Fisher Investments Institutional Group®

Personalized Retirement Outcomes (PRO)

Myths of Managed Accounts
Myth #3

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MANAGED ACCOUNTS ARE TOO EXPENSIVE

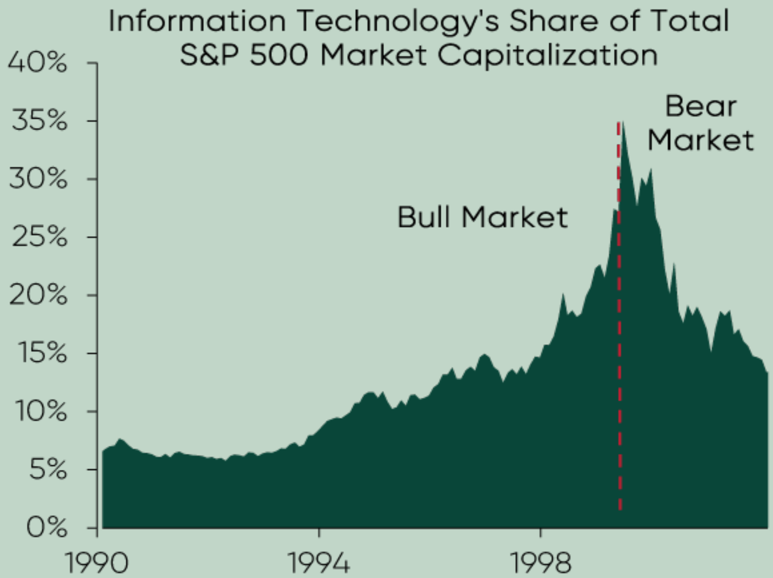
Historically, when comparing retirement options such as target date funds and managed accounts, in most cases managed accounts have been the most expensive option on the menu[1], especially as a Qualified Default Investment Alternative (QDIA). Why is this? With a managed account service, the data used to construct a participant's asset allocation is far more robust and takes more effort on the part of the provider than simply constructing the asset allocation based on age alone. Data points beyond just age such as account balance, gender, salary, savings rate, employer match, and many more are used when constructing these allocations. Empower estimates that this level of personalization in constructing an asset allocation alone adds approximately 30 basis points of value for an engaged 50 year old, and approximately 27 basis points for an unengaged 50 year old. When you pair this with the additional advice features a Retirement Managed Account offers, the added value for an engaged 50 year old totals approximately 258 basis points and 92 basis points for an unengaged 50 year old.[2]

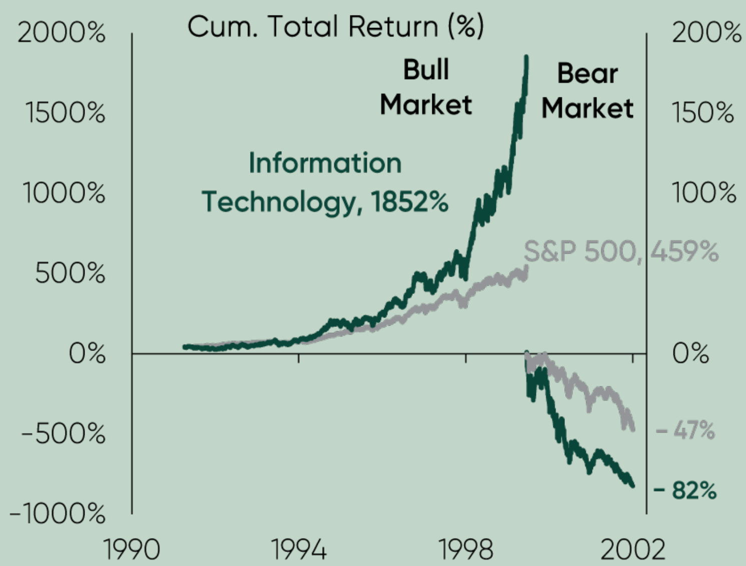
In addition to the personalized allocations commonly associated with retirement managed accounts (RMAs), participants can benefit from the proactive rebalancing of their allocations as well. Unlike the "set it and forget it" mentality of a target date fund's glide path, RMAs rebalance a participant's asset allocation on a proactive and routine basis to help ensure the allocation is in the right mix of equities and fixed income to achieve their retirement goals. But perhaps one of the more advantageous benefits of an RMA beyond just the personalization and proactive nature of the solution is the commonly seen "expert guidance" or advice that they offer participants enrolled in the service. Tailored advice such as increasing one's savings rate, recommended age to take social security, the best age to retire given a participant's stated retirement goal, tax withdrawal advice, etc. are features generally seen with a RMA and provide additional value for both engaged and unengaged participants. In fact, savings rate advice alone can add an additional 80 basis points of value for an engaged 50 year old and 30 basis points for an unengaged 50 year old.[3] It is this level of advice paired with the personalization component that has the potential to lead to better retirement outcomes.

