



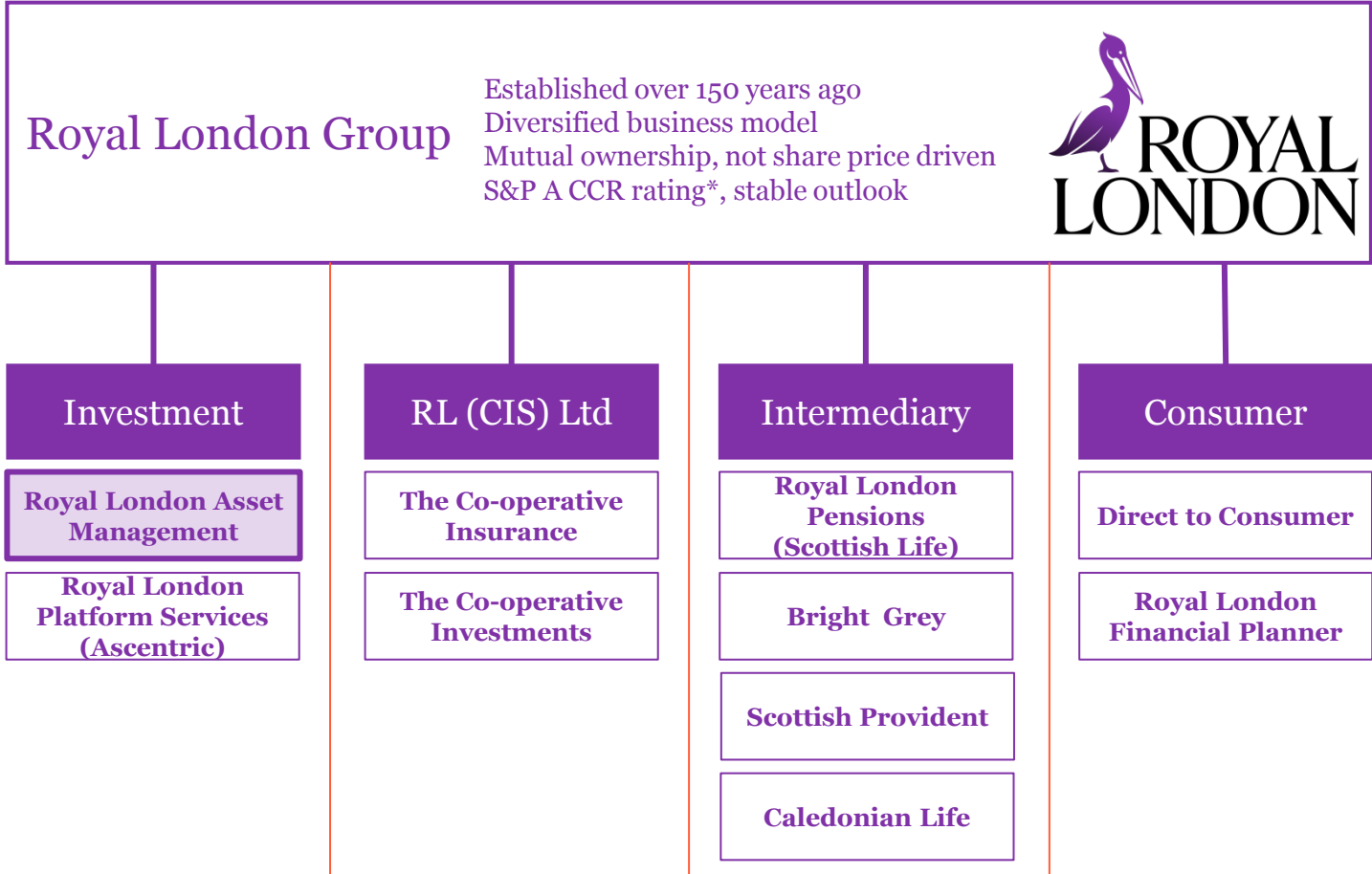
WILL RATES RISE AND HOW DO WE PREPARE?

Craig Inches – Senior Fund Manager

Emmanuel Archampong – Business Development Manager

29 April 2015

ASSET MANAGEMENT

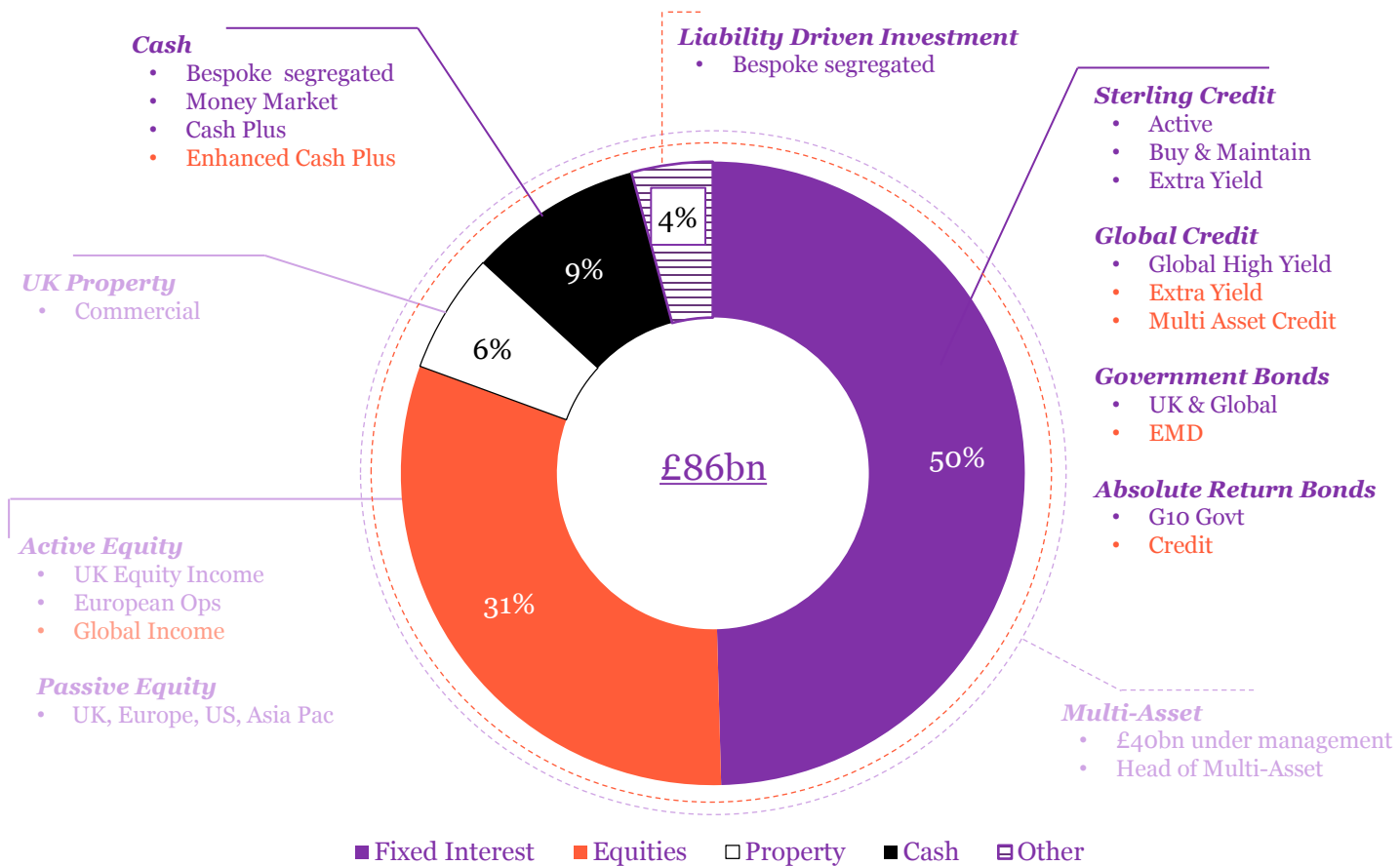


Source: Royal London as at 31 March 2015. *Source: S&P May 2014.



