

Taking Aim at Your Retirement: A Look at Target Date Mutual Funds

By John Markese

There is an appealing simplicity in the concept of target date funds that has a strong attraction for investors: Just pick a year, and lean back—your portfolio management is now on autopilot, with coordinated diversification among the major asset classes that is re-balanced periodically toward your estimated time of arrival, your target date.

But while the concept of the target date fund has a justified appeal to a broad range of investors, making the right choice among the many target date fund offerings and understanding how the funds work is not quite as simple as it appears at first glance.



The Risk/Growth Dilemma

Target date funds are built on the assumption that investors who are farther from their target retirement date should have higher allocations to stocks, and that the stock commitment should decrease as the target date approaches. Thus, funds with an earlier target date will start out with a lower stock allocation than funds with a later target date, but all of the target funds within a family will decrease their commitment to stocks as the target date approaches.

When the target date arrives, the asset allocations resemble a portfolio suitable for a retirement period that may extend for decades. This terminal target date portfolio will

have substantially less risk than a target date fund with 40 years to run before the target date, and it will also have a significant income emphasis rather than the growth emphasis of a distant target date fund.

However, the portfolio composition at the target date confronts a familiar dilemma: How should the conflicting goals of low-risk investment in retirement be balanced against the need to incorporate into the portfolio some stock investments

that, although higher risk, will serve to outpace inflation?

The practical implications of this risk/growth trade-off, particularly for investors nearing retirement target dates or in the years just after the retirement target date, become real with a sudden and significant drop in worldwide stock prices. Withdrawing money from the stock portion of a retirement portfolio when stock prices are depressed can have lasting negative implications for the sufficiency of assets to last the lifespan of the investor. Even if you manage to pick the right target date, sometimes decades before the event, target funds are not without uncertainty.

Choosing Among Funds

And then there is the decision to be made—among the increasing number of offerings of target date mutual funds—of a specific fund.

The target date mutual fund offerings are dominated by Vanguard, Fidelity, and T. Rowe Price, with funds available also from Schwab and American Century.

