INVESTMENT ADVISORY COMMITTEE (IAC)
QUARTERLY MEETING

MINUTES OF MEETING HELD ON 22/08/2014

Present	In attendance	Apologies
Julius Pursaill (Chair) Ewan Smith Colin Taylor	Robin Herd (Scottish Life) Patrick McGrath (Scottish Life) Lorna Blyth (Scottish Life) Robert Talbut (RLAM) Robert Whitehouse (RLG) Peter Watts (Moody's Analytics) Gareth Dickinson (RLAM) Chris Cormack (RLG)	Phil Loney Isobel Langton Andy Carter

ACTION

1. REVIEW OF PREVIOUS MINUTES

The minutes of the 28th May meeting were approved with discussions on the following action points taking place during the meeting:

- Accessing Infrastructure as an asset class
- Changes in default investment proposition in light of budget changes
- Impact of cash dilution on asset allocation analysis
- SL Property
- SL UK Smaller Cap Specialist (Investec UK Smaller Companies)
- SL/Neptune Balanced & Global Equity
- SL/Jupiter Merlin Worldwide

2. PROJECTS

Investment default design and budgetary impact

We are about to begin a research project with corporate advisers to test our framework and design. The results of this will inform our approach. LB

Infrastructure Investigation

The IAC agreed that the previous work which identified infrastructure as a potential asset class of interest should be revisited and updated. In addition to this SL continue to have discussions with fund management companies around how a potential solution could be structured. Further updates on this will be provided as this is progressed. RT/RH

Impact of cash dilution to asset allocation of the Governed Portfolios

Cash levels within SL Global Managed have stabilised at a lower level. SL will continue to monitor cash levels to ensure cash remains within acceptable levels. The IAC agreed that no further action was necessary and this will now be incorporated into the quarterly report.

Property – mandate review

Recommendation accepted to widen the investment mandate of the Property fund to allow the team to make use of other investment strategies such as lend lease agreements, money market vehicles and other property sectors. RW/LB

Governed Portfolios & GRIPs – Tracking error limits

As part of our proactive, internal governance process, the Royal London Board Investment Committee (RLBIC) reviews aspects of the investment proposition periodically. An action from the last RLBIC meeting was to review the Governed Portfolio and GRIP tracking error targets. They commented that the actual tracking error of the portfolios was historically low compared to the targets and felt a review of these measures would be prudent.

It was highlighted by the IAC that the tracking errors have been lower than expected due to low market volatility and that there is significant risk within markets that is not being reflected in the figures.

The IAC agreed that this review will be carried out after the conclusion of the budget change work. The review will include the other strategic measures and analysis will be reported to the RLBIC. A work plan will be sent to RLBIC in time for their October meeting. RD

3. CUSTOMER INVESTMENTS

STRATEGIC ANALYSIS

Governed Portfolios & Managed Strategies

No changes are recommended to the Governed Portfolio and Managed Fund benchmarks this quarter. All the portfolios are reporting as efficient with the exception of Governed Portfolio 3. The real return is small and so increasing efficiency would require substantial changes with a very modest increase in return and the IAC were comfortable that the efficiency level would continue to be monitored but no change would be made this quarter.

Governed Retirement Income Portfolios

No changes are recommended to the strategic benchmarks this quarter. The portfolios are now 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.

Update to Moody's Analytics model

The economic model that underpins the Governed Portfolios is reviewed and updated regularly to reflect the latest views. This quarter there were some bigger changes to the model that were noted by the IAC. These were as follows,

- Interest rate model changes
- Change in supplier of credit data
- Change in the property return calibration model

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

All the portfolios are within their tactical risk budgets. No tactical changes have been made since the last meeting. The portfolios remain overweight in equities in favour of investment grade & high yield corporate bonds, index linked gilts and property.

Short term tactical view of the Chief Investment Officer

RT reviewed Q1 2014 and presented his rationale for his current short term tactical view:

"With the close of the second quarter, deep cross-currents continue to occupy investors, some positive, others less so. Equity markets have continued to rally, reaching fresh highs in May and June, credit markets have remained buoyant, and M&A activity has rebounded as economic growth appears to be moving into an expansionary phase. However, whilst financial markets have been resilient with remarkably low levels of volatility, challenges such as rising geo-political risks, excess debt, government deleveraging, and an ongoing reluctance on the part of consumers to increase spending, may be poised to impact returns going forward.

