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Target Date Funds: Retirement Savers' Guide

Autopilot is a familiar feature to many drivers. Using the cruise control function puts a car on a steady pace that does not change until the driver hits the brakes or the gas pedal. A similar “set it and forget it” approach is increasingly popular for retirement savings. So-called target date funds, sometimes referred to as “lifecycle funds,” are intended to make investing for retirement more convenient by automatically adjusting the mix of investments over time. Unlike cruise control, target date funds don’t lock in on a single investment and stick with it; instead, they take a more aggressive investment approach when retirement is far in the future and become more conservative as the targeted retirement date comes closer. Just as cruise control can help drivers stay within the speed limit, target date funds can help investors avoid common investment pitfalls, such as taking excessive risks, being too conservative, or concentrating holdings rather than diversifying them. However, careful drivers know they can’t take their eyes off the road and investors in target date funds need to do the same: in other words, if you set it, don’t forget it.

We developed this brochure to help investors who already have target date funds, and those who are considering investing in them, to better understand these funds and assess whether they are a good match for their investment needs.

Target Date Retirement Fund Basics

Target date funds, which hold a mix of stocks, bonds

and other investments, have gained popularity since their introduction in the mid-1990s. Many are offered as mutual funds that are available to individual investors and those in work-based 401(k) retirement savings plans. A number of 401(k) plans now use target date funds as the default for employees who do not select any of the plan’s investment options. The employer will enroll these employees in a target date fund based on the employee’s age.

Target date funds are designed to be long-term investments for individuals with particular retirement dates in mind. The name of the fund often refers to a target date. For example, you might see funds with names like “Portfolio 2030,” “Retirement Fund 2030,” or “Target 2030” that are designed for individuals who intend to retire in or near the year 2030.

Yet target date funds with the same target date may have very different investment strategies and risks. The financial crisis of 2008 highlighted the volatility and variability among funds with the same target dates. Losses in 2008 for funds with a 2010 target date ranged between approximately 9% and 41% and averaged nearly 24%, compared to a 37% decline that year in the Standard & Poor’s 500 Index and the Wilshire 5000 Total Market Index. In 2009, returns for 2010 target date funds turned positive but continued to vary widely, with gains ranging from about 7% to 31%, with an average return of approximately 22%.

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As the 2008 experience shows, investing in a target date fund does not guarantee that you will have sufficient retirement income at the target date. Also, keep in mind that you can lose money in these kinds of funds. Target date funds do not eliminate the need for you to decide, before investing and from time to time afterward, whether the fund fits your financial situation. Even if you plan to retire in 2030, you may decide, based on your investment objectives, tolerance for risk, and other assets, that a 2020, 2040, or other target date fund is more appropriate for you. Or you may decide that a target date fund isn't suited to your needs.

Asset Allocation

Target date fund investors do not have any control over the fund's asset allocation strategy. Asset allocation is the division of investment funds among different classes of assets, such as stocks, bonds and cash. There are asset allocation funds that are not target date funds; for instance, a balanced fund may evenly split holdings so that 50% of the portfolio is in stocks and 50% is in bonds. Some investors prefer to make their own asset allocation decisions based on personal preferences, including their individual risk tolerance. That could lead one investor to choose a portfolio that is heavily invested in stocks rather than bonds, while another invests heavily in bonds rather than stocks.

A target date fund takes asset allocation decisions out of the fund investors' hands.

Most target date funds are designed so that the fund's mix of investments will automatically change to become more conservative as the target date approaches. Typically, target date funds heavily favor stock invest-

ments in the beginning and later shift to a mix weighted more toward bonds. Stocks are higher-risk investments that historically offer higher returns over time than bonds; the risk of losses on stocks may be tolerable for someone whose retirement is more than 20 years away and less tolerable for someone intending to retire in a year or two.

Of course, all investments carry some level of risk. This is true even for the same type of investment, as some stocks have less risk than other stocks and some bonds have more risk than other bonds. While bonds are often considered to be less risky than stocks, some types of bonds may be riskier than some stocks.

Your investments should reflect the level of risk you can tolerate. Your risk tolerance likely will change as you get closer to retirement, so it is critical to pay attention to what the target date fund invests in over time. Also, be aware that while a target date fund discloses its investment mix and how it will shift over time, the fund manager can make changes in the future without the approval of fund investors, even if those changes increase the risk that investors may lose money. That is one reason to monitor a target date fund's investments over time.

Same Date, Different Results?

