INVESTMENT ADVISORY COMMITTEE (IAC)
QUARTERLY MEETING

MINUTES OF MEETING HELD ON 23/08/2011

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

ACTION

1. REVIEW OF PREVIOUS MINUTES

The minutes of the 31 May meeting were approved and the action points were presented by NL.

Differences between the asset allocation of the Managed Funds and Governed Portfolios remain. Further clarification required. RT

The review of Close Teams and Fidelity International is ongoing. LB

RT provided data to explain the tracking error on the American pension fund and there is no further action required.

NL confirmed that data on the fund holdings is now being received in a new format.

It was noted that Scottish Life are launching ten new funds at the end of November.

The following action points are to be carried forward :
IAC annual evaluation report. NL
Inclusion of performance information following any matrix fund replacement. GC
Analysis of the two underlying funds within the SL/Fidelity Special Situations Blended fund. LB

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

- SL Property pension fund
- Long Corporate bond fund
- Duration matched gilt funds
- Corporate bond and duration bond funds
- Far East ex Japan
- Schroder UK Mid 250
- Invesco Perpetual UK Growth
- Investec American
- Investec Global Free Enterprise
- Blackrock Aquila funds
- Invesco Perpetual Japan
- Index Linked life fund restructure
- RLAM FTSE 350 tracker

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

The key points were:

Economic outlook and asset forecasts

- A fall in inflation expectations has resulted in a decrease in nominal yields from gilts and corporate bonds. The model shows low expected real returns from cash, gilts, corporate and index linked gilts over the short term and from index linked gilts over the medium term.

- Expected real returns from UK and overseas equities in sterling terms are broadly unchanged.

- As this analysis is as at end June the IAC asked B&H for their view of the impact of the recent market volatility. PW confirmed that their model takes account of both long and short term market conditions. Although recent market volatility will impact the short term forecast, the impact on the longer term benchmark forecast is marginal.

- The IAC requested benchmark performance of the Governed Portfolios from the end June to the current date to review the benefit to customers of being in a diversified governed portfolio during this period of high market volatility. GC

Benchmark Analysis

- It was noted that all the Governed Portfolios and Managed funds are within their benchmark risk targets and no changes were recommended.

- The IAC noted that in the current market conditions index linked gilts are showing a poor risk/return profile relative to other assets. However this is a central scenario which assumes that inflationary pressures persist in the future and there is some real growth in the economy. The IAC asked for a review of the impact on the benchmarks and requested a report to inform their view on whether index-linked gilts were overvalued or fair valued, on a longer term outlook. The expertise of the RLAM economist and head of fixed interest investments will be sought in preparing the report This will be presented alongside a B&H report on the impact of inflationary pressures on the GP benchmarks. AC

Tactical Analysis

- RT made a tactical change on 16 June 2011. Broadly he increased the overweight position in risk assets (equities & corporate bonds), increased the underweight position in index linked gilts and maintained an underweight position in property.

3. SHORT TERM TACTICAL VIEW OF THE CHIEF INVESTMENT OFFICER

RT reviewed Q2 2011 and presented his rationale for his current short term tactical view:

"Volatility was the key word to describe the second quarter of 2011. This encompassed not only the economic data but increasingly market participant's views around policy maker's actions and statements. In contrast corporate results appeared generally in good shape and their finances remained strong.

Throughout the second quarter the overall trend was for a gradual loss of momentum in growth particularly in the developed markets. Trends of employment failed to show any further improvement, as did survey data covering the manufacturing and service sectors, while the consumer appeared reluctant to increase spending. However uncertainty remained as to how much of this stalling of momentum was due to the ripple effects of production and supply chain disruption post the Japanese tsunami. The general assumption was that this had had a material impact upon production and that economies were also still dealing with the negative impact from higher oil prices caused by political turbulence in the Middle East. We shared the view that with oil prices falling back from their first quarter spike and then the rebuilding of production and inventory that the growth outlook would improve. This confidence was reinforced by virtually all of the company contact that we had where managements remained confident over their own prospects and where profit forecasts were holding up.

However the other area where clarity appeared somewhat lacking was in the area of policymaking. Against a background where the ECB were starting the process of increasing interest rates markets were confronted with various efforts to stabilise resurfaced concern over the sovereign debt position of a growing number of EU countries. The conclusion was that we had moved beyond a process whereby individual country positions could be addressed individually and markets were increasingly calling for a far more comprehensive solution covering the whole of the EU. Part of the reason for some of the market volatility throughout the period involved rising or falling optimism on the prospects for such a deal. As mentioned last quarter this issue did have the capacity to cause significant disruption to financial markets but the belief persisted that ultimately a suitable policy response would be forthcoming. There were also concerns regarding the debt situation in the US and how this was to be addressed.

Hence we were confronted with still good corporate fundamentals contrasting with growing uncertainty over macro/political policy response. Our house view remained that disruption from policy would not be sufficient to derail the global economy through this year and into 2012. This belief was aided by still good growth coming through from the more emerging nations, despite some tightening in policy rates.

