

Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date

29/08/18

Present members

Julius Pursaill (Chair)
Colin Taylor
Ewan Smith
Piers Hillier
James McCourt

In attendance

Lorna Blyth
Niall Aitken
Khalid Khan
Kirsty Ross
Ryan Hamill
Robert Whitehouse
David Coombs &
Will McIntosh-Whyte
(Rathbones)

Apologies

Trevor Greetham

Owner

1. **REVIEW OF PREVIOUS MINUTES**

The minutes of the 5 June 2018 meeting were approved.

All

2. **PROJECTS**

Rathbone Global Alpha Fund

Will McIntosh–Whyte (London) and David Coombs (via telephone) attended the meeting to provide an annual update on the fund.

KK

The IAC discussed many aspects of the fund including performance, current holdings, strategy and positioning. The IAC is pleased to see an improvement in performance following some underperformance through the Brexit referendum.

There was in-depth discussion on the risk budget and Rathbones expressed the desire to increase their current risk budget to help them deliver better outcomes for customers through the uncertainty of Brexit negotiations.

The IAC were open to the idea of increasing the risk budget and asked for further analysis from Rathbones on the current position, the proposed position and reasons why current markets are different to the environment they have been operating in for the last 5 years.



Given that this is a time sensitive issue the IAC were keen for Rathbones and the RLI proposition team to progress this prior to the next IAC meeting. Approval must be sought from IAC prior to any change.

In addition the IAC also asked for information on two further aspects: the funds positioning with respect to ESG integration and a comment on the transaction costs provided as well as direction of travel. This information is to be provided at the next meeting.

GP Efficiency Metric

KR

A paper was presented which clarified one of the strategic risk metrics which helps the IAC analyse the efficiency of the strategic asset allocations of the governed portfolios. Where the expected performance differential between the SAA and the efficient portfolio is small, defined as less than 15bps, then the cost of any change neutralizes any benefit and IAC agreed that the return efficiency metric should take this into account. The IAC was comfortable that the cost of change was included in the decision making process and approved the change subject to the two queries below, which have now been answered:

Has the 15bps minimum difference in absolute returns been run by Royal London’s financial risk team?

Financial risk are supportive of this approach. RLI have tightened up the wording in the paper so that the action taken off the back of a red rating is “discussion at IAC with a view to resolution either through conducting a SAA review, or accepting the risk for an agreed period of time before further discussion is required (period to be agreed by the committee)” (previously the wording was simply “discussion at IAC”)

What would the transaction costs be to achieve an additional 15bps return?

We have estimated the transaction costs for two case studies with results supporting our decision to impose a 15bps absolute minimum. The estimated transaction costs are higher than the added expected return in both cases:

Period	Portfolio	Return Efficiency	Absolute Difference	Transaction costs to move to efficient portfolio
Q1 2018	GP2	89.50%	0.03%	0.09%
Q4 2016	Balanced Short Term Managed	17.60%	0.16%	0.17%

Based on the answers above, the IAC is comfortable to approve the change and this will be implemented for the next IAC meeting.

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

previous quarter.

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 5th percentile)

Lifestyle Path Analysis

The expected real income for annuity lifestyles has decreased compared to the previous quarter over the longer term but increased over the shorter term. In particular, the expected annuity incomes have decreased by 1% over fifteen years and increased by 1.4% over 5 years.

The expected real fund value of the drawdown lifestyles has increased across all periods. In particular, the expected real fund values have increased by 4.1% over 5 years.

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 April, we increased the allocation to index linked government bonds, bringing this almost in line with the benchmark; this was funded by reducing our overweight holding of equities and from cash. With economies continuing to expand and inflation remaining benign, we were overweight global equities, global high yield bonds and commodities.
- In May, we took further profits on the extra equities purchases made during the market lows; we also reduced the overweight allocation to commodities. Proceeds of these sales were moved into government bonds and cash. Longer term, we were positive on stocks and were overweight global equities, global high yield bonds and commodities.
- In June, after capitalising on weak markets in the first quarter to increase equity exposures, we took profits on our overweight position as prices recovered, moving the proceeds into cash. Longer term, we remain positive on stocks but more cautious on government bonds. We are moderately overweight global equities, global high yield bonds and commodities.