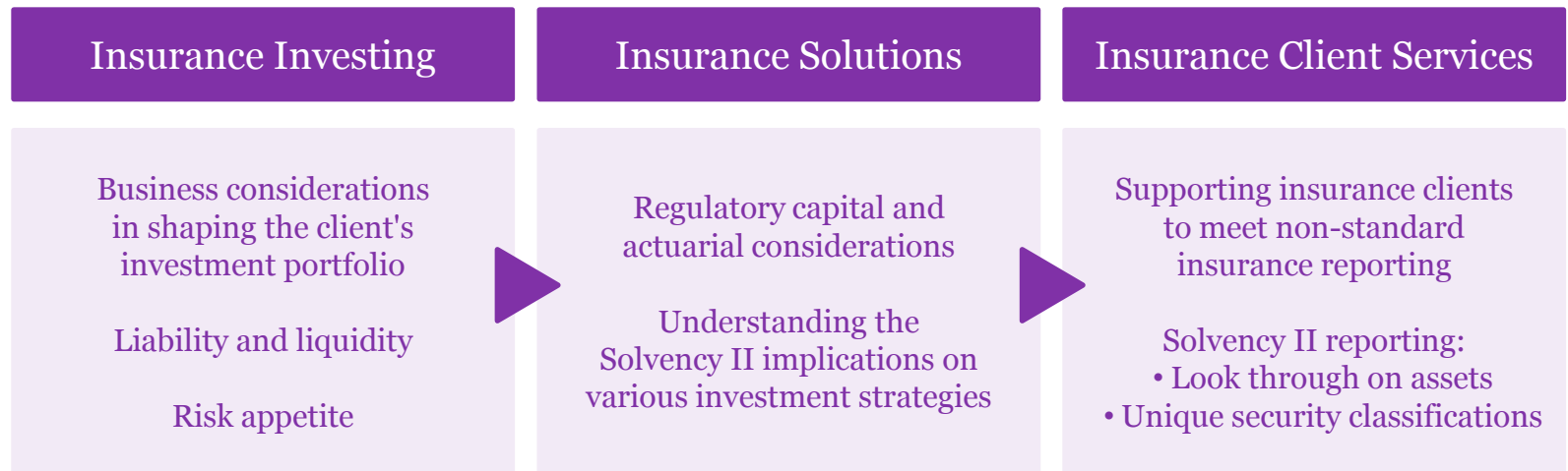
OUR CAPABILITIES

ASSET MANAGEMENT



- 45bn of our total assets are managed for insurance companies.
- Over 60 unique insurance companies across all sectors: Life, P&C, Health, Reinsurance and Captives.

Source: RLAM as at 31 March 2015



We believe insurance investment management requires a dedicated partner with an understanding of the local insurance industry.

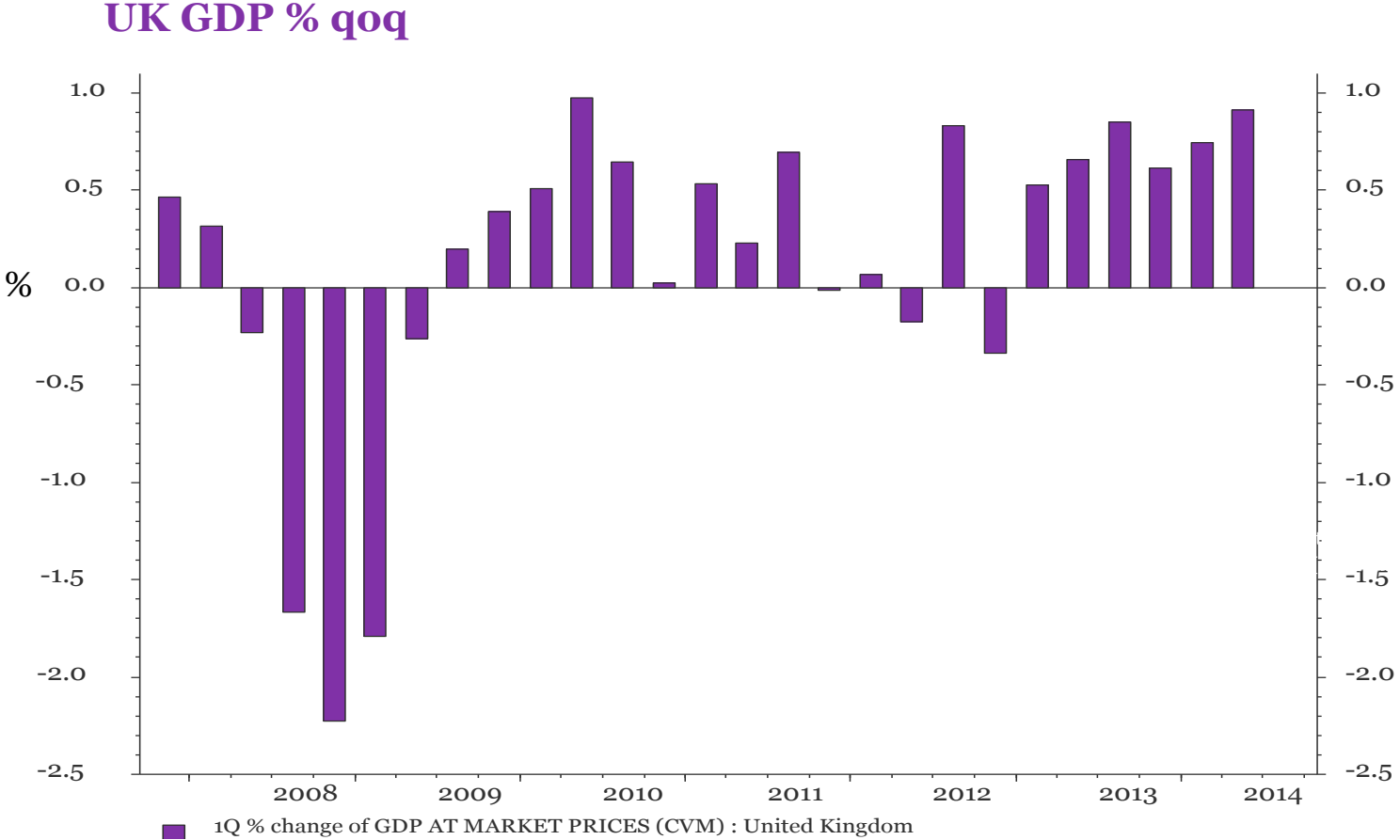


WILL RATES RISE?

