Commentary
**Defined Contribution**

**October 2020**

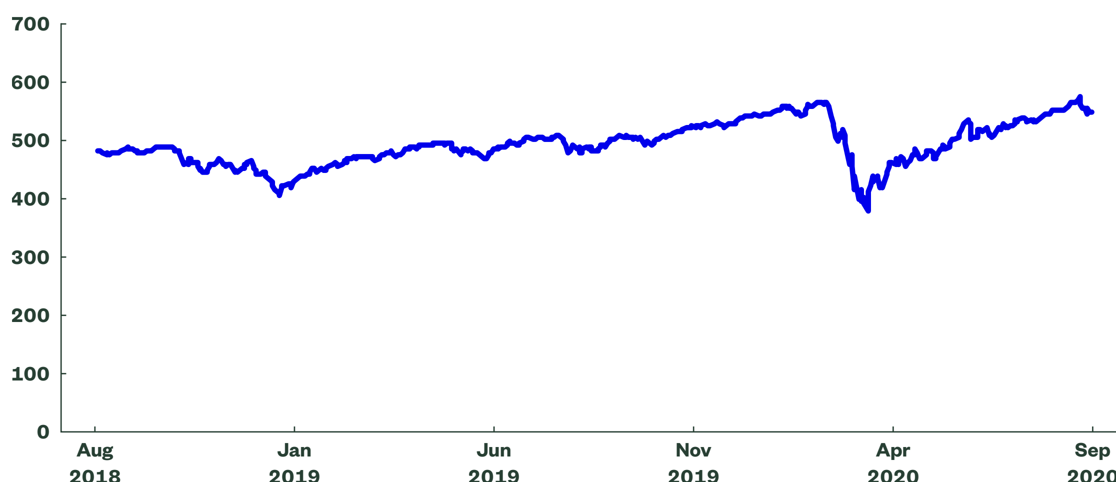
# Dynamism in Action

**Alistair Byrne, CFA**
EMEA Head of Pensions and Retirement Strategy

**Olivia Kennedy, CFA**
Senior DC Investment Strategist

- With plans for the introduction of auto-enrolment in Ireland, it is crucial that DC schemes have well-designed default investment strategies that give members confidence.
- Periods of heightened global market volatility, such as those experienced recently, reinforce the importance of managing investment market risk.
- Large falls in financial markets can seriously knock the confidence of DC savers. It is therefore critical that default strategies seek to reduce losses.
- Using a default with built-in volatility management, such as State Street Global Advisors' Timewise Target Retirement Funds, can help reduce losses in market downturns.

Figure 1
**Heightened Global Market Volatility**
FTSE All World Developed Equity Index



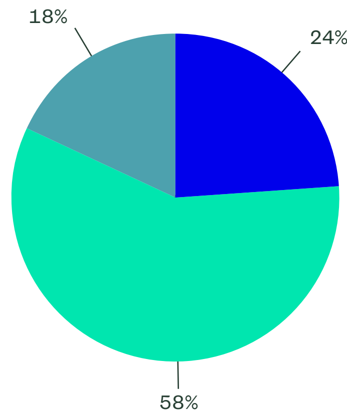

Source: State Street Global Advisors as 31 March 2020.

## Introduction

Savers react to gains and losses differently, exhibiting greater sensitivity towards losses[1]. Evidence suggests that consumers are becoming increasingly sensitive to market shocks, placing more importance on protection from falls in value than the potential to increase income.

A recent survey we conducted of 403 Irish savers illustrates this.

Figure 2
**Irish DC Savers' Investment Preferences**
Given the choice, which of the following would you prefer for the investments that your retirement savings plan invests in:




- Relatively high expected returns, but with higher chances of a loss
- Relatively lower expected returns but with less chance of a loss
- Don't know

Source: State Street Global Advisors 2020 Global Retirement Reality Report. Survey data collected by YouGov. 403 DC savers surveyed between 4th and 20th May 2020.

Timewise Target Retirement Funds (Timewise) are designed to protect members' pots in times of market turbulence. The insights of behavioural finance have played an important role in the design and management of these funds.

