Russell Investments

Making Super Personal

Pivoting Australia's superannuation system to a mass personalised, goals-based approach will help more Australians live the life they want in retirement.



Contents

Foreword 3

Executive summary 4

1 The retirement savings gap 9

1.1 A global challenge 9

1.2 Our share of the US$70 trillion shortfall 9

1.3 The real retirement gap 10

2 Closing the gap 12

3 Optimising contributions 13

3.1 Why optimise contributions at the individual level? 14

3.2 A personal and voluntary approach requires engagement 14

3.3 Hurdle one: Intent to engage and take ownership of their retirement lifestyle 16

3.4 Hurdle two: Choosing the retirement income goal they would like to work towards 17

3.5 Hurdle three: Understanding how they are tracking to their goal 20

3.6 Hurdle four: A clear picture of the action required to close any gap (i.e. contributions) 20

4 Investment earnings 21

4.1 Why optimise asset allocation at the individual level? 22

4.2 All current default options compromise asset allocation 23

4.3 These compromises are poorly understood by investors 24

4.4 Australians struggle to choose an option better suited to their needs 25

4.5 Professional advice can address these issues, yet few Australians draw on the available options 28

4.6 Low cost personalised advice has been available in the U.S. for almost a decade 30

5 The impact 31

6 Introducing GoalTracker 32

6.1 How GoalTracker improves engagement and contribution levels 33

6.2 How much does GoalTracker cost? 34

6.3 How GoalTracker improves investment outcomes 35

6.4 Improved outcomes, even for the disengaged 37

In closing 38

Foreword

We are all different.

When it comes to saving for retirement, we each have our own unique financial circumstances and individual aspirations for life after work.

Yet, for many years, those willing to pay for financial advice have been closer to realising these aspirations, with an approach built around their unique needs. For everyone else, one-size-fits-many has been close enough. A necessary compromise to manage superannuation cost efficiently.

This paper seeks to understand and address these compromises, analysing how we can reduce the number of investors falling short of their retirement income goals. Drawing on best practice from within our industry and without, we show how a mass personalised, goals-based approach will help more Australians get, and stay, on track to the life they want after work.

The enduring impact of COVID-19 has brought retirement adequacy into focus, again highlighting the challenges and misconceptions many Australians face when saving for retirement. Yet, with every crisis comes the opportunity for positive change. This paper does challenge the status-quo, but with a focus on understanding our shortcomings, so we can overcome them. I hope you find the following insightful, for both yourself and the people you guide—a realistic and cost-effective path forward to help more Australians reach their great life after work.

Jason Edgar
Managing Director,
Head of APAC
Russell Investments



Executive summary

Closing the *real retirement gap*

The gap between what each individual wants and what they are on track to achieve.

The challenge

A global problem

Funding the retirement of working populations is a global challenge. The 'retirement gap', measured in trillions of dollars by most estimates, has captured the attention of the world's largest institutional investors for decades. Employers have faced this challenge to pay pensions for their retiring employees, managing these obligations collectively through Defined Benefit (DB) plans.

But the world of retirement funding is changing. With the steady shift towards Defined Contribution (DC), the responsibility for retirement funding is moving away from large institutions and onto individuals themselves.

A significant body of research has delved deeply into the projected retirement savings gap, both locally and abroad. Yet for all this valuable effort, little has focused on the gap that matters most to individuals: the gap between the retirement income they want and what they are on track to achieve.

Understanding this *real retirement gap* presents a considerable challenge, particularly in Australia where national data on individual retirement income aspirations has never been collected. However, we shed light on the issue, drawing on analysis of the retirement goals and financial circumstances of around 8,000 superannuants. The findings are significant. Well over half are projected to fall short of their desired retirement income by at least 10%. This is the *real retirement gap*. A gap we, as an industry, must help to close.

As part of this effort, we have investigated the two levers that have the biggest impact on helping everyday Australians close their retirement gap. Firstly, the contributions—how much is put in and when. Secondly, how those contributions are invested over the course of a working life.

► Jump to this chapter

Optimising contributions

The first lever to closing the gap

In Australia, the seemingly obvious answer and topic of much debate is a blanket increase to mandated super guarantee contributions. While this appears logical, the reality is much more nuanced. Independent research highlights the punitive nature of a blanket increase, particularly for low-income earners. In reality, the right answer is not uniform, it depends on the individual and their personal situation. In most cases, this will rely on some combination of superannuation guarantee and voluntary contributions from the member themselves. Accurately optimising voluntary contributions depends on the personal circumstances of each investor, and importantly, the retirement income they are trying to achieve. Obtaining this information requires interaction and input from the individual. In other words, we need engagement.

It is broadly believed many Australians are disengaged from their super—retirement is a distant financial problem outweighed by more immediate needs. Our research points to a much more complex reality, with a broad range of issues. The first, the investors' capacity to make additional contributions. Without this capacity, and with more pressing and essential needs, there is little reason to engage. For those who do have financial flexibility, the complexity of superannuation is a significant barrier. Making important financial decisions can be overwhelming when faced with complex investment concepts (e.g. asset allocation, investment risk and return volatility). Our analysis explores the impact simplification, and proven engagement techniques, could have in helping more investors engage and make the contributions needed to achieve their goals.

An extensive body of research points to the transformational impact goal setting and tracking could have on engagement. By focusing individuals on the retirement lifestyle they would like to achieve (rather than complex investment decisions), the entry into superannuation can be significantly simplified and much more engaging. Analysis of our own master trust highlights the power of goal setting on deeper engagement—members who used our goal setting tool were 67% more likely to have made voluntary contributions, relative to those who didn't.

Based on a survey of more than 3,000 Australians, Russell Investments has identified four key hurdles each individual must overcome to be in a position to optimise their contributions:

Hurdle one: Intent to engage and take ownership of their retirement.

Hurdle two: Choosing the retirement lifestyle, and/or retirement income, they would like to work towards—setting a goal.

Hurdle three: An understanding of how they are tracking to their goal. Both now and as things inevitably change.

Hurdle four: A clear picture of the action required to achieve their goal (i.e. the additional contributions needed).

Just 11% of survey respondents felt they had overcome each hurdle with a set level of voluntary contributions to keep them on track to their retirement goal. It remained unclear whether their level of contributions aligned with what they actually needed.

By providing individuals with guidance through each of these key hurdles, we can empower them to be in a better position to achieve their goal.

For example, by helping people optimise contributions (contributing up to 5% of their salary in additional contributions when tracking behind or reducing contributions when tracking ahead), our analysis shows the proportion of members on track to their goal would increase by more than half.

► Jump to this chapter

Optimising asset allocation

The second lever to closing the gap

Independent research highlights the strong influence asset allocation has on investment returns, driving 85% or more of the outcome.

Asset allocation is fundamentally the balancing of risk and return. Too little risk and retirement savings won't grow as much as needed. But too much risk at the wrong time can jeopardise those savings.

Given the importance of investment returns, it may come as a surprise to many that most Australians don't have an asset allocation well suited to their needs. When it comes to superannuation, most Australians are defaulted into options that significantly compromise.

The vast majority are defaulted into one-size-fits-many options that apply a single asset allocation to all members or an age-based cohort. This approach ignores the other additional personal information that could improve asset allocation, such as the superannuation account balance, contributions and the individual's retirement income goal.

Our system does encourage individuals to make an investment choice to deal with these trade-offs.

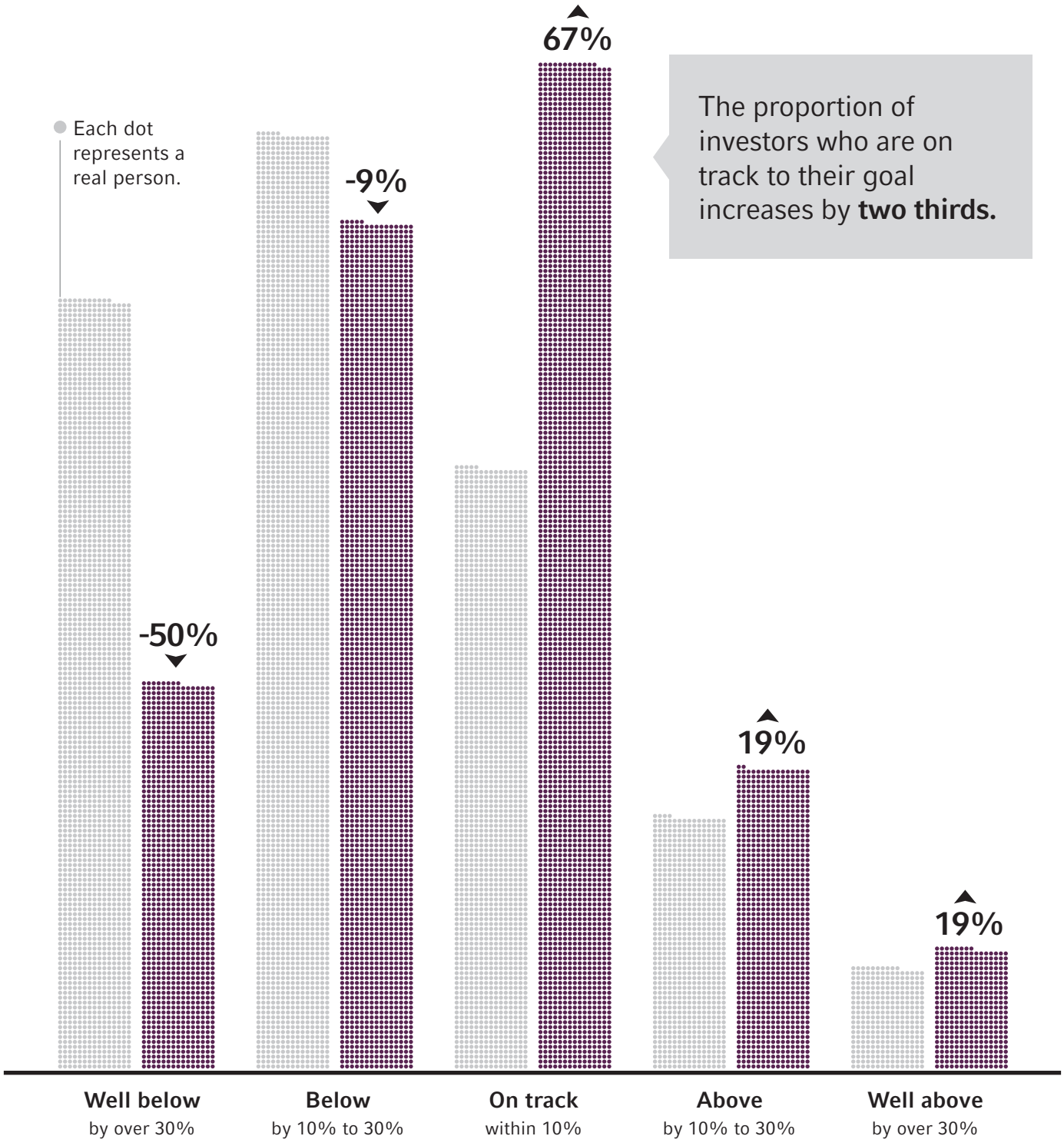
While some will have the expertise to do that themselves, our research shows that many others are constrained by poor financial knowledge, unreliable information sources, overconfidence and emotional biases in their decision making.

Professional financial advice can help with the trade off, yet few Australians access these services, primarily due to the financial cost and a poor understanding of the value. A 2019 survey by the Australian Securities and Investments Commission highlighted only 12% of Australians had received financial advice in the last 12 months[1] and barely 1% of Australians had accessed limited advice through their super fund.

Shifting from 'one-size-fits-many' to 'mass personalisation' of investment strategy is a real 'free lunch.' It provides a benefit without an associated trade off. It does that by removing the compromises in the current one-to-many approaches. For example, by optimising asset allocation (removing the compromises of one-size-fits-many approaches), our analysis shows more than two thirds of those analysed would have higher projected retirement incomes, with some incomes increasing by over 30%.

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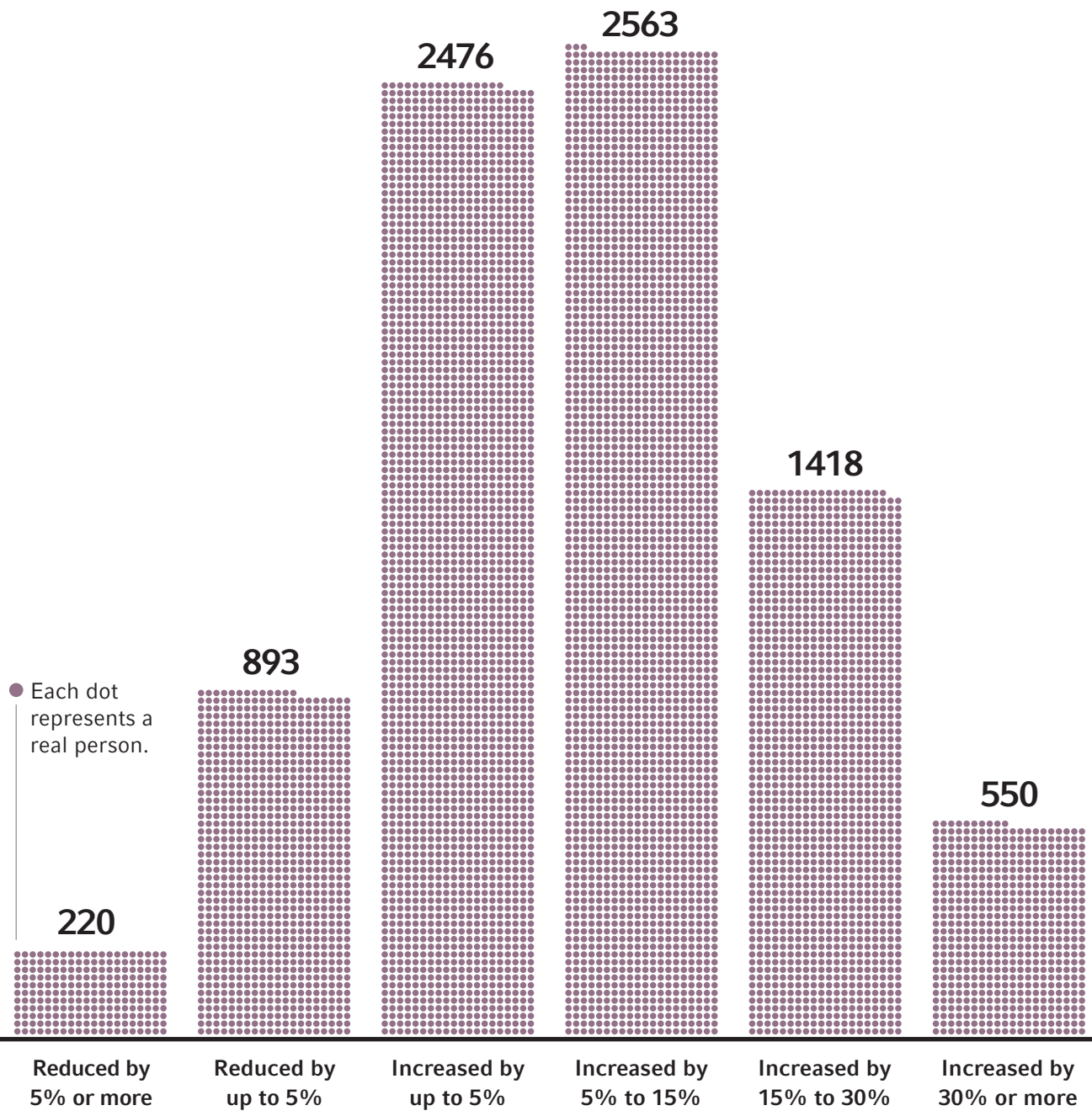
The impact on the *real retirement gap*: Optimised contributions and improved asset allocation will help more people get on track.



