Commentary
Defined Contribution

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Dynamism in Action

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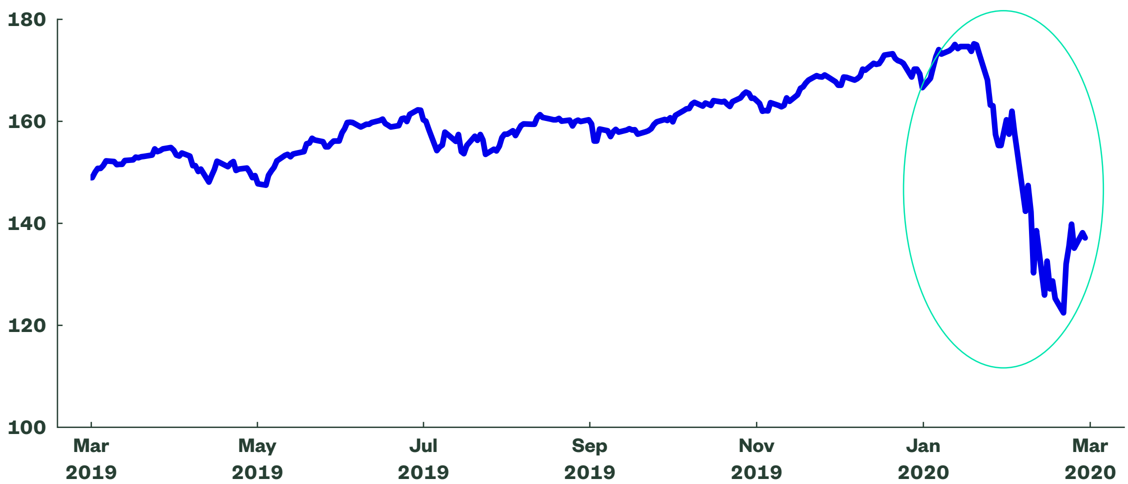
- With plans for the introduction of auto-enrolment in Ireland, it is crucial that DC schemes have well-designed default investment strategies that give members confidence.
- Periods of heightened global market volatility, such as those experienced recently, reinforce the importance of managing investment 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



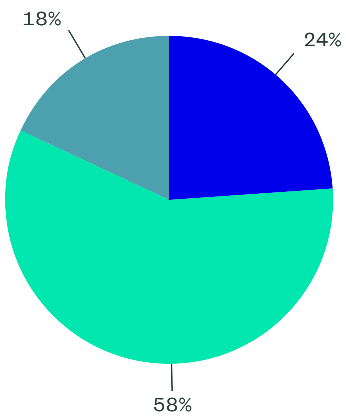
Source: State Street Global Advisors as 31 March 2020.

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.

