Investment Advisory Committee (IAC) Quarterly Meeting

Minutes of Meeting

Date

01/12/2020

Present members	In attendance	Apologies
Candia Kingston (Chair)	Robert Whitehouse	Dr James McCourt
Ewan Smith	Carrie Johnson	
Piers Hillier (RLAM)	Trevor Greetham (RLAM)	
JB Beckett	Michael Clarkson (RLAM)	
	Lorna Blyth	
	Niall Aitken	
	Euan Craig	
	Ryan Hamill	
	Lewis Daley	
	Mayer Raichura	
	Emer Drayne	

Owner

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

The minutes of the 03/06/2020 were approved. No new conflicts of interest were notified.

2. **INVESTMENT PATHWAYS** — RH

Ryan Hamill provided an update to the committee on the proposed investment options for Royal London's Investment Pathways.

IAC were generally supportive but there was some discussion on the proposal for Pathway 4, given the focus from FCA on short-term customer outcomes and the impact of sequencing risk during a relatively short time frame. Ryan confirmed that Moody's stochastic engine was used to model shorter term projections and thus help determine a suitable investment solution.

JB Beckett challenged the analysis and asked about the suitability of Moody's model output for short term optimization given the longer term of most portfolio design analysis. Niall Aitken confirmed that in the shorter term of the modeling for pathway 4 current market conditions have more relevance than long term expectations and were appropriate for use.

Candia Kingston asked what evidence there was to suggest customers are more likely to withdraw their money towards the end of 5yrs rather than within the very short term (<1 year) as well as the potential for capital loss. Ryan Hamill reassured the committee that Royal London had considered existing customer behavior data to support the proposals and would monitor future experience closely in this regard.

JB raised the issue that Pathways would encourage financial advisers to compare the optimal strategy chosen for clients, with that of Royal London's advised proposition. Niall Aitken confirmed that the Pathways Propositions had to be offered to both advised and non-advised customers and Lorna Blyth confirmed that the financial adviser would need to justify their proposed alternative as being better suited for their client. Niall also highlighted that if the circumstances of non-advised customers changed, they would have access to the wider fund range to find a more suitable option to suit their circumstances.

Ewan Smith noted the cautious approach taken by the optimal strategy of Pathway 2 and Niall reassured that the strategy was chosen to meet the key customer need of maintaining annuity purchasing power.

JB Beckett raised the concern of customers not fully understanding the product they're purchasing and requested to see the communication and guidance process that will be in place for Pathway customers before the launch on 1st February. It was noted that customer behaviour would be monitored and the existing income sustainability tracker would be used at an individual customer level to help policyholders stay on track for their desired outcome.

The IAC also formally agreed to update terms of reference to include governance of Pathways in their remit going forward.

3. STRATEGIC PACK NA

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, yet the expected future returns across most asset classes have increased, which should improve future performance.

The fund risk metrics for GRIPs 3, 4 and 5 are all within tolerance, however GRIP 1 is now flagging amber and GRIP 2 is flagging red. Although 1 year volatility for UK equity has decreased from 19.6% to 18.8%, volatility for conventional and index-linked gilts has increased. This, combined with an increase in correlation between fixed interest generally has led to increases in the fund risk metric for all GRIPs, in particular the lower risk portfolios with higher exposure to fixed interest. RLI will assess the changes to Moody's calibrations and review this against the proposed SAA changes in GRIPs 1 and 2 and update IAC prior to implementation.

IAC also requested that RLI return to the committee as needed with an update when the new SAA fund risk metrics are available.

Lifestyle Strategy Analysis to update
Annuity income and real fund values for drawdown lifestyles have increased since last quarter.

2 **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:

    - In June, equities had recovered since March, but were marking time over warnings from central banks about long-term economic damage, particularly to the labour market, and increasing Covid-19 cases in the US. Although data continued to suggest that economies were recovering, this remained virus dependent. Following the strong performance of global stockmarkets and with the risk of renewed lockdowns in the US and elsewhere, we slightly reduced equities, but remained modestly overweight. We increased our small overweight in gilts and remained overweight in global high yield credit. We were underweight in UK commercial property as weightings had drifted lower due to the Property fund suspension.

    - Global equity returns were positive in July, although UK-based investors were impacted by sterling strength. While there were renewed spikes in Covid-19 cases, these were managed with travel restrictions or local lockdowns, otherwise, data suggested that leading economies were recovering reasonably well. Central banks maintained low interest rates and governments were committed to fiscal stimulus. In August, to reflect this positive environment, we increased our overweight in equities and moved overweight in commodities. We remained overweight in investment grade and global high yield credit, but cut gilts to around neutral. We also remained underweight in UK commercial property and cash.

