Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date

02/09/2020

Present members	In attendance	Apologies
Candia Kingston (Chair)	Robert Whitehouse	
Ewan Smith	Peter Dorward (IGC)	
Dr. James McCourt	Carrie Johnson	
Piers Hillier (RLAM)	Trevor Greetham (RLAM)	
JB Beckett	Susan Spiller (RLAM)	
	Michael Clarkson (RLAM)	
	Lorna Blyth	
	Niall Aitken	
	Euan Craig	
	Ryan Hamill	
	Joseph Smith	

Owner

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

The minutes of the 3rd June 2020 were approved. No new conflicts of interest were notified.

2. **Property Update** — NA

Niall Aitken provided an update to the committee on the RLP Property fund deferral and the plans for reopening the fund. It was noted that the outcome of the strategic asset allocation (SAA) agreed at the end of 2019 has not yet been implemented and it was prudent to revalidate the property weightings given the current market.

The IAC commented on an apparent disconnect between RLP Property and general physical property valuations relative to REIT performance through 2020. Piers Hillier commented on the higher correlation of REITs with equities rather than physical property and outlined how REIT performance is more reflective of market sentiment and is more generally sector specific rather than a broad representation of property performance which could be compared to RLP Property. Piers Hillier further outlined the valuation process within the property fund which has 3 independent valuers to provide assessments based on real activity in the market. Following this update the committee were confident that when the material uncertainty clauses are removed from valuations and RLP Property can re-open, customers will continue to be invested in property assets with valuations reflective of their true market price.

RLI provided assurance to the IAC that they will continue to work closely with RLAM on validating the SAA following the events in H1 2020 to ensure there are enough opportunities to purchase new properties and avoid cash build up in the fund given current projected inflows.

Finally, the IAC asked if Unit Linked Governance were comfortable that they can process existing queues and new flows when the property fund re-opens. Robert Whitehouse provided reassurance on this.

3. **Global Managed Review** NA

Niall Aitken presented a paper to the committee outlining the proposed change to the strategic asset allocation of RLP Global Managed which is the default equity option for the Governed Range. The paper sought the support of the committee for reducing the exposure to UK equities and increasing the exposure to global developed market equities and emerging market equities. The paper focused on moving to an approach which models UK equities and splits out emerging market equities from global developed market equities.

Peter Dorward asked whether the market assumptions driving the analysis of the review included the impact of COVID-19 and if so how RLI had accounted for this in their recommendation. Niall advised that the review used end March calibration, but the results had been sense checked against the latest calibration from June to confirm the output.

The committee asked about the overall exposure to the UK economy gained through other asset classes, noting the majority of customers access this fund through the multi-asset portfolios. Trevor Greetham noted the approach taken is to decide the strategic allocation of Global Managed as a standalone fund with input from the Long-term Economic Assumptions Forum (LEAF) to develop future opportunity/return assumptions. The implications of any changes to Global Managed SAA would then be accounted for in the overall strategic analysis of the Governed Range separately.

The IAC then discussed the proposed benchmark changes querying whether the non-UK exposure should be benchmarked to an all-world index rather than world ex-UK as, from an investor viewpoint, the global component of the portfolio should be truly global including UK and a standalone UK component would then reflect Royal London's home bias strategy for UK based investors. The committee also commented on the benefits of an all-world benchmark from a practical viewpoint during implementation. The committee asked that this should be accurately reflected in any modelling. The IAC further discussed potential improvements to the fund's objective to more clearly outline the strategy of the fund to customers, with RLI and RLAM agreeing to work on this as part of the next steps.

Overall, the committee was supportive of the proposal subject to the above challenges being considered. The IAC asked for a timeline of any potential changes being mindful of some major upcoming political and economic events. The committee then outlined the importance of clear external messaging for any changes made to RLP Global Managed.

It should be noted that subsequently the view of PH and JB regarding the degree of reduction of the UK allocation was less supportive than other members of the committee, citing concerns with reductions based, at least in part, on past performance but also around the modelling which potentially bakes in past economic events that may not necessarily repeat in the same way going forward. JB further commented on economic exposure vs simple listing weights in standard market indices and the global earnings exposure we derive from UK companies which is also affected by positions in other asset classes eg credit. These concerns were noted by the committee and RLI and will be considered as the proposal moves into internal governance over the remainder of 2020.

4. **PERFORMANCE PACK** EC

All data is at end June 2020.

RLI Governed Range

All Governed Portfolios underperformed their benchmarks over 1, 3 and 5 years to end of June 2020 with the exception of GP7 over 1 year and GP2, GP3, GP6 and GP9 over 3 years, and GP3 and GP6 over 5 years.

