Investment report for Teesside Pension Fund December 2020

Political and economic outlook

At the time of writing this the pandemic continues apace with the number of the cases more than doubling and the number of deaths rising by 65%. There continues to be a significant improvement in the death rate after infection which has fallen by a third over the quarter. So there has been good news on the mortality rate and on the vaccination front where we might see mass inoculation starting in December.
The bad news has been that in the UK we have entered another lockdown and have the prospects of a stricter tier system going forward. We are not unique in reintroducing a more onerous regime.The longer these restrictions apply the more permanent long-term damage is done to the UK and World economy. For many sectors we are no longer in the era of bounce back we have entered the era of a long slog back which will take years rather than months to achieve. I consider the chancellor's forecast of a return to pre covid GDP levels by the end of 2022 as highly optimistic. Unfortunately his optimism is reflected in economic forecasts across many economies throughout the world as economists underestimate the impact of the virus. As has been noted previously there have already been significant changes in the shape of economies. Across the globe the leisure sector has been decimated; businesses have realised that they do not need as much office space as they previously thought which will have serious repercussions for the property market ; the airline industry as we knew it has disappeared and does not have the financial clout to recover; and the impact on domestic rail travel cannot even be calculated over the medium term future. These are just some of the issues and it doesn't matter how flexible labour markets are and how ingenious companies are, this repositioning of economies will take some time.

With the new vaccines coming along we can potentially see a return to a New Normal towards the end of 2021 when the world economy is likely still to be in poor shape. The return to a functioning labour market does, at least, give the opportunity for the economy to return to a more steady growth trajectory. The rollout of vaccines across the entire world is crucial to the extent to which normality can be achieved. The slower the rollout the longer restrictions of one type or another will remain. This reentry to normality will give politicians ample scope to show their skills. We can only hope that they have been on a steep learning curve.
One brighter note is the election of Joe Biden as president of the United States which ensures that fiscal stimulus will be greater and monetary policy looser than it would have been under Trump. This policy stance will be supportive to financial markets and the world economy.
Nevertheless we are in uncharted territory and huge uncertainties persist on the direction of the economy and corporate earnings. Even the long term viability of the developed western economies model is being called into question.

Markets

With all the uncertainty around at the moment and into the medium-term or even long-term future it is extremely difficult even to predict the direction of stock markets. Extreme changes in the shape of economies are likely to have adverse impacts on corporate earnings. Stock markets are clearly not looking absolutely cheap at current valuation levels. If we get downward earnings revisions they will start to look expensive. This puts us in an invidious position, because in quoted markets, equities look to be the only game in town. Given the explosion in government debt worldwide investors could be considered certifiably insane if they start committing large amounts of cash for this area. The pricing of debt is incredibly generous to governments and this has had a knock on impact on most bond and credit markets.

There will be major changes in the property sector as discussed above. This uncertainty could cause an increase in yields across the whole market.The certainty is that there will be marked relative yield changes between sectors of the market. This should mean that we find attractive opportunities within property. The difficulty might be in restructuring the portfolio efficiently as sales may well be problematic.

Within alternative investments there are likely to be products arriving which will be attractive especially in this low interest rate high liquidity environment. The increasing size and diversity of this area should enable us to invest more at attractive rates of return.

The lack of attractive investment alternatives has increased the viability of cash as an asset despite its zero return. It's abundance might put one off as an investor however.

Portfolio recommendations

Despite the central banks' efforts to flood the world economy with liquidity at ridiculously low interest rates the outlook is such that it is probably time to trim equity holdings from their current high levels given the uncertainty over earnings performance. Our present actuarial surplus suggests this is an opportune time to make this move. Property and the unquoted alternative investment sector should be our preferred investment destinations. We have already committed a large amount to alternatives and infrastructure through Borders to Coast and need to monitor closely their ability to successfully deploy the investment.

During this transition cash levels can legitimately be higher than normal to protect against stock market setbacks especially as bond markets don't appear to be an attractive investment area.
The unprecedented levels of uncertainty make it extremely difficult to make asset allocation recommendations with any certainty or conviction.
However the strong position of the fund makes it prudent to take some risk off the table. I would not consider investing in bonds as the way of taking risk off the table as in my opinion it would increase the risk of the fund failing to meet its actuarial commitments. Alternative investments, property and cash (temporarily) should be the major recipients of this risk adjustment.

Peter Moon
26 November 2020