AllianceBernstein

Research Agenda for 2024

Driving Ongoing Innovation in the AB UK Target Date Funds

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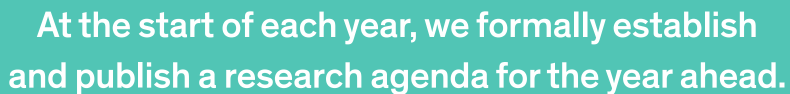


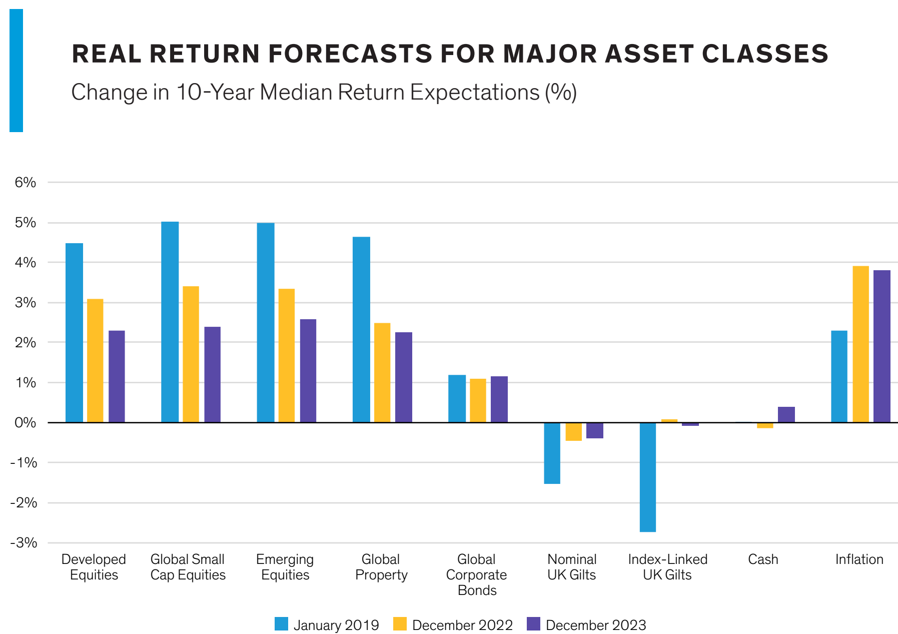
At the start of each year, we formally establish and publish a research agenda for the year ahead. The research agenda outlines the key areas of investment research, product enhancement/development or data/reporting improvement projects for our UK target date funds (TDFs). This paper collates the 2024 agenda, along with our rationale and analysis, into one single—and hopefully digestible—document, for your reference throughout the year.

A key feature of our process is a continuous commitment to leveraging research to enhance our strategic asset allocation, investment processes and wider TDF proposition through time, as new investment approaches emerge, long-term opportunities arise, or regulatory/market conditions change. In so doing, we believe we reinforce our strategies' capabilities to deliver on client objectives efficiently and continuously—not just at the strategy outset.

Key Dynamics Informing Our 2024 Agenda

Our proprietary Capital Markets Engine (CME)—a quantitative capital-market forecasting tool—is a key input into the design and ongoing management of our UK TDFs. By projecting forward a range of potential outcomes, it allows us to test asset allocation designs and to measure changes in capital-market expectations through time. This helps us to continue meeting our real return objectives, while remaining invested within predefined member risk budgets.

The latest 10-year real (i.e., after the effects of inflation) return forecasts from the CME are shown below. For comparison, we show the forecasts as they stood last year and five years ago.



Data do not represent past performance and are not a promise of actual results or a range of future results.

Nominal and index-linked gilts represented by UK government seven-year constant maturity bonds; global stocks by a universe similar to MSCI World Index. All returns are reported in and hedged into GBP. As of 31 December 2023. Source: AB

Implications for Asset Class Dynamics

These forecasts present the following key observations

- **Elevated Inflation Expectations:** Our median forecast for UK inflation over the next decade is 3.8%. This forecast continues to represent a significantly elevated level of inflation compared with the pre-pandemic experience. By extension, and all else being equal, this expectation sets a high hurdle for delivering positive real returns that will be more challenging for almost all asset classes to meet.
- **Bonds Are Nominally Attractive Again:** The sharp sell-off in bonds triggered by the re-emergence of inflation and tighter monetary policy has set the asset class up for notably more attractive forward-looking returns compared with where they were five years ago. After inflation, however, bond returns are expected to be broadly flat.
- **Lower Equity Risk Premium:** Equities are one of the asset classes with our highest nominal return expectations and hence are a crucial asset in the fight against inflation—though they're unlikely to meet our strategies' objectives on their own. The main challenge for equities is a diminished risk premium (i.e., expected excess return from taking on equity risk). With the improved forecasts for UK gilts, the associated risk premium has shrunk meaningfully below the long-term norm.

