Investment Advisory Committee (IAC) Quarterly Meeting

Minutes Of Meeting

Date
24/2/2015

Present members	In attendance
Julius Pursaill (Chair)	Robin Herd
Colin Taylor	Robert Dundas
Andrew Carter	Natasa Margariti
Ewan Smith	Lorna Blyth
Rachel Elwell	Piers Hillier
Isobel Langton	Robert Whitehouse

Owner

1. **REVIEW OF PREVIOUS MINUTES**

The minutes of the 26 November meeting were approved with discussions on the following action points taking place during the meeting:

- Changes in default investment proposition in light of budget changes — RD

2. **IAC MEMBERSHIP CHANGE**

After three years on the IAC, Phil Loney has now stepped down to allow him to focus on other initiatives. Phil is comfortable that there is a robust governance process in place and feels that the IAC will benefit from a rotation in membership.

Rachel Elwell has replaced Phil. Rachel is a qualified actuary and heads up Royal London's Investment Office, which amongst other duties has responsibility for oversight of the performance of Royal London Asset Management on behalf of Royal London Group, as well as being responsible for management of the Royal London staff pension schemes.

The IAC formally thanked Phil for his involvement in the committee over the past three years and welcomed Rachel as a member.

3. **IAC TERMS OF REFERENCE** LB

The terms of reference have been updated for the change in membership and to include the Pegasus fund range available within Royal London's intermediary protection channel. This has been circulated to the members for approval.

4. **PROJECTS**

Investment default design and budgetary impact RD

The project to review our investment default and proposition changes in light of the budget is progressing. A paper on our investment default will be provided to the IAC for approval before the next meeting.

In April 2015 we will be launching drawdown lifestyles so that customers can smoothly transition from accumulation in GRIP portfolios and be ready to start taking an income from their fund.

Property – mandate review LB

Work is ongoing to widen the Property fund mandate. This is being picked up as part of a wider RLP mandate review.

Governed Range – Tactical Asset Allocation discussion RD

The IAC agreed that while index-linked gilts have performed well for customers, they queried whether a tactical index-linked gilt exposure will continue to be appropriate amidst concerns that this asset class appears poor value relative to other asset classes.

Piers Hillier, Chief Investment Officer – RLAM, commented that while the current pricing of this asset is challenging, exposure to index-linked gilts is key to prudently managing uncertainty in the markets and more extreme market scenarios when index-linked gilt holdings will outperform. In general terms RLAM also feel that risk is not fully priced into the market which means that current and recent volatility appear low. Overall RLAM will continue to keep the tactical positions under review as market circumstances evolve and make changes as appropriate subject to IAC approval.

5. **CUSTOMER INVESTMENTS**

STRATEGIC ANALYSIS

Governed Portfolios & Managed Strategies

No changes are recommended to the Governed Portfolio and Managed Strategy benchmarks this quarter. As per last quarter, all the portfolios are reporting as efficient with the exception of Governed Portfolio 3 & 6 and the Cautious Medium Term Strategy. The expected real return differences on these latter portfolios are very small so the IAC was comfortable that no change was necessary.

Governed Retirement Income Portfolios

No changes are recommended to the strategic benchmarks this quarter. The portfolios continue to be within both the long and short term targets.

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 (GRIPs)
There was a tactical change made within the portfolios effective from 4th December 2014 to remove some minor inconsistencies. The portfolios are within their tactical risk budgets. The portfolios remain overweight in equities and underweight in investment grade & high yield corporate bonds, index linked gilts and property.

Short term tactical view of the Chief Investment Officer

PH reviewed Q4 2014 and presented his rationale for the current short term tactical view:

Positioning

- The Governed Portfolios entered the 4th quarter with an overweight in Equities at the expense of Corporate and Index-linked Bonds, and a small underweight in Property.

Q4 Market Background

- Q4 was a volatile quarter for Equities containing two sharp sell-offs followed by equally dramatic rebounds. UK Equities actually fell over the quarter on the back of weakness in Resource stocks following a collapse in commodity prices. Overseas equities generated positive returns, largely driven by the US, but lagged gains in Fixed Income.
- During the quarter, investors sought to determine how steep falls in the oil price, declining growth in China, and growing deflationary forces in Europe would impact asset prices.
- Against this backdrop, Fixed Income markets experienced large upward price moves as global growth concerns and the prospect of deflation in Europe pushed yields lower.
- Credit markets saw divergence between high and low quality issues with High Yield spreads widening on concerns that falling oil prices could spark defaults in the Energy sector.
- Momentum and sentiment in UK commercial property markets showed no signs of abating during the 4th quarter as Property delivered another quarter of c. 4.0% total return on the back of encouraging UK growth statistics and continued capital inflows from both domestic and overseas investors.

