

Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date

29/08/2017

Present members

Julius Pursaill (Chair)
Colin Taylor
Ewan Smith
Rachel Elwell

In attendance

Ryan Medlock
Robert Whitehouse
Ryan Hamill
Niall Aitken
Trevor Greetham
Piers Hillier
Robert Dundas
Lorna Blyth
Ian Dilks

Apologies

Andy Carter
Isobel Langton

Owner

1. **REVIEW OF PREVIOUS MINUTES**

The minutes of the 13 June 2017 meeting were approved.

2. **PROJECTS**

GRIP risk metrics & Strategic Asset Allocation (SAA) review

RD

A paper was presented highlighting revised risk metrics for the IAC to consider using for the GRIPs. This included new metrics to highlight retirement income sustainability score and age of ruin. The IAC are supportive of the proposal and look forward to seeing them being implemented in due course.

An update was provided on the proposed GRIP SAA changes. The proposed allocations are subject to approval within Royal London's governance framework.

Workplace pension investment default

RD

The IAC reviewed the investment default end-point and appropriate customer outcomes. The IAC were supportive of the review and recommended that it should also be discussed by the Independent Governance Committee (IGC).



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 risk measure for all GRIPs is triggering red, suggesting that the portfolios are below their target risk levels. The long term measure for all portfolios has deteriorated further, meaning the portfolios are further outside their target range. This issue is being addressed through the GRIP SAA review currently ongoing and is anticipated to be addressed by the end of the year.

This quarter we have seen an improvement in the short term risk metric for GRIP5 taking it back within its target range. This is mainly being driven by the slight increase to the real yield curve.

Lifestyle Path Analysis

The expected real income for 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 3.6% over 5 years and 2.8% over 15 years.

The expected real fund value of the drawdown lifestyles has increased by 2.03% over 5 years and by 3.15% over 15 years.

4. **TACTICAL ANALYSIS**

Governed Portfolios & Managed Strategies

All portfolios remain within their tactical risk budgets.

There have been three tactical changes since the last meeting. The change in June saw us trimming our positions in commodities and absolute return, and adding to bonds. In July, we removed our overweight commodities position in favour of bonds. In August, we added to global high yield out of absolute return strategies including cash.

The overall position as at end June, was overweight equities, commodities and high yield bonds; underweight absolute return strategies (inc. cash) and gilts; neutral property; with mixed positioning in index-linked bonds and corporate bonds.

Governed Retirement Income Portfolios (GRIPs)

All portfolios remain within tracking error budgets.

There has no tactical change since the last meeting.

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

Short term tactical view of the Chief Investment Officer

TG reviewed Q2 2017 and presented RLAM's rationale for the current short term tactical view:

Positioning & activity

- Overweight positioning in equities was reduced over the quarter, as global growth and inflation indicators showed signs of peaking. Seasonality also suggested taking profits in equities ahead of the traditionally more volatile summer months in order to buy on dips. Positioning in Global High Yield was increased as a lower risk way of gaining corporate exposure.
- Regionally, the underweight exposure to Europe was decreased ahead of the French Presidential election and moved to overweight as the European political outlook stabilised and growth indicators continued to improve. We maintained modest overweight's in Japan and the Far East as the outlook for global growth remained broadly positive.
- Fixed income exposures remained underweight, but with inflationary and interest rate pressures declining, the underweight position was reduced by adding exposure to Gilts. Despite trimming the Credit overweight, the preference for corporate bonds, particularly in the UK, was maintained given ongoing demand from the Bank of England's asset purchase program.
- For portfolios with an allocation to Commodities, concerns over weakening Chinese activity following monetary tightening led us to trim the overweight positioning. Property and Cash exposures were maintained at or around benchmark weights.

Q4 market background

- Global equities returned 0.5% for Sterling-based investors over the 2nd quarter. Europe generated the best return (GBP) of 5.2% followed by Japan and Asia Pacific excluding Japan, which returned 1.5%, and 0.9% respectively. The US market fell 0.7% over the quarter led by Energy and Telecom Services. The UK underperformed with a return of 0.3%.
- Global bond market returns diverged over the period. Peripheral Eurozone government debt generated positive returns, benefiting from a decline in European political risk and dovish ECB monetary policy guidance. US Treasuries also performed positively, whilst UK conventional and Index-linked Gilt yields rose on political uncertainty.
- Having been volatile during April and May before grinding lower into mid-June, UK government bond yields rose sharply at the end of Q2 following the unexpected general election result and a surprise split BoE MPC decision on interest rates. Index linked Gilts were particularly weak with a fall of 2.4%, compared to conventional bonds which fell 1.4%.
- Sterling Investment Grade Credit outperformed UK government bonds with a positive 0.5% return in the quarter. Gilt yields were volatile, reflecting increased political uncertainty around the snap general election and Brexit negotiations. A sell-off in global bond markets in late June took ten-year UK government bond yields above the level prevailing at the beginning of the year. This upward move in yields reflected expectations that supportive monetary policies could soon be withdrawn in several of the major economies. Against this background, Sterling corporate bond markets remained resilient; especially as signs of a slowdown in UK activity became more evident.

- Commodities fell during Q2 led by a sharp decline in oil prices during June amid fears that higher inventories and US shale production would offset the effect of a supply cut extension agreed by OPEC. Having been volatile throughout the period, the oil price ended the quarter roughly 9% lower, at around \$46 per barrel.
- UK Commercial property remained relatively stable in performance terms, with capital values on average growing at around 0.3% per month during the first half of the year. The IPD Monthly Index generated a total return of 2.5% in Q2 led by Industrials which gained 4.6%. Outside of Industrials, overall rental income and capital growth rates remained subdued.

