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Review prepared by Morningstar Investment Management Europe Ltd
1 Oliver's Yard, 55-71 City Road, London EC1Y 1HQ

Quarterly Model Portfolio Change Rationale

Asset Allocation and Fund Selection Update

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Model Portfolios – Asset Allocation and Fund Selection Update – February 2024

This communication provides a summary of asset allocation and fund selection changes which were published in February 2024.

Asset Allocation

EV provides the asset allocations for the Model Portfolios over which Morningstar has no influence. As a result of the recent asset allocation update from EV, there were changes to the asset allocation for the following Model Portfolios.

Summary of Changes

Cautious Portfolio – Medium Term

- The Government Bonds weight has increased from 58.00% to 59.00%
- The Index-Linked Bonds weight has increased from 16.00% to 17.00%
- The US Equity weight has decreased from 10.00% to 9.00%
- The European Equity weight has decreased from 3.00% to 2.00%

Moderately Cautious Portfolio - Medium Term

- The Government Bonds weight has increased from 54.00% to 55.00%
- The US Equity weight has decreased from 16.00% to 15.00%

Balanced Portfolio - Medium Term

- The Government Bonds weight has increased from 42.00% to 43.00%
- The UK Equity weight has decreased from 17.00% to 16.00%
- The US Equity weight has decreased from 25.00% to 23.00%
- The European Equity weight has increased from 9.00% to 10.00%
- The Japanese Equity weight has increased from 7.00% to 8.00%

Moderately Adventurous Portfolio - Medium Term

- The Corporate Bonds weight has increased from 6.00% to 7.00%
- The UK Equity weight has decreased from 21.00% to 19.00%
- The US Equity weight has decreased from 33.00% to 32.00%
- The European Equity weight has increased from 13.00% to 14.00%
- The Japanese Equity weight has increased from 9.00% to 10.00%

Adventurous Portfolio - Medium Term

- The UK Equity weight has decreased from 14.00% to 13.00%
- The US Equity weight has decreased from 50.00% to 49.00%
- The European Equity weight has increased from 24.00% to 26.00%

Cautious Portfolio - Long Term

- The Corporate Bonds weight has increased from 4.00% to 5.00%
- The UK Equity weight has decreased from 8.00% to 7.00%
- The US Equity weight has decreased from 21.00% to 20.00%
- The European Equity weight has increased from 10.00% to 11.00%

Moderately Cautious Portfolio - Long Term

- The Corporate Bonds weight has increased from 8.00% to 9.00%
- The UK Equity weight has decreased from 10.00% to 9.00%
- The US Equity weight has decreased from 27.00% to 26.00%
- The European Equity weight has increased from 12.00% to 13.00%

Balanced Portfolio - Long Term

- The Corporate Bonds weight has increased from 11.00% to 13.00%
- The UK Equity weight has decreased from 13.00% to 11.00%
- The US Equity weight has decreased from 33.00% to 32.00%
- The European Equity weight has increased from 14.00% to 15.00%

Moderately Adventurous Portfolio - Long Term

- The Corporate Bonds weight has increased from 19.00% to 21.00%
- The UK Equity weight has decreased from 15.00% to 13.00%
- The US Equity weight has decreased from 33.00% to 31.00%
- The European Equity weight has increased from 15.00% to 17.00%

Adventurous Portfolio - Long Term

- The UK Equity weight has decreased from 17.00% to 15.00%
- The European Equity weight has increased from 19.00% to 21.00%

Model Portfolios – Asset Allocation and Fund Selection Update – February 2024

Fund Selection

Moderately Cautious – Long Term

- Remove Artemis Income
- Remove Royal London Sustainable Leaders

To accommodate the decreased allocation to UK equities we have removed the Artemis Income and Royal London Sustainable Leaders funds.

Balanced – Long Term

- Add Royal London Corporate Bond

To accommodate the increased allocation to UK Corporate Bonds we have introduced the Royal London Corporate Bond fund.

Royal London Corporate Bond

Key Pillars

The fund's two named managers are Shalin Shah and Matt Franklin. Shah joined the team in mid-2008 and has been a co-manager on the strategy since October 2016, taking on responsibility following the departure of long-standing manager Sajiv Vaid. Franklin was added as co-manager in January 2022 having been a member of the Sterling Credit team for eight years. Head of fixed income Jonathan Platt is no longer a named manager but will continue to provide strategic input and challenge the other managers as head of fixed income.

The investment process starts with a review of the macro environment to identify the most-attractive credit markets. This is followed by in-depth bottom-up credit research, with a heavy emphasis on bond covenants and structure, which forms the core of the strategy. This has led to a bias towards secured bonds historically in sectors such as social housing, investment trusts, and asset-backed securities.

While more than 80% of the fund typically consists of agency-rated "high-profile" bonds, the team members actively look for under-researched "low-profile" bonds (including unrated bonds) that offer higher return potential, in their view. The strategy's long-term horizon allows it to exploit the illiquidity premium built into these bonds, but diversification across 250-350 holdings helps reduce specific issuer risk.

Returns since inception are comfortably ahead of category peers on an absolute and risk-adjusted basis and has been consistent over multiple years.

Opinion

Although Franklin has limited PM experience, Shah is well tenured and the managers are backed by a collegial team led by veteran Jonathan Platt, who employs a time-tested, team-based approach.

The strong performance reflects a focus on under-researched bonds and the long-term approach.

Moderately Adventurous – Long Term

- Add Janus Henderson European Sel Opps

To accommodate the increased allocation to European Equities we have introduced the Janus Henderson European Sel Opps fund.

Janus Henderson European Sel Opps

Key Pillars

Long-standing portfolio manager John Bennett has announced that he will be retiring at the end of August 2024. Bennett is an experienced manager and has managed European equities for more than two decades, including 17 years at GAM. Until his retirement Bennett will continue to work closely with Tom O'Hara and Tom Lemaigre, who were hand-picked by him in 2018 with succession planning in mind. O'Hara and Lemaigre have more than 14- and seven-years' experience, respectively. O'Hara was named comanager in January 2020 and Lemaigre in 2022.

The managers combine bottom-up and top-down research to build a portfolio that can outperform the FTSE World Europe ex UK Index through the market cycle. They pay close attention to global macro and sector trends as these provide valuable insights into the prospects of European companies. Aware of the potential for mean reversion in stock markets, they also look for contrarian trades. Bennett has added considerable value through stock selection over the years while also proving adept at steering the portfolio in line with his macroeconomic views. For the former, he focuses on identifying companies with attractive cash flow return on investment, or CFROI, that are undervalued, or those that are at inflection points where profit margins and/or CFROI are either improving or have the potential to do so in the future.

Opinion

While Bennett's eventual retirement will be a loss for the team, we believe that the fund will retain its flexible approach and that we have evidence of O'Hara and Lemaigre demonstrating their ability to implement this process effectively and in keeping with the fund's remit.

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