INVESTMENT ADVISORY COMMITTEE (IAC)
QUARTERLY MEETING

MINUTES OF MEETING HELD ON 03/09/2013

Present	In attendance	Apologies
Julius Pursaill (Chair) Ewan Smith Colin Taylor Andy Carter Hugh McKee Phil Loney	Nick Leitch (Scottish Life) Robin Herd (Scottish Life) Patrick McGrath (Scottish Life) Robert Dundas (Scottish Life) Lorna Blyth (Scottish Life) Robert Talbut (RLAM) Robert Whitehouse (RLG) Peter Watts (Barrie & Hibbert)	

ACTION

1. REVIEW OF PREVIOUS MINUTES

The minutes of the 7th June meeting were approved with discussions on the following action points taking place during the meeting:

- GRIP risk target analysis
- Economic scenario testing within Governed Portfolios
- Efficiency triggers with Governed Portfolios / GRIPs
- Internal fund review
- SL FTSE 350 Tracker life & SL FTSE 350 Managed life
- SL Property
- SL Global Blend Core Plus (Close TEAMs Global Alpha)
- SL Global Managed Equity Core Plus (Fidelity International)
- SL Emerging Markets Specialist (First State Global Emerging Market Leaders)
- SL/Fidelity American
- SL/Fidelity UK Growth
- SL/Neptune European Opportunities

2. PROJECTS

Infrastructure Investigation

RT remains engaged with the NAPF over an infrastructure solution. This is a medium term development so no immediate progress expected. RT

Scenario testing within Governed Portfolios

The IAC agreed that looking at the portfolio returns from a scenario test perspective would be beneficial, and a complement to the mean variance analysis approach. It would bring an appreciation of how the portfolio performance might change according to differing economic conditions and asset mixes. A framework report was presented which was well received. The next stage is to turn this into a live document - RT will use B&H stochastic data to help construct economic scenarios and the impact for asset classes. RT will overlay this with his view on current asset valuations. RT

Criteria for assessing proposed changes to strategic benchmarks when they trigger "inefficient"

The new portfolio must first pass a 'materially better' assessment. The test was presented to the IAC and they approved it. RT will review the transaction cost assumptions. RT

Risk tolerance targets for GRIPs.

These will be reviewed and a proposal presented at the next meeting. EFS

3. CUSTOMER INVESTMENTS

GOVERNED PORTFOLIOS & MANAGED STRATEGIES

Benchmark analysis

No changes were recommended to the Governed Portfolio and Managed Fund benchmarks this quarter. GP3 is the only portfolio to trigger as inefficient but this is only by a marginal 2%. It was agreed that this did not require a change this quarter.

Tactical analysis

All portfolios remain within their tactical risk budgets. Robert Talbut made one tactical change within the portfolios since the last meeting.

On 13th June he removed his position in cash and increased the overweight in equities. He continues to also be overweight in global high yield and underweight in index linked gilts, corporate bonds and property.

GOVERNED RETIREMENT INCOME PORTFOLIOS

Benchmark analysis

No changes are recommended to the strategic benchmarks this quarter. They are all outwith the risk targets at the minimum level however this has highlighted the risk measures are too sensitive to small changes. This issue is covered in the separate risk target analysis noted in section 2.

Tactical review

All the portfolios are within their tactical risk budgets. Robert Talbut has made one tactical change within the portfolios since the last meeting.

On 13th June 2013 he removed the overweight position in cash and placed the proceeds into equities. He is currently overweight equities and underweight in index linked gilts, corporate bonds, high yield bonds and property.

LIFESTYLE PATH ANALYSIS

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

SHORT TERM TACTICAL VIEW OF THE CHIEF INVESTMENT OFFICER

RT reviewed q2 2013 and presented his rationale for his current short term tactical view:

"The second quarter of the year saw a marked contrast between more encouraging news flow on the economic front contrasting with negative returns from both bonds and equities. The key ingredient in explaining this was the initiation of a debate in the US about how and when to start to remove the monetary stimulus that has been in place since the financial crisis. How this policy change plays out is likely to be the dominant influence upon financial markets over the next 12-24 months with the potential for increased volatility and uncertainty as market participants respond to the removal of some of the catalyst for the pricing and performance of all asset classes.