Projected incomes are calculated based on data and assumptions and are not a guarantee of actual retirement incomes. Projected incomes were determined based on data from the 8,120 members who used the Russell Investments goal setting tool (which excludes significant outliers with projected income more than 50% away from the desired income). Data includes current age, current balance, current income, current investment strategy, current contribution level (including member voluntary), desired age to retire from the workforce and desired level of annual income in retirement. Projected income is based on assumed returns applicable to the current investment option and contributions, or the GoalTracker default strategy and optimal contributions, member data and the assumption all savings are spent by the age of 94. The projected income was compared to the desired level of income.

The impact on income.

Over 85% of those analysed have higher projected incomes.



Projected incomes are calculated based on data and assumptions and are not a guarantee of actual retirement incomes. Projected incomes were determined based on data from the 8,120 members who used the Russell Investments goal setting tool (which excludes significant outliers with projected income more than 50% away from the desired income). Data includes current age, current balance, current income, current investment strategy, current contribution level (including member voluntary), desired age to retire from the workforce and desired level of annual income in retirement. Projected income is based on assumed returns applicable to the current investment option and contributions, or the GoalTracker default strategy and optimal contributions, member data and the assumption all savings are spent by the age of 94. The projected income was compared to the desired level of income.

Turning theory into reality

Introducing GoalTracker, Australia's first mass personalised, goals-based superannuation solution—delivering a personalised investment strategy and engagement experience designed around the unique goals and circumstances of each member.

GoalTracker brings together each of the key insights discussed in this paper. Designed to help each individual reach their retirement income goal, GoalTracker provides guidance through the four key engagement hurdles, helping each member set a goal and optimise contributions.

GoalTracker can optimise asset allocation to the member's goal and personal circumstances, cost-efficiently removing the compromises embedded in one-size-fits-many approaches.

For the first time for super fund members in Australia, the dots are connected between individual goal setting, the right investment strategy and contributions for each member—to help improve the likelihood of funding their lifestyle aspirations in retirement.

We are really excited by this—our analysis shows that the GoalTracker approach to super can help many more Australians get on track to fund their great life after work.

► Jump to this chapter

1 The retirement savings gap

1.1 A global challenge

While there is debate on the global scale of retirement underfunding, most would agree, the shortfall is significant.

Independent analysis by the World Economic Forum (WEF), spanning some of the largest established pension systems in the world, estimated a collective retirement income shortfall of US$70 trillion (A$107.10 trillion) as at 2015. A shortfall set to rise dramatically to US$400 trillion (A$612 trillion) by 2050[1].

Over 75% of the US$70 trillion shortfall represented pensions promised to public employees and unfunded government pensions. The remaining 25% was primarily the difference between the income provided by mandatory public systems and the 'top up' needed to provide 70% of pre-retirement income (the income replacement rate in line with OECD guidelines).

Global trend shifting responsibility from institutions to individuals

Historically, DB plans were the most dominant form of retirement savings vehicles. After years of dedicated work for your employer, you would be rewarded with a pre-agreed monthly income throughout your retirement: the defined benefit. While the responsibility for managing the investments used to fund your retirement lay with the plan trustee, the responsibility for funding the liability lay entirely with the employer. They carried the investment risk and the responsibility to cover any shortfall.

With the rise of DC plans globally, the responsibility is shifting from employers to each individual. According to a study by Willis Towers Watson, global DC asset pools exceeded global DB asset pools for the first time in 2019[2].

As DC plans have replaced DB globally, the responsibility has shifted away from well-resourced institutional investors (employers) to individuals. Unlike a DB plan with a set benefit, DC plans have a set contribution rate. Ensuring the contributions (and investment earnings) will adequately fund retirement is the responsibility of the individual.

If the asset allocation is inappropriate, or the contributions insufficient, the individual shoulders the risk and will need to live with the consequences.

1.2 Our share of the US$70 trillion shortfall

The Australian retirement system is broadly considered among the best, ranking third behind the Netherlands and Denmark in a Mercer comparison of 37 retirement systems[3]. With mandated employer contributions, tax incentives to encourage voluntary contributions, and the safety net provided by the age pension,

Australians are in a significantly better position relative to people in many other countries.

However, despite these strengths, the WEF data highlighted a US$1 trillion shortfall, projecting Australians will outlive their retirement savings by a significant margin. While Australians expect to spend 23 years in retirement, the WEF estimated Australians will only be able to maintain 70% of pre-retirement income for an average of 10 years. Once exhausted, they will need to rely on the age pension, an income that allows little spending beyond the necessities[4].

1.3 The *real retirement gap*

While the retirement income measures discussed are helpful in understanding the broad scale of the challenge, each is based on a standardised level of retirement income. We would argue standardised income levels are a poor measure for Australia's primarily DC system—with the responsibility for achieving an adequate retirement income placed squarely on the individual.

We all have our own unique perspective on an adequate level of retirement income, based on our own circumstances and expectations. These diverse income requirements are not captured by standardised income levels. These measures shed little light on the *real retirement gap*, the gap that matters most to each individual—how they are tracking relative to what they are trying to achieve.

Unfortunately, analysing how Australians are tracking towards their retirement income aspirations on a national basis is not possible—the data simply doesn't exist.

However, we can shed light on the issue by drawing on analysis of the Russell Investments Master Trust. Through the goal setting process available on our website and app, we have been able to capture the retirement goals and personal circumstances of around 8,000 individuals—the goals they've chosen to model. By analysing this data, we have projected how each is tracking to their retirement income goal.

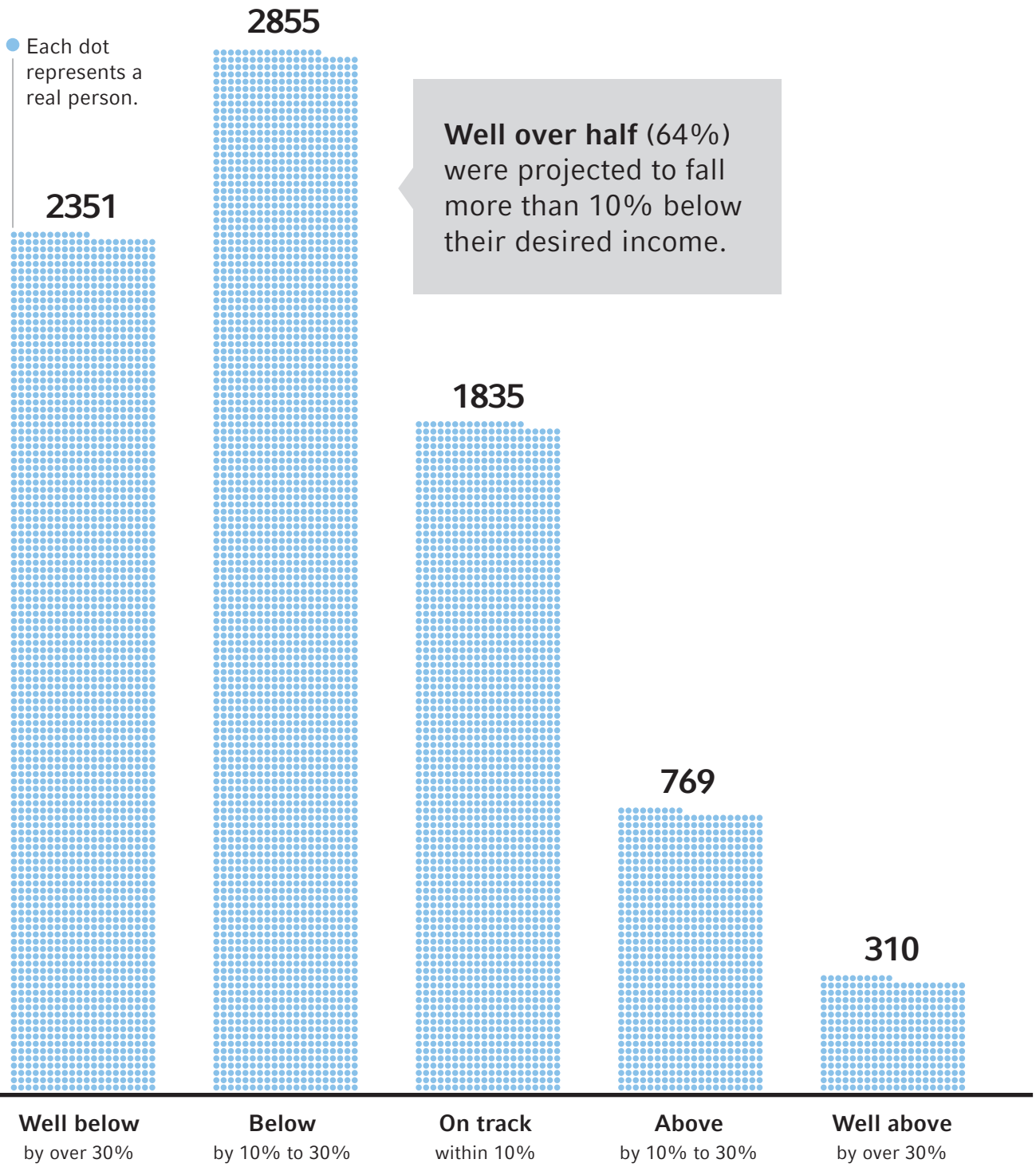
The findings were significant. More than half (64%) of the participants were projected to fall short of their desired income by more than 10%.

Our analysis also uncovers a second, poorly understood issue. The potential for overfunding—unintentionally saving more than needed. Over one in ten participants were projected to exceed their goal by more than 10%, sacrificing spending now to achieve a future retirement income well above what they want.

64%

More than half of the participants were projected to fall short of the retirement income they wanted to achieve by more than 10%.

How do the projected retirement incomes of 8,120 Australians compare with the incomes they want to achieve?



Projected incomes are calculated based on data and assumptions and are not a guarantee of actual retirement incomes. Projected incomes were determined based on data from the 8,120 members who used the Russell Investments goal setting tool (which excludes significant outliers with projected income more than 50% away from the desired income). Data includes current age, current balance, current income, current investment strategy, current contribution level (including member voluntary), desired age to retire from the workforce and desired level of annual income in retirement. Projected income is based on assumed returns applicable to the current investment option, member data and the assumption all savings are spent by the age of 94. The projected income was compared to the desired level of income.

2 Closing the gap

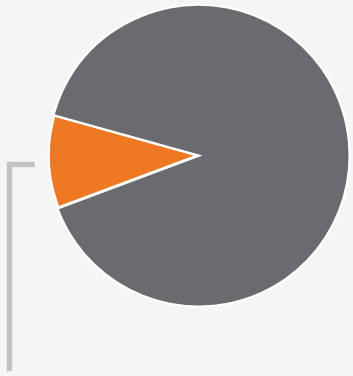
Where can change have the biggest impact?

The figure below highlights the two primary levers we have to directly influence retirement income, the contributions and the investment returns. Our analysis focuses on these fundamental drivers, those that will have the greatest impact on retirement adequacy.

FIGURE 2.1: What has the biggest impact?

A rough guide to retirement income

Breaking down a typical retirement income



10% comes from contributions

90% comes from investment earnings

What really matters

How much money goes in

For example, **$1,000** contributed per year, $46,000 over a working life, would provide roughly **$3,720** in additional retirement income per year (when earning 7% p.a.).*



How long the money is invested

For example, contributing the same $46,000 as above, but starting at age 40 instead of age 21, provides only **$1,520** in additional retirement income per year.**



Investment earnings

For example, while an after-fee return of 7% delivers $3,720 per year in the above example, adjusting the return to 6% would only deliver **$2,750** per year.*



* Working life assumed to be 21 to 67. Disclosed assumed return is after fees and tax. $46,000 in total contributions paid in equal instalments of $1,000 p.a throughout the working life at the end of each year. Accumulated lump sum amount at retirement age 67 was converted into a retirement income using the Moneysmart retirement calculator using standard Moneysmart assumptions. Retirement income results shown are discounted back to age 21 into 'today's dollars' using a deflator of 3.2%p.a.

