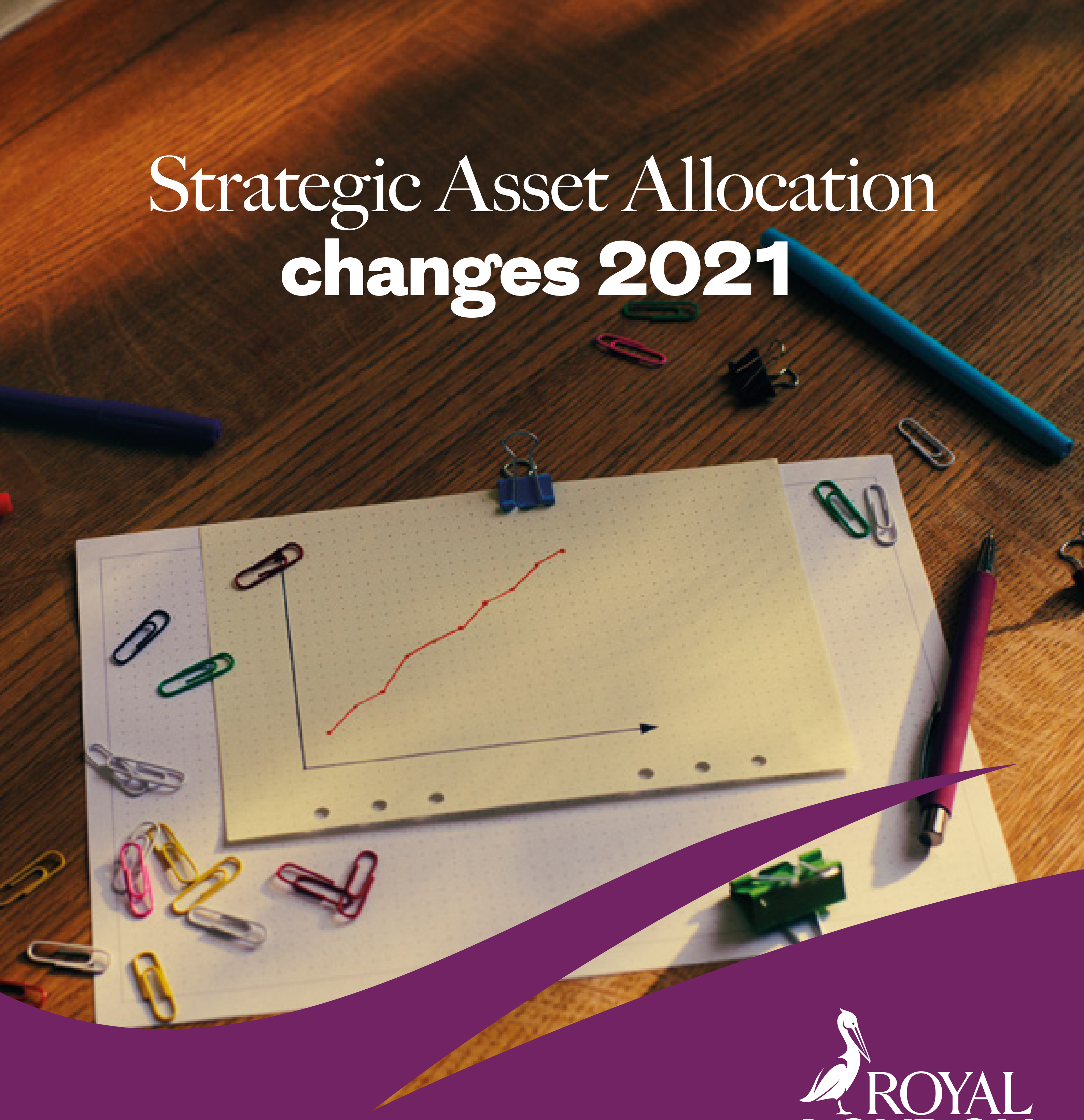
Strategic Asset Allocation **changes 2021**



Investments | Governed Range

ROYAL LONDON

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This document provides details of the changes we've made to the strategic asset allocations of the Governed Portfolios and Governed Retirement Income Portfolios in order to improve expected returns for customers.

