CAPTRUST | Financial Advisors™

TARGET DATE FUNDS: BUYER BE *AWARE*

SUMMARY

Investing is a journey, and every traveler has distinct preferences. Target Date Funds (TDFs) represent just one of many tools designed to help investors through their retirement savings voyage.

However, despite claims of universal application for prospective retirees, TDFs are not suitable for everyone.

In this paper, CAPTRUST discusses this important product set in the hopes of providing a clear synopsis of what investors and Plan Sponsors should recognize and expect from TDFs going forward.

Target Date Funds are first and foremost, a specific method of investing—an investment program, if you will. As such, they should be evaluated on a case-by-case basis given the high variability across product providers.

At CAPTRUST, we provide Plan Sponsors with independent advice on several levels, including plan design, fiduciary best practices, investment analysis, and participant education. TDFs span all of these realms, and this paper will focus on TDFs from an investment advice perspective, as we believe the other advice levels are too client-specific to adequately address here. Proper assessment of TDF inclusion within a defined contribution plan involves plan design and fiduciary best practices consultation, with Plan Sponsors being mindful of their participant base and advisors being fully aware of TDF properties and attributes.

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TARGET DATE FUNDS: BUYER BE *AWARE*

Eric Freedman | Managing Director, CAPTRUST Consulting Research Group

Our goal as advisors is to empower Plan Sponsors to pass through two critical fiduciary hurdles: first, are TDFs appropriate for their plan, and second, which TDF is most appropriate for their population.

We build our investment advice around a fairly simple concept: investors should understand what they own and why they own it. Most are probably familiar with the phrase "Buyer Beware" from the Latin phrase *Caveat Emptor*. Its application ranges from used cars to individual stocks and bonds. Negative connotations aside, this concept is highly relevant to TDFs: investors need to know what they are, what they are not, and what investors can reasonably expect from them in the future. Our upfront conclusion is this: Target Date Funds are first and foremost, a specific method of investing—an investment program, if you will. As such, they should be evaluated on a case-by-case basis given the high variability across product providers. The industry has touted TDFs under the banner of catch-phrases such as "set it and forget it" and "defined benefit management in a defined contribution setting." Both of these phrases are structurally and conceptually flawed for investors *en masse*, and we will explore why in the sections that follow.

In short, investing is a journey, and like any journey, everyone has their own travel preferences. TDFs are not for every traveler, and it is up to the investment community including advisors, Plan Sponsors, asset managers, and investment fund evaluation groups to help the general public determine whether or not TDFs are right for the individual. Thus, we title this paper-and more broadly scope our overall role—as helping the buyer be aware of TDF properties, including the positive and negative features, as well as the implicit assumptions inherent in TDF investing. Our goal as advisors is to empower Plan Sponsors to pass through two critical fiduciary hurdles: first, are TDFs appropriate for their plan, and second, which TDF is most appropriate for their participant population. This paper will not get into the second hurdle, but it will provide detailed context on the first. ■

PRODUCT ATTRIBUTES, FEATURES, AND IMPLICIT ASSUMPTIONS

TDFs have varied implicit assumptions in areas such as expected retirement date, assumed longevity, and retirement savings accumulation levels. However, one consistent TDF feature is the glidepath, or the transcending asset allocation weightings between stocks, bonds, and other asset classes over time. While TDF asset managers incorporate their varied implicit investor assumptions to drive their glidepath allocations, other differences between providers rest in their capital market forecasts and return/risk/correlation assumptions. While we will explore this more closely later in this section, it is important to understand that TDF providers have several different assumptions driving their building blocks. Irrespective of the provider, these differing building blocks all create the same thing: a glidepath.

