

Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date

27/02/2019

Present members

Julius Pursaill (Chair)
Colin Taylor
Ewan Smith
Piers Hillier
Candia Kingston
JB Beckett

In attendance

Lorna Blyth
Niall Aitken
Kirsty Ross
Euan Craig
Robert Whitehouse
Joseph Smith
Trevor Greetham (RLAM)
Cathy Gibson (RLAM)

Apologies

Dr. James McCourt

Owner

1. **REVIEW OF PREVIOUS MINUTES**

The minutes of the 04 December 2018 meeting were approved.

All

2. **PROJECTS**

Terms of Reference Update

Lorna Blyth discussed the updated terms of reference to reflect changes in IAC membership and the removal of unit-linked life funds and Pegasus fund range which now fall under remit of Investment Performance Committee (IPC).

Following last assessment in 2015 a new effectiveness review is being progressed with Cossec and proposal will be presented to the committee in June. IAC questioned whether a review had already been carried out since 2015 and requested this be checked. IAC formally accepted ToR.

LB

Active Bond Management

IAC had requested view from Investment Office (IO) on the matter of retaining the active management of RLI unit linked Gilt funds following the group decision to move some gilt portfolios from active to passive. Robert Whitehouse confirmed the IO are comfortable.

RW



The IAC requested assurance on the durational performance of the funds and the value added through active management. Against RL criteria, the funds are outperforming against their respective benchmarks. Following this, the IAC approved the final position and accepted the issue as closed.

Transaction Costs & Best Execution

CG

Cathy Gibson (RLAM) attended the meeting to discuss RLAMs provision of Best Execution in compliance with the requirements of the EU Markets in Financial Instruments Directive (MiFID II).

The IAC requested confirmation from RLAM that insured funds with direct investments are treated in the same way as mutual funds. GAP analysis against their controls showed it is not possible for RLAM to favor one fund over another when placing deals.

The IAC expressed interest in the delivery of a more granular quantitative analysis alongside the qualitative governance processes highlighted within the paper and asked that this be brought back to IAC in 6 months with greater detail and quantitative analysis that supports the proposition.

Global Managed Deep Dive

TG

Trevor Greetham talked through rolling 3-year relative performance of Global Managed and reviewed the changes to the fund structure and portfolio management since the implementation of tactical futures, active FX overlay and Global Equity allocation.

The IAC discussed some of the key drivers of recent performance including the BREXIT vote in 2016; cash flows and how the fund has managed the resulting cash drag; lack of exposure to Canada which has been rectified through the introduction of futures.

The IAC were pleased with the level of detail provided in terms of performance attribution and analysis, and asked for this to continue in future meetings. The committee would also like to continue to see look-through cash reporting.

Furthermore the IAC agreed that RLI should review the strategic structure of the Global Managed fund with particular focus on the core satellite nature of the UK and European exposure. The committee will look to review this work later in the year.

Rathbones Global Alpha

LB

The IAC discussed the proposal from Rathbones to change the investment approach of the fund to a fully unconstrained one focusing on Global Equity which predominantly invests in direct equities rather than collectives.

The committee felt that the proposal constituted a material change, and if this was progressed then this should be evaluated in the same way as for a new manager, rather than a corporate action.

The committee also highlighted that customers have bought a fund of funds approach and it might be reasonable to expect this structure is maintained going forward unless

there are significant reasons why we have concerns about continued use of this approach.

The IAC were not supportive of Rathbone's proposal given these challenges. They requested that RLI work on addressing these concerns and come back with clear next steps.

Brexit / Liquidity Update

KR

Kirsty Ross provided a summary of the progress made on our operational readiness to manage liquidity within the main unit linked property fund (RLP Pooled Property Fund). The IAC was comfortable with the actions being taken and pleased with the progress that has been made. They were reassured by the level of scrutiny this matter is receiving.

Performance Pack

EC

All data is at end December 2018.

RLI Governed Range

All Governed Portfolios underperformed their benchmarks over the quarter. Only Governed Portfolios 3 and 6 are ahead of benchmark over 3 years to end of December 2018. Governed Portfolios 2, 3, 6 and 9 are ahead of benchmark over 5 years to end of December 2018.

All five GRIPs are below of benchmark over the quarter. They continue to outperform over three and five years and also since launch, with only GRIPs 4 and 5 underperforming over one year.

