INVESTMENT ADVISORY COMMITTEE (IAC)
QUARTERLY MEETING

MINUTES OF MEETING HELD ON 31/05/2011

Present	In attendance	Apologies
John Deane Ewan Smith Andrew Barrie	Nick Leitch (Scottish Life) Lorna Blyth (Scottish Life) Helen Carter (Scottish Life) Emma Jones (Scottish Life) Graham Carson (Scottish Life) Robert Talbut (RLAM) Peter Watts (Barrie & Hibbert)	Mike Yardley Andy Carter David Bird (Royal London)

ACTION

1. REVIEW OF PREVIOUS MINUTES

The minutes of the 1 March meeting were approved and the action points arising from that meeting were presented by NL.

Action for NL to provide an annual evaluation of the IAC for review is carried forward. NL

RT commented that the differences in asset allocation of the Managed Funds compared to the relevant Governed Portfolios were now reduced. HC to speak to RT to discuss if there is scope to reduce differences further. HC

IAC requested confirmation that reporting data on the fund holdings is produced on a look through basis with deposits and futures reported separately in the fund factsheets. LB

IAC requested in future we include extra information on the performance of matrix funds following any fund replacement. GC

It was noted that we now have one year performance history for the 39 funds launched in March 2010.

Discussion on the following action points took place during the meeting:

- Asset allocations of Managed Funds and Governed Portfolios
- SL American pension fund
- SL Property pension fund
- Duration matched gilt funds
- Long Corporate Bond fund
- Bond fund restructure
- Blackrock Aquila funds
- Close Teams
- Schroder UK Mid 250
- Invesco Perpetual UK Growth
- Fidelity International
- Investec American

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

The key points were:

Economic outlook and asset forecasts

- Increase in short term inflation expectations.

- Short term equity volatility has reduced slightly but is unchanged for longer horizons. No change in expected real returns from UK equities although nominal returns have increased due to increase in inflation expectations.

- No change to expected returns and volatilities from overseas markets.

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 has slightly reduced from last quarter, mainly due to a small decrease in equity volatility.

Tactical Analysis

- RT made a tactical change on 10 March 2011. He increased the overweight position in risk assets (equities & corporate bonds), reduced the underweight position in index linked gilts, removed the position in long gilts & cash and maintained the underweight position in property.

The IAC had a lengthy discussion about the effects of different inflationary outcomes on the portfolios. General market consensus is that UK inflation is expected to remain an issue over the next eighteen months but will reduce over the medium term. It was noted that the current asset allocations of the portfolios are designed with inflation protection in mind however there was agreement amongst IAC members that we should consider an alternative economic scenario where UK and global inflationary pressures could remain more persistant for longer than expected. The IAC asked that analysis be carried out to inform what the benchmarks might be under this alternative economic scenario and also what the tactical asset allocations might look like.

PW/HC

3. SHORT TERM TACTICAL VIEW OF THE CHIEF INVESTMENT OFFICER

RT reviewed Q1 2011 and presented his rationale for his current short term tactical view:

"The first quarter of 2011 saw a fair amount of volatility after the more optimistic tone that had prevailed through the fourth quarter of last year. While the macroeconomic data generally showed the global economy to be making continued good progress in growth terms there were the first signs of the fact that the expansion was starting to proceed at a slower rate. While this was always likely to be inevitable, the evolution of the data did start to cause some caution in risk assets. Secondly there were some more signs that inflation was an issue for policy makers, which ignited the debate over the sustainability of the ultra low interest rates that had prevailed for a very long period. This was fuelled by further moves to tighten policy in China and other emerging nations given their very rapid rates of growth. Lastly there were some rising nerves over what would happen when the US ceased its policy of quantitative easing in June and the issue of sovereign debt security and solvency was returned to given the lengthening list of names where it was seen to be relevant. The last major influence was the rise of social and political unrest in North Africa and the Middle East. This had the effect of raising oil prices quite appreciably and overall raising levels of uncertainty relating to the region and how events would unfold.

The outcome of these various influences was that equities and credit still made some positive progress globally, while government yields rose slightly and property yields fell on continued investment demand. However the intra-period moves were far more volatile that the end points would suggest given the ebb and flow of the various news stories.

We retain the view that despite some slowing in progress that the global economy is in reasonable shape and that a healthy level of growth will be achieved for the year as a whole. We also see that policy makers will retain the ultra accommodative stance to policy and that the inflation concerns that exist currently will over time fade given the lack of second round effects into wage levels. Clearly the issues over the Middle East and sovereign debt are far less predictable or forecastable but have the potential to cause significant turbulence depending upon how they play out. On the latter we believe that policy makers will continue their efforts to 'kick the issue down the road' but it is always possible that markets suddenly decide not to allow this with potentially very disruptive effects.

Through the quarter our asset allocation remained overweight towards the risk assets of equities and credit while underweight towards index-linked and property on the basis that we see better returns in the former two. In addition we sold out of our remaining conventional gilts as they appeared relatively fully valued and we held little cash. Within equities we still remain overweight overseas versus the UK as valuations and fundamentals appear superior. Through the period we added to Japanese equities (both prior to and post the earthquake) on the basis of their relatively cheap valuations, and the likelihood of greater policy assistance. We have retained these strategic positions into Q2 on the belief that while progress for our preferred risk assets is unlikely to be smooth we still see the conditions of growth and low interest rates as being supportive of credit and equities."