Glidepaths are designed to shift assets away from asset classes with higher perceived risk as an investor ages. This feature is consistent with both intuition as well as economic Consumption Theory. To understand glidepath mechanics and unearth some specific implicit assumptions, let us briefly review how they work. TDFs are designed such that investors select (or are defaulted into) a vintage year based on their age. A vintage year is, for example, the Fidelity Freedom 2040 Fund or the JP Morgan Smart Retirement 2015 Fund. Without question, certain TDF investors select vintage years based on their underlying allocations or even invest in multiple vintage years, but from a design standpoint, TDFs are structured so that any single age group will invest in the same vintage year. This feature reveals four implicit assumptions deeply rooted in TDF design:

1. **Age is the most important attribute for TDF vintage year selection, and by implication, high risk with low balances (early years) will counteract low risk with high balances (later years).**

2. **TDF investors will stay invested throughout the glidepath.**

3. **Investors have selected (or have been defaulted into) the correct vintage year based on their retirement plans/goals.**

4. **Individuals in the same age group (vis-à-vis their TDF vintage year selection) have similar enough risk tolerance/appetite to justify an identical asset allocation and glidepath.**

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ASSUMPTION (1): Age is the most important attribute for TDF vintage year selection

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Age is an important variable, but age ignores diverse risk tolerance, and CAPTRUST views risk tolerance as the most important factor when determining asset allocation. "Risk tolerance" can be a nebulous term, but we define it as *the aggregate consideration set of variables that adequately describe an individual's financial picture.* Since investors likely have more certainty (and control) over their future than they have certainty about the capital markets' direction and timing, risk tolerance discovery involves marrying investor behaviors/psychology regarding their future with an asset allocation that best suits the individual's lifestyle needs and behaviors. Investor behaviors/psychology is a function of lifestyle choices, and asset allocation is a function of past and predicted asset class return, plus correlation assumptions derived by their own experience or in consultation with others. Within that framework, age is an important input, but not a sole determinant. Of course, Plan Sponsors cannot assume that all of their participants will actively gauge their risk tolerance.

Time can be a driver of risk tolerance preferences, but time is not the sole factor when prospective retirees are considering a proper asset allocation. We posit that many asset managers and investors alike simply use time as a front for the notion "I have years to make up for a considerable capital loss." With the recent financial crisis eclipsing a lost decade for US equities (stocks are lower at the end of the decade than they were at the beginning), we fear that "time" can be used as a form of moral hazard: the more years one has before retirement, the riskier one's allocation can become; after all, one has all that time to make up for the mistakes made in my investment "youth." Should a participant fall victim to poor investment performance, they may be forced to postpone their retirement plans and seek additional employment years.

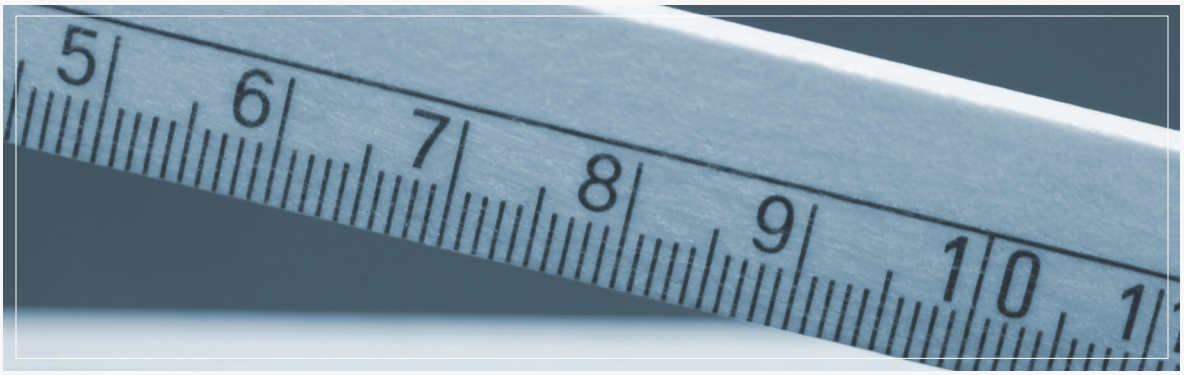
ASSUMPTION (2): TDF investors will stay invested throughout the glidepath

The second assumption is one that TDF providers have significant evidence in which to justify their implicit position. Considerable academic contributions from behavioral economists and pension researchers conclude that "investor inertia" existed prior to the 2008-09 financial crisis. The average investor does not do much repositioning or trading in their 401(k) account, and using data from Schwab, Fidelity, Hewitt, and other large plan administrators, 2008 offered scant evidence of a divergence from this trend despite large financial market

CAPTRUST views risk tolerance as the most important factor when determining asset allocation.

downdrafts.[3] While this inertia may have been the norm in recent years, we would be surprised if US workforce demographics permit such behavior going forward. Given that many workers may have to delay (or potentially forego) retirement post the recent market malaise, we doubt investors will sit on their proverbial hands going forward. US Census data from 2000 reveals that over 21% of the US population is over age 55, and census projections state that by 2030, 20% of the US population will be 65 and older, and by 2050, the percentage of the population in "working ages" (18-64) will fall from the current 63% to 57%.[4] An aging workforce may not demonstrate the same behavioral inertia as recent data show, especially following significant market volatility in 2008 and 2009.

