INVESTMENT ADVISORY COMMITTEE (IAC)
QUARTERLY MEETING

MINUTES OF MEETING HELD ON 01/03/2011

Present	In attendance	Apologies
John Deane Ewan Smith Andy Carter Andrew Barrie	Nick Leitch (Scottish Life) Lorna Blyth (Scottish Life) Gordon Law (Scottish Life) Scott Manson (Scottish Life) David Bird (Royal London) Robert Talbut (RLAM) Peter Watts (Barrie & Hibbert)	Mike Yardley Helen Carter (Scottish Life) Phil Mowbray (Barrie & Hibbert)

ACTION

1. REVIEW OF PREVIOUS MINUTES

The minutes of the 23 November meeting were approved and the action points arising from the meeting were presented by NL.

NL advised that the SL Governed Range won the "Corporate Adviser Ultimate Default Fund" for the second year running. This follows strong validation from AKG on our Governed Range and the processes underpinning it. This recognition in the market place is reflected in the fact that two out of three customers invested in the Governed Range during 2010. The IAC helps these customers through their governance decisions.

The Committee's Terms of Reference have been reviewed and will be updated to specify the roles and responsibilities of all involved in the IAC process. NL will draft an annual evaluation of the IAC for review. NL

It was noted that information on fund style bias has been added into the reporting for the SL matrix funds.

NL advised that the IAC decision at the last meeting to replace Artemis European Growth had been communicated to customers. The replacement fund is Neptune European Opportunities which is a blended all cap fund, AA rated and has strong long term performance.
Discussion on the following action points took place during the meeting:

- Fidelity International
- Investec American
- Schroder UK Mid 250
- Invesco Perpetual UK Growth
- Blackrock Aquila funds
- JP Morgan US
- Impact of negative yield on index linked gilts
- Long Corporate Bond fund
- SL Worldwide
- SL American
- UBS UK Equity

2. GOVERNED PORTFOLIOS AND MANAGED FUNDS – REVIEW OF BENCHMARK AND TACTICAL POSITIONS

The key points were:

Economic outlook and asset forecasts

- Inflation projections have increased over the medium to longer term.

- Short term equity volatility reduced but is broadly unchanged for longer horizons. There is no change in the excess return over bonds from uk equities and the increase in projected returns has been driven by an increase in nominal yields.

- Expected returns from overseas equities have changed similar to uk equities. This is due to similar changes in inflation prospects in the UK relative to other major economies.

- It was confirmed that the financial model dealt with the current market conditions of negative current yield curves. The B&H economic forecast is for low total returns from index-linked assets over the short to medium term. EFS commented that the forecast returns could be very sensitive to how quickly yields (which are at historical lows currently) are assumed to increase to a long-run average. The IAC commented that historically there have been periods when rates have stayed low for a long time before moving upwards, which if repeated may give slightly better total returns than being forecast.

Benchmark Analysis

- It was noted that all the Governed Portfolios and managed funds are within their benchmark risk targets, and the IAC confirmed that no changes were required.

- The volatility of the strategic benchmarks is broadly unchanged from last quarter. Equity volatility has decreased slightly and corporate bond volatility has increased slightly resulting in a broadly neutral net effect.

Tactical Analysis

- RT made three tactical changes during Q4 2010 and all were within the risk budgets. These were broadly as follows:
  9 September – moved underweight equities and property and overweight long gilts from a neutral position.
  26 November – moved underweight index linked bonds and added cash.
  17 December – moved to a small overweight in equities and corporate bonds and reduced the underweight in long gilts, maintained the underweight in property and index linked bonds.

- It was noted that a review of the historical risk/return of the portfolios will be presented in Q4 2011.

- It was noted that the managed funds and the governed range allocations were slightly different. RT to review. RT

3. SHORT TERM TACTICAL VIEW OF THE CHIEF INVESTMENT OFFICER

“RT reviewed quarter four and presented his rationale for his current short term tactical view:

“The fourth quarter of the year proved to be a very strong one for equities but with positive returns from property as well, which contrasted with negative returns from bonds. The principal catalyst for the upward move in equities was a significant switch in sentiment with respect to the growth prospects in the US. During Q3 of the year there had been evidence of an easing back in activity levels which prompted much debate about the durability of the developed world recovery. As Q4 progressed the economic and company news flow supported a much more upbeat assessment of the prospects. In reality the US recovery appeared to be particularly marked in the export and industrial areas while the US consumer still appeared to be restrained the more so because of the still difficult jobs market.

