Investment Advisory Committee (IAC) Quarterly Meeting

Minutes Of Meeting

Date
25/8/2015

Present members
Julius Pursaill (Chair)
Colin Taylor
Ewan Smith
Rachel Elwell
Isobel Langton

In attendance
Robin Herd
Robert Dundas
Natasa Margariti
Lorna Blyth
Piers Hillier
Trevor Greetham
Robert Whitehouse

Peter Dorward *(attending on behalf of Independent Governance Committee)*

Apologies
Andrew Carter

Owner

1. **REVIEW OF PREVIOUS MINUTES**
The minutes of the 2 June meeting were approved.

2. **PROJECTS**

Governed Portfolio tactical asset allocation TG

Trevor Greetham presented his tactical asset allocation process covering how he uses research from quantitative models and combines it with qualitative assessment to manage the tactical asset allocations within the RL Governed Range. There is no reliance on one single measure or model and that taking information from a number of different sources and applying practical thinking helps allow for the many risks apparent in financial markets.

The IAC were given confidence in the strength of the process and the rigor applied to it. They felt there were benefits to applying the "Investment Clock" process to establish where markets are currently and which asset classes, geographies and sectors will benefit from this.

Strategic asset allocation review RD

We have initiated a review of the Strategic Asset Allocations (SAAs) with Moody's Analytics of the Governed Portfolios as part of our normal robust governance process. As well as reviewing the asset allocations across our existing asset classes, we are investigating a wider range of potential asset classes to assess if any are suitable for inclusion within the Governed Portfolios. JP requested that this remains on the IAC agenda over coming quarters so that the IAC are kept abreast of progress.

Default investment choice post April 2015 LB

LB provided an update on the investment default review. A proposal is due in Q4 based on customer segmentation and research conducted with RLI customers and across the market.

5. **CUSTOMER INVESTMENTS**

STRATEGIC ANALYSIS

Governed Portfolios & Managed Strategies
No changes are recommended to the Governed Portfolio and Managed Strategy benchmarks this quarter. Governed Portfolio 6 is being reported as inefficient against the efficiency measure. The expected real return difference compared to the efficient portfolio is 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 with the exception of GRIP 5. This portfolio has triggered just below the lower level of the long-term target. The IAC were comfortable that no change was necessary as this measure in current circumstances will fluctuate and to bring the portfolio back within target would involve increasing the risk being taken.

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. A tactical change was made on 9th July 2015 strengthening the overweight in equities at the expense of investment grade corporate bonds and index linked gilts. The portfolios also remain overweight in high yield bonds and neutral in property.

Governed Retirement Income Portfolios (GRIPs)
All portfolios are within their tactical risk budgets. A tactical change was made on 9th July 2015 strengthening the overweight in equities at the expense of investment grade corporate bonds and index linked gilts. The portfolios also remain overweight in high yield bonds and neutral in property.

Short term tactical view of the Chief Investment Officer

PH reviewed Q2 2015 and presented his rationale for the current short term tactical view:

Positioning

- The portfolios remained overweight in Equities, with a bias towards overseas markets, during Q2 at the expense of Corporate Bonds and Index-linked Gilts. The portfolios were broadly neutral on Property

Q2 Market Background

- Global markets were mixed in Q2 as uncertainty from the ongoing bailout negotiations in Greece and the equity market reversal in China weighed on markets late in the quarter.
- Amid this backdrop, equity markets across the UK and Europe finished lower, while markets in the US, Japan and China appreciated in local currency terms. The Chinese equity market in particular experienced high levels of volatility with indices trading up as much as 35% during the quarter before giving back half the gains in late June.
- Yields on long dated fixed income securities across the US, Japan and Europe increased as investors adjusted inflation expectations higher as economic growth picked up in Europe and the odds of an interest hike by the Federal Reserve later this year increased. Credit markets generally finished lower on economic uncertainty and weak commodity prices.
- After a softer Q1 for UK Property, market momentum picked up again during the 2nd quarter with returns stronger across all sectors. Recent sector trends continued with Office and Industrials once again the best performing areas with Retail returns lagging. Transaction volumes remained high whilst values between primary and secondary properties narrowed.
- Commodity markets ended the quarter mixed with energy finishing higher due to a strong rally early in the quarter, while industrial and precious metals fell on concerns of slowing Chinese demand. In currency markets, the Pound rallied against all major currencies following a decisive general election result in May and this resulted in a fall in overseas equity returns over Q2 when expressed in GBP terms.

