Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date
14/6/2016

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

In attendance
Robin Herd
Robert Dundas
Natasa Margariti
Lorna Blyth
Ryan Medlock
Piers Hillier
Robert Whitehouse
Euan Craig

Apologies
Andrew Carter
Isobel Langton

Owner

1. **REVIEW OF PREVIOUS MINUTES**
The minutes of the 3 March 2016 meeting were approved.

2. **PROJECTS**

Governed Portfolio Strategic asset allocation – Implementation and communications

Communication and implementation plans for the SAA changes were presented. The IAC were comfortable that all appropriate steps have been taken and the changes were progressing as planned. Materials will include an article from RLAM on why these changes are being made. — LB

SAA implementation has already started following RLMIS board approval and the new benchmark change is planned to be changed 1 July. JP asked how frictional costs and market risk had been factored in to the agreement of the timeline. RD explained that additional trade dates had been arranged to take account of market conditions and known events such Brexit which had been agreed with all stakeholders. RLAM agreed to provide some information on the implementation costs after the benchmark change. — TG

RLP UK Ethical

A paper was submitted outlining plans to review the selection criteria and management of the RLP UK Ethical fund.

The fund's selection criteria hasn't been reviewed since the fund was launched in 1999 and with the change in management to the RLAM sustainable investment team, we feel it is an appropriate time to adopt a more sustainable approach and allow the RLAM sustainable investment team more scope and flexibility to manage the fund in a similar way to the suite of RL Sustainable funds. This means more emphasis placed on positive screening instead of negative screening although the fund would continue to operate certain exclusion criteria.

The IAC require information on any specific sectors or stocks that were not previously included but could be used if a more sustainable approach is adopted. This information will be circulated to the IAC prior to the next meeting. RM

Default review

The IAC discussed the risks to policyholders of de-risking into inappropriate low risk matching strategy if the vesting of benefits takes place after expected retirement date. It was agreed this risk would be reviewed in the light of MI around the numbers of customers taking benefits on or near to their expected retirement date relative to those taking benefits late. LB

3. CUSTOMER INVESTMENTS

STRATEGIC ANALYSIS

Governed Portfolios & Managed Strategies

No changes are recommended to the Governed Portfolio and Managed Strategy benchmarks this quarter based on the risk metrics, although the proposed SAA changes previously discussed will be effective from 1 July 2016.

Governed Portfolios 3 & 6 efficiencies have improved and, whilst 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. As in previous quarters, all the portfolios continue to be within their short term risk targets with the exception of GRIP5. Due to no material change in the assumptions used to monitor the portfolios, GRIP1, GRIP2 and GRIP5 continue to be outside of their long term risk target range. This suggests that these portfolios may not be taking enough risk. However, the IAC continue to be comfortable that no change is necessary. A strategic review of the GRIPs is due in the second half of 2016, similar to the work recently done in the GPs.

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 since the last meeting in March.

The first change was effective as of 3/3/2016 reducing the overweight in equities in favour of index linked gilts, reducing the underweight in that asset class. New exposure to absolute return government bond and cash strategies was introduced.

The second change was effective as of 21/3/2016 reducing exposure to equity, corporate bonds and index-linked bonds. Exposures to absolute return strategies (including cash), high yield and government bonds were increased.

The third change was effective as of 2/6/2016 reducing the exposure to equity, corporate bonds and index-linked bonds in favour of absolute return strategies (including cash), high yield and government bonds.

Overall, the asset allocation is now overweight in equity, government bonds, absolute return strategies (including cash) and high yield bonds and underweight in corporate bonds and index-linked bonds.

Governed Retirement Income Portfolios (GRIPs)

All portfolios remain within their tactical risk budgets.

There have been three tactical changes since the last meeting in March.

The first change was effective as of 3/3/2016 reducing exposure to equity, high yield bonds and 10 year government bonds and increasing exposure to 10 year index-linked bonds whilst introducing a holding in cash.

The second change was effective as of 21/3/2016 reducing the exposure to equity, corporate bonds and index-linked bonds. The proceeds were used to increase exposure to absolute return strategies (including cash), high yield and government bonds.

The third change was effective as of 2/6/2016 reducing exposure to equity, corporate bonds and index-linked bonds whilst increasing exposure to absolute return strategies (including cash), high yield and government bonds.

Overall the asset allocation is now overweight in equity, government bonds, absolute return strategies (including cash) and high yield bonds and underweight in corporate bonds and index-linked bonds.

