Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date
28/02/2017

Present members	In attendance	Apologies
Julius Pursaill (Chair)	Ryan Medlock	Piers Hillier
Colin Taylor	Robert Whitehouse	
Ewan Smith	Ryan Hamill	
Rachel Elwell	Niall Aitken	
Andrew Carter	Trevor Greetham	
Isobel Langton	Robert Dundas	
	Lorna Blyth	
	David Coombs (Rathbones)	
	Will Mcintosh-Whyte (Rathbones)	

Owner

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

2. **PROJECTS**

Neptune European Opportunities matrix fund replacement
At the last IAC meeting, a paper was presented outlining a proposal to remove the RLP Europe Specialist (Neptune European Opportunities) fund. The IAC approved the decision to replace the fund based on underperformance over the longer term coupled with the magnitude of risk taken within the fund.

A paper was presented at this meeting detailing the analysis completed in selecting a replacement for the above fund. The IAC approved the recommendation to replace this fund with the Columbia Threadneedle European Select fund. We plan to make this change later in 2017 and will be mailing affected policyholders and their advisers ahead of the change.

GRIP SAA review
A paper was presented on the progress of reviewing the GRIP strategic asset allocation (SAA) positions. Investigations continue and it is planned that we will complete the review and seek approval for changes later in 2017. The IAC are pleased with the progress of this project and look forward to the next update in Q2.

3. **CUSTOMER INVESTMENTS**

STRATEGIC ANALYSIS

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. The real volatility for the majority of the portfolios has remained broadly unchanged compared to the previous quarter.

Governed Retirement Income Portfolios (GRIPs)
Similarly to previous quarters, the long term measure for all GRIPs is triggering red, suggesting that the portfolios are not taking enough risk. The long term measure for all portfolios has deteriorated further, meaning the portfolios are further outside their target range. This risk metric compares the portfolios to a 10 year index linked bond, the expected real returns of which have remained broadly the same within Moody's model. The IAC requested detailed analysis to establish what SAA changes would be required to bring the portfolios back within budget, but concluded that the increased risk required was too substantial for the IAC to accept pending the completion of the SAA review

Lifestyle Path Analysis
The expected real income for policyholders following annuity lifestyles has increased compared to the previous quarter due to an increase in the yield curve. In particular, the expected annuity incomes have increased by 3.7% over 5 years and 5.3% over 15 years.

The drawdown lifestyles are generating higher expected returns compared to the cash lifestyles, but have lower projected values in extreme scenarios (at the 5% tails), due to the investment in riskier assets. The expected real fund value of the drawdown lifestyles has decreased by 1.25% over 5 years but increased by 2.41% over 15 years.

RLP Commodity fund
We continue to monitor those policyholders invested in the RLP Commodity fund out with the Governed Range and engage with advisers.

Default review
We continue to monitor workplace pension customer behaviour and there has been no material change in trends. We remain comfortable that an annuity endpoint remains appropriate for a majority of our customers pending completion of the GRIP SAA review.

4.

TACTICAL ANALYSIS

Governed Portfolios & Managed Strategies
All portfolios remain within their tactical risk budgets.

There has been one tactical change since the last meeting. The change in January saw us reducing our exposure to index linked bonds and government bonds, while increasing our exposure to equities and commodities.

This leaves us overweight in equities, commodities and corporate bonds with underweight positions in government bonds, index linked bonds and absolute return strategies (including cash). The portfolios continue to be neutral in property and global high yield.

Governed Retirement Income Portfolios (GRIPs)
All portfolios remain within tracking error targets, although GRIP 1 remains amber due to increased stock selection risk. However, we are at the lower end of the amber scale.

There has been one tactical change since the last meeting. The change in January saw us reducing our exposure to bonds, while increasing our exposure to equities.

The current overall position is overweight in equities, high yield bonds and government bonds. We are neutral in property and underweight in index linked bonds and corporate bonds.

