Investment Advisory Committee (IAC) Quarterly Meeting

Minutes Of Meeting

Date
1/12/2015

Present members
Julius Pursaill (Chair)
Colin Taylor
Ewan Smith
Rachel Elwell
Andrew Carter

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

Apologies
Isobel Langton

Owner

1. **REVIEW OF PREVIOUS MINUTES**
The minutes of the 25 August meeting were approved.

2. **PROJECTS**

Strategic asset allocation review — RD

Work has been ongoing to review the strategic asset allocation (SAA) of the Governed Portfolios (GPs). A paper was submitted updating and seeking IAC comment on investigations and high level proposals to improve the GPs.

The extent of this project includes analysis on the asset classes used within the portfolios and investigating where new asset classes & investment strategies could be introduced to add value to the existing portfolios.

Following a detailed discussion, the IAC endorsed the high level intention of this work. Further in-depth information and supporting analysis was requested. A special IAC meeting will be arranged in January seeking IAC approval for the changes. Details of any proposed changes will be captured at future meetings and reflected in the minutes of those meetings.

As part of this project, further work will be conducted on the risk metrics currently used within the Governed Portfolios whilst also reviewing the SAA of the Governed Retirement Income Portfolios (GRIPs). Timescales for this work are to be agreed and communicated to the IAC.

Default investment choice post April 2015 LB

LB provided an update on the investment default review. This included data showing how all workplace pension members aged 55 and over have taken their retirement benefits and shows the majority have either taken them as cash or purchased an annuity. The IAC were comfortable that the current default remains appropriate for RLI members who are not engaged in their pension investment options. This will be reviewed on a quarterly basis and any significant changes will trigger a further review of the default.

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 efficiency has improved and, whilst it is still outside the desired target the expected real return difference is very small so the IAC was comfortable that no change was necessary.

Governed Retirement Income Portfolios (GRIPs)
No changes are recommended to the GRIP strategic benchmarks this quarter. The portfolios continue to be within both the long and short term risk targets with the exception of GRIP 5. This portfolio continues to trigger below the lower level of the long-term target. The IAC continue to be comfortable that no change was necessary as this measure is expected to fluctuate in current circumstances 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. There have been three tactical changes over the period on 10 September, 8 October and 19 November. Across these changes we have incrementally reduced some equity exposure by taking a small overweight in gilts and reducing the underweight in index linked bonds. The portfolios are overweight in equities, conventional gilts and high yield bonds, neutral in property and underweight index linked gilts and corporate bonds.

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Short term tactical view of the Chief Investment Officer

PH reviewed Q3 2015 and presented RLAM's rationale for the current short term tactical view:

Positioning

- The portfolios were overweight Equities during Q3 at the expense of Credit and Index-linked Gilts. Within equities, they were overweight Japan and Europe at the expense of the UK and the Asia Pacific region. We increased the Equity overweight at the start of the period as investor sentiment declined sharply over fears of a Greek Euro exit and trimmed it somewhat towards the end of the quarter as the risk of more generalised economic weakness stemming from China rose.

Q3 Market Background

- The third quarter saw heightened global uncertainty leading to broad de-risking across markets generally. The quarter started with turmoil in Greece as political leaders there ultimately reached a bailout agreement that would keep the country in the Eurozone. The relief around the mid-July resolution in Greece was short lived as markets shifted their focus to economic weakness in China and growing uncertainty around the impact that lower commodity prices could have on emerging market economies.
- These fears accelerated in early August after the People's Bank of China devalued the Chinese Renminbi sparking concerns of an impending currency war. The broad-based weakness in markets and uncertainty around the health of the global economy led the U.S. Federal Reserve to keep interest rates unchanged during the quarter despite the fact that US labour markets continued to improve.
- Amid this backdrop, equity markets across the globe finished materially lower, with Emerging Markets generally underperforming Developed Markets. Equity markets in China continued to experience a high level of volatility finishing down over 25% for the quarter. At a sector level, Energy and Basic Materials continued to experience weak performance and the healthcare sector experienced a sharp reversal lower due to stretched valuation levels and concerns about increased scrutiny of drug pricing polices within the U.S.
- Yields on fixed income securities across the U.S., Europe, and Japan decreased as investors became concerned about weakening global growth and the potential for deflationary forces to re-emerge. Credit markets finished lower as global economic uncertainty, poor liquidity, and weakness in commodity prices weighed on securities.
- The third quarter saw the UK property market continue to deliver above-trend performance with Office and Industrial again the strongest performing sectors. Retail continued to lag someway behind, albeit still delivering positive capital growth, as well as a stable income return.
- Commodity markets continued their downward trajectory with energy, base metals, precious metals, and agricultural commodities all trading down. Finally, the U.S. Dollar strengthened against most currencies with the exception of the Euro and Japanese Yen.

