

Investment report for Teesside Pension Fund March 2022

Political and economic outlook

I rarely, if ever, go back to past reports I've written for the committee but I had an inkling that I had said a couple of pertinent things which in itself is extremely unusual for fund managers. I was also struggling to put into words just what's happening in the world today so I thought a recap might be useful.

In September I wrote “ In the last quarter USA has relinquished any pretence that it is interested in remaining the world's policeman. This has devastating consequences for western democracy and Global stability. After significant improvements in global relationships between Russia, China and the West up until the year 2000 there has been a telling deterioration since the arrival of presidents Putin and Xi. They have repressed their own people and taken an aggressive stance against the USA which has accommodated their every thrust for increased power.”

In December I was a little more optimistic, but I was wrong. “ Meanwhile in America US foreign policy appears to be bouncing about a little bit. First there was the withdrawal from Afghanistan which indicated that the US was losing interest in international influence. Then an agreement with Australia and the UK (AUKUS) to provide nuclear-powered submarine surveillance and protection in the South China Sea and waters around Australia. AUKUS is an admission of the threat that China poses in the region and that alliances are prepared to oppose it.” However the action and reaction don't look resolutely strong.

Putin has clearly seen the writing on the wall with the American's withdrawing from their world role; he has however underestimated the Ukrainian's determination to defend their own land and the cohesion of NATO and the Western democracies in the face of unprovoked aggression.

I've been surprised how quick the deterioration in the world order has been, but where do things go from here?

It's not easy when you're dealing with a madman. Putin has done many things that other world leaders would not have done. He has annexed Crimea supported terrorists within Ukraine and helped despotic regimes around the world so there's no guarantee that he won't press the nuclear button and this is made the Western response so difficult. The West's use of sanctions against Russia at last looks as if it means business and they will be destructive to Putin's economy but it may take even more, such as cutting the gas pipelines. The Russian economy is unbalanced and weak and although its fortunes have been improving on the back of rising energy prices it remains the 11th largest economy with a per capita GDP of under \$12000. It is very vulnerable to a serious sanctions regime.

However in recent days Russia has attacked another nuclear power station and taken control of it increasing the likelihood of nuclear fallout and it may be that the West is being forced into a corner where it has to respond militarily as there is no sign of any limit to Russia's territorial ambitions. On a different scale the UK political situation remains as dire as it did before the events in Ukraine. Boris Johnson will be relieved the domestic pressure has been taken off him. On the other hand, he'll be disappointed that his Churchillian rhetoric has been trumped by President Zelensky of Ukraine.

In Europe the show of unity and resolve has pushed the coronavirus pandemic onto the back burner but the flow of refugees may reignite the civil unrest we were beginning to see previously.

I'll stop about politics there because outside the Ukraine situation nothing else really matters for the time being.

Likewise trying to forecast economic developments is also pretty futile.

Having said that, most equity markets have headed south since the beginning of the year, and they have held up better than I was expecting.

There are reasons to believe that inflationary pressures will continue to be strong which could have a detrimental effect on markets as interest rates rise and monetary conditions tighten. However real interest rates will likely

fall as interest rates rises fail to match the increase in inflation which could reach double digits.

Markets

Equity markets dislike inflation and rising inflation even more over the short and medium term. Over the long-term however equities are a store of real value and the increasingly negative real interest rate environment will prove to be positive for equities over the medium to long term as corporate profitability reflects favourable negative interest rates. Therefore, although declining equity prices could put pressure on the funding level over the medium term, in the long term valuations are likely to recover to restore it to current levels at the very least.

The emerging inflationary shock is very bad news for all forms of conventional fixed interest although short-term credit markets could benefit eventually from the better corporate environment.

Index linked securities should benefit from nominal price increases in their value but real returns will remain extremely low.

Property will be impacted by the increased level of uncertainty over the shorter term but the longer term environment should be beneficial as the corporate environment improves. The difficulties for office space remain intact.

Alternative investments as the name implies cover a wide range of investment opportunities (or otherwise). The investment universe covers among other things infrastructure ; cryptocurrencies ; derivative strategies ; collectables ; crowdfunding ; private equity ; distressed debt and all manner of financially engineered products.

Before I joined the city in 1972 I was sent away by my prospective employer with a number of books to read, one of which suggested that if

you did want to purchase esoteric investments you should go and take a long walk in the long grass with or without a joint. Sound advice indeed.

This highlights the difficulty of investing in these areas however attractive they look and how difficult the task will be for the team to make the strategic changes that the advisors recommended in any short or even medium time frame.

Portfolio recommendations

The world is a very different place to the one that existed in the December report but the recommendations remain the same with a more relaxed attitude to cash levels rising.

The fund should continue the strategy of moving away from equities when suitable investments in property and alternatives can be found which give a long-term equity type return.

Fixed interest investment should be kept at its current low level.

The search for real assets which have some protection against rising inflation within the alternative space should continue to be the main focus of attention. There will be some assets which fall outside the definition of real assets which have provided long-term sustainable returns which might enter the list of suitable investments.

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