

## **Investment report for Teesside Pension Fund December 2021**

### **Political and economic outlook**

Not much has changed in British politics over the past quarter.

First the Owen Paterson affair and the prime minister's defence of his actions and then his spectacular u-turn which left Tory MPs feeling a little bemused. It is not clear whether his reduced standing in the Conservative party will be healed by the passage of time and a little bit of smooth talking or whether it has caused permanent damage. Boris Johnson has managed to talk himself out of a lot of impossible situations in the past.

There continues to be the perception that covid rules and guidelines don't apply to the Prime Minister and his entourage. His "little" Christmas party at Downing Street last year has done nothing to dispel this perception nor have the plans of the Tory Party to have another celebration this Christmas helped the situation.

These miscalculations possibly explain to some extent the rise in popularity of the Labour Party and its leader Keir Starmer. It will be interesting to see whether the fortunes of the two parties continue on the same trajectories. Stability in Europe is likely to be tested over the next few months as covid appears to have gained a new lease of life (even before the arrival of the new Omicron variant) which could impact seriously on economic performance. There are already signs of increasing social unrest and civil disobedience. Another major uncertainty is the attitude of Russia in its spat with the West and Ukraine in turning off gas supplies to Europe. To add a little bit of spice the arrival of German Chancellor Scholz is likely to encourage a turf war on who is in charge of the EU with President Macron of France.

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.

Economic growth has generally been robust internationally as the world learns to live with covid and shakes off the effects of lockdowns in 2020. Further economic growth will be more difficult to achieve as the bounce back progresses and as covid takes a firmer grip as we move into winter and new variants emerge.

There has been a lot said about supply shortages and skill shortages across many economies. The supply shortages have to a large extent been caused by skill shortages because of , for example, the lack of HGV drivers to transport goods around. Labour has also been in short supply partly because of covid and partly in the UK because of our exit from the EU. Effectively we have the wrong type of labour required for the shape of our economy. This is not a problem which will go away anytime soon. The inflation caused by the shortcomings in the economy is the most dangerous economic development over the past six months or so. It is likely to have a detrimental impact on stock markets and on fixed interest markets over the coming months as it is priced in through higher interest rates and potentially lower PE ratios. All in all the medium term outlook is not particularly positive.

## Markets

My assessment of markets has not changed over the past quarter. Inflation has been on the rise since the second quarter of the year and during this time equity markets, in general, have gone sideways. As I've said before many times, equity markets dislike inflation, especially rising inflation. If equity markets are to make progress it will be against strong headwinds, the medium-term looks difficult.

The same is true of fixed interest markets. There may be times when government bonds appear to be safe havens and demand increases from time to time but I believe these episodes will be short lived and that interest rates are destined to trend upwards. In a nutshell quoted financial markets will find it difficult to produce a positive return.

Rent collection in the property sector continued to improve over the year as the return to Economic and Social normality progressed. It appears that working practices have altered to some extent during the pandemic but it is not clear whether this will lead to a significant reduction in the demand for office space.

In the alternative investment space there seems to be an adequate supply of finance especially into cryptocurrencies and into large infrastructure projects. Structured fixed interest and credit products will, in my opinion, struggle in a rising interest rate environment. There are however many other alternative investments available which should be attractive at the right price.

Cash has become even more unattractive given the inflationary environment that has developed, this is unlikely to change to any significant extent in the medium term as central banks have very little room for manoeuvre to raise short-term interest rates.

## **Portfolio recommendations**

As so little in the outlook has changed over the quarter my portfolio recommendations remain unchanged from last time.

Equities are becoming increasingly unattractive but the challenge for the fund is to find investments in the alternative arena which will give a similar return. Stock selection in alternatives and in property will be the key to continued acceptable performance. The good thing is that alternatives is a very wide-ranging universe with many opportunities for us to exploit.

As I said last time the natural thing for the fund to do given the prospects for falling equity markets is to raise cash. Therefore another pool for us to consider is where the expected return is greater than cash for short to medium term investment.

**Peter Moon**

**6 December 2021**