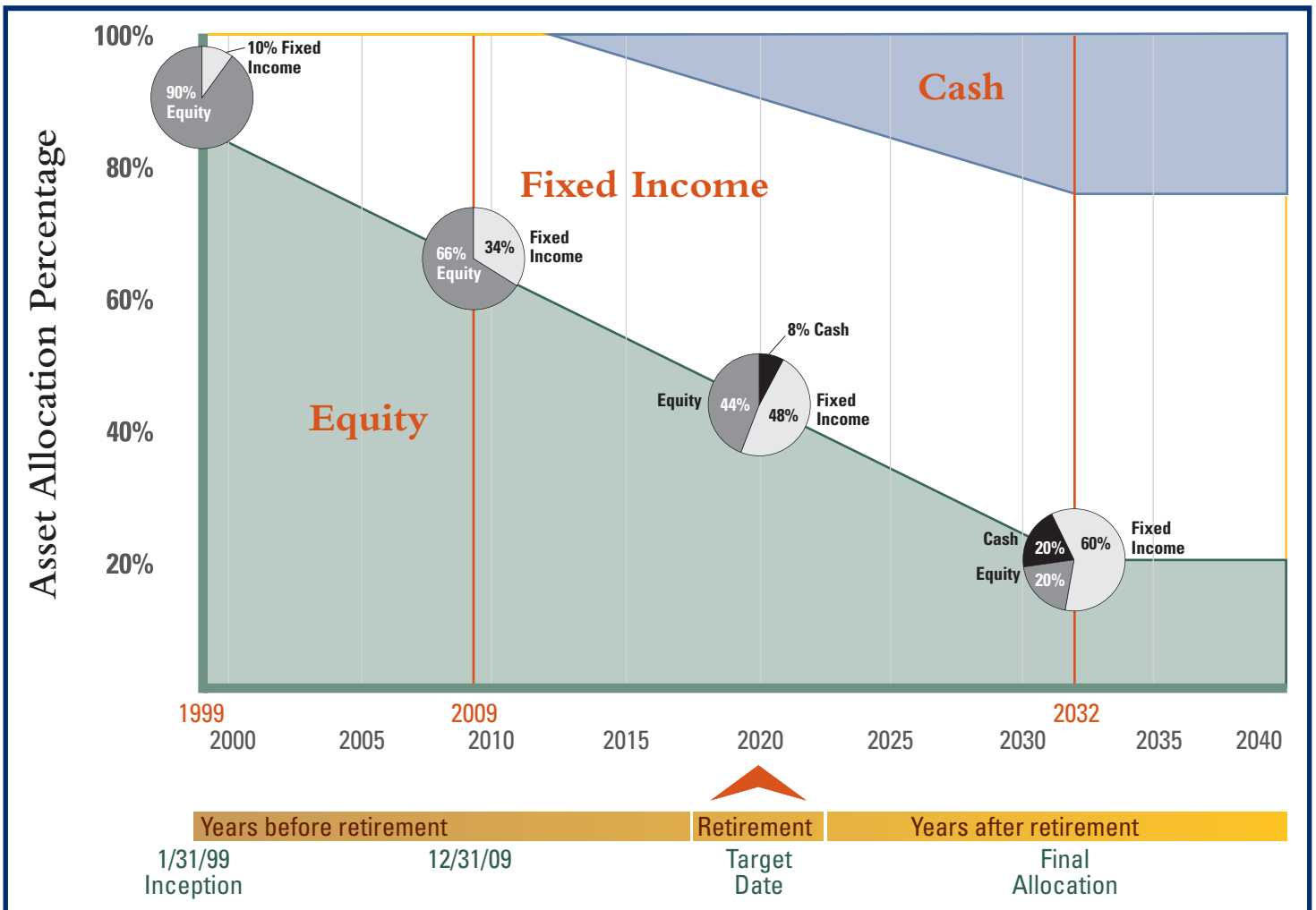
Vastly different results for target date funds with the same target date reflect the fact that each fund has its own "glide path" or changes in asset allocation, toward a "landing point," at which time the asset allocation will not change but remain fixed. The landing point for some target date funds occurs at or near the target date while for others it comes years after the target date. The different approaches sometimes are referred to as managing the fund "to" retirement or "through" retirement. Because of these different approaches, stock holdings in target date funds at the target date may differ

dramatically. One target date fund might hold about 25% of the portfolio in stocks at the target date, while another might be 65% invested in stocks. Some may not reach their final asset allocation until years after the target date. There are differing views as to which glide path is best and an approach that works well for one investor may not be best for another. In short, you can't judge a target date fund by its name.

The prospectus for a target date fund may include illustrations depicting the fund's glide path and landing point, which can help investors to better understand the fund and compare it to other target date funds with the same target date. Here is one example of how this might be done:

Evaluating a Target Date Retirement Fund

As with any investment, investors should evaluate a target date fund carefully before investing. The target date may be a useful starting point in selecting a fund, but you should not rely solely on the date when choosing a fund or deciding whether to remain invested in one. You should consider the fund's asset allocation over the whole life of the fund and at its most conservative investment mix, as well as the fund's risk level, performance, and fees. This information is available in the fund's prospectus.



Remember that funds with the same target date may have different investment strategies and levels of risk. These variations may occur before the target date, at the target date and after it. Some target date funds may not reach their most conservative investment mix or “landing point” until 20 or 30 years after the target date, while others may reach that point at the target date or soon after.

Target date funds, including those with the same target date, may have different investment results and may charge different fees. Often a target date fund invests in other stock and bond mutual funds, and investors may be charged fees for these funds as well as for the target date fund. Layers of fees can reduce investors’ returns: keep in mind that a fund with high costs must perform better than a low-cost fund to generate the same returns for you. Even small differences in fees can translate into large differences in returns over time. You should also consider how a target date fund fits in with your other investments. If you have other stock, bond, or mutual fund investments, you should carefully examine your overall asset allocation.

In summary, before investing in a target date fund:

Consider your investment style. Do you want to play an active role in managing your investments, or prefer a more hands-off approach of monitoring the performance of a target date fund?

Check the fund’s prospectus to see how the fund will invest your money. Do you understand the strategy and risks of the fund, or of any underlying mutual funds held as investments?

Understand how the investments will change over time. Are you comfortable with the fund’s investment mix over time? In particular, make sure you understand when the fund will reach its most conservative investment mix and whether that will occur at or after the target date. Does your level of risk tolerance match how aggressive or conservative it is?

Take into account when you will access the money in the fund. How does the fund’s investment mix at the target date and thereafter fit with your plans for the future, whether they are to withdraw your money at retirement, or to continue to invest?

Examine the fund’s fees. Do you understand the costs for both the target date fund and for any mutual funds in which the target date fund invests?

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