Investment Advisory Committee (IAC) Quarterly Meeting

Minutes Of Meeting

Date
2/6/2015

Present members	In attendance
Julius Pursaill (Chair)	Robin Herd
Colin Taylor	Robert Dundas
Andrew Carter	Natasa Margariti
Ewan Smith	Lorna Blyth
Rachel Elwell	Piers Hillier
Isobel Langton	Trevor Greetham
	Robert Whitehouse

Owner

1. **REVIEW OF PREVIOUS MINUTES**

The minutes of the 24 February meeting were approved with the following correction:

Under "Investment default design and budgetary impact" it was stated that a paper would be issued for approval, however it was noted that this is for consideration by the IAC, not approval. The minutes are updated with the following statement –

"A paper on our investment default will be provided to the IAC for consideration before the next meeting."

2. **PROJECTS**

Governed Portfolio tactical budgets — RD/TG

As part of ongoing internal governance, the Royal London Board Investment Committee tasked RLP to review the risk metrics for the Governed Range to ensure they are still appropriate. It is planned that this work will form part of a wider investigation around the use of the strategic and tactical asset allocations and the interaction between RLAM, RLI and Moody's Analytics. This exercise is to ensure that the asset allocation strategies used are the most effective and ultimately allows RLP to deliver an appropriate outcome for customers.

In discussing this topic the IAC debated the use of the tactical asset allocation budget which has been lower in recent years. This has been a deliberate position taken by Royal London Asset Management due to the uncertainty in market movements and their view that the markets are not adequately pricing in risk.

The IAC did comment strongly that more frequent tactical decisions could be taken and asked RLAM for comment, particularly around the bond exposure within the portfolios. They specifically queried the apparent contradiction in allocation between index linked gilts and corporate bonds given their views and allocations in other strategies.

PH commented, "The GP's underlying benchmark seeks a real return (inflation adjusted) and therefore of all the asset classes in the mix, index linked bonds provide the closest proxy for the benchmark. As such any major position versus this asset class uses a significant proportion of the risk budget. Given that there are no conventional government bonds in the benchmark, in order for us to implement our preferred top down asset allocation strategy, in favour of equities versus bonds, we have had to run an underweight position versus the benchmark in corporate bonds."

IAC noted that RLAM have gone through some senior changes in personnel with Piers Hillier being appointed CIO in January and the subsequent appointment of Trevor Greetham from Fidelity as Head of Multi-Asset. Trevor briefed the committee that RLAM and RLP are reviewing the current tactical asset allocation process and how this might change to a more actively managed process going forward.

JP asked RLAM to present how their tactical asset allocation process will evolve at a future IAC meeting.

Default investment choice post April 2015

A paper was presented to the committee outlining the continued use of a balanced annuity lifestyle strategy as the default for workplace pension schemes. Royal London Intermediary approved the decision to continue with this default after the introduction of the Freedom and Choice pension changes. This decision was taken after considering factors such as characteristics of our existing customer base, other pension benefits they may hold, and areas such as longevity risk.

IAC are also comfortable with the research undertaken to reach this decision and that this decision was appropriate. IAC noted that this will be a change to the Strategic Asset Allocation to the end point for annuity lifestyle customers. There is a plan in place to review the default investment lifestyle at the end of 2015 as the market develops.

Annuity lifestyle improvements RD

RLI have an ongoing governance commitment to review the lifestyles used for customers purchasing an annuity.

In current market conditions, index linked bonds have become increasingly expensive in providing the inflation protection required for these customers. To manage this risk, RLI are launching a tactical annuity fund which will deliver a better customer outcome.

The fund is targeted for launch in Q3 2015.

Transaction costs

IAC noted that the transaction cost project will be overseen by the Independent Governance Committee. IAC have asked to be kept informed of progress.

5. CUSTOMER INVESTMENTS

STRATEGIC ANALYSIS

Governed Portfolios & Managed Strategies
No changes are recommended to the Governed Portfolio and Managed Strategy benchmarks this quarter. Governed Portfolios 3, 6, and the Cautious Medium Term Strategy are being reported as inefficient against their efficiency measures. As in previous quarters, this is due to the prolonged low rates we have been experiencing. The expected real return differences on these portfolios are very small so the IAC was comfortable that no change was necessary.

Governed Retirement Income Portfolios
No changes are recommended to the strategic benchmarks this quarter. The portfolios continue to be 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.

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

Short term tactical view of the Chief Investment Officer

PH reviewed Q1 2015 and presented his rationale for the current short term tactical view:

Positioning
- The Governed Portfolios maintained an overweight position in Equities at the expense of Corporate and Index-linked Bonds, and a small underweight in Property over the first quarter of 2015.

