Appendix B

Investment report for Teesside Pension Fund September 2023

Political and economic outlook

The political environment continues to fail to inspire in most democratic nations and this is continuing to have consequences in the world order. Communist regimes and dictatorships have taken advantage of this weakness to increase their sphere of influence and expand their Neo Colonial ambitions. There has been a total disregard in some cases of international law as the situations in Ukraine and to a lesser extent Hong Kong testify. The potential for China to make a move against Taiwan is no longer a distant possibility, it is becoming more and more probable. It doesn't take a genius to conclude that this erosion of democratic and western power will continue until the quality of government in the West improves.

I had anticipated that the arrival of Rishi Sunak would lead to a happier period in UK politics where the country might once again become a trusted liberal democracy. But it's clearly not been that easy as the government makes error upon error in housing immigrants and on climate change amongst other things. These seemingly populist approaches do not appear to have improved the Conservatives standing amongst the British people and certainly not abroad.

The situation on the economic front is hardly more cheering. It is good news that inflation is subsiding following the supply side shocks of covid and the war in Ukraine. The reduction has certainly not come about by the actions of Central Banks. The current decision-making process of the Federal Reserve, the European Central Bank and the Bank of England has to be called into question. Until recently these Banks had been forward looking and determining policy on the basis of what they forecast was likely to be happening in the economies under their jurisdiction and what needed

to be done. The banks are now making decisions based on historical data, they have become data dependent on lagging indicators which is no way to set interest rates and determine monetary policy. The quality of Central Bank management has consequently taken a serious dip. This is worrying especially at a time when economies will be onshoring, expanding domestic production, as a result of heightened tensions globally.
The recent fall of 0.5% in GDP in July should really have come as no surprise as the UK economy continues to struggle following its exit from the EU. As I mentioned in my last report, growth in the UK economy prior to our entry into the EU back in the 1970s was anaemic at best. Maybe this is a return to the "good old days".
The inflation rate in the United States appears to be stabilising at around the three and a half percent level. In the UK we can expect further declines in inflation but it is likely to settle at around 4 or 5%. There are persistent inflationary pressures within Western economies which are being offset by significant productivity increases due to continuing rapid technological innovation.

Markets

Bond yields in the US and UK are similar at about four and a half percent Inflation in the UK is 6.8% versus 3.7% in the US. Therefore US real rates are a positive 0.7% and UK rates a negative 2% leaving the US bond market a tad on the expensive side and the UK very poor value. This anomaly will eventually correct itself with rates potentially rising in the US and rising substantially in the UK given my inflation assumptions. It is probably wise to continue to avoid fixed interest markets at the moment. Given the level of uncertainty yields on index linked securities are likely to rise which will have an adverse effect on capital values. Higher inflation rates will tend to increase the value of index linked but the rising yield profile is likely to nullify the positive inflation impact.

Other forms of fixed interest Investment will find it difficult to give positive returns while government bond values decline.
The golden period for equities is now in the past as central banks have effectively turned off the excess liquidity tap which fueled their rise for so long. Continuing modest growth and stable inflation along with significant productivity improvements should lead to modest increases in equity values and therefore rising markets. However as the profit share in GDP declines the advance in markets will be limited to near inflation rate returns, maybe one or two percent above inflation.
The property market should respond to the same forces as the equity markets. I would expect it to stabilise initially and then modestly advance towards the end of the year.
Private equity markets and infrastructure are also likely to respond positively to the improved environment.
Cash returns have improved modestly but remain inadequate with inflation running at the level it is.

Portfolio recommendation

I have become a little more positive on real assets such as property and public and private equity and infrastructure. Fixed interest markets are unlikely to provide rewarding investment returns and our current stance should be maintained.
The current holding in public and private equities should be retained.
The imperfect nature of the property market makes it a prospective area for investment if the correct assets can be found.
Cash should be utilised to facilitate the changes in asset allocation.

Peter Moon

18 September 2023