Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date
04/12/2018

Present members	In attendance	Apologies
Julius Pursaill (Chair)	Peter Dorward	
Colin Taylor	Lorna Blyth	
Ewan Smith	Niall Aitken	
Piers Hillier	Joseph Smith	
James McCourt	Khalid Khan	
Candia Kingston*	Kirsty Ross	
	Robert Whitehouse	
	Gareth Dickson	
	Paul Rayner	
	Ben Nicholl	
	Trevor Greetham	

*Welcome to Candia Kingston who has joined the IAC as an independent member from December

Owner

1. **REVIEW OF PREVIOUS MINUTES**
The minutes of the 29 August 2018 meeting were approved. (subject to CK being added to attendee list). — All

2. **PROJECTS**

Property Fund — GD & NA

Gareth Dickson (RLAM) attended the meeting to provide an update on the cash position of the Property fund, and the impact this has had on performance.

The IAC initially discussed the cash position following the 2016 Brexit vote to date. It was noted that there was a slowing down of property purchases following the vote due to the uncertainty in the market. The IAC requested more visibility of the RLMIS oversight of the fund going forward and particularly in the run up to Brexit. RLI will work with the Property team to provide this detail.

The IAC appreciated the difficulties in managing a property fund of this size, and they noted that the property team were expanding and that lot sizes have increased. However the IAC did want further assurance that plans being put in place now are sufficient to deal with the expanding nature of the fund not just in 2019, but in the following years too. The IAC was supportive of additional cash management tools, as well as extending the available property investment universe, subject to BAU governance and approval processes.

Active Bond Management KR, PR & BN

The IAC had previously asked for justification for maintaining an active management approach for the RLI Gilt and Index Linked funds, given decisions elsewhere in the group to move to a passive approach.

Paul Rayner and Ben Nicholl attended the meeting to talk through the justification, which centred around 3 key points:

1. Active management has delivered outperformance over 3 years
2. Active management can better exploit both the expected volatility in bond markets and rising yields
3. There are timing issues with the rebalancing of the governed range which would result in randomised over or under performance of a passive strategy vs the benchmark; these issues can be managed better through active management.

The IAC were generally supportive of the continued use of active management for these funds, however they requested a view from the Investment Office on the matter. They also asked for clarity on whether bond futures could be used in these funds.

SAA Framework Review – GP5 NA

Royal London Group are currently implementing a Strategic Asset Allocation framework across the group. GP5 was used to test the framework, and Niall Aitken presented the outcome of this test to the IAC for information. The test was conducted by Willis Towers Watson (WTW) and they concluded we are holding an efficient portfolio for GP5. This validated the methodology of Moody's Analytics in informing our SAA, and Peter Dorward noted that the outcome of the WTW analysis provided reassurance that SAA is optimal.

The IAC noted the ability to better model absolute returns now compared with when the SAA review was last conducted. They expressed some interest in the use of Multi Asset Credit within the portfolios and this will be looked at as part of the review in 2019.

STRATEGIC ANALYSIS NA

Governed Portfolios & Managed Strategies
No changes are recommended to the Governed Portfolio and Managed Strategy benchmarks this quarter.

All portfolios remain within their target ranges for real volatility with the exception of GP3 and the Cautious Long Term Managed Strategy which have dropped slightly below the lower limit. This was discussed and no further action for these portfolios was agreed at this time. This is the first quarter these portfolios have been flagged, and there is a SAA review due for the GPs in 2019.

Governed Retirement Income Portfolios (GRIPs)
No changes are recommended to the GRIPs strategic benchmarks this quarter.

All portfolios remain within their targets for the income risk metric (income sustainability) and the fund risk metric (maximum 1 year loss at the 5^{th} percentile)

Lifestyle Path Analysis
Driven by higher expectations of inflation the expected real income for annuity lifestyles has decreased by almost 3% compared to the previous quarter over the longer term, and stayed flat over the shorter term.

The expected real fund value of the drawdown lifestyles has increased across all periods. In particular, the expected real fund values have increased by 1.2% over 15 years, 3.0% over 10 years and 2.8% over 5 years.

TACTICAL ANALYSIS

Governed Portfolios, Managed Strategies and Governed Retirement Income Portfolios (GRIPS)

All portfolios remain within their tactical risk budgets.

There have been three tactical changes in the last quarter;

- In July, we continued to take profits on our equity positions reducing the overweight to its lowest level since 2012. We also reduced our overweight commodity allocation with the proceeds moved into government bonds and cash reducing these underweight positions. We were modestly overweight global equities, global high yield bonds and commodities.
- In August, we continued to reduce exposures to equities and commodities, bringing the latter into line with the benchmark. The proceeds were moved into government bonds, short dated high yield debt and cash. We were modestly overweight global equities and short dated global high yield bonds.
- In September, we continued to de-risk portfolios by reducing exposures to equities and commodities, moving the latter allocation to an underweight relative to the benchmark. The proceeds were moved into government bonds, short dated high yield debt and cash.