The key implication of our CME forecasts is a need to generate greater nominal returns and/or thoughtfully integrate real asset and inflation-sensitive assets to strengthen our ability to meet long-term real return objectives. Also, weaker equity and stronger bond return expectations flatten the distribution of expected returns across the asset allocation glidepath.

Effective Diversification Is Becoming More Challenging

A weaker equity risk premium makes the decision to allocate between equities and bonds more difficult. Equities are still expected to offer higher returns than bonds though, which is crucial for investors with real return objectives. But leaning too heavily on equities may not represent an effective use of members' risk budgets. So, beyond the expected returns of each of these asset classes in isolation, the other important consideration is the risk diversification benefit of holding both asset classes.

A key factor supporting diversification, and therefore informing overall portfolio risk, is the tendency of equities and bonds to perform differently from one another. If we consider these two large asset classes over the very long term, correlations have tended to be positive—but low. Since 2000, we saw an exceptionally long period of negative correlations between them: when one asset class delivered negative performance, the other tended to have positive performance. But in 2022, amid multi-decade high inflation and rapid increases in interest rates, this inverse relationship ended abruptly.

On a near-term basis, we expect correlations to become more supportive as inflation normalises from recent extremes. That said, we have made the case in **previous work** that the deeply negative correlation of stock and bond returns is unlikely to be repeated. While low positive correlations are still helpful for diversifying portfolio risk, bonds no longer represent the reliable risk management tool that they once did. To appropriately manage risk in the approach to retirement (and beyond), it's important to re-evaluate strategy diversification and dig deeper into the toolkit for sources of differentiated returns.

The growing concentrations within asset classes—especially passive market-capitalisation-weighted approaches—provide another important reason to think carefully about diversification. Imagine a simple 60/40 portfolio consisting of 60% developed-market equities (similar to the MSCI World Index) and 40% global developed-market sovereign bonds. This provides exposure to approximately 24 countries' stock markets, 21 countries' sovereign bonds and 13 global currencies. That sounds highly diversified, surely? Perhaps not. When we analyse the constituents, we find this portfolio's risk is dominated by a handful of big positions. One clear example is US equities and bonds exposure which, make up nearly 60% of the total. Compare this with 2010 where this weight was closer to 40%. The structural divergence and outperformance of the US over the last 10–15 years (including the dominance of the 'Magnificent Seven' US mega-cap stocks in 2023) has seen growing concentration within market capitalization approaches. This concentration is also exacerbated by the increasing skew of the sector exposures within US equities toward the information technology and communication services sectors (which make up nearly 40% of the S&P 500 Index).

Broader Horizons—and More Regulation—for DC

2023 was another year of milestones in the UK DC arena. The Task Force on Climate-related Disclosures (TCFD) reporting requirements expanded their coverage from the largest pension plans, with smaller ones now required to publish their first disclosures. The Mansion House Compact was formed and signed by pension providers across the market, underpinning a commitment to unlisted assets. Government consultations considered important topics like value for money and performance disclosures, and decumulation options in retirement such as Collective Defined Contribution (CDC). With increasing market pressures and developments, our research must naturally consider these pertinent issues and we must make continued strides to offer market-leading services and support to our clients.

New Survey Highlights Members' Needs

In 2023, we undertook our biennial member survey, which forms a key input into our assessment of UK members' needs. We polled around 2,500 UK DC savers on topics ranging from retirement planning to retirement income expectations to how they engage with their savings to views on responsible investment and risk sharing. The survey results reinforced our long-held view that members require and value flexibility, given their high levels of uncertainty about when to retire. This uncertainty extends into retirement too: our survey showed a large proportion (56%) of members did not know how much income they could sustainably draw down in retirement, and nearly 10% thought they could sustainably withdraw more than 11% of their savings per year. While our survey revealed a small minority of informed and engaged members, the vast majority need help. They are ill-prepared for the complexity of financial planning and the management of evolving risks over a multi-decade horizon to and through retirement. Based on our experience from the accumulation phase, we cannot rely on members making informed decisions in retirement, and therefore an effective post-retirement solution should be provided as part of a default pathway.

