Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date
03/12/2019

Present members
Julius Pursaill (Chair)
Ewan Smith
Piers Hillier
Candia Kingston
JB Beckett

In attendance
Lorna Blyth
Niall Aitken
Euan Craig
Ryan Hamill
Joseph Smith
Trevor Greetham (RLAM)
Mike Clarkson (RLAM)
Carrie Johnson
Nicola Livingstone
Peter Dorward

Apologies
Dr. James McCourt
Robert Whitehouse

Owner

1. **REVIEW OF PREVIOUS MINUTES** — JP

The minutes of the 03 September 2019 meeting were approved. No new conflicts of interest were notified.

2. **MATRIX FUND REPLACEMENTS** — EC

Euan Craig presented three papers outlining the proposed replacements for underperforming funds identified from the matrix range. The proposals considered our own in-house research, external research and analysis provided by Morningstar.

Stewart Investors Global Emerging Market Leaders

The IAC discussed the proposal to replace this fund with the Fidelity Emerging Market fund. The Stewart Investors GEM fund sits in the Emerging Market specialist category of the matrix. A number of alternatives were ruled out because their Tracking Error (TE) was too low. Given its cyclical nature, the committee requested further insight into the TE of the potential replacement and was satisfied that the analysis covered a sufficient period to cover multiple market cycles.

The committee then further discussed the analysis' coverage of other factors including value bias given the current market outlook, portfolio turnover and cost. The IAC was satisfied across all these areas especially that the proposed fund was not only cheaper than the existing offering but also lower than the sector median. There was concern that the ESG scoring was not detailed enough and the IAC asked RLI to expand this going forward.

The committee supported the replacement proposed subject to no red flags from the due diligence questionnaire.

Invesco Japan

Currently, Invesco Japan sits in the Japan specialist category of the matrix. It was proposed to the IAC that T.Rowe Price Japanese Equity replace the Invesco fund.

The committee highlighted concerns over T.Rowe from an ESG and climate change perspective given the recent media coverage on the US arm of the business and requested more information from T.Rowe on ESG integration. The committee again raised flags as to the growth bias of the fund however were generally satisfied considering the devaluation of the Japanese market and the impact this has on growth cycles relative to other economies.

One key advantage of the T.Rowe fund over the available alternatives was the significant discount offered as they try to break into the UK market. This discount is offered via a rebate structure and the committee requested that conversations are held as to whether a clean share class is available at the same price. This is in light of the FCA's request for assessment of value which specifically asks about "classes of units – whether it is appropriate for unit holders to hold units in classes subject to higher charges than those applying to other classes of the same scheme with substantially similar rights". The IAC agreed that a clean share class would be preferred from a transparency perspective.

Given the challenges raised by the committee the replacement was supported pending engagement and confirmation from Morningstar and T.Rowe on ESG considerations and the finalised pricing structure.

Schroder UK Alpha Plus

Schroder UK Alpha Plus sits in the UK Equity specialist category of the matrix focusing predominately on large cap stocks. It was proposed to replace this with Baillie Gifford UK Equity Alpha given the lack in confidence in Schroders ability to meet the TE requirement.

The committee was advised that there were two alternative funds which had stacked up well in the initial analysis. Liontrust Sustainable Future UK Growth fund had been ruled out due to concerns over fund capacity and charges and Lindsell Train UK Equity was ruled out due to concerns around potential lack of risk oversight and high concentration risk. It was noted that Lindsell Train had now signed up to UNPRI. With this in mind, the committee was happy to support the replacement fund given its strong track record and low fund manager turn over subject to no red flags from the due diligence questionnaire.

3. PERFORMANCE PACK EC

All data is at end September 2019.

RLI Governed Range

All Governed Portfolios outperformed their benchmarks over the quarter, 1, 3 and 5 years with the exception of Governed Portfolio 7 to end of September 2019.

All five GRIPs are above benchmark over the quarter. They continue to outperform over one, three and five years and also since launch, with all portfolios ahead of benchmark over all time periods. The committee acknowledged the significant inflows to Governed Range in the past 12 months highlighting the continued success of this proposition.

Global Managed

The fund had underperformed benchmark over the quarter as well as over 1, 3 and 5 years.