While investors continue to keep an eye on these challenges, strong manufacturing and employment data, despite a negative GDP reading for the first quarter and lowered 2014 GDP expectations, coupled with current guidance on the trajectory of US monetary policy, have provided reasons for optimism in recent months. Also, recent signs of a renewed focus on corporate capex also appear to point to growing business confidence levels and bode well for longer-term economic growth. The US appears to be shifting to the expansionary phase in the cycle, though monetary policy may be lagging in an unprecedented manner. We believe this potential asymmetry has important implications for the trajectory of interest rates and the potential for inflationary surprises from uncomfortably low levels seen today. Set against this, US equities continue to trade at elevated levels compared to historical averages.

In Europe, the European Central Bank (ECB) has continued to seek to invigorate the economy with a series of monetary easing measures designed to lift inflation and encourage growth. Low inflation is becoming entrenched across most Eurozone countries and in many components of the consumer price index. At the same time, Europe remains the most exposed to the growing geo-political risks surrounding the stand-off between the West and Russia over the Ukraine, and its potential impact on energy supplies and business confidence.

After the performance reversal in early 2014, many investors abandoned Japanese equities. In the near term, reforms to the corporate tax code, a potential asset allocation shift into equities by domestic institutions, coupled with an orderly absorption of the April sales tax hike, we believe should provide support to the equity market and attract renewed flows from global investors.

Elections have been a major focus in a number of Emerging Markets (EM) so far in 2014, with many around the world hoping that new governments can do more to unleash the economic potential of these regions. This is especially true of India, where the National Democratic Alliance, led by the BJP, won a sweeping majority on a pro-reform anti-corruption platform. In China, leading manufacturing indicators in Q2 have shown signs of stabilisation after weakening earlier in the year. Although the country's property market continues to slow, infrastructure investment and consumer spending have remained resilient which has support construction and economic activity as a whole.

In the UK, economic data has exceeded rising expectations with GDP now around its pre-recession peak in 2007. The latest Purchasing Managers' Index was also positive for all nine regions of the UK, a sign that the recovery is spreading beyond London. With rising house prices having supported much of the consumer-led recovery to date, and the pace of job creation exceeding expectations, Mark Carney the Bank of England Governor began signalling that interest rate hikes could come earlier than the market had anticipated. However, with real wage growth struggling to gain traction and household debt still at high levels, we expect UK interest rates to normalise at lower levels.

This economic backdrop resulted in strong performance for UK commercial property. More specifically, take-up in Central London offices in the second quarter was 18% above the 10 year average, which has led to the availability rate reaching its lowest point since the first quarter of 2008. The combination of strong take-up, tight availability, and the lack of supply until 2016 are expected to lead to a resumption of speculative construction.

Returns on Fixed Income risk assets in the developed economies should be positive, but lower than in the post-2009 recovery phase. Risk asset returns tend to be modest but positive in the expansion phase and there is little to suggest that will not be the case this time. While we see a supportive default environment in Credit, we remain conscious that as interest rates rise and the business cycle matures, allocators may begin to unwind the credit carry trade and shift positioning into equities. In Government bonds, we believe that the current rate environment offers insufficient compensation for bearing central bank policy and potential inflation risks. Furthermore, market volatility could increase more than normally expected for this phase of the cycle as the probability of an external factor such as an energy supply shock centred on the Middle East and the Ukraine rises.

The developments in the first half of 2014 serve as a reminder that no matter how clear the outlook may seem markets are always subject to unforeseen events from weather to geopolitical news or substantial revisions to economic data. In developed markets, recovery in the US has come in fits and starts, but the overall trajectory remains positive. Decisions made by central banks and policymakers will continue to play a major role in shaping the macroeconomic landscape, with much of what lies ahead dependent on the ECB's ongoing actions and Japan's continued efforts to foster growth and fuel inflation. In EM, recent and pending elections alongside a tumultuous geopolitical environment have made it more important than ever to take a cautious and measured approach when evaluating individual countries and investment theses. Furthermore, we also view the current level of market volatility, which reached historical lows towards the end of the quarter, as unsustainable and fully expect a rise from current levels.