Relative Positioning & TAA Performance

- Tactical asset allocation positioning at the broad asset class level marginally detracted over the period following the fall in equity markets late in the quarter. The preference for overseas versus UK equities, which had been a consistently positive contributor to performance, produced a negative effect in Q2 entirely driven by currency effects following Sterling's post-election rally. RLAM was able to cover this underweight sterling position ahead of the election in funds able to use currency forwards.
- UK Property significantly outperformed other assets in Q2 which resulted in the portfolio's marginally underweight position generating a negative attribution.

- The underweight Fixed Income position was broadly neutral over Q2 as the negative impact of underweighting Index-linked gilts was offset by an underweight in Credit. Credit underperformed during the period as spreads widened against a backdrop of rising government bond yields, high levels of new issuance, and ongoing uncertainty over energy related commodity prices.
- Despite a small pull-back in Q2, the performance contribution from tactical asset allocation remained positive over 2015 as a whole.

Outlook & Views

- With the US economy rebounding from a surprisingly weak first quarter and falling commodity prices keeping global inflation well below central bank target levels, we view the current outlook as equity friendly and are positioned within the multi-asset portfolios accordingly. We added to exposure during market weakness over Greece in early Q3. We expect returns to remain relatively depressed over the summer in line with seasonal norms but see better prospects for 2015 Q4 and onwards.
- Within Equities, we continue to underweight the UK market given the negative impact of falling commodity prices on the highly represented Oil & Gas and Mining sectors. Across the overseas regions, we favour Europe ex-UK and Japan where policy is loosest and earnings revisions are strong. We are underweight Asia Pacific and Emerging Market equities as they face a debilitating mixture of rising US interest rates, strengthening US Dollar, and falling commodity prices as China's economy slows.
- Fixed Income yields remain extremely low and are likely to rise as the US Federal Reserve starts tentatively to raise interest rates. Within Credit, although corporate cashflow remains positive and debt servicing costs are at the lower end of the historical range, there has been some deterioration in quality metrics and concerns remain over levels of trading liquidity in the event of a market stress. We remain underweight long duration Index-linked Gilts, although we recognise their potential portfolio diversification benefits should economic growth disappoint and the outlook for corporate earnings deteriorate.
- The outlook for the UK property market remains positive across the regions and particularly in London and the South East. A positive rental growth story in key sectors and locations together with a steady and significant weight of investor capital seeking UK property should mean that market conditions remain buoyant in the short to medium term. However, valuations are becoming more stretched in some areas, notably prime Central London.

Update to tactical commentary in light of recent market events.

Financial markets have recently seen wild gyrations with market volatility spiking to levels not seen since the height of the Eurozone debt crisis in 2011.

Global equities, commodities and emerging market currencies all suffered significant falls in the latter half of August triggered by a surprise 'one-off' currency devaluation by the People's Bank of China (PBoC), and weaker than expected Chinese manufacturing data. Both events intensified investor fears over a potential 'hard landing' for the Chinese economy, and its negative impact on the global economy as a whole.

Equity markets did however manage to rally into the end of August as sentiment improved on the back of monetary easing moves by the PBoC, dovish comments from US Federal Reserve officials, and a strong Q2 US GDP release.

Although we expect equity market volatility to remain elevated over the short term, we continue to favour equities within our tactical asset allocation mix. Alongside the recent easing of monetary policy in China, both Europe and Japan are expected to continue with monetary stimulus, whilst the US may now delay moves to raise interest rates given recent turbulence.

Furthermore, falls in commodity prices, led by oversupply conditions in oil markets, are expected keep inflation levels below policy target levels, and help growth prospects through boosting disposable incomes, at a time of rising wages.