So wouldn't it make sense to charge a little more for this level of quality service in comparison to a basic target date fund? Studies have shown that the nominal expense of managed accounts is far outweighed by the participant's outcomes.[4] The structure of the fees commonly seen with RMAs generally includes investment fees for the investments offered and a service fee for the customized managed account solution.[5] According to Morningstar, a common managed account service fee is around 40 basis points.[6] It is this fee on top of fees structure that has made managed accounts one of the most expensive options for most retirement plans.

One method by which managed account providers were able to lower retirement managed account fees was by adding passive (index) investing to the mix. In today's retirement world, it is well known that passive index funds are traditionally cheaper (in most cases) than actively managed investments[7] and as a result, more plan sponsors and their advisors select indexed target date funds as their participant's retirement mechanism as seen in Morningstar's latest research report; "virtually all the $55 billion in overall estimated 2018 net inflows to target date mutual funds went to series that held more than 80% of assets in index funds."[8] According to Jeff Holt, Director of Morningstar's multi-asset and alternative strategies team, "The demand is not necessarily for index funds, per se. It's more so the demand is for lower cost. One of the ways you can get the lower cost is via index funds."[9] So why the big push for lower cost? We believe there are two reasons. One is the passive versus active debate. Some argue that as of late, passive investing has generated similar if not better results than actively managed investments.

So why pay more for an actively managed approach if a passive strategy yields similar performance for a fraction of the cost? There are many reasons. The first is an investor will likely follow an index's performance and there is no variation. Essentially, an investor will net underperform the benchmark with a passive approach, as they are paying a small fee to have the returns of the benchmark. Furthermore, there is no room to gain alpha within an investor's returns. For example, when an investor mimics an index and it performs poorly, the investor's performance will generally follow along with it. There is no opportunity for downside capture in this scenario. Additionally, if investors own passive investments, they become more exposed to sectors that have historically seen their market capitalizations rise throughout a bull market. Take for example the 90's bull market. During this time, Information Technology had cumulative returns of 1852% compared to the S&P 500's return of 459%.[10] While the S&P 500 had high exposure to Information Technology at the peak of the bull relative to its historical average, it also had high exposure during the subsequent bear market with significant underperformance. The image below displays the downside risk associated with passive investing late in a market cycle. Add to this the lack of defensive capabilities passive investors experience and you can start to see why active management has its perks.





Source: FactSet. Top chart shows weights as of month-end for Information Technology sector in the S&P 500 Index. Bottom chart shows performance Over Time Period shows cumulative returns of S&P 500 and respective S&P 500 Sectors Index, USD. Bull Market period: 10/12/1990 - 3/23/2000; Bear Market period: 3/24/2000 – 10/9/2000. Largest sector is measured at the peak of the bull market.

The second reason for the drive towards lower cost is fueled by recent litigation in the retirement industry, specifically fiduciaries selecting more expensive share classes of the same investment when lower cost shares are available for the same product. Take for example the recent litigation against Rollins, Inc.'s 401(k) plans where the plan sponsor is alleged of using seven retail mutual funds as investment options when institutional shares were a valid option due to the large size of the plans.[11] In this scenario, it is an apples-to-apples comparison; the same investment product but different share classes. One can, therefore, conclude that the issue appears to be one of share classes in comparison to an active versus passive argument. The Department of Labor states that, as a fiduciary, there is a responsibility to "ensure that fees paid to service providers and other expenses of the plan are reasonable in light of the level and quality of services provided."[12] As described previously, managed accounts provide a more robust service, offering advice and personalization, and as a result of this added value, one can expect to pay more than that of a simple target date fund

