# Investment Advisory Committee (IAC) Quarterly Meeting

## Minutes of Meeting

**Date**
03/09/2019

| Present members | In attendance | Apologies |
|---|---|---|
| Julius Pursaill (Chair) | Lorna Blyth | None |
| Dr. James McCourt | Niall Aitken | |
| Ewan Smith | Carrie Johnson | |
| Piers Hillier | Ryan Hamill | |
| Candia Kingston | Euan Craig | |
| JB Beckett | Robert Whitehouse | |
| | Trevor Greetham (RLAM) | |
| | Mike Clarkson (RLAM) | |
| | Fraser Chisholm (RLAM) | |

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**Owner**

1. **REVIEW OF PREVIOUS MINUTES** All

The minutes of the 12 June 2019 meeting were approved and IAC members confirmed there are no new conflicts of interest.

2. **PROJECTS**

### RLP Annuity Fund RH

RLI presented their view on RLAM's proposal to transition the underlying holdings of RLP Annuity into GMAP conservative following the change of workplace pension default from target annuity to drawdown in 2018 and the subsequent reduction in investors in the RLP Annuity funds.

The committee discussed the objective, asset allocation and suitability of GMAP Conservative relative to RLP Annuity to confirm both funds are aligned and customer outcomes are not affected by the transition.

The IAC was satisfied with the overall proposal subject to receiving confirmation of the monitoring process to ensure that going forward these assets continue to meet the needs of RLP Annuity customers, particularly around changes to yield curve and duration. IAC also asked to see details of the costs of the transition and specifically whether the group or the fund would bear the cost.

## RLP Rathbone Global Alpha

MC

Mike Clarkson (RLAM) provided an overview to the committee of his fund proposal and its potential as a replacement for the RLP Rathbone Global Alpha fund. This overview covered the investment process, portfolio construction, model performance and overall fund management capabilities. The proposed fund is a fund-of-fund structure in line with the current Rathbone fund utilising Mike Clarkson's expertise in this area.

The IAC queried potential conflicts of interest on two fronts:

- First, the conflict of an RLAM fund-of-fund manager selecting his own company's funds against external ones, and
- Second, moving from the use of an external (to the group) fund-of-fund manager to RLAM.

On the first point Mike Clarkson clarified to the committee that RLAM funds would be excluded from the investment.

The IAC discussed the second conflict and agreed that they could be comfortable with this subject to receiving sufficient evidence of the proposed fund's governance and processes, and further subject to customers experiencing a reduction in costs.

The committee discussed the use of passives in a fund-of-fund structured investment and reviewed concerns around costs and the potential for overlap with the alternative offer of the passive global managed fund. Mike confirmed that passive funds remained within scope and would go through the same screening process as active funds, but would normally be used only where it was strongly felt that active managers could not add value.

The committee requested that Mike provide insight into the historic hit rate of his fund selection process, more detail on the costs of the new fund noting that the underlying fund costs appeared to be presented as the MiFIDII 'ongoing charge' rather than MiFIDII cost template. They also requested clarification on the cost of transition and who would be absorbing these, average holding periods, fund manager reviews and ESG.

The committee also questioned Mike on key man risk and asked RLAM to provide more detail on processes and cross training across the multi asset team. Follow up responses will be provided to IAC prior to the next meeting to allow this proposal to go through internal governance.

## Terms of Reference Update

LB

RLI discussed the updated terms of reference to reflect changes in IAC membership and addition of consideration of charges when replacing matrix funds. IAC noted that ESG and RI policy falls outside of their remit and formally accepted the ToR.

## RLP Property - Cash Exposure

NA

RLI presented a paper outlining the current cash level within RLP Property and some possible measures to reduce this given its potential impact on customers who hold this fund directly rather than through a multi-asset portfolio.

