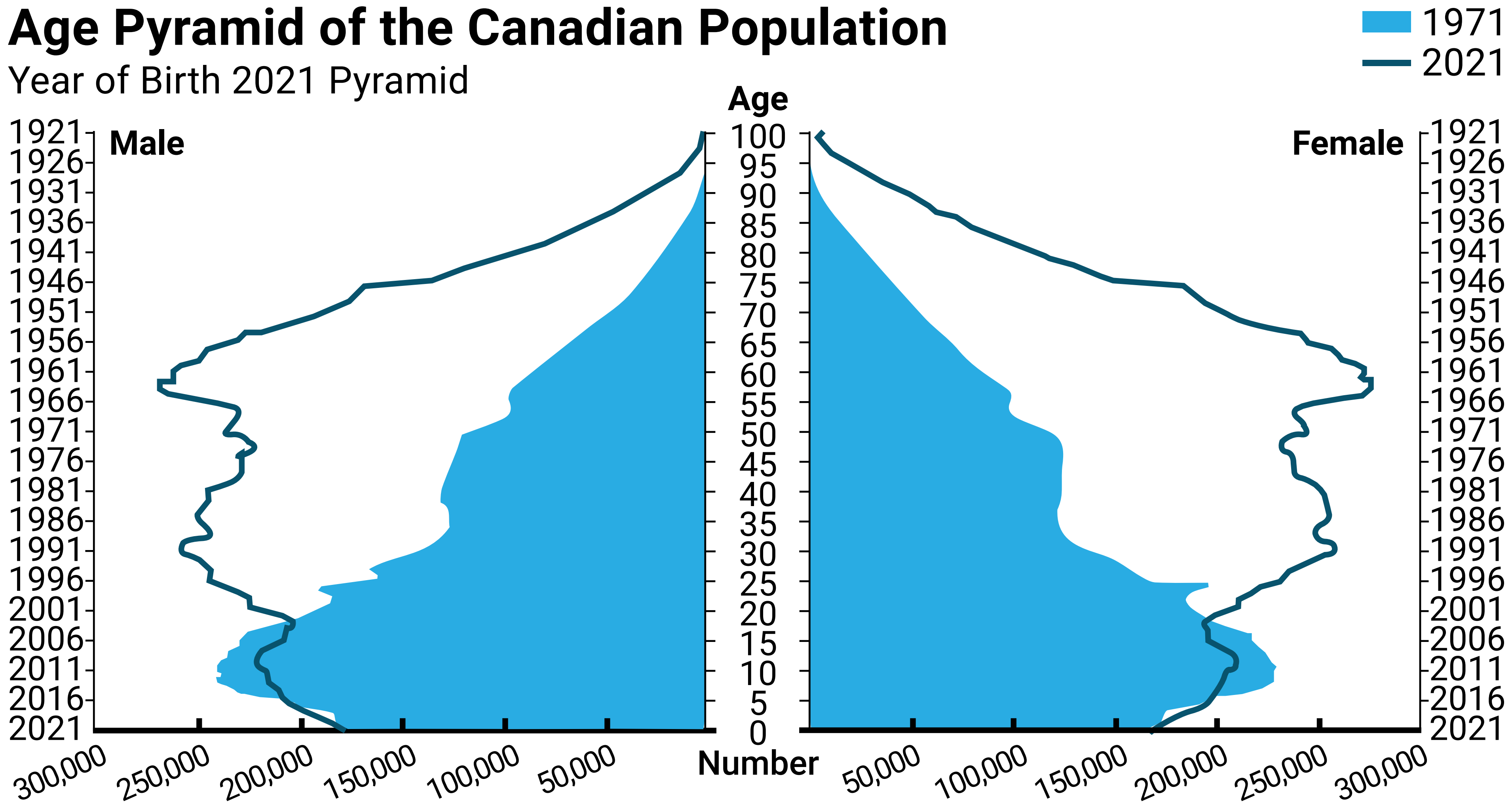
Key Portfolio Trend 02

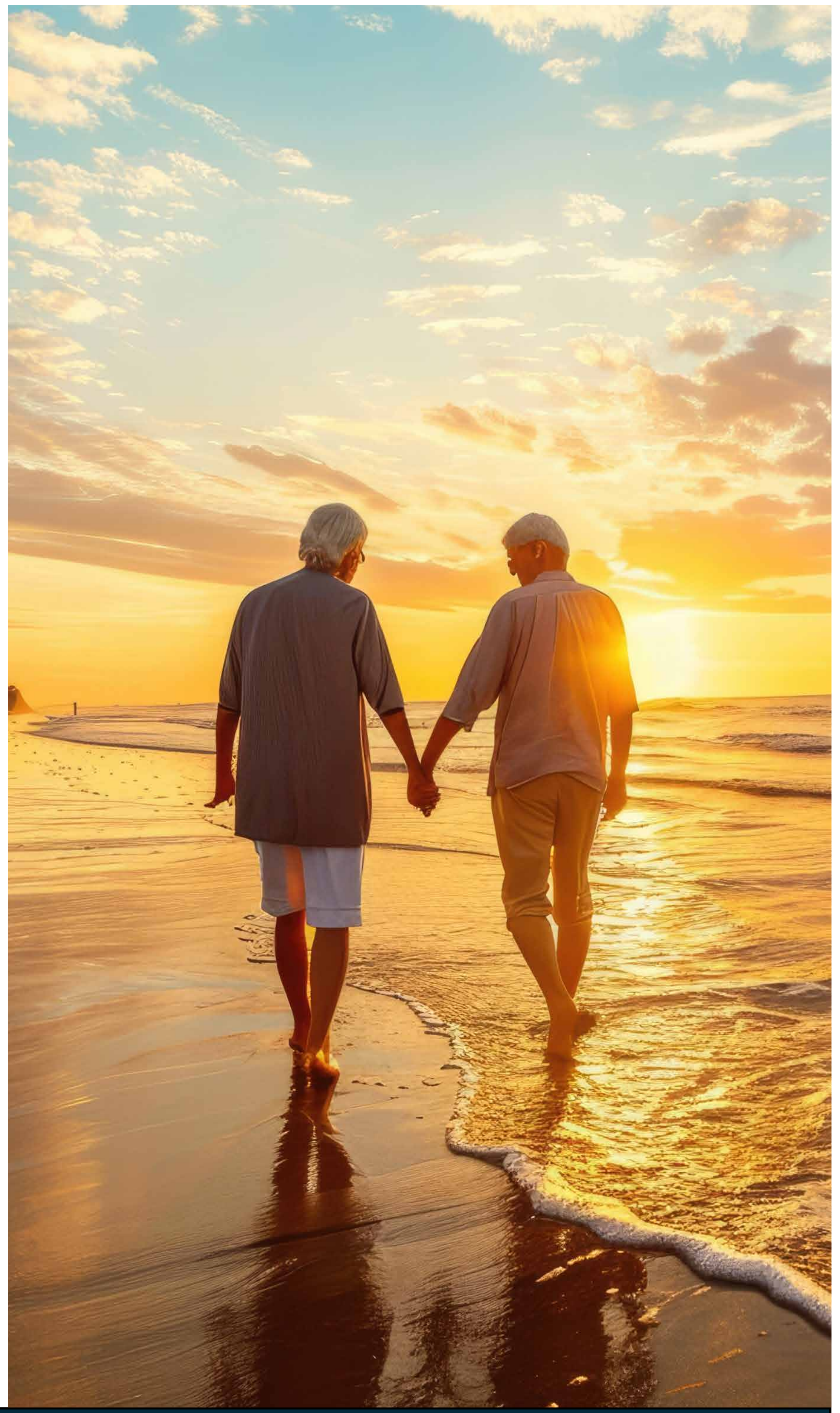
Rethinking Retirement Portfolios

Rethinking Retirement Portfolios: Ensuring Golden Years Aren't Tarnished by Bubbles or Inflation

Almost 1 in 8 Canadians are turning 65 over the next decade, triggering a pressing need for guidance on how to construct an investment portfolio that maximizes spending power while minimizing the risk of outliving savings. Well constructed, goals-based portfolios designed to minimize shortfall risk provide greater certainty for pre-retirees and retirees. This is especially true during the critical transition from accumulation to decumulation.



