DRW INVESTMENT RESEARCH

Towards a Sustainable Retirement Plan VII

An Evaluation of Pre-Retirement Investment Strategies:

A glide path or fixed asset allocation approach?

Abridged Summary

Daniel R Wessels

June 2014

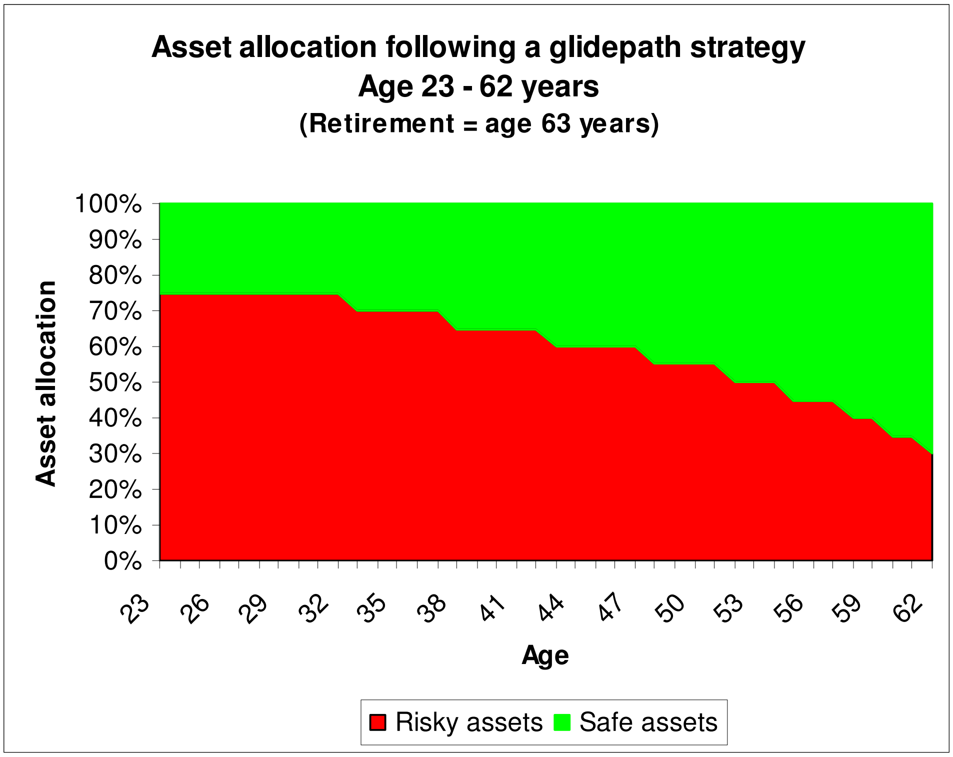
- Conventional financial wisdom: one's exposure to risky assets (equities and property investments) should decrease in relation to safe or low-risk assets, such as bonds and cash, as one gets older and nearing retirement or is already in retirement.

- Equities and property investments are notoriously volatile and from time to time will experience sharp declines in asset values. Markets, after a sharp decline, may take a long time to recover to their previous price levels.

- A well-known rule-of-thumb is that one's exposure (in percentage terms) to risky assets should equal 100 (110) minus one's age. Thereby a 65-year old person should not have more than 35% (45%) exposure to risky assets, while a 45-year old should be invested 55% (65%) in risky assets.

- The advent of life stage or target date funds: The automatic age-related allocation of investments to different asset classes following a specific glide path according to a pre-determined set of allocation rules and limits.

- An example of a glide path approach towards asset allocation:

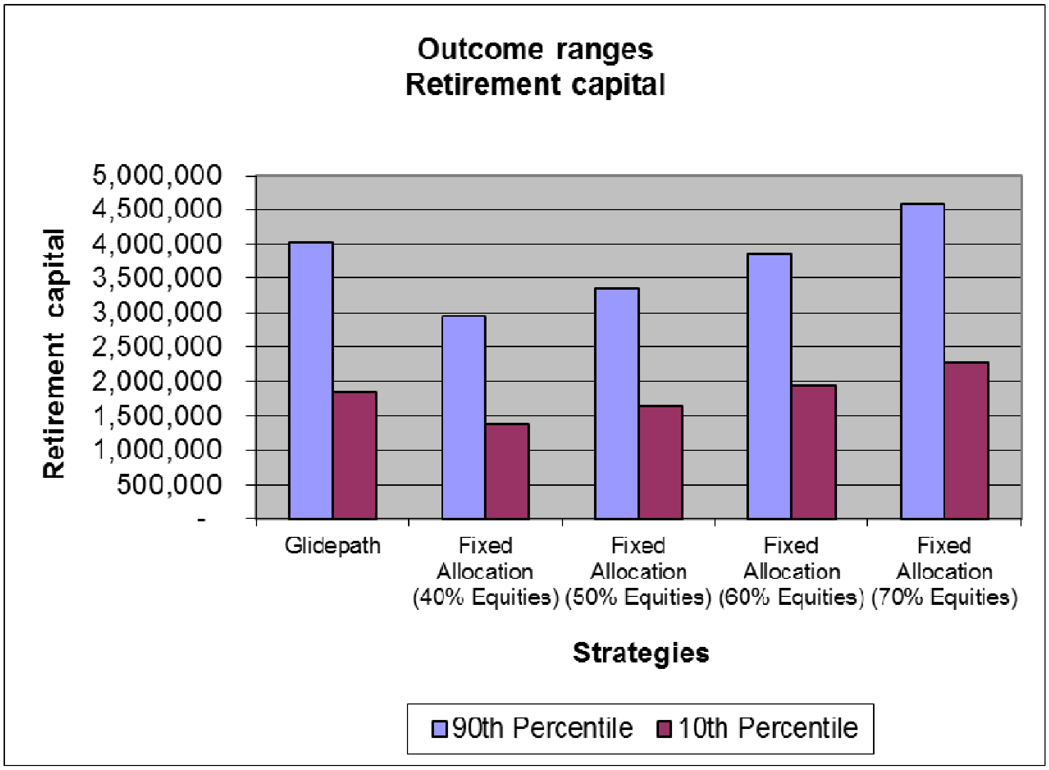


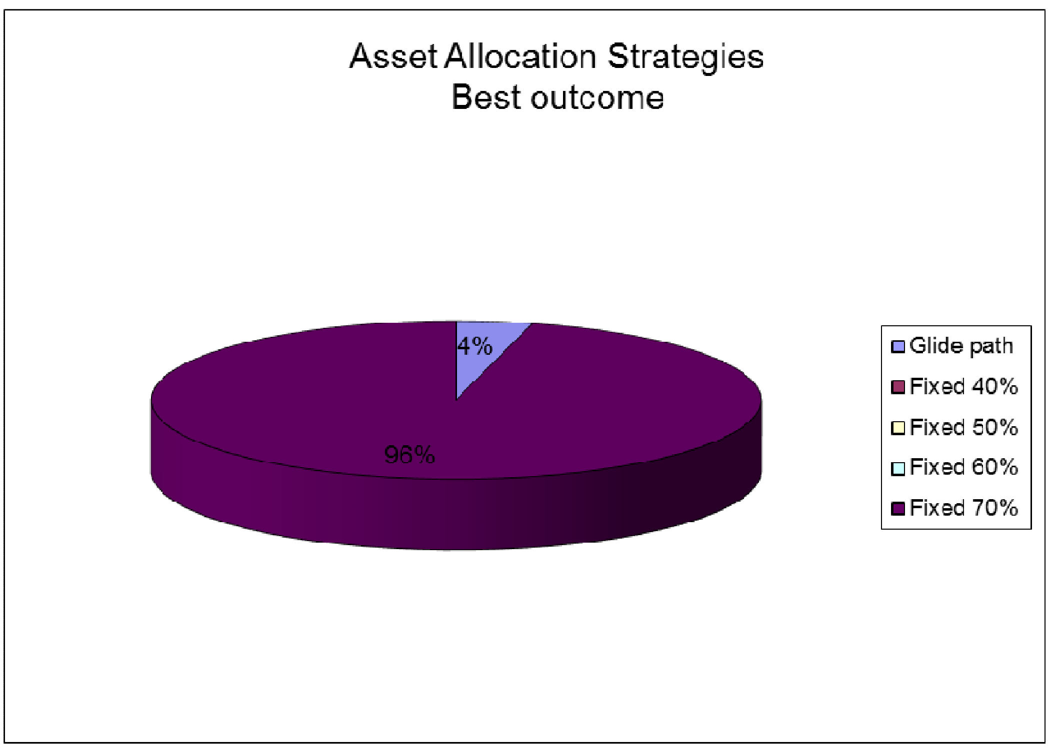
- How well would the glide path approach have worked considering historical asset class returns? Or, when expanding the range of outcomes by means of simulated asset class returns?