Short term tactical view of the Chief Investment Officer

TG reviewed Q4 2016 and presented RLAM's rationale for the current short term tactical view:

Positioning

- Moderate overweight positioning in equities was increased at the expense of Cash at the start of the quarter, as economic and survey data continued to surprise on the upside and a tentative OPEC supply agreement helped to underpin oil prices. Positioning was then tactically trimmed ahead of year end as sentiment indicators approached euphoric levels
- Regionally, the Europe underweight was deepened in early Q4 before taking profits into the Italian referendum, whilst adding to Japan on a pick-up in nominal growth and USD strength
- Fixed income exposure was reduced in the middle of the quarter after tactical model readings on bonds moved to maximum underweight as global growth and inflation indicators continued to strengthen. With fixed income positioning mainly expressed through UK bonds, a more moderate underweight is applied given an uncertain 2017 UK economic outlook
- For portfolios with an allocation to Commodities, exposure was maintained at neutral during Q4 as rising global growth demand was counterbalanced by oversupply conditions in key markets and a strengthening US Dollar. UK Property, where returns continued to lag on uncertainty related to Brexit, was held at a neutral level during the quarter.

Q4 Market Background

- The election of Donald Trump was the dominant event of the quarter, as hopes of reflationary policies and firmer economic and survey data, boosted growth and inflation-linked assets
- Global equities rallied almost 5% in local currency terms, and c. 7% in Sterling in Q4 as investor sentiment was boosted by the unexpected US election result. Expectations of fiscal stimulus combined with major US tax reforms and deregulation also led to a rise in inflation and growth expectations which in turn

caused a selloff in global government bond markets

- Despite a narrowing corporate bond spreads, IG Credit markets also fell over Q4 whilst Global High Yield indices managed a marginally positive return on Energy-related gains
- Sterling fell by a further 5% against a surging US Dollar over the quarter, as US-UK interest rate differentials continued to widen. However, the Pound recorded gains of 2% and 10% against the euro and yen respectively as ECB and BoJ policies remained highly accommodative
- Commodities rose in both local and Sterling terms after oil prices surged 15% following co-ordinated agreements by OPEC and non-OPEC suppliers to cut production and support pricing. Industrial metals also jumped on stronger Chinese growth data whilst Gold fell back on rising US rate expectations and waning investor appetite for haven assets
- After a swift pricing correction in the summer, the UK property market proved to be surprisingly resilient in Q4 on better than expected UK economic data. With limited supply, low vacancy and robust occupier take-up, Industrials extended outperformance over Office and Retail in Q4. Office continued to lag on the perceived Brexit threat to the City of London.

Relative Positioning & TAA Performance

- TAA effects contributed positively over Q4 as performance continued to benefit from overweighting outperforming equities, and unhedged overseas markets in particular, funded out of Fixed Income. UK Property, Commodities, and Cash & Absolute Return allocations were all maintained at or around benchmark levels during the period
- Regional underweight stances in US and Europe detracted, as both markets rallied sharply led by financials and industrials, whilst regional overweights in Japan and Asia/EM lagged
- Fixed Income positioning was also a positive contributor over Q4 as a result of short duration positioning expressed through underweighting conventional and index-linked Gilts. Relative returns also benefited from a preference for Investment Grade Credit as corporate credit spreads tightened over the period
- UK Property exposure continued to be held at a broadly neutral level as the market outlook remains delicately poised between post-Brexit uncertainty weighing on the London City Office market and good long term income generation supported by better than anticipated consumer spending and growth data.

Outlook & Views

- We expect a positive investment backdrop for risk assets to continue with global growth strengthening and interest rates remaining below the level of inflation.
- That said, an unpredictable leader in the White House, Brexit negotiations, and a crowded electoral calendar in Europe could result in a selloff in risk assets from time to time. However with global growth picking up and the earnings outlook improving, we would view market dips as likely buying opportunities
- With nominal global growth now at its strongest since the financial crisis, we also consider the environment is now becoming more favourable for Commodities and less attractive for Cash and bonds where low yields offer very little protection against upside surprises in inflation
- Although UK Property remains an attractive proposition with a 5% income return supported by robust occupier demand and a shortage of good quality stock in prime locations, there are risks to this outlook. Brexit related risk to central London offices and the secondary end of the market means we retain a neutral

stance.