The committee discussed at length the proposed measures in the context of current market conditions eg Brexit uncertainty and increased sterling volatility. There was also a discussion and differing views amongst the Committee and RLI around the merits of holding a *liquidity buffer*, given the recent FCA consultation and guidance to dissuade funds holding *excessive* buffers. RLAM reiterated the importance within RLP Property to acquire assets of suitable quality and stressed it would not deviate from this to reduce cash levels in the short term. The IAC agreed that given these factors they were comfortable with the current cash position in the fund but requested that wording is added to the fund factsheet and we communicate to advisers on the use of cash within the fund and its potential applications in the run up to/post Brexit. RLI and RLAM agreed to work closely on these steps and discuss any further action.

## Governed Portfolio - Strategic Asset Allocation Update

NA

RLI presented the progress of the current SAA review for the Governed Portfolios. The full review covers asset return assumptions, analysis of the UK/overseas equity split and asset class constraints. Initial results showed the current portfolios remain highly efficient but there is some potential to further diversify the less liquid assets. Final proposals will be presented at the next IAC.

Royal London’s newly established Long-term Economic Assumptions Forum (LEAF) provides capital market assumptions that feed directly into the SAA modelling. LEAF adjusts the underlying Moody’s calibration data to reflect Royal London’s views. It was highlighted to the committee that the output from the model is highly sensitive to changes in assumptions. The committee queried the membership of LEAF but was supportive of the adjustments that had been made prior to the SAA review to reflect Royal London’s views. The IAC did however request that the LEAF process be documented and presented at the next meeting to provide a deeper understanding of the procedure and any internal challenge that exists on these assumptions.

The committee queried the proposal to maintain the current 50:50 UK/overseas equity split given current competitor bias to have greater levels of overseas exposure. After discussion, the IAC were satisfied that the 50:50 split remains appropriate given the LEAF calibrations increase to the UK equity risk premium and the ability within the fund to take a tactical stance on regional allocations. RLI highlighted to the committee that they will continue to look at this with RLAM and intend to model the emerging market exposure separately to the developed overseas, seeking to confirm that the split between UK, developed overseas and emerging markets remains optimal in the long term.

Given the sensitivity of any property allocation to the assumptions the IAC requested further clarity on the modelling of property and what costs are included in this. RLI will look to update the IAC on this prior to final SAA approval due in December.

Finally, the committee discussed the use of Dynamic Equilibrium (DE) and Best Views (BV) calibrations in setting the cash constraint. The IAC requested that a consistent stance on calibration is used across all asset classes in the final proposal.

## Fund Replacement Proposal EC

RLI presented a proposal to replace the Artemis UK Special Situations fund which sits in the specialist category of the matrix focusing on predominately large cap stocks. This highlighted the Baillie Gifford UK Equity Alpha fund as the proposed replacement subject to due diligence.

Overall the committee was pleased with the structure, level of due diligence and inclusion of ESG factors supporting the fund replacement procedure, with recommendations to amend the scoring matrix so it is less binary and to include the incumbent fund for comparison. The committee was further satisfied that transition cost analysis had been considered as part of the replacement process.

Subject to acceptable due diligence from the fund manager the IAC was supportive of the proposal and was reassured that the analysis included independent input from Mike Clarkson in his capacity as fund of fund manager and Morningstar.

## Performance Pack EC

All data is at end June 2019.

*RLI Governed Range*

All Governed Portfolios outperformed their benchmarks over the quarter with only Governed Portfolios 4, 7 and 8 behind benchmark over 1 year. All portfolios were ahead of benchmark over 3 and 5 years to end of June 2019.

All five GRIPs were above benchmark over the quarter. They continued to outperform over 1, 3 and 5 years and also since launch, with all portfolios ahead of benchmark over all time periods.

*Global Managed*

The fund was ahead of benchmark over the quarter and 3 years but was slightly behind over 1 and 5 years.

This underperformance was driven by the active elements of the underlying RLP UK equity and RLP Europe funds. The underperformance of these funds had previously been challenged by the committee and they were comforted that year to date performance for these funds had significantly improved.

The committee was pleased with the performance of the active global RLAM Global Diversified strategy within the fund since the decision was taken to add this strategy to the fund last year.