This improving trend in the US coincided with the continuation of strong growth out of the emerging world as well as in some parts of Europe. However while the developing world was exhibiting good growth there were emerging signs that some inflationary pressures were emerging and this was leading to some tightening of policy in certain countries. This latter concern did not significantly disturb the growing optimism that the growth outlook for 2011 should be good which would be very supportive of corporate earnings and hence equities.

However the growing optimism on growth did lead to a sell-off in government bonds as investors decided that ‘risk-insurance’ was less required. While this provided a headwind to corporate bonds this asset class was also hit by further concerns over European sovereign debt issues this time particularly related to Ireland. Concerns over how this would unfold led to pressure on corporate financial bond valuations.

Markets finished the year taking a generally upbeat view on the prospects for the global economy, believing that this would therefore underpin the prospects for financial markets. We generally shared this view, and while appreciating that there were still a number of potential ‘potholes’ that could upset the path, believed that equities could make good progress in 2011 and that corporate bonds would also perform well as the spreads of yields over government bonds would close over the year. Our belief was that commercial property would provide minimal capital return given the polarity of interest between prime and secondary assets. However we also took the view that a holding in long dated government bonds was a reasonable counterbalance to our preference for riskier assets, as we thought longer dated inflation expectations would remain well anchored, and that they would also perform well if the optimistic positioning of financial markets were to be reassessed.

During the quarter we did increase our holdings of equities both out of cash but also by reducing our gilt holdings. This went into both the UK and also into Japan. The latter was added to as it had lagged other markets and we felt valuations were more attractive and that corporate change did appear to be taking root in the corporate sector. ”

4. SCOTTISH LIFE FUND REVIEW

Funds managed by RLAM

Governed Portfolios – In the year ending 2010 the portfolios delivered returns significantly above inflation, and over three years have beaten benchmark. Short term performance is slightly below benchmark, the primary reasons for this were the tactical asset allocation and the Property fund.

Property fund –The fund manager has highlighted that the property benchmark (IPD UK ALL Property Monthly Index) is extremely difficult to beat, because it does not allow for the need to maintain liquidity within the fund nor does it allow for transaction costs associated with buying or selling property, both of which can be more significant for a property fund compared to an equity fund. The IAC want to make sure that the benchmark fairly assesses manager performance, and also ensures that the manager runs the fund to the right risk profile. They had sympathy with the fund manager’s position and the IAC asked Scottish Life to prepare a report to define their requirements for liquidity to help manage the fund and to investigate whether the benchmark should be amended to address the issues highlighted by the manager NL

American fund - RT advised that the tracking error was due to different pricing points for the fund compared to the index. NL requested to see this analysis. JD asked that fund holdings be reported on a fully look through basis, with deposits and futures reported separately. RT

Duration matched gilt funds – There was small underperformance over one and three years. The fund manager explained that some of this was due to the impact of cashflows into and out of the fund in the second half of 2010 and will investigate further. NL

Long corporate bond fund – RLAM presented a paper on the use of derivatives. The IAC approved the use of swaps within the fund to meet the duration and have requested a paper setting out the specific use of swaps for this fund and the economic impact of investing in cash backed securities. RT

Various bond funds – RLAM have proposed changes to three Scottish Life bond funds to provide wider diversification for customers and to make the management more efficient, without compromising the objectives of the funds.. The proposals are as follows :
To in-specie transfer the index linked life fund into an RLAM OEIC fund.
Fixed interest life and pension funds – the gilt component to be invested directly and the corporate element to be in-specied into various RLAM OEICs

The IAC welcomed these moves, would like more information on the impact of ongoing costs to the customers, and confirmation that the tax and rebate structure was in place. RT
The IAC confirmed approval of a maximum 80/20 gilt/corporate split for the fixed interest funds but recognise there is a transitional period.

The following funds were highlighted but it was agreed that no further action was required:

Worldwide fund – Performance of the fund has improved recently, with the managers tactical underweight in emerging markets being positive for performance. The fund is under benchmark over one year and beats benchmark over three years.

Duration matched index linked gilt funds – Short and medium funds underperformed over one and three years. The fund manager explained this was due to an underweight position in medium and long dated bonds and a significant change in the yield curve over this period.