ASSET MANAGEMENT

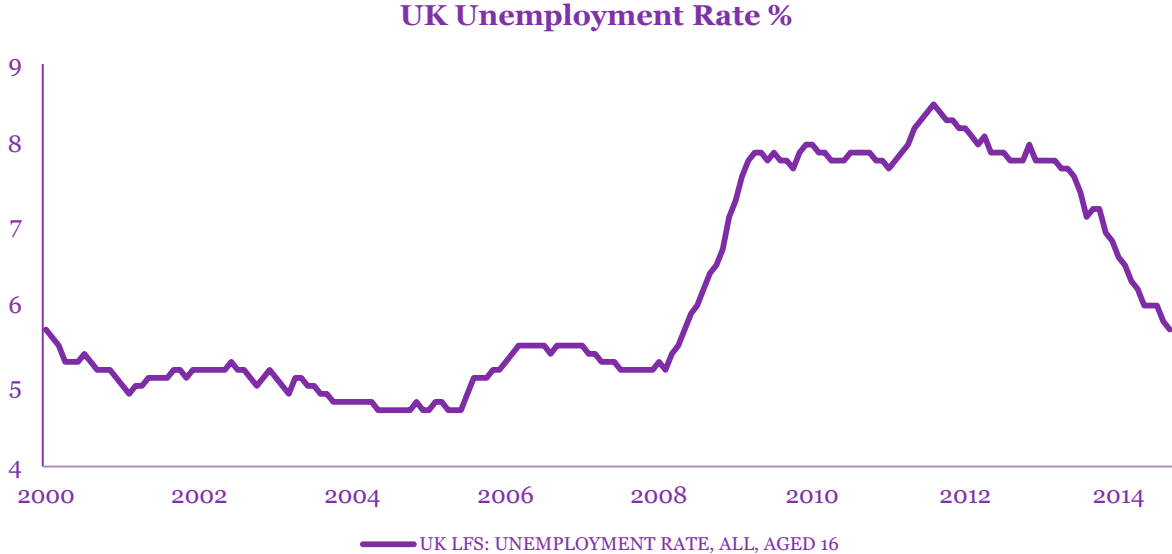
Scenarios

1. Slow rehabilitation – more typical of recovery from previous financial crisis
2. Cheap money delivers strong recovery. Reflation is the only way out
3. No traction in recovery



Source: Thomson Reuters Datastream

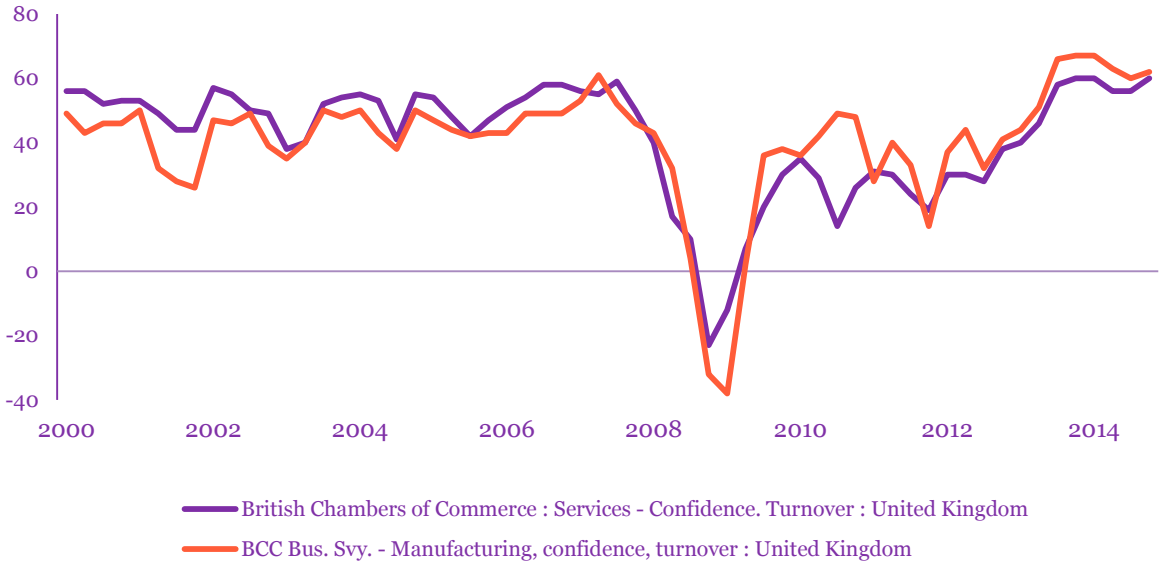




Source: Thomson Reuters Datastream as at March 2015.

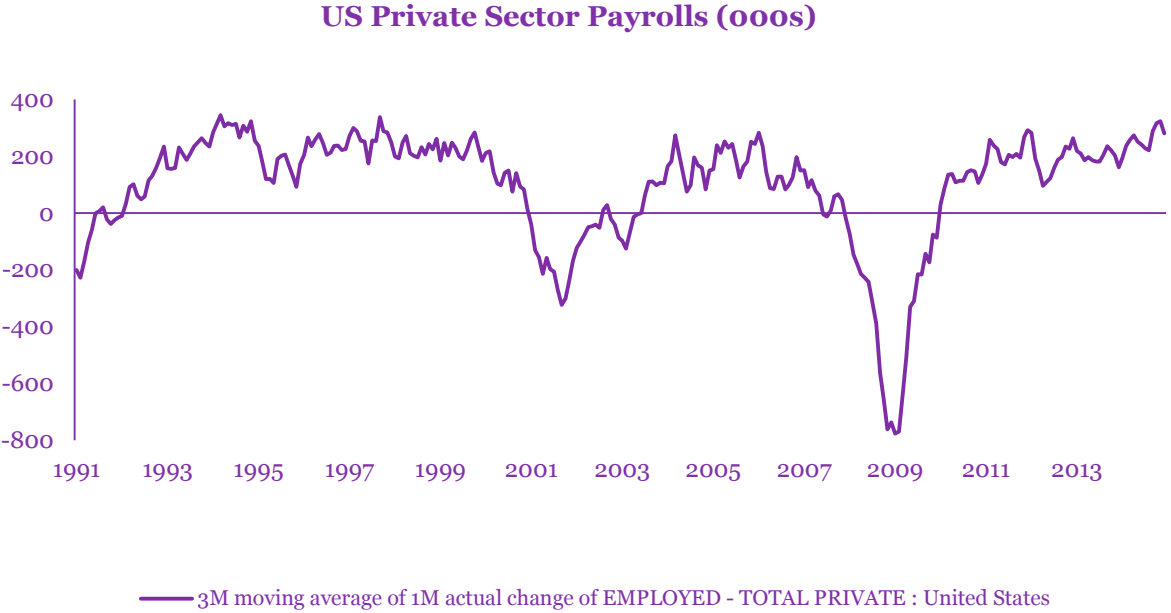


BCC Survey - Business Confidence



Source: Thomson Reuters Datastream as at March 2015.





Source: Thomson Reuters Datastream as at March 2015.





Source: Thomson Reuters Datastream as at March 2015.