    - Global equities delivered strong returns in August, and although Covid-19 cases rose in Europe and the UK, which led to travel restrictions and local lockdowns, the global economy continued to recover, albeit at a slower rate. Low interest rates and fiscal stimulus supported this. Following the strong bounce in equity markets, we slightly reduced our overweight given ongoing economic and political risks. We increased our overweight in commodities, given the inflation protection they provide, and trimmed the overweight in fixed income. We remained underweight in UK commercial property and cash.

    - The overall position as at end September, was overweight Equities, Commodities, High Yield, Corporate and Index Linked Bonds; neutral Government Bonds; underweight Absolute Return Strategies (inc. cash) and Property.

- The IAC noted the latest attribution analysis from RLP Global Managed and asked about the added value from tactical and sector positioning during Q3. IAC requested if the regional equity allocation could be split out from the asset allocation and stock selection attribution going forward.

- The IAC commented on the degree of divergence from benchmark within the passive portfolio, and the extent to which holding futures, whilst considering roll costs and lack of dividends compares to holding their physical equivalent. The IAC asked whether the use of derivatives to implement tactical positions adds more value than trading in and out of the assets directly, due to the associated costs and impact of physical trading and stamp duty. Reassurance was provided by RLI that there's no concern about the management of derivatives within Global Managed.

- Reassurance was provided by RLAM on the limited exposure to the Arcadia Group and Debenhams following recent news.

5. **PERFORMANCE PACK** EC

All data is at end September 2020.

RLI Governed Range
All Governed Portfolios underperformed their benchmarks over 1 year to end of September 2020 with the exception of GP7. All portfolios outperformed their benchmarks over 3 and 5 years with the exception of GP7.
All five GRIPs were behind benchmark over 1 year. They continued to outperform over 3 and 5 years and also since launch.

Global Managed
The fund outperformed benchmark over 1 and 3 years but was behind over 5 years.

Property
The fund outperformed benchmark over 1, 3 and 5 years to end of September 2020.
As at the end of September 2020, RLPPF cash holding was 10.1%.

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

Sterling Extra Yield
The fund underperformed benchmark over 1 and 3 years and outperformed over 5 years to the end of September 2020.

Absolute Return Government Bond
The fund outperformed benchmark over 1, 3 and 5 years to the end of September 2020.

Global High Yield Bond
The fund outperformed over 3 years to the end of September 2020.

Externally Managed Matrix Funds
It was noted that Matrix fund persistency compared to other external funds remained relatively consistent over Q3.

Invesco Global Equity
The fund has had a new manager since the beginning of 2020 and the investment process has changed as a result. Euan confirmed that following the latest fund manager meeting in November 2020, the team were comfortable to continue holding the fund as performance against benchmark is improving but will continue to maintain a shortlist of potential replacements. The fund retains a 3Q rating of 3 and it was noted that this score is based on 3-year and 5-year risk return metrics and hence are impacted by the previous fund manager. The performance of the fund was impacted by Covid-19, as the fund manager had just repositioned the fund in line with his process and views.

Invesco Asian
The fund had a particularly poor 2019 which has driven the majority of underperformance. Euan confirmed that due to stronger long term performance the team are comfortable to continue holding the fund at this time. The fund has a 3Q rating of 3. Piers Hillier raised concerns regarding the underperformance of the fund, however it was noted that relative performance had improved in the recent quarter.

Merian North American Equity
Morningstar have recently downgraded the fund from Silver to Bronze due to recent underperformance and the 3Q rating has been reduced from 2 to 3. Euan confirmed the team is comfortable to continue holding the fund as the majority of underperformance stems from the previous fund in this space. The IAC remains mindful of the downgrades and will continue to monitor other options in case performance worsens.

Merian have recently announced a takeover from Jupiter Asset Management, although Merian have advised there will be no change to their North American funds, however this is something the team agreed to monitor and keep in regular contact with both funds houses about.

JB Beckett noted that it would be worthwhile looking at the fund's asset base when carrying out performance analysis and raised concerns regarding the challenge associated with finding an appropriate replacement option. It was concluded that the team will continue to monitor other options in case performance worsens.

6. **Assessment of Value reports** EC

Euan Craig continued to present analysis on the Assessment of Value reports received from external fund managers within the matrix range. Euan highlighted that this is the first time this topic has been presented to the IAC.