Default Strategies Must Evolve

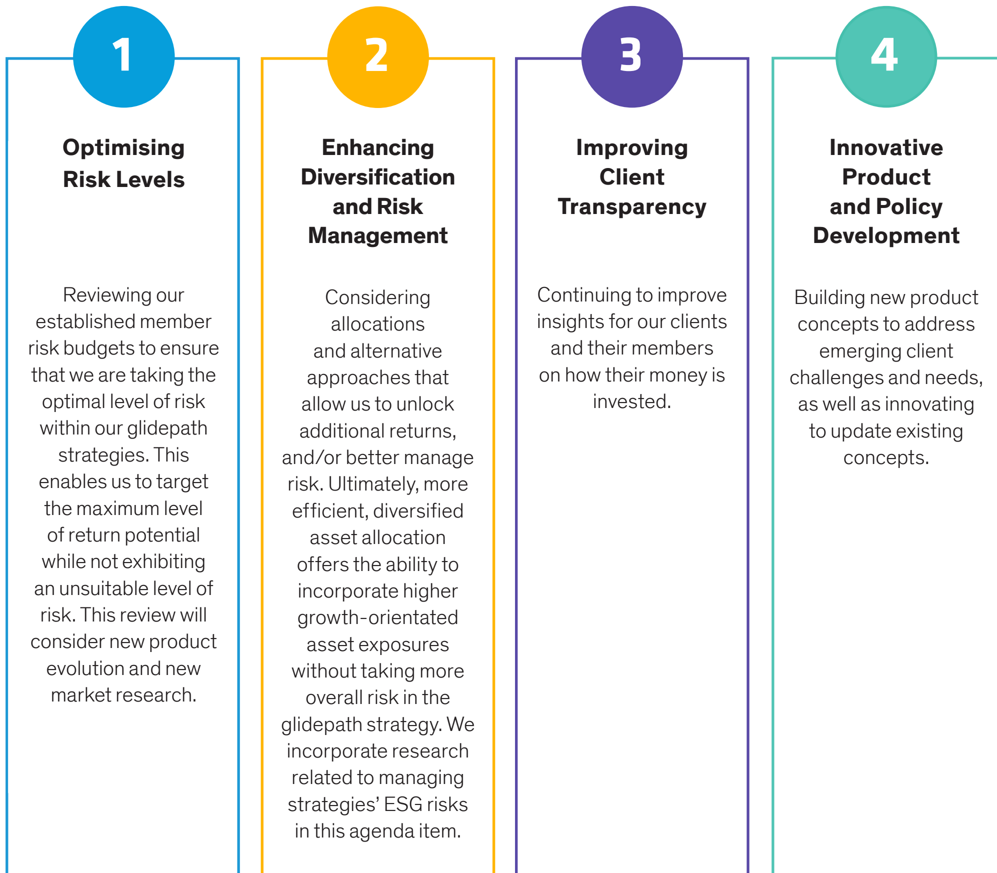
This combination of an evolving capital-market regime, ongoing developments in the industry, and need for better member support means that the default strategies and approaches built in the past may no longer be fit for purpose. Innovation in DC retirement provision is needed—particularly in the areas of environmental, social and governance (ESG) integration, the inclusion of private market investments, and post-retirement solutions. Default strategies must continue to efficiently meet the long-term risk-return needs of members, while integrating a prudent assessment of different risks and opportunities (such as those presented by material ESG factors). And members need both flexibility and support when they make the daunting jump from accumulation to decumulation. Our research in recent years has been focused acutely in these areas and we have identified several areas of continued evolution and innovation which will remain central to many of the research items on the agenda for the year ahead.

"The Basics" Remain Vital

While innovation is crucial, and often exciting, it's important to remember the basics—the more vanilla or simple exposures that make up an asset allocation strategy, such as developed-market equity allocations. These tend to make up a significant allocation size and are therefore the most material drivers of overall return. Keeping good member outcomes as our North Star, the pursuit of innovative private market allocations or specialist ESG allocations should not come at the detriment of an efficient and robust foundation of core asset class exposures. This is why we also keep more routine reassessment of risk budgets and traditional exposures in a prominent position on our agenda.

RESEARCH THEMES

Similar to previous years' agendas, our research for the year ahead can be segmented into the following key themes:



Research Agenda Summary

Below is a summary of the items on our research agenda for 2024.