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

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Short term tactical view of the Chief Investment Officer

PH reviewed Q2 2018 and presented RLAM's rationale for the current short term tactical view:

Positioning & Activity

- Overweight exposure to equities was maintained during the second quarter, against a backdrop of generally supportive global economic data (albeit with some weakening outside the US) and relatively low inflation; the holding of bonds remained underweight. However, the magnitude of both active allocations was reduced substantially during the period.
- The holding of commodities also was kept overweight throughout the quarter in relevant portfolios, as rising oil prices supported returns. However, this exposure also was progressively reduced in magnitude. The allocation to UK commercial property was maintained at a neutral level over the period.
- At the regional equity level, above benchmark exposures to the relatively defensive US market and to Japan, which tends to benefit from a stronger dollar, were retained throughout the quarter. The allocation to emerging markets was moved to an underweight from an overweight, as these nations have more difficulty in servicing dollar-denominated debt when the US currency strengthens. We moved to a neutral position in Asia Pacific (excluding Japan) from an underweight and maintained underweights in the UK and continental Europe.

Market Background

- Global equities returned 7.2% for sterling-based investors during the quarter. The US market delivered the strongest return in sterling terms at 10.0%, while

- continental Europe (3.4%), Japan (3.2%) and Asia Pacific (excluding Japan) (2.4%) lagged behind. In the UK, the FTSE All Share Index returned 9.2%.
- Sterling recorded its largest quarterly fall since 2016, as slower economic growth prompted the Bank of England (BoE) to leave interest rates on hold in May and Brexit uncertainty continued to dominate UK politics. The dollar and the euro strengthened against the pound.
 - Conventional UK government bonds (all maturities) returned 0.2% over the quarter and the benchmark 10-year yield fell moderately, as the BoE kept rates unchanged and a lack of clarity about Brexit continued to support demand for the security of government debt. Index linked gilts (all maturities) returned -1.0% over the quarter as inflation slowed moderately Sterling investment grade credit returned -0.2% during the quarter, underperforming UK government bonds, as factors including Italy's political crisis caused volatility that curbed investor appetite for risk. The average sterling investment grade yield spread widened by 10 basis points to 1.2%. Investment grade sterling credit issuance slowed modestly compared with the prior three months, held back by a sharp drop in May.
 - Commodities recorded a positive return for the quarter, driven by oil; the price of Brent crude rose 13% and topped \$80 a barrel, supported by previously agreed output cuts and by interrupted supply in nations including Libya. Metals fell, as trade-related tensions weighed on copper and a strengthening dollar eroded demand for gold.
 - UK commercial property recorded a 2.2% return over the quarter, bringing the year-to-date return to 4.5%.

TAA Performance

- TAA effects contributed positively over the quarter, with performance benefiting from the overweights in equities and commodities in GBP terms, funded out of fixed income and cash. Property exposure was maintained around benchmark during the period.
- Regional positioning within equities benefited significantly from the overweight allocation to the US, which was increased during the quarter. Above benchmark exposure to Japan was moderately supportive, while the underweight in the UK was disadvantageous, given the market's robust performance.
- In fixed income, the overweight exposure to investment grade corporate debt and underweight holding of conventional UK government bonds detracted from returns as the latter outperformed. The below benchmark allocation to index linked gilts was supportive, as these lagged behind both corporate issues and conventional government debt.

Outlook & Views

- Our Investment Clock temporarily dipped into mild 'Stagflation' during the summer as global growth momentum cooled from the recent peak, especially outside of the US, whilst inflation has risen from a low base

- We maintain modest overweights in equities along with a moderate underweight in bonds. Within equities, we are overweight the US and Japan, with a neutral position in Asia Pacific (excluding Japan) and underweights in the UK, continental Europe and emerging markets. Within bonds, we are overweight investment grade corporate issues and short duration global high yield debt, with an underweight in government bonds. Portfolios with commodity exposure have been moved back into line with benchmark whilst Property is held at neutral
- With no central banks in a major rush to tighten monetary policy, global nominal growth could pick up again over the next few months, which would be supportive for stocks and high yield. We remain prepared to buy dips in markets.