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

- Portfolios entered 2016 with an overweight in Equities at the expense of Fixed Income, concentrated in government bonds. During Q1, the overweight stance in Equities was increased at the end of January following a sharp sell-off in risk assets. As equities rallied and sentiment normalised, profits were then taken towards the end of the quarter.
- The portfolios remain moderately overweight Equities, funded predominantly out of Fixed Income and UK Gilts in particular. Our favourite equity markets remain Japan and Europe where we expect monetary policy to remain most supportive for asset prices. More recently, we have recognised the improved outlook for Chinese growth, a recovering oil price, and a more dovish US rate outlook, by reducing our underweight in Emerging Markets.

Q1 Market Background

- Global markets experienced elevated levels of volatility as concerns about slowing global economic growth, rising credit defaults, and ongoing commodity price weakness, resulted in broad-based declines in risk assets over the first half of the quarter. Markets found their footing over the second half of the period as an uptick in global commodity prices, a stabilisation of economic conditions in China, and dovish comments from the U.S. Federal Reserve, resulted in a rebound in both equity and credit securities.
- Against this backdrop, equity market returns experienced dispersion across geographies. Markets in Europe and Japan struggled amid sluggish economic growth, unexpected currency appreciation, and the adoption of negative interest rate policies. Additionally, investors expressed concerns about rising contagion risk surrounding the UK European referendum.
- Yields on government bond securities declined sharply as investors rotated into haven assets and expectations regarding US Fed policy receded. Credit spreads tightened and high yield securities rose following a rally in crude oil prices.
- Commodity markets experienced upward reversals in both crude oil and industrial metals, while precious metals traded higher throughout the period as investors sought safety amid the market volatility. Finally, the US Dollar weakened against most major currencies on tempered rate expectations whilst Sterling saw significant weakness on referendum uncertainty.
- Q1 2016 provided a number of headwinds for UK property. The first was the announcement in February of the date of the European Referendum which led to a pronounced slowdown in market activity, which was followed by a surprise budget change in March to the Stamp Duty Land Tax which led to the first monthly fall in capital values in almost 3 years.

Relative Positioning & TAA Performance

- An overweight position in Equities, which suffered one of their worst starts to a calendar year, and underweight in Fixed Income concentrated in Gilts, meant that tactical positioning detracted from relative performance in Q1.
- Within Equities, our preference for overseas markets was a positive factor as the UK significantly underperformed the World ex-UK Index in GBP following Sterling's 6% trade weighted depreciation in Q1. The decision to reduce the underweight in Emerging Markets during the period also added value. However the overweight stances in Japan and Europe detracted as both equity markets underperformed in the face of unexpected currency headwinds.
- The underweight Fixed Income position reversed a strong positive Q4 contribution in Q1 as long bond yields dropped significantly as investors turned increasingly risk averse on elevated volatility in equity and currency markets. There was a

positive contribution for a number of portfolios from a rebound in Global High Yield following the recovery in oil prices.
- UK Property was maintained at a broadly neutral level as returns lagged broader portfolio gains. Industrial and Office sectors outperformed Retail during the period as investors continued to target relatively higher rents in the former and compress yields in the latter as rental growth prospects remained underpinned by an undersupply of good quality space.

Outlook & Views

- Stocks are generally volatile over summer months and with continued risks around US interest rates, 'Brexit' fears, and uncertainty over Chinese policy, we have recognised near term downside risks by taking equity exposure down further and increasing portfolio cash.
- However we retain an optimistic view on the global growth outlook, and would buy dips if markets follow their usual seasonal patterns. Growth is picking up and inflation is low, a combination that has historically favoured equity relative outperformance. We are staying underweight Fixed Income, as we expect growth to surprise and inflation pressures to build.
- The UK property market has entered a hesitant phase with the impending European referendum vote introducing uncertainty and a cooling of sentiment and investor appetites. On the positive side, occupier demand remains relatively strong and a shortage of supply in prime assets continues to support rents, particularly in the Office and Industrials sectors. We expect the market to remain subdued until the European referendum vote takes place. We will maintain our Property allocation at a broadly neutral level.

6. ROYAL LONDON FUND REVIEW

Governed Range

The following funds/portfolios were discussed:

Governed Range – All of the Governed Portfolios and GRIPs underperformed their benchmarks over the first quarter of the year. The heightened volatility in Q1 coupled with the overweight position in equities, has had a negative impact on relative performance. This has impacted 12 month performance to the end of March where six Governed Portfolios are now underperforming as well as all the GRIPs. However, all 14 portfolios continue to comfortably outperform over three years.