Therefore in combination global growth forecasts remained quite robust into next year with interest rates still very low provided what we saw as a helpful background for corporate related securities, both bonds and equities. We believed that prospects were better than existed in property, where valuations of good quality assets remained essentially unchanged and pretty rich, and in index-linked securities which had very low real yields – much lower than on corporate securities. Hence our asset allocation remained unchanged throughout the period as we believed the period of volatility would ease as policy uncertainty was removed allowing investors to refocus upon the growth outlook and attractive corporate valuations."

4. SCOTTISH LIFE FUND REVIEW

Funds managed by RLAM

Governed Portfolios – Performance is below benchmark over 1 year but above over 3 years. Analysis shows the 1 year underperformance is due to a combination of tactical asset allocation decisions and weaker Global Managed fund performance against benchmark.

Property fund – Fund performance over 1 year has improved slightly and the fund is now 2nd quartile relative to peers over 1 year. Fund will remain on watch until overall trend is positive. A report covering proposals on the fund liquidity and the benchmark has been drafted and will be reviewed out with the IAC NL

Long Corporate bond fund – JD confirmed that he is comfortable that the use of swaps is consistent with RL policy and the IAC approved the use of these for efficient portfolio management to obtain the required duration.

Duration matched gilt funds – The previous underperformance was only significant in the long dated gilt fund and was caused by the impact of large inflows and outflows during the year. There are difficulties in estimating the benchmark and the IAC agreed that the process to calculate the benchmark should be reviewed. SM/GC

Corporate bond and duration bond funds – The IAC noted a marked difference between the performance of the corporate bond fund and the duration bond funds over one year. RT to investigate. RT

Far East (ex Japan) – Fund performance over 1 and 3 years has worsened against benchmark although the 1 year peer ranking has improved. The fund remains on watch.

Matrix Funds

Invesco Perpetual UK Growth – Performance continues to improve and year to date is 9th percentile. The IAC recommended that this fund remains on watch.

Schroder UK Mid 250 – This fund will be replaced in November 2011 with the Rensburg UK Mid Cap Growth fund. This will be changed to the Franklin UK Mid Cap fund from 17th October. A mailing has been issued to all affected customers and advisers.

Investec American – It has been agreed to replace this fund with Fidelity American in November 2011. A mailing has been issued to all affected customers and advisers. The new fund has a strong track record and is rated A by OBSR.

Investec Global Free Enterprise – Performance has continued to improve and the IAC agreed to remove this fund from watch.

Blackrock Aquila funds – This work is now being progressed as part of a wider project within RL looking at the tracking of all external funds. JD

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

Invesco Perpetual Japan – This fund has underperformed benchmark over 1 year. The fund is within our higher volatility range and OBSR remain confident in its process. It continues to be rated by OBSR.

The following fund was discussed but no action was taken.

Fidelity European Blended – This fund has slightly underperformed over 1, 3 and 5 years. The fund consists of a blend of two underlying funds, Fidelity European and Fidelity European Opportunities, both of which are OBSR rated.

Other external managed funds

SL/Fidelity UK Growth – Performance against benchmark is marginally negative over 1 and 3 years while performance over 5 years remains positive.

SL/Investec Blue Chip – Performance marginally behind benchmark over 1 year with larger underperformance over 3 years.

SL/Baillie Gifford High Yield Bond – The fund has significantly underperformed over 1 year. The IAC have requested that this be investigated and also to ensure the correct benchmark is being used. GC

Newton Managed – There is a significant difference between performance of the "A" funds and "non A" funds. This is to be reviewed as part of the wider external tracking project.

UBS Global Blend – There is a significant difference between performance of the "A" fund and "non A" fund. This is to be reviewed as part of the wider external tracking project.

Other Scottish Life funds

Index linked life fund – Discussions have been ongoing regarding moving this fund from a direct investment to an OEIC structure. The IAC have reviewed analysis and requested further work to show a summary of the impact of costs and in particular the tax charges and also a copy of the customer communications before approving this change. LB/AC

FTSE 350 Tracker – Investigation into the tracking against benchmark continues. RT

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

FSTE 350 Managed fund – Fund performance is below benchmark across 1 and 3 years but is above benchmark since launch. Schroders have confirmed this is due to a combination of a modest cash position and an overweight in mining and support services sectors causing a drag on performance.

5. ROYAL LONDON FUND RANGE

UTD Friendly Life UK Equity – Performance is below benchmark over 1 and 3 years. The IAC requested commentary from RT to explain this. RT

UTD Friendly Life UK Managed – Performance is below benchmark over 1 and 3 years. The IAC requested commentary from RT to explain this. RT

RIL Equity – Performance is below benchmark over 1 and 3 years. The IAC requested commentary from RT to explain this. RT

UFLA American – Slight underperformance against benchmark over 3 years. No action required.

7. DATES FOR 2011 MEETINGS

Next quarterly meeting is 29 November 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.

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