DFA and S&P Collaborate on STRIDE Index

By Kerry Pechter *Tue, Feb 2, 2016*

STRIDE stands for Shift To Retirement Income and DEcumulation. 'We see the index as an appropriate benchmark for the transition from wealth accumulation to income,' said Philip Murphy, vice president at S&P Dow Jones Indices.

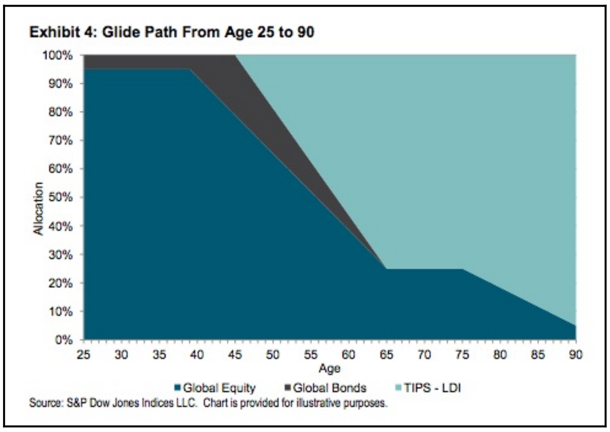
For years, economist Robert Merton has tried to commercialize his solution to an alchemical challenge: How to transmute the piles of tax-deferred paper wealth that Americans accumulate in tax-deferred plans into the actual consumption of food, clothing, transportation and shelter over a 25-year span of retirement.

Merton has long believed that, given the drawbacks of annuities, building a nest egg mainly out of Treasury Inflation-Protected Securities (TIPS) can best meet that challenge. So far three firms, SmartNest, Trinsum Group, and Dimensional Fund Advisors have tried to monetize his vision, but without much success.

The latest vehicle for bringing the Nobelist's patented idea (Merton shared the 1997 prize in economic sciences with Fischer Black and Myron Scholes for their options pricing model) to market was introduced last week when Standard & Poor's announced the debut of a news series of indices called **STRIDE**.

"Our mission is to help validate Merton's idea, and to help create a new space in the asset management industry," said Philip Murphy, vice president at S&P Dow Jones Indices told *RIJ* last week. "We see the index as an appropriate benchmark for transition from wealth accumulation to income."

STRIDE stands for Shift To Retirement Income and DEcumulation. As the name suggests, it carries Merton's belief (and he is hardly alone in thinking so) that defined contribution plan participants need to change their current focus on asset growth and concentrate on funding their post-retirement liabilities by adopting a less risky LDI (liability-driven investing) strategy.



The STRIDE Index is designed to map that shift and provide a tool for implementing it. As a retirement readiness metric, it bridges the path from accumulation to decumulation by periodically calculating (based on current interest rates) the present cost of $1 of lifetime income from age 65 until age 95. Applying that to participants’ current account balances, the index can show whether they are on track to fund their future income liability.

STRIDE is also a template for a new series of target-date funds for defined contribution plans. Each fund’s glide path would start at age 25 with a 95% allocation to global equities and 5% to global bonds. At age 45 it would start gliding toward TIPS, reaching a 75% TIPS allocation at age 65. By age 90, the fund would hold 95% TIPS and 5% global equities.

There’s one more aspect to STRIDE: In the post-retirement stage, the program calculates an annual sustainable monthly payout. “Starting in January each year, the strategy determines the amount of TIPS assets for the year to divest (rebalance out of the Index) in order to provide hypothetical income streams for the cohorts currently in the decumulation phase,” a research brief from S&P Dow Jones Indices said.

When you’re trying to interest asset managers in a new investment idea, it always helps to provide a metric for it, and an index does exactly that, Murphy said. “The culture within the asset management industry is sensitive to performance measures,” he told *RIJ*. “For any subcategory of investments you typically have one single benchmark that’s most popular.

Although DFA has its own TDFs, with their own specific holdings, the STRIDE Index is meant to allow other asset managers to build their own TDFs along the same lines, but with their own investment choices. “The underlying strategies behind the index and Dimensional’s TDFs are similar but distinct. The benchmark is run independently of DFA funds. We are creating a space where other asset managers can apply their funds to the strategy,” said Murphy (at left).

If the Index becomes popular, DFA and S&P both earn licensing fees. "There's nothing exclusive about the relationship, we're not pushing any particular products," he added. "We consider it to be a revenue sharing relationship. We will both benefit from it. They suggested it but we think it's a good idea. We're very excited about it."

The Dimensional 2015 TDF (for those retiring last year) currently holds 75% TIPS and 25% global equities, including shares of almost 1,000 different companies, none of which represents more than 0.45% of the total. The top 10 companies are Apple, Microsoft, Exxon Mobil, Amazon, Johnson & Johnson, Wells Fargo, JP Morgan Chase, General Electric, Berkshire Hathaway and AT&T.

STRIDE resembles another existing product: BlackRock's CoRI Retirement Index. It too calculates the fluctuating price of $1 of lifetime income. People saving for retirement can use that number, plus their desired income in retirement, to see how close or far they are from having enough savings to retire on. They can also invest in BlackRock's CoRI Funds, which track the index.

According to the CoRI website, "The CoRI Retirement Indexes ("CoRI Indexes") are a series of real-time, age-based indexes designed to help Americans measure retirement readiness and plan for future income goals. Each CoRI Index provides a daily 'level' that can be used to estimate, as early as 10 years before retirement, how much annual lifetime retirement income your current retirement savings could generate."

The CoRI 2015 Fund, which has a 58% allocation to U.S. Treasuries, isn't quite as conservative as the Dimensional 2015 Fund. Its major stock holdings (Verizon, JP Morgan Chase, Wells Fargo, Bank of America, General Electric, Citigroup, Morgan Stanley, Goldman Sachs and AT&T) appear to weight financial stocks more than DFA does.