CENTRAL BANK CHECKLIST

MORE DUCKS TO ALIGN THAN IN THE PAST

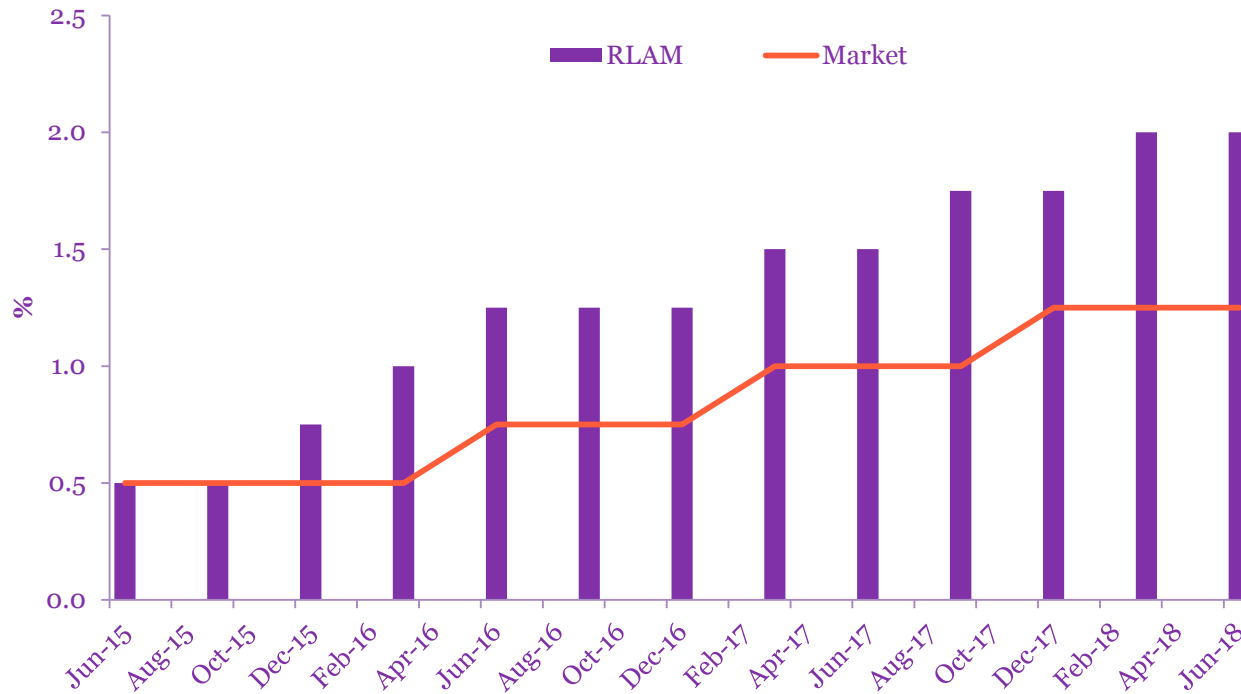
ASSET MANAGEMENT

	1994	2003-2007	2014
Employment growth (k)	✓	✓	✓
Headline unemployment rate	✓	✓	✓
Involuntary part time employment (m)	✓	✓	✓
Core CPI			✓
Headline CPI	✓		✓
Household inflation expectations %			✓
Unit labour costs %yoy			✓
Trade weighted dollar			

	1994	2003-2007	2014
Employment growth (k)	240	130	260
Headline unemployment rate	6.1	5.1	6.1
Involuntary part time employment (m)	4.6	4.4	7.2
Household inflation expectations %	3.3	2.9	2.8
Unit labour costs %yoy	0.3	1.7	1.8
Trade weighted dollar	91	87	83
Core CPI	2.8	2	1.7
Headline CPI	2.6	2.9	1.6

RATE EXPECTATIONS MARKET RELUCTANT TO BELIEVE IN RECOVERY

Expected path of Interest Rates



Source: Bloomberg as at April 2015.

- UK economy has staged strong if belated recovery
- Labour market data shows mixed picture
- Signs of improvement in Europe
- Inflation remains low
- BOE sending confused signals (?)
- Interest rates likely to rise, but peak lower
- A more unpredictable political environment

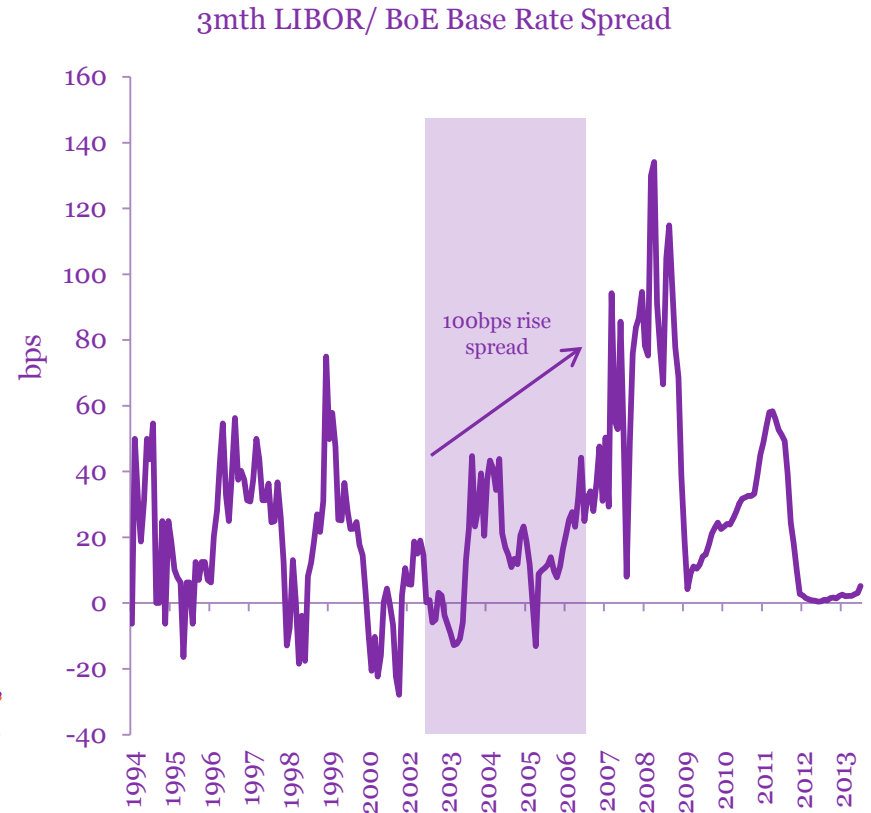
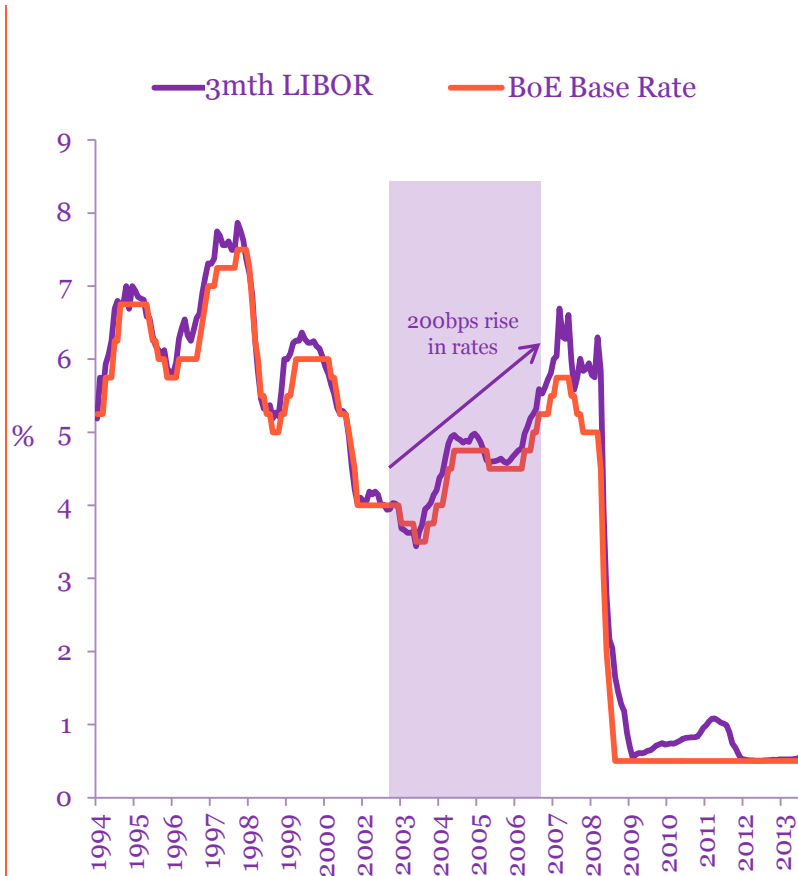


HOW DO WE PREPARE?

