



Leading the Way: Integrating Private Alternatives into Target Date Funds

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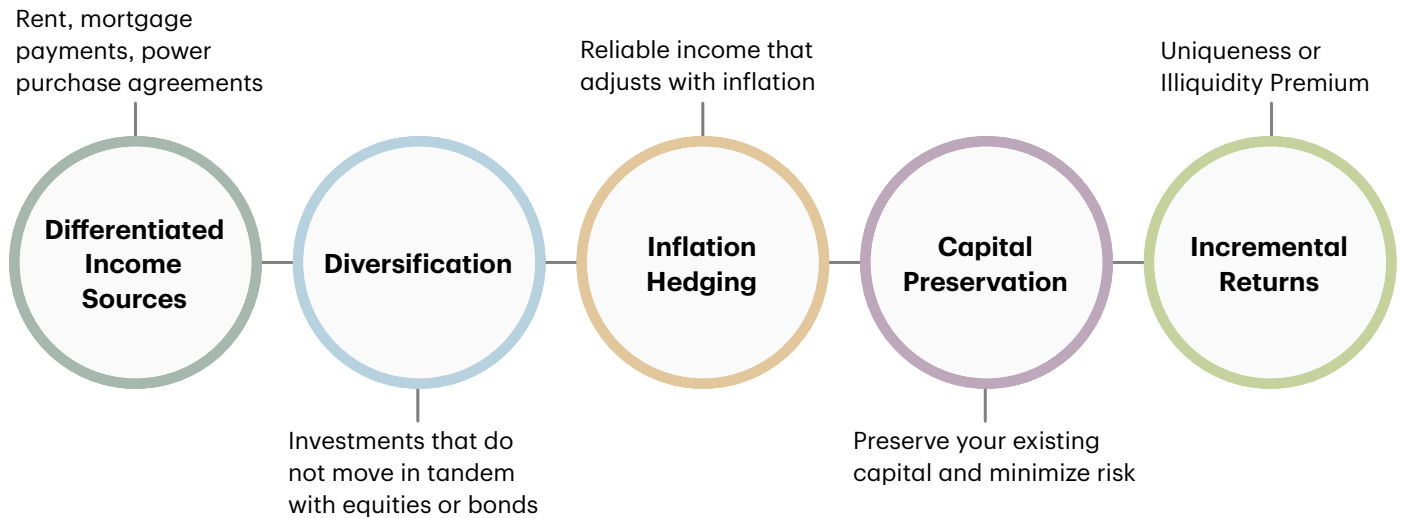
Research consistently shows that an allocation to private alternatives improves retirement outcomes for members of Capital Accumulation Plans (CAPs). TD Asset Management Inc. (TDAM) pioneered the use of private alternatives in Target Date Funds (TDFs) nearly a decade ago, and we have a demonstrated track record of managing a sizeable allocation to alternatives with skill and prudence. Our TD Greystone Target Date Plus Funds allocate about 20 to 25% of their assets to private alternatives – similar to the weight that large institutional investors allocate to private alternatives - which has delivered strong results for clients.

Benefits of Alternatives

CAP plan sponsors are increasingly aware of the various ways in which private alternatives – including real estate, private credit and infrastructure - can enhance portfolio returns and retirement outcomes. Private alternatives offer lower correlation to public

markets, stable income generation, inflation hedging properties, and a premium paid to investors for holding private market assets (see Figure 1). For a deeper dive into private market investments, check out our recent in-depth piece [Bridging the Gap >](#).

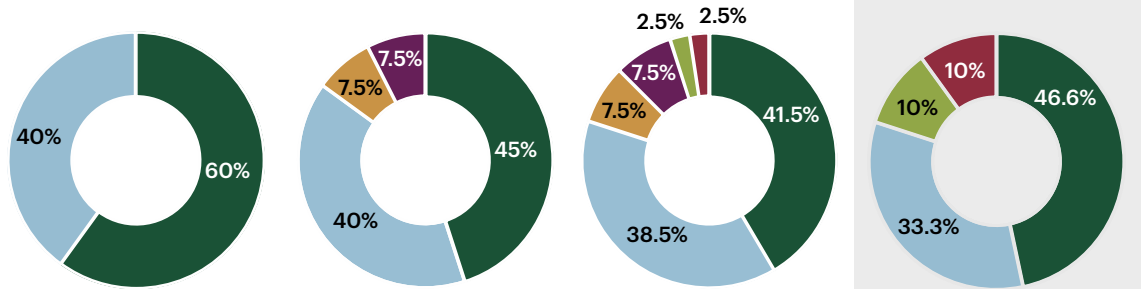
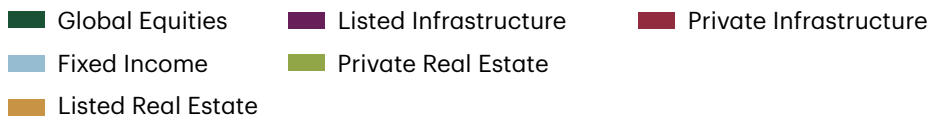
Figure 1: Benefits of Private Alternatives