All five GRIPs are behind benchmark over 1 year. They continue to outperform over three and five years and also since launch.

Global Managed

The fund has outperformed benchmark over 1 year but is behind over 3 and 5 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 June 2020.

As at the end of June 2020, RLPPF cash holding was 9.8%.

Commodity

The fund has underperformed benchmark over 1 and 3 years to the end of June 2020. RLP Commodity was launched in June 2016 and as such lacks a longer-term track record.

Sterling Extra Yield

The fund is underperforming benchmark over 1 and 3 years and outperforming over 5 years to the end of June 2020.

Absolute Return Government Bond

The fund has outperformed benchmark over 1, 3 and 5 years to the end of June 2020.

Global High Yield Bond

The fund is outperforming over 1, 3 and 5 years to the end of June 2020.

Externally Managed Matrix Funds

It was noted that Matrix fund persistency compared to other external funds has continued to improve again over Q2. The committee asked RLI to include a historic record of outperformance relative to benchmark to demonstrate the persistency of different components of RLI's proposition.

Invesco Global Equity

The fund now has a new manager who has his own investment process. RLI confirmed they were comfortable to continue to hold the fund in the short term however propose that the fund is placed on a probationary period until the end of the year. RLI will hold a further meeting with the fund manager between now and the year end to review how the fund has evolved. There has been a large amount of turnover in the fund so far; the most notable being an increased allocation to US and Tech in particular. The fund retains a 3Q rating of 3.

Invesco Asian

The fund had a particularly poor 2019 which is driving the majority of underperformance. Strong longer-term performance (5 years) means RLI is comfortable to continue holding the fund at this time. The fund has a 3Q rating of 3.

Merian North American Equity

Due to the long-term performance of the underlying fund, coupled with Morningstar's Silver rating and the fact the fund was only introduced to the Matrix a year ago, RLI is happy to continue holding this fund. The fund has a 3Q rating of 3. Merian have recently announced a takeover from Jupiter Asset Management and advised there will be no change to their North American funds. RLI agreed to monitor this situation and keep in regular contact with both firms.

5. **STRATEGIC PACK** RH

Governed Portfolios & Managed Strategies

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.

Governed Retirement Income Portfolios (GRIPs)

There have been no changes to the GRIPs' strategic benchmark this quarter.

All portfolios remain within their target ranges for the income risk metric. Income sustainability scores have marginally declined from last quarter as annuity rates remain at historically low levels and the expected future returns across most asset classes have declined.

The fund risk metrics for all GRIPs are now back within tolerance following the red flags for GRIPs 3, 4 and 5 in the first quarter of 2020. This was driven by increases in short term volatility for risk assets within the model. UK equity 1-year volatility has decreased from 26.8% to 19.6%, while global equity volatility is 18.4%, down from 22.4% last quarter.

Lifestyle Strategy Analysis to update

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

Tactical Analysis

GPs, Managed Strategies and GRIPs

All portfolios remain within their tactical risk budgets.

RLAM gave the following update on their five tactical changes in the last quarter:

- Three tactical changes occurred through April as risk assets began their recovery. Disruption caused by the coronavirus pandemic caused turmoil in financial markets in March, exacerbated by the collapse of oil prices. Governments and central bank stimulus was positive, but with limited visibility of the scale of the health crisis and its impact on the global economy, we reduced our risk weightings. We trimmed our overweight across equities after the rally and moved underweight in commodities. We also reduced the overweight position across global high yield and corporate bonds funded out of a reduction in gilts. The property weighting had increased as a result of the impact of the property fund suspension rather a tactical decision.

  Tactical positioning generally remained the same across all three changes in April however small reductions were made to the equity overweight using the drift of the portfolios and adjustments were made to manage the portfolios exposure to the suspended property fund.

- In May, despite the dire economic data resulting from the lockdown, investors responded to the unprecedented fiscal policy support from governments and monetary policy easing from central banks. Lower bond yields and reduced inflation expectations supported the continued outperformance by high-quality growth stocks. With the strength across global equities, we trimmed our overweight position slightly, taking some profits by reducing the underweight in commodities. We maintained our exposure to investment grade and high yield credit whilst adding to gilts and index-linked bonds. Commercial property exposure had drifted further underweight.