Global Managed

This fund invests c. 80% in RLP unit linked funds which have underperformed their respective benchmarks. RLP American, European, Pacific and UK Equity have all experienced underperformance across 1, 3 and 5 years. Of the underlying OEICs, RL UK Equity, UK Growth, UK Mid Cap and UK Smaller Companies have in fact outperformed their benchmarks over the 1, 3 and 5 year periods; however the holdings in these funds were too small to negate the underperformance of RL European Growth, European Opportunities and UK Opportunities.

The underperformance is largely attributed to stock selection with active UK equity the largest detractor through the UK Opportunities fund. Exposure to North America also detracted from performance. This exposure is passive and therefore timing differences between fund valuation and benchmark close as well as cash flow adjustments need to be considered.

The IAC have asked for more detail on the level of attribution we receive for this fund and discussed this as part of the Global Managed deep dive agenda point.

Property

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

As at the end of December 2018, RLPPF cash holding had reduced to 10.8% due to a number of purchases being completed in Q4.

Commodity

The Fund is outperforming over the quarter and 1 year to the end of December 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 just below benchmark.

Global High Yield Bond

The insured pension fund is underperforming over 3 and 5yrs to the end of December 2018, but the underlying RLAM OEIC is outperforming its benchmark over 1 and 5 years. The OEIC benchmark is not available on Lipper so a similar benchmark has been selected on the advice of the fund manager. Over Q4 the fund outperformed the benchmark with exposures to energy attributed to the positive performance. The fund continues to retain a shorter duration than the index and has a preference for B and BB rated issues.

Next quarter we will provide more information on underperformance due to benchmark difference if appropriate.

Externally Managed Matrix Funds

Rathbone Global Alpha

The fund finished behind the benchmark over Q4 2018, as well as 1, 3 and 5 years to the end of December 2018. Positive contributors over the year include the funds positioning in US equity markets with the Brown Advisory US Equity Growth Fund performing particularly strongly. Contribution from Europe was also positive over the year with the Jupiter European Income Fund being a particular highlight. However, both UK equity and Japan and Asia positioning detracted from performance over the year.

Over the longer term, the Rathbone Investment Committee is already aware of the drag on performance from the fallout from the UK referendum, and the difficulties in reducing UK small and midcap exposures within a fund of funds structure. This continues to affect both the 3 and 5 year numbers.

Following a discussion with Rathbones over positioning they have proposed a change to the fund structure moving from a fund of funds approach to a mixture of directly held investments and a smaller number of OEICs. This new proposal was discussed in a standalone agenda point above.

Governed Portfolios & Managed Strategies

No changes were recommended to the Governed Portfolios and Managed Strategy benchmarks this quarter.

All portfolios are within their target ranges for real volatility with the exception of GP3 and the Cautious Long Term Managed Strategy which remain below the lower limit. GP7, GP9, and Balanced Short were all amber on the lower side of their target volatility last quarter – they've moved back into the green now. Forward looking volatility has been on a generally downward trend and this factor will be considered as part of the SAA review later this year. As such, there were no further actions proposed to the portfolios.

Governed Retirement Income Portfolios (GRIPs)

No changes are recommended to the GRIPs strategic benchmark this quarter.

All portfolios remained within their target ranges on both the income risk metric and the fund risk metric. Sustainability scores have stayed relatively flat since last quarter, while the maximum 1yr loss numbers have increased very slightly.

Lifestyle Strategy Analysis

Annuity income and real fund values for drawdown lifestyles have remained relatively flat since last quarter.

Tactical Analysis**GPs, Managed Strategies and GRIPs**

All portfolios remain within their tactical risk budgets.

There have been three tactical changes in the last quarter:

- In October, following market panic we began contrarian purchases of equities based on growth and risk outlooks. Further to this, we also increased commodity exposure but still remain under benchmark. These purchases were funded from government bonds and cash. Overweight positions across high yield bonds and corporate bonds were maintained.
- In November, investor sentiment remained in panic territory and as such we added to equity exposure, funded out of cash and short duration high yield debt. We remained conscious that markets may retest recent lows however with a positive outlook for equities through 2019, albeit with increased volatility, we remained positive on equities. Neutral positions were maintained across property and index linked bonds.
- In December, market volatility remained following US Federal Reserve signals of near neutral interest rate levels and US-China trade negotiations. With long term expectations of economic expansion across 2019, we continued to purchase equities, increasing our overweight position. As higher volatility is expected to remain, we expanded government bond allocation, funded from commodities, high yield corporate debt and cash.