Another potential divergence from past inertia rests in the ever-changing investor mindsets towards risk. After analyzing explicit TDF provider building block assumptions and coupling this analysis with our work with both private investors and retirement plan participants, we feel TDF providers focus too much on the retirement endgame. Incorporating our claim that investing is a journey, TDF providers focus too much on the destination (retirement or life expectancy depending on the provider) and not enough on the trip itself. Recent market volatility has forced investors to think about the journey as well as the destination, and we think the market malaise heightened participant



introspection. While retirement plan administrator data suggests that participants did not do a lot with their retirement investments as a group, CAPTRUST staff indicated a material increase in participant advice calls, especially first-time participant conversations. These calls included a large proportion of basic questions such as how to check existing balances and requests for login information.

Couple these trends with increased financial literacy and information saturation across the media, and we may see investors start to change their investment evaluation framework. Mark Kritzman and Don Rich offer a credible framework in which to evaluate investor choices in the future. In their paper "The Mismeasurement of Risk," the authors note that:

> **Investors typically measure risk as...the amount that can be lost with a given probability at the end of their investment horizons. This view of risk considers only the final result, but investors perceive (or should perceive) risk differently. They are affected by exposure to loss throughout the investment period, not just at its conclusion. [5]**

TDF vintage years closer to an age group's assumed retirement date had poor absolute performance through the equity market's recent downturn; from market peak (October 2007) to the March 2009 lows, the average 2011-2015 vintage year TDF fell 25%. For prospective retirees with all or most of their retirement savings in these vintage years, this may prove too large a dip for investors to swallow during their investing "journey." Perhaps many investors didn't react because they simply did not look at their retirement balances or truly know what they were invested in (or were too afraid to check- "what I don't know can't harm me.")

Indeed, financial markets may rebound rapidly and existing TDF allocations and assumptions may prove prescient by the time a vintage year destination arrives, but investors may not decide to stick around for the outcome.

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The 2008-09 market malaise helped solidify a psychological principle known as "Prospect Theory," which states that humans are psychologically more hurt by losses than they are happy about equivalent gains (Daniel Kahneman won the 2002 Nobel Prize in Economics for the seminal work he did on this subject with the, by then deceased, Amos Tversky). In other words, the absolute value of pain is greater than the absolute value of joy for equivalent losses and gains. While this concept may not be fully reflected in retirement plan investor behavior to date, (1) increased financial literacy, (2) improved awareness post recent market volatility, (3) greater employee dependence on defined contribution plans for retirement, and (4) more of a "take charge" attitude towards savings—may change attitudes going forward. We suspect both the Kahneman/Tversky and Kritzman/Rich frameworks will see greater adoption, especially if financial markets remain volatile, challenging implicit assumption (2).

ASSUMPTION (3): Investors have selected (or have been defaulted into) the correct vintage year based on their retirement plans/goals.

A fundamental question surrounding if an investor is in the right vintage year comes from whether or not the investor understands if the TDF provider is managing to a retirement date consistent with the investor's own specific goals. In our experience, this can be as simple as investors understanding that to which the target date refers. Thoughts ranging from ***retirement date*** to ***death date*** to ***"when I will actually need the original principal I invested***," are all reasonable interpretations, but they may be completely incorrect depending on the investment vehicle (and the latter interpretation suggests a false hope about a guaranteed principal repayment). This bleeds a bit into assumption (4), but really hints more at a clear definition of what target date funds are actually designed to do for investors.

Another issue enveloping assumption (3) reflects the fact that investors are dynamic individuals and their needs frequently change. For example, time horizon (also known as time preferences) can shift for several reasons. The horizon can become shorter should a household accumulate enough savings to drive an earlier retirement: the opposite also holds. TDFs do not adjust for idiosyncratic time horizon shifts, and an investor would have to opt out of one vintage year and into a new one should time preferences change. Ostensibly, investors seek TDF strategies to minimize retirement account "maintenance," so it is not clear that time preference shifts would be reflected in an investor's allocation.