Q1 Market Background
- Q1 was a strong quarter for Equities and Credit as global markets appreciated on the back of the European Central Bank's long awaited announcement that it would initiate an asset purchase program, otherwise known as quantitative easing (QE). Even with this favourable backdrop, markets continued to experience bouts of

volatility due to mixed economic data out of the US, uncertainty over the bailout program for Greece , the Swiss National Bank's surprise decision to lift the peg on the Swiss Franc, and the ongoing oversupply of crude oil.

- Fixed Income markets traded higher in Europe anticipating the ECB's decision on QE, while rates in the US stabilised as investors sought to determine when the Federal Reserve would begin raising short term interest rates.
- After a very strong finish to 2014, UK Property returns remained positive in Q1, albeit at a slower rate. Good UK economic growth in Q4 2014 coupled with increasing employment had a positive impact, whilst relatively weak wage growth and the continued threat of e-commerce to the Retail segment tempered returns.
- Energy-related commodities remained weak with both oil and natural gas finishing lower, whilst base metal prices traded lower on concerns about slowing demand from China.

Relative Positioning & TAA Performance

- Tactical positioning contributed positively to performance in Q1 and was predominantly driven by the overweight allocation to Equities which significantly outperformed all other allocations.
- The regional equity allocation bias favouring overseas markets within the Global Managed portfolio further contributed to outperformance as all overseas regions, led by Japan and Europe ex-UK, significantly outperformed the UK. Currency effects were on the whole positive in Q1 as weakness in the Euro was more than offset by US Dollar gains against Sterling.
- Within Fixed Income, the underweight Credit position detracted whilst High Yield exposure underperformed further over the quarter as ongoing weakness in oil continued to weigh on Energy related names, whilst an underweight Index-linked stance contributed positively.
- A small underweight to Property, which underperformed on a relative basis in Q1, contributed positively to portfolios with higher Equity and Credit allocations.

Outlook & Views

- Despite recent concerns over global growth momentum, which we view as a temporary slowdown, we retain a constructive view on Equities. Although the US Federal Reserve is expected to raise rates in the second half of the year on improving economic fundamentals, tightening is expected to be shallower with a lower peak compared to previous tightening cycles. Outside of the US, monetary policy is expected to remain accommodative as cheap energy dampens inflationary pressures and boosts disposable incomes, whilst corporate earnings growth momentum is expected to remain positive.
- Within Equities, we retain a preference for Overseas versus UK as the latter continues to face a highly uncertain political environment, with the highly represented Oil & Gas and Mining sectors continuing to face energy and base metal commodity markets in chronic over-supply. Within Overseas, positive earnings momentum and comparatively lower valuations in Europe and Asia, coupled with aggressive central bank easing, should support further relative gains versus the US although ongoing speculation over the outcome of Greek debt talks will result in bouts of market volatility.
- Current levels of Fixed Income yields continue to offer relatively little compensation for taking on interest rate and inflation risk and we retain an underweight view. Within Credit, although corporate balance sheets remain relatively healthy at this stage of the business cycle, there has been some deterioration in quality metrics and concerns remain over potential levels of

secondary liquidity in the event of a market stress. The underweight to Index-linked remains tempered by the downside protection they would offer should economic growth disappoint and corporate earnings momentum stall.

- Investor appetite for UK Property is forecast to remain strong against a positive domestic economic backdrop of rising UK household incomes and the return of positive earnings growth in real terms. The weight of money is expected to contribute to further yield compression on expectations of continued real rental growth (rents grew by 1.1% in Q1 alone) across many sectors and locations.

6. ROYAL LONDON FUND REVIEW

Governed Range

The following funds/portfolios were discussed:

Governed Portfolios – The Governed Portfolios had a strong Q1 and are outperforming over 1 & 3 years (with exception of GPs 3 & 6 over 1 year). Underlying fund performance remains relatively strong across all assets classes within the portfolios.

RL Pension funds

The following funds were discussed but no action was required:

UK Government Bond
The fund has underperformed over the quarter marginally and is now under benchmark over 1, 3 & 5 years.

Matrix Funds

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

Neptune European Opportunities RH
This fund had a very strong Q1 2015. The combination of this and older poor performance dropping out has improved performance.

Subsequent to the last IAC meeting, Neptune facilitated a call with Rob Burnett, the lead manager on the fund. We were given comfort that the fund is being run to the manager's conviction and that he is holding true to his approach long term on the basis that the fund will be rewarded. This is starting to show, however we will keep the fund under review and monitor performance going forward.

Fidelity American RH
As with many active funds, 2014 was a poor year with active positions detracting against a generally defensive market. However, Q1 2015 has seen a turnaround where active management has been rewarded. The fund performed strongly in Q1 and is now only marginally behind the benchmark over 1 year. Performance over 3 & 5 years has also improved.

