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INNOVA ASSET MANAGEMENT

INVESTMENT MANAGEMENT INSIGHTS FOR PROFESSIONAL FINANCIAL ADVISERS

LIFECYCLE SUPER FUNDS STILL FALLING SHORT FOR INVESTORS

Lifecycle funds suggest a better way to save for retirement by automatically de-risking a portfolio as retirement age approaches.

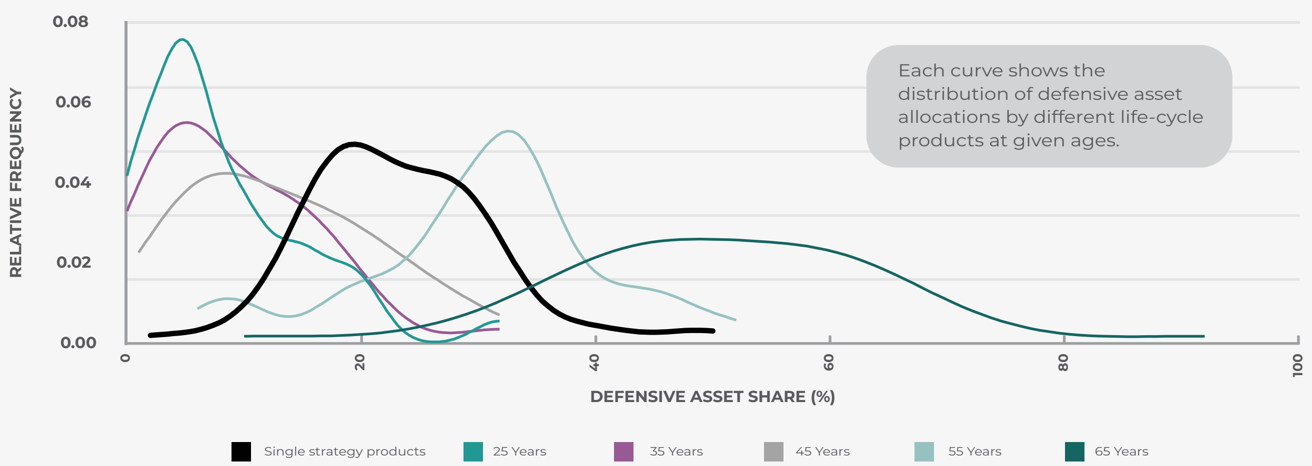
The real question is: whose lifecycle exactly? Averages often hide the truth about actual experiences.

It's possible to strike a comfortable average temperature with one foot in an oven and one foot in an ice bucket. It's possible to drown in a river that has an average depth of one metre. Neither description is helpful.

Few individuals currently holding a lifecycle fund – which account for almost $300 billion of assets or about 40% of all funds in **MySuper products** – match the average.

Meanwhile, some of the smartest minds in the financial services industry have widely different interpretations about how risk and return should be managed for the average, as shown in the graph below.

FIGURE 1: THERE IS NO REPRESENTATIVE LIFE CYCLE (OR SINGLE STRATEGY) MYSUPER PRODUCT[a]
30 JUNE 2018



[a] The data relate to the target asset allocations reported by funds.
Source: Productivity Commission Overview - Superannuation: Assessing Efficiency and Competitiveness - Inquiry report. Technical supplement 6: Analysis of members' needs.

MANAGING SEQUENCING RISK

Risk is a topic close to Innova's heart. Saving for retirement marks the ultimate risk-return trade-off: every working Australian is forced to contribute to a super fund for decades without knowing exactly how much money they'll receive or how long it needs to last.

Sequencing risk, which describes the greater impact that a market downturn can have on those approaching or in retirement, is a genuine risk that is often ignored.

The recent Productivity Commission's report into **super** found that well designed lifecycle products can produce benefits greater than or equivalent to single strategy balanced products, while better addressing sequencing risk for members.

"In practice, however, many lifecycle products have simply ended up leaving members with lower retirement balances than they would otherwise have got in a fixed strategy product," the Commission said in its report.

"This is a combination of failing to adequately take account of members' personal characteristics – as not all members will need to de-risk ahead of retirement – and of dialling down risk too early in the life cycle (in some cases as early as 30 years of age)."

On the other side of the ledger, many of the default single-strategy funds leading the SuperRatings return tables are taking on significantly more investment risk than their 'balanced' label would suggest. (APRA is expected to release a **discussion paper** tackling the growth versus defensive asset label debate later this year.)

PERSONALISATION IS THE KEY

There's a limit to how much trustees can do for disengaged members. That limit will be more thoroughly tested in coming years as APRA enforces its new **member outcomes** prudential standard[1].

Lifecycle funds are one attempt that theoretically is little different than goals-based investing, but without an individual's goals – they are implicitly assumed and based on little more than the investor's age.

Personalisation is the obvious missing link.

It takes a deeper understanding of an investor's current financial position and what their goals are over time to deliver better retirement outcomes. Advisers are well placed to discern what each investor's priorities are and how much risk they're prepared to take to achieve them. Goals have to be regularly adjusted in response to lifestyle changes such as buying a house or allowing for worsening health.

While smarter lifecycle default funds, which customise their underlying investment strategy on a range of factors beyond age and balance, are likely to play a role, delivering tailored advice services to a mass market has so far eluded the industry.

Stand-alone automated advice has yet to take off and faces some steep hurdles, but technology and big data will play a key role in producing better investment outcomes for clients (a theme we will explore in more detail in next month's Insight).

Until data allows us to know investors better than we know ourselves, people should look closely before opting for a lifecycle fund to avoid their retirement becoming a casualty of statistics.

[1] *The Member Outcomes standard, which takes effect from January 1, 2020, will force funds to perform an annual review to ensure that they are delivering sound, value-for-money outcomes for members.*

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Dan Miles is the Managing Director & Co-Chief Investment Officer of Innova Asset Management. Innova is a boutique risk-focused portfolio manager that has been managing client portfolios for 8 years. Innova was founded on the principles of providing robust and research-intensive insights to help investors meet their financial goals. The firm focuses on managing the multi-faceted nature of investment risks for clients.

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