INVESTMENT ADVISORY COMMITTEE (IAC)
QUARTERLY MEETING

MINUTES OF MEETING HELD ON 28/05/2014

Present	In attendance	Apologies
Julius Pursaill (Chair) Ewan Smith Colin Taylor Andy Carter Isobel Langton	Robin Herd (Scottish Life) Patrick McGrath (Scottish Life) Robert Dundas (Scottish Life) Lorna Blyth (Scottish Life) Robert Talbut (RLAM) Robert Whitehouse (RLG) Peter Watts (Moody's Analytics)	Phil Loney

ACTION

1. REVIEW OF PREVIOUS MINUTES

The minutes of the 25th February meeting were approved with discussions on the following action points taking place during the meeting:

- Accessing Infrastructure as an asset class
- GRIP risk target analysis
- Impact of cash dilution on asset allocation analysis
- SL Property
- SL UK Income Specialist (Invesco Perpetual Income)
- SL UK Smaller Cap Specialist (Investec UK Smaller Companies)

2. NEW IAC MEMBER

Isobel Langton, CEO for Royal London Intermediary business has joined the IAC. JP welcomed Isobel noting that her extensive experience in building up Scottish Life's leading customer service capability will bring valuable insight to the IAC going forward.

3. PROJECTS

Investment default design and budgetary impact

LB confirmed default review work has started and is being worked on alongside the bigger at retirement workstream. Aim to present this work at the next meeting for IAC overview. LB

Infrastructure Investigation

This is ongoing, Robert Talbut remains engaged with the NAPF however the IAC are also engaging with fund management companies to look at other potential vehicles such as segregated mandates. RT/RH

Risk tolerance targets for GRIPs.

The existing risk measure used within the GRIPs looks at income over a lifetime and measuring on this basis alone has suggested that the portfolios should be taking a bit more risk. . The IAC felt that in addition to this longer term measure, a short-term target should be introduced to measure the worst reduction in income an investor could experience over a one year period by investing in a GRIP. The IAC approved this new measure and the portfolios are all within this short-term target. Going forward both measures will be used.

Real return/volatility measures introduced.

Although we have a strong risk governance focus, we also think it is useful to consider the real return performance we are delivering for customers and consider how this relates to the levels of return that customers might expect from their illustrations or annual statements. To reflect this the IAC agreed to introduce some additional real return measures into the quarterly IAC review pack.

Impact of cash dilution to asset allocation of the Governed Portfolios

The level of cash held within the Global Managed fund and its effect on the portfolios' volatility and returns, continues be of concern to the IAC. They have requested ongoing full look through cash analysis & for work to be undertaken to determine if there are any methods of allowing for the cash holdings within the asset allocations. This will be performed for the next IAC. PMcG

Smart Beta.

SL have completed an initial high level overview investigation into Smart Beta investment strategies as part of the IAC's ongoing intention to review alternative investment strategies. There is merit into looking this further but the impact of the budget changes on the proposition will take priority. RD

4. CUSTOMER INVESTMENTS

STRATEGIC ANALYSIS

Governed Portfolios & Managed Strategies

No changes are recommended to the Governed Portfolio and Managed Fund benchmarks this quarter. All the portfolios are reporting as efficient.

Governed Retirement Income Portfolios

No changes are recommended to the strategic benchmarks this quarter. The portfolios continue to be below the long-term risk measure target however are within the new short-term targets implemented this quarter.

Lifestyle Path Analysis

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

TACTICAL ANALYSIS

Governed Portfolios & Managed Strategies

All portfolios remain within their tactical risk budgets. No tactical changes have been made since the last meeting. The portfolios remain overweight in equities and high yield bonds in favour of investment grade corporate bonds, index linked gilts and property.

Governed Retirement Income Portfolios

All the portfolios are within their tactical risk budgets. No tactical changes have been made since the last meeting. The portfolios remain overweight in equities in favour of investment grade & high yield corporate bonds, index linked gilts and property.

