INVESTMENT ADVISORY COMMITTEE (IAC)
QUARTERLY MEETING

MINUTES OF MEETING HELD ON 13/11/2013

Present	In attendance	Apologies
Julius Pursaill (Chair) Ewan Smith Colin Taylor Andy Carter Hugh McKee	Robin Herd (Scottish Life) Patrick McGrath (Scottish Life) Lorna Blyth (Scottish Life) Ian Kernohan (RLAM representing Robert Talbut) Robert Whitehouse (RLG) Peter Watts (Barrie & Hibbert)	Phil Loney Robert Talbut

ACTION

1. REVIEW OF PREVIOUS MINUTES

The minutes of the 3rd September meeting were approved with discussions on the following action points taking place during the meeting:

- GRIP risk target analysis
- Economic scenario testing within Governed Portfolios
- Efficiency triggers with Governed Portfolios / GRIPs
- Internal fund review
- SL FTSE 350 Tracker life & SL FTSE 350 Managed life
- SL Property
- SL/Fidelity American
- SL/Neptune European Opportunities

2. PROJECTS

Infrastructure Investigation

RT continues to engage with the NAPF over an infrastructure solution. A meeting is scheduled for December. RT

Scenario testing within Governed Portfolios

Conversations are ongoing with Barrie & Hibbert around data they can provide to help formulate economic scenarios to stress test the Governed Portfolios and GRIPs based on the framework outlined at the last IAC meeting. Once the various data options are received RT will engage with PMcG and Barrie & Hibbert around constructing the scenarios. RT/PMcG

Criteria for assessing proposed changes to strategic benchmarks when they trigger "inefficient"

Work continues with RT to establish the impact of transaction costs on making portfolio changes based on inefficiency measures. JP indicated that the issue of transaction costs is gaining a lot of market exposure and there is a lot of focus within the industry to understand the impact of these costs. RT/RH

Risk tolerance targets for GRIPs.

Work is underway with Barrie & Hibbert to review the risk tolerance targets for GRIPs. Data has been provided to PMcG and work will be done to understand this data and form a proposal to be submitted at the next meeting. EFS/PMcG

3. CUSTOMER INVESTMENTS

GOVERNED PORTFOLIOS & MANAGED STRATEGIES

Benchmark analysis

No changes are recommended to the Governed Portfolio and Managed Fund benchmarks this quarter. All the portfolios are reporting as efficient with GP3 back within target since the previous quarter. The IAC noted how close to 100% efficiency the portfolios were.

Tactical analysis

All portfolios remain within their tactical risk budgets. Robert Talbut made one tactical change within the short duration portfolios since the last meeting.

On 19th September he increased his underweight in investment grade corporate bonds within the short term portfolios in favour of short duration high yield bonds .

GOVERNED RETIREMENT INCOME PORTFOLIOS

Benchmark analysis

No changes are recommended to the strategic benchmarks this quarter. They continue to be outwith the risk targets at the minimum level however this is a consequence of the risk measures being too sensitive to small changes. This issue was covered last quarter and will be resolved by the work being done on the GRIP risk tolerance targets.

Tactical review

All the portfolios are within their tactical risk budgets. There have been no tactical changes since the last meeting.

LIFESTYLE PATH ANALYSIS

Each Governed Lifestyle Strategy continues to be appropriate for its risk profile and investment objective.

SHORT TERM TACTICAL VIEW OF THE CHIEF INVESTMENT OFFICER

RT reviewed Q3 2013 and presented his rationale for his current short term tactical view:

"The third quarter in financial markets was dominated by debate over the possible partial withdrawal of the exceptional monetary support in the US and how this would affect markets together with the introduction of 'forward guidance' in the UK and EU regarding the setting of short term interest rates. Both central banks committed to holding short-term rates at historic lows for a considerable time with the UK linking any withdrawal to sustained improvement in the employment market. In the US we saw the effect that even very moderate changes in monetary policy could have on markets as the Fed signalled that it was likely to reduce the pace of monetary injections into the economy. While equities initially performed relatively well given the continued improvement in macro data, bond markets exhibited fairly pronounced weakness and this ultimately started to unnerve equities.

The bond weakness spread to both UK and European markets with this being given an added push as economic data in these areas started to show some surprising strength. Signs of life could be detected in industrial production, surveys of future intentions and even the consumer areas appeared to show some more optimism. In truth the European data painted a picture of some stabilising in the economy rather than a robust turnaround but this was enough to alter sentiment away from the extreme safety first of safe government bonds and more towards equities. In the UK this was particularly so with the added dimension of a rising debate over the housing market as the government announced further measures to boost housing activity and so prices. While the majority of headlines referred to strength in the London market there were signs that the improvement would spread outwards so boosting consumer confidence in time honoured UK fashion.

