Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date
05/03/2020

Present members
Candia Kingston (Chair)
Ewan Smith
Piers Hillier (RLAM)
JB Beckett
Dr. James McCourt

In attendance
Robert Whitehouse
Carrie Johnson
Trevor Greetham (RLAM)
Mike Clarkson (RLAM)
Lorna Blyth
Niall Aitken
Euan Craig
Ryan Hamill
Joseph Smith

Apologies

Owner

1. **REVIEW OF PREVIOUS MINUTES**

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

2. **MATRIX FUND REPLACEMENTS** EC

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

Invesco Japan

An update was provided on the proposed replacement from T.Rowe and their ESG integration process as well as information on share class prices. The IAC were satisfied with the commitment from T.Rowe to expand their ESG team and the information provided on ESG integration into the investment process. There remained some concern around their voting record and it was agreed that their policy of engagement rather than disinvestment (with companies with a poor ESG record) needed to be monitored to ensure it is effective in practice.

T.Rowe also confirmed that if a clean share class were to be made available, RLI could switch to this at no additional cost.

In light of this information, the IAC gave their support for the fund change while reiterating that ESG issues need to be a priority in Matrix fund selection going forward.

Note IAC emphasised the importance of considering ESG and other non-performance factors when shortlisting and replacing Matrix funds.

Schroder Tokyo

Schroder Tokyo sits in the Japan Core Plus category of the Matrix. The proposal recommended that the mandate for this be moved to the Baillie Gifford Japanese Income Growth fund.

This fund has a lower charge than the incumbent, has a strong long-term performance record and scored well on the CQS* quant matrix. In addition, it was felt that Baillie Gifford demonstrated a strong investment process across Japanese equities and IAC liked that their team has been working together for a number of years.

From an ESG perspective, Baillie Gifford demonstrated a clearly defined process with analysis integrated fully into the decision-making process and ESG analysts sitting on each stock selection team.

With this in mind, the committee were happy to support Baillie Gifford Japanese Income Growth as the replacement for Schroder Tokyo subject to no red flags from the due diligence questionnaire.

**Consistency Quantitative Score – propriety quantitative analysis provided by RLAM which identifies funds which have demonstrated a high consistency of outperformance.*

3. PERFORMANCE PACK EC

All data is at end December 2019.

IAC sought clarification that the performance summary reflected RL unit-links and therefore was an accurate reflection of the performance of Matrix. This is the case. It was noted by IAC that the overall persistency of Matrix remains poor albeit had improved more recently. There was a brief discussion as to the ongoing active-passive debate and broad studies.

RLI Governed Range

All Governed Portfolios outperformed their benchmarks over the quarter, 1, 3 and 5 years to end of December 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 has outperformed benchmark over the quarter as well as over 1 and 3 years.

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, 3 and 5 years to end of December 2019.

As at the end of December 2019, RLPPF cash holding was 20.1%.

IAC noted that steps were underway to reduce cash holdings within the fund, RLI working with RLAM. It was further noted that IAC members have made some suggestions to enhance the performance report to; include rolling median OCF, median 3Q score and ESG metrics.

Commodity

The fund has outperformed benchmark over 1 and 3 years to the end of December 2019. RLP Commodity was launched in June 2016 and as such lacks a longer-term track record.

Sterling Extra Yield

The fund has outperformed over 3 and 5 years to the end of December 2019.

Absolute Return Government Bond

The fund has outperformed benchmark over 1 and 3 years to the end of December 2019.

Global High Yield Bond

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

RLI noted last quarter that the OEIC benchmark was not available on the Lipper performance management system. RLI now have access to the correct benchmark meaning there should no longer be a discrepancy between the RLP fund performance and the underlying RLAM fund.

Matrix Funds

Rathbone Global Alpha

The fund has outperformed benchmark over the quarter as well as 1 and 3 years to the end of December 2019. Over the longer term, fallout from the UK referendum continues to affect the 5-year figures.

Rathbones will be removed as the manager of this mandate in Q2 2020 and replaced with Mike Clarkson using his 3Q process. This proposal received approval at Investment Strategy Committee, and RLI are in discussions with Rathbones regarding the transition process, timeline, final costs and confirmation of who will bear any costs incurred.

Invesco UK Growth

Due to the period of underperformance, a Morningstar downgrade from 'Silver' to 'Neutral', and the 3Q rating of 4, RLI are currently looking for a replacement for this fund.