Focus was spent on the matrix funds that have been flagged within the reports. Invesco Japan has had a red rating on their performance, however this fund is being replaced next week. The JPM UK Equity Growth fund has flagged as amber due to its charges. This fund has an Ongoing Charges Figure (OCF) above market average and the team will continue to monitor progress and consider whether this is still appropriate or if we can access an alternative fund with a better charge.

Euan reported that the Invesco Global Equity fund has had their fund management team replaced due to its performance.

Euan also mentioned that there are some funds flagging amber and red within our standard fund range and highlighted a couple of funds where action has been taken.

JB Beckett added that tracking the quality of AoV reports (independent opinion) may prove as important as the stated outcomes in the reports itself. JB also offered to engage with Euan outside of the committee on this matter and hopes to suggest some resources to help.
The IAC noted that assessment of value reports will form part of the fund analysis going forwards and when looking for alternative funds as well.

8. **RLAM ESG tilts** LD

The IAC were supportive of the proposal overall which covered the move from traditional passive funds to ESG tilt funds. Candia noted the committee would like to see the future-noted action on tilting towards those companies with active climate transition plans sooner rather than later. JB asked who would bear the costs of trading and how the additional tracking error will be consumed. These issues are still to be agreed but it was noted that trading costs are usually borne by the fund. Niall outlined that the existing tracking error budget has enough room to absorb this change. Furthermore, the Investment Office are currently working on a TAA framework policy which may affect this decision. The committee asked for further clarification on this point.

9. **Responsible Investment and Climate Change Asset Manager Monitoring** LD

Lewis updated the committee on the monitoring framework and approach covering all asset managers. All have now responded and have been analysed. Not all asset managers have responded with strong answers. The team will implement an escalation process for those managers that cause concern.

Ewan Smith queried whether asset managers would be scored lower if their ESG approach was different to RL. Lewis confirmed the scoring is an initial fact find, understanding whether asset managers have a defined policy and acknowledging any differences.

Niall questioned how the team aims to deal with in house differences between fund managers across funds. Niall also queried how the decision to class asset managers with assets greater than £100m as ‘Key asset managers’ was determined.

Lewis acknowledged that the response from some asset managers were from a firm level, others from a strategy level. This is something the team is still to work through, although are looking to capture since both levels are important to understand. On the £100m limit, Lewis noted that this decision partly involved a resource element however smaller funds are being reviewed on an ongoing basis anyway.

10. **AOB** ALL

Candia asked if impact funds have a place within the matrix range, whether that be with RLAM or externally. Royal London confirmed this is under consideration.

APPENDIX: Chief Investment Officers Short Term Tactical View

Market background

- Major global stock markets were more muted in the third quarter after the previous quarter's dramatic recovery, but still posted positive aggregate returns in sterling terms. The MSCI benchmark rose +3.6%. However, within this there was a wide geographical dispersion, with the UK and many European markets falling, and the US once again proving robust (+5.1%).

- As with the last quarter, the market recovery may seem surprising given the ongoing Covid-19 crisis. Indeed, the pandemic has had clear negative impacts on corporate performance, which in some cases look to be structural rather than a shorter, cyclical hit. However, the monetary and fiscal responses have been equally dramatic, and have driven down fixed income yields to very low levels and equity discount rates to over 20-year lows and economies are gradually opening up.

- As we have seen in recent years, a falling equity discount rate favours long-duration, highly profitable, idiosyncratic growth businesses – and this was again the case in the third quarter. At a sector level, information technology is dominated by businesses like this and rose +7.3% in sterling terms in the quarter; some of the best consumer discretionary stocks also have these characteristics and they too performed strongly (+11.3%). At the opposite end of the spectrum, financials, which are often struggling to grow earnings from traditional loans, fell - 2.3%; energy had another difficult quarter (-19.1%), despite oil prices remaining relatively stable. As described, the US, where most of the innovative technology companies are based, performed strongly over the quarter.

- The scale of the impact of the pandemic on government finances became clearer. UK government borrowing in the current year is now estimated to be £370bn (c. 18% of GDP). The Bank of England (BoE) has continued to neutralise the impact of government bond issuance through asset purchases; this is due to be complete in November, although a further extension of quantitative easing is expected. With the economic recovery slowing and activity remaining below normal levels, and with so much monetary stimulus and government bond issuance, yields on benchmark 10-year government bonds fell over the quarter in nearly all major developed markets, apart from the UK, US and Canada. The yield on 10-year gilts increased 6 basis points (bps) to 0.23% and short-dated government bond yields remained negative at maturities of less than seven years, although the BoE played down the imminent likelihood of negative base rates. Conventional gilts returned -1.23% (FTSE Actuaries – all maturities).

