BACK TO **BASICS . . .**

ON INVESTMENT GLIDE PATHS

BY BRYAN MCGOVERN

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Simply put, a glide path is a calculation designed to support an employee's desired retirement timeline through investments in a target-date fund.

When an employee first joins a defined contribution pension plan with a target-date fund, they're exposed to capital appreciation assets that offer the most attractive risk-adjusted returns in the wealth accumulation phase, typically through exposure to public equities. As the plan member ages and nears retirement, the investment approach becomes gradually more conservative, favouring increased exposure to fixed income.

Through this calculation, plan members can effectively sit back and let their retirement savings slowly build over time with little input needed. However, the strategy relies on the plan member to determine their own retirement timeline.

"It's really a solution that is designed to achieve the objective of generating stable, consistent income in retirement," says James Robertson, senior portfolio manager and head of asset allocation for Canada at Manulife Investment Management Ltd.

A glide path approach also provides asset managers with a straightforward method to contend with risks such as plan members not saving enough or outliving their savings.

Risks from a glide path approach

While a glide path provides plan members with a 'set it and forget it' approach predicated on their own goals and time horizon, the strategy can have its drawbacks, says Robert Wilson, head of portfolio construction consultation services at Picton Mahoney Asset Management.

"It's not a tailored approach. It's not going to take into account someone's specific situation or their life circumstances. It's also going to have a lower return potential . . . compared to a portfolio that maintains a static strategic asset allocation." Market timing can be another point of contention for plan members determining a glide path, as the performance of the investment will depend mostly on equity returns throughout the plan member's lifetime. "Because it's simple and it's automated, there's a risk that an investor can get overly complacent."

Glide path evolution

While the traditional glide path follows a gradual de-risking strategy by shifting equity allocations to fixed income assets, Wilson says there are

BY THE NUMBERS

As at Dec. 31, 2022, the Pension Investment Association of Canada found, among reporting DC plan sponsors, target-date funds accounted for **17.82%**, or **$5.6 billion**, of their asset mix. By comparison, target-risk funds accounted for **41.17%** (**$12.99 billion**) and balanced funds accounted for **22.63%** (**$7.1 billion**) different ways to reduce risk in a glide path model. For example, the plan member and the asset manager can consider de-risking by adjusting overall gross exposure to allow for less concentration in risk and still achieve a high quality of return over time, compared to simply adjusting the stock and bond mix.

However, the traditional glide path may be evolving amid emerging evidence that supports diversification of target-date funds through the addition of real and private assets as well as other alternative investments, he says.

Indeed, a recent report by John Hancock Investment Management supports exploration beyond the established equities and bond mix, suggesting sub-categories of the primary debt, equity and alternative asset classes be considered in glide paths. It noted the addition of alternative assets can lead to risk protection in the presence of market downturns, as these assets can offset correlations between core asset classes. "[The] conventional and simplified view of an investing glide path conceals the significant roles played by sub-asset classes that target-date funds can use to calibrate risk and opportunity carefully enroute to — and through — an investor's retirement," said the report.

It also suggested there's an opportunity to create an overarching glide path built from component glide paths that determine a fund's exposures to a range of traditional and non-traditional equity and fixed income securities.

While exposure to riskier assets like equities is typically decreased as a plan member nears retirement in a standard glide path, Wilson says there's opportunities for plan members willing to take a "shallower glide path," where a flip of the standard calculation takes place.

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