It was confirmed that RLI use a total return index as the benchmark for passive RLP Funds whereas RLAM use a capital return index for their overseas passive equity OEICs. IAC asked RLI to review how much underperformance should be attributed to tax and costs and present this at the next meeting.

At the request of the IAC more granular performance attribution for RLP Global Managed and the underlying funds was provided.

*Property*

The fund had outperformed benchmark over 1 and 5 years to end of June 2019.

As at the end of June 2019, RLPPF cash holding was 18.5%. More detail on this topic can be found in the standalone RLP Property agenda point.

*Commodity*

The fund had outperformed benchmark over 1 and 3 years to end of June 2019.
The fund was launched in June 2016 and as such lacks a longer term track record.

*Sterling Extra Yield*

The fund was outperforming over 1, 3 and 5 years to the end of June 2019.

*Global High Yield Bond*

The fund underperformed over 1, 3 and 5 years to the end of June 2019, but the RLAM OEIC outperformed 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 Q2 the fund underperformed the benchmark by 3bps, with an underweight position in basic industry attributed to the negative relative performance.

*Externally Managed Matrix Funds*

*Rathbone Global Alpha*

The fund finished ahead of benchmark over Q1 2019, however was still behind benchmark over 1 and 5 years to the end of June 2019.

The lag over 1 year is the result of a difficult Q4 2018. This had also caused underperformance for the 1 year to end 2018. YTD to the end of June, the fund was 2% ahead, helped in part by the recovery of growth assets, in particular Japan. The overweight to the US continued to be a positive, with selection in UK, US, Japan and Europe all helping.

Over the longer term, the Committee were already aware of the drag on performance from the fallout from the UK referendum, and the difficulties in reducing our small and midcap exposures in the UK within a fund of funds structure. This continues to affect the 5 year number. It was noted by IAC that Rathbones had moved away from a multi-manager strategy two years ago for its own funds and that lead David Coombs had recently been quoted in the press regarding the challenges ahead for multi-Manager funds.

*The following funds were highlighted due to underperformance against benchmark and commentary was provided to IAC. Where there was a downgrade by Morningstar the IAC requested a deeper dive by RLI.*

Fidelity Moneybuilder Dividend

The fund recorded negative returns and underperformed the index over the 1 year period to June 2019. Morningstar retain a bronze Analyst Rating for this fund and note that a change in structure allows the fund manager to fully focus on this strategy. Performance is marginally above benchmark since the change.

Invesco Japan

The fund is underperforming against benchmark over 1, 3 and 5 years. Morningstar have reduced the Analyst rating on the fund from Bronze to Neutral and consider other teams in the Japan equity space to be better resourced. This combined with the long-term underperformance will result in a review of potential replacement funds.

Schroder Tokyo

The portfolio outperformed the benchmark during the quarter due to a positive contribution from stock selection quarter and the underlying OEIC is now outperforming over 3 years, however the RLP version of the fund is underperforming over 1, 3 and 5 years.

Schroder UK Alpha Plus

The fund is underperforming over 1, 3 and 5 years. The fund manager was replaced in March 2018 and resulted in an improvement in performance, however the fund has recently moved towards a more neutral style blend leading to higher than normal turnover. Due to this change in philosophy we've arranged a call with the fund team.

Invesco UK Growth

The fund is underperforming over 1, 3 and 5 years. Morningstar retain a silver Analyst Rating for this fund, citing the funds long term track record in terms of providing risk adjusted returns.

The IAC discussed whether the fund was experiencing issues in common to the team's flagship UK Income strategy managed by Mark Barnett. Although fund sizes, and many positions held differ there is a shared investment philosophy and team approach and IAC suggested further investigation might be warranted if the fund were to continue to trigger.

Invesco Global Equity

The fund is underperforming over 1, 3 and 5 years however has delivered strong performance over the longer term (10yrs+).

