

Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date

03/06/2020

Present members

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

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**

CK

The minutes of the 05 March 2020 were approved. No new conflicts of interest were notified.

2. **MATRIX FUND REPLACEMENTS**

EC

Euan Craig presented a paper proposing to replace Invesco UK Growth which sits in the UK Specialist category of the matrix. The proposal recommended that the mandate for this fund be replaced with the Fidelity UK Opportunities fund. This is based on in-house research, external research and analysis provided by Morningstar. It was noted that the analysis now also considers ESG scoring from Morningstar based on quant data and the committee were happy to see this included going forward.

The Fidelity fund was proposed due to a stronger performance record, lower costs and a higher ESG score. The committee asked why the scoring for manager tenure was low and Euan confirmed that the fund manager had been running the fund since 2011, however it was bought over by Fidelity in 2015, which is the period Morningstar considered when applying their score.

The committee noted that there didn't appear to be a lot of options to choose from and Mike confirmed that there were not many value-based funds which had outperformed the broader UK market. Overall the committee were satisfied with the proposed replacement subject to no red flags from the due diligence process.



The committee noted that the dates for the other matrix fund replacements were scheduled for Q4 and queried the length of time it took to process the change. Lorna Blyth advised that the process requires a 90-day notice period to customers and advisers as well as systems resource and this had been lower priority due to dealing with the impact of COVID on the business.

3. **Rathbone Global Alpha update**

MC

Mike Clarkson provided an update on the transition from Rathbone which is ongoing and expected to complete by end June. The committee asked to see transaction costs and details on any out of market risk and this will be provided at the September meeting.

4. **PERFORMANCE PACK**

EC

All data is at end March 2020.

RLI Governed Range

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

All five GRIPs are behind benchmark over the quarter and 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 the quarter as well as 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 March 2020.

As at the end of March 2020, RLPPF cash holding was 9.1%.

Commodity

The Fund has outperformed benchmark over 1 and 3 years to the end of March 2020. The fund was launched in June 2016 and as such lacks a longer-term track record. The Committee asked for further information regarding RLAM's views on commodities and requested a separate session be arranged to cover this before the next IAC meeting.

Sterling Extra Yield

The fund is underperforming benchmark over 1 and 3 years and outperforming over 5 years to the end of March 2020. The committee asked for further information from RLAM to detail management of liquidity and deferrals and requested a separate session be arranged to cover this before the next IAC meeting.

Absolute Return Government Bond

The fund has underperformed benchmark over 1 and 3 years to the end of March 2020, however underperformance is extremely minimal.

Global High Yield Bond

The fund is outperforming over 3 and 5 years to the end of March 2020

Externally Managed Matrix Funds

It was noted that Matrix persistency compared to other external funds has improved over Q1.

Invesco Global Equity

The fund is now being managed by a new manager who has his own investment process. RLI are comfortable to continue to hold the fund on a probationary period until Q3. The fund retains a 3Q rating of 3.

The committee raised concerns over the incoming fund manager, their ability to turn performance around and if so, how will the strategy differ from the existing mandate. RLI acknowledged these concerns and agreed initial analysis for replacements will be prepared so if the decision is made to replace Invesco Global Equity, action can be taken quickly in the best interest of the customer.

Franklin UK Mid-Cap

Paul Spencer, manager of the Franklin UK Mid Cap fund, will retire from fund management on 30th September 2020. This takes effect as at the end of June however he will continue to be involved and offer support until this date.

Mike Clarkson is meeting with the replacement fund manager in June and will provide an update to the committee following this. It was noted that although Paul's retirement is disappointing, the fund has always operated with a close team approach which should help mitigate any transitional impact.

The Committee asked if the performance pack could include CQS and ESG scores going forward.

5. GLOBAL MANAGED REVIEW

NA

Niall Aitken presented a paper to the committee outlining the proposed structure of the review of RLP Global Managed, the £17bn global equity fund which is the default equity option for the Governed Range Portfolios.

This follows the recent approval of the Governed Portfolio (GP) Strategic Asset Allocation (SAA) review, where RLI signposted the additional modelling work on RLP Global Managed. RLI also aim to review key elements of fund strategy, namely active vs passive exposure, FX positioning and sector exposures resulting from relatively higher UK weights.