Part of a plan sponsor and advisor's fiduciary responsibility is to act "solely in the interest of the participants and their beneficiaries."[13] As a result, one could argue a comprehensive investment solution such as a managed account that takes into consideration multiple participant data points is able to create a more personalized solution than a target date fund and fosters improved participant behaviors. While an indexed target date fund is generally less expensive than an actively managed account solution, what is the lost opportunity cost in selecting a target date fund as the Qualified Default Investment Alternative (QDIA)?. What are participants missing out on as a result of being defaulted into a "set it and forget it" type product? FI believes it is improved participant behaviors that lead to better retirement outcomes. Behaviors such as higher savings rates, participant stickiness (retention within the solution) and increased engagement are commonly seen with a retirement managed account, even when used as the default solution.[14] In fact, research by Morningstar demonstrates the median DC participant defaulted into a RMA saves 2% of salary more, on average, than the median participant defaulted into a target date fund.[15] In addition to increased savings rates, RMAs drive higher levels of participant engagement. Morningstar cites that approximately 10% of managed account participants engage with the solution at or shortly after enrollment and engagement increases to over 20% after being in the solution after two years. And lastly, those enrolled in a managed account solution tend to stay within the service longer than those enrolled in a target date fund. According to Alight, over a 10 year period, participants enrolled in a RMA exited the solution at a rate of 26% in comparison to those enrolled in a target date fund exiting at 67%[16] and is further validated by recent Morningstar research.[17] It is these aforementioned improved behaviors that ultimately lead to better retirement outcomes[18] such as more wealth at retirement.

MORNINGSTAR'S RESEARCH BACKS IMPROVED OUTCOMES WITH MANAGED ACCOUNTS

Morningstar's research projects the annual retirement income for the average 30 year old participant using the managed account service would increase by 56% assuming a 40 basis point fee for the managed account solution in addition to the underlying fund expenses.[19]

30 years	560 bps	40 bps
FOR AN AVERAGE AGE	**ADDED VALUE**	**MANAGEMENT FEE**

The research is there; the positive outcomes of a managed account solution can justify the additional cost associated with the service. Perhaps it is time that we as an industry look beyond the lowest cost option for defined contribution participants and focus on other factors such as improving plan health, boosting participant's retirement readiness and assisting corporations on improving their bottom line by ensuring employees retire on time; all of which can be achieved through an affordable, actively managed account solution such as Personalized Retirement Outcomes, where participants are more than just their age.

ABOUT FISHER INVESTMENTS PERSONALIZED RETIREMENT OUTCOMES SOLUTION

Fisher Investments Personalized Retirement Outcomes (PRO) is a next-generation managed account created to help improve retirement outcomes for participants and their plan sponsors. Available to a retirement plan as either an affordable Qualified Default Investment Alternative (QDIA) or as an additional positive election option, PRO utilizes information automatically provided by the recordkeeper to implement and monitor personalized asset allocations for each individual participant without requiring engagement. For no additional cost, PRO offers an easy-to-use online portal for participants who would like the option to better understand their retirement outlook and provide additional information (such as spousal age and outside income) that could further refine their personal asset allocations.

Unique amongst all managed account options, PRO participants receive the benefit of actively managed investment funds advised by Fisher Investments stable Investment Policy Committee (IPC) allowing for cohesive and effectively communicated management in addition to providing risk controls should market conditions change. PRO's consistent and streamlined approach to portfolio construction provides participants diversification without complexity and allows for plan sponsors and their retirement advisors easy benchmarking capabilities. As a service oriented organization with an extensive background in delivering personalization to both high net worth individuals and institutions across the world, the Fisher Investments PRO team would work alongside retirement advisors and the plan sponsor to offer a customized service plan tailored to their needs. We encourage all plan sponsors and advisors to embrace their fiduciary responsibilities and consider whether PRO could improve the retirement readiness of the participants more so than the plan's existing investment options. While the benefits of managed accounts have been documented in numerous studies, not all plans are alike.

To see if your plan could benefit, please contact Fisher Investments Personalized Retirement Outcomes (PRO) for a free analysis of your plan at:

(888) 803-1621 or FisherPRO@fi.com
www.fi-inst.com/pro

Disclosures

Investing in stock markets involves the risk of loss and there is no guarantee that all or any capital invested will be repaid. Past performance is no guarantee of future returns. This document constitutes the general views of Fisher Investments and should not be regarded as personalized investment or tax advice or as a representation of its performance or that of its clients. No assurances are made that Fisher Investments will continue to hold these views, which may change at any time based on new information, analysis or reconsideration.

Endnotes

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