ASSUMPTION (4):
Individuals in the same age bracket have similar enough risk tolerance/ appetite to justify an identical asset allocation and glidepath.

Assumption (4) is perhaps the most central assumption that leads us to conclude that TDFs are not appropriate for all investors. Conceptually, this assumption is not too dissimilar from assumption (1) but bears specific considerations. Differing saving and income levels, investment knowledge, lifestyle circumstances, and innumerate other factors drive material differences in risk tolerance, and these differences cannot be captured in an identical asset allocation per vintage year/age group. While TDF investors can spread their "risk" across multiple vintage years within a plan (and empirical evidence suggests individuals do select multiple vintage years), neither TDF providers nor Plan Sponsors should rely on investors to make that adjustment.

A more draconian view of this assumption mirrors the "mistakes made in my investment youth" concept we noted under assumption (1), but the essence of our concern here is that every investor will have (1) unique lifestyle changes and (2) different reactions to those lifestyle changes in the context of capital market activity. That said, TDF investors must consciously recognize the tradeoff they face when investing in TDFs: customization/ individualization yields to the inherent TDF assumptions. An exception to this rule is if and when the Plan Sponsor changes the individual's default option as changes in circumstances are reported, but this lacks scale and presents a considerable administrative burden on the Plan Sponsor. A potential fix to this issue has been advocated by industry thought leader Dalbar, who advocates completing a brief annual questionnaire to help a participant determine if any adjustments are needed.

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After reading the previous section, the reader may infer that we do not have a favorable view of TDFs as investment solutions, but that is not the case; we simply want to outline what we consider to be the major TDF inherent assumptions. In fact, our view does not preclude Plan Sponsors from determining that TDFs are appropriate default options—we think they can be—but we do advise Plan Sponsors to demonstrate and document the process they took to arrive at their conclusion. ■

TARGET DATE FUNDS AS AN INVESTMENT PROGRAM

Investors have no shortage of retirement plan investment options, and within a defined contribution construct, TDFs can be thought of as avenues or streets. One avenue is to "do it yourself," allocating assets among different stock, bond, balanced fund, and other assets classes, either within the plan or through a self-directed brokerage account "window." Another avenue is risk-based models, where participants fill out a questionnaire designed to help them characterize their investment posturing, specifically their tolerance for downside over a given time horizon. Still another avenue is investing in Target Date Funds. Each avenue has their merits and drawbacks, but the opportunity cost of walking down the wrong avenue for any individual participant is high, as are the trade-offs between options.

For example, assume Karen, a 25 year-old retirement plan participant invests or is defaulted into her age-appropriate TDF and the equity market subsequently suffers a large drop in value. Karen heard that TDFs shifted assets from stocks to bonds over time, but it turns out that Karen is highly risk-averse, and given how equity-heavy her vintage year allocation is, Karen becomes disillusioned with investing post a high percentage drop in market value and she does not add to her existing plan assets ever again. While this scenario is likely the exception and not the rule, not all investors make investment decisions based on time and for many the journey is as important, (if not more in our "here and now" society), than the destination. Since it would be a better outcome (read: higher plan balance at retirement) for Karen to contribute to even the most conservative investment vehicle over her career versus not participating at all, TDFs represent a potentially significant opportunity cost for Karen.

Another hypothetical example involves James, a 62 year-old participant who opted for a capital preservation-focused risk-based model over his accumulation phase (defined as the period where a participant adds to their retirement plan balance through periodic contributions and employee matches). Suppose James selected this choice when he joined the firm in his mid thirties, completing a risk-based

questionnaire while he was heavily influenced by the fact that he and his wife just had twin girls and the fact that his wife opted to leave the workforce and stay home with the children. Further, the economy had just gone through a downturn and James' equity-heavy 401(k) holdings at his previous employer had tanked. James did not want to repeat that same experience, and hence went into a more capital preservation-focused strategy.

The Plan Sponsor's role, from a plan design standpoint, is to develop an investment option menu that offers participants mutually exclusive and collectively exhaustive avenues in which to invest, centering their decisions on both prudent judgment (as defined by ERISA where applicable) and their specific plan demographics and properties.