ASSET MANAGEMENT

- Low return world
- Concentration risk
- Liquidity problems
- Outlook for deposit rates
- Consider Floating Rate Notes (FRNs)
- Secured assets in a “bail-in” regime
- Making the right fund choice

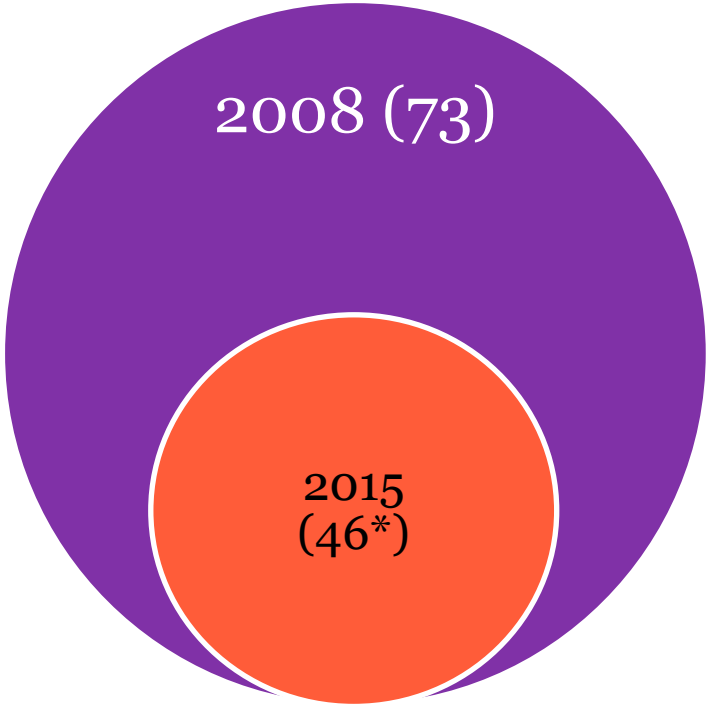
RETURNS ARE A REFLECTION OF LIBOR DECLINE



Source: Thomson Reuters Datastream April 2014.

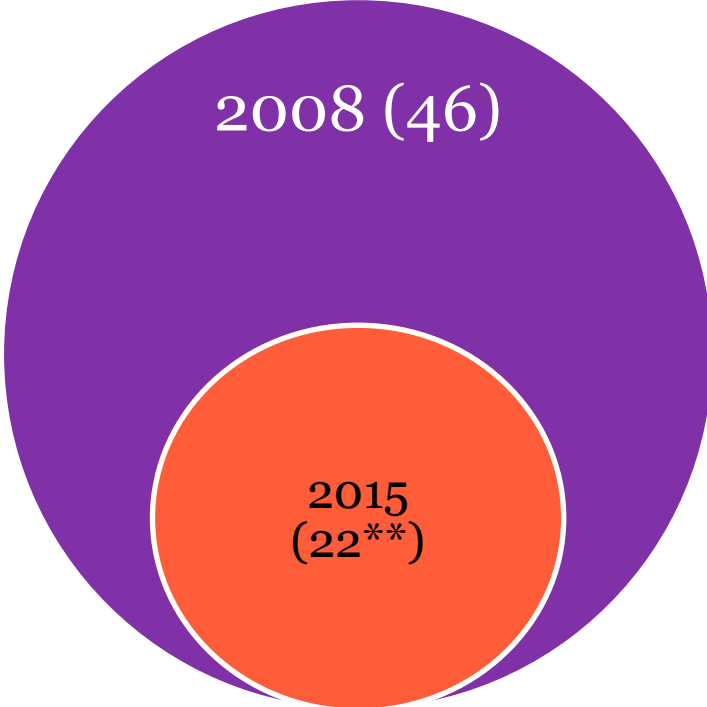


- Royal London universe of cash counterparties



*31 on negative credit watch

- Average AA- or Aa3



**13 on negative credit watch

Source: RLAM as at 31 March 2015.



What is it?

- A **non-breakable/breakable** deposit held at a financial institution that has a fixed rate of interest and maturity date

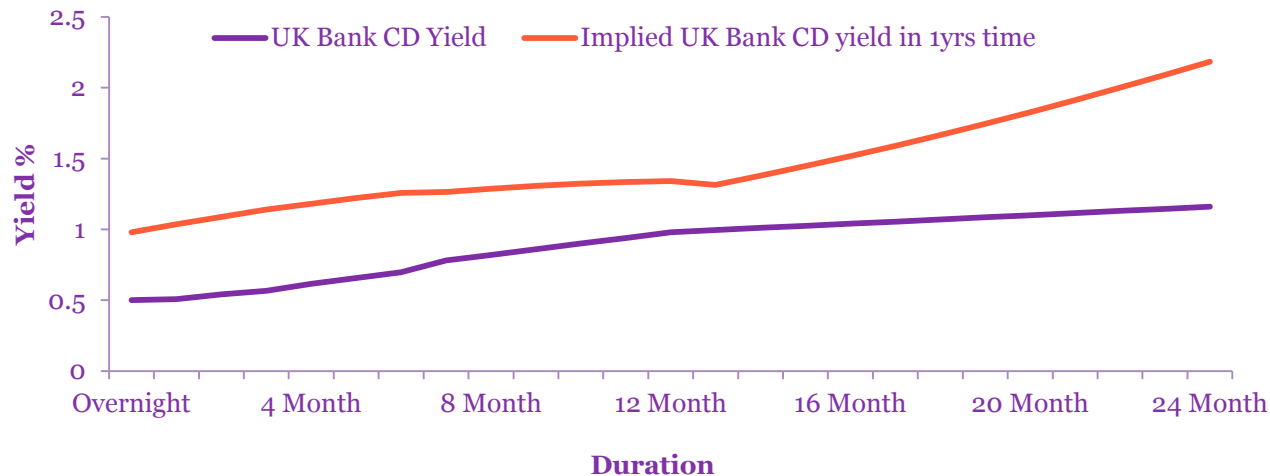
Themes

- Historically, deposits received preferential rates due to illiquidity
- In recent times financial institutions offered attractive rates direct to long term investors (not to large financial institutions)
- Liquid instrument, but the secondary market is not what it once was due to lack of bank balance sheet

Risks

- Unsecured lender (default & Bail-in risk)
- Concentrated counterparty risk
- Mark to market risk if rates rise

- Less access to cheap government funding/continued funding for lending scheme should result in LIBOR increasing
- Bank capital positions continue to improve, yet not reflected in ratings, hence lower rated banks have to offer attractive yields to fund
- Banks trying to fund early ahead of potential rate rises and the expected increase in LIBOR rates
- RLAM expects BoE base rate to be 0.75% by end 2015

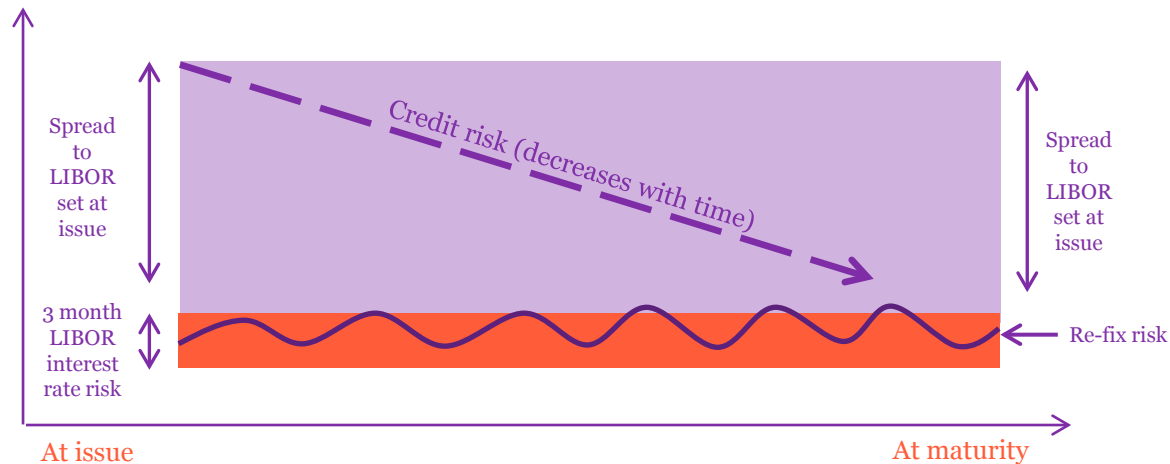


Source: RLAM as at 24 April 2015.

