

Investment report for Teesside Pension Fund December 2022

Political and economic outlook

The political situation remains uncertain with the strains which have been present for most of this year. There seems to be no sign of an ending of the conflict in Ukraine. Russia seems to be in control of energy supplies to Europe and increasingly prepared to put further squeezes on them before Europe turns off the taps voluntarily in 2030. The European Community had intended to reduce off take from Russia by 40% initially and taper down zero by 2030 however the Russians seem to be in charge of the process by cutting off supplies through NordStream 1 and 2 by blowing them up. Effectively this policy of international terrorism puts Russia in charge of economic developments in the European Union. This is not a state of affairs to be relished and implications will result in long term lasting damage to Europe. Those economies reliant on Russian gas have been lucky up to now as it has been a relatively mild winter but this is not a situation that can be relied on to continue indefinitely. The past mistakes in policy will eventually come home to roost with traumatic consequences.

The outlook for the UK is no better despite the new and improved looking Prime Minister. At least we have a person in charge who has a good knowledge of Economics and hopefully of politics. The wreckage left by previous incumbents in the position has gifted Rishi Sunak with an unenviable task. Getting Brexit done isn't progressing as smoothly as Boris Johnson had indicated, in fact is going nowhere except backwards. Trade deals have been hard to come by, in short no meaningful deals have been signed and the minor ones that have been are not on particularly favourable terms. The Northern Ireland protocol has yet to be sorted out and is having a detrimental impact on relationships in Ireland. The levelling

up agenda has been put on the back burner along with just about everything else as the government struggles to come up with any coherent policies to keep the economy afloat. On domestic energy prices, on infrastructure, on the NHS, on education. In fact on just about everything. The chances of Rishi Sunak delivering are substantially higher than the recent run of prime ministers so we can only wish him luck and a following wind.

One area where the political tension seems to be easing a touch is between the USA and China despite the recent sabre-rattling over Taiwan. The meeting between president Biden and Xi Jinping in Bali will hopefully improve Communications and lead to reduced chances of any significant mistakes being made.

The hopeful expectation that inflation would tail off in a relatively short period of time has been replaced more and more by the realisation that it will continue for longer than was initially forecast. Core inflation is now running at about 6% in the US and UK with slightly lower levels elsewhere. This is reflected in the Misery index which is now at its highest level since 1982 so it should come as no surprise that workers are demanding higher wages and are prepared to go on strike to get them.

Markets

As core inflation becomes embedded at higher levels than current Central Bank targets the monetary environment will remain tight which is not necessarily good news for stock and bond markets. There is clearly the potential for Central Banks to become overly restrictive which would have a negative impact on markets. Fiscal policy, as we have seen in the UK, is also likely to become increasingly tight as governments struggle to regain control of their finances. Stock markets worldwide have already had quite a setback so despite the difficult conditions I do not envisage them falling substantially from these levels. Developing markets which are in better

financial shape than the developed markets and have better growth trajectories in many cases are likely to outperform. Many of these markets have better thought out economic programmes with better demographics to deliver superior performance.

Fixed interest markets are also facing a hostile environment as core inflation remains high over the medium term. The tight monetary Policy should mean that bond markets struggle to maintain their current levels and I expect further declines, despite the recent improvement in pricing. Credit markets appear to be unattractive in a high inflation, slow growth environment. Index linked securities are likely to be weak and volatile until real yields move into positive territory. In the present environment this is likely to be some time off.

Property is likely to find progress difficult in this tight environment especially with the changing employment and consumer practices. However there will always be some sectors which will perform adequately.

Likewise there will always be some sectors in alternative Investments that perform well whatever the environment. Private equity is struggling under the burden of higher fuel prices and financing costs. Infrastructure is facing uncertainty in the light of declining economic performance and higher interest rates. Alternative energy providers and those facilitating the transition to renewables are performing well and look to do so for some time to come. There are other alternative strategies which are likely to do well.

Cash, as I've been saying for some considerable time, still looks like an unattractive investment with yield levels and inflation where they are.

Portfolio recommendations

With core inflation at its current level bond prices have the potential to fall considerably and therefore they remain unattractive. The same applies to credit markets which have the added uncertainty of corporate performance. Index linked Securities should be avoided until a realistic real yield basis has established itself, which could be some time. I therefore recommend that we keep our current for low weighting in fixed interest securities.

Equity markets have corrected somewhat and are probably fairly priced to take account of the difficult future environment. I would recommend holding our current investment stance and increasing weighting on any setbacks especially into developing markets.

With the array of investment options available in the alternative space opportunities will occur which should enable us to invest within our investment guidelines.

Selective investment should be made in the property portfolio when appropriate opportunities occur.

The cash position should be run down when attractive Investments within growth assets become available.

Peter Moon
5 December 2022