Following December's IAC, RLI had identified potential replacements through internal analysis and Morningstar recommendations however, after fund manager meetings, it was agreed none were suitable. RLI will continue with their research and arrange an ad-hoc IAC meeting once a replacement is identified.

IAC noted that increased engagement in respect to monitoring Invesco redemptions would be advisable.

Invesco Global Equity

The fund is now being managed by a new manager with a new investment process. The committee raised concerns about the ability to turn performance around and if so, how the strategy will differ from the existing mandate. RLI acknowledged these concerns and agreed to continue holding the fund for six months with this period ostensibly used to carry out initial analysis for suitable replacements. The fund retains a 3Q rating of 3.

Fidelity MoneyBuilder Dividend

Fidelity acknowledged issues with this fund in May 2018 and made changes to focus the fund manager solely on this fund and relinquish control of other funds within his remit. Performance has picked up substantially over the past 18 months and the fund is no longer triggering red. Although the fund retains a 3Q rating of 3, Mike Clarkson clarified that this score is likely to improve if performance continues as it has over the last 18 months. Traditionally the improvement in RAG status would drop the fund out of the 'under review' section of the pack however the IAC confirmed that they would like to continue seeing more granular reporting on this fund at future meetings until Mike's score improves.

Merian North American Equity

This fund was added to the range a year ago and holds a Silver rating from Morningstar. RLI support holding this fund which has a 3Q rating of 2.

Merian have recently announced a takeover from Jupiter Asset Management and confirmed there will be no change to their North American funds. The committee outlined the importance of ongoing monitoring from RLI as the takeover progresses. RLI agreed to keep in regular contact with both funds' houses.

There was a discussion between IAC on the long-term performance of the manager and IAC noted that the manager tends to underperform at least at one point in a market cycle. There was discussion about the manager's performance in 2008, process changes since, growing fund size and capacity and the Jupiter-Merian takeover.

Fidelity European Blended

The fund is a blend of Fidelity European and Fidelity European Opportunities and current underperformance is minimal. This, coupled with the Fidelity European fund's Silver Morningstar rating, means RLI support holding this fund.

Artemis UK Special Situations

This fund is being replaced by Baillie Gifford UK Equity Alpha at the end of Q1 2020.

Stewart Investors Global Emerging Market Leaders

A fund replacement was agreed at December's IAC – this fund will be replaced with Fidelity Emerging Markets. RLI will update on timescales when this has been agreed.

Schroder UK Alpha Plus

A fund replacement was agreed at December's IAC – will be replaced with Baillie Gifford UK Equity Alpha. RLI will update on timescales when this has been agreed.

4. **GRIP STRATEGIC ASSET ALLOCATION (SAA)** NA

Niall Aitken presented the results of the SAA review for the Governed Retirement Income Portfolios (GRIPs). The full review covers asset return assumptions, asset class constraints and the nuances of decumulation objectives relative to accumulation. The results of the review showed that generally the 'riskier' GRIPs remained efficient but there was potential for the less risky portfolios to improve efficiency with some minor changes.

Following the Investment Strategy Committee's review of the initial proposal, RLI provided further information for the IAC on customer behaviour in drawdown. The committee commented on the value of the insight and context it provided. RLI outlined the optimization method of GRIPs compared to GPs and the focus on downside risk and sustainable income rather than the accumulation metrics of volatility and expected return. The committee were happy that RLI materially considers the objective of accumulation and decumulation customers differently and supported the methodology.

The IAC queried the assumptions used for Sterling High Yield bonds and were comfortable that these had input from RLAM. The committee asked whether property constraints were set based on liquidity requirements. RLI outlined that this was not the case as the RLP Property fund pooled accumulation and decumulation customers in the same fund, minimising liquidity risk for drawdown customers as accumulation premiums offset income through unit encashment.

The IAC noted the use of Global High Yield given current market conditions and market cycle considerations and were pleased with the qualitative overlay from RLI on the modelling outputs to justify its positioning in the portfolios.

The committee were supportive of the proposed candidate portfolios and moving forward with implementation.

5. **SAA IMPLEMENTATION** NA

Niall Aitken presented an update to the committee on the transition to the new Strategic Asset Allocation (SAA) benchmarks for the Governed Portfolios.

