The following is in response to Rob Arnott’s commentary, *The Glidepath Illusion*, which was published on September 25:

Dear Editor,

Do you agree that older people should invest entirely in stocks?

Rob Arnott claims that a glidepath with increasing – rather than decreasing – equities results in greater wealth with about the same risk. This conclusion is not new or reasonable.

In fact, it’s way off base.

Arnott’s observation is a reflection of the fact that risk usually gets rewarded especially if you're brave enough to gamble as you near retirement. The problem is that we each get only one shot at this experience, so target-date funds (TDFs) are like religion – you don’t know if you picked the right one until it’s too late. Feel lucky today? See here for a sad but funny video of the problem.


So what is wrong with this picture? Few if any would recommend 100% equity exposure at retirement. In other words, our intuition tells us that retirees can’t “afford” that much risk taking, but the Basu-Drew and now Arnott simulations tell us otherwise. I wrote rebuttals that were published in 2009 here and here. Risk is multi-dimensional, and it’s important to measure it correctly for those who rely on us for protection. Trust your intuition.

At retirement, TDFs should be invested in very safe assets, like short-term TIPS and T-bills, rather than bonds or stocks. The need for stability and predictability is critical as retirement nears because that’s when retirement plans are made, and when future lifestyles are dreamt about and finalized. Bonds are not safe investments; neither are stocks.

But warnings about target date funds are indeed in order. TDFs are designed for profit rather than the benefit of the participant, so it’s no surprise that many equity shops end at the target date with 80% in...
equities while bond shops end with 80% in bonds.

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Rob Arnott replies:

I'm not at all surprised that folks in the target-date community don't like our short white paper, or its conclusions. I've admired Surz’ work in the past, and hope he feels the same about mine.

I'm not advocating that people adopt an inverse glidepath. It’s dangerous for anyone to follow a formulaic approach, whether a glidepath or its inverse. In the article, I pointed out the obvious: If our dollar-weighted average allocation is more aggressive, we’re more likely to be better off; and ramping up risk as we age has exactly this effect – our dollar-weighted average allocation is more aggressive.

If there’s a positive risk premium, that’ll be more profitable, most of the time. The other thing that’s worrisome is that the boomer generation is de-risking – moving from stocks to bonds – at a time when real bond yields are negative!

It’s dangerous to pursue a formulaic process that assures bond purchases at negative real interest rates.

The genesis for the study was a conversation between two highly respected folks, who shall go unnamed. One said that conventional glidepaths lead to a richer retirement with greater confidence in knowing one’s likely retirement income, at least 10 years in advance. The other said, no, it’s neither better nor worse than just having a static mix for life. I said, “Why don’t we test this on historical market returns, and randomized historical returns, and see what history says.”

I was surprised by the results. I thought conventional glidepaths would fare about the same as their inverse, and was surprised that it did not. Until, of course, I realized that the dollar-weighted average mix was more conservative with a conventional glidepath than with a static mix. The inverse glidepath was tossed into the mix to emphasize the point, but not as a recommended alternative.