Relative Positioning & Tactical Asset Allocation (TAA) Performance

- TAA positioning detracted over the quarter driven by the overweight positioning in Equities. The preference for overseas versus UK was a marginal positive as the UK continued to be adversely affected by weakness in its large resource sector exposure.
- The underweight Fixed Income position also detracted as 'safe haven' flows dominated in the face of waning risk appetite.
- Positioning in UK Property was held at a broadly neutral level in Q3. Property was the best performing asset class over the period as investors continued their reach for yield following further signals from a number of central banks that monetary policies are set to remain highly accommodative.
- Performance will have improved since the end of Q3. Equities rebounded strongly as fears over Emerging Markets eased. Risk appetite was further boosted by the ECB signalling an expansion of monetary stimulus. Gains were led by Japan and Europe where the portfolios have a strong regional preference.

Outlook & Views

- With continued above trend growth in advanced economies supporting the global growth outlook and inflation low, the Investment Clock model that guides asset allocation decision-making, remains supportive of Equity markets.
- Within Equities, we remain overweight Japan and Europe, where central bank policy is particularly loose and growth has been picking up. We are also slightly overweight US equities. We are underweight Asia Pacific, a region dominated by resource-sensitive Australian and Emerging markets which are most exposed to the negative news out of China. We also have a large underweight in the UK equity market with its large resource sector exposure.
- Overall we remain underweight Credit and Index-linked gilts in order to fund the equity overweight. We maintain out of benchmark overweight positions in global High Yield, a bond market sector that has suffered from Energy sector weakness in the US but where fundamentals remain largely positive. We are building a small position in conventional Gilts in view of expensive Index-linked valuations relative to UK inflation prospects.
- We remain neutral on Property. We see a positive market outlook when comparing rental yields relative to bonds but more upside potential in Equities.

6. ROYAL LONDON FUND REVIEW

Governed Range

The following funds/portfolios were discussed:

Governed Range – The Governed Portfolios and GRIPs are returning in line with their benchmarks over 1 year and are all comfortably outperforming over 3 years. Although they did underperform over the quarter, recent performance to the end of October shows the portfolios have recovered.

RL Pension funds

The following funds were identified as requiring further discussion through the performance reporting but no action was required:

Adventurous Managed

The fund had a poor quarter due to the downturn in equity markets which has caused it to underperform the benchmark over 1 and 3 years. Historical underperformance continues to affect the five year track record.

Managed
The fund underperformed over the third quarter due to the downturn in equity markets which has had a negative effect on the 1 and 3 year figures. Historical underperformance continues to affect the five year track record.

Global Equity
The fund slightly underperformed over the third quarter in light of the correction seen in equity markets and has returned in-line with the benchmark over both 1 and 3 years. The fund is still underperforming over 5 years but the figures have now improved over this period.

RH

UK Government Bond
The fund underperformed the benchmark over the third quarter and is marginally underperforming over 1, 3 and 5 years. The long term numbers have improved over the last couple of quarters though.

Index Linked
The fund outperformed the benchmark over the third quarter and now only marginally underperforms over 1 and 3 years due to historic poor performance. The fund is outperforming over 5 years. RH

Externally Managed Matrix Funds

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

Fidelity American
During the third quarter, the management of the fund transitioned from Peter Kaye to Aditya Khowala who also manages a Fidelity US Equity Sicav. In the process of transitioning the fund, the new manager has reduced exposure to some bank and biotech stocks in the portfolio, believing them to be overvalued. Aditya is a long term thematic investor looking for long term growth trends then identifying companies that will benefit from these trends. Performance will be monitored closely over the next six months with updates being submitted to subsequent meetings.

Schroder Core UK Equity
The fund continues to perform badly and had another poor quarter. It's now underperforming significantly over 1, 3 and 5 years. Both the fund's business cycle positioning and stock selection detracted during the quarter.

Positioning within the portfolio over 2014 and 2015 YTD has affected performance over the longer term. Underweights in defensive bond-proxies and overweight in resource & cyclical based stocks have been the major detractors. Schroders remain positioned for these areas to benefit from a recovery coming from relatively distressed valuations. They are holding conviction in their process for the fund to benefit longer term.

Performance will be monitored closely over the next six months with updates being submitted to subsequent meetings.

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

JPMorgan US
The fund experienced a poor quarter which means it is now underperforming over 1, 3 and 5 years. Exposure to consumer staples combined with poor stock selection in that sector held back returns during the quarter as did stock selection in the IT and industrials sectors. The fund has triggered due to the poor performance over Q3 and the impact of market volatility.

