Investment report for Teesside Pension Fund December 2023

Political and economic outlook

In the UK the Chancellor's autumn statement signalled the start of the election race by reducing National Insurance and putting more money in people's pockets. Unfortunately this means that non-protected government department budgets will be cut by about £19 billion over the next three years. This demonstrates just how little room for manoeuvre the Chancellor had as he relies on fiscal drag to replenish the coffers. With falling growth rates and very little growth in prospect over the next few years the Chancellor is relying on inflation and frozen tax thresholds to get himself out of the bind he finds himself in. As things stand the Chancellor will have no room for manoeuvre in the spring budget and the Conservative Party will go into the next election with the public paying the highest level of taxes for well over 70 years with the prospect of them rising to the highest ever level by 2027.

The covid inquiry has not been comfortable for the government and any kudos they have tried to claim in the past is looking rather hollow now. Boris Johnson and Matt Hancock might still have a chance to redeem the situation when they appear before the inquiry. The road to the next election is not quite as smooth as the government might have hoped. Furthermore the recent announcement by the Bank of England that interest rates would stay high for the foreseeable future hasn't helped the situation any. If the governor is serious in his ambition to get inflation back to the 2% level there might be no growth in the economy for some considerable time and the very real potential to fall into recession.

The International political situation remains extremely tender with the number of conflicts on the increase. With Trump looking as if he could return to the White House the prospects for any improvement are looking

more and more remote. In the shorter term China and U.S relations appear to be on an upward trend which can only be good news. However this is likely to be just a short term improvement in the long term declining fortunes of the Western economies, at least until we get a better quality of leader in democracies.

Markets

The 10 year US treasury market has remained pretty stable over the last three months with yields basically unchanged at 4.3%. The 10-year UK gilt yield has fallen by about 20 basis points to 4.2%. Over the same period U.S CPI has moved from 3.7% to 3.2% and UK CPI from 6.7% to 4.6%. Effectively this means the US treasuries are now giving a real yield of north of 1% and British gilts continue to trade in negative real yield territory.
The real return on these debt markets appears to be inadequate given the countries have gross debt to GDP ratios of 123% and 100% respectively. These anomalously low real interest rates should eventually return to more sustainable levels of 2% or so. Index linked securities will suffer when this shift occurs and capital values will fall. Corporate bonds are likely to underperform in the environment of falling government bond prices.
Equity markets have been relatively quiet over the past three months with the US and German market up a little and the UK and wider European markets falling marginally. The high levels of uncertainty both politically and economically are having a negative impact on equity markets. However valuation levels in most markets are not particularly demanding.
With the peak of inflation having been reached the property market should be able to make reasonable progress and give positive returns over the medium term. As always the caveat of good covenants and good properties remain as the drivers of individual property performance.
The divergence of investment opportunities in private markets should make it easier to pick outperforming strategies, however the higher interest rate environment and lack of new capital has made it a difficult time for

these markets. With interest rates hopefully at a peak and modestly falling inflation the more difficult times in these markets are probably now over. With cash returns of around 5% it is no longer a drain on returns however it is still not a preferred investment .

Portfolio recommendation

Despite the modest real yields available on the US treasuries in general fixed interest markets those conventional and index linked continue to look poor value. Although clearly the U.S market looks much better value than most other fixed interest markets.
Quoted equities look better value than fixed interest markets . Despite the improving environment for private investment there is currently some embedded overvaluation which is likely to pull back any performance in the medium term.
I continue to be favourably disposed to property investment due to its imperfect nature and the ability to cherry pick investments.
Despite being on an improving trend the returns on cash still make it fit only to be a facilitator for changes in asset allocation.

Peter Moon
29 November 2023