What is it?

- Floating rate notes (FRNs) are bonds that have a variable coupon, equal to a money market reference rate, like LIBOR, plus a quoted fixed spread

Benefits



- Re-fixes quarterly to 3mth LIBOR rate, hence offers protection against rising interest rates

Risks

- Mark to market credit risk (spread movement and extension risk)
- UK housing market risk (in the case of covered FRNs)
- Default risk (low in the case of high quality credit)

- The EU Bank Recovery and Resolution Directive (BRRD)
 - Aims to minimise taxpayers' exposure to banking failures
 - UK – Jan 2015
 - Europe – Jan 2016
- Bail-in provisions will give authorities the ability to disrupt the rights of creditors and shareholders and to sell or transfer the business of an institution

Assets excluded from Bail-in:

- Deposits covered by insurance protection
- Covered bonds
- Unsecured deposits with original maturity < 7 days

Assets liable to be Bail-in include:

- Shareholders
- Bondholders
- Unsecured depositors >7 days not covered by insurance protection

- Banks currently have up to three levels of upgrade by ratings agencies because of potential systemic support
- Bank credit ratings likely to move down in anticipation of declining sovereign support
- Solvency II recognises cash is not “risk free” – deposits have *counterparty risk*

What is it?

- Securities issued by banks and building societies, where the security is backed by a separate pool of loans. Covered bonds typically carry a maximum 10 year maturity rate and enjoy relatively high credit ratings

Benefits

- Collateralised by a high quality pool of mortgage assets that are regulated by the BoE. Bondholders have both a secured claim on assets and an unsecured claim on the bank
- Exempt from bail-in and highly liquid

Risks

- Mark to market credit risk (spread movement)
- UK Housing market
- Default risk (limited as no covered bond defaulted to date)



Lloyds 0% 22/03/17	
Coupon	Floating
Size	£1bn
Credit rating	AAA
Charge on properties	Legal charge on prime UK mortgage book
Current yield	0.70%
Spread (vs LIBOR)	0.12%

Source: RLAM as at 10 April 2015.



SHORT DURATION FUND SUITE

CASH & ENHANCED CASH

ASSET MANAGEMENT

	Short Term Money Market	Cash Plus	Enhanced Cash Plus
Rating	AAA	AAA	AA
Duration	Max 60 Days	3 to 6 months	> 6 months
Target	7 Day LIBID	7 Day LIBID + 0.50% to 0.75%	7 Day LIBID + 1.00% to 1.25%
Key Features	<ul style="list-style-type: none"> • Liquid • Diversified 	<ul style="list-style-type: none"> • Liquid • Diversified • Higher yielding than MMF • Broader investment universe 	<ul style="list-style-type: none"> • Liquid • Diversified • Higher yielding than Cash Plus • Broader investment universe • Larger exposure to FRNs

SHORT DURATION FUND SUITE

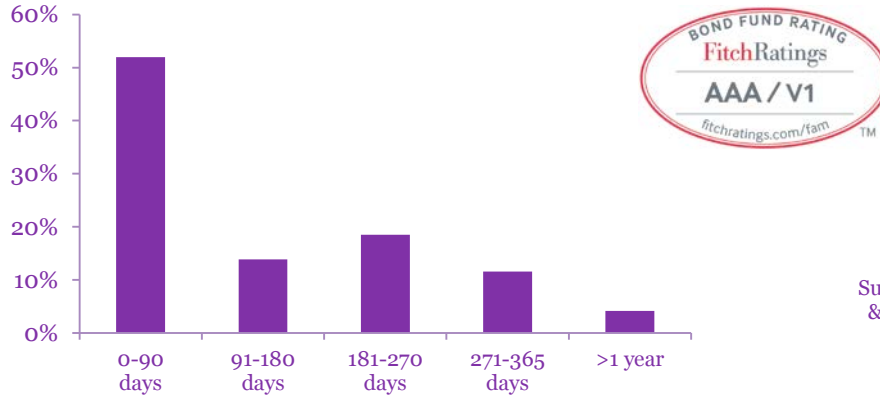
CONSERVATIVE ALPHA

ASSET MANAGEMENT

	Short Duration Gilts	Short Duration Global Index Linked	Short Duration Credit
Average Rating	AA+	AA	A-
Duration	3 years	5 years	3 years
Benchmark	FTA Gilt <5 years Index	50% Barclays UK 1-10 yr 50% Barclays Global 1-10yr Inflation Linked Bond Indices	BofA ML 1-5 year Sterling Non-Gilt All Stocks Index
Target	+ 0.50%	+ 0.50%	+ 0.50%
Key Features	<ul style="list-style-type: none"> • Captures market inefficiencies • Invests according to long-term strategic view • Exploits short-term tactical opportunities 	<ul style="list-style-type: none"> • Globally diversified • Captures market inefficiencies • Invests according to long-term strategic view • Exploits short-term tactical opportunities 	<ul style="list-style-type: none"> • Focus on security • Capture illiquidity premium • Sterling issuance, globally diversified

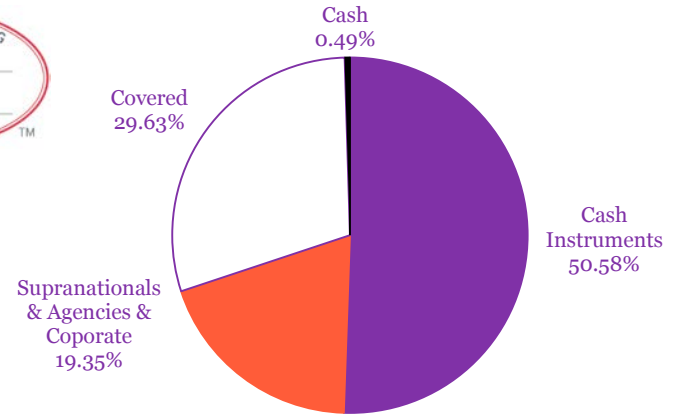
	Duration Hedged Credit	Absolute Return Government Bonds	Short Duration Global High Yield
Average Rating	BBB+	AA	B
Duration	Typically 3 months	+/- 1 year	< 2 years
Benchmark	3 Month LIBOR	SONIA	3 Month LIBOR
Target	+ 2.00%	+ 2.50-3.00%	+ 4.00%
Key Features	<ul style="list-style-type: none"> • Duration hedged with swaps • Focus on security • Capture illiquidity premium • Sterling issuance, globally diversified 	<ul style="list-style-type: none"> • Invests in G10 economies • Designed for all market conditions • Captures market inefficiencies • Invests according to long-term strategic view • Exploits short-term tactical opportunities 	<ul style="list-style-type: none"> • Globally diversified • Focus on US, European and EM high yield markets • Focus on security