Source: TD Asset Management Inc.

Moving from the conceptual to the quantitative, Figure 2 shows the favourable impact on risk-adjusted returns of incorporating different types of alternatives (listed and private), at different weights, across four model portfolios.

Figure 2: Private Alternatives Can Enhance Outcomes



Asset Mix Statistics (%)	Public Market Only	+ Listed Alternatives	+5% Private Alternatives	+20% Private Alternatives
Expected Return	6.3	6.5	6.5	6.5
Expected Standard Deviation	7.8	7.6	7.2	6.3
Expected Risk-adjusted Return	0.80	0.85	0.90	1.03

¹Compared to public market only asset mix.

Note: No assurance that forecasted asset mix statistics will be achieved. Asset mix statistics calculated using the active long-term asset class assumptions of TD Asset Management Inc. (TDAM).

Source: TD Asset Management Inc. As of September 30, 2023.

Potential of ~30% enhancement in Risk Adjusted Return¹

More and more TDF providers today are adding private alternatives to their solutions. But many rely on listed alternatives - e.g., Real Estate Investment Trusts (REITs) or infrastructure equities - and/or they have a relatively low allocation (less than 5%).

By contrast, the TD Greystone Target Date Plus Funds have a material 20-25% allocation to private alternatives – commensurate with the weight that defined benefit (DB) pension plans and large endowments have maintained for decades.

A representative asset mix for the TD Greystone TDF portfolios is the fourth portfolio in Figure 2.

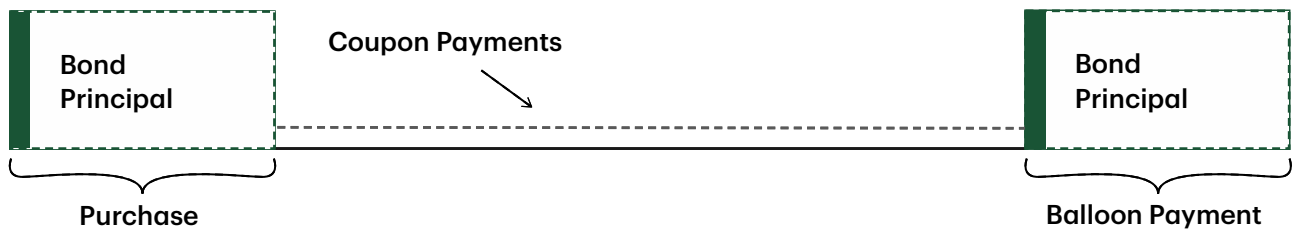
At TDAM, we have been successfully integrating private alternatives into multi-asset solutions for more than 35 years. In the remainder of this paper, we explore the key components of our ability to deliver this DB-like solution to CAP clients of any size – namely, our expertise in private and public markets, robust TDF design features and disciplined investment processes.