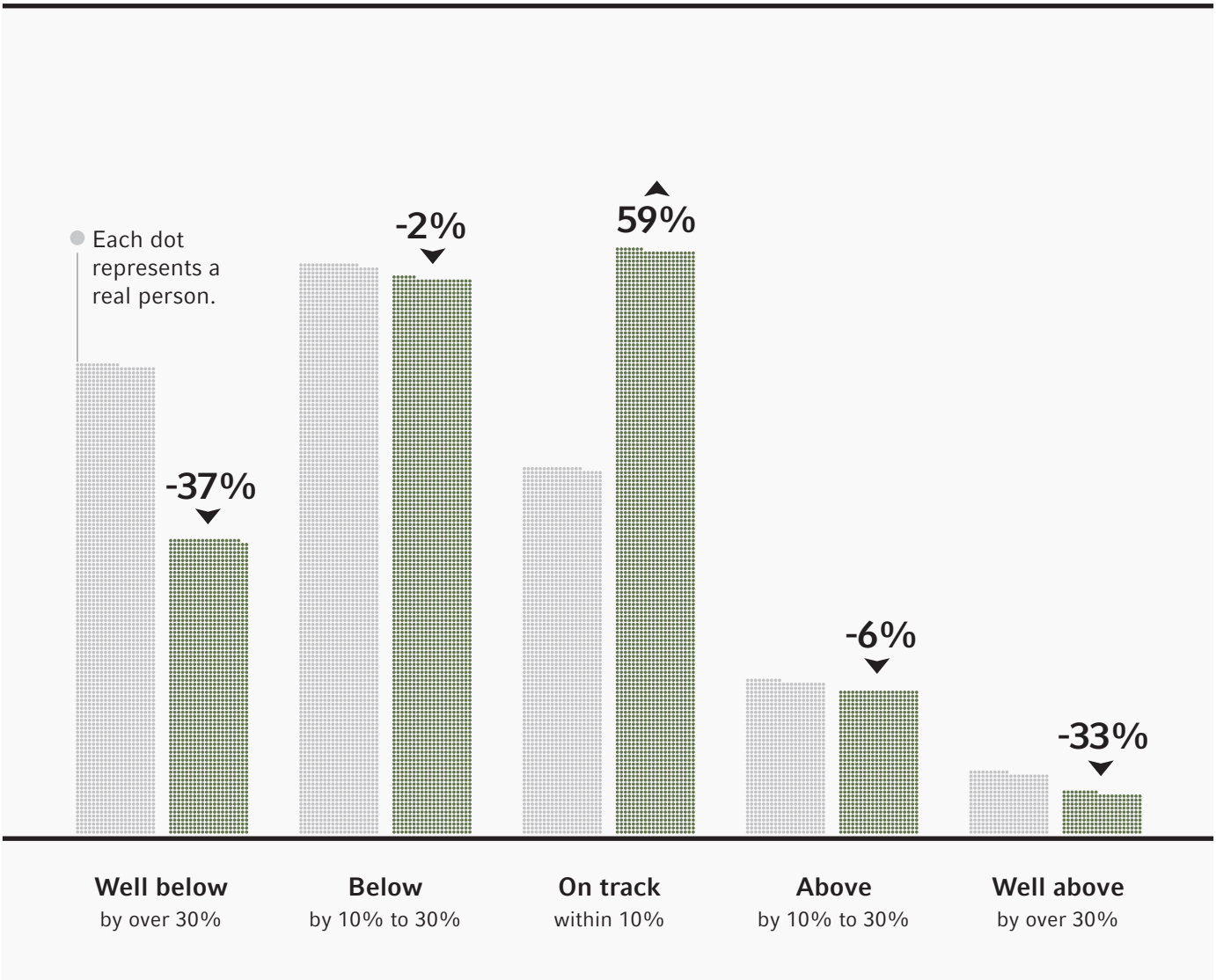
** As per disclaimer above, except the total payments of $46,000 are split into 27 equal instalments of $1,703.

3 Optimising contributions

Contributions—the savings put towards retirement—is the first of the two primary drivers of retirement income. Our analysis shows optimising contributions at the personal level can play a significant role in closing the *real retirement gap*.

For example, by helping people optimise contributions (contributing up to 5% of their salary in additional contributions when tracking behind or reducing contributions when tracking ahead) our analysis shows the proportion of members on track to their goal would increase by more than half.

FIGURE 3.1: Impact of optimised contributions on the *real retirement gap* (adding up to 5% additional voluntary contributions, or reducing them if overfunded)



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3.1 Why optimise contributions at the individual level?

Independent research shows a blanket increase to mandated superannuation contributions would be punitive, particularly to low-income earners.

On the global stage, Australia is in an enviable position with substantial levels of existing savings. We have a mandated contribution rate of 9.5% of salary and there are significant tax incentives to motivate additional voluntary contributions. Given recent volatility and member withdrawals, the debates around the correct level of mandated contributions continue.

Simplistically, increasing the Superannuation Guarantee (SG) rate would mean Australians accumulate more superannuation over their working lives, increasing the likelihood of a comfortable retirement. However, the reality is much more nuanced.

Unlike a DB system, where any broad benefit will be shared by all members, Australia's largely DC system places the risk of falling short on each individual. Increasing contributions broadly, thereby improving the average, can hide significant impacts at the individual level—impacts that won't be shared across other participants.

There is an increasing body of research demonstrating there isn't a single right answer for the SG rate. While different researchers have found different ranges, this finding is clearly illustrated by papers by Rice Warner[5] and researchers at the Australian National University[6]. The research highlights the 'right level' for the SG rate is hugely variable, primarily driven by the individual circumstances of each person involved.

Beyond the immediate debate around the SG level, this research highlights how a one-size-fits-all approach to contributions will likely generate results widely short of, or widely in excess of, sensible targets for individuals. Analysis covered earlier in this paper highlights an existing overfunding issue—13% of members are projected to exceed their goal by more than 10%—an issue that would only be exacerbated with a blanket increase.

In the real world, the right level of contributions is not the same for everyone. It depends on the individual and their personal situation, and the retirement income they are trying to achieve.

3.2 A personal and voluntary approach requires engagement

There are four key hurdles each individual must overcome prior to being in an informed position, ready to make and maintain optimal contributions.

It is broadly believed many Australians are disengaged with their super—retirement is a distant problem outweighed by more immediate needs. We would argue that this view oversimplifies the reality and our analysis points to a broader range of issues.

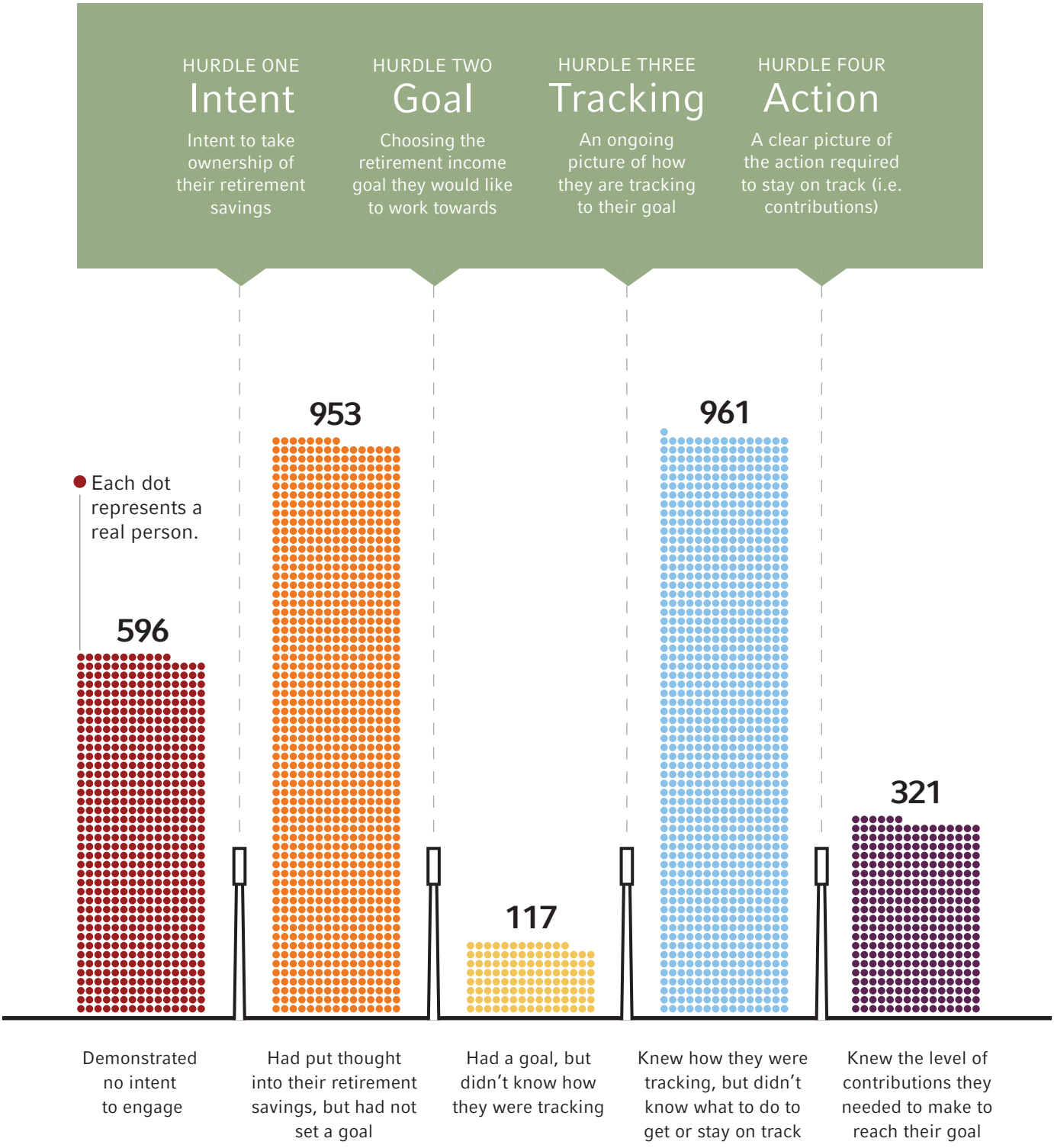
To further understand the drivers of engagement, we commissioned independent analysis of more than 3,000 Australians, those that don't currently pay for financial advice. The analysis highlights the significant challenges faced by Australians as they engage and try to take positive action to reach their retirement goals.

Around one in 10 participants said they had a set level of contributions that they believed would keep them on track to their retirement goal. While this figure clearly illustrates a problem, our analysis points to four key hurdles each individual must overcome prior to being in an informed position, ready to make and maintain optimal contributions.

11%

11% of survey respondents said they had a set level of contributions to keep them on track to their retirement goal.

The four key hurdles each individual must overcome to be in a position to make optimal contributions.



Analysis is based on the individual responses to a survey of more than 3,000 Australians who didn't have a financial adviser. Conducted by Yell Research in 2020.

3.3 Hurdle one: Intent to engage and take ownership of their retirement lifestyle

Our analysis points to roughly one in five participants who demonstrated little intent to engage with their retirement savings.

Roughly 20% of participants had put little thought into life after work, demonstrating little to no understanding of super and how their retirement savings were tracking.

- When asked whether respondents were aiming for a specific retirement goal, 21% indicated they didn't know or hadn't thought about it.
- This proportion of disengaged respondents was similar when asked whether their current super balance was ahead of, on track to, or behind where it needs to be to fund their retirement, with 16% of respondents indicating they didn't know or were unsure.

Interestingly, our findings challenge the theory that engagement is primarily driven by proximity to retirement. The proportion of respondents who hadn't thought about their retirement income goal showed no significant change between Millennials, Gen X and Baby Boomers with 21%, 20% and 18%, respectively.

When you consider a little under 15% of the Australian population live below the poverty line[7], it is clear a material proportion of Australia's population will have more pressing and immediate financial needs. Retirement adequacy will be far down the list of priorities and our analysis indicates financial flexibility, or excess income, plays the most significant role in determining engagement and intent. More than a third of those who had little thought into their goal had an income below $50,000.



21%

Millennials

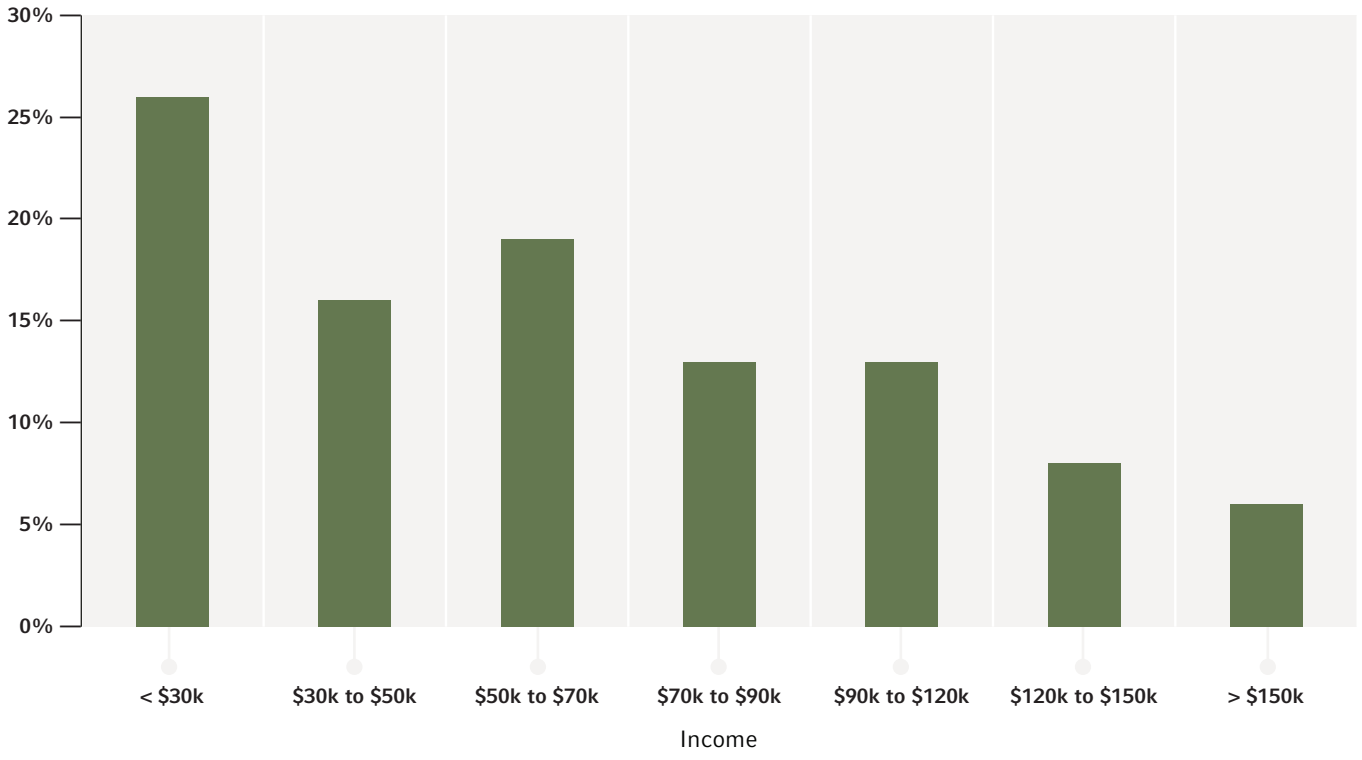
20%

Gen X

18%

Baby Boomers

FIGURE 3.2: Income distribution of respondents who had put little thought into their retirement goal



3.4 Hurdle two: Choosing the retirement income goal they would like to work towards

Roughly one third of participants had put some thought into their retirement savings, but had not set a retirement goal (i.e. the level of retirement income they would like to work towards).