4. **ROYAL LONDON FUND REVIEW**

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

RLI Governed Range

All Governed Portfolios have outperformed their benchmarks over one year, except Governed Portfolio 7, which underperformed its benchmark by 0.07%. Over three years, Governed Portfolios 3, 6 and 9 outperformed benchmark, the remaining portfolios slightly underperformed benchmark on an annualised return basis. All of the portfolios are outperforming benchmark over 5 years on an annualised return basis. The slight underperformance over 3 years is due to a dip in the equity market in 2016 and RLP Global Managed's overweight position in US and Japan.

All five GRIPs continue to outperform over one, three and five years and also since launch. GRIP4 and GRIP5 have returned over 10% above benchmark since launch.

RL pension funds

The number of RLAM funds triggering for review over this reporting period is 13 however no funds have significantly underperformed.

RLAM funds on watch:

- Adventurous Managed
- Managed
- UK Opportunities
- American
- Far East (ex Japan)
- European
- Japan
- Pacific
- Worldwide
- Global Equity
- International Government Bond
- Global High Yield Bond
- Global Index Linked

Global High Yield

Underperformance over Q2 remains marginal. The Fund is marginally behind benchmark over 1, 3 and 5 years. The IAC challenged RLI to provide more information on this fund and why RLI are recommending no action required.

Global Equity

The fund outperformed over the quarter and has minimal underperformance over 1, 3 and 5 years. A majority of the fund is passive (88%). There is a proposal to review the underlying assets in this fund given it is a close match to the Global Managed fund.

UK opportunities

The fund outperformed over the quarter and 5 years. It is marginally underperforming over 1 year but long term performance of the fund has been poor. A new fund manager assumed stewardship of the fund in January 2018. The fund produced first quartile performance in the three months to June and is ahead of benchmark over the first half of 2018. This was driven by a number of shares including Ashtead and Greencore which recorded double digit gains in May.

European

The fund is a mix of passive and active with dealing costs impacting performance. During the last quarter the fund was ahead of benchmark with positive contributions from Sika and DNB. Year to date the fund is in line with benchmark but longer term performance remains below benchmark due to stock selection. The fund is marginally behind benchmark over 1, 3 and 5 year periods.

Externally managed matrix funds

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

First State/Stewart Investors Global Emerging Markets Leaders

The Fund had a good quarter, outperforming the benchmark by 4.8%. The fund is minimally below benchmark over 1, 3 and 5 years. Morningstar have recently upgraded the fund from bronze to silver. We recommend maintaining the Stewart Investors Emerging Market Leaders Fund as our Emerging Market Specialist category choice within the Matrix. However, we will continue to closely monitor the performance of this fund with particular emphasis on the recent improvement in performance, and how successful management are in maintaining this turnaround into the longer term.

Stewart Investors Asia Pacific Leaders

The fund outperformed benchmark over the quarter and is only underperforming benchmark over 3 years. The improvement in performance has resulted in the fund RAG metric moving to amber for the most recent quarter. We recommend maintaining the Stewart Investors Asia Pacific Leaders Fund as an Asia Pacific Core Plus proposition.

Angus Tulloch retired from Stewart Investors in September 2017. In the years leading up to his retirement, Angus handed all of his portfolio management responsibilities, including management of the Asia Pacific Leaders Fund which has been ran by David Gait since April 2016. The investment philosophy and process which Angus established in 1988 remains largely the same now as it did then, though it has

naturally evolved over the years. Stewart Investors emphasize a team approach and reiterate the belief that regardless of who is managing their funds, a consistent investment philosophy and process remains in place

Rathbones Global Alpha

Please see the commentary on this fund earlier in these minutes.

The following funds were also discussed during the meeting:

Invesco Perpetual Japan

The fund has been triggering red for at least five consecutive quarters.

The biggest detractors from relative performance came from the more economically sensitive areas of the market, to which the strategy is tilted. For example, holdings in industrials such as auto manufacturers and steel companies were amongst the biggest detractors.