## Three Layers of Volatility Management

The Timewise glidepath is designed so members hold an appropriate mix of assets for their life stage. Furthermore, Timewise employs three layers of protection to help protect members' pots in volatile market environments and to reduce drawdowns experienced:

1. Strategic **diversification** of asset classes
2. Active asset allocation via the **Flexible Asset Allocation Plus** Fund
3. Systematic **Target Volatility Triggers** closer to retirement

The market turbulence seen in the COVID-19 pandemic has highlighted the importance of these mechanisms. Here we look at each of them in more detail.

### Layer 1: Diversification

The benefits of diversification within investment portfolios are well documented, however, the degree of diversification employed should balance the risk taken with the reward received. Over-diversification can have a negative impact on the value of members' pots by dampening investment returns and incurring excessive trading costs.

It is for this reason that we target the right level of diversification in Timewise by strategically allocating to the following building blocks:

- Developed and Emerging Market Equities
- Smart Beta Equities (targeting specific factors such as value, size, volatility, quality and momentum)
- High Yield and Emerging Market Debt
- Euro and Global Bonds
- Cash

Whilst strategic diversification can help smooth returns over the long term, in the short term we do not believe this alone is enough. An element of dynamic response to market movements is important, particularly when market sentiment can change drastically over a short period of time.

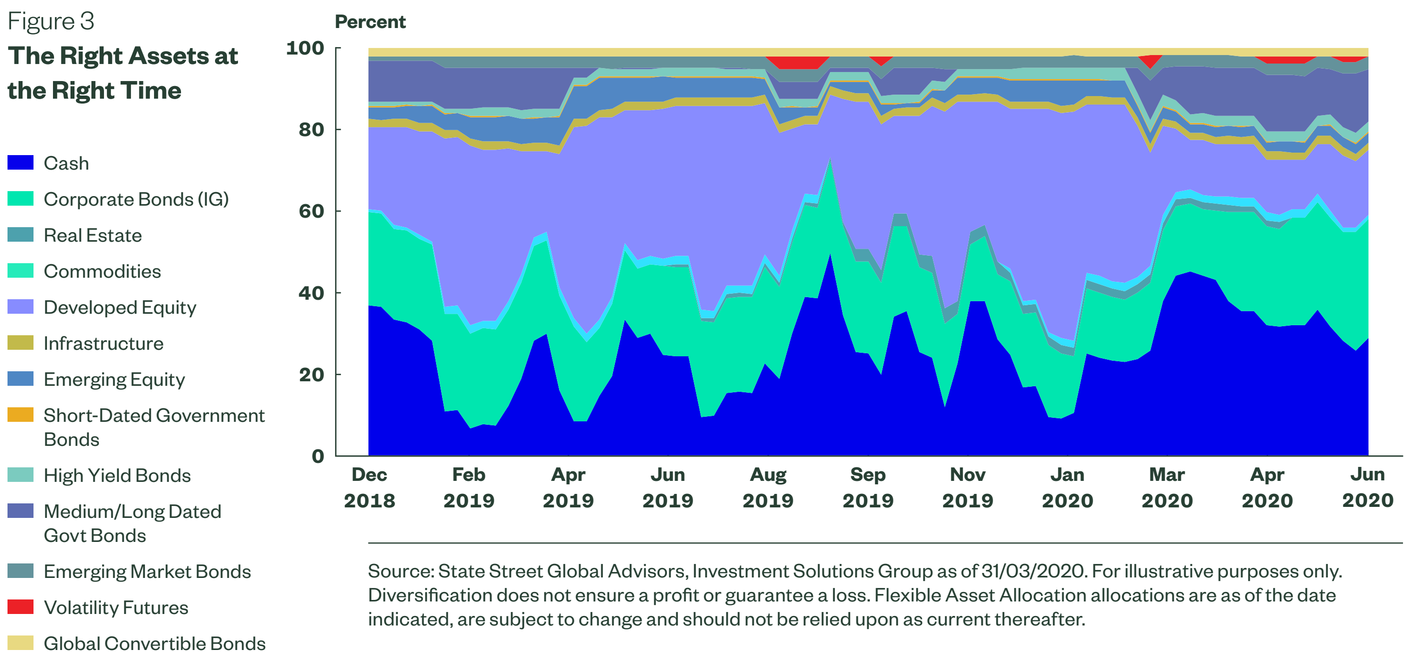
The following two layers are the dynamic components that we use within Timewise to target a smoother journey with reduced short-term drawdowns.