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 suffered another poor quarter which now means that it underperforms its benchmark over 1 year. It continues to outperform over 3 years and the underperformance over 5 years has marginally improved.

Global Equity
The fund marginally underperformed over Q1 which is causing underperformance over

12 months. The relative underperformance over 5 years has improved and it continues to outperform over 3 years.

Managed
The fund has gone from outperforming over all periods in Q4 2015 to underperforming over Q1, 1 and 5 years. The relative performance over 3 years has marginally reduced but continues to outperform.

UK Ethical
The fund has suffered two consecutive poor quarters meaning it now underperforms over 12 months and 5 years. It continues to outperform over 3 years but relative performance has worsened over all time periods. See proposal to refocus this fund.

UK Government Bond
After a positive quarter last time, the fund's performance worsened again in Q1. This means the fund continues to marginally underperform over 3 and 5 years. It does, however, continue to outperform over 12 months.

UK Mid Cap
The fund's relative performance has worsened over all time periods. The fund continues to outperform over 5 years but underperforms over the other periods.

Externally Managed Matrix Funds

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

Fidelity American
The fund's poor performance continued over Q1 which means the underperformance over 1, 3 and 5 years continues. As agreed at the last meeting the fund will be given some time to recover performance. When compared against benchmark this fund looks poor, however recent analysis against the peer group was more favourable and illustrated the lack of good performance across active US managers as a whole. RM

A meeting was held with the manager in March. They accept their positioning was poor and like many active managers they were positioned for growth from cyclical-type stocks when the market went against them. The fund remains positioned for growth and should benefit from a continued recovery in the US economy. The manager is more domestically-focused as exposure to US companies operating in emerging markets previously impacted the fund. The fund will remain on watch.

Schroder Core UK Equity
The fund had a positive quarter and outperformed its benchmark. It is still underperforming over 1, 3 and 5 years but relative performance has improved over all periods. RM

A conference call was held with the manager on 3rd June. Poor performance has come mainly from 2014/15 where the manager was doubly impacted by an overweight in commodity-based cyclicals in addition to being underweight gilt-proxy defensive assets. Schroders have changed the fund to sit within their Pan-European Core Equity team with the manager, David Docherty being retained. There is now a stronger alignment between the fund manager and the research analysts with the latter being remunerated in line with the success of their recommendations. This should ensure more buy-in from the research team and better performance.

We gained a degree of comfort that performance issues have been addressed and recent performance has picked up. The fund will remain on watch and future performance monitored.

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

JPMorgan Emerging Markets
The fund had another positive quarter but remains an underperformer over 12 months. The historical poor performance continues to haunt the fund but relative performance has marginally improved.

The fund has a quality focus and therefore tends not to participate in short term rallies driven by sentiment. More sustained quality-driven rallies will favour the fund. Stock selection was the key detractor during the month, as core holdings in India and China underperformed. The portfolio is pointed towards domestic demand in emerging markets with overweights in the consumer sectors and financials, and underweight commodities.

JPMorgan US
The fund suffered a poor quarter and is now underperforming over 1, 3 and 5 years – performance has worsened over all of these periods.

Underperformance has been very short term coming mostly in January & March. January's poor performance was offset by comparable outperformance in February.

Neptune European Opportunities
The fund's performance had improved and it was no longer triggering for review. However, the fund suffered from very poor performance in Q1 underperforming the benchmark by almost 9%. This has resulted in significant underperformance over 1, 3 and 5 years.

The fund's European bank holdings – particularly in Italy – were the worst performers during the quarter as investors adopted a 'risk-off' stance. The fund's financials sector focus was the primary driver of the fund's underperformance over this period.

Other external funds

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

Fidelity Moneybuilder Income
The fund's performance picked up over Q1 and outperformed the benchmark. However, it is still underperforming over 1 and 3 years due to historical performance.

Fidelity Strategic Bond
Performance worsened this quarter and the fund now underperforms over 3 and 5 years in addition to 12 months causing the fund to trigger.

The fund has only just triggered so we will review again next quarter and if it is still triggering, feedback will be sought from Fidelity.

Investec Emerging Local Currency Debt
A positive quarter for the fund saw the underperformance over 12 months marginally improve. However, the fund remains haunted by poor historical performance over 3 and 5 years.

The fund produced positive returns over the quarter, although did underperform the performance comparison index. This was largely the result of a relatively cautious positioning going into the quarter, particularly within currencies.

