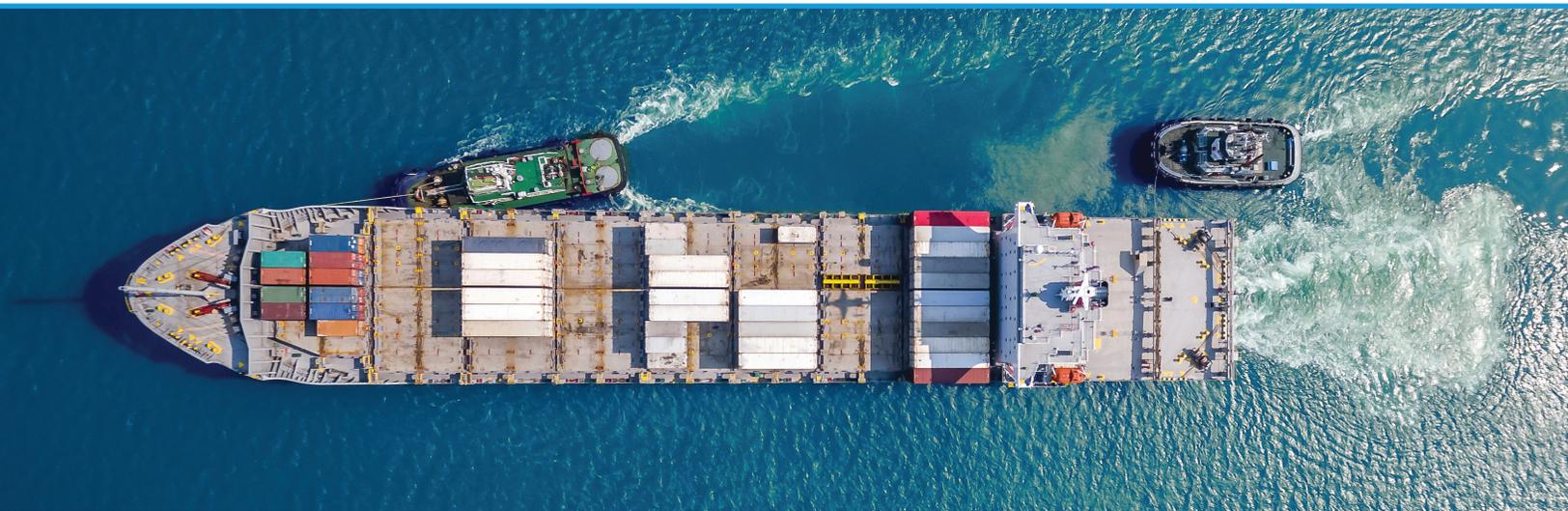


A glide path approach to equity risk in emerging markets



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Key takeaways

- Characteristics of emerging markets have changed, with potentially increased risk
- Emerging and developed markets assets are increasingly moving in unison due to greater financial and economic integration
- Given greater risks, our Series uses an age-appropriate approach to emerging markets equity exposure

Emerging markets equities, despite their volatility, have provided compelling diversification and appreciation opportunities, which means they have been a critical holding within many gliding and static multi-asset portfolios.

But their characteristics have shifted in recent years. An approach that relies on historical correlations, risk-return dynamics and index compositions is likely to miss what amounts to a regime change within the entire asset class. With the American Funds Target Date Retirement Series, we take a distinctive approach that treats emerging markets assets as risk-return magnifiers, which aren't appropriate for every investor at every stage of life.

But the target date industry overall continues to collectively maintain emerging markets exposure across the glide path, which we believe could result in poor outcomes, particularly for older participants, who are the most sensitive to downside risk.

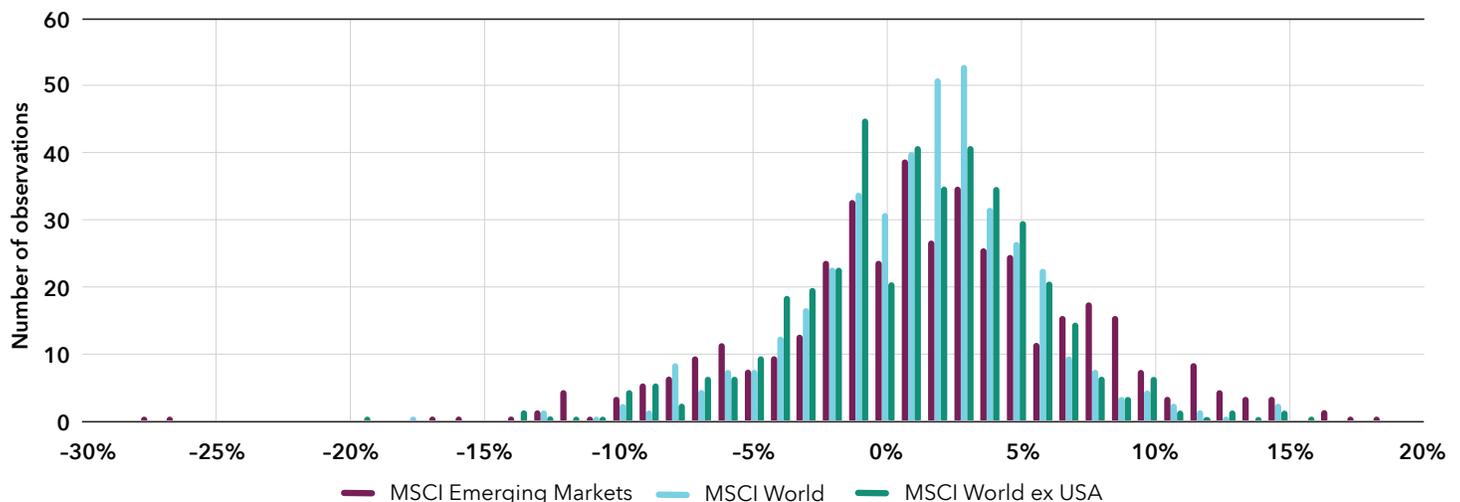
Emerging markets investing has become riskier