Private and Public Market Expertise

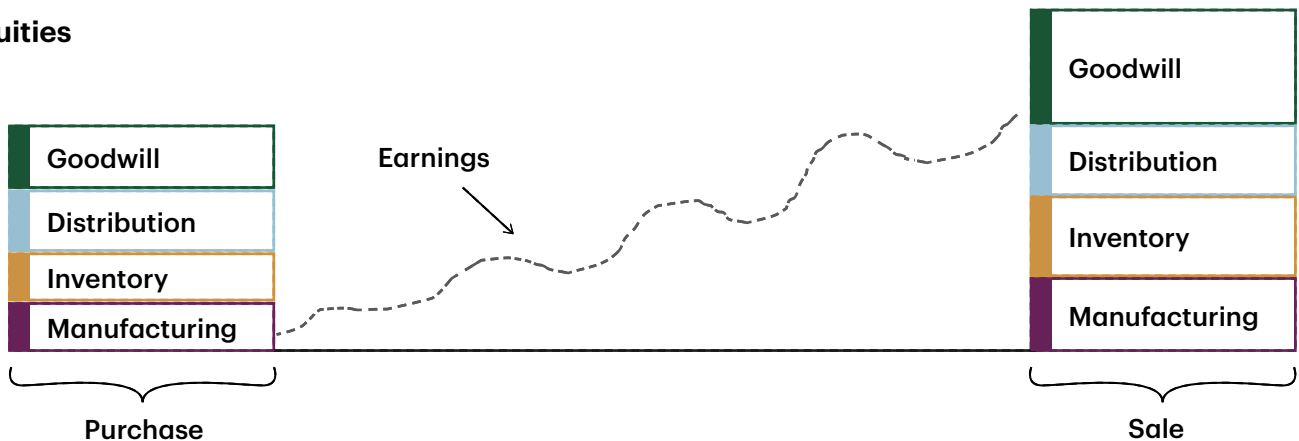
Critical to incorporating private alternatives in TDFs is a deep understanding of how they perform relative to public market assets. This includes the fundamental drivers of return for each asset class (depicted in Figure 3), as well as each asset’s sensitivity and exposure to factors such as interest rates, economic growth, quality and credit.

Figure 3: The Fundamentals of Investment Returns

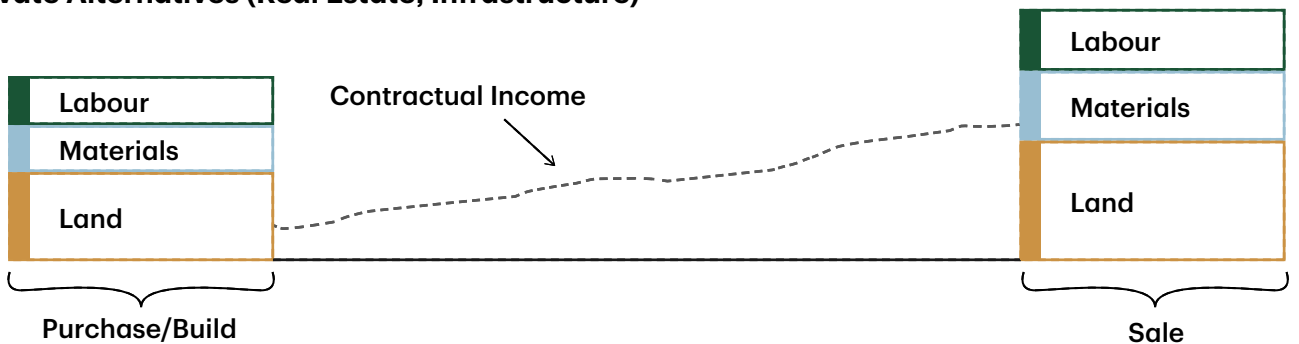
Bonds



Equities



Private Alternatives (Real Estate, Infrastructure)



For illustrative purposes only. Source: TD Asset Management Inc.

This analysis informs our portfolio construction process, which seeks to achieve optimal factor diversification across the glide path – the way the strategic asset mix changes for our TDFs over time. This analysis also helps us avoid unintended risks or concentration of factors.

In addition, our expertise in each individual private asset class enables us to identify secular trends, relative value and long-term growth trajectories that help us position the total portfolio to take advantage of the most accretive opportunities. Our ability to add value is further enhanced by our scale and deep relationships in the private market space.

Robust TDF Design Features

The TD Greystone Target Date Plus Funds use in-house, open-ended private alternative strategies designed to be part of a multi-asset solution. In particular, all of our strategies emphasize core, high quality, income-producing assets whose relatively greater liquidity and stability align well with the needs of CAP members.

Still, private market assets trade less frequently than public market securities. TDFs must contend with this reduced liquidity by building in design features that allow them to satisfy the four types of cash flow requirements common to TDF programs:

- **Daily cash flows** - from plan member fund selections and payroll contributions.
- **Glide path rolldown** - from gradually de-risking the fund as retirement approaches.
- **Active rebalancing** - rebalancing back towards the strategic glide path as the portfolio drifts due to market movement.
- **Plan sponsor changes** - adding or removing a TDF provider from the plan's fund line-up.