Goal setting is a critical element in any engagement process, a key hurdle as individuals progress towards optimal voluntary contributions. There is a significant body of scientific evidence highlighting the positive impact goal setting has on an individual's (or a group's) ability to achieve it. Analysis of our Master Trust members highlights the significance of goal setting—members who had used our goal setting tool were 67% more likely to have made voluntary contributions, relative to those who hadn't.

Goal setting is a critical element in any engagement process, a key hurdle as individuals progress towards optimal voluntary contributions.

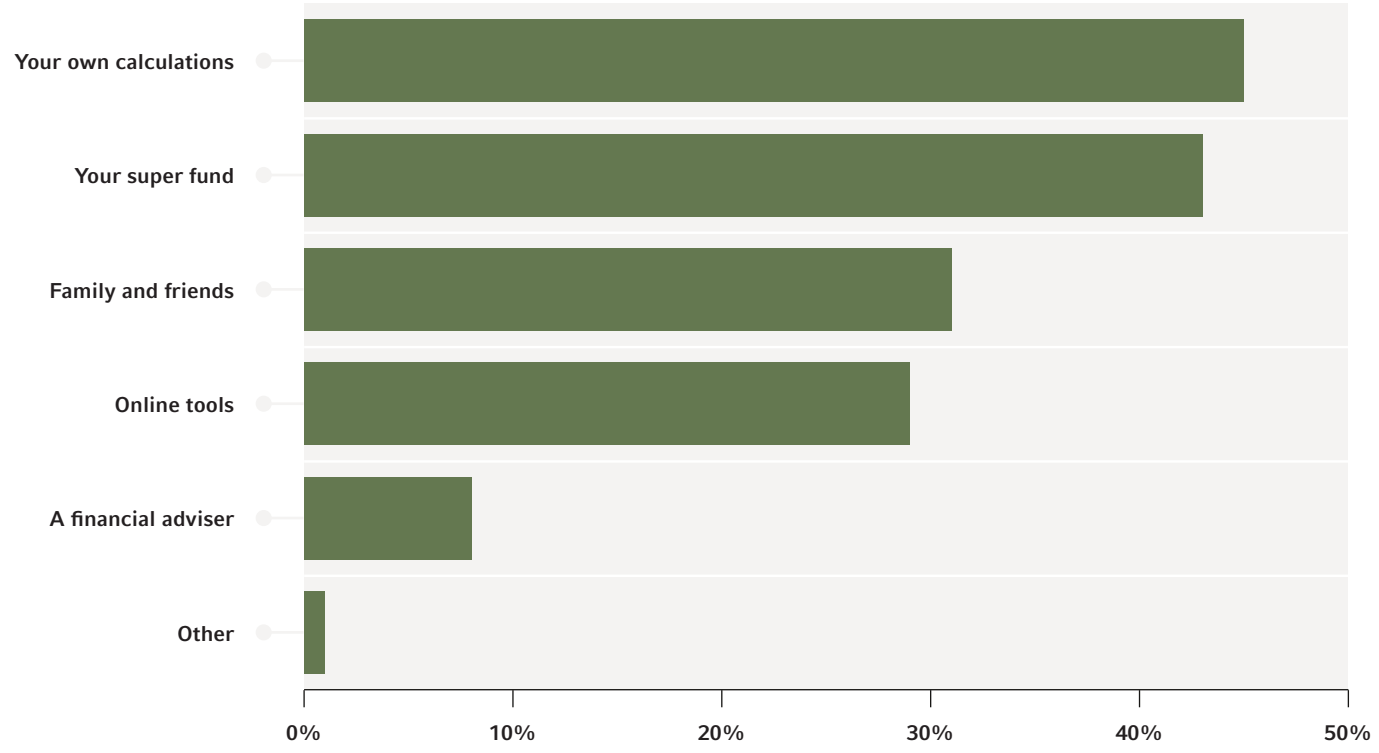
Yet, as covered earlier, many super funds place very little emphasis on the individual retirement goals of their members, a distinctive difference from the approach taken by a financial adviser or an institutional investor.

When it comes to retirement planning, choosing an appropriate income goal can be challenging. Of the 48% who had set a goal, 45% used their own calculations to help determine their goal, creating significant room for error. For example, many assumed a proportion of their current income would suffice, but failed to consider the impact of inflation, choosing an income with significantly less purchasing power than they expected.

1/3

Roughly one third of respondents had considered their retirement, yet had not set a retirement goal.

FIGURE 3.3: Response to—which of the following do you use to help decide on your superannuation goal and how much needs to be contributed each pay period or year?



The science behind goal setting and tracking

The power of setting and tracking goals has long been studied and acknowledged in philosophical, psychological and behavioural fields.

Pioneering researcher, Edwin Locke, developed the Goal Setting Theory of Motivation[8]. Tested and supported by hundreds of studies involving thousands of participants, his work highlights the significant positive influence of goal setting on performance. He found goal setting influences performance in four critical areas:

Choice
Goals focus attention and direct efforts towards goal-relevant activities and away from perceived undesirable and goal-irrelevant actions.

Effort
Goals can have an energising function, leading to more effort. The higher the goal, the greater the effort invested.

Persistence
Individuals become more determined to work through setbacks when pursuing a goal.

Cognition
Goals can activate cognitive knowledge and strategies, leading individuals to develop and optimise their behaviour.

Research[9] shows goal tracking can also play a significant role in engagement and improve the chance of reaching the goal. An obvious example is the emergence of technology, delivering personalised goal tracking in the health and fitness industries, highlighting four significant benefits of tracking:

1 **The Mere-Measurement Effect:** Measuring activity pushes you to move more. When you keep track of how much you spend on food, you dine out less. When you watch how many glasses of water you drink each week, you drink more.

2 **Makes it easier to set realistic goals:** Tracking helps you to figure out where you're currently at, which is a critical step in figuring out where you want to be. It provides the context to set a realistic personal improvement goal. For example, if you're currently only getting 2,500 steps a day, setting a target of 5,000 makes a lot more sense than 10,000.

3 **Reinforces positive action:** Keeping track helps you to measure improvement. Tracking shows the positive impact of your actions and keeps you progressing towards your goal. It also highlights the lack of progress, helping you to know when to course-correct.

4 **Focuses your attention:** People who track, stay on track, because they're paying attention to their behaviour. It forces attention to the behaviour you're trying to change. It keeps it top of mind and doesn't allow you to push it down your list of priorities.

A study published in the Journal of Medical Internet Research[10] studied the impact of fitness apps on positive behavioural changes. The team surveyed 726 participants in three groups—current app users, non-app users and former app users—and discovered that almost 75 percent of current app users reported being more active, as opposed to under half of non-users and former users.

75%

Almost 75 percent of current app users reported being more active, as opposed to under half of non-users and former users.

In an interview, Associate Professor of Psychology Leib Litman, one of the study's authors, said that they sought to test whether exercise apps could help make exercise more accessible to those who use them, and they succeeded. "Exercise apps can be a vehicle for behaviour change in exercise in the same way that a nicotine patch can be a vehicle for behaviour change in smoking."

Further research suggests that fitness apps definitely work, but are especially effective when they're personalised to the user. When features include things like training goals, specialised diets or contact with 'real live trainers,' people are more motivated to work out more consistently[11].

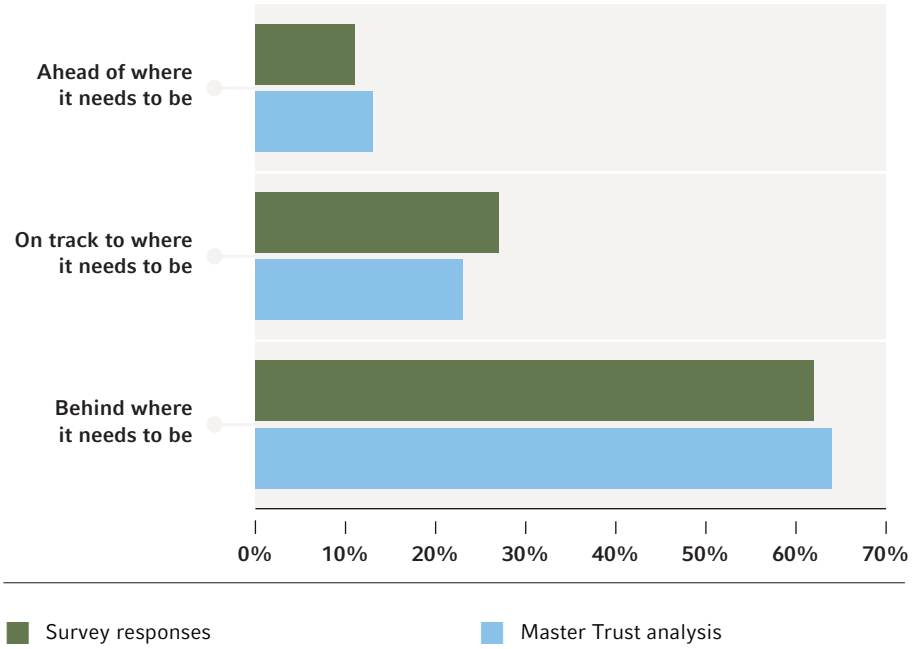
For the study, Mary Jung, an Assistant Professor at UBC Okanagan's School of Health and Exercise Sciences, teamed up with an unnamed fitness app company. The study introduced features like goal setting, personalised feedback and other key elements of behaviour change to the app's users, monitoring exercise levels in app users and non-app users. The study showed that the group who did not use the improved version of the app experienced no changes in their daily routine, while the test subjects who did, exercised more.

3.5 Hurdle three: Understanding how they are tracking to their goal

Just 4% of participants had a goal, but didn't have a clear picture of how they were tracking.

Most survey participants had a general understanding of how they believed they were tracking, with the vast proportion either on track or behind. Interestingly, the distribution of survey respondents was similar to the gap analysis on the 8,120 members presented earlier in this paper, with a slight bias towards on track rather than behind.

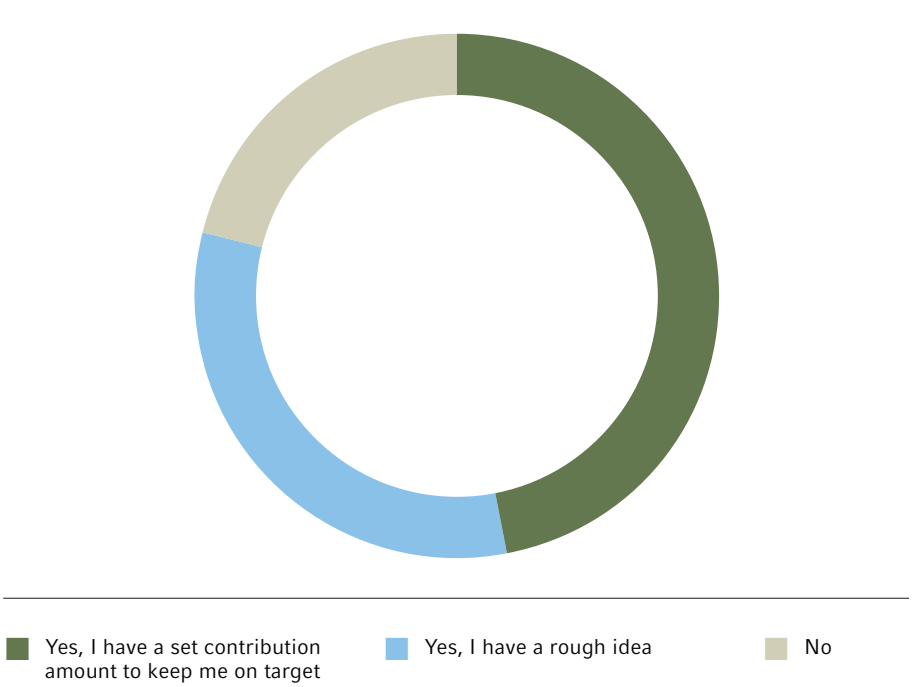
FIGURE 3.4: Tracking to retirement goal



3.6 Hurdle four: A clear picture of the action required to close any gap (i.e. contributions)

32% of participants knew how they were tracking, but didn't know what to do to get or stay on track. Importantly, just 11% of participants overcame each hurdle and felt they had a set level of contributions to keep them on track to their goal.