However, James did not update his allocation as he aged. His wife went back to working full-time, one of his daughters received a full scholarship to college, and his other daughter went to a state college with relatively low tuition. While he did periodically contribute to his company's plan and enjoyed a modest company match, his retirement account did not keep up with inflation. James faced the prospect of either working longer or materially altering his retirement plans. In this instance, the risk-based model represented a considerable opportunity cost for James. In both of these examples,

the participants invested in options that they theoretically should not have invested in based on an *ex post* assessment. *Ex ante* assessments are much more important (and difficult). Plan Sponsors, advisors, and product providers all play key roles in helping participants make the correct investment decisions both before and after life-changing events through the various investment avenues available in the plan. The Plan Sponsor's role, from a plan design standpoint, is to develop an investment option menu that offers participants mutually exclusive and collectively exhaustive avenues in which to invest, centering their decisions on both prudent judgment (as defined by ERISA where applicable) and their specific plan demographics and properties. Plan Sponsors also need to ensure reasonable and adequate communication and education opportunities surrounding the various plan options/investment avenues to ensure participants' ability to enhance their understanding. The common missteps between Karen and James rests not in the avenues themselves (Investment Policy Statements and periodic benchmarks are designed to evaluate individual avenues/options), but instead in their misuse.

We view TDFs as a holistic investment program, occupying one distinct avenue in a plan design; no other plan option replicates what TDFs provide. As mentioned earlier, it would be presumptive in this paper to assert TDF applicability across all plans. We do view it as necessary that the Plan Sponsor understand TDFs features from a product set standpoint, and it is equally essential that Plan Sponsors look at the specific assumptions driving the TDF option(s) available in their plan. Part of the Plan Sponsor's calculus should weigh the inherent TDF assumptions, deciding if giving plan participants the option to invest or even auto-enrolling/defaulting investors into TDFs is better than alternative investment options/avenues for their population in general. ■

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TARGET DATE FUND PERFORMANCE RELATIVE TO OTHER OPTIONS

TDFs have been subjected to rash criticism following the global equity market peak in October 2007. Some funds have been criticized for specific sub-fund performance, others for their asset allocation heading into a downturn, and still others for a combination of the two (the Oppenheimer Transition 2010 Fund, for example, had a 60% allocation to equities and lost 41% in market value in 2008, also hurt by its investment in the Oppenheimer Core Bond fund which fell almost 36% due to weak underlying credit exposure). Consistent with our view that investors care about the journey as well as the destination, TDF absolute performance has all but eradicated the notion that "set it and forget it" is an apt TDF characterization.

Wharton classmates James Valentine and Josh Alexander, Professor Chris Geczy and I studied monthly TDF performance from October 2005 through January 2009, evaluating nineteen (19) different TDF families selected at random but with enough return history to cover the above time frame. Our complete findings can be found in a forthcoming paper.

Without getting into an exhaustive (or exhausting) discussion on methodology, we evaluated TDF family performance by including each vintage year in a family's product set. We created a basket of vintage years with a rebalancing policy consistent with the risk-based/static allocations we compared the TDFs to in order to maximize comparative data (and fairness).

We compared the TDF family performance with 5 different hypothetical risk-based models, including 70/30, 60/40, 50/50, 40/60 and 30/70 equity/fixed income splits using indices to represent various asset classes (see the Exhibit 1 table for specifics). For performance purposes, we rebalanced each basket monthly, consistent with the TDF methodology outlined above. We segmented the time periods into three tranches: pre-crisis (October 2005 – October 2007), post-crisis (November 2007 – January 2009), and full period (October 2005 – January 2009). This time period provided us with a robust monthly data set as well as periods of both rapidly rising and rapidly falling financial markets. Our hypothesis was that in order to justify their fees from an investment standpoint (in other words, isolating the investment value-add from the "TDFs as an investment program" concept), the TDF glidepath should offer investors some compensation, either in risk-adjusted or excess return terms. To test this hypothesis, we regressed the TDF family data and the hypothetical risk based model total returns (to test for risk-adjusted compensation) and ran a t-test of cumulative excess returns (to test for excess return compensation). Our data set and methodology yielded 19 different fund families across 5 hypothetical risk-based models over three time periods, or 19 x 5 x 3 = 285 total data points.