This is a fund of fund structure which invests in a number of RLP unit linked funds. RLP American, European and Pacific have underperformed over 1, 3 and 5 years. Of the 7 active funds in the portfolio, 5 have outperformed their respective benchmarks over 3 years. In the funds that have underperformed (European Opportunities & UK Opportunities), stock selection has been the main detractor. Global Managed has a large allocation to RLP American, a fund which links to RLAMs US Tracker Fund. This fund closely tracks its benchmark but incurs trading costs that are not reflected in the benchmark. Timing differences between the RLP unit linked fund and the RLAM Fund, settlement differences and timing differences between fund and benchmark also create divergence in relative performance. The IAC asked about the levels of cash holdings in the fund and requested further detail on the rationale for the spikes seen at month end.

More detailed performance attribution for RLP Global Managed was provided in the strategic pack following request from the IAC.

Property

The fund has outperformed benchmark over 1 and 5 years to end of September 2019.

As at the end of September 2019, RLPPF cash holding was 19.6%.

Commodity

The Fund is underperforming over the quarter but is ahead of benchmark over 1 and 3 years to the end of September 2019. The fund was launched in June 2016 and as such lacks a longer-term track record.

Sterling Extra Yield

The fund is outperforming over 3 and 5 years to the end of September 2019.

Absolute Return Government Bond

The fund has marginally outperformed benchmark over 3 years to the end of September 2019.

Global High Yield Bond

The fund is underperforming over 1, 3 and 5 years to the end of September 2019, but the RLAM OEIC is outperforming its benchmark over all periods. The OEIC benchmark is not available our performance management system (Lipper) so a similar benchmark has been selected on the advice of the fund manager.

Externally Managed Matrix Funds

Rathbone Global Alpha

The fund underperformed benchmark over the quarter as well as 1, 3 and 5 years to the end of September 2019.

The lag over one year is the result of a difficult Q4 2018, on which Rathbone has previously provided commentary (see previous minutes). The fund was 1.6% ahead YTD to the end of September, helped in part by the recovery of growth assets, in particular Japan. The overweight to the US continues to be a positive, with selection in UK, US, Japan and Europe all helping.

Over the longer term, previous minutes have detailed the drag on performance from the fallout from the UK referendum, and the difficulties in reducing small and midcap exposures in the UK within a fund of funds structure. This continues to affect the 5-year performance.

IAC had previously supported replacing Rathbone as the manager of this mandate and supported the proposal to appoint RLAM's Mike Clarkson as manager. This proposal has received internal governance approval and RLI are in discussions with Rathbone regarding the transition process and costs. An update will be brought back to IAC once the process for divestment and likely costs has been agreed.

Schroder Tokyo

Since the new manager took over running the fund at the beginning of the year performance has picked up, although it has dropped slightly below benchmark over the last quarter. The RL 3Q rating remains at 3 and we remain comfortable to continue holding the fund. The longer-term underperformance remains a concern and RLI have agreed to set up a call with the Schroder team prior to the next IAC to discuss the fund in more detail and any changes made by the new fund manager.

The committee asked for clarity on repercussions for this fund if Morningstar and 3Q ratings are further downgraded and were satisfied that a replacement would be prepared in Q1 2020 if no significant improvements were made.

Invesco UK Growth

The committee raised concerns of contagion risk from Mark Barnett's fund (a protégé of Neil Woodford at Invesco) as advisers begin to pull money. Morningstar downgraded two of Barnett's funds due to high exposure to smaller companies. IAC members are concerned that we will see further downgrades from Morningstar and requested that potential replacements are scoped as a matter of urgency.

Invesco Global Equity

The committee highlighted that whilst the investment philosophy of the Invesco Global Equity fund was interesting, it has not been working in practice resulting in significant underperformance in the last 12 months. The upcoming departure of the CIO and UK contagion risk were noted by the committee and it was agreed that this fund should remain on watch given the underperformance has not yet passed the minimum threshold for a potential replacement to be considered.

Fidelity MoneyBuilder Dividend

Fidelity acknowledged issues with the fund in May 2018 and allowed the fund manager to focus on this fund and relinquish control of other funds he was managing. Performance since this change has been above benchmark. The fund retains a RL 3Q rating of 3 and the IAC is happy with the decision to hold this fund and await Mike Clarkson's report following a meeting with the fund manager in Q1 2020.

Merian North American Equity

This fund was introduced a year ago as a replacement within its matrix sector however it has underperformed benchmark over this time period albeit absolute returns are double digit. It has a silver rating from Morningstar and the committee was happy with the recommendation to continue holding the fund subject to a level of scrutiny.

The IAC expressed interest in the current oversight of value/growth bias for funds proposed as replacements relative to the current position of the economic cycle. RLI outlined the current neutral view taken on investment styles but outlined future plans to modify the proposition with clearer value and growth segments.