Short term tactical view of the Chief Investment Officer

RT reviewed Q1 2014 and presented his rationale for his current short term tactical view:

"The first quarter of the year will in part be remembered for being a period whereby various asset classes seemed to perform less based upon economics or other fundamentals and far more upon whether investors were seen to be particularly positively or negatively positioned in that asset class at year end 2013. Hence we saw government bonds, emerging market equities and commodities move upwards and developed market equities and in particular growth oriented equities start to struggle. The former were pretty consensual longs of investors, but suggesting that growth surprises or disappointments explained these moves as opposed to shorter term 'stop-loss' positioning trades we believe to be an inaccurate assessment. These trends have continued into Q2 but our belief is that it would be incorrect to read too much into the asset moves but instead accept that such strange shifts can occur based upon little real information and reflect some of the post-financial crisis reality that exists.

The authorities currently attempting to provide complete clarity over their likely actions on monetary policy reflects both the dependence of the financial system upon the 'emergency assistance' and the fear that 'surprises' would not be coped with well. The assumed fragility of financial markets, we'd suggest, is a reflection of the continuing reality of excess debt, government's deleveraging, and an unwillingness or inability on the part of consumers or corporates to increase spending ensuring that global growth will remain unspectacular and certainly lower than enjoyed pre-crisis.

Another major factor shaping the environment for financial markets is what has been referred to as the global savings glut. We support the idea that globally there is an excess of savings that is struggling to find a suitable home. This has emerged from both the deliberate monetary stimulus and from global trade flows. The consequence of this has been to support government bond prices, has certainly leaked into riskier bonds and equities in the search for a return and lastly helps to explain the persistence of extremely low real yields. Our view is that given the fragility of the global economy referred to above, this combination of exceptionally transparent central bankers, and very skittish financial markets is likely to define the foreseeable future.

The last factor to consider is that the efforts of the authorities to make banks safer have meant that their ability to facilitate trading in markets is diminished. Hence why we believe that while there may be a great deal of 'liquidity' in the financial markets searching for a return there is actually much less 'liquidity' in terms of depth of markets. As a consequence we take the view that some investors are shifting their portfolios towards what they believe will be more liquid investments in an attempt to manage their risk profile. Ultimately our view is that such moves are likely to be pretty futile as the depth of markets is such that markets will likely seize up in any crisis.

We'd suggest that this set of circumstances should frame the way we look at financial markets. In terms of return expectations we'd expect that post the exceptional returns in the early post-financial crisis period we should expect returns to be relatively low, and probably lower than historical norms. The other implication is that periods when markets show short-term skittish return profiles linked to very minor changes in market perception or fundamentals are likely to be a persistent occurrence. In part this reflects the fact that the normal reactions of financial markets and economies are being suppressed by the exceptional monetary stance globally. The absence of clear pricing signals emanating from macro variables which would historically have led to portfolio shifts from investors is both leading to increased risk taking and low observed market volatility. Hence we'd suggest that the recent noise in markets does not signal a major shift in fundamentals but instead is a reminder of markets fragility. Our response to these shifts could either be to try and trade them or alternatively to ride them out – our preference remains the latter. However looking through our scenarios approach reinforces the point that our portfolio positioning is more 'risky' than the quant tools would indicate. Fundamentally we are living through an extended period of unstable-stability as defined by Minsky and this is why our view is that this is not the time to be taking significant amounts of portfolio risk. While we still see us as on the path to a normalised world the process still looks to be taking longer than many believed would be the case.

As suggested above the economic fundamentals have changed extremely little in Q1; while growth expectations have been shaded at the margin they have not altered the central view of a respectable year for global GDP as the healing process continues. While the UK has been an exception in seeing forecasts continue to be raised this has not lead to any marked change in expectations for interest rates or the overall stance of policy. Globally inflation remains too low for comfort and reflects the persistence of excess capacity which in combination with financial markets and real economic dependence upon it will mean that monetary policy will remain flexible and loose for a considerable period to come.

Against the above bond markets had a good quarter and while equities rose it was by less than from credit. In addition property had a strong period helped by weight of money and actually an improving market for occupancy and hence rent levels. We have not altered our asset allocation through the period and notwithstanding recent moves we still see equities as the least ugly asset class against a background of rich bond valuations, negative real yields, the difficulty of finding attractive property assets and virtually no return from cash. Hence we remain overweight equities at the expense of small underweights in all other asset classes."

4. SCOTTISH LIFE FUND REVIEW

Governed Range

The following funds/portfolios were discussed:

Governed Portfolios – The Governed Portfolios are continuing to perform strongly over both 1 & 3 years. Most of the outperformance continues to come from the underlying funds with asset allocation positioning adding marginal value.