What's inside

Introduction

The Governed Range consists of risk targeted portfolios and lifestyle strategies. It provides the opportunity to invest in UK and global financial markets within a risk managed framework and provides a consistent investment approach that is regularly monitored by our Investment Advisory Committee and automatically updated at no extra cost.

The Governed Range is based on the following beliefs:

Strong governance

We believe that all investment options should be monitored on a regular basis and that through strong governance we can help to ensure they deliver in line with their objectives.

Customer - focused investment propositions

We believe the main driver behind designing investment propositions should be delivering positive customer outcomes.

Greater diversification

We believe that investing in a wide range of asset classes and strategies will result in more consistent performance across a wide range of economic conditions.

Responsible Investment

We aim to generate good returns whilst also making a positive contribution to our society and environment.

Strategic Asset Allocation drives performance

We believe that strategic asset allocation (SAA) is the main driver of long-term performance and that SAA's should perform well in both nominal and real scenarios.

Capitalising on market opportunities

We believe in active management where it can add value relative to a low cost passive approach, and that a tactical asset allocation (TAA) overlay can add value over the long-term.

Value for money

At the heart of our investment proposition is the aim to deliver value for money to customers. We aim to prevent unnecessary costs by ensuring efficient implementation and to be as transparent as possible.

Launched in 2009 the Governed Range invests across a wide set of asset classes. We think that's the best way to control risk over the short and long term. Since launch the Governed Portfolios have delivered returns ranging between 5.0% - 8.9% per annum and the GRIPs have delivered returns ranging between 4.2% - 7.9% per annum.*

*as at 31 March 2021 Source: Royal London. 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. The Governed Portfolios were launched in 2009 and Governed Retirement Income Portfolios in 2012.

Strategic Asset Allocation review

Strategic asset allocation (SAA) represents our long term view of an efficient asset mix for each portfolio and is reviewed regularly.

We formally review SAA every 3 years and the Investment Advisory Committee monitor how the SAAs are delivering against their risk objectives each quarter. The formal review ensures that portfolios remain appropriate for their long term objectives which are designed to optimise returns within their risk framework. This is based on appropriate risk metrics for each portfolio and uses a combination of quantitative results and qualitative pragmatic investment experience.

The last formal review was performed in 2016 where we broadened and increased the asset class universe used by the Governed Range Portfolios to include Gilts, Global High Yield (GHY) bonds, Commodities and Absolute Return Strategies (incl. cash) in order to add diversification benefits and provide increased resilience to market shocks.

Objective and Approach

The portfolios have real return objectives and are designed around a risk target framework where risk metrics are based on the objective of each portfolio. The objective of the review is to improve long term outcomes for customers, and we review expected risk, return and correlations for each asset class in order to identify the most efficient mix going forward for the longer term. As part of the latest review, we specifically investigated the following areas:

Asset class assumptions

We reviewed the previous SAA's based on the latest set of capital market assumptions.

Allocation between regional equity markets

Our previous equity split represented a significant home bias to UK equities which may no longer be appropriate over the longer term. We reviewed the equity allocations in order to increase exposure to faster growing countries and sectors of the world.

Cash Allocations

This asset class provides liquidity in order to make short term tactical changes within the portfolios and we tested our view on what an appropriate level should be

Consider the addition of other asset classes

We reviewed the potential to add exposure to new asset classes in order to improve diversification benefits.

Process

The review used the long-term expected return, volatility and correlation assumptions as set by Royal London. This is based on Moody's Analytics capital market assumptions which are then overlaid with a Royal London house view. Each asset class has a set of assumptions that reflect our expectations of risk, return and how they move in relation to one another. These assumptions determine the risk return trade-off for each asset class.

