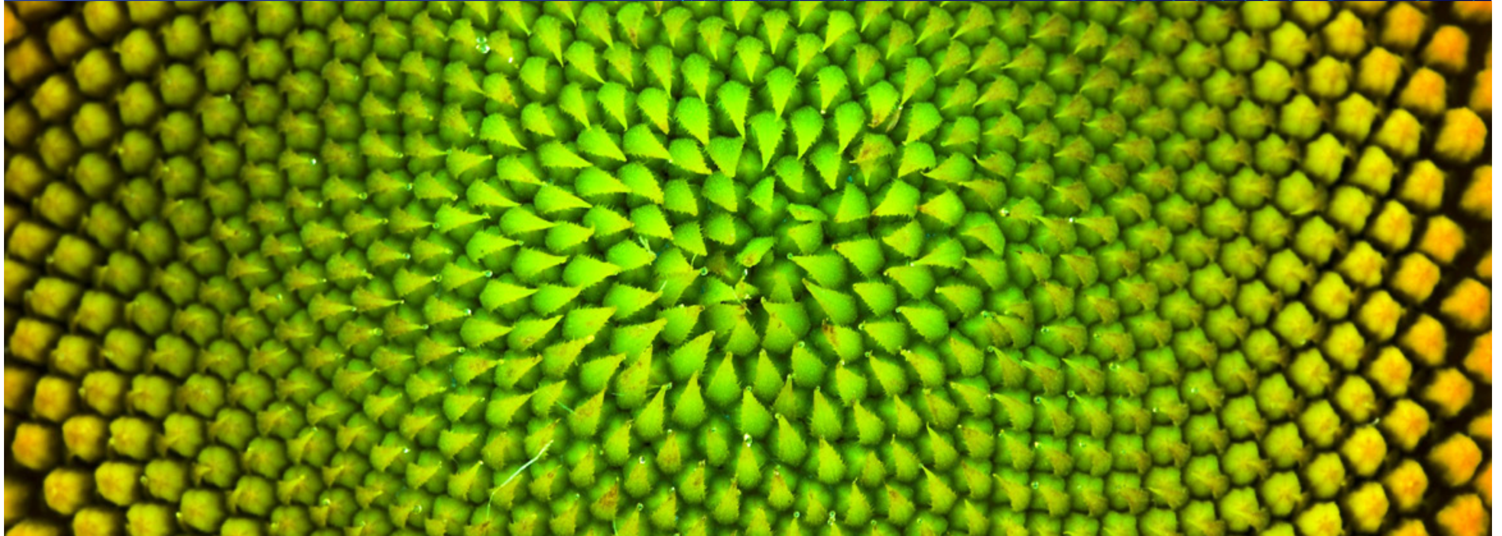

Retirement Insights: Better Data for Better Outcomes

Retirement plan participants faced a litany of challenges in 2022, as persistently high inflation reduced their purchasing power while traditional approaches to portfolio construction—such as target date funds that tilt heavily toward supposedly "conservative" fixed income investments for those in or closer retirement—failed to provide sufficient ballast.

Though market stability has re-asserted itself in 2023, 2022's events are an important reminder that retirement savers—whether just starting out in the workforce or approaching retirement—need access to a range of differentiated investment options designed to help them accumulate, grow and preserve wealth in disparate investment environments.

Sponsors intent on providing their participants with such options may benefit from looking beyond the usual fund-scoring systems to new methodologies that provide more reliable and nuanced fund performance data, peer comparisons and insights into manager consistency. By leveraging enhancements to traditional methods of sourcing and analyzing fund data—such as those found in the investGrade™ GPA scoring system—sponsors may be better positioned to construct plan lineups supportive of positive participant outcomes in retirement.

KEY TAKEAWAYS

- 2022 was a strong reminder that retirement plan lineups should contain a range of fund types that in aggregate give participants the tools they need to grow and preserve wealth across disparate investment environments—not just the concentrated, ever-upward equity markets that have predominated since the global financial crisis.
- The first step in building a better plan lineup may be reconsidering the methodology used to analyze the many options available. We believe sponsors can benefit from recent enhancements to the sourcing and analysis of fund data—and thus be better positioned to construct investment lineups supportive of positive outcomes for their participants.
- A more thoughtful methodology should include the evaluation of quantitative and qualitative attributes of managers to identify consistent and repeatable processes.

Building a Better Mousetrap

We believe plan sponsors can benefit from recent enhancements to the sourcing and analysis of fund data that seek to ensure its integrity and thoroughness—and thus be better positioned to construct investment lineups supportive of positive outcomes for their participants. We believe such an approach could also help advisors and sponsors improve business practice efficiency. There are a number of key aspects to this effort, as below.

Start with Data Integrity. We believe a better fund scoring system begins with access to the most accurate and timely data available. Most scoring systems rely on feeds from third-party data providers and lack processes to independently verify the accuracy of that data, which in some cases may be both stale and unsound. In our opinion, best practice would be to harvest and cross-reference data feeds from multiple sources—including, most importantly, data directly from investment managers—to filter out inaccuracies. Further, waiting until 30 days after quarter end to finalize the information serves as another layer of diligence and allows any reporting delays to be reflected in the final statistics.

Separate Apples from Oranges. When built on a foundation of trustworthy data, scoring systems can provide a nuanced view of how differentiated investment strategies interact with one another at the plan level. While scoring systems typically categorize funds based on asset classes or geographies, many do not distinguish between management styles within these categories—most notably, between passive and active—leaving sponsors unable to make true apples-to-apples comparisons of funds.