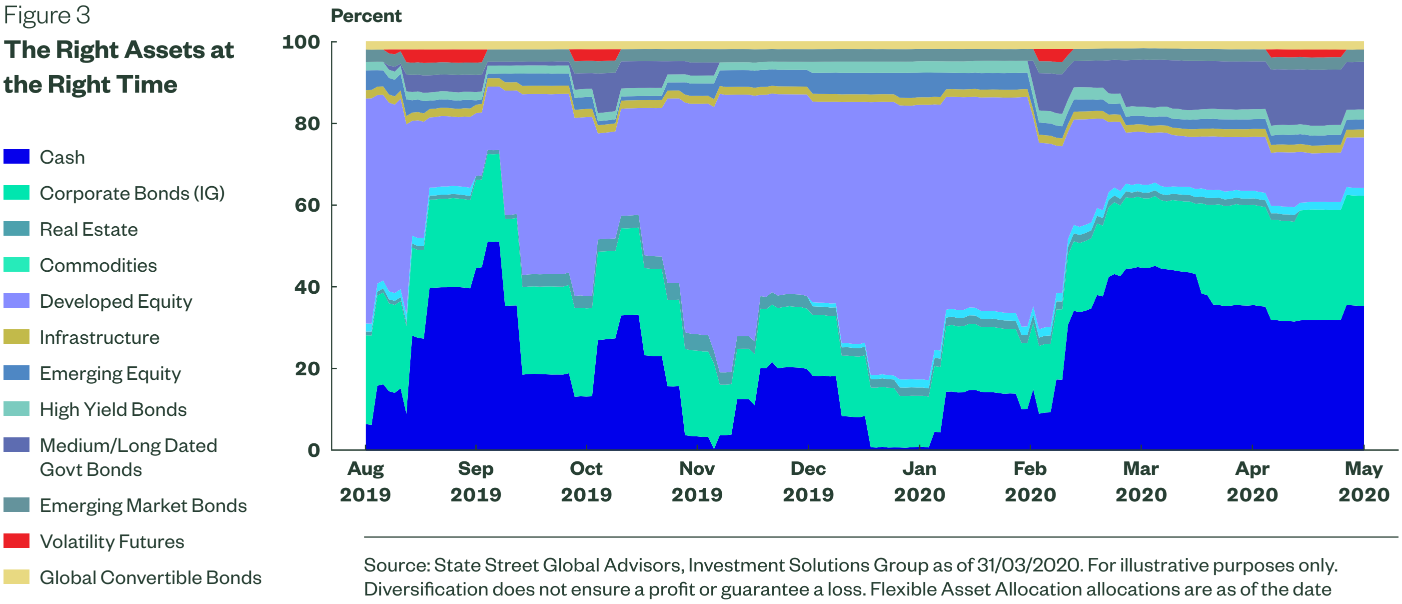
The following two layers are the dynamic components that we use within Timewise to target a smoother journey with reduced short-term drawdowns.

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.

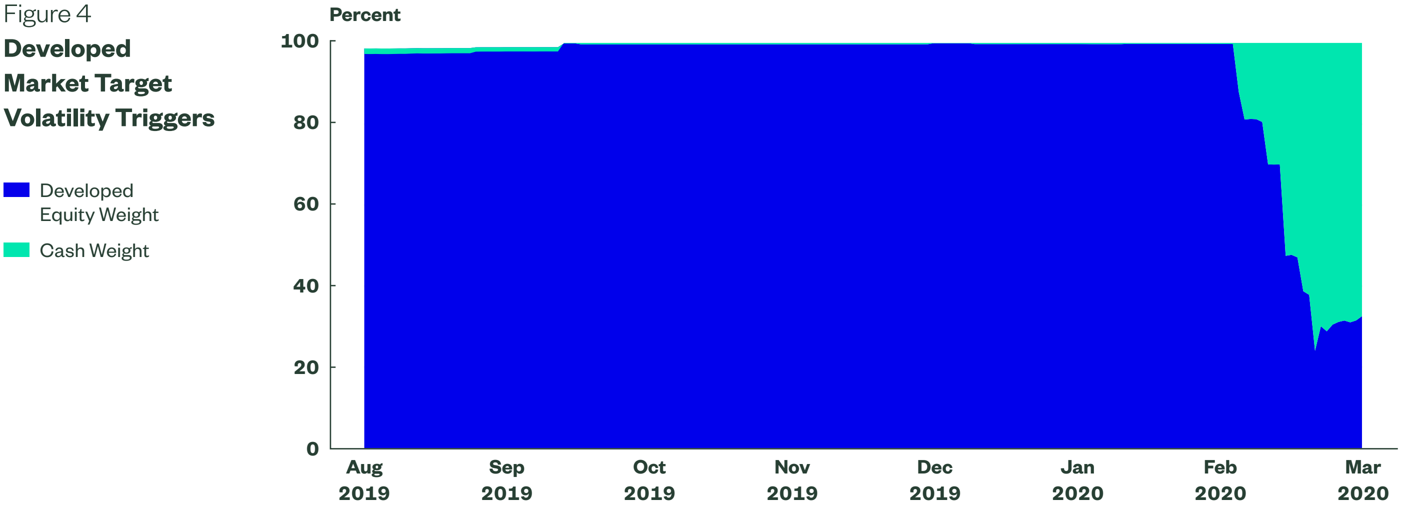
Layer 3: Target Volatility Triggers

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.

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Endnote

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

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* This figure is presented as of March 31, 2020 and includes approximately $51.62 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.

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