Matrix Funds

Blackrock Aquila funds – DB confirmed that he was reviewing the box management process for these funds, and would report back to the IAC. DB

Close Teams Global Equities and Global Alpha funds – These funds are now behind benchmark over one and three years. The IAC agreed that alternative options be sought, and a review will be presented. NL

Invesco Perpetual UK Growth – Fund continues to underperform although remains rated by OBSR. The fund is defensively positioned and it is anticipated that if defensive sectors continue to outperform this will have a positive impact on the fund. A list of other funds available in this sector was presented and the IAC agreed the fund would remain on watch to see if performance improves.

Schroder UK Mid 250 – The IAC approved a suitable replacement for this fund. The new fund is AA rated and will be disclosed once existing investors have been notified. NL

Fidelity International – Sourcing a suitable replacement for this fund has been problematic and so far we are unable to source a strong fund that has the appropriate UK and overseas equity risk criteria. The IAC agreed that the best approach would be to consider this as part of the work to review the Close Teams mandate. NL

Investec American – Many mainstream funds in the US have experienced high volatility in recent years and it's been a challenge to source a suitable new fund with the appropriate risk profile. The IAC reviewed a likely candidate replacement with a strong record, but requested further analysis on the risk profile before confirming this recommendation. NL

The following funds were highlighted as "on watch" and will be subject to further review at the next quarterly IAC meeting:

Investec Global Free Enterprise – Performance has continued to improve with the fund marginally below benchmark over one year and a slight improvement over three years. The fund continues to be AA rated by OBSR.

JP Morgan US – Performance of the fund has improved over the quarter and the fund is now outperforming the benchmark over 3 years although still underperforming over 1 year. The manager comments that the fund is value and momentum driven which has affected the fund over recent periods. Since then the manager has strengthened the team and the new sector analysts have enhanced the qualitative overlay. It remains AA rated by OBSR.

The following fund was highlighted but it was agreed that no further action was required:

Invesco Perpetual Global Equity – Fund is now outperforming across all time periods.

Gartmore - There has been a lot of adverse publicity about Gartmore Fund managers with net outflows from the business, the departure of high profile managers and the imminent sale of the business to Henderson Global Investors. We remain comfortable with the fund on our platform - OBSR views have not changed on the funds we link to and intend maintaining their ratings. They have also received confirmation that the specific managers of the funds we link to have all signed contracts with Hendersons ensuring continuity.

Other external managed funds

The following funds were highlighted as "on watch" and will be subject to further review at the next quarterly IAC meeting:

Newton Managed A – Performance has improved over the quarter but still underperforms over one and three years. Remains AA rated by OBSR.

UBS UK Equity – Performance continues to be weak over all periods although there has been an improvement since last quarter. Comments were sought from the manager who confirmed the following:

- For Performance up to the 31st March 2008 there was significant under performance from the manager Andrew MacLaren and the decision was taken to replace the manager with Ian Paczek
- Following the changes performance improved in 2008 and 2009 and, whilst 2010 performance has been disappointing, the overall picture is that since the new manager took control the fund is above benchmark.

Other Scottish Life funds

The following funds were highlighted but it was agreed that no further action was required:

American life fund – Fund performance is below benchmark across 1, 3 & 5 years, and is influenced by similar factors to that covered above. This fund operates to a tracker basis and the underperformance is a result of the difference in the pricing points of the fund and the underlying benchmark.

European life fund – 3 year performance is now above benchmark with 1 year performance improving.

Pacific life fund– Fund is underperforming marginally over 1 yr with longer term now being above benchmark

5. ROYAL LONDON FUND RANGE

The following funds were highlighted but it was agreed that no further action was required:

UTD Friendly Life UK Managed – There was a benchmark change introduced on this fund on 3/6/2010. This is affecting relative performance figures.

RIL Property – Fund performance has worsened over the quarter for the same reasons reported for the pension fund.

UFLA Index Linked Gilt - Fund is marginally below benchmark over 1 and 3 years.

Utd Friendly/Refuge Pension Managed - Fund is below benchmark over 1, 3 & 5 years. Recent stock selection and market calls within Far East and Europe have caused underperformance.

Utd Friendly/Refuge Pension Property - Fund performance has worsened over the quarter for the same reasons reported for the pension fund.

6. DATES FOR 2010 MEETINGS

Next quarterly meeting is 31 May 2011.

IMPORTANT IMFORMATION

Past performance is not a guide to the future. Prices can fall as well as rise. Investment returns may fluctuate and are not guaranteed.