Investec Global Energy
Relative performance worsened over Q1 causing greater underperformance over all time periods. The fund continues to suffer from historical performance.

Refining, midstream and renewable energy has weighed on the short-term performance of the fund. At a stock level, underweights in Petrobras and Canadian Natural Resources have been the main detractors in the fund.

Investec UK Special Situations
The fund had a positive quarter relative to the benchmark but due to historical performance, now marginally underperforms over 3 years in addition to 12 months.

The fund has only just triggered so we will review again next quarter and if it is still triggering, feedback will be sought from Investec.

Jupiter Ecology
Underperformance in Q1 means a marginal underperformance over 1 year after a strong Q4. This is in addition to poor performance over both 3 and 5 years.

Relative returns were impeded by the rally in resources stocks, which are not held in the fund due to its environmental focus, as commodity prices rebounded from their late-2015 lows. Elsewhere, global growth concerns impacted stocks that are sensitive to economic cycles.

Jupiter Financial Opportunities
The fund continues to suffer from poor performance over both 3 and 5 years. It remains an outperformer over 12 months but a poor Q1 has eroded the relative difference.

The fund’s low exposure to commodity currency countries was beneficial at the start of the year, when the defensive positioning assisted performance in a declining market. However, a sharp rebound in the energy complex in the second half of the quarter meant that the fund’s underweight position detracted from the fund’s quarterly performance. A bounce in relatively low-quality European banks in March also negatively affected the fund’s relative return for the period.

Jupiter Merlin Income
The fund had previously only been a marginal underperformer over 3 years. A poor Q1 means it is now underperforming over 1 year but is still outperforming over 5 years.

The fund has only just triggered so we will review again next quarter and if it is still triggering, feedback will be sought from Jupiter.

Jupiter Merlin Worldwide
The fund underperformed over the quarter and now sits below the benchmark over 1 year in addition to 3 and 5 years.

Reflecting the troubles in the global mining and energy sectors, the sold its position in a specialist gold mining fund early in the year which had a negative impact on performance.

Legg Mason US Smaller Companies
The fund was previously underperforming over 1, 3 and 5 years. Q1 was a strong quarter for the fund with over 5% outperformance. This now means that the fund is marginally outperforming over 12 months.

The fund's traditional downside protection characteristics thanks to its higher quality nature, which hadn't played out in recent years, finally came through during the start-of-the-year market correction resulting in this outperformance. Underlying stock performance has delivered most of the performance this quarter and a reversal in oil price declines and dollar strength should favour the fund.

M&G Global Basics
Short-term performance is starting to pick back up again due to another good quarter. The fund is now outperforming over 12 months but remains under the benchmark over both 3 and 5 years.

In a rollercoaster quarter for global equities, the fund outperformed the FTSE Global Basics Composite Index in euro and sterling terms. An overweight position and stock selection in basic materials added significant value, as did an underweight position and stock selection in consumer goods.

M&G Global Dividend
The fund finally had a good quarter but still underperforms over 1 and 3 years.

Energy-related holdings and stock selection in consumer discretionary added value over the first quarter. However, stock picking in materials was negative. Stocks in the fund's 'quality' basket, which emphasises steady dividend growth, underperformed holdings in the 'assets' bucket, which includes many of the energy-related holdings that recovered strongly during the quarter.

M&G Global Leaders
After a positive Q4, the fund took a backward step in Q1 and performance over 1 and 3 years worsened.

The fund's underperformance over the quarter was largely driven by stock picking in financials, technology and industrials. Performance was also detracted from sector allocation, in particular the fund's overweight position in technology.

M&G Recovery
The fund suffered another poor quarter meaning the underperformance over 1, 3 and 5 years continues.

Janice MacLean and Ryan Medlock attended a seminar hosted by Graham Mason, CIO at M&G, on 14 April. Graham explained that he is keeping the current management team in place for this fund despite the poor performance. The fund's manager (with Graham's guidance) is refreshing the portfolio by getting rid of smaller holdings. Graham suggested that performance was turning around due to his leadership and guidance, which he thought was lacking until his arrival. Whilst technically true, performance remains a worry.

Neptune Balanced
The fund underperformed by almost 4% in Q1 making the relative underperformance greater over 1, 3 and 5 years.

Neptune believe that the oil price will remain lower for longer, due to significant shifts in oil supply and disruptive alternatives, such as the growth of electric cars. Therefore, Neptune is significantly underweight in the energy sector compared to the benchmark, which has held back short-term relative performance. Underperformance was also driven by an overweight to Japan, particularly holdings in Japanese multinationals, which sold off given their Chinese exposure. In addition, the yen's strength also meant that the Fund's currency hedge suffered.