RLI highlighted the external challenge that this fund's strategic positioning is creating. The preference for UK equities in comparison to competitors has been a significant drag on relative performance. The committee noted that any recommendation should be supported by strong material evidence with RLI mindful of hindsight bias.

The committee were generally supportive of the intended approach however challenged the approach as being too narrow and asked that RLI should seek to answer the question "how would the fund be structured if we were to create a global equity fund from first principles now".

It is expected that results will initially be presented to the IAC in September and taken through internal governance as appropriate.

6. IMPACT OF COVID19

NA

Niall Aitken provided the IAC with a broad update on how RLI are managing the proposition in response to the challenges arising from the COVID-19 pandemic. Covering varying aspects of how the pandemic has impacted RLMIS, RLI, the Governed Range and the underlying asset classes utilised therein.

The committee questioned on the latest outlook for the property fund and the current position with regards to the material uncertainty clause that currently applies to all underlying assets of the fund. RLAM outlined the expectation that material uncertainty clauses could be lifted on a sector by sector basis with the central thesis that the clauses will remain in place until Q3 2020 at least. The committee were also interested in rent collection levels for the fund through this period.

The committee also queried the operational resilience of RLAM and were pleased with Piers Hillier's updates on how the management teams have coped working from home and how RLAM have dealt with recent challenges.

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. Sustainability scores for the lower risk GRIPs have remained largely unchanged however for the higher risk portfolios there has been a slightly decline in sustainability.

GRIPs 3, 4 and 5 have moved above the 10% tolerance for the maximum one year loss metric and are now flagging red. This increase is being driven by increases in short term volatility for risk assets within the model. UK equity 1-year vol increased from 15.6% to 26.8%, while Global Equity is 22.4% up from 16.1% last quarter. The longer-term volatility assumptions however have remained largely unchanged highlighting the expectation that the market impact of CV-19 will be relatively short-term.

RLI recommended that no action be taken off the back of this flag given the data has been cut at the end of March and reflects the bottom of the CV-19 market crash. Niall Aitken highlighted to the committee that volatility since the end of March has significantly reduced and we should expect to see these risk metrics move back within their target ranges at next quarters update.

The committee queried what action would be taken if these flags remained red the following quarter and asked for this to be tracked more frequently and updates provided to the IAC on a monthly basis. It was agreed that if the figures do not improve then this could trigger either a strategic asset allocation review, a tactical asset allocation change or a process to cap volatility within the portfolios.

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 three tactical changes in the last quarter:

- Global equities continued to rise in December as the US and China trade tensions eased and the UK general election delivered a strong parliamentary majority, reducing political uncertainty. There were further signs that the global economic slowdown was bottoming out. While inflation remained low, it has picked up slightly with higher oil prices, which may have constrained central bank flexibility. We added to commodities out of government bonds, partly to hedge against increased geopolitical risk and partly against some inflationary pressures. We also added slightly to our overweight position in high yield bonds.
- After a benign start to 2020, the coronavirus outbreak shook global financial markets in late January. World equities delivered negative returns for sterling investors in the short term. Economic growth forecasts for China had been cut sharply for the first quarter, but the authorities have introduced stimulus measures and the virus impact could have been short lived. We bought the dip in equity markets as they looked to be overly pessimistic on the economic impact of the outbreak. We added to global high yield bonds, while moving further underweight in gilts and trimming commodities to neutral.
- Stock markets declined sharply in reaction to the coronavirus outbreak. We reduced equity exposure in view of further downside risk to the world economy, but we retained a small overweight as we see this shock as ultimately temporary - investor sentiment was extremely depressed, and valuations were more attractive. We also moved underweight commodities. We added to government bonds and commercial property and increased corporate and global high yield bonds at wider spreads as we expected them to offer resilience.

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

Chief Investment Officer – Short-term Tactical View

Market background

- Global stock markets fell sharply over the quarter because of the coronavirus shock, with most markets falling between 15% and 20% in local currency terms. The UK was a notably weak outlier – falling 24.2%. However, most international market falls were more muted in sterling terms, given the currency's weakness, with Japan returning -11.0% and the US -14.1%.