FIGURE 3.5: Awareness of required contributions to achieve super goals



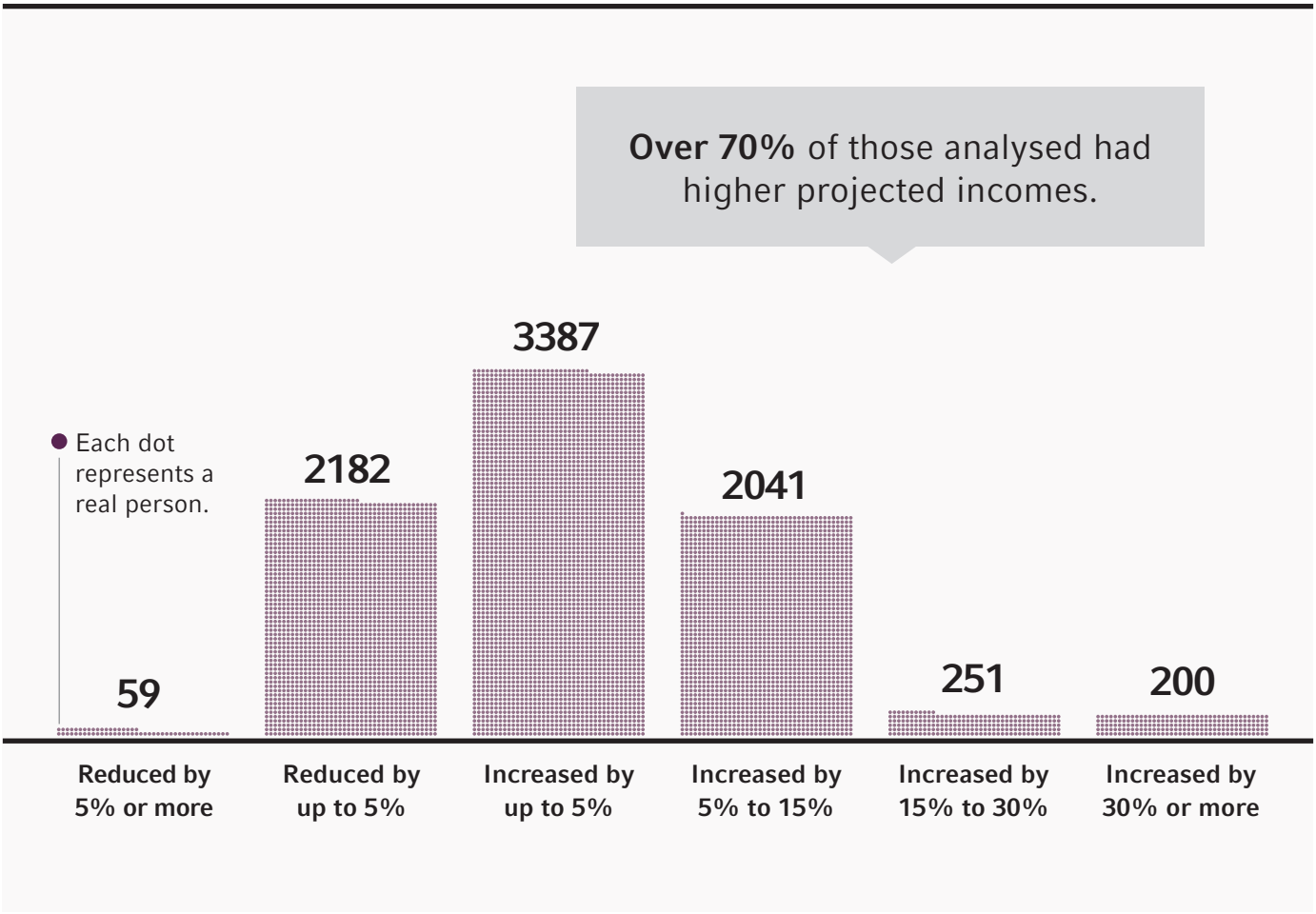
4 Investment earnings

By optimising asset allocation (the single most influential factor on investment earnings) at the individual level, we can materially improve Australians' retirement adequacy.

Our analysis of around 8,000 individuals shows a more personalised approach—individually increasing growth allocations earlier in life and more precisely reducing growth allocations when approaching retirement—can increase the projected retirement income for more than two out of every three people, while simultaneously reducing the impact of a significant market event later in life.

In addition, by incorporating the individual's desired income, asset allocation can be further optimised to reduce the chance of falling short. For example, if an investor is on track to their retirement income goal, but not above, a more defensive growth allocation can help ensure they don't fall below their target income.

FIGURE 4.1: Impact of a more personal approach to asset allocation on retirement income



Projected incomes are calculated based on data and assumptions and are not a guarantee of actual retirement incomes. Projected incomes were determined based on data from the 8,120 members who used the Russell Investments goal setting tool (which excludes significant outliers with projected income more than 50% away from the desired income). Data includes current age, current balance, current income, current investment strategy, current contribution level (including member voluntary), desired age to retire from the workforce and desired level of annual income in retirement. Projected income is based on assumed returns applicable to the current investment option or the GoalTracker default strategy, member data and the assumption all savings are spent by the age of 94. The projected income was compared to the desired level of income.

4.1 Why optimise asset allocation at the individual level?

Independent research by Vanguard Investments[12] (analysing returns across 3,400 diversified funds in Australia, U.S., U.K., Canada, Japan and Hong Kong over a 26-year period) found strategic asset allocation drove 85% or more of investment returns.

Asset allocation is fundamentally the balancing of return expectations and risk, or uncertainty, using a range of asset classes. Each asset class typically has an expected return and an expected level of volatility (the uncertainty associated with the return, i.e. how far the return is expected to move away from expectations over different time periods). Asset classes with higher expected returns and volatility are known as growth assets (e.g. shares and property). Those with lower expected returns and lower volatility are known as defensive assets (e.g. bonds and cash).

For younger savers, high allocations to growth assets can improve the expected retirement income, as they have the time to outlast any negative volatility. Closer to retirement, high growth allocations can be risky. Significantly, more savings are invested (relative to a younger investor who is yet to make many years of contributions), increasing the impact of a market shock like the Global Financial Crisis (GFC) or the COVID-19 crisis. Investors may need to draw on their savings before they have time to recover their losses, either reducing retirement income or delaying retirement.

The investor's goal can also play a significant role. For example, if an investor is on track to their desired retirement income, reducing growth allocations will help ensure they don't fall below. However, an investor significantly ahead of their goal doesn't need to sacrifice the upside potential, as they have the savings needed to fund their income, irrespective of short-term volatility.

Given the importance of asset allocation on investment returns, it may come as a surprise to many that most Australians don't have an asset allocation well suited to their needs, particularly when you consider the 40+ years spent saving for retirement.

The following analysis looks into the three primary methods used to determine asset allocation:

A

Remain in the default investment option provided by the super fund

All default options significantly compromise growth allocations, optimising to the total membership base, or an age-based cohort, at the expense of the individual.

B

Choose their own investment option

While some investors choose an option better suited to their needs, poor financial knowledge, unreliable information sources and emotions see many choose poorly.

C

Seek professional help

Personal advice can improve asset allocation, yet few Australians draw on professional advice.

4.2 All current default options compromise asset allocation

All default options significantly compromise growth allocations, optimising to the masses at the expense of the individual.

Saving for retirement is a 40+ year journey. Over this time, every investor in a default option will experience significantly compromised growth allocations, materially reducing retirement adequacy. For example, our analysis shows a 25-year-old with an annual salary of $50,000, targeting a balance of $305,000 will be more than $50,000 worse-off at retirement when investing in a lifecycle fund relative to an optimal growth allocation. The same investor in a static option (70% growth) will be more than $65,000 behind.

These findings are supported by external analysis conducted by Rice Warner. The analysis found, for an individual aged 30 with an opening balance of $26,000, a multifactor lifecycle product that considers more of the investor's personal circumstances had a 91.8% chance of outperforming a balanced fund by retirement at age 63. In more compromised cases, the research found the income a member receives in retirement was up to 35% higher relative to a balanced fund with a 70% allocation to growth assets[13].

To understand these compromises, it's helpful to know how growth allocations are determined for default options. The growth allocation is designed in one of two ways:

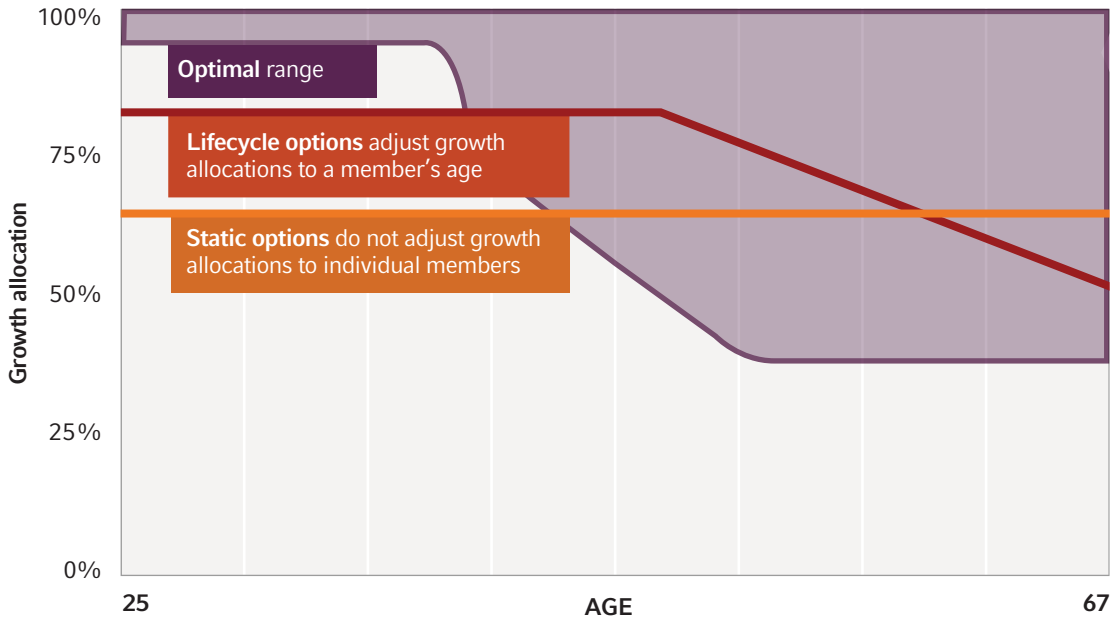
- **static options** share a single target growth allocation across all investors; and
- **lifecycle options** share growth allocations across age-based cohorts.

Both approaches share the same fundamental flaw: allocations designed for a cohort, at the expense of individual appropriateness.

Static options have a very broad membership with potential to create significant compromise. For example, a 25-year-old will sacrifice substantial growth potential and a 65-year-old will take on significant investment risk, with a single asset allocation designed to accommodate both.

Age-based lifecycle options do reduce this compromise. Yet, optimal asset allocation can still differ significantly within age bands. These options ignore the nine additional data points needed to determine an optimal growth allocation. For example, an investor with significantly more savings than needed can maintain a higher growth allocation when approaching retirement. The excess savings will allow them to maintain a comfortable income through a negative period and into the future recovery as they can draw income from the excess, ensuring their savings don't fall below the point needed to meet their needs.

FIGURE 4.2: Optimal growth allocation zones

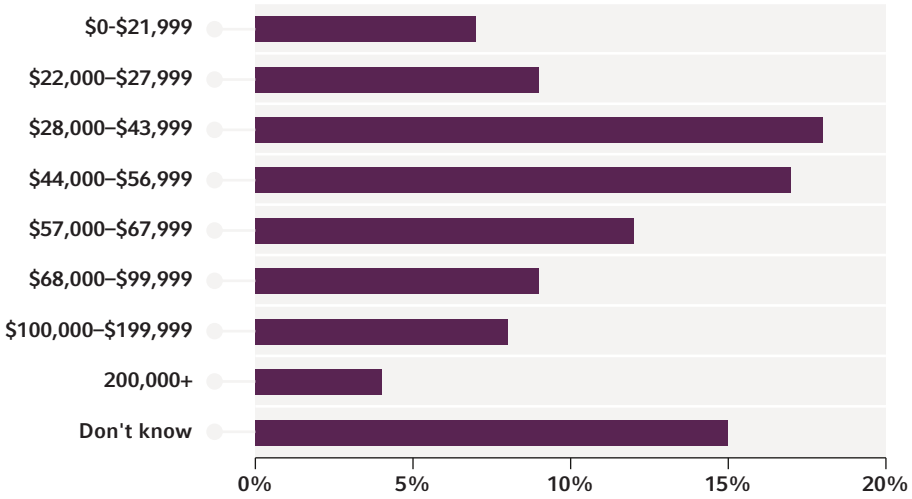


An optimal personal growth allocation can be anywhere within the purple range, while a static or lifecycle option only follows a single path.

Both advisers and institutional investors understand the importance of financial goals to any optimal asset allocation. Contrast a one-size-fits-many approach to the typical experience with a financial adviser. A substantial amount of time will be dedicated towards understanding what the client wants to achieve, so the advice can be tailored to achieve their goals. This dynamic is just as true for institutions investing billions of dollars. Every piece of consulting advice provided to our institutional clients, representing more than three trillion dollars of assets globally, is firmly grounded in their financial goals.

Yet, unlike an adviser or institutional investor, super funds are potentially dealing with thousands of personal income goals. Each of us has a different idea of the kind of retirement lifestyle we want to achieve and our retirement income will be unique to our needs. Our survey uncovered almost half (48%) of the 3,000 participants already had a retirement financial goal in mind—with an average desired retirement income around $66,500 per annum. But this simple figure hides the wide dispersion of retirement income investors were targeting, ranging from below $20,000 to above $200,000.

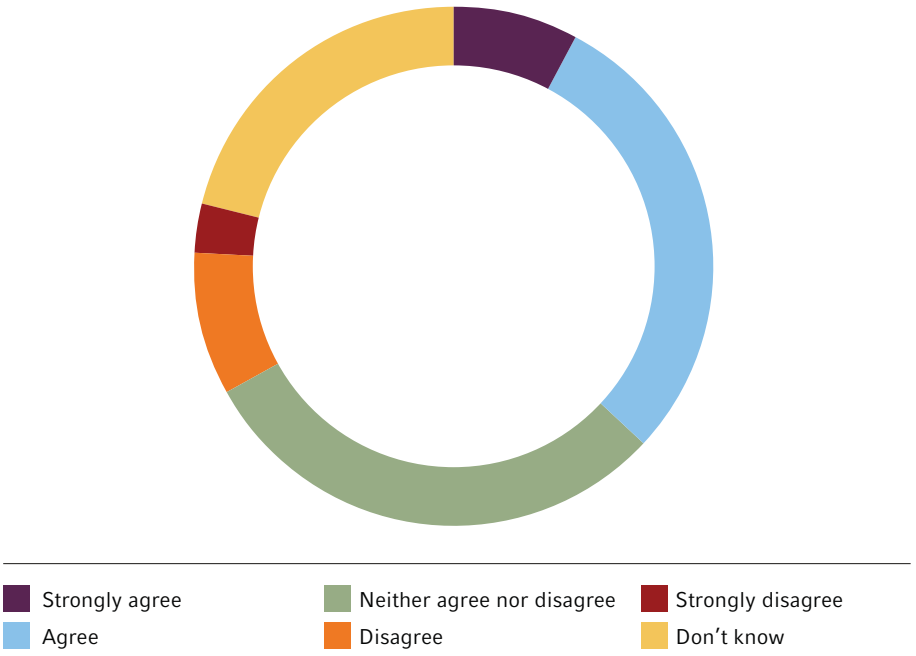
FIGURE 4.3: Response to—how much annual income (after tax) do you think you (as an individual) will need each year to live the life you want in retirement (in today's dollars excluding rent)?



