Pensions crisis

Target date funds 'failing investors'

Strategy limits the wealth that can be saved for retirement

Judith Evans MAY 20, 2015

The typical investment strategy used by so-called "target date" funds, also known as life cycle funds, limits the wealth people accumulate for retirement and makes them more likely to run out of money, academic research has suggested.

Target date funds, a popular off-the-shelf retirement savings product, typically hold a high allocation to equities in their early years but move money into bonds as an individual's retirement date approaches, with the aim of reducing risk.

However, research by Javier Estrada of IESE Business School in Barcelona, covering data from 19 countries over 110 years, indicated that strategies which increased — rather than reduced — equity allocations towards retirement were more successful.

Over time, these strategies offered both greater growth potential and more protection from downside risk, according to the research in the Journal of Portfolio Management.

"It's the conventional wisdom that you move into lower-risk investments as you move towards retirement, but that doesn't take into account that when you start investing, when you're young, you don't have any assets," said Chris Darbyshire, chief investment officer at 7IM, a wealth manager.

"Your best chance to make money is by investing in the best-returning asset class and taking some risk closer to retirement, when you have accumulated more wealth.

"You need to be more in equities than the current 'lifestyling' approach provides."

Mr Estrada tested eight portfolios with varying allocations of stocks and bonds, and found that worldwide, the portfolios moving gradually towards greater holdings of stocks — rather than the other way around — had much lower "failure rates", defined as running out of money less than 30 years from retirement.

A straight "60-40" portfolio, invested 60 per cent in equities and 40 per cent in bonds throughout, also showed better results than the target date strategies, he found. He also surveyed previous research on the subject.

A third of over-55s targeted by pension tricksters

Officials are being urged to step up pension scam awareness campaigns after a new survey found a third of over-55s had received approaches about worrying investment opportunities. Research by Which?, the consumer group, found that 33 per cent of 2,000 over-55s surveyed this month said they had been approached by a company they were unsure about.

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Separate research from the US, published by three executives from the alternative indexing firm Research Affiliates in the Journal of Retirement, supports his conclusions, finding that "the typical glidepath implementation fails to solve the basic problems facing most investors".

Mr Estrada acknowledges that the typical target date approach does provide more certainty about how much wealth retirement savers will own, as results from these strategies showed less variation. This might reassure pensioners after the experience of the 2008 financial crisis, which left some savers who retired shortly afterwards with much less wealth than they expected.

Nevertheless, the findings are important as longevity increases and populations wrestle with shortfalls in pension savings, said Mr Darbyshire.

He said that shortfalls could be worsened by approaches to risk management which prioritise low volatility without considering the risk of simply not accumulating enough savings.

"Which would you rather have — a few ups and downs in your portfolio or 30 years living in poverty?" he said. "This is important not just to individuals but to society."