The next stage of the process was to review and test the current SAAs against hundreds of potential other combinations of portfolios over thousands of different future scenarios working with Moody's Analytics. This helped us to identify the most efficient mix of assets given the risk targets for each portfolio. In other words which asset allocation offers the best potential performance for the level of risk taken in each portfolio and hence offers the best risk / return trade off. This performance may be either a higher expected return for the same level of risk for a customer in a Governed Portfolio, or a higher sustainability of income for a drawdown customer in a Governed Retirement Income Portfolio.

Results

The 2020 review concluded the following:

- An increased exposure to emerging and global developed equities delivers potential for higher long-term returns for a small increase in risk.
- A higher weighting in UK equities improves outcomes relative to UK inflation in comparison to a global market cap index.
- There are significant differences in sector exposure that result from different regional allocations. Increasing Global Developed and Emerging Market exposure provides a more balanced sector exposure overall.
- Reducing property and increasing global high yield maintains risk / return characteristics while marginally increasing diversification and liquidity.
- In the current low yield environment the modelling showed a relative preference for cash over Gilts and we have maintained our cash allocation.
- We could improve potential income sustainability for customers in GRIPs 1 and 2 by small additions to the equity and high yield bond exposure within the portfolios while maintaining similar downside performance.
- The use of multi asset credit was discounted due to the requirement for daily liquidity reducing the effectiveness of the strategy for portfolios.

What's changed

Governed Portfolios

As a result of this review we have made the following changes to the strategic asset allocations of the Governed Portfolios.

Asset Class	Change
Equity	Equity allocations will change to a new split of 35% UK equity, 55% developed market equity and 10% emerging market equity across all portfolios
Property	Reduction in allocation (2.5%) across portfolios (bar GP3 & GP9)
Global High Yield	Increase in allocation (2.5%) across portfolios (bar GP3 & GP9)

The new strategic asset allocations are shown in the table below.

	Cautious			Balanced			Adventurous		
	GP1	GP2	GP3	GP4	GP5	GP6	GP7	GP8	GP9
UK Equity	18.4%	14.9%	5.3%	23.6%	19.3%	11.4%	28.0%	24.5%	15.8%
Global Developed Equity*	28.9%	23.4%	8.3%	37.1%	30.3%	17.9%	44.0%	38.5%	24.8%
Emerging Market Equity	5.3%	4.3%	1.5%	6.8%	5.5%	3.3%	8.0%	7.0%	4.5%
Property	15.0%	10.0%	5.0%	15.0%	12.5%	10.0%	12.5%	12.5%	10.0%
Commodities	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
GHY	5.0%	5.0%	10.0%	2.5%	5.0%	5.0%	2.5%	2.5%	2.5%
Gilts	5.0%	9.2%	16.7%	1.7%	5.0%	11.7%	0.0%	1.7%	9.2%
IL Gilts	5.0%	9.2%	16.7%	1.7%	5.0%	11.7%	0.0%	1.7%	9.2%
Corporate Bonds	5.0%	9.2%	16.7%	1.7%	5.0%	11.7%	0.0%	1.7%	9.2%
Absolute Return Strategies (incl cash)	7.5%	10.0%	15.0%	5.0%	7.5%	12.5%	0.0%	5.0%	10.0%

* this includes 2% exposure to UK. Percentages may not add up to 100 due to rounding.

Governed Retirement Income Portfolios

Similarly, we made the following changes to the strategic asset allocations of Governed Retirement Income Portfolios.

Asset Class	Change
Equity	Change to a new split of 35% UK equity, 55% developed market equity and 10% emerging market equity across all portfolios. Equity allocations increase by 2.5% for GRIP 1 and 2.
Gilts, IL Gilts and Corporate Bonds	Reduction in allocation (3.3%) for GRIP1 and (2.5%) for GRIP2
GHY and UK High Yield	Increase in allocation (3.75%) for GRIP1 and (2.5%) for GRIP2

The new strategic asset allocations are shown in the table below.