The area that was most affected by the potential monetary 'tapering' were the emerging markets as shorter term speculative funds were withdrawn given the prospect of higher rates in the US. This started to expose some of the countries that had high and rising trade deficits and where structural reforms had not been sufficiently enacted. Hence we saw fairly significant falls in a number of equity markets which then fed back into the developed markets as investors worried about the negative consequences for global growth and in particular the prospects for the many companies where EM have been big growth markets for them.

Towards the end of the period investors were also confronted with the prospect that the divided US political system would be unable to agree a deal on government finances with negative consequences for growth. However the other substantive issue was the still very sluggish performance of the US employment market especially given its strong linkage into the Feds view of when monetary policy could normalise. It appears that the combination of the disappointing labour data and the uncertainty over US fiscal policy ultimately led to the Federal Reserve surprising markets by pulling back from any monetary 'tapering'. This resulted in very strong short term returns from both bonds and emerging market equities while developed equities (which had been much less negatively affected) saw some further gains. Overall for the quarter this resulted in equities, with the exception of the US, performing well comfortably outperforming conventional and index-linked bonds. Property provided some further positive returns as did corporate bonds with spreads over government bonds tightening further.

Throughout this period our asset allocation remained unchanged, with a pro-equity stance counterbalanced by underweight positions in bonds and property. Within corporate bonds we shifted further towards high yield on the belief that total returns will be superior to investment grade given our view of a continued gently improving economic trend.

The events of Q3 have probably given us a taster of how difficult it will be for the monetary authorities to withdraw from the monetary stimulus settings and indeed to how dependent financial markets are becoming to the policy. We have a situation where central banks are boosting almost all financial markets but the performance of the underlying economy remains disappointing. We have arrived now at a situation where it is difficult to make the case for bonds, equities or property as being good value and instead we are rationalising them on the basis that there are no 'cheap' assets available and that cash delivers no return. While this is an uncomfortable situation our view is that the combination of still loose monetary policy and some economic growth will favour equities. If growth does turn out stronger then again we see equities as being less negatively affected than bonds (but obviously cash would outperform), whereas the scenario where equities would be badly affected, on much weaker activity, we see as being a relatively low probability event. However given all of this we may well reduce our overweight to equities at some stage."

4. FUND OPERATIONS REVIEW

Tracking differential update – The review aspect of the project has been completed. RW

FTSE 350 tracker and active funds – The FTSE 350 Tracker fund will be dealt with initially. Work is now continuing to progress the transition of the assets in this fund. LB

5. SCOTTISH LIFE FUND REVIEW

Governed Range

The following investments were highlighted as requiring action:

Governed Portfolios – The Governed Portfolios had a positive Q3 2013 with most of the constituent funds generating outperformance. All of the portfolios/strategies continue to outperform over 1 year whilst the 3 year performance has also improved. Fund performance remains the bigger contributor to performance with asset allocation broadly unchanged over the quarter.

Work to understand the impact of cash on a "look-through" basis within the portfolios is ongoing. The level of cash within the portfolios mainly reflects the Property fund's cash holding. This is acceptable given the liquidity a Property fund needs to maintain. PMcG is looking further into the levels of cash within the sub funds that make up the Global Managed fund. This will be presented back to the IAC members during the quarter. PMcG

The following funds/portfolios were discussed:

Rathbone Global Alpha – It was noted that this fund has been live for two months and performance versus the benchmark is positive and within the appropriate tracking error. Flows into the new fund have also been positive since launch.

SL Global Managed – The fund added a third consecutive quarter of outperformance. Three year performance has improved and the five year figure remains strong. The UK and US funds contributed to performance and the European fund detracted from performance.

Other funds managed by RLAM

The following fund is "on watch" and will be subject to further review at the next quarterly IAC meeting:

Property pension – Fund performance is very strong over all time periods, however the cash level within the fund remains just under 19% and the fund has a void rate of 8.6%, 0.2% below the IPD level. The team have completed 13 purchases totalling £133m with a strong pipeline in place for early 2014. The IAC are aware that current flows are strong and that any significant increase in demand for the property fund will need to be addressed by the team. The IAC will maintain oversight on the fund to ensure they are comfortable with incoming flows and subsequent purchases. RH

The following funds were discussed and no action was taken:

Managed - This fund is performing strongly over one year but historical performance is still affecting the three year figure.

Global Equity - Fund performance over one year is above benchmark with the three year figure subsequently improving. Historical performance is still affecting the longer term numbers.