Relative positioning & TAA performance

- TAA effects contributed positively over Q2 as performance continued to benefit from the overweight positioning in Equities, funded out of Fixed Income, whilst a marginal overweight position in Commodities detracted. Allocations to Cash & Absolute Return and UK Property were maintained at or around benchmark levels during the period.
- Within Equities, an overweight exposure to small and mid-cap with the UK allocation contributed positively as well as a regional overseas preference for Japan and Asia Pacific ex-Japan at the expense of an underperforming US market.
- Across Fixed income, the preference for corporate bonds over government debt continued to boost relative performance as credit spreads narrowed further over the period. The overweight positioning in Global High Yield debt was also beneficial, with the asset class outperforming Investment Grade debt as investors continued to seek out additional income.

Outlook & views

- We expect a positive investment backdrop for risk assets to continue with global growth stable and interest rates remaining at historically low levels
- Politics could still affect markets. An unpredictable White House, Brexit negotiations, concerns regarding Chinese growth, could result in a sell-off in risk assets over the summer. However, with global growth and the corporate earnings outlook positive, we would view market dips as likely buying opportunities.

5. ROYAL LONDON FUND REVIEW

The following funds/portfolios were discussed:

RLI Governed Range

Absolute performance as at end Q2 for both the Governed Portfolios and the GRIPs continues to remain strong over 12 months. All nine Governed Portfolios are outperforming their benchmark over one year and GP4 and GP7 are under benchmark since launch.

The uptake in short-term performance has been driven by improved returns from RLP Global Managed. This is now outperforming the benchmark over one year due to strong relative performance from the European and active UK components.

The GRIPs continue to outperform over one and three years and since launch. The GRIPs will complete their five-year track record on 28 August.

RL pension funds

The number of RLAM funds triggering for review has reduced significantly from 15 last quarter to three over this reporting period. The three funds triggering are all fixed income funds, the International Government Bond fund, Global Index Linked fund and Global High Yield fund, although we note that Q2 performance is positive.

RLAM funds on watch:

- International Government Bond
- Global High Yield
- Global Index Linked

Externally managed matrix funds

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

Schroder Core UK Equity

This fund has suffered from very poor performance. We have held two interviews with the investment team over the last 18 months and have taken comfort from a turnaround in short-term performance and that the manager had addressed the previous concerns.

The fund had a blip at the end of 2016 but has now outperformed for successive quarters and couple with the good performance from Q3 2016, is now outperforming over 12 months.

Due to the continued improvement in short-term performance, our recommendation is to continue holding the fund but to keep the fund under review. We would look to instigate action if this upward trend in performance reverses.

JPMorgan US

The fund has been a serial underperformer over the last two years. It has triggered for review for the last eight quarters and once again underperformed the benchmark in Q2.

Morningstar have downgraded the fund from 'Silver' to 'Neutral' and we held a meeting with JPM to discuss the investment process and positioning. JPM confirmed there have been no changes to the quant-driven strategy and we believe the investment approach is too cautious for a Specialist fund. We have concerns over the fund's performance record and its ability to outperform the benchmark going forward.

We believe that there are more compelling solutions in this area and the IAC approved the proposal to replace this fund and identify a more suitable replacement at the next IAC meeting.

The following funds were also discussed during the meeting:

Investec UK Smaller Companies

Investec have announced that there will be a change of manager for this fund in September 2017. Matt Evans will be joining Investec from Columbia Threadneedle and

has a strong track record in managing UK small and mid-cap equities. Current managers Ken Hsia and Calum Joglekar will remain within Investec Asset Management's 4Factor team and will focus on the Luxembourg-based Investec GSF European Equity fund.

Given the forthcoming change of manager and investment process, we will be meeting the new manager in October and an update will be provided at the next IAC meeting.

First State Global Emerging Markets Leaders

The fund had a disappointing quarter and is suffering from poor performance over one year and marginal underperformance over three years. It continues to outperform over five years but the relative position has slightly worsened.

This fund remains soft-closed to new investors and is experiencing net outflows. We will continue to monitor the fund closely and investigate alternative solutions

Other external funds

The following funds also remain on watch:

- 7IM AAP Adventurous
- 7IM AAP Balanced
- 7IM AAP Moderately Cautious
- Baillie Gifford High Yield Bond
- BMF Balanced
- Fidelity Emerging Europe, Middle East and Africa
- Invesco Perpetual Global Bond
- Investec Emerging Local Currency Debt
- Investec Global Energy
- Investec UK Special Situations
- JPMorgan Cautious Managed
- JPMorgan Natural Resources
- Jupiter Ecology
- 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 Balanced
- Newton Global Higher Income
- Newton Real Return
- Sarasin Food & Agriculture Opportunities

- Schroder European Opportunities
- Schroder MM Diversity Balanced
- Schroder MM Diversity Tactical
- Schroder Global Cities Real Estate
- Columbia Threadneedle Absolute Return Bond
- Columbia Threadneedle Latin America
- UBS Global Blended (50:50)

From next quarter, the review and oversight of these funds will transfer to the Royal London Investment Performance Committee. The IAC welcome this move and the additional scrutiny this will bring particularly around those funds which have been on watch for a long period of time.

6. **DATE FOR NEXT MEETING**

The next quarterly meeting is 28 November 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.

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