The results (see Exhibits 2 and 3) were categorically contrary to our hypothesis. In risk-adjusted terms, only one TDF family delivered statistically significant, positive alpha relative to any of the risk-based models, and this occurred during the pre-crisis period. Other than that, all other readings had alpha or excess returns as either statistically non-different from zero or statistically significant and negative. If nothing else, we felt our methodology would yield statistically non-different from zero results, but that was not the case. Simply put, based on our methodology, TDFs underperformed hypothetical risk-based models and did not add investment value in risk-adjusted or excess return terms. This leads us to conclude that TDF utility rests not in dominant performance over other asset class choices, but instead in the service TDFs provide of migrating a participant from a perceived higher to lower risk allocation over time. In other words, the results above suggest that TDF value rests in their attributes outside of investment performance.

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EXHIBIT 1: RISK-BASED MODEL CONSTRUCTION DETAIL

	Risk-based Model 1	Risk-based Model 2	Risk-based Model 3	Risk-based Model 4	Risk-based Model 5
Equities Weighting	70%	60%	50%	40%	30%
Fixed Income Weighting	30%	40%	50%	60%	70%
US Equities					
S&P 500	31.36%	26.88%	22.40%	17.92%	13.44%
Russell MidCap	13.72%	11.76%	9.80%	7.84%	5.88%
Russell 2000	3.92%	3.36%	2.80%	2.24%	1.68%
International Equities					
MSCI EAFE (USD)	16.80%	14.40%	12.00%	9.60%	7.20%
MSCI Emerging (USD)	4.20%	3.60%	3.00%	2.40%	1.80%
Fixed Income					
BarCap Aggregate	28.50%	38.00%	47.50%	57.00%	66.50%
Citigroup 3-Month T Bill	1.50%	2.00%	2.50%	3.00%	3.50%
TOTAL	100%	100%	100%	100%	100%

EXHIBIT 2: RISK-ADJUSTED RESULTS

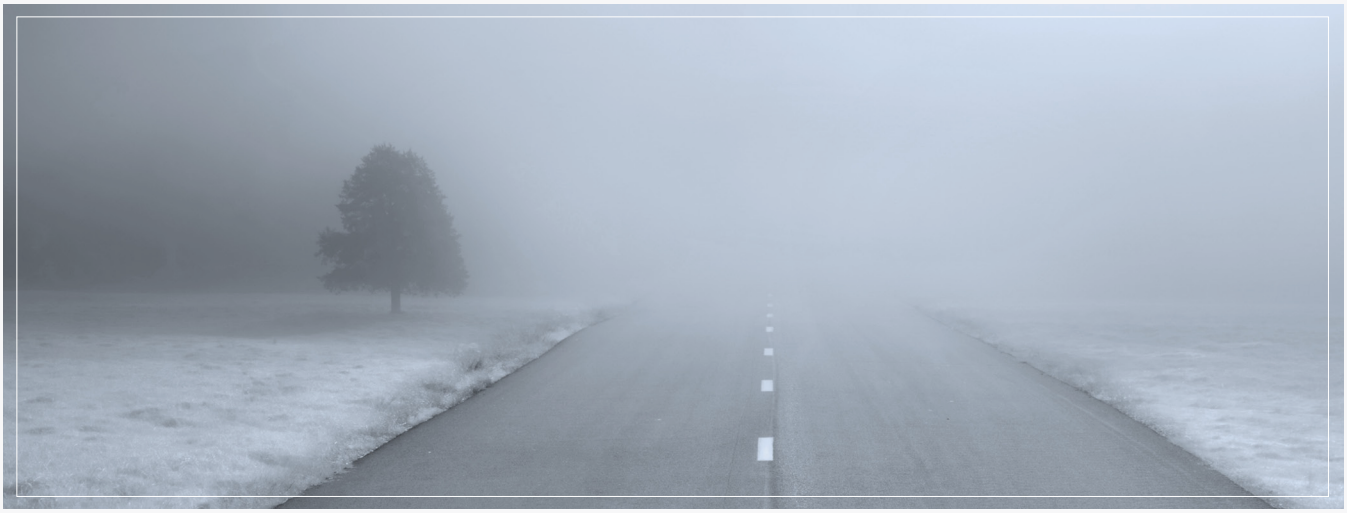
Risk-adjusted Measurements: Target Date Fund Family (Dependent Variable), Static Allocations (Independent Variable)

