

INVESTMENT ADVISORY COMMITTEE

QUARTERLY MEETING

MINUTES OF MEETING HELD ON 25/08/09

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

ACTION

1. REVIEW OF PREVIOUS MINUTES

The minutes of the 21st May IAC meeting were approved.

The action points arising from the 21st May meeting were then reviewed:

- RT explained that he had sourced a potential tracking system. AB expressed some reservations about the ability for that system to model property fully. EFS suggested that B&H might be able to deliver the analysis at lower cost. RT to discuss with PM. RT/PM/NL
- PM confirmed he had circulated the corporate risk premium analysis to all meeting attendees as requested.
- NL confirmed that the main IAC report had been extended as requested. MY asked for additional updates – ‘first on watch’ date be added. EFS requested that two life funds, 350 Managed and 350 Tracker be included, and for analysis for these funds to be circulated prior to the next IAC meeting. NL
- The IAC reviewed funds that had been highlighted as “on watch” at the last meeting, but where no further action was deemed necessary:
 - **Invesco Perpetual UK Growth** – performance improved significantly over the last quarter against the peer group and the benchmark. In addition Old Broad Street Research (OBSR) have indicated that they have no concerns with this fund or the new manager (appointed June 08).
 - **Invesco Perpetual International Equity, Investec American, Fidelity Special Situations Blended, Schroder Managed Balanced** – the fund performance for all of these funds moved significantly ahead of benchmark to end June 09 on a one and three year basis.
 - **Societe Generale managed fund range** – NL explained that following the change in ownership to GLG, they have appointed a new fund manager (Ben Funnell, Head of Global Strategy at GLG Partners) as overall fund manager for

the managed funds, and have made personnel changes to strengthen the UK equity part of the team.

- **United Friendly fund range** - RT confirmed that short term underperformance of the United Friendly Far East was due to an underweight in Far East relative to Japan Managed.
- Discussion on the following action points took place during the meeting:
 - The UK/Overseas equity benchmark split
 - Fixed Interest fund
 - Duration bond funds
 - Life property fund structure
 - Artemis European Growth
 - JPMorgan Premier Equity Growth
 - Schroder UK Mid 250
 - UBS Managed and UK Equity funds

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

Information was presented by PM, RT and NL - the key points were as follows:

- Economic outlook – the outlook for expected nominal gilt yields over the next 10 years rose, but remained broadly unchanged over longer periods. Long and short term inflation expectations also increased. Short term equity volatility remains above its long term level, however it has moderated from the very high levels reported last quarter (currently estimated at 19.0% for UK versus 22.2% previously reported). There was a small reduction in the forecast credit risk premium of corporate bonds.
- The stochastic model was updated to reflect the new market conditions. The impact on the forecast asset class returns since the last quarter was, in summary, as follows:
 - Expected nominal returns from gilts over the short to medium term increased.
 - Expected nominal return from short dated corporate bonds has increased slightly, but remain stable over longer periods.
 - Expected real returns from equities are broadly unchanged, but in nominal terms have increased.

EFS queried the 10 year spot returns on different asset classes. PM to issue a note.

PM

- The IAC approved 55% UK/45% overseas equity benchmark split was evaluated as remaining appropriate – the analysis suggested that it continues to provide the equity mix that maximises the diversification benefit of overseas equities relative to a starting point that is 100% UK Equities.
- NL explained that there was a marginal increase in the long term volatility of some of the benchmark portfolios, and a slight decrease in expected real return of the benchmark portfolios. Overall however, these movements were minor, and the risk and reward statistics were close to those presented last quarter. The “risk versus reward” analysis indicated that, over the timeframe for which the portfolios and funds are designed;

- The benchmarks and tactical positions for eight of the nine Governed Portfolios continue to fall within their target ranges, although Governed Portfolio 8 has now moved to the edge of its target range.
- The benchmarks and tactical positions for all three Managed Funds continue to fall within their target ranges.
- Balanced Short and Adventurous short managed strategy benchmarks continue to fall beyond their risk target.
- The tactical positioning of Cautious Long managed strategy is towards the upper end of the target range.

Following discussion, the IAC decided that the current benchmarks should be maintained. The IAC continue to take the view that the Balanced Short and Adventurous Short managed strategy benchmarks will naturally move within target as equity volatility moderates, and agreed that a watching brief is appropriate for Governed Portfolio 8.

The IAC requested that RT reduce the risk being taken within the Cautious Long managed strategy, as it was felt to be on the high side currently.

RT

3. SHORT TERM TACTICAL VIEW OF THE RLAM CHIEF INVESTMENT OFFICER

RT advised that he continued to be happy with the tactical positioning that he had put in place across the portfolios in April 2009.