## Layer 2: Flexible Asset Allocation Plus Fund

We recognise that different asset allocations are suitable for different market environments. The Timewise funds achieve this by actively varying their asset allocation in response to market conditions via our Flexible Asset Allocation Plus Fund. In the earlier years, 15% of the Timewise glide path is allocated to the Flexible Asset Allocation Plus Fund, increasing to 18% in the later years.

For example, during March this year, we saw a vast increase in market volatility triggered by global concerns over the COVID-19 pandemic. Using a variety of tools, the Flexible Asset Allocation Plus Fund was able to de-risk its asset allocation quickly, switching equity allocations into lower risk assets such as cash and government bonds.

Figure 3
**The Right Assets at the Right Time**




Source: State Street Global Advisors, Investment Solutions Group as of 31/03/2020. For illustrative purposes only. Diversification does not ensure a profit or guarantee a loss. Flexible Asset Allocation allocations are as of the date indicated, are subject to change and should not be relied upon as current thereafter.

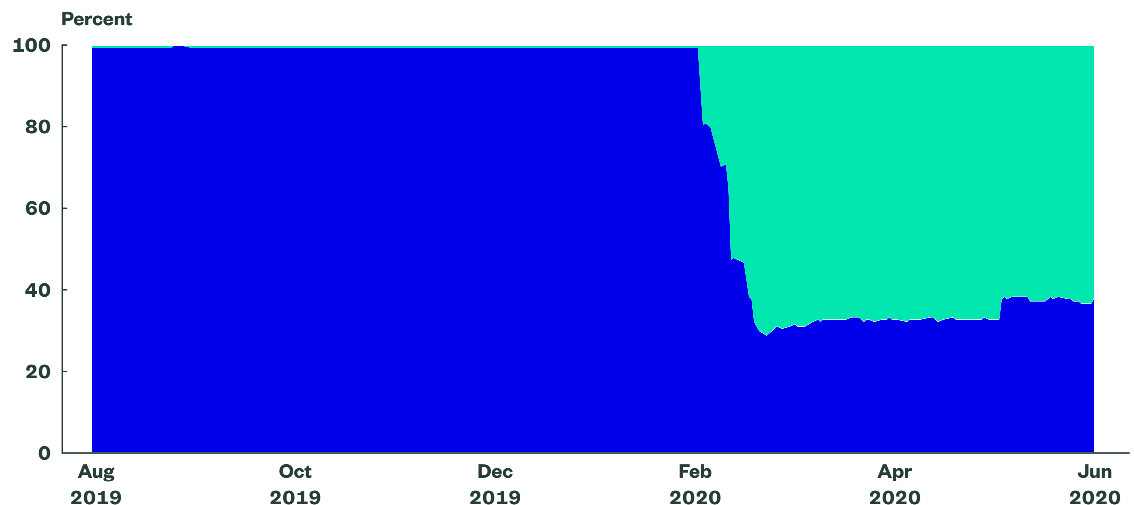
## Layer 3: Target Volatility Triggers

Heightened volatility can be damaging to returns across any time frame, however, the impact is intensified as members approach retirement since their ability to tolerate losses diminishes and they have less time to recover.

One way of helping to protect a portfolio against significant market upheaval is to reduce equity exposure when volatility is high. Target Volatility Triggers are a systematic monitoring and adjustment mechanism aimed at managing equity market volatility. We achieve this by targeting a volatility level and dynamically adjusting the level of equity if volatility spikes above this target level. The intention is to remain largely invested in equities but protect portfolios in extreme market drawdowns.