- Through May risk assets continued their recovery. Equity investors continued to look through the short-term effects of the lockdown on companies, taking reassurance from the unprecedented financial support packages from governments and central banks. Leading financial data suggested that the global economy would rebound quickly, although this was dependent on Covid-19 remaining under control. Following this, in June we added to equities, moving further overweight and trimmed our underweight in commodities to reflect the optimism. These changes were mainly funded from cash. We remained overweight short duration global high yield credit whilst commercial property exposure drifted further underweight.

The overall position as at end June was overweight equities, high yield, corporate and index-linked bonds; underweight absolute return strategies (inc. cash), government bonds and commodities. Property weightings have continued to drift downwards as a result of the property fund suspension.

Chief Investment Officer – Short-term Tactical View

Market background

- All major global stock markets rose sharply over the period, rising between +10% and +22% in sterling terms. Having fallen more than other leading markets in the first quarter, the UK was a notable laggard, reflecting its larger energy and resource sector weighting and lack of significant technology sector exposure. US equities, as measured by the S&P 500 index, are now only down -3.5% year-to-date, whereas the FTSE 100 is still down c. -17%. Much of the recovery happened over the first two months with financial markets pausing for breath and trading sideways for much of June.

- The equity market recovery may seem surprising given the ongoing Covid-19 crisis, with the IMF forecasting a 3% decline for the global economy in 2020, worse than during the global financial crisis. However, the monetary and fiscal responses have been equally dramatic, with governments and central bank stimulus packages of an unprecedented scale and speed and the recovery in markets also reflects a re-opening of economies from the strictest part of the lockdown.

- Over the second quarter the US Congress authorised $2trn of support through the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Whereas the banks were deemed too big to fail in 2009, the US credit markets were too big to fail in 2020. Large scale Federal Reserve asset purchases kept credit flowing during a period of severe cash flow shortage. The IMF estimates global fiscal support is currently $8trn, which is c. 10% of global GDP.

- From May, developed economies started to emerge from lockdown and bounce back faster than many had feared. Within this, there were periods of uncertainty and correction around renewed spikes in coronavirus cases in China, Germany and Japan, although these outbreaks were quickly brought under control. However, as quarter end approached, cases and hospitalisations rose sharply in certain US states, while Brazil and India continued to struggle with the pandemic.

- The various monetary stimulus packages globally have driven down fixed income yields to very low levels and equity discount rates to over 20-year lows. A falling equity discount rate favours long-duration, highly profitable growth businesses – and this was the case in the second quarter. At a sector level, the technology sector rose +31% in sterling terms over the quarter; some of the best consumer discretionary stocks also performed very strongly. At the opposite end of the spectrum, consumer staples, which can struggle to deliver growth, only rose +9%, while utilities rose +7%. Regionally, the US, where most of the innovative technology companies are based, performed strongly (+22%); Japan, which is a far more mature market, only managed +12%.

- With economic activity remaining well below normal levels and so much monetary stimulus, yields on benchmark government bonds fell over the quarter in most major developed markets, apart from Japan. The yield on 10-year gilts fell 18 basis points (bps) to 0.17%; although the US 10-year treasury yield fell by just 1bp to 0.66%, this compares to c. 1.9% at the start of the year. In corporate bond markets, credit spreads tightened sharply, reflecting increased confidence in a reasonably quick recovery. High yield bond market saw a strong recovery from their late March lows.

- Sterling was among the weakest major currencies as investors expressed concern over Brexit negotiations and favoured the currencies of countries managing the pandemic more successfully. It notably weakened against the euro, but was only marginally weaker than the US dollar or the yen. Weakness was a positive for sterling investors in global equities.

- Having collapsed by more than -65% in the first quarter, the price of Brent crude oil weakened further in April. However, with action by major suppliers and signs of a recovery in economic activity, the price nearly doubled in May, ending the quarter +81% higher at over $41 a barrel. Copper also strengthened as economic activity picked up in China, rising +22% over the quarter (its best performance in over a decade). Gold rose +11.6% to multi-decade highs just below $1,800/oz. This is surprising, given the concurrent recovery in risk assets, but suggested that some investors wanted protection from the metal's perceived 'safe haven' qualities.

TAA performance

- During the quarter, we continued to take an active approach to tactical asset allocation with a view to generating returns irrespective of market direction. Having scaled back our risk exposure when the crisis unfolded in February and March, we retained a modest overweight in global equities as the second quarter started because of the huge monetary and fiscal stimulus packages and because public health experts were starting to talk of the virus impact peaking, which would lead to lockdowns being eased. We were overweight US equities (including the technology sector) given the relatively defensive nature of the market; and moderately overweight emerging markets, potentially a safer haven as the virus appears to be under control in China. We were underweight UK equities, a long-term underperformer hampered by heavy resource and financials sector weightings.