Relative Positioning & TAA Performance

- Tactical positioning detracted from performance in Q4 and was concentrated in the underweight allocations of Index-Linked and Corporate Bonds as inflation releases surprised on the downside and yields moved lower.
- Within Fixed Income, exposure to High Yield also detracted as a dramatic 40% fall in oil prices during the quarter led to a sell-off on fears that a large proportion of high yield bonds issued by US Energy companies to develop US shale deposits in recent years are now

at risk of default.

- The overweight stance in Equities marginally detracted as returns lagged those of Fixed Income. A bias towards Overseas Equities at the expense of the UK within the Global Managed portfolio generated positive attribution.
- A small underweight to Property which outperformed in Q4 marginally detracted from performance.

Outlook & Views

- We remain constructive on Equities given our solid outlook for the global economy, positive earnings growth, and the quality of corporate balance sheets at this stage of the cycle. We also believe that steep oil price falls will ultimately prove to be a significant net positive to growth from boosting disposable incomes and lowering input costs.
- Within Equities we favour overseas markets as we expect political uncertainty and relatively high index exposure to resource stocks will constrain UK equity performance. Regionally, we continue to favour the US on positive personal consumption and business investment momentum, and in Europe recent moves by the ECB are likely to result in liquidity driven gains in Eurozone asset prices. China is expected to continue slowing as it transitions to a more consumer-led model, whilst oil price falls will benefit Asia most.
- Fixed Income yields near record lows continue to offer relatively poor value and protection as and when monetary policy normalises. We believe yields continue to reflect too pessimistic a view of the global outlook having been distorted by central bank policies and global financial regulation enacted over recent years.
- Despite historically high valuations, the underweight to index-linked is tempered by the downside portfolio protection they should provide in the event of a deflation shock or growth disappointment.
- On Property we retain a balanced view. On the one hand, a wide range of domestic as well as international investors continue to seek investment opportunities at a time of limited supply of quality properties will keep yields at low levels, however a market adjustment may still be evidenced as and when prevailing strong capital flows ease.

6. ROYAL LONDON FUND REVIEW

Governed Range

The following funds/portfolios were discussed:

Governed Portfolios – Although the Governed Portfolios continue to outperform over 3 years, the 1 year figures have marginally worsened. Due to a particularly volatile Q4 the portfolios have underperformed (with the exception of GPs 4, 7 & 8) their benchmarks. With the current portfolio positioning, underperformance in the type of market we saw in Q4 was expected. The underperformance is mainly within the shorter duration portfolios where index-linked asset allocation detracted. Underlying fund performance remains relatively strong across all assets classes within the portfolios.

Matrix Funds

The following fund was highlighted as requiring action: RH

Neptune European Opportunities

This fund is underperforming over 1, 3 & 5 years. Neptune run a high-conviction approach and performance can be volatile however the manager's stance has not been rewarded for some time. RLP will hold further discussions with Neptune regarding the fund and report back at the next meeting.

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

Fidelity American
The fund continues to underperform despite some good performance earlier in 2014. The manager maintained his overweight in energy stocks which significantly impacted the fund. Four of the top five detractors were energy stocks however he has recently cut these positions. The fund is positioned for a domestic US recovery to continue with falling petrol prices and improved employment being key indicators for performance going forward. RLP will liaise with Morningstar OBSR to investigate alternative funds and report back at the next meeting.

The following funds were discussed but no action was required:

Invesco Perpetual Japan - The fund is underperforming over 1 & 5 years. Recent performance in 2014 has been affected by a focus on cyclical companies and underweight positions in defensive sectors. This is consistent with many other active funds in the market however as has been highlighted in the past, performance of this fund can be volatile. It remains 'bronze' rated by Morningstar OBSR.

Schroder Core UK Equity (formerly Cazenove UK Growth & Income) - The fund is underperforming across 1, 3 & 5 years. Having had positive years in 2012 & 2013 the fund has been impacted in 2014. The manager was positioned for cyclical growth including an overweight in resource-based companies. Market uncertainty prevailed and the strategy was not rewarded. Schroders are confident in their strategy but are keeping a watch on the political and market uncertainty that may remain.

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

Investec UK Smaller Companies, Fidelity European Blended, JPM US.

Other external managed funds

The IAC had requested additional reporting on five funds that have been on watch since 2013.