Artemis UK Special Situations

This fund is being replaced by Baillie Gifford UK Equity Alpha at the end of Q1 2020. The committee challenged the time taken from when a replacement fund is agreed to the actual implementation. RLI agreed to review the current process at upcoming strategy meetings. Further to this, the IAC raised questions of post-switch monitoring to provide confidence that the replacement framework produces funds that provide positive customer outcomes relative to the original investment. RLI agreed to implement this monitoring to the quarterly performance updates.

4. **SAA UPDATE** NA

The committee formally agreed the minutes of the special IAC meeting that occurred at the beginning of November. Niall Aitken provided an update to the committee on the challenges raised at the special IAC as well as outlining the next steps for the SAA review. The committee discussed the impact on capital requirements stemming from the strategic review and outlined the main considerations that RLAM will have when leading the implementation in early 2020.

5. **LONG TERM ECONOMIC ASSUMPTIONS FORUM (LEAF) Overview** NL

Nicola Livingstone (Investment Office) outlined the current approach for setting economic assumptions for use in Strategic Asset Allocation (SAA) reviews following the request from the September IAC.

The economic assumptions used to optimize and evaluate the potential candidate portfolios are significant inputs to any SAA review. As a result, these assumptions are subject to scrutiny and a sign off process within the group on a quarterly basis to ensure that they are appropriate for use. The approved assumptions are used across all SAA reviews being performed within RLMIS – including those performed for the with-profit, Legacy, Consumer and RLI funds.

The committee noted adjustments to certain risk premia in the LEAF assumptions relative to the Moodys raw figures. The IAC was reassured that this had been discussed widely at LEAF. Changes had been made due to the foreign exchange premia that Moody's incorporate into global equity returns and also to reflect the more positive outlook on UK equities and UK property held by RLAM. Meetings with other asset managers also help to drive RLAMs own views on capital market assumptions, a fact which was well received by the committee who acknowledged the importance of this external exposure when developing in-house views. The IAC requested that changes to the LEAF assumptions are highlighted in the strategic pack going forward.

6. **RLAM VFM UPDATE** LB

Lorna Blyth provided a verbal update to the committee on the value for money (VFM) assessments in line with the 2018 FCA policy statement. RLAM expect to produce VFM assessments in July 2020 and we will also request these from our external fund partners.

7. **RESPONSIBLE INVESTMENT UPDATE** LB

Following a request to add RI as a standing agenda point Lorna Blyth provided an overview of the RI project.

At the end of September, Royal London published their Responsible Investment and Climate Change policies on the public website. These commit Royal London to proactively asking their asset managers to include financially material, environmental, social and governance factors in the investment decision process. It also commits Royal London to report on asset managers stewardship activities during 2020. Lorna advised that any asset manager who is not reaching the standards set may end up being removed from the Royal London range.

The committee was pleased with the commitment to sign up to the United Nations-supported Principles for Responsible Investment (UNPRI), the UK stewardship code and the Task Force on Climate-related Financial Disclosures (TCFD) as asset owners in 2020. The IAC acknowledged the importance of customer education and engagement on responsible investment as well as the importance of transparency for Royal London to avoid 'greenwashing', reputational risk and set an example of effective responsible investment implementation.

8. NA

STRATEGIC PACK

Governed Portfolios & Managed Strategies

Updates on the strategic asset allocation review for the Governed Portfolios can be found in the 'SAA Update' standing agenda point.

All portfolios are within their target ranges for real volatility with the exception of the Cautious Long-Term Managed Strategy which is below the lower limit. As mentioned in previous IAC packs the forward-looking volatility of the portfolios and strategies have generally been on a downward trend reflecting lower current market volatility than is expected in the long term.

Governed Retirement Income Portfolios (GRIPs)

There have been no changes to the GRIPs strategic benchmark this quarter. The GRIP SAA review is underway and is expected to be presented to the IAC in Q1 2020.

All portfolios remain within their target ranges on both the income risk metric and the fund risk metric. Sustainability scores have decreased since last quarter, while the maximum 1yr loss numbers have worsened very slightly.

Lifestyle Strategy Analysis

Annuity income and real fund values for drawdown lifestyles have fallen since last quarter reflecting the fall in yields over the quarter to the end September

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 early July investor sentiment recovered and stock markets rebounded following signals from the Federal Reserve that it would likely cut rates. Trade tensions also appeared to ease as there were positive signals about a US deal with China. Despite ongoing political uncertainty and slower global growth, risk of global recession in 2020 had arguably reduced as policymakers signaled easier policies. RLAM moved further overweight in equities, funded out of conventional gilts and cash-based strategies and also added to high yield. Positions in commodities were reduced, given upside risks to oil prices.