However we did see more evidence of economic recovery starting to take hold in the developed markets as we witnessed improved housing, employment and survey data in the US and UK and in Europe not only a stabilisation in the data but even some signs of improvement both in the core countries but even in the periphery. Overall this led to some gentle revising up of economic forecasts for H2 and into 2014 as the belief grew that economies could build further momentum on the back of improved consumer and in particular industrial confidence. The latter is particularly important as we need to see a turnaround in business capex spending if we are going to see more robust economic performance. However in the shorter term the improvements in the UK and US have been led by activity levels in housing picking up, helped in the former case by some specific government measures.

In contrast to improvements in the developed world, there were signs of strain in the developing world. For example in China the new leadership's continued efforts to rebalance the economy away from its dependence upon exports led to concerns over the overall growth rate for the economy and then credit quality and over investment issues. Elsewhere a number of nations were confronted by capital outflows for the first time in a number of years given the potential for higher yields in the US and this led to equity markets performing quite poorly through the quarter. Overall there was a marked shift in fund flows out of EM and into DM equity markets which further extended the outperformance of developed equity markets over developing which has been in place for over 12 months now.

The rising debate over the potential for withdrawing or 'tapering' of monetary stimulus led to a significant backing up in bond yields and increasing talk over the end of the 30-year bond bull market. Arguably what we are seeing is a correction in the prices of developed market government bond prices which became severely distorted by the actions of central bankers and these are now gravitating towards a more realistic level as monetary policy is normalised. Equity markets have had to contend with this rising in the discount rate as bonds sold off versus the positive belief that economic recovery would lead to improved earnings. The interplay between these two forces resulted in marginal rises in global equities over the quarter which was in contrast to falls of between 4% & 6% from gilts and index-linked in the same period.

Over the quarter our asset allocation positions became more pro-equity when we took the decision to shift the corporate credit position underweight given both our belief in rising yields but also the tightness of credit spreads which had occurred. The proceeds were invested into equities, and in particular the UK market, and we also reduced the underweight position in property as we see relative returns as being better than in fixed income.

Our view on the outlook is that the path away from monetary stimulus is very unlikely to be smooth but that it is necessary to prevent financial markets becoming too dependent upon the policy. However we expect the withdrawal to be undertaken very cautiously in order that disruption is contained as far as possible and that the economic recovery is not jeopardised. In reality this should be seen as a sign that normality (of a sort) is being returned to, albeit that it will not look and feel like the 'reality' that existed prior to the financial crisis. Overall we see a world of relatively modest returns given that the process of healing government finances and the banking system still has a long way to go. Given this view we see equity returns being in excess of fixed income."

4. FUND OPERATIONS REVIEW

Tracking differential update – Paper is to be submitted internally to agree what actions are to be taken on the funds involved in this review. Further update to be provided once this paper has been agreed. RW

FTSE 350 tracker and active funds – An impact analysis study is to be done prior to transitioning the assets and communicating to customers. Further update to be provided at next meeting. NL

5. SCOTTISH LIFE FUND REVIEW

Governed Range

The following investments were highlighted as requiring action:

Governed Portfolios – The portfolios had a strong second quarter in 2013. Two consecutive quarters of outperformance has resulted in the portfolios outperforming their benchmarks over 1 year. All funds within the portfolios contributed above benchmark performance. The 3 year figures are still being affected by historic performance and are therefore underperforming.

Work to show the effectiveness of the tactical asset allocation changes that have taken place since the launch of the portfolios is ongoing and will be included in future reports. PMcG

Work to understand the impact of cash on a "look-through" basis within the portfolios is also ongoing. This is where underlying funds have their own cash holdings for liquidity purposes and the IAC want to fully understand the effect this cash has on diluting the overall asset allocation. This analysis will be included in a future report PMcG

The following funds/portfolios were discussed:

Close TEAMs Global Alpha – This fund was replaced with the Rathbone Global Alpha fund on 19th August 2013. The fund is now called the SL Global Blend Core Plus (Rathbone Global Alpha).

SL Global Managed – The fund added a second consecutive quarter of outperformance resulting in strong year to date and 1 year performance. 3 year performance remains poorer but the 5 year track record has strengthened further.