- Total returns for UK index linked gilts were -2.18% for the period (FTSE Actuaries UK Index Linked Gilts Index – all maturities), driven by weakness at the longer end. The yield on the 10-year index linked gilt fell 9bps to -2.93%. The 10-year breakeven (implied) inflation rate increased 16bps to 3.06%. The yield spread between UK index linked gilts and US TIPS tightened by 16bps to 198bps. At the annual Jackson Hole symposium in late August, Federal Reserve (Fed) Chair Jerome Powell announced a revised approach to US monetary policy –average inflation targeting – under which inflation and employment will be allowed to run higher. This is likely to keep interest rates low for several years, causing dollar weakness.

- In corporate bond markets, credit spreads tightened further reflecting increased economic activity and the support of central banks for struggling companies. The average sterling investment grade spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) ended the quarter a further 18bps tighter at 1.29% – it was well over 2.0% in March. The tightening of credit spreads boosted the performance of sterling credit with the Markit iBoxx Sterling Non-Gilt All Maturities Index delivering total returns of 1.16% for the quarter.

- Sterling was among the strongest major currencies over the quarter, strengthening over 4% against the US dollar as the Federal Reserve altered its inflation targeting methodology. It strengthened only marginally against the euro. Nonetheless, sterling strength tempered the returns for sterling investors in global equities.

- Oil prices were far more stable in the quarter than earlier in the year. The price of Brent crude oil fell by -0.5%, although it was notably weaker in September, falling by -9.6% to under $42 a barrel. Despite this stability, however, energy stocks were notably weak over the quarter as investors increasingly considered the risk of stranded assets in a carbon-neutral economy. Copper continued to strengthen as economic activity picked up in China, rising +10.6% over the quarter. Gold rose +6.4% to $1,900/oz., despite weakness in September. It had reached multi-decade highs in early August of nearly $2,100/oz. as some investors sought a safe haven should markets fall on renewed Covid-19 fears.

TAA performance

- Within our moderately constructive view of equities, we were overweight in the US (particularly technology and consumer discretionary) and emerging markets, and underweight UK equities. These positions were all very positive performance as US and emerging markets equities outperformed over the quarter (+5.0% and +5.1%, respectively) with the US driven by the consumer discretionary and technology sectors. The UK was one of the worst-performing global markets, returning -4.7%.
- During the quarter, we tactically increased our exposure to Japanese equities and also moved underweight in Europe (ex-UK). In late August, following the strong performance of global equities since March, we slightly reduced our equities exposure, particularly in the US. Against this, we started to reduce the underweight in UK equities. These positions generally benefitted performance as Japanese equities performed well in August and September, contrasting Europe (ex-UK). The UK, however, remained weak, delivering negative returns.

- We remained overweight high yield bonds, particularly short duration high yield. Otherwise, we returned to our view that corporate credit will outperform government bonds as the global economy recovers. These allocations contributed positively to performance over the quarter.

- At the start of the quarter, we were neutral in commodities and moved overweight during the period. This was positive for performance as commodity prices rose strongly.

- We were underweight in UK commercial property; this was positive for performance given the asset class's economic sensitivity.

Outlook and views

- The strong recovery in global equity markets from the lows of March means that risk and return are more balanced in the shorter term. Uncertainty remains around both the speed and the shape of the economic recovery and this continues to create market volatility, which could be exacerbated by further lockdowns, a failure to agree a post-Brexit trade deal or political and social tension in the US during or after November's elections.

- We remain constructive on global equities, but moved to a more neutral position as two-way risk increased in late August. While we continue to favour the US and emerging markets over the UK, and technology and consumer discretionary over energy, we have dialled down our stronger weightings. In particular, UK equities could benefit from more clarity around a trade deal with the

EU, although perversely they could also perform well if sterling fell sharply as the value of overseas revenues would increase.

- While significant upside from here will require the global economy to recover more strongly and probably an effective vaccine for Covid-19, further volatility in global equity markets would represent an opportunity to increase our equity weightings. There may be challenging periods over the next 12 months driven by further waves of the virus. However, it is clear that governments and central banks are committed to the long haul. In the longer term, equities offer significant value against bonds and the equity discount rate is not extended.

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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