Todd: Good morning, and welcome back to the special edition DC REC briefing. I am your host, Todd Schnick, back from New York City and part 2 of our important conversation on the benefits of blending public and private real estate for the defined contribution marketplace. Joined again by doctors Adam Walk and Michael Drew. Adam is a senior research fellow and Michael is a professor of finance, both from Griffith University in Australia. Gentlemen, welcome back to the show. I appreciate you again joining us for part 2. So, Michael, let's kick off this segment. There is a lot of discussion on sequencing risk. Can you please provide an overview of exactly what this is and why it matters?

Michael: Sequencing risk has a number of names: the portfolio size effect, path dependency. This is such an important construct in DC plan design. Sequencing risk shows that, for the average DC member, they accumulate about half of their final balance in the last 10 years of their working life. So sequencing risk acknowledges that it's not the average of returns that drives the outcome in the retirement balance. It's actually the order of returns that drives the outcome. So sequencing risk is so important, that if you have, say, a negative event close to your retirement event, this can destroy a multiple of your lifetime contributions to the DC plan. So as DC plans around the world mature, this is to us, perhaps the critical risk that plan sponsors are there to manage, and hopefully mitigate, in the last decade of the accumulation phase, and the first decade of the retirement income phase.

Todd: Good stuff. So, Adam, usually the most interesting outcomes from a research project are the things you don't expect, the surprises. What was the biggest surprise in this research?

Adam: Doing research a fair bit, it's always a bit of a surprise when your hypothesis proves to be true. So, in this case, that was surprising. We ended this research with the important one for me, anyway, was the fact that you might have a higher private real estate allocations later in the accumulation phase. And our expectation was that would cause better risk management aspects to the portfolio, and it proved to be so, so the downside was improved. There was more consistent outcomes, although there was some upside forgone, but it wasn't really a surprise, except that in research, sometimes getting what you expect is a surprise.

Todd: I hear that. So, Michael, we've been talking about this dynamic approach. Is this just academic analysis or is there a practical application that can be implemented by a plan administrator here?

Michael: I think that's a great question. For us, this is very much out of the classroom and into the field. There is absolutely benefits in this research and other work we've been involved with. It has shown that a dynamic approach, a target aware approach, an approach that places the plan member at the center of design, is critical to improving retirement security. So one of the great challenges we have as an industry is we think a lot about target date funds and target risk funds, and we think about asset allocations 25-30 years into the future. A dynamic approach actually acknowledges where the plan member is in their retirement savings journey and thinks about asset allocation informed by an outcome. Now, this seems a subtle difference, but it's very important. Asset allocation not to big peers, asset allocation not to top lead tables, asset allocation to replace real retirement income. A different frame, a nudge, a behavioral finance aspect, but for us, this is the next generation of target date fund design.

Todd: Got it. All right, so Adam, to get the full benefit of the dynamic approach that we're talking about here, would this need to be implemented by an individual participant or the fund administrator level?

Adam: No, I don't think it does. Increasingly these days, DC plans are getting very good at customizing to cohorts and subsets of their plan member population, so I think it's absolutely doable in DC plans today. In fact, in some respects, I think it's more ideal to be doing DC plans, particularly because private real estate, for example, is hard to get an allocation on an individual basis, certainly not the kind of diversification within that asset class that you could get within the DC plan. So I actually think it's probably better to be done in a DC plan.

Michael: I absolutely agree, Adam, and I think also it frames the outcome for DC plans. It frames success as the destination. And too much in this business, we look at the inputs, like investment returns. They're important, they're critical success factors, but they are only an input to the income. So we want to encourage plan sponsors to think about questions like, "What does this allocation mean for, say, our 58-year-old plan members? Where are they on their retirement income journey?" They're the sorts of questions we think that the next generation of these plans will look at and will be at the heart of how they measure success.

Todd: All right, well, gentlemen, unfortunately we are about out of time. Michael, before we let you go, should anyone need any more information on this, where should they go?

Michael: The white paper is available from the defined real estate council website, www.DCREC.org, or e-mail contact@DCREC.org.

Todd: Okay. Dr. Adam Walk, senior research fellow, and Dr. Michael Drew, professor of finance, both from Griffith University in Australia. Gentlemen, again, thanks for coming by. I appreciate you stopping in and joining us. Well, thank you for joining us today. That's all the time we have for this episode. On behalf of my guests Dr. Adam Walk and Dr. Michael Drew, I am Todd Schnick. We're all coming to you from New York City and we'll see you next time on the DC REC briefing.