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Life-Cycle Investing: The Way To Go In Financial Planning?

Life-cycle investing is an investment concept that has gained widespread popularity in the US and UK. In the US, life-cycle portfolios are the fastest growing type of retirement/pension fund for employees¹. In this article, Norman Wu, Senior Director of UOB Asset Management explores the concept of life-cycle investing in the context of financial planning.

Based on the concept of life-cycle investing, life-cycle funds are generally balanced portfolios where the asset allocation is automatically adjusted between global equities and global bonds to suit an investor's life-stage. Compared to global bonds, global equities generally yield higher returns but have higher risk levels. Against this background, the rationale behind the concept of life-cycle investing seems logical:

- When you are young and have an income, you can generally afford to take more risks to get more returns. You are building up your nest egg at this stage. Hence, a larger portion of your wealth can be invested in equities.
- As you grow older, your risk appetite will gradually drop and your investment portfolio should increasingly change from more equities to more bonds. In other words, as you advance through different life-stages, you will be looking to protect the nest egg that you have built up over the years.

This shift in asset allocation over different stages of a life-cycle to increasingly lower risks in investments provides some protection from extremely negative outcomes nearer the retirement age, when an investor is generally less able to withstand investment risks and shocks to his nest egg. The idea is that your money should work harder in the earlier years and become more stable in the later years of your life.

In addition, investing in a life-cycle fund may help investors instill some investment discipline for the long-term, for example, setting aside some funds for financial goals such as children's education and personal retirement. In Singapore, there are several life-cycle funds with different investment time horizons.

Nonetheless, there are some concerns raised over the life-cycle investing concept. One comment is that life-cycle asset allocation should consider other factors such as the size of an investor's overall investment portfolio in addition to the number of years till his retirement. For example, you can continue to take more risks if you have a larger investment portfolio, compared to other investors of the same age with a smaller portfolio. Another comment is that life-cycle funds may eliminate upside potential, depending on the market cycle and an investor's life-stage. For instance, the life-cycle portfolio of an investor who in his late life-stage will largely consist of bonds, and this could deprive the investor of the upside potential should the investment markets be up.

However, such analyses are typically based on historical returns and may not represent future performance.

The jury is still out on the life-cycle investing concept. Like any other investment concept, life-cycle investing is not a one-size-fits-all. Ultimately, an investor needs to consider his unique investment needs and goals in any investment.

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1 Source: In the Black magazine, May 2009.

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