	Full Period Regressions		Pre-Crisis Regressions		Post-Crisis Regressions	
	# of Datapoints	%	# of Datapoints	%	# of Datapoints	%
Statistically Significant, Positive Alpha	0	0.0%	1	1.1%	0	0.0%
Alpha Statistically Non-different from Zero	17	17.9%	70	73.7%	52	54.7%
Statistically Significant, Negative Alpha	78	82.1%	24	25.3%	43	45.3%
TOTALS	95	100.0%	95	100.0%	95	100.0%

EXHIBIT 3: EXCESS RETURN RESULTS

Non Risk-adjusted Measurements: Target Date Fund Family excess returns relative to Static Allocations

	Full Period Regressions		Pre-Crisis Regressions		Post-Crisis Regressions	
	# of Datapoints	%	# of Datapoints	%	# of Datapoints	%
Statistically Significant, Positive Excess Returns	0	0.0%	0	0.0%	0	0.0%
Excess Return Statistically Non-different from Zero	72	75.8%	85	89.5%	95	100.0%
Statistically Significant, Negative Excess Return	23	24.2%	10	10.5%	0	0.0%
TOTALS	95	100.0%	95	100.0%	95	100.0%



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While TDF performance in aggregate may improve over time (past performance is no future result guarantor) and there have been some incremental improvements in fund design, based on what we have seen thus far, TDFs have not added value in investment terms. Since TDFs have yet to demonstrate better risk-adjusted or absolute performance than a series of hypothetical risk-based allocations, we believe performance cannot be a credible variable on which to draw a conclusion. ■

This leads us to conclude that TDF utility rests not in dominant performance over other asset class choices, but instead in the service TDFs provide of migrating a participant from a perceived higher to lower risk allocation over time.

CASE-BY-CASE EVALUATION

To this point, we have focused on macro issues surrounding TDFs as a group. However, not enough attention is paid to the micro assumptions inherent in each TDF's construction. This section is intended to emphasize the importance of assessing the distinct underlying assumptions that cause differentiation between TDF allocations. Case-by-case assessments reveal material differences across several TDF families, and we will explore some of the major category considerations we feel Plan Sponsors and investors alike should note.

One of the most basic considerations is the age to which the TDF provider manages to: retirement date or death date. This is a central assumption which can impact the underlying asset allocation and diverge from an investor's expectations. Given that American life expectancy, based on 2008 US Department of Health and Human Services data, is 77.7 years at birth, 83.5 years for those who reach age 65 and 86.6 for those who reach age 75, understanding the specific TDF investment period mandate is essential.[6] Note that some TDF providers assume post-retirement life expectancy of thirty years, which is meaningfully higher than the expectancy statistics highlighted above; in summary, Plan Sponsors should be aware of such assumptions.

Other important micro considerations focus on investor characteristics leading up to retirement. Some TDF providers assume a specific annual income percentage increase, others assume a specific salary level at retirement, and still others assume neither and instead focus on more of a weighted aggregate risk tolerance that drives their asset allocation decisions and glidepaths leading to their assumed investor retirement dates. Also, TDF providers differ in their contribution assumptions over a participant's accumulation phase, which can impact a contributor's ability to dollar cost average into a retirement savings position over time.

TDF provider assumptions also vary with respect to investor properties at and during retirement. Note that TDF providers have mixed views on Social Security as an ongoing concern, and some choose not to forecast its impact on their products.

In addition to life expectancy differences, investor withdrawal rates, income replacement needs, and total accumulated savings assumptions are highly heterogeneous. For example, one TDF provider assumes over $1.3 million in accumulated retirement savings, which may be a realistic (and even conservative) estimate for some companies and industries. However, based on an Employee Benefit Research Institute and Matthew Greenwald & Associates Survey, responses on total savings and investments (not including pension plan assets or primary residence) indicated that just 12% of employed respondents had assets over $250,000.[7] While this particular TDF provider may perform well for investors irrespective of their asset size, it is worth knowing how that assumption drives portfolio decisions, if at all.

Plan Sponsors should demonstrate the linkage between TDFs and their population, both from a macro and a micro standpoint.