The committee questioned the use of tactical allocations to progressively transition the portfolios to the SAA. Both RLI and RLAM highlighted that the tactical models were beneficial to this transition in that they supported some of the trades but acknowledge this is a challenge for future SAA transitions which will need to be considered.

The IAC also looked for clarification on customer communication given the transition to the new SAA was already underway, but benchmark changes are not yet in affect. RLI outlined that given the size of the trades there is a careful balance between communication and implementation in order not to alert the market and cause detriment to customers.

The IAC noted the use of Global High Yield given current market conditions and market cycle considerations and were pleased with the qualitative overlay from RLI on the modelling outputs to justify its positioning in the portfolios. The IAC noted some concerns with regards to High Yield more generally, rising default rates were noted, whilst noting that both SAA and TAA were adding risk: equities and High Yield. It was noted that the changes were relatively small and well within risk budget.

Finally, the committee asked for RLIs comments on the cash levels in the property fund and how ongoing purchases within that fund are considered as cash levels could vary through the transition period. Niall Aitken confirmed that the implementation is dynamic and there is/will be regular ongoing monitoring of the property fund to ensure the transition does not impact the funds core strategy.

6. STRATEGIC PACK RH

Governed Portfolios & Managed Strategies

All portfolios are within their target ranges for real volatility with the exception of Cautious Long-Term Managed Strategy which is below the lower limit. The IAC noted that generally volatility has been on a downward trend reflecting lower current market volatility than is expected in the long term. Volatility has since reversed sharply.

Governed Retirement Income Portfolios (GRIPs)

There have been no changes to the GRIPs strategic benchmark this quarter. The GRIP SAA review was presented as a standalone agenda item.

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

Lifestyle Strategy Analysis

Annuity income and real fund values for drawdown lifestyles have increased since last quarter.

Tactical Analysis

GPs, Managed Strategies and GRIPs

All portfolios remained within their tactical risk budgets.

There were two tactical changes in Q4 2019:

- Global equities rose again in October in local currency terms as investors focused on the supportive monetary policies of central banks and US-China trade talks moved towards an agreement. Given inflation remains muted, RLAM expected lower interest rates to trigger a mini cyclical upswing. Having been broadly constructive on the outlook for stocks all year, despite mixed economic data, RLAM increased their overweight position in equities. In addition, they increased their allocations to commodities and global high yield bonds. Against this, with bond yields remaining close to historical lows, they further reduced their holdings of government bonds.

- Global equities rose again in November as investors focused on the accommodative monetary policies of central banks and early signs that global growth was stabilising. However, stock markets are always vulnerable to political setbacks, such as US-China trade deal delays or Middle Eastern tensions. While remaining constructive on the outlook for equities, they took some profits and reduced their overweight position. They also reduced their allocation to commodities, building up cash to buy equities on weakness.

The overall position as at end December was overweight equities, high yield and corporate bonds; underweight absolute return strategies (including cash), government bonds and commodities. Neutral positions were maintained across property and index-linked bonds.

Current markets

The IAC asked for an update and views on the current markets due to concerns over the Coronavirus (Covid-19). Trevor confirmed that RLAM were comfortable that the market movements are being managed through tactical decisions and that the shock is still within scope of our existing governance framework. The IAC noted some concern that both the SAA and TAA had been adding risk (e.g. High Yield) in the run up to the virus outbreak.

We are not yet at the stage where the movements are impacting long term assumptions on asset classes, but this will be monitored closely. IAC asked for this to be reaffirmed following the Long-Term Economic Assumption Forum on 16th March. The IAC asked about messages to customers and RLI confirmed that customer facing statements have been added to our websites as well as a podcast to reassure customers about the long-term nature of pensions. We have seen an increase in customer queries requesting information about fund values, but we have not seen significant outflows to date.

Chief Investment Officer – Short-term Tactical View (as at Q4)

Market background

- Global equity markets were more subdued in the fourth quarter compared to earlier in the year, while still posting positive returns. Over the quarter, most major countries and regions appreciated in sterling terms. While economic data remained somewhat mixed, leading indicators started to bottom out, supported by the accommodative policies of leading central banks. The Fed cut rates again in October (the third cut in four months) and the European Central Bank restarted its quantitative easing programme through asset purchases. In addition, the Chinese authorities continued to introduce stimulus measures to boost the country's economic growth. Meanwhile, after months of negotiations, the US and China finally agreed the first phase of a trade agreement; while the UK general election ended the extended period of political stalemate around Brexit, which investors believe will restore some confidence to the flagging economy.

