Investments at Scottish Life

INVESTMENT ADVISORY COMMITTEE

INTERIM WORKSHOP

MINUTES OF MEETING HELD ON 16/4/09

Present	In attendance	Copies
Ewan Smith	Phil Mowbray (Barrie & Hibbert) Nick Leitch (Scottish Life) David Bird (Royal London) Robert Talbut (RLAM) Helen Carter (Scottish Life)	Mike Yardley Andy Carter John Deane Andrew Barrie

ACTION

BACKGROUND

This meeting was convened to discuss two action points arising from the IAC meeting of 24th February 2009.

REVIEW OF FOUR MANAGED STRATEGY PORTFOLIOS

Phil presented analysis from Barrie and Hibbert. This showed that:

- In June 2008 the predicted expected equity volatility over the short and long term was close to the long term trend (around 18-19%).
- The extreme market environment during Q4 2008 caused a significant increase in predicted short term equity volatility. As at end December 2008 the predicted short term expected volatility was around 29%, and was forecast to revert to trend by around end December 2009.
- From Mar 2008 to Dec 2008, the spike in equity volatility caused a steady, but modest, increase in the volatility of the following four portfolios - Cautious Medium Managed Strategy, Cautious Long Managed Strategy, Balanced Short Managed Strategy, Adventurous Short Term Managed Strategy.

The attendees discussed the equity volatility assumptions. There was agreement that equity volatility will moderate, but there was debate over how quickly this will happen – in particular, Robert was of the view that when you enter a period of high volatility it typically persists for longer than the Barrie and Hibbert model. Phil advised that he would circulate details of the Barrie and Hibbert forecasting method as background.

PM

There was debate around whether to alter the benchmarks or not – we concluded that 3 of the 4 portfolios should not be changed for now - on balance the conclusion was that the market will return to normal equity volatility in the short to medium term, and that the portfolio benchmarks will naturally, and in a reasonable timeframe, move back in line with their targets without requiring alteration at the moment.

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The conclusion was that the benchmark for the Cautious Long Managed Strategy should change, and a revised benchmark recommendation will be put to the IAC for approval. The current economic environment has increased the uncertainty (i.e. volatility) around long-term inflation. We concluded that this portfolio is likely to continue to exceed its volatility target as a consequence, even as equity volatility moderates. The recommendation would be based on reducing the amount of "riskier assets" held in the benchmark.

HC

Robert will separately consider the tactical positioning following the benchmark change, and a review will be carried out to ensure that the risk budget for the portfolio is maintained. Robert indicated that he still favours equities currently. His view is that high volatility typically creates 'buy' opportunities, and he would seek to exploit this through the tactical budget.

HC

STRESS TEST

There was discussion around the stress testing based on stress test conditions suggested by David and Robert. These were interpreted as being immediate and sustained deflation of around 1.5% p.a.

Phil presented analysis from Barrie and Hibbert. The conclusion was that if an 'extreme economic event' occurs, but that it remains important to build inflation protection into the portfolios, then the current benchmarks remain broadly reasonable.

More fundamentally however, it was identified that if the IAC central view were to be that we will enter a sustained deflationary period (which it isn't), then the B&H model would be re-set to seek out portfolios that deliver strong 'nominal' protection as opposed to 'inflation' protection. Robert confirmed that when the Japanese economy entered a long-term deflationary period, nominal assets such as gilts and cash performed better than equities, corporate bonds and commercial property.