Investment report for Teesside Pension Fund June 2020

Political and economic outlook

Covid-19 is still dominating politics and market sentiment. In my last report at the very end of February 90000 people had contracted the disease and about 2500 had died with a mortality rate rising from 1% initially to nearer 3%. Despite most countries deploying measures to restrict the spread of the virus, that figure now stands at 6.6 million who have fallen victim to it and 390000 deaths, a mortality rate of 6%. It is thought that about 7% of the UK population have contracted the virus. Herd immunity, where the spread of the virus is contained, occurs at levels of 40% or more. In particularly contagious diseases such as measles and probably covid-19 that level rises to 95%. At the present level of transmission, which the National Health Service can cope with, without a vaccine it could take another 3 to 4 years before restrictions on movement can be relaxed much. Clearly this is an untenable prospect for the economy and for society. Tracing and tracking technology may be the way forward until a vaccine is developed, as you are aware this has worked well in Singapore and South Korea . The UK government has been slow to adopt this form of containment and has paid the price. In the UK the slow implementation of such technology and it's uncertain effectiveness is a cause of further concern. Until we can monitor the spread of the virus and react appropriately the economy is likely to remain in a similar state to its current position. The economy will not recover until the virus is contained and the prospects of that occurring in the UK in the short-term is not good.

Just as a footnote in Iran, one of the first countries to succumb to the virus where there was some success in bringing the outbreak under control, new cases have now returned to record levels.This does not bode well for

coming out of lockdown and rebooting the UK or any other Western economy.
Covid-19 is also causing disruption in the world of politics. Hard decisions are having to be made across all countries and some politicians have been particularly effective during the pandemic. As the experts and statisticians keep saying it is too early to confidently say who did a good or bad job of handling the outbreak, so we will have to wait sometime before we look at the efficacy of policy stances. Despite that it is clear to see that both Trump and Putin are looking shaky and Boris merely looks out of his depth. This comes at a time when the opposition party in the UK appears to be getting its act together under new leadership. Nothing in international politics looks as settled or as certain as it did just a few months back.
The UK Chancellor's initial response to the virus appears to be correct and has limited its impact. It will be interesting to see if he pushes forward with more aggressive fiscal policies in the future given the amount of help that has been given to the economy since the crisis began. If he does continue with fiscal expansion then the economy could recover quite sharply however he is nursing an extraordinary debt burden from the actions he's already taken and this makes it very difficult to predict what he will do in the future. There are some very tough times ahead for the world population personally, economically and socially and difficult choices for its leaders

Markets

There is an old stock market adage advising that it is best not to fight the Fed.
Loose monetary Policy has given a following wind to stock markets over the past decade where we have seen extraordinary gains. The seemingly irrational response in markets to the pandemic, an extraordinary bear market sized fall followed by an equally extraordinary recovery in the face

of a significantly deteriorating economic outlook is puzzling. The policy response of governments has led to an even looser monetary stance and reduced further the attractiveness of fixed interest securities. Money has been pumped into the economy and the cost of borrowing cut to near zero. The real economy has shrunk and left ever more excess liquidity in the system which has to go somewhere. That money will seek to invest in the markets that seem most attractive.

With near-zero interest rates fixed interest markets are of limited attraction despite their government backed guarantee.

The property market has been dealt a body blow by governments' response to the virus.It will take a long time for rental levels to recover and for confidence to return if it ever does. Populations have found new and easier ways of getting what they need delivered to the door. Distribution hubs will no doubt be in demand, retail outlets and offices probably not.

Despite the significant dividend cuts seen in stock markets, ranging from 30 to 40% in the UK to much lower figures of 15 to 20% in some younger or more growth orientated international markets, equities still look relatively attractive versus the alternative quoted markets.

A number of existing alternative investment types will look attractive in this very low interest rate environment and others will come into view.

Cash remains an unattractive place for funds.

Portfolio recommendations

The Covid 19 outbreak has developed in such a way that the disruption that it brought will be with us for some considerable time.The increased uncertainty and reduced dividend income will have a lasting impact on stock markets. The fiscal and monetary policy responses so far have been supportive for financial markets and the economy.

My recommendations remain little changed from my previous advice.

Fixed interest markets remain overvalued and unattractive and no investment is recommended in this area.
Equity markets which generally look about two years ahead appear to be discounting a fairly rapid and smooth recovery from the worst impacts of the virus. At this current time I'm expecting equity markets to decline a little or tread water. However they are the most attractive asset class around and our overweight position should be maintained. Some equity protection could be put in place to soften the impact on our funding level on a market fall if the appropriate mechanism can be found.
Uncertainty in the property market will hamper the ability to find appropriate investments given the uncertain direction of the economy and an inability to forecast which sectors will thrive and which will suffer over the long term.
The commitment to the alternative investment market should continue over the longer term . It will take a long time to build this portfolio given our resources and also given Borders to Coast resources but attractive investments will be found in the current interest rate environment.
Cash levels are comfortably high at the moment, given the high level of uncertainty,and can be run down to accommodate further investment in alternative investments and any shortfall in cashflows.

Peter Moon

4 June 2020