canada life

Multi-asset fund bucketing

An income drawdown strategy which could protect your clients from sequencing risk

There are real differences between the investment objectives and risks for clients who are saving for retirement (accumulation) compared with those for clients who are drawing benefits (decumulation), as you can see in the table below.

Key differences between accumulation and decumulation

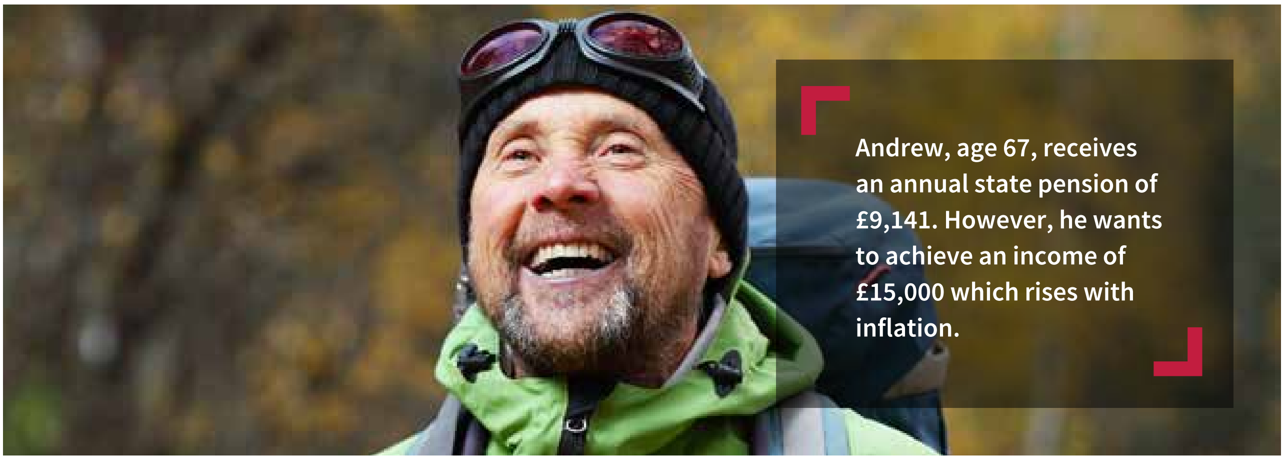
Accumulation	Decumulation
Converting income into capital	Converting capital into income
Fixed term horizon	Unknown time horizon
Investing for growth	Investing for income
Increasing capital	Reducing capital
Pound cost averaging can be beneficial	Pound cost ‘ravaging’ is a risk

Risk-rated multi-asset funds are popular within retirement portfolios, and a typical process is to invest in a fund that matches the client’s risk profile (for example a balanced fund) and draw income solely from that fund.

Here we look at a different type of strategy where money is invested across a range of investment funds - lower, equal to and higher than the client’s risk profile.

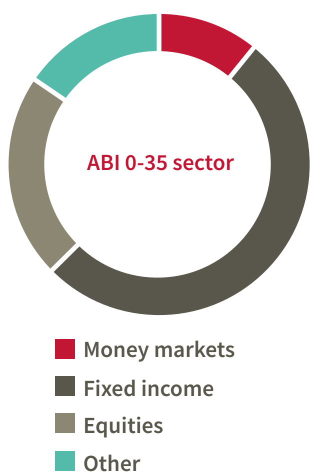
Meet Andrew

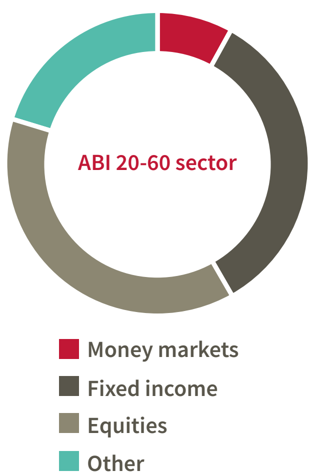
Case Study

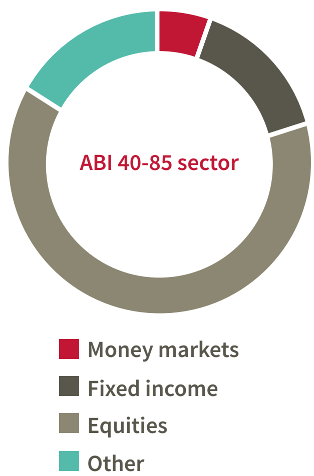


To make up the shortfall between his state pension and his required income, and taking inflation into account, over a 30-year period Andrew needs income from drawdown totalling £257,195.

Canada Life Asset Management have modelled the likelihood of Andrew's drawdown pot lasting 30 years, based on the historical performance of three ABI sectors with varying degrees of equity exposure (Andrew's risk appetite sits in the middle), assuming an initial investment of £125,000. To provide a representative set of results the modelling used 1,000 random simulations on the actual returns of the ABI Mixed Investment sectors. Each simulation randomly mixed the last 30 years of returns (to account for sequencing risk) to help calculate the likelihood of the pot lasting.