The TD Greystone Target Date Plus Funds' 20-25% allocation to private alternatives was determined based on robust liquidity modelling of the above four cash flow requirements, including large contribution and drawdown testing in a variety of up- and down-market scenarios. The allocation is reviewed annually through our formal Annual Glide Path Update process to make sure it remains appropriate, creating an optimal level of private alternatives to provide enhanced risk-adjusted returns, while ensuring sufficient liquidity to meet CAP plans' ongoing cash flow needs.

Another key design feature of the TD Greystone Target Date Plus Funds is the Private Alternatives

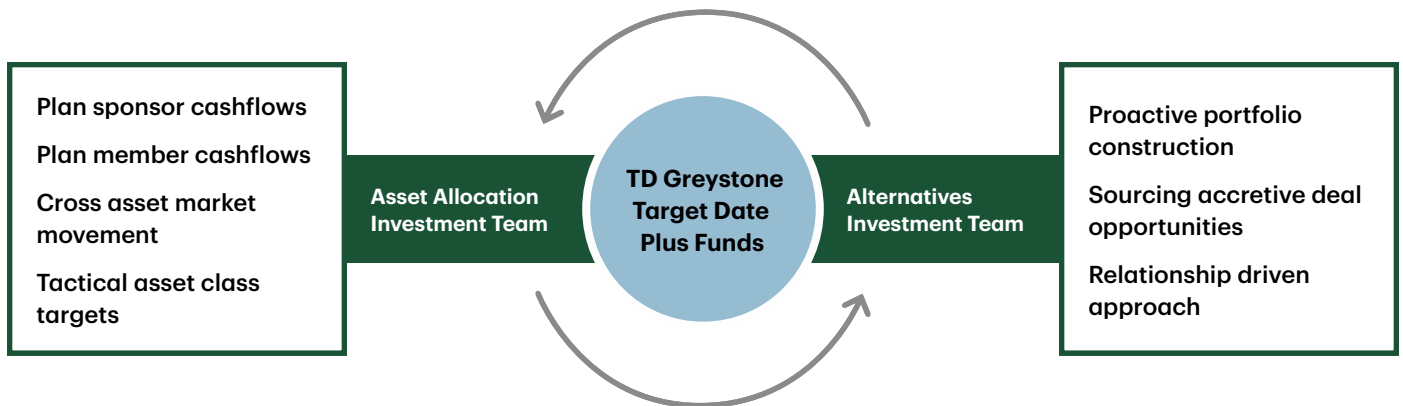
Proxy – a mechanism to manage cash flows for the funds. The Private Alternatives Proxy is a basket of public market securities whose volatility matches that of the private alternatives. When the TDFs receive new cash, the portion intended for private alternatives is invested in the Proxy portfolio, with a corresponding commitment made to each private alternative fund. The composition of the Proxy portfolio can be adjusted to reflect different market regimes, as well as anticipated time to private market deployment, ensuring that existing plan members benefit from a consistent investment experience.

Disciplined and Developed Processes

Disciplined and well-defined processes for cash flow modelling, forecasting and communication are critical to reducing the time lag between receiving a new cash flow and investing it in private alternatives. At TDAM, we forecast and model the four types of TDF program cash flows monthly. This information is incorporated directly into our alternatives portfolio modelling and helps better coordinate timing for sourcing and executing on accretive private alternative deals (Figure 4).

Given the extent and frequency of information sharing required for robust modelling and forecasting, in our view these processes can be properly executed only when public market, private market and TDF teams are fully integrated and operate within the same firm.

Figure 4: Integrated Modelling, Forecasting and Communication Processes



Source: TD Asset Management Inc.

Equally important are strong risk management processes for private alternatives, grounded in public market governance standards. These standards provide clarity and transparency around private asset valuations, which impact the overall returns of the TDF strategy. At TDAM, our private alternatives are valued quarterly by accredited independent third-party