Invesco Perpetual Japan
The fund marginally underperformed over the third quarter. It's returned in line with the benchmark over 12 months and comfortably outperforms over 3 years but is underperforming over 5 years. Stock selection in cyclical areas, such as industrials and financials, has hurt relative returns, while the underweight to defensive sectors was also negative.

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

Neptune European Opportunities, Close TEAMs UK Equity 1% & 2%.

Other external funds

The following funds are subject to further action over the next six month and will be updated for the next quarterly IAC meeting:

Neptune Balanced RH
The fund suffered another poor quarter meaning that the fund is now underperforming again over 1 year and remains poor over 3 and 5 years. A conference call was held with the manager to address performance issues and we have a degree of comfort that performance issues have been addressed sufficiently and the funds and management company are better positioned now.

Over 3 years, the Fund has significantly underperformed its benchmark. The fund saw weaker performance in the final quarter 2012 and in 2014, impacting its 3 year number. For example, risk appetite rose significantly in the final months of 2012 and our underweight to areas such as Europe and the financials sector inhibited performance. Over 12 months, the Fund's underperformance was primarily attributed to the volatility within Chinese equities during Q3. This was because Japanese global multinationals – in which the Fund is overweight – have significant exposure to the emerging markets.

Neptune Global Equity RH
The fund was poor over quarter 3 which has impacted the 1 and 3 year figures. The fund is outperforming over 1 year but underperforming over 3 and 5 years. This is predominantly driven by very poor historic performance. A conference call was held with the manager to address performance issues and we have a degree of comfort that performance issues have been addressed sufficiently and the funds and management company are better positioned now.

This underperformance was primarily due to the fund's large emerging markets weighting in 2012. This saw the Fund underperform by 11% in 2012. However, in April 2013 a number of changes were made to the portfolio – shifting the portfolio's focus to the US and Japan – since which performance has stabilised. More recently, despite outperforming in the final quarter of 2014 and the first six months of 2015, the Fund endured a difficult third quarter, underperforming the market by 5% due to its Japanese exposure and yen hedge. However, performance has since rebounded and is outperforming over 12 months.

Newton Balanced RH

Fund performance has improved over the quarter and one year periods. Underlying Newton fund is seeing positive inflows and track record has improved. Historical performance still affects the longer term numbers however, given Newton's more active focus on promoting their multi-asset funds this fund should be given a chance to further improve performance.

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

Investec Cautious Managed

After two strong quarters of outperformance, the fund suffered a disappointing third quarter underperforming the benchmark by 4.1%. This has caused a decline in the long term numbers after a positive improvement over the first half of 2015.

Over recent years, the fund's manager has adopted a value, contrarian equity investment style, focused on large-cap stocks. This has coincided with mid and small cap stocks outperforming. The fund continues to hold a low exposure to equities due to heightened market risk and continues to remain focused on large-cap companies.

Investec Emerging Local Currency Debt

This fund has underperformed again over the quarter and continues to be below benchmark over one, three and five years. This asset class has been out of favour in a quality-driven market where assets within bonds have tended to flow towards developed markets. The specialist nature of this fund does mean it will underperform in specific stages of the market cycle however performance will continue to be monitored over coming quarters.

Investec Global Energy

The fund underperformed its benchmark by 6.9% over the third quarter and has resulted in worsened figures over 1 and 3 years. Performance over 5 years has improved though.

In addition to the falling oil price, the energy sector has recently reached absolute and market relative lows. The fund has suffered over the short term due to its overweight position in oil exploration and production companies. The operating environment for this sector has been very challenging but the fund manager doesn't want to reduce this position as he believes these companies will be the first beneficiaries of an oil price recovery.

JPM Natural Resources

After outperforming the benchmark in quarter 2, the fund underperformed over quarter three. This means that the underperformance over 1 and 3 years remains poor and has worsened.

All subsectors within the fund are detracting from absolute returns. The fund's neutral position in Glencore was the largest absolute detractor over the third quarter. Shares fell as investors worried about the robustness of the balance sheet in the current commodity price environment. JPM have reshaped the fund over September, shaving the overweight to the base metals and diversified sector. The fund manager has added to existing energy holdings.

JPM New Europe
The fund had a decent quarter 3 comfortably outperforming the benchmark. The fund is now outperforming over 1 year but remains under the benchmark over 3 and 5 years.

Both stock selection and regional allocation contributed to the positive performance over the short term. Stock selection in Turkey and a zero-weight allocation to Greece detracted performance but this was well offset by positive stock selection gains in Hungary, Russia and Czech Republic.

