Article 4.

"The tail wagging the pension income dog"

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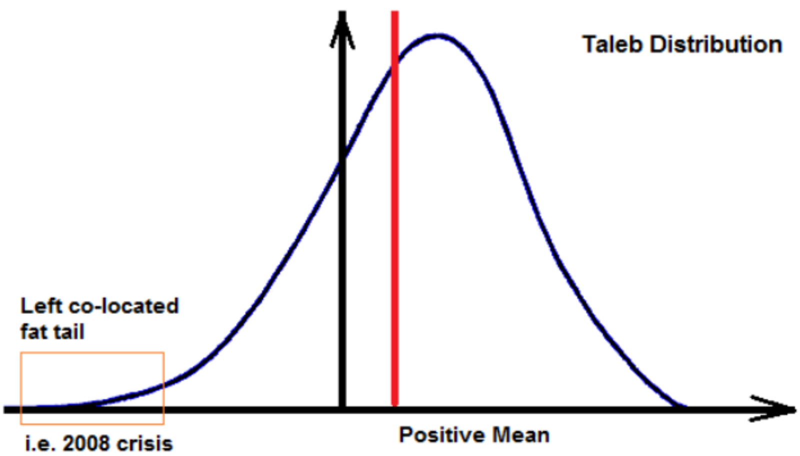
Alpha Beta Partners

The tail wagging the pension income dog

"Some adviser firms have not yet updated their investment strategies for decumulation clients. In addition, they may not have adequately considered decumulation risks" FCA Sector Views 2019

"This concern appears to be borne out by research in recent months which also suggests that many firms are using the same investment strategy for decumulation clients as they do for accumulation clients. This is despite the different dynamics of clients' needs in retirement and different risks, in particular sequence of returns risk and pound cost ravaging. Simply adopting the same investment strategy in retirement can be dangerous for clients and the FCA is on to this." Rory Percival, Former FCA regulator

The expected return of a typical investment strategy has a distribution which normally provides a positive return over time but also carries a small but significant risk of suffering a big loss known as a 'left tail' event. This is known as a Taleb distribution, after Nassim Taleb of 'Black Swan' fame, and looks something like this:



Suffering from the kind of large investment loss represented by the left tail is never welcome, but in the accumulation phase, particularly through pound cost averaging if continuing to regularly invest at lower prices, diversified portfolios have historically recovered.

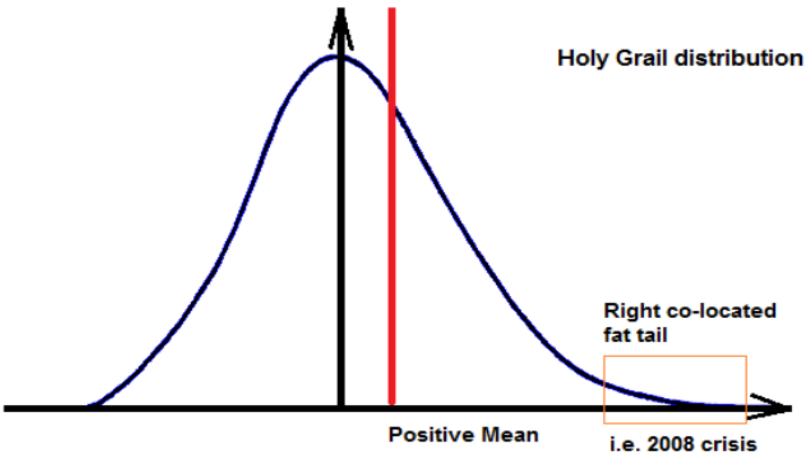
When in the decumulation or the drawdown phase, however, this is not the case. The outcome for pension income here can be catastrophic, particularly for retirees just starting

drawdown when a pension pot may be at its greatest and investment losses are crystalised immediately prior to or just after retirement. Even if not occurring at the outset, the impact of a left tail event and reverse pound cost averaging (so-called "pound cost ravaging" where a fixed withdrawal is being taken from a falling asset value) can be significant.

What can be done to stop these left tails wagging the pension income dog?

Several mitigants have been proposed and researched, including:

- Using options to provide 'tail protection'. This is feasible in theory but is likely too complex and expensive to be practical for most individuals.
- Scenario analysis and stress testing. Various tools are available and, though they cannot foresee events, they can emphasise various outcomes and what a client may stand to lose. In practice these generally operate more as education than mitigation.
- Implement a complementary investment strategy that helps reduce the impact of market performance shocks. This is known as a holy grail distribution and looks something like this:



In 2008, certain strategies, notably 'trend following' systematic strategies, performed very well to help extend the right tail of return distributions for those who had adopted them.

Professor Clare and colleagues, based at Cass Business School, have extensively researched the impact of sequence risk in decumulation They have published their research in multiple papers and have reached one very definitive conclusion, having considered over 100 years of equity and bond return data:

By systematically switching equity exposure to cash when markets turn lower (and vice versa), according to an entirely rules-based strategy based on a trend following, sequence risk can be effectively mitigated.

The result of employing this strategy is that it reduces and shortens the left tail, resulting in higher sustainable withdrawal amounts each year when in decumulation.

The AB Lifetime portfolio, a diverse, mixed asset growth portfolio has licensed the Professors' strategy to provide clients with a differentiated investment option for those in and entering the decumulation phase.

Please contact Andrew Thompson for more information about the AB Lifetime portfolio, for copies of the Professors' papers and a discussion as to how together we can stop the left tail wagging the pension income dog to improve client outcomes in retirement.

If you have feedback or questions, we would be delighted to hear from you. Thank you for your ongoing support

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