- The recovery in global growth expectations reversed the third quarter's strong performance in sovereign bonds. US 10-year treasury yields were 25 basis points (bps) higher at 1.92% and German 10-year bund yields increased 39bps to -0.19% over the quarter. UK gilts sharply underperformed sterling investment grade credit as economic data strengthened and investors adopted a 'risk on' approach. All-maturities returns were -3.9% and -0.7% respectively. Index-linked gilts delivered the worst quarterly returns on record at -8.5%.

- After two weaker quarters, the price of Brent crude oil rebounded (+8.6%) and ended the quarter at $66 a barrel. Signs of recovery in the global economic outlook and an increase in geopolitical tensions were behind this recovery. Copper and gold were also stronger over the quarter, rising 8.5% and 3.3%, respectively.

- Sterling was the strongest performing G10 currency as the political stability implied by the Conservative Party's general election victory suggested greater economic confidence. It was notably stronger than the other main global investment currencies, appreciating +4.6%, +7.3% and +7.8% against the euro, US dollar and yen, respectively. This strength was a headwind for sterling investors in global assets.

TAA performance

- RLAM increased equity positions in the fourth quarter, citing improvements in leading growth indicators and a reduction in trade war rhetoric between the US and China. The portfolios remained moderately positive on equities. Trade tensions and geopolitical risk could mean things could get worse at some point, but RLAM are primed to buy dips in global stock markets, while interest rates remain at low levels with little current inflationary pressure to change rates.

- RLAM remained constructive on short duration global high yield as a way to benefit from moderate global growth with little inflation risk; they marginally reduced the position in commodities over the quarter as there were signs that global economic growth was stabilising, but still wasn't likely to impact demand for commodities significantly.

- Regionally, RLAM started the quarter with an equity position tilted in favour of overseas markets, regionally focused on North America, where growth was most robust in developed markets, and Europe, where there were signs of improvement after significant weakness. They had less exposure to Asia Pacific (ex-Japan) and emerging markets, which were more impacted by trade war rhetoric damaging global growth for those exporters. Japan was showing some signs of improvement despite a slight increase in consumption taxes and exposure was increased. RLAM reduced UK exposure as Brexit political stress peaked early in the quarter, but then added when Boris Johnson won a substantial majority, which reduced medium-term political uncertainty (even if longer-term questions remain).

Outlook and views

- RLAM remain positive on the global economy as data and surveys seem to be bottoming out, central banks remain supportive and trade tensions have eased following the signing of the first phase of the US-China trade deal. Their view is that this cycle has further to run and stocks should continue to outperform bonds over the next year or two.

- Downside risks remain. Potential conflict in the Middle East or an escalation of trade tensions between the US and the EU/China, among other things, could trigger a relapse in market sentiment and provide a further shock to global growth. RLAM are primed to buy dips in global stock markets assuming the positive macroeconomic backdrop persists.

- 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.

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.

The committee noted RLAM's commitment to ESG integration across all asset classes by the end of 2020 and the steps that would have to take place prior to full integration across the fund management teams. As part of the RI project there are workstreams to implement a framework to assess external fund managers. This will be brought back to IAC in September 2020.

Finally, the committee discussed the importance of an oversight process to monitor that the business is doing what it has outlined in its commitments. Progress on this will be included in the September 2020 RI update.

IAC was thankful for the update, noting that it did not have a formal capacity to input directly. However, IAC would need to best apply into GP/GRIP and Matrix. IAC noted that IGC was accountable and IAC asked what steps IGC was taking.

8. TRANSACTION COSTS EC

Euan Craig provided an update on the progress made in respect of the collection and reporting of transaction cost data for the relevant funds.

The update showed a large reduction in costs attributable to increased efficiency and the continued use of derivatives to implement equity allocations across the Governed Range. The committee noted the impressive reduction in costs and recognized the benefits of derivative use over physical asset purchase in terms of stamp duty savings and lower anti-dilution levies that drive some of the negative implicit costs.

Through 2019 the amount of stamp duty saved on physical asset purchase through derivative use is around £4million, a significant saving which has been passed on in full to Royal London customers.

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.