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

Short Term Tactical View of the Chief Investment Officer

Positioning & Activity

- We took advantage of market panics and deeply oversold sentiment readings during Q4 to increase exposure to equities in our multi asset portfolios and ended the period with a significant overweight. Holdings of both stocks and bonds, which were held around neutral levels at the end of Q3, were increased at the expense of cash during the final quarter.
- The position in commodities was moved further underweight to reduce exposure to a near term downward surprise in global growth after Brent crude oil prices slumped and copper declined on Chinese and global growth concerns. The allocation to UK commercial property was maintained at a neutral level over the period.
- Among regional equities markets, we stayed overweight in the US throughout Q4 given the relative strength of the nation's economy, and in Japan, a leading exporter, which tends to benefit from global economic growth and from a stronger dollar. Exposure to emerging markets was moved to an overweight from an underweight, given the commitment by Chinese authorities to economic stimulus. We maintained below benchmark positions in the UK and continental Europe, which face Brexit uncertainty, and in Asia Pacific (excluding Japan).

Market Background

- World stocks returned -10.9% in sterling terms during Q4. Returns were negative across regions; the best performance came from Asia Pacific excluding Japan (-8.1%), followed by the UK (-10.0%), continental Europe (-10.9%), the US (-11.5%) and Japan (-12.4%). For the year as a whole, the return from global equities was -3.1% for UK investors.
- Trade weighted Sterling weakened for a third consecutive quarter, as the outcome of Brexit remained unclear after UK legislators overwhelmingly rejected a draft EU withdrawal agreement, keeping political uncertainty elevated. The dollar and the euro strengthened relative to the pound.
- Conventional UK government bonds (all maturities) returned 1.92%, outperforming sterling investment grade credit (which returned 0.14%, all maturities) as elevated volatility across financial markets supported demand for the security of government debt and curbed buying of corporate issues. The average sterling investment grade credit spread widened by 31 basis points to 1.51%. The return from index linked gilts (all maturities) was 1.87% as the oil price fell sharply. For 2018 as a whole, conventional and index linked gilts returned 0.57% and -0.28%, respectively, compared with -1.51% for sterling investment grade credit.
- In commodities markets, oil prices fell almost 35% and copper declined for a fourth consecutive quarter, against a backdrop of concern about a US-led trade war and

signs of slowing growth in China. Gold rose, rebounding from two straight quarterly retreats, as declines in equities markets supported demand for a haven.

- UK commercial property returns slowed to 0.25% during the 4th quarter, for a return of 7.3% over the course of 2018. Capital values saw declines during the last two months of 2018 led by weakness in Retail. Over the year, Industrials and Hotels led gainers with total returns of 17.1% and 14.1% respectively, whilst the Retail sector saw an overall decline of -0.2%.

TAA Performance

- Fears of a global slowdown in economic growth led to broad negative performances across financial markets, and this was reflected in relative portfolio performances over the quarter.
- Asset Allocation detracted in Q4 after global equities fell sharply in December given concerns over US-China trade tensions and US Federal Reserve (Fed) plans to raise interest rates. There were positive contributions from underweighting commodities and the overweight position in short-dated high yield. Allocation effects remain positive over longer time periods.
- Within Fixed Income, the preference for sterling investment grade corporate bonds at the expense of conventional gilts marginally detracted as credit spreads widened.

Outlook & Views

- Our investor sentiment gauge was in deep panic territory for most of Q4, given heightened market volatility and declining equities. However, US directors continued to buy their own shares, a positive signal. During the period, our Investment Clock model moved into its Reflation stage from Stagflation, reflecting lower oil prices and reduced concern about inflation.
- While there was some loss of momentum in the global economy during Q4, we still expect world growth to be solid in 2019, with US fiscal policy remaining supportive and China putting stimulus measures in place. In our view, stock markets were premature to price in a US recession, and the recovery in equity prices has further to run. Longer term, we remain positive on stocks.
- Within Equities, we have overweight positions in the US, Japan and emerging markets, with below benchmark allocations to the UK, continental Europe and Asia Pacific (excluding Japan). Within the overweight Fixed Income allocation, we continued to favor sterling investment grade corporate bonds and short duration global high yield debt versus Gilts. Commodity exposure has been moved further underweight, and UK commercial property exposure kept around neutral.

AOB

All

JB Beckett requested the IAC consider adding Responsible Investment (RI) as a standing agenda point.

The IAC would like to see a list of potential matrix fund replacements, so that underperformance can be considered in the context of available alternative solutions.

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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