While both may have their place in retirement plan lineups, passive funds and active funds serve different functions and, in our view, should be evaluated distinctly from one another. Passive funds seek to replicate benchmark performance with low tracking error; assuming a track record of success in doing this, cost becomes the key consideration for sponsors. In contrast, actively managed funds generate returns through security selection rooted in a well-defined investment philosophy and process. For example, some active funds aim to exceed their benchmarks during up markets while risking greater losses when indexes' fall, while others are designed to limit downside exposure while participating in up markets. Accordingly, active managers within the same categories may also perform differently as investment environments change.

We have previously discussed the importance of selecting investment strategies based on the potential ability to build wealth across a variety of market environments—not just the conditions that have predominated in the years following the global financial crisis to the benefit of large domestic growth stocks and the indexes and passive strategies that held them. Traditional scoring systems that do not distinguish between passive and active strategies are not providing sponsors with the level of detail necessary to make informed decisions on product lineups and to provide their participants with the various tools needed to pursue retirement goals over the long term, nor do they discern performance in different macroeconomic regimes.

Don't (Only) Look Back. While a strong track record over standard historical periods is nice for a fund to have, we believe sponsors would be well served by attempting to identify managers whose performance characteristics suggest processes that may be consistent and repeatable across different investment environments—not only annualized returns over the previous one, three and five years. In our view, sponsors can achieve a more detailed assessment of manager performance by comparing funds across a range of risk-based performance metrics, including:

- Sharpe ratio, which measures the return of a portfolio in excess of the risk-free rate relative to its volatility
- Alpha, which measures the risk-adjusted return of a portfolio relative to its benchmark
- Information ratio, which measures the consistency of excess returns in a portfolio relative to its benchmark
- Upside and downside capture, which measures how much portfolios participate in the positive and negative movements of its benchmark; this is often expressed as a ratio

We think a holistic approach to evaluating fund managers for consistent and repeatable processes must include not only the above quantitative factors but also qualitative ones like management tenure, retention and compensation programs. A fund with a long-tenured management team and high staff retention rate, particularly across multiple market cycles and different investment regimes, would appear likely, in our view, to replicate its investment process and performance characteristics over time. Manager compensation, meanwhile, provides insights into how funds achieve outcomes and which truly "eat their own cooking"—an important consideration when looking for managers whose interests are aligned with those of shareholders.

A Time and a Place for Everything

Today's workers may spend 40 years of saving and building wealth and then another 25 plus years of living on the income generated in retirement, a multidecade period that is likely to include multiple economic cycles and a number of extreme events. Over the past 25 years alone, for example, we witnessed multiple boom-and-bust scenarios include an internet bubble, the worst recession since the Great Depression, a global pandemic that brought economic activity to a near standstill and several geopolitical conflicts. In this context, does a fund's performance over the trailing one-, three-, five- or even 10-year periods seem likely to provide much insight into its potential behavior over the multitude of challenges plan participants may face?

First Eagle has always sought to maintain the distinction between backward-looking quantifiable risks, which can be modeled and thus managed, and the true unknown "risk" of investing. We believe events of 2022 in particular—the outbreak of war, persistently high levels of inflation and rising interest rates—should serve as an important reminder of such risks and a retirement plan's need for differentiated investment options that address disparate investment conditions. In our view, a holistic fund-scoring system—such as investGrade™ —may help plan sponsors identify such options.

Does Your Scoring System Help You Run Your Business?

The primary purpose of a fund scoring system is to help plan sponsors and advisors select investment options. But does your scoring system also help you run your business more efficiently? Being able to build a more thoughtful plan lineup for participants is first and foremost, but we think that sponsors and advisors should also consider how scoring systems can help manage day-to-day operations and enhance record keeping. In our view, this may include features that help schedule and update reminders; implement, update or cancel proposed changes; schedule, track and verify fund changes; and aggregate and analyze data across the entire footprint. These tools can help sponsors and advisors improve operational efficiency and identify and resolve problems faster.

First Eagle is committed to partnering with retirement professionals to provide support wherever it may be needed. We believe this includes helping plan sponsors and advisors elevate their practice to the next level, provide better service to their clients and enhance the overall capabilities of their practice. Click here to learn more.

Please reach out to your First Eagle or LeafHouse representative to learn how we can partner together in an effort to build resilient long-term wealth for retirement participants.

Definitions

Upside Capture measures performance in up markets relative to the benchmark.

Downside Capture measures performance in down markets relative to the benchmark. A down market is defined as those periods in which the market return is less than 0.

Alpha is a risk (beta-adjusted) return measurement. If two managers had the same return, but one had a lower beta, that manager would have a higher alpha.

Sharpe Ratio is a risk-adjusted measure that measures reward per unit of risk. The higher the Sharpe Ratio, the better. The numerator is the difference between the portfolio's annualized return and the annualized return of a risk-free instrument. The denominator is the portfolio's annualized standard deviation (population).

Information Ratio is a measure of consistency in excess return. The annualized excess return over a benchmark divided by the annualized standard deviation (population) of excess return.

Tracking Error is the divergence between the price behavior of a position or a portfolio and the price behavior of a benchmark. Tracking error is reported as a standard deviation percentage difference, which reports the difference between the return an investor receives and that of the benchmark they were attempting to imitate.

Target-Date Fund (TDF) is a fund offered by an investment company that seeks to grow assets over a specified period of time for a targeted goal. While target-date funds aim to reduce risk overtime, they—like any investment—are not risk free, even when the target date has reached. Target-date funds do not provide guaranteed income in retirement and can lose money if the stocks and bonds owned by the fund drop in value.

Risk Disclosures

All investments involve the risk of loss of principal.

Past performance is no guarantee of future results.

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