6. ROYAL LONDON FUND REVIEW

Governed Range

The following funds/portfolios were discussed:

Governed Portfolios – The Governed Portfolios had another strong quarter and are comfortably outperforming over 1 & 3 years. Underlying fund performance is strong across all assets classes within the portfolios with the exception of Long (15yr) index linked.

RL Pension funds

The following funds were discussed but no action was required:

UK Government Bond
The fund had a positive second quarter which has subsequently improved the longer term numbers. The fund is underperforming over 1 & 5 years.

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

RLP American.

Matrix Funds

The following funds are subject to further action before the next quarterly IAC meeting:

Neptune European Opportunities RH

Fund performance has been strong over the last two quarters, with the fund now performing 7.6% ahead of the benchmark year to date. This has improved the longer term track record to the point where the fund only triggers as ‘amber’. It would be prudent to retain watch on this fund to ensure fund performance continues to be positive.

Fidelity American RH

It has been announced that the manager of this fund will be leaving on 1st September. The fund will be managed by Aditya Khowala who already manages the Fidelity American Growth Fund. A recommendation is being provided by Morningstar OBSR to suggest whether this fund should be replaced and which rated funds are available for investment.

Schroder Core UK Equity RH

Fund performance did improve over the quarter however 1 & 5 year performance is still poor. Morningstar OBSR has recommended that this fund is replaced. A proposal for replacement will be submitted to the IAC for approval.

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

Invesco Perpetual Japan.

Other external funds

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

Investec Cautious Managed

The fund had another strong quarter outperforming the benchmark by 1.3%. Continued good performance has resulted in an improvement in the longer term numbers.

Investec Global Energy

The fund marginally underperformed over the quarter however longer term figures across 1, 3 & 5 years have improved. The fund is still underperforming over those time periods.

JPM Natural Resources

The fund strongly outperformed in quarter 2 improving the 1 & 3 year numbers. Underperformance over 5 years has remained poor however peer positioning is around the median.

JPM New Europe

The fund again underperformed in the second quarter and remains under benchmark over 1, 3 & 5 years.

Jupiter Financial Opportunities

This fund had a third consecutive positive quarter improving the shorter term track record with the fund outperforming over 1 year. 3 & 5 year performance remains extremely poor reflecting historic underperformance.

Jupiter Merlin Income

This fund has triggered again this quarter with performance dropping below benchmark over 1 & 3 years. The fund is outperforming over 5 years reflecting better historic performance.

Jupiter Merlin Worldwide
This fund has had a poor quarter after two successive positive quarters. 3 & 5 year performance remains poor due to historic underperformance.

Legg Mason Smaller Companies
A strong quarter has improved performance across 1 & 3 years however historic performance still affects the 5 year track record.

M&G Global Leaders
This fund has had a second consecutive positive quarter improving the 1 & 3 year performance figures.

M&G Recovery
This fund had a strong second quarter outperforming the benchmark by 3.2%. This has subsequently improved the 1 & 3 year performance numbers. Stock selection has driven recent performance against a backdrop of company fundamentals being rewarded again.

Neptune Balanced
Fund performance worsened marginally over Q2 after a very positive first quarter. This has caused the 3 & 5 year numbers to worsen. RLP will continue to monitor performance of this fund, however it is scheduled to be closed after the investment endorsement is complete.

Neptune Global Equity
Fund performance was strong over Q2 which has improved the 1 & 3 year numbers. The fund is still affected by poor historic performance particularly over the 5 year period.

Newton Global Higher Income
Performance has worsened again over the quarter with the fund underperforming over 1, 3 & 5 years.

Schroder Global Property Securities
Fund performance over the quarter worsened and is underperforming marginally year to date. 3 & 5 year performance is particularly poor.

Threadneedle Latin America
Fund performance worsened over the quarter affecting the longer term performance figures. The fund is however flat versus benchmark over 3 years.

UBS Global Blended & UBS UK Equity
These funds were closed week commencing 27 July 2015. Communications were issued to policyholders and advisers at end June 2015.

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

Neptune US Opportunities, Schroder US Mid Cap.

7. **DATE FOR NEXT MEETING**

The next quarterly meeting is 1st December 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.

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