- The glide path strategy was evaluated against a number of alternative investment strategies, e.g. static or fixed asset allocation strategies, say, 40%, 50%, 60% and 70% allocation to risky assets.

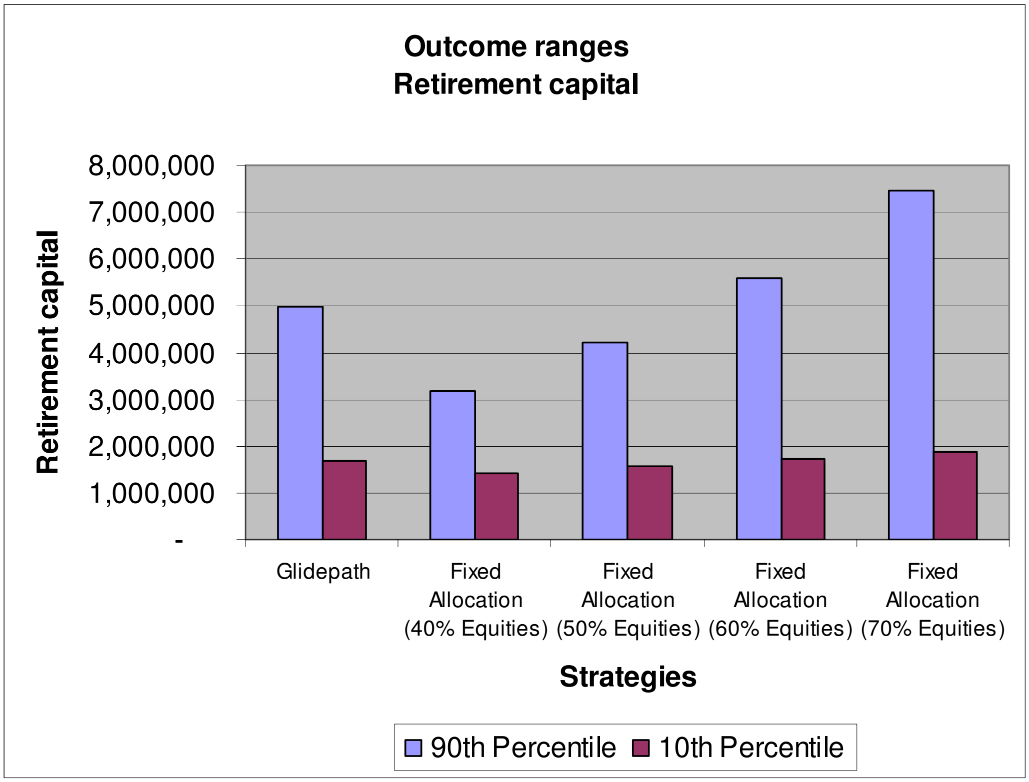
- The results compared in terms of real retirement value accumulated over 40-year contribution periods, savings multiple (retirement value relative to contributions), potential annuity income (the inflation-linked annuity that can be bought with the available retirement value) and the value added over the last ten years before retirement (additional annuity income added).

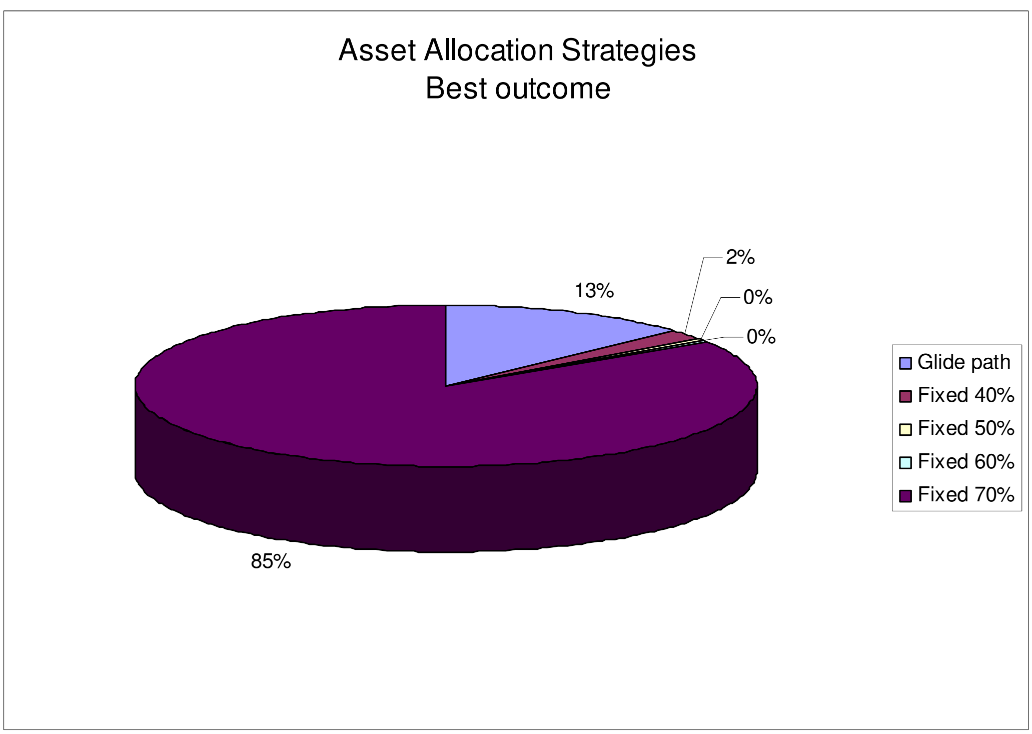
- For example, based on historical asset class returns:





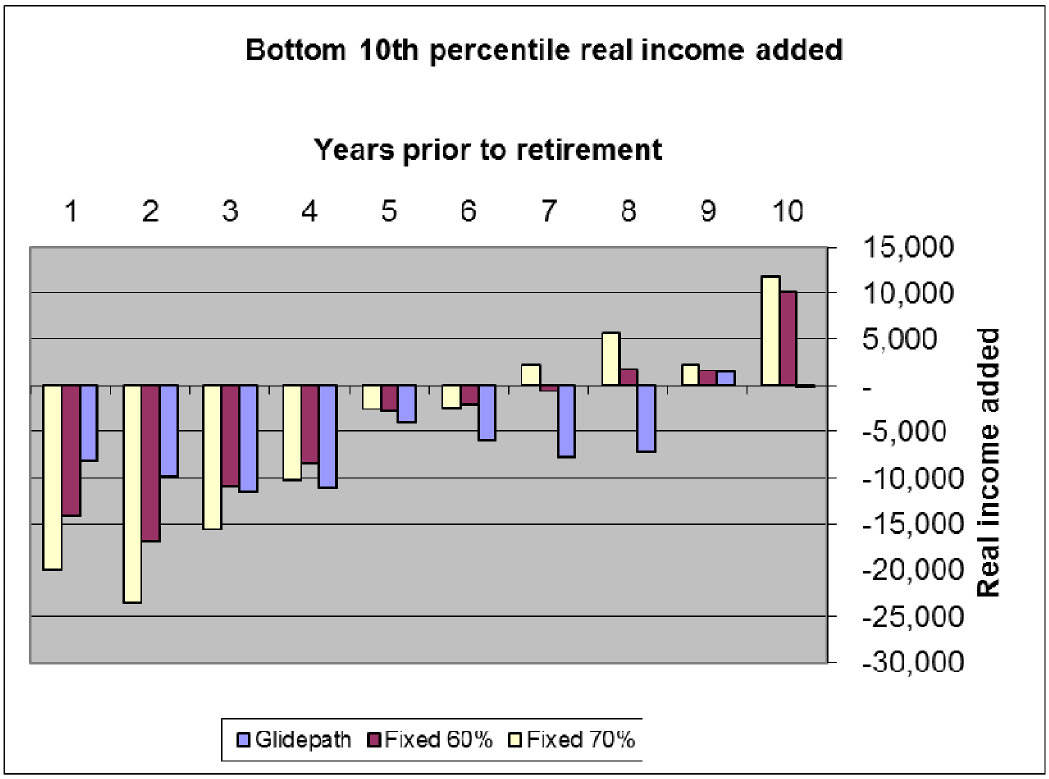
- And based on simulated returns:





- The basic idea behind the glide path approach is to protect potential retirement value against major declines near retirement age…but is this protection (reducing exposure to risky assets) worthwhile, i.e. the opportunity cost involved? And if such protection added value, when was the optimal period before retirement to do so?

- For example, considering the worst historical outcomes *n* years before retirement, which strategy yielded the best outcome?



Investment Research

- Request a copy of the full article: enquiries@indexinvestor.co.za

- Contents of full article:
    - Introduction – context
    - Asset class returns
    - Methodology – research model and assumptions
    - Investment strategies
    - Analysis of historical outcome
    - Analysis of simulated outcome
    - Contextualisation – real return trends
    - The value-added proposition
    - Appendix - Alternative glide path model