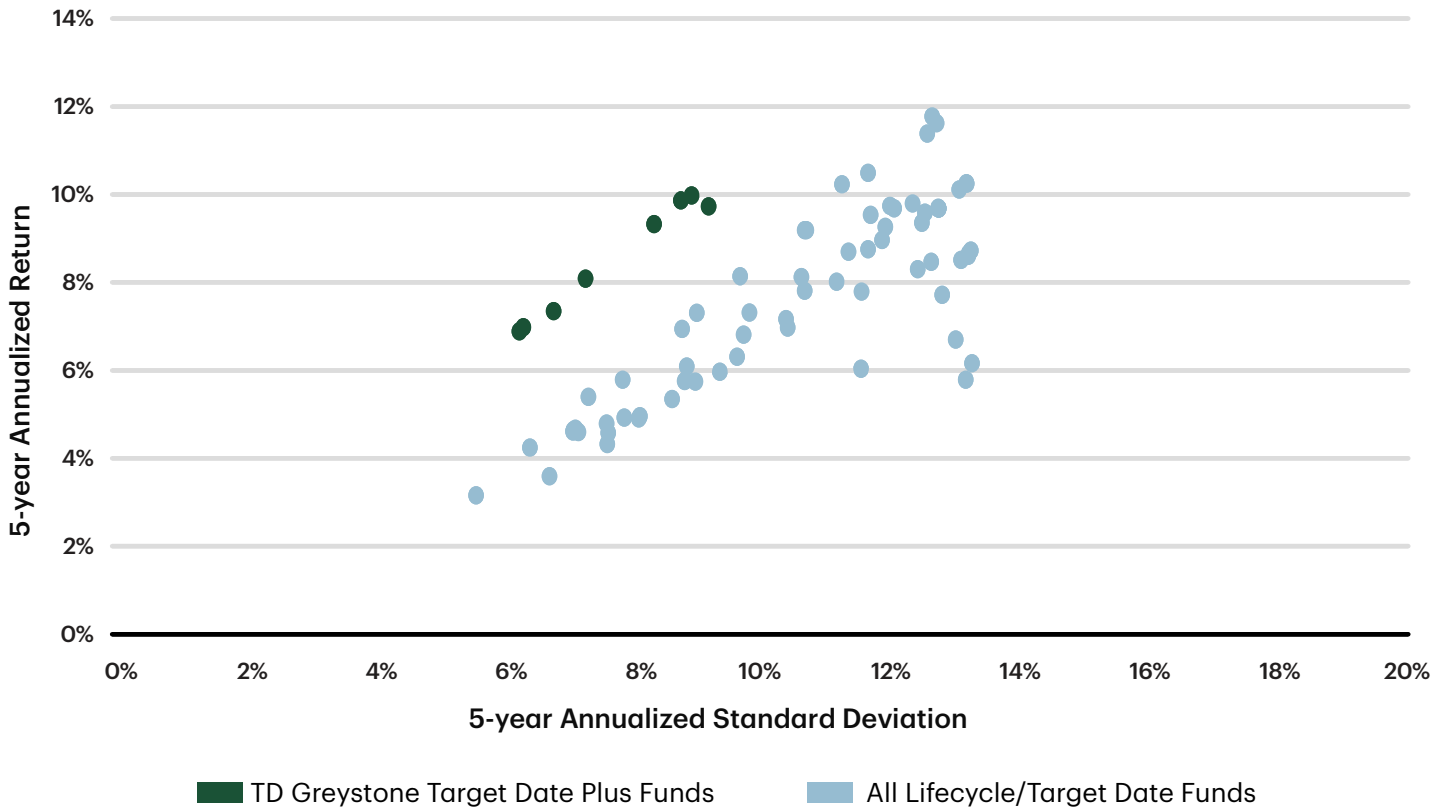
appraisers and follow best-in-class practices. This is supplemented by internal governance structures, such as the TDAM Valuation Committee, which ensure adherence to robust and consistent valuation policies, providing peace of mind for CAP members and sponsors.

Process

Delivering Results for Plan Members

Due to TDAM's expertise in private and public markets, robust TDF design features and disciplined investment processes, the benefit of private alternatives is optimally realized in member portfolios through enhanced risk-adjusted returns (Figure 5).

Figure 5: Strong Risk-Adjusted Returns across the TD Greystone Target Date Plus Funds



Note: Grey dots are funds across vintages in the eVestment Alliance, LLC – Fund Category: All Lifecycle/Target Date; only includes products with C\$ as base currency. Current number of funds in the category 195; 75 reporting 5-year returns.
Source: eVestment Alliance, LLC. As of Dec 31, 2023. Data pulled January 15, 2024.

Returns

Conclusion

Private alternatives can enhance retirement outcomes for plan members due to unique benefits such as steady income, inflation hedging, liquidity premiums and enhanced diversification. At TDAM, we pioneered the use of private alternatives within TDFs, having integrated them in multi-asset portfolios for over 35 years. The TD Greystone Target Date Plus Funds integrate private alternatives at a material 20-25% weight, which is enabled through expertise in private and public markets, robust TDF design features and disciplined investment processes. These funds have been able to deliver strong risk-adjusted returns for CAP members. ■

Private Alternatives



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