Investment report for Teesside Pension Fund January 2020

Political and economic outlook

The political situation has certainly shown some improvements in terms of reduced uncertainty. The recent general election in the UK has resolved a huge number of uncertainties on one level but leaves not insignificant levels of doubt on major issues. For example there is no doubt that the UK will exit the European Union but there's a huge amount of doubt on the type of deal on which the country will leave and in what time scale. Prime Minister Johnson clearly enjoys setting firm deadlines and, from his record, does not mind jettisoning them on a whim. His track record as Mayor of London is riddled with broken promises and non delivery. These are traits which appear to be hardwired in him but we can only hope that he has had a damascene conversion since his promotion to Prime Minister (a position he so badly desired) that his performance improves. A little comfort I suppose can be taken from the fact that his concentration span is slightly less than that of a gnat and that others will take over the baton and run things in a more comprehensible and understandable way. Given the size of the Conservative majority we will no doubt have a few years to discover the integrity or otherwise of Boris Johnson.
Moving onto another populist and promoter of Boris, Donald Trump. Both Trump and Johnson are Masters of rhetoric in their own different ways which seems to convince the electorate that they are competent. However both are unpredictable and without coherent strategies which is not ideal for economic growth or stock market performance. Unfortunately we are going to have to make the best of a bad thing Johnson looks unassailable for the next decade unless he does something ridiculously stupid. Trump looks set to be elected for a further term so we will just have to get used to the certainty of these politicians being around and the uncertainty that it brings.

I could mention a further bunch of politicians such as Putin or those in Europe but I think I have said enough for you to get the feel of their impact on economic growth and stock market performance.

There is a great theory in economics which states that if you have n consistent goals then you will need n or more control variables to achieve those goals.
Politicians and central banks alike prefer moderate economic growth, positive real interest rates and inflation running at about 2%. There are clearly not enough control variables around to enable these preferences to occur. Economic growth is anaemic, real interest rates are negative and there is very little evidence of any meaningful inflation. Central banks appear are confused by the fact that economic variables are not responding in a predictable fashion. However instead of looking for alternative ways of stimulating the economy the response has been to lower interest rates to absurd levels and pump vast amounts of money into economies. While this may have been the appropriate response initially to the global financial crisis to still be following policies which are clearly not working over 10 years on shows a startling lack of imagination. The danger is that the central banks will be able to do very little if the world economy slips into recession. Having said that there are few signs that central banks will alter their modus operandi in the future, still it's not without its positives!

Markets

The world economies remain in a liquidity trap more than a decade after the financial crisis. Although the real economies have not responded particularly positively to the enormous policy stimuli over the longer term financial markets certainly have. Furthermore, the likelihood that we will get more of the same from the central banks indicates that stock markets and other financial assets should benefit again in the future. It is difficult to be too negative on the outlook for stock markets.
Some of the uncertainties I mentioned in my previous report have now dissipated, especially in the UK and, by association, Europe. That implies

these markets should be able to make positive progress over the medium term. Markets have become more used to the new world political order, that is they have adjusted for the way in which the leaders in the most powerful countries are operating.
The environment remains supportive for financial markets with a loose monetary policy and increasingly supportive fiscal policy.
Fixed interest markets continue to look poor value and are likely to provide low returns.
Quoted equities continue to look good value when compared to other financial assets.
Property valuations are not demanding but the impact of shifting consumer preferences has increased uncertainty within this market place.
The low interest rate and loose monetary environment should expand the choice available in alternative investments as fund manager's tailor investment portfolios to the needs of investors in an era of low interest rates.
Cash is not an appropriate long-term investment for a pension scheme even in a period of positive real interest rates. In the current climate of negative yields it is even more inappropriate. Cash should only be held on a temporary basis to facilitate portfolio realignment.

Portfolio recommendations

My recommendations remain effectively unchanged since my last report. The fund’s extremely low exposure to fixed interest should be retained. Returns from this asset class are likely to be poor.

Equities look good value against other asset classes and should outperform them over the longer-term. The fund’s high weighting in equities should be retained until there is a significant shift in the interest rate environment. Given the funding level of the pension scheme some downside protection should be considered to protect against a fall in stock markets.

The property market still has pockets of good value with good covenants but these are becoming increasingly difficult to find. Investments should only be made when appropriate opportunities present themselves.

The alternative investment market continues to evolve which should enable the fund to find suitable investments. Due diligence is a lengthy process and building up this portfolio to reduce the cash position is a long-term mission. Building up the alternative investment position is putting additional strains on the resources available within the Investment team but it has risen to the challenge.

Peter Moon