Source: Statistics Canada, The 7 million people aged 65 and older represent nearly 1 in 5 Canadians in 2021.
https://www150.statcan.gc.ca/n1/daily-quotidien/220427/g-a002-eng.htm



The Problem with 60/40 Portfolios for Retirement

The traditional 60/40 portfolio leaves significant room for improvement in meeting investors' objectives. By limiting investments to stocks and bonds, this classic asset allocation model concentrates risk excessively, only performs well in a narrow set of economic conditions and exposes investors to disproportionate market downside for the returns it offers. A key vulnerability of 60/40 is its reliance on bonds acting as a hedge when equities sell off. Bonds may effectively mitigate growth shocks, but they fail – or even amplify – risk during inflation shocks. The potential for this unforeseen positive correlation can leave portfolios exposed when diversification is most needed.

Why 40/30/30 is the New Approach for Retirement Portfolios

We believe the 40/30/30 model – 40% equities, 30% fixed income, and 30% alternatives – offers investors a more balanced and resilient approach to achieving higher expected returns while reducing the risk of significant losses – particularly early in retirement. Its diversified construction provides broader diversification, greater capital and fee efficiency, higher-quality returns, and the flexibility to navigate a wider range of economic and market conditions effectively.

Key Performance Indicators (KPIs) for Retirement Portfolio Success

We believe key performance indicators should be considered when constructing goals-based portfolios for retirees and those saving for retirement:

01 Growth KPI — Expected Return

The higher the expected return of the portfolio, the more income the portfolio will likely be able to sustain in retirement.

02 Risk KPI — Sequence of Return Risk

The smaller the risk of large losses early in retirement, the more income the portfolio will likely be able to sustain in retirement.

Two Insights to Reframe Retirement Portfolio Construction

01/ The "Retirement Red Zone" Matters Most

- **Provide Resilience Against Drawdowns During the Retirement Red Zone:** The decade before and after retirement is the most critical time to guard against large drawdowns. Shifting from 60/40 to 40/30/30 reduces exposure to market shocks when retirees are most vulnerable.
- **Adjust Equity Exposure Post-Red Zone:** After navigating the red zone, investors may consider increasing equity exposure, as the risk of large losses causing shortfalls diminishes.

02/ Reallocate Risk, Don't Just Add More

- **Identify and Rebalance Key Risks:** The most effective way to enhance portfolio consistency is by identifying its greatest risk, scaling it back, and reallocating capital to exposures that maintain outperformance potential while introducing unique, uncorrelated risks.
- **Leverage Alternatives for Diversification:** Alternative strategies and assets offer access to differentiated exposures, enabling broader diversification and greater certainty in achieving client goals. Additionally, because alternatives often involve lower sensitivity to interest rates and equity markets, they can reduce the risk of investors abandoning their plans during periods of acute market stress.

The Case for Change Through Brewing Bubbles

We believe the 40/30/30 portfolio is a necessary evolution for retirees and pre-retirees seeking greater certainty in achieving their retirement goals. By putting dollars to work across a broader range of exposures rather than by concentrating investor allocations in the riskiest assets, this new approach can offer a more efficient way to deliver on client expectations than the 60/40 model. Dedicated allocations to diversifying strategies and assets also help address the inconsistent relationship between stocks and bonds. In doing so, a portfolio can still meet investor objectives in an uncertain world brewing with bubbles.

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