospects of any meaningful discussions regarding Brexit will be extremely difficult unless a government of national unity is formed. It will take, and maybe this will come, a significant change in the composition of the House of Commons to get a unified strategy with regard to Europe.

There is a slight possibility that the European Union itself will become tired of waiting and just tell us to go.

On the international stage President Trump has certainly got the flavour for restricting world trade by the aggressive use of tariffs having honed his skills in negotiations with China. He's taking an increasingly hardline with Europe and as this policy is proving popular at home he is likely to take it further to improve his chances of reelection. Economies worldwide are fragile and this heightened level of uncertainty will undoubtedly prey on stock market sentiment. The policy response of Central Banks should however provide support for stock markets and extend the low interest rate environment.

So in summary, bond market yields continue to be low with little upward pressure on interest rates as monetary policy remains supportive.

This low interest rate environment will prove supportive to equity markets despite the other uncertainties. Central Bank policy will continue to fuel the rise in equity markets but the uncertainties will rein back any upward

movements so stock market gains are likely to be modest over the next few months. Overall equity markets represent good value when compared to the fixed interest markets.

Property markets will suffer from the same uncertainties as equity markets and will probably fare less well given the retail and Brexit uncertainties.

Well selected alternative investments should provide superior returns by identifying inefficiencies and anomalies and exploiting them.

Cash should be used as the investment of last resort coming into play when alternative uses for the money cannot be found.

Portfolio recommendations

The fund's low fixed interest exposure remains appropriate given expected returns.

Equities look fair value and the position should be retained despite the fund's high weighting in this asset class. They should outperform most other assets over the medium term.

Property is a very individual asset class and if high quality, high return propositions can be found with good covenants then investments should be made.

The alternatives market is broad and diverse which should enable investments to be found in suitable vehicles over the longer term.

Alternatives require a lot of due diligence to ensure that the appropriate asset classes are found and appropriate providers are appointed at the correct price. This will be a long term process which should continue to enable the cash position of the fund to be run down further.

Peter Moon