- We remained overweight high yield bonds, particularly short duration high yield, as we expect the asset class to be resilient over the medium term and it would give upside exposure to any recovery. Otherwise in fixed income, while we generally prefer investment grade corporate bonds to gilts, given the latter's negative real yields, we moved from underweight to overweight in gilts given the concerns about the impact of the lockdown on economic growth. These positions all proved very positive for performance as did a tactical allocation to continental European equities during the quarter: these markets performed strongly over the quarter, with the US a standout performer driven by technology stocks.

- Otherwise, we started the quarter underweight in commodities as there had been notable 'demand destruction' with global lockdowns. We reduced this underweight as the quarter unfolded and economies began to reopen, but this position detracted from performance as industrial commodity and gold prices rose in May and June. We were underweight UK commercial property; this was positive for performance given its economic sensitivity.

Outlook and views

- Having participated in the equity rally, we have now moved to a more neutral position in global equities as the rise in new coronavirus cases threatens to disrupt the economic reopening story. We favour emerging markets over the UK and technology over financials. Otherwise, we have a strong preference for (short duration) global high yield bonds over commodities and UK commercial property.

- With the possibility of renewed spikes in coronavirus cases in Australia, the US and elsewhere, and the likelihood that the US death toll will rise sharply in the coming weeks, we expect further volatility in global equity markets and remain vigilant regarding data emerging.

- Longer term, we remain constructive on equities as we believe the very supportive monetary policies of central banks and the fiscal support from governments, coupled with spare capacity to keep inflationary pressures at bay, will lead to a strong bounce back in the global economy on a 12-24-month view, assuming virus risk is contained successfully. This is likely to support outperformance in equities, which are around long-term average valuations and appear attractive compared to government bonds with low or even negative yields.

- We have de-risked our currency positions as interest rates have converged: we are overweight in the euro, yen and Australian and Singaporean dollars, and underweight in the US and Canadian dollars and sterling.

- Our investment process has weathered difficult markets in the past and added significant value over the global financial crisis in 2007-09. We believe a disciplined and active approach to both risk control and tactical asset allocation will be crucial in portfolios, as markets respond to the current crisis and policy responses being implemented.

6. **RLAM Value for Money** SS

Susan Spiller presented an overview of the process and outcomes from the Assessment of Value report produced for the RLUTM and RLUM fund ranges. Generally, the building blocks of the Governed Range are funds under RLUTM so whereas the report itself does not cover assessment of value for RLI's proposition in detail, the committee noted RLAM's work will help to demonstrate value across the Governed Range to the Financial Conduct Authority and it will be useful to leverage RLAM's expertise in this area going forward.

The IAC asked how factors such as comparable service and economies of scale in RLAM's assessment of value report may relate differently to RLI than it does to RLAM external clients given the asset management team is 'in-house'. Susan outlined that the assessment of value was primarily focused on share classes that are sold to external clients and these factors and benefits filter through to RLI in a more nuanced way through the pricing strategies and service agreements as a whole.

Finally, the committee discussed ongoing projects within RLI to address structural challenges that exist (or will exist) given the scale of the proposition and its inflows, and how value for money and efficiency may be addressed in these areas.

7. **Responsible Investment Update** LB

Lorna Blyth provided the committee with an update on the Responsible Investment (RI) project from the RLI perspective. The overall status of the project remains amber reflecting a revised delivery plan to meet regulatory deliverables and based on additional work on exclusions and engagement proposals. *Lorna outlined RLI's continued engagement with RLAM to produce passive tilts with carbon reductions across equity holdings and noted the property team's engagement with an external consultant to shift to a net zero approach across the property fund strategies*. From an external asset manager perspective, it was noted that all have now responded to an RI questionnaire with further meetings to take place with the largest managers to probe their responses further. A RAG status report with corresponding KPIs will be presented to IAC in December 2020.

Piers Hillier then provided the committee with a verbal update from RLAM's perspective. The IAC asked if it was clear where RLAM draw the line between engagement and avoidance and at what point would they divest if engagement was not successful.

Piers highlighted to the committee that it was a good opportunity for RLAM to show they are able to generate investment returns but also push positive effects across society as a whole. Piers further highlighted that maintaining the high standards RLAM are known for in the development of the responsible investment strategies is vital. As part of this Piers outlined RLAM's view of engagement specifically across carbon-related industries where the expectation of turning these off in a 5-year timeframe is unsustainable and therefore engagement would help to push them in the right direction over the long term. Then, if key timing targets are missed, divesting would be the next step.

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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