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TARGET DATE FUNDS

Target Date Funds: Have Investors Been Lulled to Sleep?

Should You Follow the Crowd?

Target Date Funds have grown wildly popular since they were introduced in 1994. Estimates believe that these funds have attracted more than $1 trillion.

On the surface, target date funds take the pain out of how to choose the right investments for investors. Investors may simply choose a single target date fund, set it and forget it. **But is that really a good thing?**

Have target date funds pacified investors into not asking the important questions about their investments and their investment path?

Target date funds lump all individuals who are "targeted" to retire on a set date, into the same allocations. There is no regard for a person individual situation like the age a person started saving for retirement, an individual's ability to save, past investment performance and risk tolerance.

Let's look at a simple example, John (age 55) and Mary (age 55) both work for ACME Corporation. Both John and Mary are "targeted" to retire in 10 years, 2030. ACME Corporation automatically default John and Mary into the same 2030 target date fund.

At first glance this might make sense, but let's dig a little deeper.

John's annual salary is $75k, but up until 5 years ago John's highest salary had been $55k. John is a 10-year divorcee who, until 5 years prior, was not able to save very much because of obligations to his ex-spouse and children.

To make matters worse, John suffered the losses of 2008 and moved all of his investments to cash. He remained in cash until 2016, when his impending retirement got him thinking it was time to "get back in the market".

John now needs to make up for lost time. Because of the losses he endured, his inability to maximize his savings and his desire to retire in 10 years, John feels like he needs to take on more risk with his investment account to make up for lost time.

Mary, on the other hand, has had an annual salary of $110k for years. Prior to her current salary, Mary's annual salary had been around $85k. Mary's spouse is also in the workforce and has been a strong earner for decades. Over the years, Mary has been able to maximize her savings for retirement using different accounts.

Mary and her spouse also suffered losses in 2008. However, Mary made necessary adjustments to her investment path, stayed in the market, and had great investment performance since 2008. Mary and her husband plan on staying invested until she retires in 10 years.

Feeling good about the size of her retirement savings, Mary feels she is better off to focus on protecting her account rather than growing it. She doesn't need or want to take much risk.

So how do Target Date Funds treat John and Mary's differently? **They don't.**

Every individual investor is lumped into the same asset allocation regardless of their salary and savings history, past investment performance, risk tolerance, lifestyle and goals.

Paul Merriman recently reported on MarketWatch.com[1]

"Here are five ways they [target date funds] fail to live up to their promise.

1. The most important drawback, by far, of target-date funds is their failure to give investors significant access to some long-established equity asset classes with superior long-term track records.

   As a result, long-term investors who think they have a full portfolio in fact miss out on returns that could literally double the amount of money they have during their retirement years.

2. There's little disagreement that young investors can afford to take more risks than older investors and have ample time to reap the likely long-term rewards of doing so. Yet target-date funds use the same mix of equity asset classes for all investors regardless of their age.

3. Target-date funds treat their shareholders as if the only thing that matters is their age. This is effective up to a point, and it's certainly convenient for fund companies.

   By lumping everybody of a certain age into a single pool, target-date funds wind up with the appropriate mix of assets for only some of their shareholders, not all of them.

   Some people are inherently adventurous (aggressive) and others inherently more skittish (conservative).

4. Target-date funds don't own individual stocks and bonds. They are funds of funds. Each of these underlying funds has expenses that shareholders must pay. Yet some target-date funds add an extra level of expense — essentially a markup without any benefit to shareholders.

   This makes about as much sense as a grocer charging a customer extra for walking out with multiple items in a single shopping bag.

5. In most target-date funds, the underlying assets are low-cost index funds. But many target-date funds include actively managed funds, which add higher expenses without any reliable expectation of higher returns.

   The extra fees can amount to 0.5% a year, enough to cost a longtime shareholder $1 million in ultimate value.

   This is clearly a disservice to target-date shareholders."

   Although target-date funds appear to be a good match for individuals retiring on a certain "target date" there are many potential disadvantages.

What's the potential biggest disadvantage? They don't account for a person's individual situation.

Are any of these people the same?

1) MarketWatch.com Author – Paul Merriman October 10, 2018 Opinion: 5 Ways Target-Date Funds Let Investors Down

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