Many of our ideas are legacies of the past: they made sense once, but not today. For example, City bonuses were a good idea when broking partnerships used them to stabilise profits, but aren’t so sensible for big banks that have imperfect oversight of employees for whom a bonus can be an incentive to take risk. Or the fear of rising bond yields made sense in the 1980s and 1990s when bond vigilantes saw inflation around every corner, but it’s not so sensible now we have a global savings glut and a shortage of safe assets. Or taxing profits and incomes suited a closed economy, but not so much a globalised one where profits can be shifted offshore and workers can migrate. And so on.

To this list we should add lifestyle investing - the idea that we should invest heavily in equities when we are young but gradually move towards bonds as we approach retirement; this is the strategy recommended by the old rule that your weighting in shares should be equal to 100 minus your age.

Such a strategy suffers from four flaws. One is that it’s insensitive to market conditions. We should (obviously) hold more shares when expected returns are high - which is usually when dividend yields are higher. Less obviously, but also truly, we should also hold more equities when volatility is low, as MIT's Andrew Lo and Yale University’s Alan Moreira and Tyler Muir have shown. Lifestyle investing, however, ignores these ideas. The lifestyle investor would have been heavily in equities at the peak of the tech bubble in 2000, but less weighted in them in 2009 when the market was cheap.

Secondly, lifestyle investing might not reduce risk quickly enough. If you want a safer portfolio as you approach retirement (and you might not), you have a problem: equity returns are not distributed normally but instead carry a disproportionate chance of a big drop. Reducing equity weightings gradually as you get older doesn’t take sufficient
account of this fact. Researchers at the University of Waterloo in Ontario show that a **better** approach for someone wanting a certain level of wealth on retirement would be to cut equity exposure faster as retirement nears.

Thirdly, lifestyle investing means having a big equity weighting when you are poor but proportionately less when you are richer and older. This puts a brake on how fast your wealth can grow. In fact, Javier Estrada at IESE Business School has shown that doing the exact **opposite** of lifestyle investing - holding more equities as you age - would make you better off in most cases.

This would have been true for lifestyle investors in the UK. If you'd kept a portfolio weighted 60 per cent in the All-Share index and 40 per cent in gilts since December 1985, a £100 investment would have grown to £1,718. But if you'd shifted one percentage point from equities to gilts per year, you'd now have £1,642 - 4.4 per cent less. And this comparison perhaps flatters lifestyle investing, because gilts have done extraordinarily well in recent years so shifting towards them gave you great returns in the 2000s which might not be repeated from now on.

Finally, there's the question: why does retirement matter? A newly retired person with average luck has another 20 or 30 years in them, and an even longer time horizon in effect if we want to leave a bequest. To the extent that equities are a better long-term investment than short-term ones (and lifestyle investing assumes they are) this argues for a high equity weighting even as you retire.

All this helps explain why some pensions providers have shifted out of lifestyle investing in their workplace pensions. But it raises a question: is there anything to say for lifestyle investing at all?

Yes. One justification for it is that many younger investors have insurance against stock market falls; they can respond to them by saving more or working longer. In effect, their human capital diversifies equity risk. As we near retirement, however, this diversifier shrinks; saving a little more over 10 years is easier than saving a lot in one or two. This makes equities riskier as we approach retirement, so we should hold less of them.

> If your job is correlated with equities - say because it's exposed to ups and downs in the economy or because you work in finance - then the opposite is true: equities actually become safer as retirement approaches

This only applies, however, to those who have relatively safe, or bond-like, human capital. If your job is correlated with equities - say because it's exposed to ups and downs in the
economy or because you work in finance - then the opposite is true: equities actually become safer as retirement approaches. Doctors might be lifestyle investors, but not (say) architects.

There's another reason why lifestyle investing makes sense: if you're planning on buying an annuity. If you're doing so, you face the danger that bond yields will fall, thus reducing annuity rates and your retirement income. This is an especially nasty risk because the circumstances in which bond yields fall are likely to be ones in which equities do badly - such as fears of a recession. Holding bonds is a perfect hedge against this, because the prices of bonds rises as yields fall, thus boosting the size of your pension pot.

This is why I say lifestyle investing is a legacy idea. It made perfect sense when we bought annuities when we retired (and had only a few years in which to live off them). It's less appropriate, however, for those who are not going to buy an annuity - which (perhaps not entirely correctly) is most of us.

Edmund Burke famously said that our institutions and ideas embody the wisdom of ages. But Niels Bohr said that the opposite of a great truth is another great truth. Sometimes, ideas linger even though the reality that validated them has changed. For many of us, lifestyle investing is one such idea.