	GRIP1	GRIP2	GRIP3	GRIP4	GRIP5
UK Equity	4.4%	7.9%	10.5%	14.0%	17.5%
Global Developed Equity*	6.9%	12.4%	16.5%	22.0%	27.5%
Emerging Market Equity	1.3%	2.3%	3.0%	4.0%	5.0%
Property	5.0%	7.5%	7.5%	10.0%	10.0%
Commodities	5.0%	5.0%	5.0%	5.0%	5.0%
GHY	6.3%	6.3%	6.3%	7.5%	8.8%
UK HY	6.3%	6.3%	6.3%	7.5%	8.8%
Gilts	16.7%	12.5%	10.0%	5.0%	2.5%
IL Gilts	16.7%	12.5%	10.0%	5.0%	2.5%
Corporate Bonds	16.7%	12.5%	10.0%	5.0%	2.5%
Absolute Return Strategies (incl cash)	15.0%	15.0%	15.0%	15.0%	10.0%

* this includes 2% exposure to UK

Impact on typical customer profiles

The tables below show the projected fund size at age 65 for Sally and Mark based on the previous and current SAA based on 100% in each portfolio.

Age 30 | £28,000 salary rising with inflation | no pension pot at outset | 8% p. a. contributions

	Current Approved SAA			Proposed SAA		
	5th Percentile Nominal Fund Value	Expected Nominal Fund Value	95th Percentile Nominal Fund Value	5th Percentile Nominal Fund Value	Expected Nominal Fund Value	95th Percentile Nominal Fund Value
GP 1	£124,281	£318,981	£659,937	£130,911	£340,444	£704,074
GP 2	£124,116	£286,155	£564,112	£129,314	£301,097	£593,391
GP 3	£124,061	£244,208	£447,341	£125,623	£248,633	£454,173
GP 4	£123,425	£363,897	£803,314	£130,103	£396,907	£880,894
GP 5	£125,992	£326,602	£683,215	£132,032	£349,798	£731,540
GP 6	£128,883	£278,656	£539,216	£132,826	£289,391	£561,535
GP 7	£119,410	£400,745	£935,699	£125,271	£445,303	£1,056,580
GP 8	£122,819	£367,028	£820,948	£128,887	£401,722	£893,983
GP 9	£128,147	£300,034	£603,721	£133,484	£317,651	£641,513

Age 58 I £50,000 salary rising with inflation I £75,000 fund at start I 15% p.a. contributions

	Current Approved SAA			Proposed SAA		
	5th Percentile Nominal Fund Value	Expected Nominal Fund Value	95th Percentile Nominal Fund Value	5th Percentile Nominal Fund Value	Expected Nominal Fund Value	95th Percentile Nominal Fund Value
GP 1	£110,519	£160,634	£218,711	£112,758	£164,303	£224,511
GP 2	£114,676	£155,018	£199,873	£116,610	£157,871	£204,222
GP 3	£124,989	£144,909	£165,512	£125,749	£145,891	£166,685
GP 4	£105,215	£166,449	£242,363	£107,379	£171,358	£248,838
GP 5	£109,985	£161,052	£220,991	£112,229	£164,910	£226,738
GP 6	£119,914	£151,744	£186,622	£121,280	£153,857	£189,611
GP 7	£100,188	£171,091	£261,660	£102,642	£177,080	£270,631
GP 8	£104,275	£166,718	£244,879	£106,741	£171,821	£251,490
GP 9	£114,764	£155,785	£202,314	£116,705	£158,941	£206,358

Notes:

- The 5th percentile represents an unfavourable outcome where 95% of possible outcomes are better and only 5% are worse.
- Expected nominal fund value represents an average outcome.
- The 95th percentile represents a favourable outcome where only 5% of possible outcomes are better and 95% are worse.
- Figures shown are before charges are deducted.
- Forecasts are not a reliable indicator of future performance. 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.