Theme	Item	Description
Optimising Risks Levels	**Risk-Return Profile / AB CyRIL**	Integrate findings of latest DC saver review into risk-return profile. We expect this, along with whole-of-life TDF product implementation, to increase risk budgets both in approach to and transition into retirement
Enhancing Diversification and Risk Management	**Private Markets**	Consistent with principles of the Mansion House Compact, continue to integrate and build private market exposures Within private equity, implement tactical allocation to exploit weakness in pricing and explore allocation increase Complete implementation of illiquid private credit for first client. Build liquid (more equity-like) private credit pool for younger members
	Currency Hedging	Revisit strategic currency hedging policy and research relationship between sterling and UK duration
	China and EM ex China	Consider appropriate long-term strategic split between China and EM ex China equity and any shorter-term implications
	Developed Equities	Complete implementation of consolidated allocation to increase operational efficiency and flexibility of ESG and stewardship policies
	Real Assets	Evaluate future role for real estate in asset allocation and consider once again best practice ESG approaches
	Commodities	Consider strategic role of gold as a stand-alone allocation
	Sustainable Opportunities	Continue to research and add new investments, particularly those focused on infrastructure assets that go beyond renewable energy
Improving Client Transparency	**TCFD Support**	Develop and roll out standardised climate scenario analysis to better support clients
	Performance Reporting	Enhanced performance reporting in line with developing FCA guidance
	Manager Monitoring	Continue roll-out of manager ESG monitoring process beyond key managers to all managers
	Stewardship	Evaluate enhancement of stewardship reporting and investigate potential to take control of voting where possible
Innovative Product and Policy Development	**Whole-of-Life TDFs**	Implement combined accumulation/decumulation (i.e. whole-of-life) glidepath.
	Industry Leadership	Continue to engage with regulators and industry on milestone consultations and share our perspectives on the UK DC landscape
	Net Zero Roadmap	Review our Climate Change Action Plan to reflect new ideas, methodologies and progress. Consider an “ongoing” item going forward
	CDC	Socialise our proposal for “fair, flexible and transparent” CDC delivery

Detailed Overview of Research Items

Below is a detailed overview for some of the rationale behind our key agenda items for 2024

Optimising Risk Levels

With the dual challenge of higher forecast inflation and weaker capital-market forecasts, it's important to keep TDF strategy risk profiles up-to-date and reflective of evolving member needs. On the one hand, if we take too much risk in the pursuit of return objectives, a market sell-off may trigger unsuitable levels of volatility and/or losses for member savings. On the other hand, too little risk weakens the ability to meet return objectives and may result in a savings shortfall for members at retirement.

Through a combination of qualitative insights from our recent member survey and quantitative insights from CyRIL (our proprietary membership analysis tool), we calibrate the risk budget along each point of the glidepath to ensure ongoing suitability for our clients.

We also adjust our glidepaths to reflect the adoption of new product designs. For example, our whole-of-life TDF design, which takes members on a default journey to and through retirement, is expected to result in a significant boost to the investment horizon (as members remain invested for longer); hence the risk budget around retirement date should reflect that need for longer-term growth.

Enhancing Diversification and Risk Management

Given the material impact that they have on member returns, we will be focusing on some of the core exposures that make up our strategies. Within developed-market equities, we will complete the implementation of our new consolidated sleeve (which combines our previous developed-markets equity allocation, climate transition equity and multi-factor equity). By combining these allocations, we can unlock operational efficiencies and use the scale to implement custom policies and systematic methodologies to achieve our desired exposures.

Considering the somewhat arbitrary weighting of China in market cap indices and the unique geopolitical risks of investing in the region, we will also review the split between our China equity allocation relative to other emerging markets to establish appropriate strategic and tactical weights to the respective regions.

Finally, we plan to revisit our currency hedging policy given the significant volatility in the pound sterling that we have seen in recent years.

Against a backdrop that requires effective real asset exposures and greater diversification to mitigate volatility and deliver on objectives, we have included multiple items related to these assets on our agenda for 2024—including items in the areas of real estate, commodities and infrastructure. One key part of our research is to re-evaluate existing exposures and their effectiveness, including any market developments with respect to ESG considerations. Another key focus is on identifying and researching new opportunities, such as the potential benefits of a stand-alone allocation to gold, or new allocations within Sustainable Opportunities. For the latter, where a significant proportion of the opportunities currently selected are within the area of renewables infrastructure, we are seeking to find more opportunities associated with digital infrastructure and broader infrastructure.