Property – The cash level has continued to drop sitting at an appropriate level of 5%. The fund continues to perform very strongly however the team are aware that the property market is a difficult environment and are therefore working with Scottish Life to identify alternative vehicles that could be utilised within the fund to generate additional returns or help minimise excess cash exposure in the future. LB

Other funds managed by RLAM

The following funds were discussed and no action was taken:

UK Smaller Companies – The fund has outperformed over the quarter helping to narrow the underperformance over the 1 and 3 year periods. Peer positioning is also relatively strong suggesting the sector is also struggling to outperform the benchmark.

Adventurous Managed - The fund has underperformed marginally over the quarter however it is still outperforming over 1 year. The underperformance over 5 years has also narrowed to 0.5%.

Global Equity – The fund has underperformed marginally over the quarter however the 3 year performance has improved. Historical performance dropping out has worsened the 5 year track record.

Matrix Funds

Invesco Perpetual Income – It was agreed since the last IAC meeting that the assets in this fund should be switched to Fidelity MoneyBuilder Dividend. The IAC were concerned about the impact of the changing news flow around the new Neil Woodford fund and subsequent outflows from the Invesco Perpetual Income fund.

This change went ahead on 28 May prior to the new Woodford fund being made available and customers and advisers were mailed in advance of this change. Due to the size of assets involved, the switch resulted in a significant cost reduction for customers invested in the fund as SL were able to negotiate a lower cost with Fidelity.

The following funds were highlighted as requiring action:

Investec UK Smaller Companies – The fund manager left Investec however Morningstar OBSR have met the new manager and know him from previous roles. They like the process operated by Investec but need to monitor the fund further to establish if the fund manager can perform within this process sufficiently. They are scheduled to meet the manager again in June/July and will feedback their view after this meeting.
RH

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

Fidelity European Blended – This fund underperformed over the quarter however, the 1 & 3 year figures have marginally improved. Strong performance historically has dropped out of the 5 year period resulting in below benchmark performance.

JPM US – A second consecutive quarter of underperformance has caused this fund to trigger with 1, 3 & 5 year time periods all showing below benchmark performance. The fund was impacted by some large drops in specific stocks particularly in financials.

Other external managed funds

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

Jupiter Merlin Worldwide Portfolio - The fund is underperforming significantly over 1 & 3 years. SL have requested more detailed analysis around reasons for underperformance and changes that have been made to rectify this.

Neptune Balanced – This fund has had a very poor quarter underperforming by 3.7%. Its peer positioning is also extremely poor. SL have requested more detailed analysis around reasons for underperformance and changes that have been made to rectify this.

Neptune Global Equity - This fund has had a significantly poor first quarter with the fund also sitting in 99th percentile within the sector. The quarter's performance has also brought the 1 & 3 year track record down. SL have requested more detailed analysis around reasons for underperformance and changes that have been made to rectify this.

The following funds were discussed but no action was required:

Investec Emerging Local Currency Debt - The fund has marginally underperformed over the quarter and remains significantly below benchmark over 1 & 3 years.

Investec Global Energy - The fund is underperforming particularly over 3 years however peer positioning is stronger.

JPM New Europe - The fund underperformed significantly over the quarter which has subsequently impacted the longer term figures. Specific country exposure impacted performance particularly around the Russia/Ukraine situation.

Jupiter India - Fund performance has worsened over the quarter however the 1 & 3 year track record has improved significantly.

Legg Mason US Smaller Companies - The fund is underperforming significantly over 3 years however it had a strong first quarter helping both the 1 & 3 year track record.

M&G Global Basics - The fund had a positive first quarter helping to improve the 1 year track record. The 3 year figure remains poor however.

Newton Balanced - Fund performance has been flat over the quarter with the 1 & 3 year figures improving suggesting some historical performance has dropped out of those numbers. The 5 yr track record is still poor.

Schroder US Mid Cap - The fund marginally underperformed over the quarter however the 3 year track record has improved significantly suggesting historic poor performance has dropped out.

Threadneedle Latin America - The fund has underperformed over the quarter however poor performance dropping out of the 3 year track record has improved the longer term performance.

UBS Global Blended & UBS UK Equity - The fund marginally underperformed over the quarter however the 5 year track record is being impacted by sever historical underperformance.

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

M&G Recovery, Newton Managed, Schroder Global Property Securities.

6. DATE FOR NEXT MEETING

The next quarterly meeting is 22nd August 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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