Newton Balanced
Jupiter Ecology
Investec Emerging Local Currency Debt
M&G Global Basics
Jupiter Merlin Worldwide Portfolio RH

A paper was provided which confirmed that most performance issues were historic and short periods of significant underperformance were affecting the overall track record. All these funds will be kept on watch to ensure that performance is improving.

The following funds were discussed and will remain on watch, but no action was required:

Fidelity Special Situations Blended
Fund performance has improved for the second consecutive quarter and only marginally underperforms over one year. The three year performance is very strong however over five years the fund is still under benchmark.

Investec Cautious Managed
The fund has drastically underperformed over 2014 with absolute performance flat compared with a benchmark increase of approx. 6% The fund has experienced three consecutive quarters of negative returns compared to three consecutive positive quarters for the benchmark.

Investec Global Energy
Severe underperformance in Q4 has impacted the overall performance of the fund. Over three years the fund is under benchmark however peer positioning is very positive. This would suggest that the majority of global energy funds have struggled to outperform the MSCI World/Energy index.

JPM Cautious Managed
The fund had a positive quarter delivering 3.1% absolute return. This has helped the longer term performance however it is still under benchmark over three & five years.

JPM Natural Resources
The fund has had two negative quarters performing below the benchmark. This has dragged the longer term performance down however peer positioning is around average.

Jupiter Financial Opportunities
This fund has had a positive quarter compared to benchmark however this hasn’t made up for very poor quarters in Q2 and Q3. This is a thematic fund and therefore will have periods of underperformance when financials are out of favour.

Legg Mason Smaller Companies
This fund had a poor last quarter in 2014 with the benchmark vastly outperforming the fund. This followed three steadier quarters of marginal outperformance.

M&G Global Leaders
The fund has had a poor eighteen months underperforming the benchmark over the previous six quarters. This fund is thematic by nature and has been impacted by the flight to quality in 2014. The rally in large cap defensives lasted longer than most investors anticipated. This is reflective of many of the higher conviction equity funds that are triggering this quarter.

M&G Recovery
This fund has seen underperformance continuously over the last three quarters. This is a thematic fund investing in distressed UK companies and holding for typically five years to obtain the resultant growth from the turnaround. Given the nature of markets over 2014, underperformance compared to the wider UK market is unsurprising.

Neptune Balanced
Fund performance has been mixed with the manager struggling to have two consecutive quarters of outperformance. The fund is still being impacted by a

significantly poor Q1 2014.

Neptune Global Equity

This fund has had a stronger fourth quarter improving the longer term numbers. As a house, Neptune had backed emerging markets strongly which has not been rewarded in recent years. They have undertaken a significant restructuring program and have rationalised their fund range. This would suggest some learning is being applied from previous mistakes and they are positioning the business to perform better in the future.

Neptune US Opportunities

The fund has had two quarters of significant underperformance affecting the longer term performance of the fund. Peer positioning is also very poor highlighting the high conviction nature of Neptune as a house where underperformance can be more significant when compared to other managers.

Newton Global Higher Income

The fund had marginal underperformance over the quarter and a third consecutive quarter of underperformance compared to the FTSE World benchmark. When compared to the IMA Global Equity Income sector average, performance is more favourable. Newton are renaming the fund as Newton Global Income removing "Higher" from the name. They have confirmed this is not indicative of a difficulty in achieving income but to bring it in line with other Newton funds and the wider global equity income sector.

Newton Real Return

This fund has underperformed marginally over the quarter however this, combined with an extremely poor Q3 2014, has dragged the one year figure to 0.9% below benchmark.

Schroder Global Property Securities

Fund performance over the quarter improved marginally but not enough to improve the one year track record. Historical poor performance has dropped off improving the three year performance, however the fund is still below benchmark.

Schroder US Mid Cap

This fund was broadly flat over the quarter compared to the benchmark however the fund now has a five year track record and historical performance has triggered the fund. One year performance is stronger.

Threadneedle Latin America

Fund performance is marginally below benchmark over the quarter and continues to affect the longer term numbers. Relative underperformance has been marginal although consistently below benchmark. A particularly poor Q1 2014 is affecting the one year figure.

UBS Global Blended

This fund continues to underperform across one, three & five years. Three consecutive quarters of poor relative performance is affecting the fund.

UBS UK Equity

This fund has had a poor fourth quarter triggering for review. One year underperformance is marginal however historical performance is affecting the five year track record particularly.

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

Fidelity UK Growth, Neptune Global Alpha, Newton Managed

7. DATE FOR NEXT MEETING

The next quarterly meeting is 2^{nd} June 2015.

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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