In recent years, private markets have been a key focus for us. We see private markets as offering a market segment currently largely untapped by UK DC plans and with the potential to enhance returns for investors. This is critical given that real returns for public market investments look challenged on a strategic horizon. So far, we have integrated exposures to private equity and built out the Sustainable Opportunities allocation (which includes non-transition sustainable investments, such as infrastructure). The next private markets asset to be included within our glidepath strategy is private credit: we will go live this year with a bespoke client strategy before offering this asset class to our broader client base. Consistent with the Mansion House Compact, and considering valuation dynamics at play within listed private equity, we continue to seek opportunities to expand our allocation to private markets.

Improving Client Transparency

Our TDFs primarily use third-party managers to implement asset allocation. This allows us to select from the most innovative managers within the marketplace and those with the most attractive/efficient implementations. This structure means that third-party managers are responsible for the stewardship (including proxy voting and engagement) of invested corporates. We collate data and monitor third-party managers' stewardship policies and activities. One area of focus for 2024 will be to consider approaches to elevate our reporting of stewardship activities undertaken for clients. We will also continue to investigate and develop processes that allow the pass-through of voting rights on underlying assets from third-party managers to AB.

We believe it's important to review our third-party managers' broader ESG policies and capabilities thoroughly—both at mandate inception and on an ongoing basis. The aim is to make sure that the managers we employ adopt best market practice for considering ESG risks and opportunities, and that their approaches align with our views as closely as possible. In recent years, we have stepped up our ongoing manager monitoring process to include detailed discussions on the areas of ESG integration, stewardship, product policies and corporate policies. This initiative focused on key managers initially, but we plan to roll it out across all of the managers that we employ in 2024.

The FCA is currently engaging with the industry on how pension plans can report performance in a manner that can enable fair comparison between arrangements and enable assessment of value for money that goes beyond pure cost. We have been fully engaged in this process and are—as always—well positioned to support our clients in providing the necessary disclosures as soon as the final details are published.

To continue building on the ESG data and support that we can offer to our clients, we will be looking to leverage our data tools in the area of climate scenario analysis. The aim is to establish and report standardised scenario metrics that can be used by clients in their own TCFD reporting.

Innovative Product and Policy Development

Continuing on from a research and design project that we started last year, we will implement our innovative whole-of-life TDFs for a founding client in 2024. The product will then be offered to other clients following this launch. The aim of this product is to make retirement planning, and drawing down an income, as easy as possible for members by offering a default retirement journey to and through retirement. Central to this proposition is a desire to embed institutional pricing and governance, ongoing flexibility and a seamless transition for members as they move into retirement and seek managed retirement income. Crucially, this product brings together the strong experience and investment performance of our accumulation TDFs (which we have managed since 2009) and our Retirement Bridge income-paying TDFs, which have built an enviable income drawdown track record since launching in 2015.

Following the establishment of our Climate Change Action Plan in 2021, we aim to review our net zero roadmap to reflect new research ideas and the emergence of any new methodologies and market best practice. Given the rapid advances in this space and the importance of continually evolving this plan, we view this item increasingly as a key part of our ongoing portfolio-management responsibilities and less as an isolated research project.

In 2023, we saw several regulatory consultations and collaborative engagements where we felt it important to share our unique perspectives as a DC solutions manager. We expect that several of the discussions with regulators and industry will continue into 2024, particularly given our ongoing work and innovation in the areas of ESG consideration, post-retirement, and private markets. We also have developed a proposal for Collective DC (CDC) that we believe overcomes some key pitfalls and is fair, flexible and transparent. We believe that it's through collective collaboration that we can best serve the needs of all retirement savers in the UK.

About AllianceBernstein

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The value of an investment can go down as well as up and investors may not get back the full amount they invested. Past performance does not guarantee future results.

Some of the principal risks of investing in Target Date Funds include country risk, emerging markets risk, currency risk, illiquid assets risk, portfolio turnover risk, management risk, industry / sector risk, derivatives risk, borrowing risk, taxation risk, and equity securities risk.

Target Date Retirement Funds (TDFs) are designed for a typical pension fund saver intending to retire in or around the years stated in the name of the Fund. As the Funds are intended to be default pension saving vehicles which seek to meet the requirements of a broad range of persons, they do not take into account an individual's personal circumstances and may not be suitable for a particular individual or group of individuals with complex financial or personal circumstances.

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