# Target retirement

## A graduated asset allocation strategy starts out aggressive and becomes conservative over time, but is this good for your client, asks JIM OTAR

After the last market crash, many financial advisers moved from pure equity to balanced funds. One of the benefits of holding balanced funds is that I can literally fall asleep at the switch for a few years and portfolios will not get hurt beyond the normal fluctuations.

Some fund companies are moving a step beyond the balanced funds. The target retirement funds start aggressively and become more conservative over time. This strategy is generally known as 'graduated asset allocation'. If I buy these funds for my younger clients, I can then fall asleep at the switch, not only for a few years but a few decades. Can this be true?

There are two main categories of asset allocation (AA) strategies: market-based and client-based.

Market-based strategies react to prevailing market trends. Trend Following, Tactical, Dynamic and Flexible AA are some of the popular strategies in this category. We will look at market-based strategies in future articles.

On the other hand, client-based asset allocation strategies ignore the market trends and focus on the investor. The following three are the popular ones:

→ **Strategic AA** – decide on an asset mix based on the client's risk tolerance and stick with it over time.

→ **Age Based AA** – the equity percentage in the portfolio reduces by age. Typically, the equity percentage is equal to 100 minus age. If you start saving at age 30, you would have 70 per cent equity and 30 per cent fixed income. Thirty-five years later, by age 65, you would have 35 per cent equity and 65 per cent fixed income.

→ **Graduated AA** – they are a more extreme version of the Age Based AA. For example, if you are 35 years away from your retirement, they would typically start with 85 per cent in equities and would come down to 25 per cent by age 65.

To analyse the effect of each of these three strategies, let's look at an example: Steve is 30 years of age. He is just starting to save for retirement. His retirement account currently holds only $10,000. He plans to save $10,000 annually, indexed by 3 per cent until age 65. He wants you to choose between the Strategic AA (65/35

## CHART 1