5. ROYAL LONDON FUND REVIEW

The following funds/portfolios were discussed:

RLI Governed Range
Performance since launch is still strong with all nine Governed Portfolios outperforming their benchmarks. All portfolios continue to outperform over five years and are in line with benchmark over three years. The Governed Portfolios had their second strongest year since launch over 2016 delivering double digit returns across the board. Despite this, relative performance over 12 months was poor.

The TAA process made a positive contribution to seven of the Governed Portfolios' performance over the course of 2016 with relative returns benefitting from the overweight position in equities at the expense of short and medium-dated bonds and cash. However, the positive effect of this was outweighed by the negative impact of the following factors below:

- RLP Global Managed fund holdings
- Timing difference on pricing between RLP Global Managed and the benchmark
- Fixed interest performance

Despite the GRIPs producing attractive absolute gains, they are also underperforming their benchmarks over 12 months and are also marginally under over three years. The same RLP Global Managed factors that are detracting performance from the Governed Portfolios are also impacting the GRIPs. In addition, the RLP Sterling Extra Yield Bond fund has underperformed its benchmark despite strong absolute returns.

RL pension funds
A significant number of RLAM equity funds have triggered for review this quarter. The main reason for the underperformance in the UK equity funds has been attributed to sector positioning. The underweight position in financials and overweight position in healthcare was unhelpful as banks rallied and pharmaceutical shares were weak in anticipation of policy changes following Donald Trump's victory in the presidential election. An underweight position in industrials and oil & mining sectors and above benchmark weighting to mid-cap shares, an area of the market which significantly lagged the broader stock market during 2016 due in part to the unexpected Brexit referendum result, were also a significant detractor.

RLAM continue to focus on investing in those companies with strong balance sheets, healthy cash flows and positive earnings optionality within their active UK funds. These defensive holdings have contributed to this underperformance but RLAM are keen to continue with these positions due to the uncertain outlook.

As noted in previous IAC meetings, RLAM's fixed interest funds are positioned for long term interest rates to rise by adopting shorter duration positions where possible. This positioning created underperformance as UK economic uncertainty in the immediate aftermath of the Brexit vote pushed long bond yields to new all-time lows. Taking all of the above into account, we are not recommending any further action on the RLAM funds that are triggering for review, but we are continuing to keep a close eye on how performance develops.

RLAM funds on watch:

- **Adventurous Managed**
- **Managed**
- **UK Equity**
- **UK Ethical**
- **UK Mid Cap**
- **UK Opportunities**
- **UK Smaller Companies**
- **European**
- **Worldwide**
- **Global Equity**
- **Global Managed**
- **International Government Bond**
- **UK Government Bond**
- **Index Linked**
- **Global Index Linked**
- **Sterling Extra Yield Bond**

Externally managed matrix funds

The following funds are under review and were subject to further action before the meeting:

Fidelity American
The fund has been triggering for review for the last ten quarters and once again underperformed the benchmark over Q4. It has also seen a number of fund manager changes over the last three years. We had previously taken comfort from the current manager's track record on the other US portfolios he manages at Fidelity.

A conference call was held with the manager to gain a better understanding of the recent performance detractors and how he is currently positioning the fund. The manager is positioning the fund with a number of significant sector bets raising concerns about the level of risk being taken and the impact on future performance relative to the peer group.

As a result of this the IAC approved the decision to replace this fund. Work is now underway to highlight a suitable replacement and a recommendation will be put to the IAC for approval at the next meeting in June.

Rathbone Global Alpha
David Coombs and Will Mcintosh-Whyte from Rathbones attended the meeting to provide an update on the Rathbone Global Alpha fund. This is the equity vehicle used in the external active version of the Target Lifestyle Strategies. Until the end of 2015 the fund had performed well against its benchmark however 2016 was a poor year. The fund underperformed over Q4 and remains under the benchmark over one, three and five years. It also remains under its three year rolling target of benchmark +2%, net of all fees.