Stewart Investors Global Emerging Market Leaders

The fund is underperforming over 1, 3 and 5 years and remains soft closed. It no longer sits in the Emerging Markets IA sector due to a 20% investment in Developed Markets and for these reasons we will bring a potential replacement to the next IAC. Morningstar have maintained a silver Analyst Rating for this fund.

## Strategic Pack

All data is at end June 2019.

*Governed Portfolios & Managed Strategies*

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

All portfolios were within their target ranges for real volatility with the exception of the Cautious Long Term Managed Strategy which was below the lower limit. As mentioned previously at IAC meetings, the forward looking volatility of the portfolios and strategies had generally been on a downward trend. This was something that would be considered as part of the SAA review and as such RLI did not propose any changes to the portfolios at the moment.

*Governed Retirement Income Portfolios (GRIPs)*

No changes were 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 had decreased since last quarter, while the maximum 1 yr loss numbers had increased (negatively) very slightly.

*Lifestyle Strategy Analysis*

Annuity income and real fund values for drawdown lifestyles had decreased since last quarter.

**Tactical Analysis**

*GPs, Managed Strategies and GRIPs*

All portfolios remained within their tactical risk budgets.

There have been three tactical changes in the last quarter. Supporting commentary from RLAM is shown below:

- In April we found that having sharply rebounded in March, investor sentiment was more neutral. Central banks signalled a loosening of policy but, while there were early signs of stabilisation, global economic activity remained mixed. Chinese economic stimulus measures to boost activity appeared to be having an effect at the start of Q2, reducing the risk of a global recession in the short term. In light of this we slightly increased our moderate overweight in equities and allocation to short duration global high yield debt, reducing cash and increasing our underweight in UK government bonds.

- In May global growth data had broadly improved, remaining patchy and with neutral investor sentiment. Central banks continued to hold off on any policy adjustments until there was more clarity on the direction of the global economy. There was a risk of disappointment from the US-China trade talks and the impact of Chinese stimulus measures, which wouldn’t make a clear impact until the second half of the year however, we maintained a constructive growth view and added slightly to our overweight in equities and short duration global high yield debt. These trades were funded out of cash position in the portfolios.

- Junes tactical came after global stock markets retrenched through May as President Trump reignited trade wars with China with new tariffs on specific imports prompting retaliation and dashing hopes of a US-China trade deal in the short term. Economic data deteriorated slightly and antitrust scrutiny weighed on technology stocks. Central banks remained concerned about trade tensions and are closer to cutting interest rates, which should boost investor sentiment. We moved overweight in UK government bonds, given weaker inflation expectations, and retain a moderate overweight in equities, given positive global growth persisting; while reducing exposure to cash and commodities which are sensitive to slowing global trade.

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

*Short Term Tactical View of the Chief Investment Officer*

## Positioning & Activity

- We started the year overweight in equities, having bought through weakness in the last quarter of 2018 and benefitted from the sharp recovery in Q1. Having benefitted from the rebound in equity markets, we took some profits but remain overweight given the dovishness of major central banks and the signs that another mini cycle could drive stocks higher once better data feeds through. Within equities, we increased our position in Europe from underweight to neutral following underperformance and the European Central Bank has now committed to easing monetary policy which should boost European equities in due course. We also increased our overweight holding of US equities given relatively strong economic growth there. Against these increases, we remained broadly neutral in UK equities given risk that a 'no-deal' Brexit will hold back the economy, but equally a deal would bring an end to the unhelpful uncertainty. We have sharply reduced our position in Japan from overweight to underweight, as the economy there continues to struggle, and cut our overweight in emerging markets, taking profits, following strong performance as the US dollar weakened on expectations of lower interest rates.

- We have overweight holdings of sterling investment grade corporate debt and short duration global high yield bonds with corresponding below benchmark allocations to UK government bonds. Government bonds have adjusted to the new more dovish environment with rising prices and falling yields. Fixed income exposure has a short duration bias to reduce interest rate risk.

- We have a slight underweight exposure to UK property as we feel the impact of Brexit-related uncertainty poses risks to the sector.

- We added to commodities, now being modestly underweight, given signs global economic growth is stabilising.