4.3 These compromises are poorly understood by investors

Only 12% of survey respondents correctly believed their super fund did not use their personal circumstances (like age, current super balance and income) to actively manage their investments. Nearly a third incorrectly believed their fund actively managed their investments based on these details.

FIGURE 4.4: Response to—my superannuation fund actively manages my investment based on my personal circumstances (such as my age, current super balance and income).

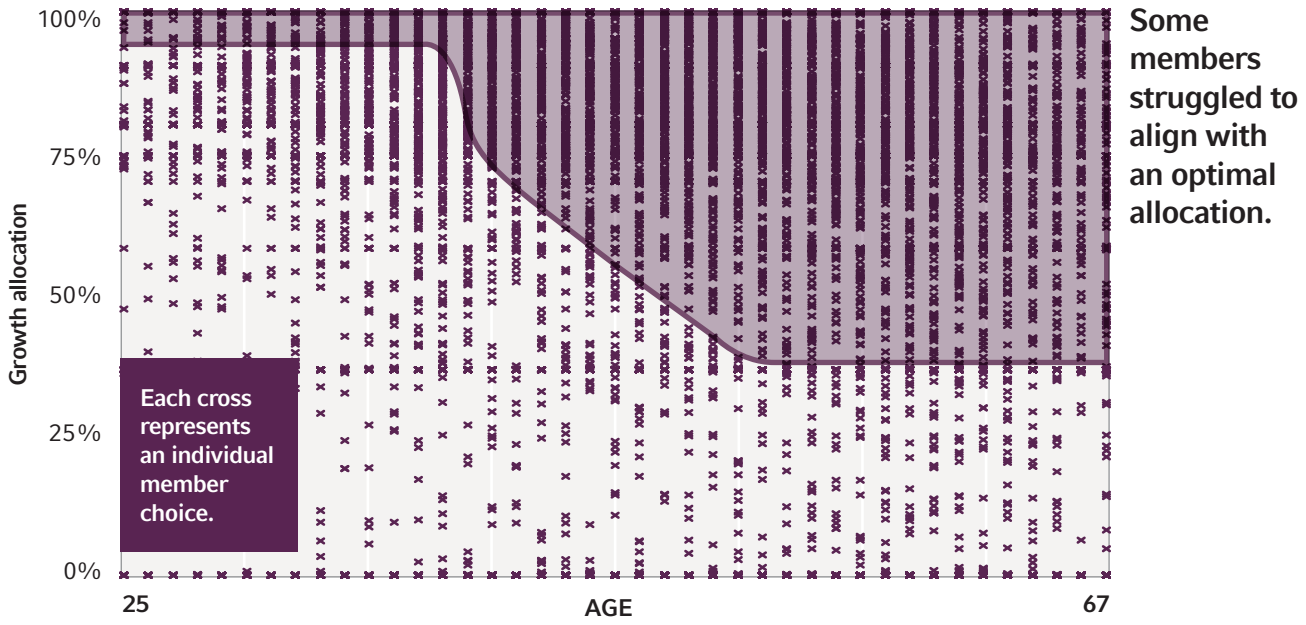


4.4 Australians struggle to choose an option better suited to their needs

Analysis of 'choice' members within the Master Trust shows a significant discrepancy between many investors' chosen growth allocations and the optimal zones covered earlier in this paper.

The below chart shows, while some Australians do make an optimal choice, many also make investment choices that either sacrifice growth potential or take on too much risk when retirement is imminent. The following sections draw out three key challenges faced by those who choose their own investment strategy.

FIGURE 4.5: For individuals who have made their own choice, many chose a growth allocation outside the optimal range.



Limited financial knowledge

Of the 1,030 participants who told us they made an active investment choice, only one third could answer the two basic financial literacy questions correctly—whether shares in one company provided greater diversification than shares in multiple companies; and whether an investment with higher returns was likely to be higher risk.

Many participants also demonstrated a poor understanding of the importance of asset allocation and contributions. When asked which factors had the biggest impact on retirement adequacy, 33% incorrectly believed fees or manager skill were the most influential.

Figure 4.6 shows, of those who have made an investment choice, 49% incorrectly believed their superannuation fund actively managed their investments based on their personal circumstances, a higher portion than those in the default or those who didn't know how they were invested.

Unreliable sources of information and overconfidence

Figure 4.7 highlights significant issues with the sources of information investors use to make investment decisions. The survey found one in four relied on help from a 'friend or relative with financial knowledge', with only three in 10 referencing the more reliable information provided by their superannuation fund.

Alarmingly, 28% told us they didn't have much investment experience and still decided to pick their own investments.

FIGURE 4.6: Response to—my superannuation fund actively manages my investments based on my personal circumstances (such as my age, current super balance and income).

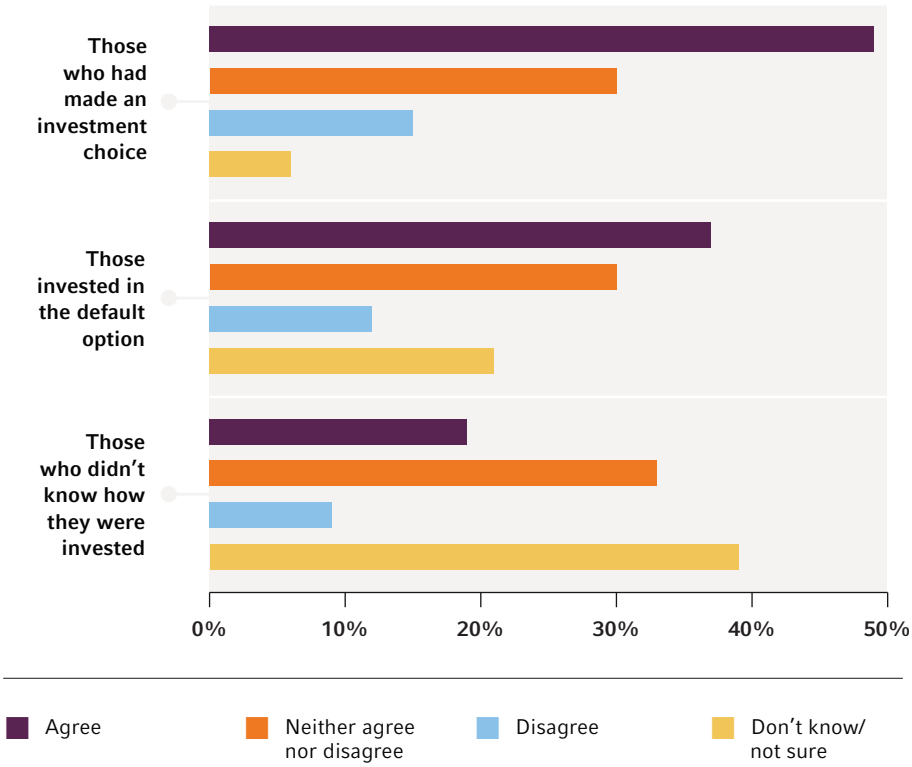
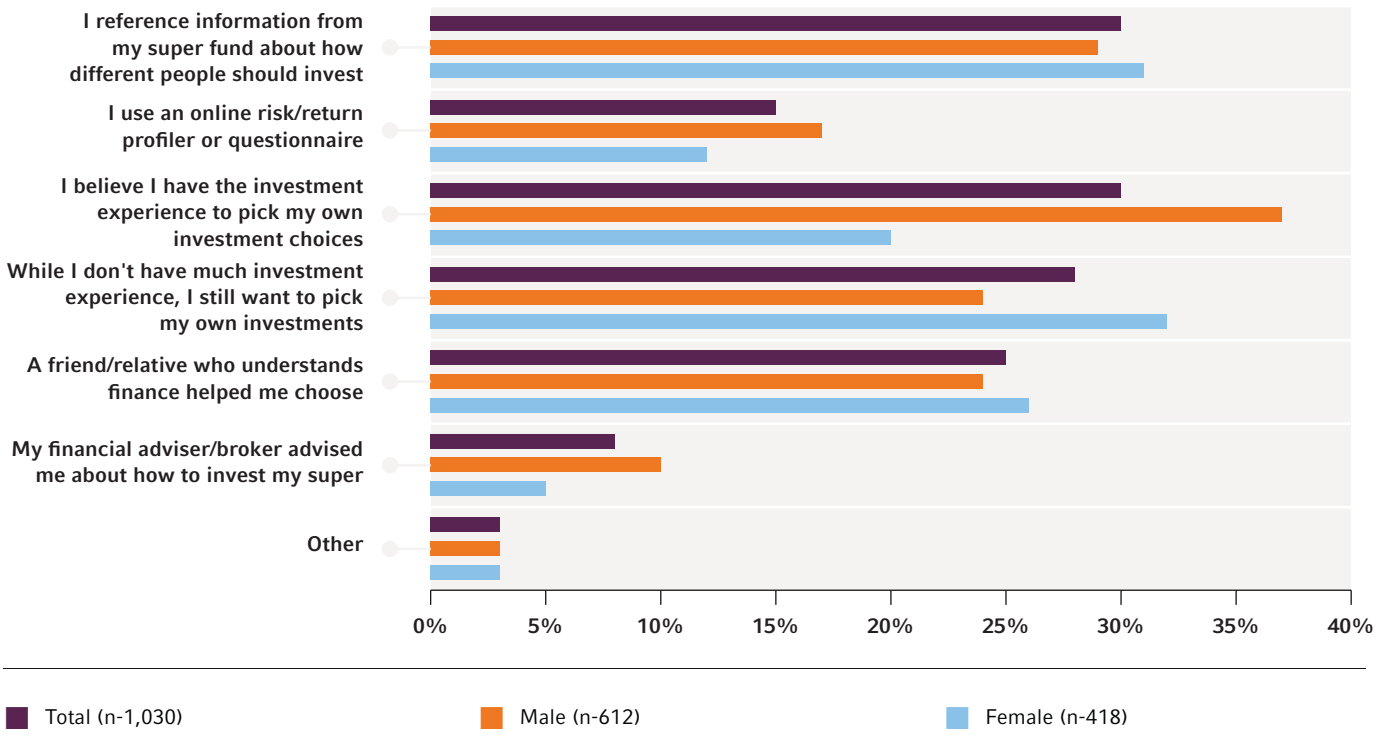


FIGURE 4.7: Response to—when making your own investment choices, how do you determine the best strategy?

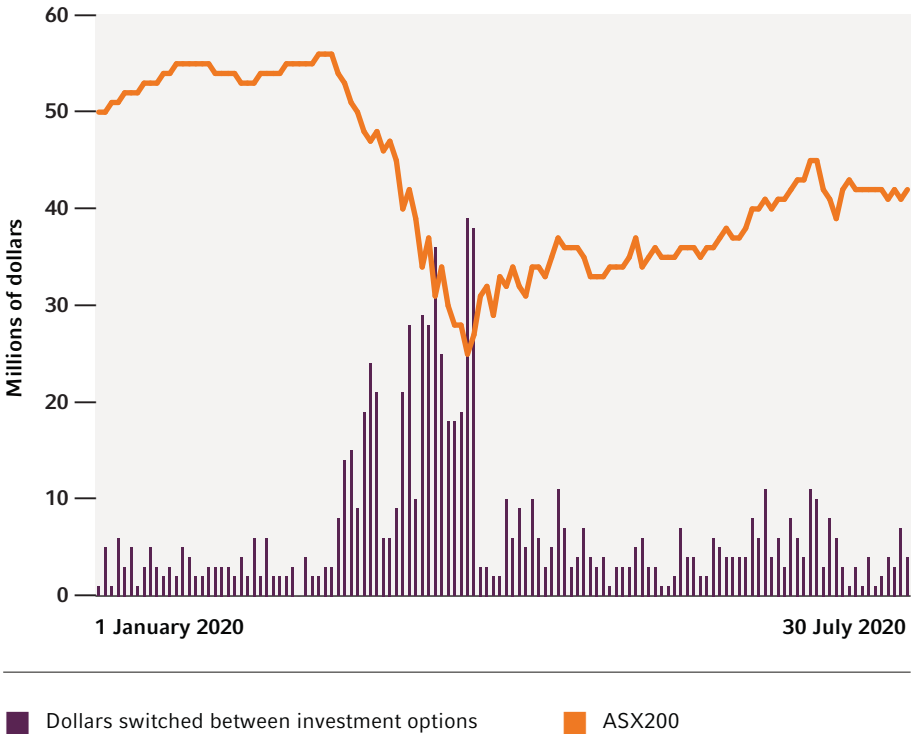


Emotional decision making

Emotions can run high when asset valuations are fluctuating. Investors who experience losses can be led by these emotions, making poor investment decisions. The recent market volatility around COVID-19 has again highlighted the tendency for some investors to shift asset allocations defensively immediately after a period of negative market performance[14].

Yet history shows that shifting to overly conservative investments when fear is dominating financial markets can significantly harm long-term wealth creation. Investors who sell in such circumstances often end up buying high and selling low, a poor investment strategy. For example, the chart below highlights the significant increase in investment switching during the COVID-19 crisis. As the ASX200 index plummeted, switching between investment options progressively increased. As the ASX200 began to lift, switching returned to normal levels pointing to the 'fear of loss' as a key driver of the increased switching volumes.

FIGURE 4.8: Investment switching during volatile markets



4.5 Professional advice can address these issues, yet few Australians draw on the available options

Personal advice, either through a super fund or financial adviser, has the potential to eliminate these compromises, but each approach comes with its own challenges.

The cost of full financial advice is a significant barrier.

Suboptimal asset allocations could be addressed through professional paid financial advice. However, independent research shows many Australians don't use, or believe they cannot afford, a financial adviser. A 2019 survey by the Australian Securities and Investments Commission found only 27% of Australians had received financial advice in the past and just 12% had received financial advice in the last 12 months[15].

Limited advice has had limited uptake.