We have not altered our asset allocation through the period and notwithstanding the recent move in equities to record highs, we still see them offering the best mix of risk and return against a backdrop of high bond valuations, negative real yields, and the ongoing difficulty of finding attractive property assets and the negligible return on cash. Hence we remain overweight equities at the expense of small underweights in all other asset classes. "

4. SCOTTISH LIFE FUND REVIEW

Governed Range

The following funds/portfolios were discussed:

Governed Portfolios – The Governed Portfolios are continuing to perform well over both 1 & 3 years , however the equity portion of the portfolios has experienced some short term underperformance due to the recent market rally to large & mega cap stocks. This is seen as a short term correction in markets and that longer term a bias to more mid & small cyclically focussed stocks will benefit the portfolios.

Other funds managed by RLAM

The following funds were discussed and no action was taken:

Adventurous Managed and equity funds – As mentioned above these funds are being impacted short term by the recent market rally to large & mega cap stocks. RLAM maintain a house view that this is seen as a short term correction in markets and that longer term a bias to more mid & small cyclically focussed stocks will benefit the funds.

Matrix Funds

The following funds were highlighted as requiring action:

Investec UK Smaller Companies –Morningstar Investment Management Europe Ltd (formerly Morningstar OBSR) have now met the new manager twice and are comfortable that the fund is being run appropriately. Performance continues to be strong but fund will remain on watch. Morningstar have suggested that there are funds in this sector that may perform better in the future and will feedback with suggested replacements over the quarter. RH

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

Fidelity European Blended – This fund continues to underperform. The underlying Fidelity European Opportunities fund has been impacted by the recent rally in large cap, defensive stocks. The fund is positioned in more cyclically focussed companies which have not been rewarded.

JPM US – A second consecutive quarter of underperformance has caused this fund to trigger with 1, 3 & 5 year time periods all showing below benchmark performance. The fund was impacted by some large drops in specific stocks particularly in financials.

Other external managed funds

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

Neptune Balanced & Global Equity – These funds have had significantly poor performance over the last 3 years. SL met with the manager to discuss performance issues and their commitment to these funds going forward. Performance has been affected by a bias to emerging markets which in the last 3 year have been out of favour compared to developed markets. The manager has adjusted the portfolios and they will remain on watch until Q1 2015 to monitor fund performance.

The following funds were discussed but no action was required:

BlackRock UK Equity - The fund has underperformed significantly over the quarter impacting the track record over one, three and five years.

Fidelity Special Situations Blended - The fund has underperformed for the second consecutive quarter causing the one year track record to worsen. Historic performance is still also affecting the five year figure.

Fidelity UK Growth - This fund has underperformed significantly over the quarter although is still outperforming over 1 year. Historic performance is also affecting the 3 & 5 year figures.

Investec Emerging Local Currency Debt - The fund has performed strongly over the quarter improving the longer term numbers however the fund is still underperforming over 1 & 3 years.

Jupiter Financial Opportunities - The fund has significantly underperformed over the quarter bringing the longer term 1& 3 year numbers below benchmark.

Jupiter Merlin Worldwide Portfolio - Fund performance has improved over the quarter and has subsequently improved over 1 year. Historic poor performance is still affecting the 3 year figure. SL met with Jupiter in late May to raise performance issues and some due diligence matters which we will continue to monitor. Reasons for underperformance were due to sector choices where the market went against a cyclically positioned portfolio.

M&G Global Basics - The fund underperformed over the second quarter with historic performance still affecting the longer term 3 year figure.

M&G Recovery - The fund has significantly underperformed over the second quarter and triggers over 1 & 3 years.

Newton Balanced & Managed - These funds underperformed over the quarter and continue to be under benchmark over the longer term.

Schroder Global Property Securities – The fund has marginally underperformed over the quarter and continues to be under benchmark over 1 & 3 years.

Schroder US Mid Cap - Fund performance has improved over the quarter helping improve the longer term 1 & 3 year track record.

Threadneedle Latin America - Fund performance has improved over the quarter helping improve the longer term 1 & 3 year track record.

UBS Global Blended - The fund again underperformed over the quarter with the 5 year track record also being impacted by severe historical underperformance.

UBS UK Equity - This fund improved over the quarter helping the 3 year figure. The 5 year track record is still being impacted by severe historical underperformance.

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

Investec Global Energy, JPM New Europe, Jupiter India, Legg Mason US Smaller Companies.

6. DATE FOR NEXT MEETING

The next quarterly meeting is 26th November 2014.

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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