Starting 20 years before the target retirement date, Timewise introduces a 14% volatility trigger on developed market equities and a 16% volatility trigger on emerging market equities. During March this year, volatility peaked above these levels, triggering de-risking into cash across both the developed and emerging market exposures.

Figure 4
**Developed Market Target Volatility Triggers**




Source: State Street Global Advisors as at 31/03/2020. Developed Market Target Volatility Trigger shown for illustrative purposes. Inception of Timewise funds: 08/08/2019.

## Closing Comments

With an increasingly uncertain market environment, and auto-enrolment still on the horizon in Ireland, we believe it is more important than ever to have a robust default which prepares members for retirement whilst maintaining their confidence.

## Contributors/ Contacts

For more information on how Timewise can protect your member's pots, please contact our Ireland relationship management team.

**Paul Dunne**
Head of Distribution — Ireland
Paul_dunne@ssga.com
Tel +353 1 7763029

## Endnote

1 See Kahneman and Tversky's Prospect Theory (1979).

## About State Street Global Advisors

For four decades, State Street Global Advisors has served the world's governments, institutions and financial advisors. With a rigorous, risk-aware approach built on research, analysis and market-tested experience, we build from a breadth of active and index strategies to create cost-effective solutions. As stewards, we help portfolio companies see that what is fair for people and sustainable for the planet can deliver long-term performance. And, as pioneers in index, ETF, and ESG investing, we are always inventing new ways to invest. As a result, we have become the world's third-largest asset manager with US $3.05 trillion* under our care.

* This figure is presented as of June 30, 2020 and includes approximately $69.52 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

**ssga.com**

**Marketing communication.**
**For professional clients use only.**

**State Street Global Advisors Ireland Limited** is regulated by the Central Bank of Ireland. Registered office address 78 Sir John Rogerson's Quay, Dublin 2. Registered number 145221. T: +353 (0)1 776 3000.

Investing involves risk including the risk of loss of principal. Past performance is no guarantee of future results.

The information provided does not constitute investment advice as such term is defined under the Markets in Financial Instruments Directive (2014/65/EU) or applicable Swiss regulation and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell any investment. It does not take into account any investor's or potential investor's particular investment objectives, strategies, tax status, risk appetite or investment horizon. If you require investment advice you should consult your tax and financial or other professional advisor.

All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.

This communication is directed at professional clients (this includes eligible counterparties as defined by the Central Bank of Ireland (CBI) and Financial Conduct Authority who are deemed both knowledgeable and experienced in matters relating to investments. The products and services to which this communication relates are only available to such persons and persons of any other description (including retail clients) should not rely on this communication.

Diversification does not ensure a profit or guarantee against loss.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates rise bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

Equity securities may fluctuate in value in response to the activities of individual companies and general market and economic conditions.

Assumptions and forecasts used by SSGA in developing the Portfolio's asset allocation glide path may not be in line with future capital market returns and participant savings activities, which could result in losses near, at or after the target date year or could result in the Portfolio not providing adequate income at and through retirement.

Investing in foreign domiciled securities may involve risk of capital loss from unfavourable fluctuation in currency values, withholding taxes, from differences in generally accepted accounting principles or from economic or political instability in other nations. Investments in emerging or developing markets may be more volatile and less liquid than investing in developed markets and may involve exposure to economic structures that are generally less diverse and mature and to political systems which have less stability than those of more developed countries.

Asset Allocation is a method of diversification which positions assets among major investment categories. Asset Allocation may be used in an effort to manage risk and enhance returns. It does not, however, guarantee a profit or protect against loss. Diversification does not ensure a profit or guarantee against loss.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA's express written consent.

**This document should be read in conjunction with its Key Investor Information Document/Prospectus. All transactions should be based on the latest available Key Investor Information Document/Prospectus which contains more information regarding the charges, expenses and risks involved in your investment.**

**The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the Markets in Financial Instruments Directive (2014/65/EU) or applicable Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.**

© 2020 State Street Corporation.
All Rights Reserved.
ID303690-3264815.1.1.EMEA.INST 0920
Exp. Date: 30/09/2021