Emerging markets assets have undergone profound changes. For one, what qualifies as emerging markets exposure has shifted meaningfully. In 2000, representation was much more evenly distributed across countries like Taiwan, Brazil, South Africa and Mexico. China was only the seventh-largest constituent, with an index weight of approximately 5%. As of December 31, 2021, Chinese equities dominated with nearly a third of emerging markets country exposure within the MSCI Emerging Markets Index, resulting in increased country-specific risk in both the index and passively implemented strategies tracking that index.

Due to increased financial and economic integration, emerging and developed markets assets have been increasingly moving in unison over the last few decades. With emerging markets' inherent higher volatility and increasing correlation to developed markets, diversification benefits have been diminished or largely eliminated for U.S.-based investors.

You can see that risk in the chart below, which compares monthly MSCI Emerging Markets Index returns from January 1988 to August 2022 to corresponding returns from the MSCI World and MSCI World ex USA indexes. On a distribution bell curve, emerging markets equities have "fatter tails" than developed markets equities, reflecting increased variability and thus, more uncertainty in return expectations due to various risks, including idiosyncratic country-specific risks.* This makes it more challenging to determine the optimal long-term mix between emerging and developed markets equities in a multi-asset portfolio.

Histogram of MSCI Emerging Markets, MSCI World and MSCI World ex USA index monthly returns
(January 1988 to August 2022)



Sources: Bloomberg, MSCI

Investment results assume all distributions are reinvested and reflect applicable fees and expenses. Past results are not predictive of results in future periods. The indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

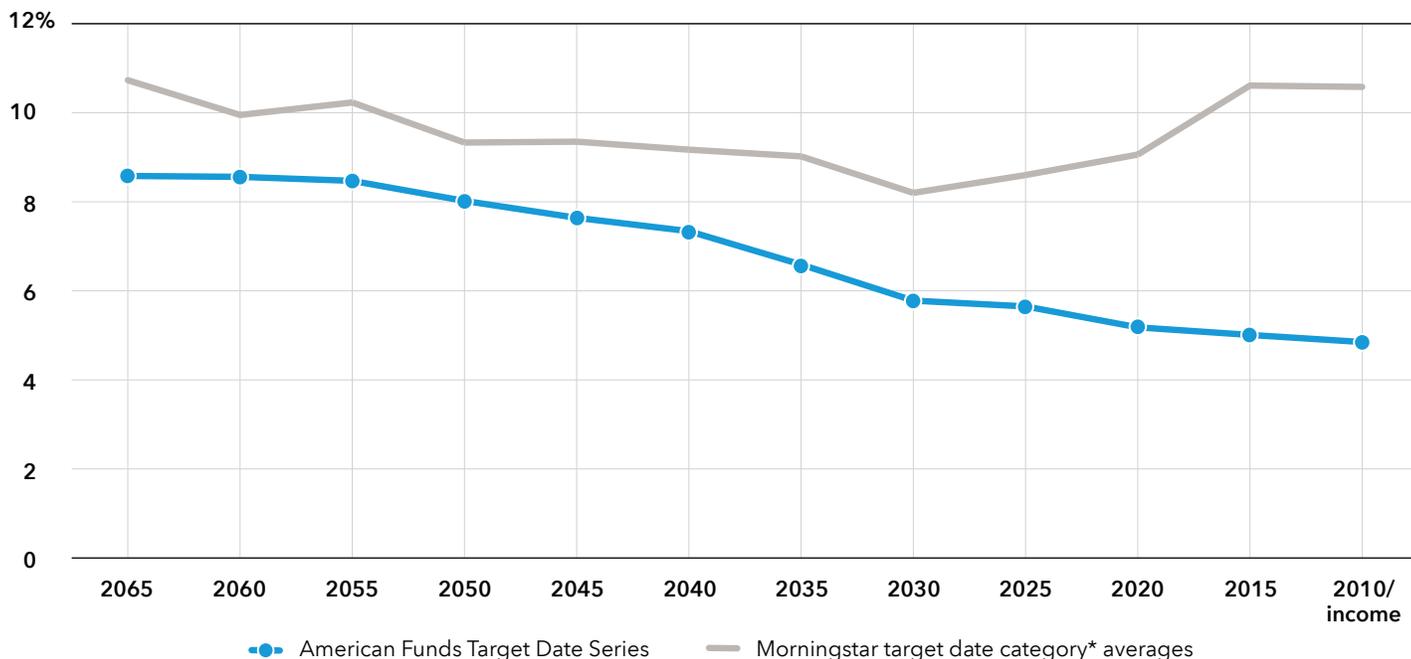
So while emerging markets equities have enjoyed strong returns historically (which informs forward-looking expectations that those strong returns will continue), as an asset class they add significant risk due to volatility and diminished diversification benefits. Exposure should be carefully managed, especially for older investors in the transition and distribution phases, and used primarily for appreciation potential.