Investment flexibility is another variable worth considering. Some Plan Sponsors may not prefer to grant TDF providers with a lot of tactical or rebalancing latitude, preferring more of a rules-based or static approach. Certain TDF providers have more investment flexibility than others, and as such, Plan Sponsors should take note of varied latitude as designated by prospectus and mandate. Again, given the unique attributes in a given participant base and the widely divergent assumptions between TDFs, Plan Sponsors should demonstrate the linkage between TDFs and their population, both from a macro and a micro standpoint. ■

CONCLUSION

At this paper's beginning, we suggested that investing is a journey and travel preferences vary. While retirement is a common destination, how we get there, and how we enjoy our stay once we've arrived, is a function of the choices we make both during the journey and upon arrival. For plan participants, Target Date Funds are one option among many, and for certain investors/participants, they represent the most optimal choice based on the linkage between product features and the investor/participant's individual attributes.

In order to determine whether or not a TDF is the best choice for either a Plan Sponsor to include in a plan or for an individual to select in their portfolio, they need to be aware of broad TDF features and attributes, implicit assumptions in their construction, as well as accept that TDFs are intended to be a holistic investment solution... the "program" concept we noted earlier. Plan Sponsors need to link their participant base with these features and attributes to determine if their participants would benefit from their inclusion, actively gauging implicit (and explicit) demand, and the ability for participants to understand TDF investments, either through their own investment acumen or through access to adequate information. Individual investors need to have reasonable expectations for their vintage year investment in both the short and long-term, in both up and down capital market environments.

I often use the phrase "most things in life boil down to individual accountability," and investing is no exception to that maxim. Many consultants, asset managers, and investors cite TDFs as a solution for investors who may be unwilling to take charge of their own financial destination. While we agree that some TDF product features offer considerable utility to certain investors, they are not a match for everyone, irrespective of how involved a participant is with their personal finances. TDFs depend on economic growth—a function of their allocations to asset classes that over time have proven their gearing to the economic cycle- and that economic gearing can prove to be an issue for certain prospective retirees unaware of inherent portfolio risks. Should that unaware investor face an adverse economic cycle and be hit with the double-whammy of weak job prospects and a shrinking retirement account due to poor capital market performance, TDFs in their present form do not present the uninformed investor with a first-best solution.

Target Date Funds are not a panacea for all investors, and they are not the "one stop shop" solution for all assets in a retirement plan given the variability inherent in the investment population. What is a universal solution is Knowledge—*buyer awareness*—on the part of Plan Sponsors, individual investors, and the Fiduciaries that support a prudently managed retirement plan. TDFs have a role in retirement plans and we continue to see advances in their construction, which can help the American workforce meet the demographic and capital market challenges that lie ahead. In the meantime, make sure to enjoy the journey. ■

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[5] Kritzman, Mark and Don Rich. "The Mismeasurement of Risk." Financial Analysts Journal. May/June 2002, page 91.

[6] U.S. Department of Health and Human Services, Centers for Disease Control and Prevention. "Health, United States, 2008." Table 26, page 203. Note that the data cited includes the 2006 data updates available at http://www.cdc.gov/nchs/data/hus/hus08.pdf#026

[7] Helman, Ruth and Craig Copeland and Jack VanDerhei "The 2009 Retirement Confidence Survey: Economy Drives Confidence to Record Lows; Many Looking to Work Longer." Employee Benefit Research Institute Issue Brief. April 2009, Number 328, page 19.

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Target Date Funds (TDFs) have seen explosive growth since Barclays Global Investors launched their LifePath Portfolio products in November 1993. While estimates vary on total asset size, 2009 Senate testimony reflected total TDF assets of over $176 billion as of the end of April 2009.[1] Industry survey data and marketplace expectations suggest that steep TDF adoption will continue into the future, despite the product set's weak performance in 2008. Prior to the 2008-09 financial crisis, one study found that TDFs were 6.6% more likely to be selected by retirement plan investors than other choices. When an employer designates TDFs as the plan's default option, that likelihood rises by 10.9 percentage points.[2] CAPTRUST agrees that adoption rates will likely continue to rise, and as such we feel compelled to add some clarity to this subject's discourse.

This paper does not intend to describe TDF history, but instead sets out to provide context on the product features and attributes that CAPTRUST feels are important for Plan Sponsors, investors, and their advisors to understand, given a changing TDF landscape. ■

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