Jupiter Ecology
Fund performance has worsened over the quarter and continues to underperform over one, three and five years. This fund is compared to a global equity benchmark and its niche focus will not always be rewarded during certain market cycles.

Jupiter Financial Opportunities
The fund has now had four consecutive positive quarters which has improved the shorter term track record. The fund continues to outperform over 1 year but remains quite poor over 3 and 5 years.

The fund has benefited from positive stock selection particularly in the consumer payment sector with stocks such as Mastercard, Visa and Global Payments all contributing to positive performance. This has been tempered slightly by the fund's allocation to Japan which was impacted by the Chinese market sell-off in the third quarter.

Jupiter Merlin Worldwide
The fund had a positive quarter which has marginally improved performance. However, 3 and 5 year performance remains poor due to historic underperformance.

Equities remain Jupiter's preferred asset class for long-term investors and this is reflected by their current 100% allocation to equities in the fund. The fund has recently reduced its exposure to the global mining and energy sectors which has contributed to positive performance.

Legg Mason Smaller Companies
The fund experienced a bad quarter underperforming the benchmark by 5.2% after a positive 2nd quarter. This means that performance over 1 and 3 years has again worsened but this is also down to poor historic performance.

The main detractor for performance over the longer term has been the accommodative monetary policy in place which has helped support poorer quality, indebted companies at the expense of the better-capitalised, value-based smaller companies. The fund manager's style is to invest in higher-quality, value focused small caps which have underperformed, particularly in the energy and asset management sectors. They remain positioned for a recovery in their favoured sectors based on the current market backdrop.

M&G Global Basics
Fund performance has again worsened over the quarter. This fund is thematic and has not participated in market performance over the medium term. Given the market backdrop it is no surprise the fund has not participated and has underperformed a generic global equity sector average.

M&G Global Leaders
The fund underperformed over the quarter. This hasn't changed the 1 year position but has resulted in the three year figures worsening. This is predominantly down to poor historic underperformance.

Style exposure in the fund was the key driver of underperformance. Whilst the fund's size bias towards small- and midcaps contributed positively, as they outperformed large-caps, the fund's exposure to value and volatility factors was a headwind for performance.

M&G Recovery
The fund had a poor quarter but the 1 and 3 year performance figures have marginally improved due to periods of poor underperformance dropping out of the window.

Stock selection and falling commodity prices were a combined hit for the resources companies held within the fund. This position along with a large underweight to consumer goods was also a significant detractor as the sector turned in such a strong performance in the third quarter.

Neptune US Opportunities
The fund suffered a bad quarter which has worsened the 1 year figure and means the fund is now underperforming over three years. This fund has only just triggered for review due to the effect of the poor performance in quarter 3.

Newton Real Return
The fund continues to underperform the benchmark although peer positioning has improved. It remains under benchmark over one, three and five years although as an absolute return fund it is delivering a positive return over three and five years.

Schroder Global Property Securities
The fund had a positive quarter which means that it is marginally outperforming the benchmark over 1 year but the 3 year number remains poor despite the improvement. Historical performance continues to affect the track record. This fund was part of a joint venture between Schroders and EIS. This arrangement ended eighteen months ago, the fund is now managed in-house and performance has improved.

Schroder Income Maximiser
The fund suffered a bad quarter meaning that it is now underperforming over 1 and 5 years. The fund is outperforming over three years and has only just triggered for review due to the effect of the poor performance in quarter 3.

Threadneedle Latin America
Fund performance has continued to worsen over the quarter and is resulting in poor performance year to date. This means that performance continues to look very bad over both 1 and 3 years.

Performance has worsened over Q3 due to several stock-specific issues in Brazil. Although the fund is underweight in this region, the overall position has hurt the fund's performance. The fund is now adopting a more defensive position as Threadneedle are adopting an increasingly bearish stance on Brazil. They are adopting underweight positions in the Andean region as well as Brazil and combined with an overweight in Mexico hope that this will contribute to a period of outperformance relative to the benchmark.

UBS Global Blended
Fund performance has again worsened over the quarter after a positive quarter 2. This means that the fund is now underperforming over all time periods due to the impact of the poor quarter and historic underperformance.

Within the overseas equity part of the fund, underweight positions in the US were the main regional detractor both at a stock level but also a currency level. Overweight in energy producers also significantly affected performance. UBS have a value tilt to this portfolio which has been a headwind in recent years. The UK portion had also been underperforming over the longer term however the underlying fund was switched to be managed by their UK value team. Since the change in May 2013, UK performance has been above benchmark.

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

Jupiter Merlin Income, Newton Global Higher Income.

7. DATE FOR NEXT MEETING

The next quarterly meeting is 3rd March 2016.

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.