Many superannuation funds offer 'limited' financial advice. This usually involves providing single-issue personal advice at low or no cost. While valuable, very few members choose to access this service. As a member-initiated service, the low levels of uptake are not surprising when you consider two thirds of survey respondents already believed their super fund was pro-actively protecting their savings from potential losses. For those who did seek advice, the onus remained on the individual to implement the recommendation and renew the advice as their circumstances changed, another barrier to improved outcomes.



27%

of Australians had received financial advice in the past.

12%

had received financial advice in the last 12 months.

A look at best practice—how billion dollar funds invest.

For more than five decades, we've advised many of the world's biggest and most sophisticated investors. While there are many differences between these large institutional investors, the consistencies sit in stark contrast to the way most Australians invest for retirement.

Step 1 Define the financial goals

The process always begins with a clear definition of the investor's objectives and constraints. In the case of a DB fund, the objective could be achieving a funding level with a specified level of certainty, or achieving a specific level of volatility in the results disclosed in the sponsoring employer's financial statements. Importantly, the objective typically has an outcome and measures the risk of not achieving that outcome. Good governance demands the trustee be very specific about the goal, ensuring accountability to the board, management and the beneficiaries of the fund. There is nothing to say the goal can't change in the future, in three or 30 years, however it must be clearly defined.

Step 2 Design the asset allocation

Typically, the trustee of a large fund will then draw on specialists to help determine the asset allocation best suited to meeting these predetermined goals. This involves determining the proportion of the fund's capital that will be placed in each asset class—typically stocks (including sub-classes like large cap, mid cap, international equities and emerging markets), fixed income, infrastructure, property, cash and money market securities. The proposed asset allocation is optimised with sophisticated market modelling tools, such as Monte Carlo simulations, which have the capability to test how the asset allocation would perform in tens of thousands of potential market scenarios.

Step 3 Access the best investment managers

Once the final asset allocation is determined, a diversified selection of thoroughly researched investment managers are hired to implement the strategy. The fund will usually employ a team of people or an external consultant to conduct extensive research in order to determine which managers are most likely to deliver on the objectives, typically specialists in each asset class. A diversified selection of managers are then given a specific mandate, managing the fund's investments on an ongoing basis.

Step 4 Have a clear and methodical approach to monitoring and reporting

Once the mandates are provided to the investment managers, it is not a process of set and forget. A large investor will have a very clear and methodical approach to monitoring the investments to ensure they are tracking towards the fund's objectives. Asset allocations are reviewed regularly to ensure the performance of the fund is in line with the trajectory required to meet the objectives.

In contrast

Consider this best practice in relation to the experience for most Australian superannuants. The vast proportion are invested in a way that has no consideration for their individual investment goals. And without the goal, there is very little support available to help them understand what else they can do to achieve it.

4.6 Low cost personalised advice has been available in the U.S. for almost a decade

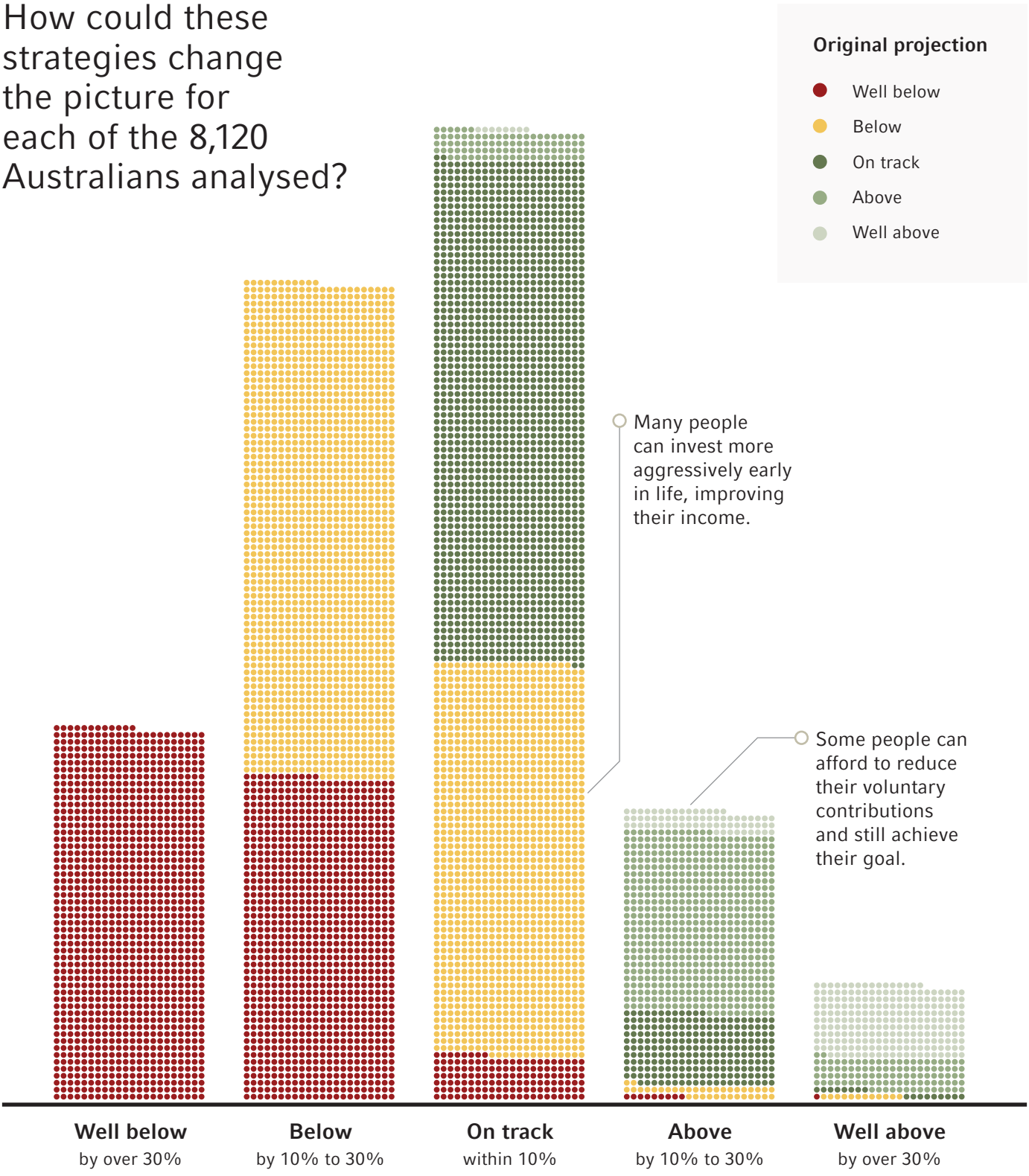
As discussed, the Australian superannuation approach to optimising investment risk has many compromises. Yet the global industry has evolved beyond Australia's limited approach. The U.S. has seen substantial growth of 'managed accounts,' technology-driven products that offer asset allocation at the member account level (these managed accounts should not be confused with Separately Managed Accounts, commonly used in Australia by individual investors and advisers to access a range of investments and investing styles). In the seven years through to 2018, total U.S. managed account assets have more than tripled to US$275 billion (A$612 billion) with participant numbers nearly doubling to three million[16].

U.S. managed accounts do cover a broad base of products with material variations between providers and the data they draw upon to customise the asset allocation. For instance, some products use what is available in the recordkeeping system (such as age, gender, savings rate and income), while others employ data points accumulated from the payroll system (such as marital status and dependants). Some providers also allow participants to add further information (such as additional assets) or provide questionnaires for participants to complete, and leading providers allow for the setting of a retirement income goal. All this information is then used to customise the ongoing asset allocation to the individual investor.

In the seven years through to 2018, total U.S. managed account assets have more than tripled to US$275 billion (A$612 billion) with participant numbers nearly doubling to three million.

5 The impact

How could these strategies change the picture for each of the 8,120 Australians analysed?



Projected incomes are calculated based on data and assumptions and are not a guarantee of actual retirement incomes. Projected incomes were determined based on data from the 8,120 members who used the Russell Investments goal setting tool (which excludes significant outliers with projected income more than 50% away from the desired income). Data includes current age, current balance, current income, current investment strategy, current contribution level (including member voluntary), desired age to retire from the workforce and desired level of annual income in retirement. Projected income is based on assumed returns applicable to the current investment option and contributions, or the GoalTracker default strategy and optimal contributions, member data and the assumption all savings are spent by the age of 94. The projected income was compared to the desired level of income.

6 Introducing GoalTracker™

Introducing GoalTracker, Australia's first mass personalised, goals-based super solution—a personalised investment strategy and engagement experience designed around the unique goals and circumstances of each member.

SIMPLIFY ENGAGEMENT AND IMPROVE CONTRIBUTION LEVELS

GoalTracker is designed to improve member engagement and contribution levels, guiding each member through the key hurdles to their own great life after work.



Removes complexity so it's easier to engage with super



Helps to determine what lifestyle to aim for



Identifies the contributions needed to get there



Tracks progress and provides proactive support to stay on track

IMPROVE INVESTMENT OUTCOMES

GoalTracker can optimise asset allocation at the individual level, cost-efficiently removing the compromises embedded in one-size-fits-many approaches.



Personalises asset allocation to each individual's goals and circumstances



Regularly optimises to changing markets and personal circumstances



Improves projected returns, even for the disengaged



Efficiently implemented with no additional costs

Ultimately, reducing the *real retirement gap*, helping more Australians reach their great life after work.

6.1 How GoalTracker improves engagement and contribution levels

As this paper highlights, the reality of superannuation can be stressful and complex. Grappling with investment concepts (like risk and return) and making decisions around (what is potentially their largest financial asset) can overwhelm investors.

Choosing the right investment strategy is a clear example. Seventy percent of respondents said it was too confusing to choose or they didn't understand how to make the right choice. Yet, this is one of many choices faced by Australians when starting a new job, a stressful situation in itself, without the additional burden of wading through complex choice forms and product disclosure documents. Some members are overwhelmed and disengage. Some choose poorly, significantly impacting their retirement lifestyle. While it is unrealistic that all Australians will actively engage with their retirement journey, as highlighted, there is much that can be done.

A simpler approach.

Getting started

The GoalTracker journey starts with a personal phone call—a proactive outreach from our concierge team. Members are welcomed to the fund, given the time to cover any questions and introduced to our online tools. They are presented with a simple To Do List, setting out each of the key actions they need to take to get on top of their super.

The first step is understanding what kind of retirement lifestyle they are currently heading for. By answering a few simple questions about themselves, we can show them their projected retirement income—the annual income their super will provide once they retire. The income is presented in today's dollars to easily contrast with their current income, a familiar territory for working Australians.

Setting the retirement income goal

With a clear understanding of the retirement lifestyle they are heading towards, the next step is to decide if it's right for them. For the 48% of Australians who already have a retirement income goal, this step is easy. For the rest, the GoalTracker goal setting tool makes it simple.

Rather than the complexity that comes with numbers, retirement income is broken down into eight lifestyle categories. Using images and descriptors, the member can step through each category, deciding on the level that works for them.



Working through eight lifestyle categories, you'll see how much your retirement could cost.

Once complete, we do all the calculations, showing the income they'll need to support the retirement lifestyle they want—highlighting any gap between where they're heading and what they would like to achieve.

We find something very unexpected happens when members see their 'gap' for the first time. It triggers an important emotional reaction as they demand to know: "What can I do to fix this gap?!" With one, simple metric—their own personal super savings gap—superannuation becomes more personal, tangible and relatable. We tap into the goal setting motivators covered earlier, particularly the 'describe it' technique, which increases the chance of achieving the goal by 1.2 to 1.4 times.

Optimising contributions

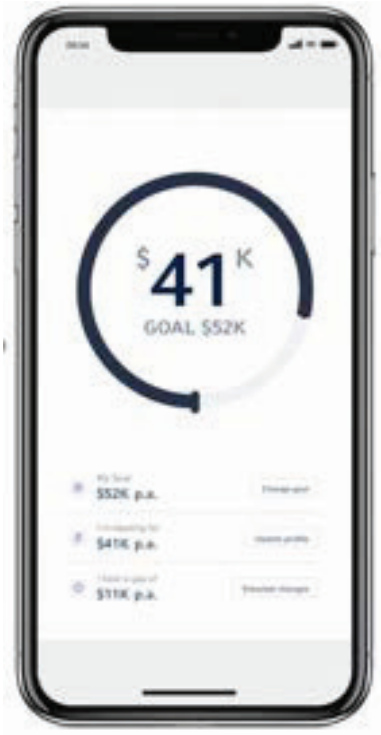
With a clear understanding of the desired retirement income, we can help each member achieve it. With the member's permission, we can optimise their investment strategy to their goal, increasing their chance of reaching their desired income. And we can help them determine the 'right' level of contributions, the amount they need to get on track.

Staying on track

Once members have completed the onboarding process, they are presented with their personal tracker, a simple dial showing how they are tracking relative to their goal. The dial draws on their personal information and balance, keeping them updated on how they are tracking. For example, if their balance drops or income increases (increasing the contributions), they'll see the impact on their dial.

Importantly, the dial is designed to keep them focused on the big picture. This is particularly important during times of substantial market volatility, like the COVID-19 crisis. Repeated news articles highlighting the billions wiped from the ASX is disconcerting. The dial shows the impact on their situation over their full investment timeframe, helping them maintain perspective.

If they do start to fall behind, we'll reach out with proactive nudges, helping them focus and get back on track.



Review how you're tracking to your retirement income goal at any time.

6.2 How much does GoalTracker cost?

GoalTracker was built for Australian investors, leveraging the personalised investing methodology developed in our U.S. business in 2011. Stress tested over many years, the existing methodology substantially reduced the development costs, allowing us to offer all GoalTracker features at the same price as our standard MySuper default.

6.3 How GoalTracker improves investment outcomes

With the member's permission and an understanding of the income each member is aiming for, we can optimise their investment strategy eliminating the compromises embedded in one-size-fits-many investment options and improving the chance they will reach their investment goals.

In addition to the diversification and manager skill embedded within our funds, GoalTracker aims to minimise the likelihood an investor will fall short of their income goal by optimising growth allocations.