These notes apply to both Sally and Mark

Age 65 | £100,000 fund |
3.5% withdrawals each month until age 90

	Current Approved SAA			Proposed SAA		
	5th Percentile Nominal Fund Value	Expected Nominal Fund Value	95th Percentile Nominal Fund Value	5th Percentile Nominal Fund Value	Expected Nominal Fund Value	95th Percentile Nominal Fund Value
GRIP1	£12,765	£28,742	£50,892	£13,954	£36,437	£68,382
GRIP2	£12,887	£40,636	£80,948	£14,444	£49,734	£102,249
GRIP3	£11,469	£54,292	£120,721	£13,432	£59,360	£130,039
GRIP4	£9,474	£71,476	£175,104	£12,348	£79,564	£191,705
GRIP5	£6,298	£87,363	£229,632	£9,451	£99,005	£255,364

	Current Approved SAA		Proposed SAA	
	Income Sustainability	Max 1-year Loss at 5th percentile	Income Sustainability	Max 1-year Loss at 5th percentile
GRIP1	100%	9%	100%	9%
GRIP2	100%	9%	100%	10%
GRIP3	99%	12%	99%	11%
GRIP4	98%	15%	99%	14%
GRIP5	97%	18%	98%	17%

Notes:

- The 5th percentile represents an unfavourable outcome where 95% of possible outcomes are better and only 5% are worse.
- Expected nominal fund value represents an average outcome.
- The 95th percentile represents a favourable outcome where only 5% of possible outcomes are better and 95% are worse.
- Income sustainability describes how sustainable an individual's income is based on 3.5% level annual income taken monthly.

The tables above show the projected fund size at the ages shown for Sam and M

Age 70 I £250,000 fund I
3.5% withdrawals each month until age 80

	Current Approved SAA			Proposed SAA		
	5th Percentile Nominal Fund Value	Expected Nominal Fund Value	95th Percentile Nominal Fund Value	5th Percentile Nominal Fund Value	Expected Nominal Fund Value	95th Percentile Nominal Fund Value
GRIP1	£118,301	£152,821	£191,412	£118,970	£161,084	£209,079
GRIP2	£115,549	£165,401	£223,216	£116,234	£174,376	£242,012
GRIP3	£109,581	£178,195	£261,637	£112,789	£183,260	£268,313
GRIP4	£103,350	£192,497	£306,047	£106,737	£199,675	£316,857
GRIP5	£96,265	£204,957	£348,097	£99,686	£214,391	£363,037

	Current Approved SAA		Proposed SAA	
	Income Sustainability	Max 1-year Loss at 5th percentile	Income Sustainability	Max 1-year Loss at 5th percentile
GRIP1	100%	9%	100%	9%
GRIP2	99%	9%	99%	10%
GRIP3	98%	12%	98%	11%
GRIP4	96%	15%	97%	14%
GRIP5	95%	18%	96%	17%

- Max 1-year loss at 5th percentile describes how much an individual's fund value can fall in a year represented by an unfavourable outcome.
- Figures shown are before charges are deducted.
- Forecasts are not a reliable indicator of future performance. 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.

Moira based on the previous and current SAA based on 100% in each portfolio.

In summary these changes:

- Increase expected returns from current levels while maintaining risk adjusted efficiency.
- Delivers a more diversified regional and sector split relative to a global market cap approach.
- Aims to improve outcomes relative to UK inflation for UK based pension savers in comparison to portfolios which contain higher overseas exposure.
- Improve liquidity profile.
- Evidence our ongoing governance.
- Are in line with our current tactical positioning.
- Changes were implemented in Q1 2021.

If you would like to discuss any of these changes please contact your usual Royal London consultant.

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