- At the start of 2020, a continuing recovery in global growth seemed probable and was supported by improving global economic data. The US-China trade deal that was signed in mid-January signaled an end to the imposition of tariffs by President Trump and retaliation by the Chinese authorities. This was expected to reboot China's slowing economy with positive implications for other economies, such as Germany. However, more-or-less as the deal was signed, investors became aware of the coronavirus outbreak in China, which had a serious impact on its economy and financial markets. The extended Lunar Year shutdown led to global growth expectations being reduced as investors feared an outbreak akin to the SARS epidemic, with severe implications for supply chains given Wuhan's importance as a global manufacturing hub.
- February was a transitional month in which the risks seemed to be getting greater but were still thought to be manageable. However, when news broke in early-March that coronavirus cases had surged in Italy and Spain, with markedly higher death rates than had been suggested by China, the outbreak was declared a pandemic and markets went into panic mode. Social distancing and lockdown measures were enforced which resulted in some economic sectors to be shuttered, causing unemployment to spike. Governments and central banks reacted with coordinated stimulus measures that were unprecedented in terms of their size and speed of implementation. As a result of the various measures, some semblance of normality returned to financial markets at the end of the quarter, with improved liquidity.
- With global economic activity suddenly collapsing, yields on benchmark 10-year government bonds fell in most major developed markets, apart from Japan and the eurozone periphery. In the US, the 10-year yield fell from 1.25% to just 0.67%, the first time in history it has been lower than 1.0%. Conventional and index-linked gilts were particularly volatile. Credit spreads widened sharply reflecting sharply increased risk aversion. The average sterling investment grade spread ended the quarter 98 basis points wider at 2.12% – it had been below 1.00% in January. While sharply lower yields on reference government bonds mitigated the effect, the blow out of credit spreads affected the performance of sterling credit. In the last week of the quarter, the sterling credit market stabilised, with activity increasing in the primary and secondary markets and improving liquidity.
- Sterling was among the weakest major currencies as investors moved to the traditional safe haven US dollar. Sterling fell 6.3% against the US dollar and 4.8% against the euro. This weakness was a positive for sterling investors in global assets.
- The price of Brent crude oil collapsed (-65.6%), ending the quarter below \$23 a barrel, as a price war between Saudi Arabia and Russia exacerbated sharply lower

global demand. Copper also fell with lower economic activity in China and other industrial economies, falling -21.0% over the quarter. Gold rose +4.8% to just under \$1,600/oz.

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. As the virus spread rapidly outside China, we took exposure down to a broadly neutral position to reflect a high level of uncertainty. We also increased our exposure to government bonds, while trimming global high yield exposure. We retain a position in short duration global high yield, a relatively defensive strategy. Lastly, we have minimal commodity exposure, having sold ahead of the crisis.

Outlook and views

- There will be pronounced economic weakness in major economies in the near term, judging by experience in China and the collapse in business confidence surveys and flash PMI data. However, at the low point for equity markets in mid-March, investor sentiment was more depressed than it was at the worst point in the Lehman crisis of 2008, yet the broad range of monetary and fiscal stimulus measures that have been announced should boost the eventual recovery.
- Stock markets bounced sharply in the last week of the quarter with more optimism on counter-measures to mitigate the damage to the global economy, after the US approved a \$2 trillion dollar package; however, volatility remained elevated with uncertainty over both the depth and duration of the health and economic crisis. Sustained recovery may have to wait until shuttered parts of the global economy start to re-open, which could be many weeks from now.
- We expect our Investment Clock model to reflect this situation by moving quickly into disinflationary 'Reflation' before moving sharply upwards into 'Recovery' when the crisis ends. We intend to make full use of our active tactical asset allocation risk budget to add to equity exposure when we judge the time is right, so we can capture some of the eventual rebound in stock prices from depressed levels.
- In the meantime, US and European public health experts are beginning to talk of the virus impact peaking, which may lead to lockdowns being eased. Regionally, we have a pronounced tilt towards emerging market and US equities and away from the UK. Emerging markets have proved more resilient with the epicentre of the virus outbreak moving from China to Europe. We introduced US sector positions in late 2019 and they have added value due to a positive view on the US technology sector relative to hard hit industrials and materials.

- We de-risked our currency positions, remaining short the economically exposed Australian dollar, and more recently moving short sterling while shifting in favour of the more defensive US dollar and Japanese yen.
- Our investment process has weathered difficult markets in the past and we added significant value over the 2007-9 global financial crisis. 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.

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TERMS OF REFERENCE UPDATE

The Committee approved the update to reflect the membership of the IAC terms of reference.

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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