## Market Background

- Equity markets posted strong returns over the quarter, despite a sharp sell off in May as US-China trade talks broke down and President Trump threatened to levy tariffs on Mexico. Markets reversed those losses as tariff threats eased and inflation data allowed the US Federal Reserve (Fed) and the European Central Bank (ECB) to shift tone towards easier policy.

- The drop in interest rate expectations helped sovereign bonds to record another strong quarter. US 10-year treasury yields ended the quarter 40 basis points (bps) lower at 2.01% and German 10-year bund yields fell further into negative territory to -0.33%.

- After the first quarter's strong bounce, Brent crude oil retrenched slightly to around $66.50 a barrel, due primarily to high stock levels in May. However, rising tensions in the Middle East towards the end of the quarter saw prices rise. Copper fell back 7.7% after rising 13.0% in the first quarter. Meanwhile, gold rose nearly 7%, reaching its highest level since 2013 on lower interest rate expectations.

- Sterling fell over the quarter as uncertainty around Brexit increased with a further delay to the scheduled date for the UK to leave the EU, ongoing UK parliamentary stasis and the resignation of Theresa May as prime minister.

**TAA Performance**

- Regionally, we added to our outperforming overweight position in US stocks, given the relative strength of the economy and positive relative earning revision trends. We cut our exposure to Japan further as earnings revisions there are negative and a strong yen is hampering exporters. We cut our overweight position in emerging markets, taking profits, moving to an underweight position, after a strong period of outperformance this year.

- We remained overweight in short duration global high yield as a way to benefit from a 'muddle through' scenario (soggy growth with little inflation risk) and moved to a more neutral position on commodities: global growth is weak but tensions on the Middle East are rising which could impact the oil price.

**Outlook & Views**

- This is now the longest US economic expansion on record but there have been three mini cycles since 2008 and a fourth may be in prospect with the US Federal Reserve easing given the lack of serious inflationary pressure. The previous mini cycles saw policy response to slower growth leading to improvement (in 2012 after Mario Draghi's "whatever it takes" and in 2015 after China stimulus). Despite falling unemployment, inflation remains benign, providing breathing space for central banks to remain accommodative.

- Downside risks still remain. Trade wars or Middle East conflict could trigger a relapse in market sentiment and provide a further shock to global growth.

- Volatility is a feature of the late stages of the business cycle. The greatest opportunities may come from being a contrarian investor, buying during panics and selling into rallies.

**AOB**

**IAC asked for an update on the impact of Brexit scenarios.** RLAM responded that the uncertainty made it difficult to predict where sterling would be a few months from now. A disruptive no-deal Brexit could see the pound weaken much further. On the other hand, a delay in Brexit with increased prospects for a deal, or even a referendum with remaining in the EU as an option, could see the pound recover sharply.

A general election would create a further layer of uncertainty for sterling. There was little prospect for a new deal with the EU under the short timetable currently available, so the markets would probably be forced to factor in a no-deal Brexit under a majority Conservative government.

A no-deal scenario would likely be a shock for the economy and property market, but UK larger companies derive 70% of their revenues overseas and we'd expect equity prices to rise as a weaker pound inflated earnings. Overseas equities and commodity investments would go up through direct translational effects. In a more positive Brexit scenario for the economy, a rise in the pound would probably crimp returns from equities and commodities, but we'd expect surveyors to mark up UK property prices.

RLAM manage our funds dynamically and take shorter-term developments into account in the tactical asset allocation. RLAM have been shifting assets away from sterling in our multi asset funds since Theresa May resigned as prime minister, as they judged the risk of no-deal to rise under the premiership of Boris Johnson. RLAM continue to monitor events closely in case political developments lead to a short-term bounce in the currency.

RLAM were moderately positive on global equities, despite increasing US-China trade frictions, as monetary policy was easing in America and elsewhere which should boost the world economy in 2020. Within that position, RLAM were broadly neutral on the UK market where attractive valuations already reflect heightened political uncertainty.

**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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