Conversely, the real estate company Mitsubishi Estate contributed positively as this industry is enjoying strong fundamentals, with office rent increases recently gaining momentum and occupancy rates remaining high. Elsewhere, Nissan Chemical added value on the back of solid results. Cosmo Energy's share price benefited from higher refining margins translating into stronger earnings

The fund is managed with a value / contrarian approach and this can lead to performance differing from the benchmark by significant margins – both on the upside and downside. This fund sits in the specialist sector and we are comfortable to continue to hold.

Artemis UK Special Situations

The fund has been triggering red for at least five consecutive quarters and has underperformed benchmark over 1, 3 and 5 years. However, performance was positive and above benchmark over the last quarter and year to date.

Performance benefited from good performance by Tesco as the main supermarket business was ahead of expectations but it was newly acquired Booker's 14% growth that stole the limelight. Although growth is not expected to continue at that rate, it does highlight why Tesco's management found the acquisition so appealing. Elsewhere, Oxford Instruments, the producer of scientific equipment, delivered decent results. Valuations in the equity market fell a little over the quarter. One sector that has had a tough year is tobacco and during June the fund took a position in British American Tobacco following a fall in valuation. It now offers a dividend yield of 5.5%. New positions were also bought in Britvic and Quilter.

In Q4 2017 we held a meeting with the fund managers Derek Stuart and Andy Grey and the decision was taken to continue to monitor the fund.

Fidelity MoneyBuilder Dividend

The fund has triggered red for three consecutive quarters and has underperformed benchmark over 1, 3 and 5 years.

While several holdings posted strong absolute returns, in aggregate, the fund could not keep pace with the overall market. Negative sector allocation, specifically the

underweight stance in energy and industrials, hampered relative performance as these stocks rallied over the period.

Royal Dutch Shell reported solid quarterly results and share price performance, but the sizeable underweight stance relative to the index detracted from relative returns. While the portfolio benefited from the lack of exposure to Vodafone, the holding in BT Group slid. Nevertheless, dividends from the stock remain secure. Meanwhile, postal services and logistics provider Royal Mail gave back some of this year's strong performance.

Multi-line retailer Next reported a stellar quarter, beating expectations and raising its full-year earnings guidance. Water utility company Pennon Group reported positive results. Tobacco group Imperial Brands was supported by a rally in its share price after it reported encouraging sales from its Next Generation Product (NGP) - blu.

Schroder Tokyo

The fund has been triggering red for at least five consecutive quarters.

Performance was in line with benchmark over 1 year, but underperformed over 3 and 5 years. However, relative performance picked up over the quarter but is below benchmark year to date.

The largest positive impact came from Fujitsu, which rose on improved expectations for future cash flow after earlier than expected asset disposals. Two of the largest contributors seen in June were TDK, an electronic component supplier, and JXTG, a major oil refiner. An unusual pattern was seen among the negative impacts, with three of the four largest negative contributions being generated by stocks not held in the portfolio. The most significant of these was SoftBank, a telecom conglomerate, where a raft of corporate announcements stimulated investor interest during July. Among the portfolios overweight positions SMC, a maker of automation and control devices, underperformed on general concerns about the outlook for growth in the key Chinese market.

We will continue to monitor this fund.

Schroder UK Alpha Plus

The fund has been triggering red for four consecutive quarters.

The fund is underperforming over 1, 3 and 5 years but has produced positive outperformance over the quarter and year to date. This is a specialist fund and is not currently recommended by Morningstar. In March the fund management structure changed with Bill Casey and Nick Kissack now co-managing the fund.

Tesco, diversified mining group BHP Billiton and equipment rental company Ashtead were among the top positive contributors over the quarter. New positions were taken in Diageo, Next, Cineworld, easyJet, cigarette manufacturer Imperial Brands and specialty chemicals business Victrex. Legacy holdings in Vodafone were disposed of.

We are comfortable to hold this fund and wait to see if the management actions taken result in an improvement in returns for customers.

5. **DATE FOR NEXT MEETING**

The next quarterly meeting is 4 December 2018.

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.

September 2018

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