Interest Rate Risk

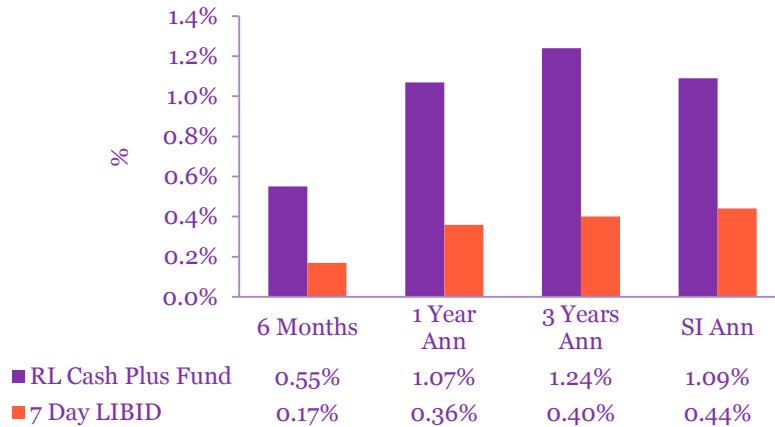


Average duration 0.4 years • Average credit spread duration 0.9 years

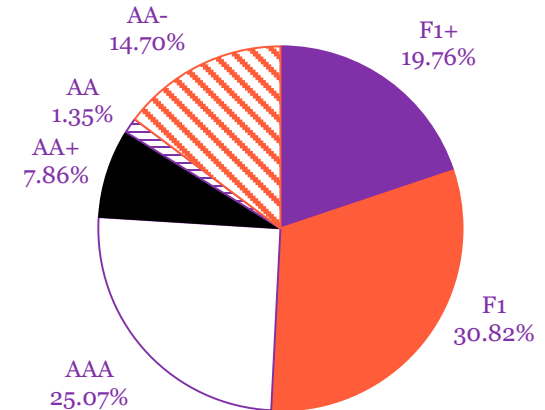
Asset Allocation



Performance



Credit Rating

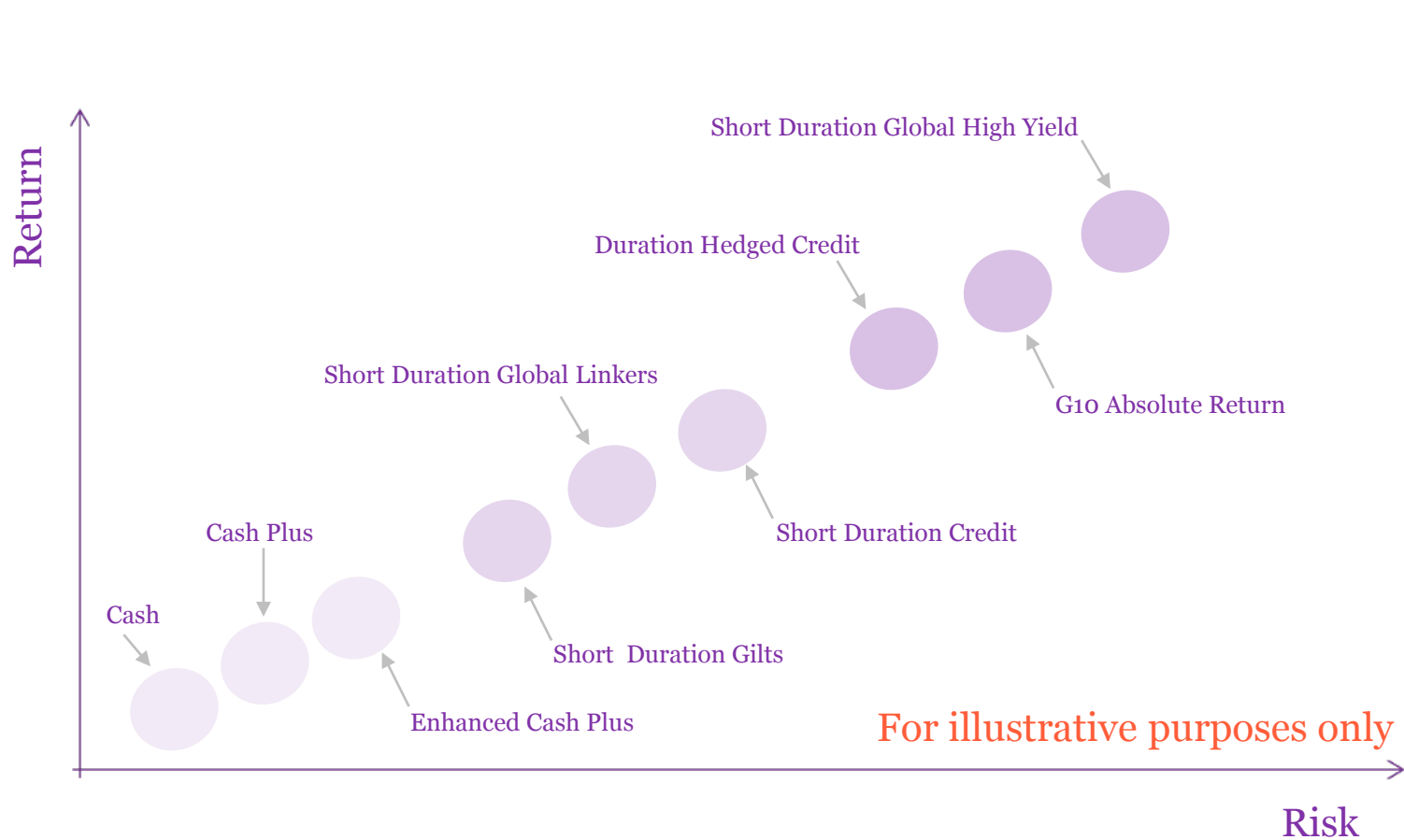


Source: RLAM and FE as at 31 March 2015.

Since inception date for RL Cash Plus Fund is 22 June 2011. Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

SHORT DURATION FUND SUITE OVERVIEW OF STRATEGIES

ASSET MANAGEMENT



*Cash refers to the Short Term Money Market Fund.

WILL RATES RISE AND WHERE TO INVEST A RANGE OF FUNDS TO SUIT ALL OUTCOMES

ASSET MANAGEMENT

Scenario	Outcome	Yield
Slow rehabilitation – more typical of recovery from previous financial crisis	Short Duration Gilt	0.7%
	Short Duration Credit	2.5%
	Short Global High Yield	3.5%
	Duration Hedged Credit	3.3%
	Absolute Return Government Bond	2.8%
Cheap money delivers strong recovery; Reflation is the only way out	Cash	0.5%
	Cash Plus	1.0%
	Enhanced Cash Plus	1.5%
	Short Duration Global Linkers	0.9%
	Absolute Return Government Bond	2.8%
No traction in recovery	UK Government Bond	1.4%
	Sterling Credit	3.5%



APPENDIX

ASSET MANAGEMENT

SHORT DURATION PRODUCT SUITE

ASSET MANAGEMENT

Fund Typical duration	Benchmark Target return	Cash	Gilts	Credit	Index-linked
Cash Plus Less than 1 year	7 day LIBID 7 day LIBID + 0.75%	Core Cash instruments	Strategic Short-dated gilts Tactical Medium-dated gilts	Strategic Covered bonds	--
Short Duration Gilt 3 years	FTA Gilt <5 years Index 1.00-1.25%	Tactical Cash instruments	Core Short-dated gilts Strategic Medium-dated gilts Tactical Overseas government bonds	Tactical Short-dated corporate bonds	Tactical Short- and medium-dated UK & overseas IL government bonds
Short Duration Credit 3 years	BofA ML 1-5 year Sterling Non-Gilt All Stocks Index 2.75-3.00%	Tactical Cash instruments	Tactical Short-dated gilts	Core Short-dated UK corporate bonds Tactical Medium-dated UK corporate bonds, short-dated overseas corporate bonds	--
Duration Hedged Credit 0 years	3 month LIBOR LIBOR + 2.0%	--	Core Gilts held as collateral against interest rate swaps	Core Broad range of UK & overseas corporate bonds	--
Short Duration Global Index Linked 5 years	50% Barclays UK 1-10 year inflation linked bond index; 50% Barclays Global 1-10 year inflation linked bond index (GBP Hedged) Benchmark + 0.50% p.a. over rolling 3 year periods	Tactical Cash instruments	Tactical Short-dated UK & overseas government bonds	Tactical Short-dated IL credit	Core Short-dated UK & overseas IL government bonds
Short Duration Global High Yield Less than 2 years	3 month LIBOR LIBOR + 2.0%	Tactical Cash instruments	Tactical Short-dated UK & overseas government bonds	Core Short-dated high yield bonds	--