- As August approached, rate cuts by the Federal Reserve in response to slowing growth saw the sixth consecutive month of rising global equity prices. While the US-China trade talks showed few signs of progress, investors remained hopeful of a resolution. Given muted inflation, RLAM expected monetary easing by central banks to trigger a mini cyclical upswing. This short-term market weakness presented a buying opportunity, and as such they moved further overweight equities, increasing the underweight commodities; and, as bond yields declined to new lows, reduced holdings of government, corporate and global high yield debt.

- In September, global equities fell for only the second month this year and the inversion of the US yield curve, which has traditionally signaled a recession, showed investors feared that escalation of US-China trade tensions could undermine global economic growth. Having taken advantage of seasonal market weakness over the summer to increase the overweight in equities, RLAM took some profits after recent strength, but remained broadly constructive on the outlook for stocks. Against this, they increased holdings in commodities as prices started to strengthen and reduced holdings in government bonds as bond yields reached new lows.

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

Chief Investment Officer – Short-term Tactical View

Market background

- Global equity markets were more subdued in the quarter compared to earlier in the year, while still posting positive returns. Over the quarter, most major countries and regions appreciated in sterling terms. In spite of the further deterioration in economic data and the ongoing US-China trade tensions, more accommodative monetary policy from the Fed and ECB restored confidence that global economic growth will continue.

- The drop in interest rate expectations helped sovereign bonds to record another strong quarter. US 10-year treasury yields ended the quarter 34 basis points (bps) lower at 1.66% and German 10-year bund yields fell further into negative territory to -0.57%.

- After the first quarter's sharp increase, the price of Brent crude oil retrenched further (-8.7%) and ended the quarter just above $60 a barrel, despite increased tensions in the Middle East and the attack on a major Saudi Arabian refinery. Copper fell back 4.4% over the quarter. Despite significant weakness in September, gold rose 3.3% over the quarter supported by softer US rate expectations and rising geopolitical risks.

- Sterling continued to be hampered by fears of a 'no deal' Brexit; weakening against the dollar and remaining broadly flat relative to the euro. In July and August, it was affected by Brexit-related sentiment; then, in September, the proroguing of Parliament followed by the successful challenge to its legality in the UK Supreme Court, increased volatility further.

TAA performance

“We used the separate TAA risk budget to increase our equity position through the third quarter, noting improvements in leading growth indicators. We took advantage of seasonal weakness in equities over the summer, adding to our position in stocks, then took profits slightly at the end of the quarter. We remain moderately positive on equities. Trade tensions and geopolitical risk could mean things get worse before they get better, but we are primed to buy dips in global stock markets.

We remained constructive on short duration global high yield as a way to benefit from a ‘muddle through’ scenario (soggy growth with little inflation risk) and increased our position in commodities over the quarter as there were signs that global economic growth was stabilising. We are now covered for any economic uptick going into 2020.

Regionally, we started the quarter with an equity position tilted in favour of overseas markets, regionally focused on North America and Europe at the expense of Japan and Emerging Markets. We increased equity exposure during the market weakness in August, before taking profits towards the end of the quarter as investor sentiment normalised. We felt Japan would continue to struggle and increased our position until the middle of the quarter, before rebuilding exposure ahead of a market recovery into quarter end. Following underperformance in the quarter, we added to our position in emerging markets. Many EM countries have US dollar-denominated debt and would benefit if the currency weakens on Fed rate cuts.”

Outlook and views

“A decade of uninterrupted growth has helped global stock markets post returns in excess of 300% since the 2009 lows but this bull market hasn’t always felt good. Recession fears caused bouts of volatility in 2012, 2015 and again in 2018/9. However, persistently low inflation means central banks are able to step in to prevent a downturn getting out of hand. Monetary policy is currently easing in the US, the euro area, China and a wide range of other developed and emerging economies. We think this cycle has further to run.

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. We are primed to buy dips in global stock markets.

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.”

The committee noted that RLAM have requested greater permissions for the commodity fund and are looking to bring a proposal to the IAC in Q1 2020.

AOB

It was acknowledged that this was the final meeting with Julius Pursaill as chair. Lorna Blyth thanked Julius on behalf of the IAC for his continued dedication and oversight during the eight years as an IAC member including six years as Chair and noted the many projects and propositional changes which Julius has overseen in his role.

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.

December 2019