Duration matched Index Linked Gilts - These funds are above benchmark YTD but marginally underperforming the benchmarks over one year. They are also underperforming over three years but again within a reasonable range from their benchmarks.

Matrix Funds

The following funds were highlighted as requiring action:

Invesco Perpetual Income – The manager has signalled his intention to leave Invesco Perpetual in April 2014. The combined assets of this fund and the Invesco Perpetual High Income fund is approx. £25bn. The departure remains a largely unprecedented event in markets for a manager running this size of assets and may have a significant impact on the UK market.

Morningstar OBSR have indicated that the IP Income fund should be replaced and SL remain engaged with them to identify a replacement fund. A proposal will be submitted to the IAC before the next meeting to ensure this matter is addressed as a priority.

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

Fidelity American – The fund is outperforming the benchmark over three months, six months and one year. The fund has benefitted from holdings in many areas particularly consumer discretionary, healthcare and energy stocks. The new manager has focussed the fund on domestically biased stocks with a view that the domestic US economy will be stronger than developing market exposure held previously.

Neptune European Opportunities – The fund outperformed strongly in Q3 and is now outperforming the benchmark since the change was made. Key drivers of performance have been in IT and consumer discretionary stocks. Underweight position in defensive stocks also helped relative performance.

The following funds were discussed but no action was required:

Schroder UK Alpha Plus – The manager of this fund left in March 2013 and the underlying fund has subsequently seen significant outflows however performance has held up well and is positive relative to benchmark.

Fidelity International – This fund was closed week commencing 18th November 2013.

Close TEAMs Global Equities (1%) – This fund was closed week commencing 11th November 2013.

The following funds have improved and are no longer on watch:

Fidelity European Blended, BlackRock Aquila US Equity Index.

Other external managed funds

The following funds were discussed but no action was required:

BlackRock UK Equity - Fund performance has worsened over the quarter and is now under benchmark over 3 & 5 years.

Fidelity Special Situations Blended – Fund performance continues to improve and has reduced the underperformance over 3 & 5 years significantly.

Investec Emerging Local Currency Debt - Fund performance is poor and has worsened over the quarter. This is reflective of the poor returns emerging markets have produced. Currency exposure and specific regional bets have harmed performance predominantly.

Jupiter Financial Opportunities - Fund performance over the quarter has worsened but the longer term 3 year track record has improved significantly.

Jupiter India - This fund continues to underperform albeit marginally over the quarter. The 1 year track record has improved.

Jupiter Merlin Worldwide Portfolio - This fund is underperforming significantly over 1 & 3 years. The themes that have supported the markets currently are in areas the fund was not positioned for. The combination of emerging markets exposure, too much of the fund in quality defensive stocks and an underweight in Europe recently have harmed performance.

Legg Mason US Smaller Companies – Fund underperformed marginally over the quarter but the longer term performance has improved.

M&G Global Basics – The benchmark for this fund is the sector average. Compared to this benchmark the fund continues to significantly underperform over 1 & 3 years. Market conditions this year particularly have favoured funds positioned in consumer staple and defensive stocks. The fund has not participated in this upward trend.

M&G Recovery - This fund continues to underperform albeit marginally over the quarter. The underperformance stems mainly from the fact that the fund does not invest in the themes that have generated the market growth in recent years.

Neptune Balanced - Fund continues to underperform albeit marginally over 3 years.

Neptune Global Alpha & Neptune Global Equity – Both funds have outperformed over the quarter particularly global alpha which has returned 7.3%. This evidences the view that Neptune are a high conviction house governed by a macro view. When this is successful the funds will tend to outperform.

Newton Balanced & Newton Managed - These funds continue to underperform their benchmarks over 1, 3 & 5 years. This quarter's performance has been marginally under benchmark and would suggest that performance issues are being managed.

Newton Real Return - The fund has outperformed over the quarter and year to date but is now underperforming marginally over the longer term.

Schroder Global Property Securities – The fund is underperforming the index however did show positive performance over the quarter and the longer term 1 & 3 years figures have also improved.

Schroder US Mid Cap - Fund performance has worsened marginally over the quarter. Fund performance over 3 years versus the index looks poor however, peer positioning is much stronger.

UBS UK Equity - The fund has underperformed over the quarter impacting the longer term numbers. Relative underperformance over the 1 & 3 years remains at less than 1%.

The following funds have improved and are no longer on watch:

Fidelity UK Growth, UBS Global Blended

6. DATE FOR NEXT MEETING

The next quarterly meeting is 25th February 2014.

IMPORTANT INFORMATION

Past performance is not a guide to the future. Prices can go down as well as up. Investment returns may fluctuate and are not guaranteed so you could get back less than the amount paid in.

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