RL SHORT DURATION CREDIT FUND

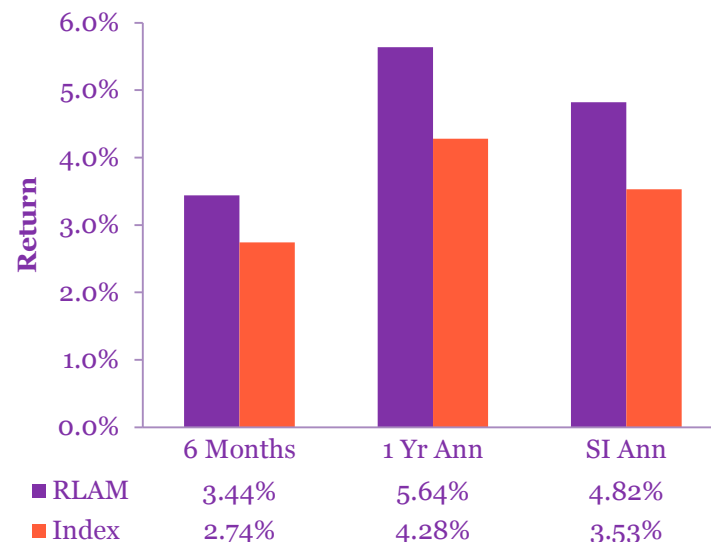
FUND PROFILE

ASSET MANAGEMENT

- The fund contains short dated, mostly investment grade credit bonds
- The fund aims to achieve outperformance from multiple sources
 - Stock selection, asset allocation, duration and yield curve management as well as off-benchmark investing
- We firmly believe in credit diversification as a way of reducing single name credit risk

Fund facts

Fund Manager	Paola Binns
Inception date	8 November 2013
Fund size	£47.4m
Duration	2.7 years
No of holdings	150- 180
Benchmark	ML 1-5 year Sterling Non-Gilt All Stocks Index
Performance Target	The fund seeks to outperform its benchmark by 0.5% per annum over rolling three year periods



Source: RLAM as at 31 March 2015. Fund performance stated gross of fees and gross of tax.

Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

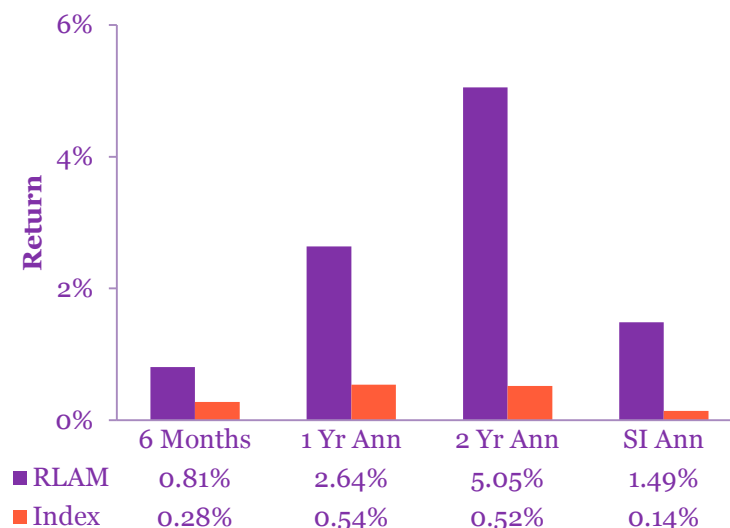
RL DURATION HEDGED CREDIT FUND FUND PROFILE

ASSET MANAGEMENT

- Aims to achieve outperformance from corporate bonds, while using derivatives to protect against interest rate risk
- Majority of assets allocated to investment grade corporate bonds across a range of maturities
- Targeting a duration of zero at all times (though may fluctuate around zero)

Fund facts

Fund Manager	Paola Binns
Inception date	24 September 2012
Fund size	£196.1m
Duration	0.3 years
No of holdings	150-250
Benchmark	3 Month LIBOR
Performance Target	3 Month LIBOR + 2% over the medium - long term (5-7 years)



Source: RLAM as at 31 March 2015. Fund performance stated gross of fees and gross of tax.

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RL ABSOLUTE RETURN GOVERNMENT BOND FUND

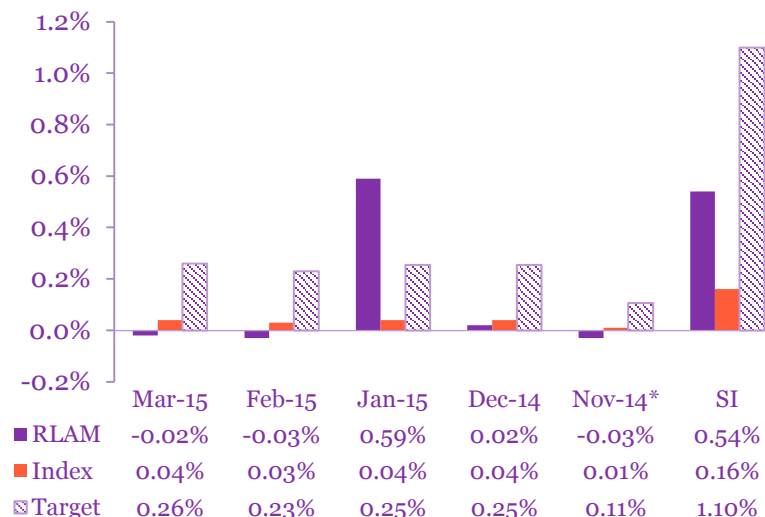
FUND PROFILE

ASSET MANAGEMENT

- The investment objective of the fund is to target absolute positive capital growth.
- The fund invests in a portfolio comprising of fixed and/or floating rate investment grade government and inflation linked bonds, supranational and sovereign Floating Rate Notes issued by the G10 Member States and derivatives (please refer to page 10 of this document for a summary of permitted derivatives).
- The fund seeks to achieve its investment objective by outperforming its benchmark, the Sterling Overnight Index (SONIA) on an annual basis by between 2.5% and 3% over rolling three year periods and aims to provide positive performance over a 12 month periods.

Fund facts

Fund Manager	Paul Rayner & Darren Bustin
Inception date	17 November 2014
Fund size	£127.6m
Benchmark	SONIA (Sterling Overnight Index Average)
Performance Target	SONIA + 2.5%-3% per annum over rolling 36 months



Source: RLAM, in Sterling, as at 31 March 2015. Fund returns are gross of fees. *Inception date of fund is 17 November 2014.

Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.





Senior Fund Manager

Craig Inches joined RLAM in January 2009 as a Fund Manager with the Fixed Income Team. He is responsible for the management of short dated cash and government bond portfolios including enhanced cash, index linked bonds, gilts and non UK sovereign debt.

Craig joined RLAM after a successful 11 year career at Scottish Widows Investment Partnership. At SWIP, Craig built up a strong track record across a wide range of fixed interest funds, being appointed Fixed Income Investment Director in 2003.

Craig has an MSc in Investment Analysis from Stirling University and a BSc (Hons) in Actuarial Mathematics and Statistics from Heriot-Watt University.

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