4. SCOTTISH LIFE FUND REVIEW

Funds managed by RLAM

Governed Portfolios – Performance is below benchmark over 1 year but above over 3 years. This is due to a combination of tactical asset allocation decisions and the Property Fund. This year has been unusually volatile in terms of changing market views and our overweight position in equities has suffered due to events in the Middle East and the Japanese earthquake. However RLAM's view is that the global economic recovery will continue throughout 2011 creating a supportive environment for equities and corporate bonds.

American fund – There is an outstanding action point for RT to provide the data relating to the tracking error for the fund. RT

Property fund – Fund continues to underperform although the level of underperformance has improved since the last IAC meeting. A recent property swap and purchase of a prime retail property has improved

the quality of the portfolio and reduced the cash weighting from 14.5% to 11.8% as at end of March. A report is being prepared on the fund's liquidity and the appropriateness of the benchmark and this work is ongoing. RT will provide his views regarding the benchmark adjustment. NL/RT

Long corporate bond fund – The IAC requested JD to review the RLPPC guidelines with DB so that the use of swaps within this fund is documented. RT confirmed after the meeting that so far swaps have not been used within this fund. JD/RT

Duration matched gilt funds – Part of the underperformance from the previous meeting was reported to be due to a switch in the pricing basis to accommodate a bulk switch. EFS requested further investigation on this. It was noted that the funds are now outperforming. HC

Various bond funds – At the last meeting RLAM proposed changes to the Fixed Interest funds to provide wider diversification for customers and to make the management more efficient, without compromising the objectives of the funds. It was confirmed that RLAM would pay any costs of the inspecie transfer of assets and that there were no tax issues for customers. The appropriate rebates are in place and the changes are now live.

The changes to the Index Linked life fund are still to be approved. It was noted that although there is a tax disadvantage to customers the outperformance of the alternative fund has been consistent enough to overcome this. The IAC requested further confirmation of this and that the switch into the new fund would be made on an appropriate basis. It was noted that the fund may be required to change its benchmark. NL

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

Far East (ex Japan) – Fund performance is now below benchmark over 1 and 3 years and above over 5 years. NL

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

SL UK Special Situations – It was noted that this fund changed its name to SL UK Opportunities on 2 May. There were no other changes.

Matrix Funds

Schroder UK Mid 250 – This fund is due to be replaced in October 2011. NL confirmed that a mailing will be issued to all affected customers in July 2011. The replacement fund will be named once we have informed customers. NL

Blackrock Aquila funds – DB has produced a report as requested at the previous meeting. The IAC asked JD to review this work and ensure it's progressed. JD

Close Teams Global Equities and Global Alpha funds – Work is ongoing to source replacement funds. NL

Invesco Perpetual UK Growth – Performance over one year has improved although 3 and 5 year remain under benchmark. Although short term trend is positive IAC recommend that this fund remains on watch. NL

Fidelity International – At the last meeting it was agreed that the best approach would be to consider this as part of the work to review the Close Teams mandate. This work is ongoing. NL

Investec American – A replacement fund has been identified however since then we have been informed that the fund manager has been replaced. The IAC requested further comment from OBSR before a decision on the replacement fund is made. GC to follow this up and communicate OBSR's view. GC

Schroder UK Equity – It was noted that this fund has been awarded an A rating from OBSR.

Artemis European - This fund was replaced with Neptune European Opportunities Fund on 2 May.

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. The IAC requested further information from the fund manager to understand if the quant process used continues to be appropriate. NL

Invesco Perpetual Japan – This fund replaced JPM Japan on 19 October 2009 so only one year of performance is attributable to this fund. OBSR remain confident in its process and it retains its A rating. NL

The following funds were removed from "on watch".

JP Morgan US – Performance of the fund has improved over the quarter and the fund is now outperforming the benchmark over 3 years. The fund remains AA rated by OBSR.

Other external managed funds

SL/Blackrock Aquila World (ex UK) Equity Index – the annual fund management charge for this fund has reduced from 1.15% to 1% as a result of negotiating better terms with Blackrock Aquila.

SL/Investec Emerging Markets Debt – Investec have advised us of a name change to better reflect the fund's focus on "local currency" bonds. This name change took place on 2 May and there is no change to the underlying process.

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

Fidelity Special Situations Blended – This fund is a composite of two Fidelity funds, Fidelity UK Special Sits and Fidelity Global Special Sits. The fund has underperformed benchmark over 1 and 3 years. The IAC requested an analysis of the two underlying funds. LB

The following funds were removed from "on watch".

Newton Managed and Managed A – Performance for both funds above benchmark over one year. Remains AA rated by OBSR.

UBS UK Equity – Performance for this fund has improved.

Other Scottish Life funds

FSTE 350 Tracker – Fund performance is below benchmark across 1, 3 and 5 years. The IAC requested that RLAM investigate this. RT

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

American life fund – Fund performance is below benchmark across 1, 3 and 5 years, and is influenced by similar factors to the pension fund 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.

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.

7. DATES FOR 2011 MEETINGS

Next quarterly meeting is 23 August 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.

5M1121 June 2011