Other funds managed by RLAM

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

Property pension – The 2 acquisitions for the fund approved at the last meeting have gone ahead. Along with a strong flow of purchases (£160m purchased YTD) this work has reduced the cash level to approximately 19%. The team continue to work hard to reduce the cash level without resorting to buying poor quality assets or paying too high a price to secure properties. RH

The following funds were discussed and no action was taken:

European pension – Fund is now being run to a tactical growth/income split. The split is currently 77% growth and 23% income. This is the most appropriate split based on RLAMs view that economic prospects are generally constructive and that this is more helpful for a growth portfolio focused upon capital appreciation than one which is more balanced in its approach.

Global Equity - Fund performance over the short term is above benchmark however the 3 & 5 year figures have worsened. Historical performance is still affecting the longer term numbers.

Short & Medium Index Linked Gilt - Fund performance against benchmark has improved over the short term with the longer term performance now only being marginally below benchmark.

The following fund has improved and is no longer on watch:

UK Opportunities

Matrix Funds

The following funds were highlighted as requiring action:

Fidelity International – This fund will close week commencing 11th November and assets will be switched to the SL Global Blend Core Plus (Rathbone Global Alpha) fund. Communications have been issued to all policyholders and their advisers affected by this change. RH

First State Global Emerging Market Leaders – This fund will soft close on 7th September 2013. Only regular existing premiums can continue to be accepted without incurring an initial charge. The fund will no longer be available for new or incremental business. RH

Close TEAMs Global Equities (1%) – This fund is to be closed and the assets switched into SL Global Managed. Target date for completion of this closure is week commencing 11th November 2013. RH

Fidelity American – The fund underperformed the benchmark marginally in Q2 2013 but performance against peers is much stronger. It is also outperforming the fund it replaced. The new manager came on board in February 2013 and has moved the fund to focus more on US domestic stocks particularly growth orientated ideas in light of the positive newsflow from the US economy. RH

Neptune European Opportunities – The fund outperformed in Q2 2013 and the manager is actively managing the fund to seek significant outperformance. A 30% holding in European financials illustrates the specialist nature of this fund and that the manager expects this sector to outperform in 2013. This stance has been rewarded so far this year but has yet to be reflected in the longer term figures. RH

Other external managed funds

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

Fidelity UK Growth – Fund performance has been flat over the quarter however poor historic performance dropping out has significantly improved the 1 year number. There has also been some improvement in the 3 year track record. RH

The following funds were discussed but no action was required:

Fidelity Special Situations Blended – Fund performance has improved significantly over the quarter having a positive effect on all but the 3 year track record.

Jupiter Financial Opportunities - Fund performance over the quarter has been relatively positive however the fund is underperforming over 1 & 3 years.

Jupiter India - This fund is significantly underperforming the benchmark. Performance in 2012 & 2011 was strong with a poor 2013 affecting the longer term track record.

Jupiter Merlin Worldwide Portfolio - The fund is underperforming the benchmark over 1 & 3 years.

Legg Mason US Smaller Companies – The fund continues to underperform over 1 & 3 years although remains bronze rated by Morningstar OBSR.

M&G Global Basics – The benchmark for this fund is the sector average. Compared to this benchmark the fund is significantly underperforming over 1 & 3 years. A strong overweight position in gold taken since 2011 has been the biggest detractor for performance.

M&G Recovery - This fund outperformed significantly over Q2 2013 but still underperforms historically over 1 & 3 years.

Neptune Global Alpha & Neptune Global Equity – Historic performance in 2012 still impacts the funds. YTD performance has also been impacted by overweight positions in emerging markets and Japan. They remain positioned in Japan expecting a longer term improvement but have reduced emerging market exposure in favour of developed markets where they currently see more value.

Newton Balanced & Newton Managed - These funds are underperforming their benchmarks over 1, 3 & 5 years despite peer positioning year-to-date being positive. Latest quarter's underperformance has been marginal.

Schroder Global Property Securities – Fund performance improved again over the quarter which has subsequently helped the 1 year track record. The 3 year figure is broadly unchanged.

Schroder US Mid Cap - Fund performance has marginally improved over the quarter helping the 1 & 3 year track record. Peer positioning over the short term remains strong.

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

Henderson China Opportunities, JPM Cautious Total Return, Jupiter Ecology, Threadneedle Absolute Return Bond.

6. DATE FOR NEXT MEETING

The next quarterly meeting is 13th November 2013.

IMPORTANT INFORMATION

Past performance is not a guide to the future. Prices can fall as well as rise and you may not get back the full amount of capital invested. Investment returns may fluctuate and are not guaranteed.

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