We received detailed commentary from the manager which reflects the above. The combination of a flight to mega-cap quality and the significant fall in oil prices impacted the fund. The manager has regained some of this performance in Q1 2015 with a focus on US domestic-facing stocks positioned to benefit from the continuing economic recovery.

The following funds were discussed but no action was required:

Invesco Perpetual Japan - Performance was broadly flat for this fund over Q1 2015. It continues to underperform over 1 & 5 years.

Morningstar OBSR commented that the manager favours undervalued companies and will take significant bets relative to the index, which can result in a volatile performance profile over the short term. The portfolio retains a pro-cyclical bias, with overweight positions in banks, real estate, industrials and materials. Conversely the fund has underweight positions in the more defensive sectors, including consumer staples and healthcare. This positioning has impacted the fund in recent times.

Schroder Core UK Equity - The fund had a broadly flat Q1 2015 but continues to underperform across 1, 3 & 5 years. The recent 2 year record has been particularly poor with an overweight in cyclical commodities detracting most of the performance.

Morningstar OBSR recently downgraded the fund to a neutral rating reflecting the poor performance and the notable departure of Julie Dean. They believe the new manager is experienced however they felt that stock selection was at fault particularly in 2014 and need to see more evidence that the manager can add value and execute the process better.

Franklin UK Mid Cap - This fund has had a strong Q1 2015 outperforming the benchmark and the fund it replaced. It is broadly flat against the benchmark over 1 year and 1% under over 5 years.

Other external funds

The following funds were discussed and will remain on watch, but no action was required:

Investec Cautious Managed
The fund had a stronger Q1 2015 helping the longer term numbers however historical performance still affects the track record.

Investec Global Energy
The fund had a marginally positive Q1 2015, however is still underperforming over 1 & 3 years. The fund also now has a 5 year track record which is significantly poor relative to benchmark. Much of the underperformance can be attributed to 2014 which was a very poor period for the fund.

JPM Natural Resources
The fund underperformed in Q1 2015 and is under benchmark over 1, 3 & 5 years. 2012 was a particularly poor year affecting the longer term numbers.

Jupiter Financial Opportunities
This fund had a second consecutive positive quarter improving the shorter term track record. The fund does now have a 5 year track record which is extremely poor compared to the benchmark reflecting periods of underperformance over 2014, 2012

and 2011.

Legg Mason Smaller Companies
This fund had a very poor Q1 2015 and has struggled in recent times. A poor year in 2013 is impacting the longer term track record. The fund has seen strong absolute gains, however it has significantly underperformed the benchmark.

M&G Global Leaders
This fund has lessened poor performance with a marginally positive first quarter in 2015. Historical performance still affects the longer term track record.

M&G Recovery
This fund marginally underperformed in Q1 2015, however historic poor performance has worsened the 1, 3 & 5 year numbers. This is a thematic fund and will be in and out of favour depending on market conditions. 2014 was a poor year for the fund where the flight to quality in markets impacted the manager's ability to add value.

Neptune Balanced
Fund performance was strong over Q1 2015 and is reflective of Neptune's general positive performance group-wide. Neptune have a very low correlation to the benchmark allocation which can result in volatile relative performance. The longer term track record has also improved.

Neptune Global Equity
As with the Balanced fund (which sits in the same suite as this fund), fund performance was strong over Q1 2015 and is reflective of Neptune's general positive performance group-wide. Neptune have a very low correlation to the benchmark allocation which can result in volatile relative performance. The longer term track record has also improved.

Neptune US Opportunities
The fund had a very strong Q1 2015 subsequently improving the 1 & 3 year numbers. Peer positioning has also improved reflecting Neptune's approach as a high conviction manager where performance can be volatile.

Newton Global Higher Income
The fund again had marginal underperformance over the quarter however longer term performance has been helped by the historically poor performance dropping out of the review period. Peer positioning over 3 & 5 years is good.

Schroder Global Property Securities
Fund performance over the quarter again improved marginally and has improved the longer term track record.

Schroder US Mid Cap
Again, this fund was broadly flat over the quarter compared to the benchmark however historical poor performance has dropped out improving the longer term track record significantly.

Threadneedle Latin America
Fund performance has improved again helping to lift the longer term track record. The fund is now only 1% behind benchmark over 3 years.

UBS Global Blended
This fund continues to underperform across 1, 3 & 5 years. Four consecutive quarters of poor relative performance is affecting the fund.

UBS UK Equity
This fund had a poor Q1 2015 and continues to underperform over 1, 3 & 5 years. UBS are closing this fund on 31st July 2015 and merging the assets into a tracker fund. As a result we are working on a project to close the fund and agree where to switch the assets.

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

Fidelity Special Situations Blended, JPM Cautious Managed, Jupiter Merlin Worldwide Portfolio, Newton Real Return.

7. DATE FOR NEXT MEETING

The next quarterly meeting is 25th August 2015.

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.