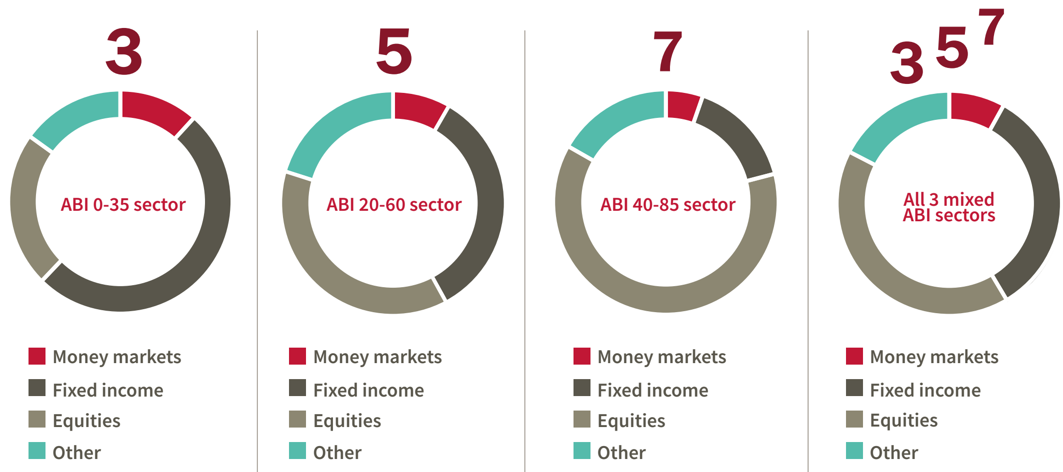
	ABI 0-35 sector	ABI 20-60 sector	ABI 40-85 sector
£125,000	94.4%	79.7%	75.5%

Percentage of 1000 simulations where Drawdown pot lasted 30 years*

If Andrew's pension was invested in a fund in the 20-60 sector, which reflects his risk profile, there is around a 20% chance that his money will run out within 30 years based on a £125,000 investment.

Using a bucketing strategy

Using the same model, Canada Life Asset Management looked at what might happen if Andrew's pension was invested in a combination of the three ABI sectors, with equal investment (33%) into each pot. For simplicity let's call these three pots 3, 5 and 7. By splitting the investment in this way the overall risk rating was still equivalent to risk profile 5.



	3	5	7	357
£125,000	94.4%	79.7%	75.5%	96.8%

Percentage of 1000 simulations where Drawdown pot lasted 30 years*

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Using the '3-5-7' strategy, as opposed to a single fund (ABI 20-60), the likelihood of Andrew's money lasting 30 years increased substantially from 79% to 96%.

This strategy could help provide your client with increased protection against sequencing risk and volatility drag, whilst maintaining the same overall risk rating.

In order for the bucketing strategy to work two things must happen:

1) The income must be taken from the sector with the lowest volatility, so in this example **3**.

2) The whole portfolio must be rebalanced at least quarterly, in order to maintain the 33/33/33 split between **3, 5 & 7**. In the example above the portfolio was rebalanced quarterly, in line with the risk profiling tool used.

On average, in **rising** markets, rebalancing means the amount invested in pot 3 is likely to be 'topped up' by better performance from the higher volatility sectors, **5 & 7**.

In a **downturn**, the lower volatility sector 3 fund's unit price is likely to fall less than the unit price of the more volatile funds in sectors **5 & 7**, and because income is taken only from sector **3**, the effect of pound cost ravaging is reduced.

***Source:** Canada Life Asset Management & Morningstar. Figures based on the ABI Mixed Investment 0-35, ABI Mixed Investment 20-60 & ABI Mixed Investment 40-85 to month end Feb 2020. Calculated a thousand simulations on the actual returns of the ABI Mixed Investment sectors. Each simulation randomly mixed the last 30 years of returns (to account for sequencing risk) to help calculate the likelihood of the pot lasting. The value of investments may fall as well as rise and investors may not get back the amount invested. Based on adviser fee of 1%.

Applying the bucketing strategy in The Retirement Account (TRA)

The success of the bucketing strategy relies on three components.

1. The ability to invest in a range of risk-targeted funds that align to specific asset allocation guidelines which ensure that they never deviate from the expected risk levels
2. The ability to set up regular rebalancing to ensure that the percentage split between funds doesn't deviate over time
3. The ability to select a specific fund from which to take income

1. Risk-targeted portfolios

We have ten risk-targeted portfolios available in The Retirement Account, five active and five passive. The funds align to Dynamic Planner's asset allocation guidelines for risk profiles 3 to 7 to ensure they never deviate from their level of risk (rebalanced daily).

Option 1	Option 2
Active	Index (passive)
A risk-targeted range that aims to continually prescribe to a set level of risk and is implemented using mainly in-house Canada Life Asset Management's funds.	A risk-targeted range that aims to continually prescribe to a set level of risk and is implemented using mainly index-tracking funds from Vanguard.

Fund	Portfolio 3	Portfolio 4	Portfolio 5	Portfolio 6	Portfolio 7
Active OCF	0.36%	0.43%	0.51%	0.57%	0.61%
Index OCF	0.16%	0.16%	0.16%	0.16%	0.16%

2. Rebalancing

The Retirement Account offers an automated rebalancing feature on a monthly, quarterly or yearly (at customer level), or on an ad-hoc basis.

3. Ability to select income from a specific fund

For income payments, you can provide instructions to our Customer Service team as to which investment fund (if you have more than one) you would like us to sell in order to make income payments.

Contact us

Interested in The Retirement Account for your clients? Our sales team will be happy to support you further either over the phone or face to face.

You can also speak to our technical support team at any time and access sales aids, client brochures and video guides at **www.canadalife.co.uk/retirement-account**

Call us
0800 912 9945

Lines are open Monday to Friday from 9am to 5pm

By email
sales.ra@canadalife.co.uk

Online
www.canadalife.co.uk/retirement-account

Important information

Past performance is not a guide to future performance. The value of investments may fall as well as rise and investors may not get back the amount invested. Income from investments may fluctuate. Currency fluctuations can also affect performance. The information contained in this document is provided for use by financial adviser use only and is not for onward distribution to, or to be relied upon by, retail investors. No guarantee, warranty or representation (express or implied) is given as to the document's accuracy or completeness.

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