FIGURE 6.1: Member data inputs

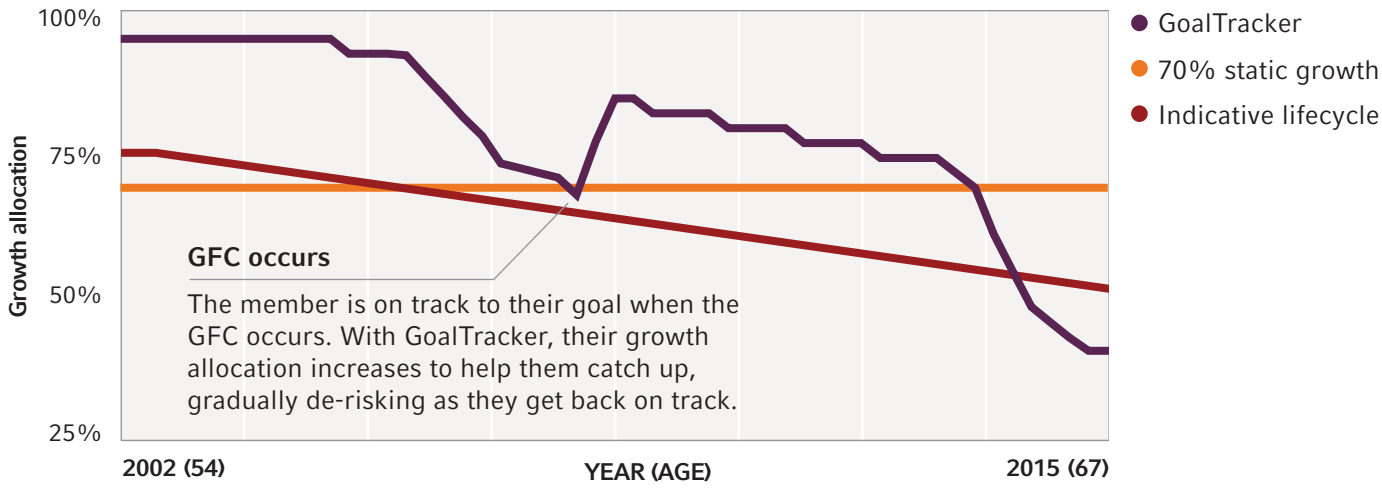
1. Age
2. Super balance
3. Other super
4. Salary
5. Desired retirement income
6. When you'll retire
7. Relationship status
8. Other assets
9. Home ownership
10. Contribution rate

Growth allocations are determined based on how each member is tracking towards their income goal. We draw on up to 10 personal data points and our capital market forecasts to determine how each member is tracking, optimising allocations in line with the four key strategies below:

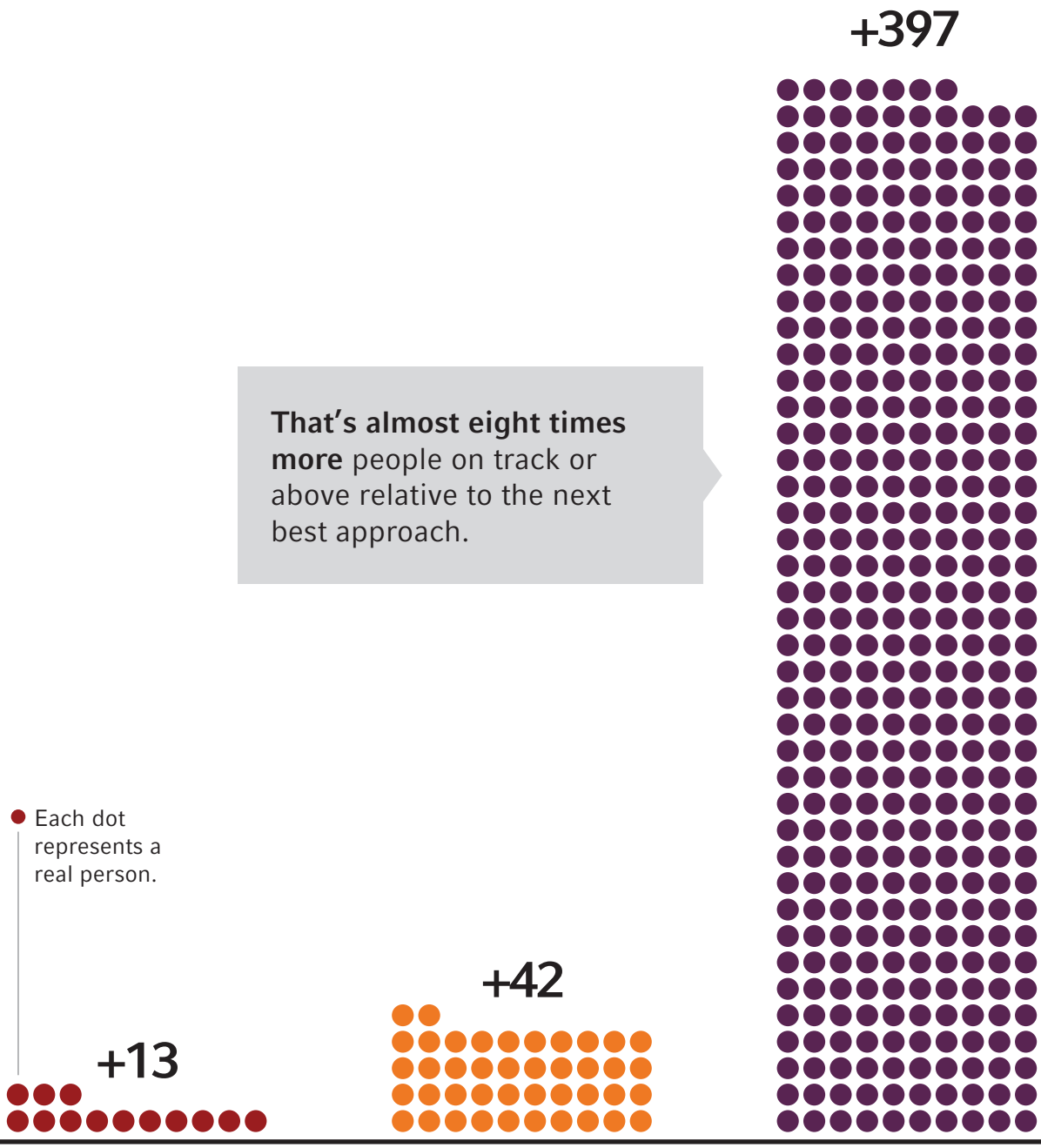
- Early in life, GoalTracker maximises growth allocations. This strategy has a higher expected return over a full market cycle. Members will experience significant downturns, but they have the time to stay invested and capture the following upside. GoalTracker maintains high growth allocations until age 55, the primary driver of higher expected retirement incomes.
- From age 55, how each member is tracking begins to influence growth allocations. If a member is **on track** to reach their retirement goal, the risk of a market downturn pushing them below their goal starts to increase. With this risk in mind, GoalTracker progressively de-risks the portfolio as the member approaches retirement (potentially as low as 36%), minimising the chance a market downturn will push them below their target income.
- For **under-funded** members—those that will fall short irrespective of market volatility—GoalTracker de-risks less aggressively, providing the opportunity to get back on track. This approach does bring additional risk, potentially exposing the member to greater shortfalls as they approach retirement. Given the heightened risks, we pro-actively reach out to each member, explaining the strategy and offering alternate approaches to help them get back on track.
- If a member is **over-funded**—for example, their projected income is materially higher than their goal—GoalTracker maintains a higher growth allocation (incrementally dropping to 70% growth from age 60) as the member has a significantly lower chance of falling short and doesn't need to sacrifice the upside potential.

Each quarter, GoalTracker reviews the member's strategy, allowing the optimisation of growth allocations to one of 59 potential points between 36% and 95% growth. This regular optimisation can see a member incrementally shift between strategies.

FIGURE 6.2: How a member's growth allocation would have changed during the GFC



Change in the number of people on track or above when switched from their current investment strategy.



That's almost eight times more people on track or above relative to the next best approach.

To an average lifecycle
Impact if all participants switched to an average of three leading lifecycle funds

To a static 70% growth
Impact if all participants switched to a static 70% growth fund

To GoalTracker
Impact if all participants switched to GoalTracker

Projected incomes are calculated based on data and assumptions and are not a guarantee of actual retirement incomes. Projected incomes were determined based on data from the 8,120 members who used the Russell Investments goal setting tool (which excludes significant outliers with projected income more than 50% away from the desired income). Data includes current age, current balance, current income, current investment strategy, current contribution level (including member voluntary), desired age to retire from the workforce and desired level of annual income in retirement. Projected income is based on assumed returns applicable to the current investment option, a 70% growth fund, an average lifecycle (an average of Suncorp, SunSuper and Aware Super) or the GoalTracker default strategy, member data and the assumption all savings are spent by the age of 94. The projected income was compared to the desired level of income.

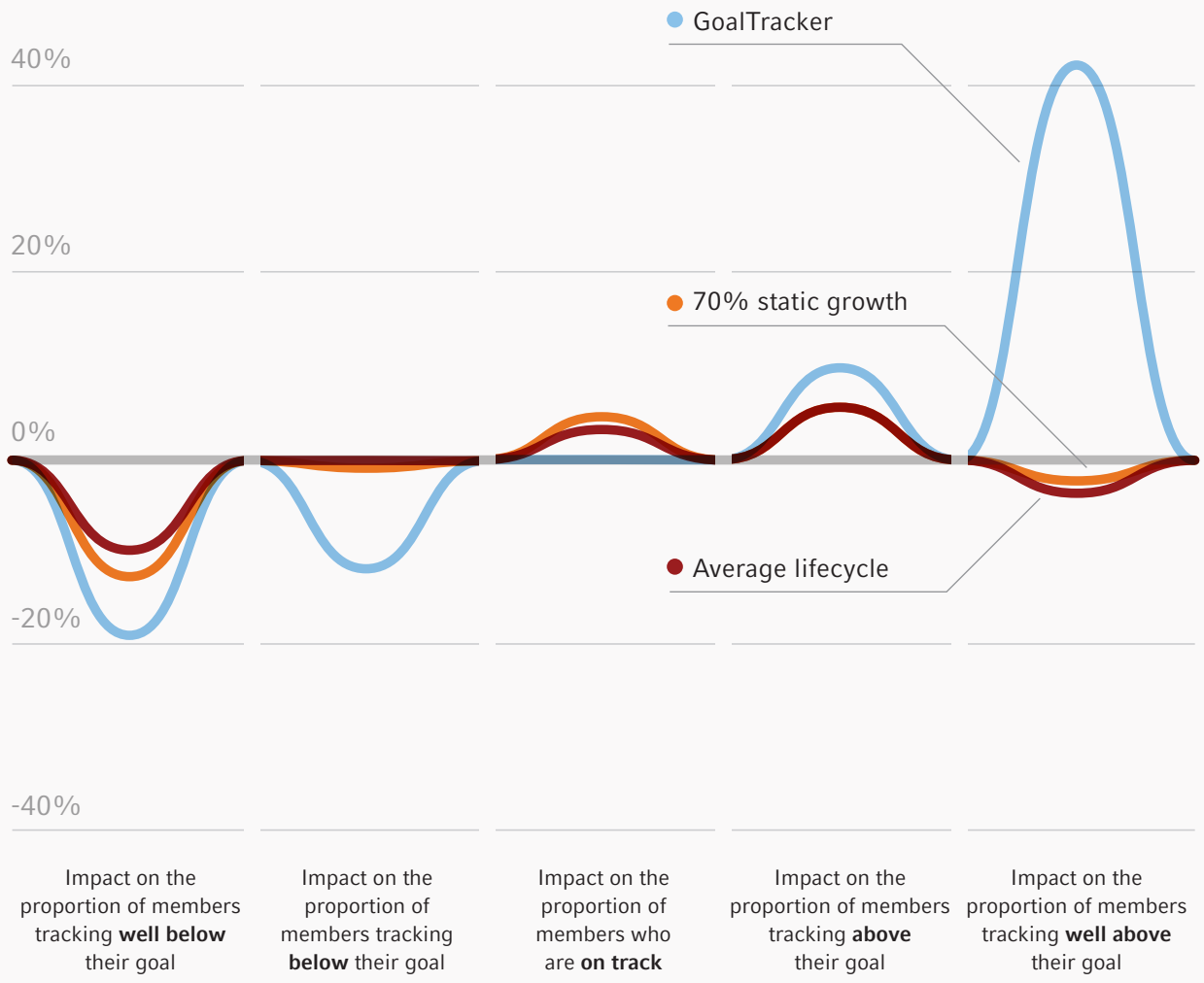
6.4 Improved outcomes, even for the disengaged

This paper highlights a material proportion of Australians (20%) who are unlikely to engage. GoalTracker can help them as well.

At its best, GoalTracker will optimise growth allocations based on up to 10 personal data points to help each member achieve their desired retirement income. But, as discussed, it is simply not practical to expect all members to supply this detail. In these situations the member will remain in the GoalTracker default strategy until we have the data and permission required. Until then, GoalTracker can't fully optimise and applies a growth allocation based on information it knows about the member (such as age).

While not capturing all the benefits of a goals-based approach, GoalTracker still determines growth allocations at the individual level, offering significant upside. In contrast to the alternative default options in figure 6.3 below, GoalTracker will still help more members achieve or exceed the comfortable lifestyle standard (for singles), provided by the Association of Superannuation Funds of Australia (ASFA).

FIGURE 6.3: Impact on the distribution when aiming for a standard retirement income, the ASFA singles comfortable lifestyle income of $43,687



Projected incomes are calculated based on data and assumptions and are not a guarantee of actual retirement incomes. Projected incomes were determined based on data from the 7,585 members who used the Russell Investments goal setting tool (which excludes significant outliers with projected income more than 50% away from the target income). Data includes current age, current balance, current income, current investment strategy, current contribution level (including member voluntary) and desired age to retire from the workforce. Projected income is based on assumed returns applicable to the current investment option, a 70% growth fund, an average lifecycle (an average of Suncorp, SunSuper and Aware Super) or the GoalTracker default strategy, member data and the assumption all savings are spent by the age of 94. The projected income was compared to an income of $43,687.

In closing

We are all different.

Different aspirations, different backgrounds, different families, different incomes, different expectations, different lives. Differences that make us who we are.

When it comes to life after work, our aspirations are just as diverse. Isn't it time your super fund helped you get to where you want to be?



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