RT presented his short term tactical view:

The second quarter of 2009 continued the improving trend for risk assets that had started towards the middle of March. Over the period there was a distinct shift in investor's perspectives, largely driven by the fact that the economic data was signalling that the economic slowdown was occurring at a slower rate, leading to growing expectations that the recession was actually going to end at some stage. In reality financial markets were discounting an extremely bleak outlook in terms of recession and company prospects, and the simple fact that the news flow turned out to be less bad than expected, allowed for a significant improvement in risk asset valuations. This was further helped by the extension of supportive policy response worldwide of both a monetary and fiscal nature. Overall therefore risk premiums could fall and hence risk assets valuations could spike higher over the quarter.

The final positive for financial markets was the fact that companies appeared to be coping with the recession better than was feared and quarter 3 2009 started off with a stronger corporate reporting season than was expected. However the more constructive tone to economies and companies meant that government bond yields rose over the quarter despite monetary policy remaining extremely accommodative. For property there were further falls in capital values, largely through a lack of demand and further weakness in rental values driven by the weak economic background.

Despite markets having 'travelled' a fair way since the troughs of March – with most markets up between 40% & 50% - RT did not believe that we have as yet 'arrived'. The re-stocking process has only just begun, and RT expected trading conditions for corporates to continue to improve for a few more months. Overall therefore he saw growth re-emerging in all regions in the second half of 2009, which given still very

healthy margins should lead to reasonably strong company earnings. Where uncertainty remains is if, when, and to what extent, the consumer side of economies will revive. Without this then the growth profile will unlikely be particularly robust and doubts will emerge over the sustainability of the economic recovery. However, RT thought it too early to be positioning for such a setback to the growing mood of optimism and hence remains positively positioned towards risk assets.

RT maintains an overweight position in both corporate credit and equities. In addition he continues to have a preference for overseas equities over UK equities. RT is of the view that we are approaching the trough in terms of property valuations, and as index-linked bonds performed very well in the first quarter, his view was that it was appropriate to reduce the previous significant underweight position in property and reduce index-linked bond exposure. On balance however RT is not yet ready to take an actively positive view on the property sector.

4. SCOTTISH LIFE FUND REVIEW

Funds managed by RLAM

The following funds were identified for follow-up action:

Fixed Interest pension fund – NL explained that work is in progress with B&H to develop an “ex-ante” risk system. Following this, a proposal regarding the use of the risk budget associated with this fund will be submitted to the IAC.

NL

Duration bond funds – RT to conduct a review of the benchmark calculation. Carried forward.

RT

Life Property fund – DB suggested a way forward to restructure the fund, and will submit a proposal to the IAC for consideration.

DB

Managed fund – EFS requested a review of the difference in tracking error between the managed fund and governed portfolio 5.

RT

Matrix funds

The following funds were identified for follow-up action:

JPMorgan Premier Equity Growth – NL advised that the recommendation to the IAC was to seek a replacement fund. Long term past performance has been disappointing, and the view expressed by OBSR in a recent meeting with them was that the constraints and risk controls that apply to this fund are a disadvantage for future performance. The fund was de-rated by OBSR earlier this year. The IAC agreed that a replacement fund should be sourced.

NL

The following funds were highlighted as “on watch” for further detailed scrutiny at the next IAC meeting:

Schroder UK Mid 250 – whilst the longer term record of the underlying fund is strong, the short term performance is weak. For a limited period the underlying fund size was large, and NL explained that this may have presented difficulties in management of the fund. In light of the market downturn these issues appear to have eased, and it was noted that the fund continues to be AA OBSR rated.

NL

Close Teams – recent underperformance was attributable to an underweight position in banks within the UK element of their funds.

NL

Fidelity International – it was noted that the underlying performance is in line with the sector, and that Fidelity have made some changes to the structure of the fund as they believe it will improve efficiency and performance.

NL

Investec Global Free Enterprise – performance has been weak over the short and medium term, but underlying performance over 5 years is better. This fund uses a scoring system to identify stocks. This process has suffered throughout the volatile period in markets particularly where sector rotation has dictated the best performers, rather than individual company fundamentals. NL explained that that quant based processes in general have suffered but that OBSR continue to have confidence in the fund manager's ability. The fund remains AA OBSR rated.

NL

Artemis European Growth – NL explained that this is another fund that operates a quant based process which has also suffered in recent market volatility, however the fund continues to be AA rated by OBSR.

NL

Other external managed funds

No funds were identified as requiring follow-up action. The following funds were highlighted as “on watch” for further detailed scrutiny at the next IAC meeting:

Baillie Gifford fund range – performance weakened due to an underweight in the banks and mining sectors. NL explained that Baillie Gifford is long-term “fundamental” investors.

NL

UBS Managed and UK Equity – performance on these funds has improved considerably in recent months, although longer term performance remains weak.

NL

5. ROYAL LONDON FUND RANGE

No funds in this range required to be placed “on watch”. The following funds were identified as requiring follow-up action:

United Friendly Managed – RT confirmed that the benchmark for this fund was under review.

RT

6. DATES FOR 2009 MEETINGS

Tuesday 24 November at 10:30am

IMPORTANT INFORMATION

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



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