'The manager stated that he had some taken action to protect the fund in case of a leave vote but the fund was still positioned for a ‘remain’ vote, and performance was impacted by the strong mid and small cap bias in active UK equity funds. This fund is run within a 1-5% tracking error against benchmark and the manager stated that this limited his ability to position the fund in line with his views. The IAC asked the manager if he wanted a larger tracking error for the fund however he was uncomfortable about adding risk to the fund at the moment.

The IAC has collated a number of follow-up questions to raise with Rathbones regarding the underperformance. Responses will be shared and discussed with IAC members prior to the next meeting. RM

The following funds were discussed and will remain on watch and under scrutiny:

Investec UK Smaller Companies
The fund had a bad quarter and continues to underperform over all time periods. The underperformance over three and five years is particularly disappointing.

The manager continues to believe it is strength in earnings which will drive UK smaller company equities. Though the pace again comes into question, recent corporate results show progress in some sectors. The manager also notes that those sectors with the most headwinds, namely financials, have had to contend with the ultra-low interest rate environment. Should this trend reverse, the manager believes will see headwinds reduce.

The fund is sitting in the fourth quartile (both in performance terms and risk-adjusted terms) over all time periods and has consistently taken a higher level of risk versus the peer group. We will be interviewing the manager in March to address the performance concerns. An update will be provided at the next IAC meeting.

JPMorgan US
The fund outperformed for a second successive quarter and the relative underperformance over one, three and five years has continued to improve.

The fund has benefitted from strong stock selection across the board. This has only been tempered slightly by the overweight position in health care.

This is a Specialist fund and has comfortably outperformed the US Core Plus fund over the long term. We are not proposing to replace this fund but we will be requesting further information from the manager in relation to how the fund is being positioned going forward. The fund has consistently been a third quartile performer on a risk-adjusted basis.

Other external funds

At the last IAC meeting, it was noted that there were concerns with the performance of a number of Jupiter funds and the suite of Invesco Perpetual’s fixed interest range that we link to. This quarter, five Jupiter funds remain triggering whilst all four Invesco Perpetual fixed interest funds continue to flag up although there was a pick-up in short-term performance in Q4. We have held meetings with both Jupiter and Invesco Perpetual to gain a better understanding of the performance detractors and how the funds are currently being positioned. We will continue to pay close attention to the performance of these funds but are comfortable with the reasons given for the underperformance.

The following funds also remain on watch:

- 7IM AAP Moderately Cautious
- Baillie Gifford High Yield Bond
- Baillie Gifford UK Equity
- BMF Balanced
- BMF Defensive Income
- Fidelity Emerging Europe, Middle East and Africa
- Fidelity Moneybuilder Income
- Fidelity Strategic Bond
- Fidelity UK Select
- GLG Balanced Managed
- GLG Stockmarket Managed
- Invesco Perpetual Corporate Bond
- Invesco Perpetual Distribution
- Invesco Perpetual Global Bond
- Invesco Perpetual Monthly Income Plus
- Investec Emerging Local Currency Debt
- Investec Global Energy
- JPMorgan Cautious Managed
- JPMorgan Natural Resources
- Jupiter Ecology
- Jupiter European Special Situations
- Jupiter Financial Opportunities
- Jupiter Merlin Income
- Jupiter Merlin Worldwide
- Legg Mason US Smaller Companies
- M&G Corporate Bond
- M&G Global Basics
- M&G Global Leaders
- M&G Recovery
- M&G Strategic Corporate Bond
- Neptune Balanced
- Neptune Global Alpha
- Neptune Global Equity
- Neptune US Opportunities
- Newton Global Higher Income
- Newton Real Return
- Rathbone Enhanced Growth
- Schroder European Opportunities
- Schroder MM Diversity Balanced
- Schroder MM Diversity Tactical
- Schroder MM UK Growth
- Schroder Global Cities Real Estate
- Columbia Threadneedle Absolute Return Bond

- Columbia Threadneedle Latin America
- UBS Global Blended (50:50)

6. **DATE FOR NEXT MEETING**

The next quarterly meeting is 13 June 2017.

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.