The overall position as at end September, was **overweight Equities, High Yield Bonds and Corporate Bonds; underweight Absolute Return Strategies (inc. cash), Gilts and Commodities.**

Short term tactical view of the Chief Investment Officer

TG reviewed Q3 2018 and presented RLAM's rationale for the current short term tactical view:

Positioning & Activity

- We continued to de-risk our multi asset portfolios during the third quarter, as economic data tended to come in on the soft side of expectations. Holdings of both equities and fixed income were at near-neutral levels by the end of the period.
- The commodities allocation was moved to an underweight from an overweight, as a backdrop of weaker global growth and a strengthening dollar tends to be negative for the asset class. Exposure to UK commercial property was maintained at a neutral level over the period.
- By region, we maintained an overweight in the US, given the relative strength of the nation's economy, and in Japan, which is a leading exporter and tends to benefit from global growth and from a stronger dollar. Below benchmark allocations were maintained to emerging markets, which have more difficulty in servicing dollar-denominated debts when the currency strengthens, and to the UK and continental Europe, which are dealing with Brexit uncertainty. We moved to an underweight in Asia Pacific (excluding Japan) from a neutral position.

Market Background

- Global equities recorded a 6.2% return for UK investors during the quarter, led by a strong performance from the US (8.8%). Returns from Japan (5.0%), Asia Pacific (excluding Japan) (3.3%) and continental Europe (3.1%) also were positive, while UK shares returned -0.7%.
- Trade weighted Sterling weakened for a third quarter in four, as political uncertainty remained elevated with the outcome of Brexit still unresolved, and the UK's scheduled departure from the EU in March 2019 drew closer. The dollar and the euro strengthened relative to the pound.
- Conventional UK government bonds (all maturities) returned -1.7% as the 10-year gilt yield rose sharply, against a backdrop of anticipated monetary policy tightening and weakness in sterling. Sterling investment grade credit and index linked government debt outperformed, returning -0.4% and -1.2%, respectively (all maturities). The average sterling investment grade credit spread narrowed to 1.2% as revived investor risk appetite and sustained strength in company earnings supported demand for corporate debt.
- In commodities markets, Brent crude oil rose for a fifth straight quarter and ended the period above $82 a barrel amid concern that US sanctions against Iran might crimp supply. Metals continued to fall, as copper was undermined by a

backdrop of concern about trade wars and gold's investment appeal was eroded by elevated equities and rising bond yields.
- UK commercial property returned 1.7% during the quarter, for a year-to-date return of 6.0%.

TAA Performance

- Given the de-risking of portfolios that took place during the summer, TAA effects were relatively muted over the quarter. There were small positive contributions from overweighting Equities and underweighting Cash whilst an overweight stance in Commodities marginally detracted. Fixed Income and Property allocation effects were broadly neutral.
- Regional positioning within Equities was positive over the quarter with performance benefiting from overweighting overseas markets at the expense of underperforming UK equities. Across the overseas regions, overweight allocations to the US and Japan at the expense of continental Europe and Emerging Markets, all contributed positively to relative performance.
- Within Fixed Income, the overweight exposure to investment grade corporate debt offset a small positive contribution from underweighting conventional and index-linked UK government bonds which underperformed as Gilt yields rose over the period.

Outlook & Views

- Our investor sentiment gauge ended October deep in panic territory, but at the same time, US company directors were still buying their own shares, indicating confidence in earnings. During this period, our Investment Clock model also moved out of its 'Stagflation' stage and towards the 'Reflation' phase following recent sharp falls in oil prices.
- These were both positive signs and we started adding to Equities from a near-neutral starting point in early Q4 predominantly funded out of Cash. The underweight in Bonds, and UK gilts specifically, was constrained given near-term risk factors including higher US interest rates and inflation, weaker growth, and geopolitical risks related to trade wars and Brexit
- Within Equities, we remain overweight the US and Japan, and underweight the UK, continental Europe, Asia Pacific (excluding Japan) and Emerging Markets. Within Fixed Income, we are modestly underweight Gilts, with above benchmark holdings of sterling investment grade corporate bonds and short duration global high yield debt. Commodity exposure has been moved modestly underweight, and UK commercial property exposure kept around neutral.
- With no central banks in a hurry to tighten policy and China easing, we remain buyers of equities on weakness, as we expect the global expansion to continue into 2019. Longer term, we remain constructive on stocks.

ROYAL LONDON FUND REVIEW KK

The following funds/portfolios were discussed. All data is at end September 2018.

