Choosing the right glidepath for the best possible retirement outcome

Sun Life Global Investments experts **Chhad Aul** and **Jason Zhang** explain how to build a stronger glidepath – with a focus on retirement outcomes

THE LIFELONG trajectory of investing from aggressive wealth accumulation to wealth preservation and finally a sustainable income is embedded in the glidepath of target-date funds, which are designed to meet plan members' needs through the entire cycle. Glidepath construction is the most important step in target-date fund design because it has the biggest impact on plan members' wealth.

"Target-date funds provide plan members with an investment journey," says Chhad Aul, chief investment officer and head of multi-asset solutions at SLGI Asset Management Inc. (SLGI). "We construct our glidepath to ensure a plan member takes an appropriate amount of risk to build assets during the accumulation phase, before transitioning to protecting their wealth and preparing for a later stage we call decumulation."

Managing this glidepath is an incredibly complex process, as investment managers make continual strategic adjustments for market and behavioral risk and investment mix at different phases of the glidepath. They also have to account for broad social shifts. People are not only living longer, they also want to be more active during their retirement years, and that often requires more money for travel, recreation, health-care, holiday homes, and so much more.

Aul, together with colleague Jason Zhang, a portfolio manager at SLGI Asset Management, recently sat down with Benefits and Pensions Monitor to discuss glidepath construction for target-date funds and the important considerations that go into building a stronger retirement outcome.

Chhad Aul, CFA, chief investment officer and head of multi-asset solutions, SLGI Asset Management Inc.

Jason Zhang, CFA, portfolio manager, SLGI Asset Management Inc.

As experts in risk, it's perhaps no surprise that Aul and Zhang have complementary definitions of risk and how it affects plan members.

Market risk

The first category of risk involves exposure to the markets. Markets fluctuate, and this can have a significant impact on a plan member's wealth.

"When people think about market risk, they tend to focus on the downside risk," Zhang says. "That's important, but we also want to ensure our younger plan members have the opportunity to grow their assets – because accumulating a strong asset base proves to be one of the biggest drivers when it comes to delivering strong retirement outcomes."

Sequence risk

Susceptibility to risk increases as a plan member moves closer to retirement. Sequence risk is the risk of a plan member withdrawing funds from the target-date fund in order to invest more conservatively. Sequence risk is also important during decumulation because withdrawing funds during a bear market will create more risk to retirement income than withdrawing during a bull market.

"This is one thing that we don't want to see," Zhang says. "We understand people tend to be susceptible to divesting during major market downturns, but this kind of behaviour usually leads to a worse retirement outcome."

It's important when designing a glidepath that investment managers understand the scope of sequence risk and take this behavioral bias into consideration in their modelling and analysis.

value of a plan member's savings, and this needs to be part of the scenario analysis when constructing a glidepath.

Stress-testing the glidepaths

We've covered the main measures of risk that an investment manager needs to consider when designing a glidepath. But what goes into quantifying those risks and calculating their impact on retirement outcomes?

Every investment manager employs a variety of stress tests to measure the different risks and assess the strength of their glidepath candidates. Aul and Zhang's team have chosen five metrics designed to address the above risks, with a goal of delivering the strongest retirement outcomes possible. The first three apply to pre-retirement and the other two to post-retirement.

> "We are looking at thousands of scenarios to ensure plan members are ultimately achieving the right balance of returns to enjoy a comfortable retirement"

Longevity risk

People are living much longer today than they did in the past. For example, individuals who retire at the age of 65 can expect to have active lives for about 25 years, if we consider mortality improvements.

This is a long time to go without employment income, making investment returns very important during the decumulation phase.

"We need to make sure that the assets that we've helped plan members accumulate for retirement can last for the longer and longer lifespans that we're now seeing," Aul says. "We don't want to see people outliving their savings."

Inflation risk

With inflation at record highs, it is no surprise that inflation risk is an important consideration. Inflation can erode the real

First among the pre-retirement metrics is a utility score. This proprietary test reveals how a glidepath is performing in terms of generating a return over a certain threshold while at the same time assessing the exposure to downside risk.

"A utility score tells us if the glidepath is hitting the sweet spot between returns and risk," Zhang says.

A second pre-retirement metric assesses the strength of different glidepaths when it comes to generating wealth at retirement.

"This is one of the most important metrics," Zhang says. "We want to see a glidepath that gives our plan members the best chance of generating wealth at retirement. We are looking at thousands of scenarios here to ensure plan members are ultimately achieving the right balance of returns to enjoy a comfortable retirement."

The last pre-retirement test is referred to as

the near-retirement drawdown test. This test focuses on the sequence risk for investors who are within five years of retiring, involves thousands of cross-asset scenarios, and measures the worst-case scenarios plan members may face as they near the end of their working lives.

SLGI has two metrics that they use to address post-retirement risks. The first, the income-replacement ratio, is a number that represents how much retirees can reliably withdraw from their savings in the target date fund account on an annualized basis, measured as a percentage of their pre-retirement wage. This analysis also factors in government support programs such as CPP/QPP and old age security (OAS).

Finally, there's the retirement resilience test, which assesses how many years assets in a retirement account are expected to last.

Aul and Zhang emphasize that a lot more goes into designing a glidepath than just math and impressive metrics.

"There's a lot of science that goes into designing a glidepath," Aul says. "But it's an art as well.

"The five key metrics are highly quantitative and depend on a very robust statistical analysis. The art lies with assessing the relative trade-offs and finding the right balance."

Creating a robust glidepath is complicated. As today's plan members live longer and look forward to a retirement free of worries and full of activities, target-date fund managers strive to deliver a glidepath and investment solution that will give them their very best retirement. BPM