Neptune Global Alpha
The fund had a very disappointing quarter leading to underperformance over 1, 3 and 5 years.

The fund has only just triggered so we will review again next quarter and if it is still triggering, feedback will be sought from Neptune.

Neptune Global Equity
The fund suffered equally badly as the Neptune Global Alpha fund in Q1. This has worsened the underperformance over 1, 3 and 5 years.

Neptune remain overweight in both Japan and the US, focusing on quality growth companies that they believe can deliver sustainable growth over the long term. These include companies in the consumer, technology and healthcare sectors, as well as financials holdings that are consistent with our view that US rates will rise faster than consensus expectations. However, whereas stock selection in the US was a large positive to the Fund throughout 2015, the reversal of trends in the first quarter of 2016 was strongly detrimental to performance as previous winners sold-off.

Neptune US Opportunities
In line with Neptune's global funds above, the fund suffered from significant underperformance over the quarter. This has resulted in worsened underperformance over both 1 and 3 years.

Some of the worst affected companies during the widespread selling of equities were those in the healthcare, technology and consumer discretionary sectors, and the Fund's higher-than-benchmark weighting to these industries contributed greatly to relative underperformance. However, Neptune continue to believe that quality, market-leading companies in these sectors will be the greatest drivers of future returns in the US so the fund remains positioned in these areas.

On 26 May 2016, Neptune announced that the fund's manager, Felix Wintle, had departed the company. James Hackman has been announced as the lead manager of the Neptune US Opportunities Fund and Head of US Equities. Patrick Close will become co-manager and Ali Unwin will be an assistant manager on the Fund.

The IAC noted particularly volatile swings in performance across some Neptune funds and requested further information on reasons for this. RM

Newton Balanced
The fund had another positive quarter and relative performance has improved across all time periods. Unfortunately, the fund is still triggering as it remains under the benchmark over 3 and 5 years.

Relative performance is much improved but clearly the defensive tilt of both strategies over the last few years is still affecting the medium term numbers.

Newton Real Return
The fund has experienced two consecutive quarters of positive performance but remains an underperformer over 1, 3 and 5 years.

Over the quarter, the fund over-saw a reduction in the fund's 'return-seeking' core through an increase in direct equity protection. The growth outlook continues to be of concern and the fund's manager believes that the second quarter is likely to be beset by continuing uncertainties.

Rathbone Strategic Growth
The fund marginally underperformed in Q1 but this has led to underperformance over both 1 and 3 years.

The fund has only just triggered so we will review again next quarter and if it is still triggering, feedback will be sought from Rathbones.

Schroder Global Property Securities
Q1 caused further underperformance for the fund and remains under the benchmark over all time periods.

Short term sentiment drove valuations in Q1 resulting in volatility in the fund. This fund tends to hold companies for the long term focused in cities that will lead global growth. Performance in April has already picked up as fundamentals have started to be rewarded again.

Threadneedle Absolute Return Bond
The fund underperformed its benchmark by more than 4% over Q1. This has worsened the relative performance over all time periods.

Underperformance can be attributed largely to a short duration bias and currency positioning. Throughout 2015, the fund was positioned for higher government bond yields, driven by a Federal Reserve tightening cycle. Whilst the Fed did eventually tighten policy in December, this was well below the manager's expectations at the start of the year. Within currency strategies, long positions on the likes of Mexican Peso contributed significantly to underperformance in the second half of the year.

Threadneedle Latin America
The fund had a positive Q4 but relative performance took a turn for the worse in Q1 and the fund remains an underperformer over 1, 3 and 5 years.

Over the past year, the fund underperformed the benchmark. The main reason for the underperformance was the fund's positioning in Brazil, where the slowdown of the consumer was underestimated.

UBS Global Blended
The fund suffered further underperformance over Q1 and continues to sit below benchmark over 1, 3 and 5 years.

UBS Global Allocation (50:50)
A poor Q1 means the fund is now underperforming over 3 and 5 years in addition to 12 months.

The fund has only just triggered so we will review again next quarter and if it is still triggering, feedback will be sought from UBS.

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

Investec Cautious Managed, M&G High Yield Corporate Bond, Schroder Income Maximiser, Schroder Managed Balanced

7. DATE FOR NEXT MEETING

The next quarterly meeting is 30th August 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.

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