RLI Governed Range

All Governed Portfolios underperformed their benchmarks over the quarter, with the exception of Governed Portfolio 3. All Governed Portfolios are ahead of benchmark over 1 year and 5 years to end of September 2018. All of the Governed Portfolios are ahead of benchmark over 3 years to end of September 2018, with the exception of GP 7.

All five GRIPs are ahead of benchmark over the quarter. They continue to outperform over one, three and five years and also since launch.

RL pension funds
The number of RLAM funds triggering for review over this reporting period is 12.

Global Managed
The fund has underperformed over the 3 and 5 year periods with the majority of the underperformance coming in 2016,when equity prices fell by around 10% over the space of 3-4 weeks. RLP Global Managed was overweight US & Japan at this time, both of which were particularly affected over this period. Over the 5 years to September 2018, the fund underperformed the benchmark by 0.1%.

The IAC noted ability to now access Canada using futures and currency forwards, and asked for a deep dive into this fund at the February 2019 Meeting.

Property
The fund has outperformed benchmark over 1, 3 and 5 years to end of September 2018.

Commodity
The Fund is underperforming over the quarter and 1year to the end of September 2018. The fund was launch in June 2016 and as such lacks a long term track record.

Sterling Extra Yield
The fund is outperforming over 1, 3 and 5 years and finished the quarter ahead of benchmark.

Global High Yield Bond
The fund is underperforming over 1, 3 and 5yrs to the end of September 2018. However the underlying RLAM OEIC is outperforming its benchmark across 1 and 5 years.. During the last quarter the fund outperformed the benchmark due to exposure to the media sector. The fund continues to retain a shorter duration than the index and has a preference for B and BB rated issues.
We are in dialogue with RLAM to understand how we can show performance against actual benchmark going forward.

Externally managed matrix funds

The following funds are under review and are subject to discussion at this meeting:

The **Stewart Investors Emerging Market Leaders Fund** has triggered red for six consecutive quarters and is underperforming over one, three and five years. Morningstar have upgraded the fund from bronze to silver based on their increased confidence in the new managers adherence to the house investment style. The fund is currently soft-closed and has underperformed by 4% over the quarter however is outperforming to end November. The fund also contains 7.8% exposure to non-GEM listed companies in addition to a cash weighting of 13%. Taking the above into consideration, the IAC were comfortable to maintain the Stewart Investors Emerging Market Leaders Fund as the Emerging Market Specialist category choice within the Matrix. We will continue to closely monitor the performance of this fund.

The **Artemis UK Special Situations Fund** has triggered red for ten consecutive quarters and is underperforming over one, three and five years. Performance over the quarter has been poor, largely driven by management's value orientated stock selection. Morningstar retain a bronze Analyst Rating for this fund. The investment process of the fund focuses on identifying companies that are in recovery, need re-financing or are suffering from investor indifference. Returns on such a specialist fund can often differ significantly from those of the underlying benchmark. We maintain a belief in the robustness of the investment process and management's ability to add value over the longer term. As such IAC are happy to hold the Artemis UK Special Situations Fund continuing to monitor performance.

Rathbone Global Alpha
The fund finished behind of the benchmark over Q3 2018, is ahead over 1 year and remains marginally behind over 3 and 5 years to end September 2018.

RLI have a meeting with Rathbones on 11 January to discuss the future strategy of the fund as well as tracking error measures. The IAC expressed concern about the mixed messages from Rathbone in terms of appetite to change risk budgets, and asked that this be raised at the meeting.

The following points were also discussed during the meeting:

Morningstar Changes
We have amended our reporting to include a clear Morningstar view of each matrix fund which has triggered. This means going forward we now have a view from Morningstar and RLI for each fund on watch.

Transaction Costs
We now receive transaction costs for all RLAM and matrix funds with the exception of the Close funds. We continue to chase Close for this information. All fund managers have confirmed they are following PRIIPs methodology and using Arrival Price where available with the exception of Artemis, Schroders and JP Morgan who have yet to respond.

RLI Life and Pegasus Funds
These funds are also monitored each quarter by the Investment Performance Committee. As these funds are neither pensions, part of the Governed Range nor matrix funds IAC agreed with the proposal to remove them from the IAC pack going forward..

AOB All

Brexit
TG gave an update on Brexit outlook, noting that positioning is about hedging risk, rather than predicting an outcome at this stage.

There was thorough debate amongst the IAC about positioning, and they agreed that, given the uncertainty, there is no appetite to position for a particular outcome. There was a consensus that it is sensible to remove unconscious risks and minimize conscious risks during this period.

The IAC noted the work underway to prepare operationally for Brexit. They expressed a sense of urgency and requested to see a documented plan of action, given the timing of Brexit discussions and deadlines.

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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