* Investing outside the United States involves risks, such as currency fluctuations, periods of illiquidity and price volatility. These risks may be heightened in connection with investments in developing countries.

Implementation considerations

Emerging markets exposure as a percentage of equity

(as of June 30, 2022)



Source: Morningstar. Calculated using MSCI Emerging Markets Index definitions. Morningstar category averages include all share classes for the funds in the category. Morningstar categories include active, passive and hybrid target date funds, as well as those managed both “to” and “through” retirement. Approximately one-third of the funds in the 2000-2010 category have a target date of 2005. In an effort to manage the risk of investors outliving their savings while managing volatility, our approach to allocating between stocks and bonds puts more emphasis on stocks (particularly on dividend-paying stocks) than some other target date funds.

*For a list of the applicable peer groups by vintage used in the analysis, see “Morningstar categories” on page 4.

Because of these risks, this research also lead us to favor international and global strategies with a flexible approach to investing in emerging markets, empowering underlying fund managers to move into and out of specific emerging markets equities and countries as opportunities arise.

In addition, our glide path reduces emerging markets exposure over time, from accumulation to transition and into distribution. We believe this is critical to reduce overall risk from fundamental and macroeconomic factors related to emerging markets investing, including the currency risk inherent to foreign markets investing in general, as investors age.

Contrast this with other practitioners in the industry: As you can see in the chart, emerging markets equity exposure increases in Morningstar target date category averages for income and retirement vintages.

The bottom line: The nature of emerging markets has changed, as have the benefits they can offer as part of a diversified multi-asset strategy. But we believe a thoughtful, flexible, age-appropriate approach can still enhance returns while managing risk, especially for target date vintages in and near retirement.

Morningstar categories

American Funds® 2065 Target Date Retirement Fund	Morningstar Target-Date 2065+
American Funds 2060 Target Date Retirement Fund®	Morningstar Target-Date 2060
American Funds 2055 Target Date Retirement Fund®	Morningstar Target-Date 2055
American Funds 2050 Target Date Retirement Fund®	Morningstar Target-Date 2050
American Funds 2045 Target Date Retirement Fund®	Morningstar Target-Date 2045
American Funds 2040 Target Date Retirement Fund®	Morningstar Target-Date 2040
American Funds 2035 Target Date Retirement Fund®	Morningstar Target-Date 2035
American Funds 2030 Target Date Retirement Fund®	Morningstar Target-Date 2030
American Funds 2025 Target Date Retirement Fund®	Morningstar Target-Date 2025
American Funds 2020 Target Date Retirement Fund®	Morningstar Target-Date 2020
American Funds 2015 Target Date Retirement Fund®	Morningstar Target-Date 2015
American Funds 2010 Target Date Retirement Fund®	Morningstar Target-Date 2000-2010

Investment and index disclosures

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.

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Although Capital Group's target date portfolios are managed for investors on a projected retirement date time frame, the allocation strategy does not guarantee that investors' retirement goals will be met. Investment professionals manage the portfolio, moving it from a more growth-oriented strategy to a more income-oriented focus as the target date gets closer. The target date is the year that corresponds roughly to the year in which an investor is assumed to retire and begin taking withdrawals. Investment professionals continue to manage each portfolio for approximately 30 years after it reaches its target date.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization weighted index designed to measure equity results in global emerging markets, capturing large- and mid-cap representation across 24 countries (Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Kuwait, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates). It has 1,380 constituents and covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI World Index is a free float-adjusted market capitalization weighted index designed to measure developed markets equity results. It consists of more than 20 developed market country indexes, including the United States.

The MSCI World Index ex USA Index is a free float-adjusted market capitalization weighted index designed to measure developed market equity results. It consists of more than 20 developed market country indexes, excluding the United States.

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