Table 1. Asset Allocations of Target Date Funds

Fund Name	Symbol	Allocation of Fund Holdings					
		Domestic Stocks (%)	Foreign Stocks (%)	Domestic Bonds (%)	Foreign Bonds (%)	Money Markets/Cash (%)	Other (%)
American Century							
LIVESTRONG Income	ARTOX	39.0	5.0	38.0	7.0	10.0	1.0
LIVESTRONG 2015	ARFIX	42.5	7.3	36.2	5.8	7.0	1.3
LIVESTRONG 2020	ARBVX	45.5	9.3	34.2	4.5	5.0	1.6
LIVESTRONG 2025	ARWIX	49.2	11.3	30.7	2.0	5.0	1.8
LIVESTRONG 2030	ARCVX	53.5	13.0	27.0	0.0	4.5	2.1
LIVESTRONG 2035	ARYIX	58.4	14.3	23.1	0.0	2.0	2.3
LIVESTRONG 2040	ARDVX	62.3	15.5	19.6	0.0	0.0	2.6
LIVESTRONG 2045	AROIX	63.7	16.3	17.2	0.0	0.0	2.8
LIVESTRONG 2050	ARFVX	66.0	16.0	15.0	0.0	0.0	3.0
Fidelity							
Freedom Income	FFFAX	18.2	0.0	40.4	—	41.4	—
Freedom 2000	FFFBX	21.0	0.3	37.4	—	41.3	—
Freedom 2005	FFFVX	35.1	8.2	41.5	—	15.2	—
Freedom 2010	FFFCX	36.9	9.9	42.7	—	10.5	—
Freedom 2015	FFVFX	38.8	10.5	42.4	—	8.3	—
Freedom 2020	FFFDX	48.7	12.9	37.1	—	1.3	—
Freedom 2025	FFTWX	52.5	14.0	33.4	—	0.1	—
Freedom 2030	FFFEX	60.1	15.9	23.9	—	0.1	—
Freedom 2035	FFTHX	62.6	16.5	20.8	—	0.1	—
Freedom 2040	FFFFX	64.9	17.0	18.0	—	0.1	—
Freedom 2045	FFFGX	65.4	17.3	17.2	—	0.1	—
Freedom 2050	FFFHX	67.3	20.7	11.9	—	0.1	—
Schwab							
Retirement Income	SWARX	15.4	5.0	54.4	5.0	20.3	—
Target 2010	SWBRX	35.5	14.6	38.3	4.2	7.4	—
Target 2015	SWGRX	41.3	18.2	32.3	3.3	4.8	—
Target 2020	SWCRX	43.6	19.3	31.3	3.6	2.3	—
Target 2025	SWHRX	48.7	21.3	22.6	2.6	4.8	—
Target 2030	SWDRX	47.7	22.0	25.3	2.9	2.2	—
Target 2035	SWIRX	53.9	23.5	17.4	2.1	3.2	—
Target 2040	SWERX	52.8	24.8	17.9	2.1	2.4	—
T. Rowe Price							
Retirement Income	TRRIX	32.2	8.4	52.9	3.2	3.2	0.1
Retirement 2005	TRRFX	39.2	10.2	44.1	3.7	2.6	0.2
Retirement 2010	TRRAX	45.2	12.9	35.9	3.1	2.6	0.3
Retirement 2015	TRRGX	51.1	15.4	27.9	2.5	2.8	0.3
Retirement 2020	TRRBX	56.3	17.9	20.7	1.9	2.8	0.4
Retirement 2025	TRRHX	60.9	19.8	14.6	1.4	2.9	0.4
Retirement 2030	TRRCX	64.2	21.2	10.2	1.0	3.0	0.4
Retirement 2035	TRRJX	66.7	22.2	7.0	0.6	3.1	0.4
Retirement 2040	TRRDX	66.6	22.2	7.1	0.7	3.0	0.4
Retirement 2045	TRRKX	66.6	22.3	7.0	0.7	3.0	0.4
Retirement 2050	TRRMX	66.5	22.2	7.0	0.9	3.0	0.4
Retirement 2055	TRRNX	66.7	22.5	6.6	0.7	3.1	0.4
Vanguard							
Target Retirement Income	VTINX	23.6	5.6	65.7	—	5.1	—
Target Retirement 2005	VTOVX	31.5	7.5	58.3	—	2.7	—
Target Retirement 2010	VTENX	41.7	10.3	48.0	—	0.0	—
Target Retirement 2015	VTXVX	49.4	12.2	38.4	—	0.0	—
Target Retirement 2020	VTWNX	55.5	13.8	30.7	—	0.0	—
Target Retirement 2025	VTTVX	61.5	15.3	23.2	—	0.0	—
Target Retirement 2030	VTHRXX	67.5	16.9	15.6	—	0.0	—
Target Retirement 2035	VTTHX	71.8	17.7	10.5	—	0.0	—
Target Retirement 2040	VFORX	71.7	18.1	10.2	—	0.0	—
Target Retirement 2045	VTIVX	71.9	17.7	10.4	—	0.0	—
Target Retirement 2050	VFIFX	72.0	17.9	10.1	—	0.0	—

Source: Fund family Web sites.

All of these funds invest in the broad-based mutual funds of their respective fund family—they are, in essence, funds of funds. However, the mix of mutual fund holdings varies based on the target maturity date. And all of these target date fund families agree on one particular concept: There is a progression among the target date funds that goes from an asset mix that favors stock and is more volatile (for the farthest target dates) to an asset mix that is less volatile and stresses more fixed-income investments (for the more current target dates and the income funds).

However, the steps along this path, and the mix of assets in the portfolio at any one step, can and do vary by mutual fund family. Here is where the simple concept of the target date fund can get a bit more complex—and this is where investors need to take the controls and pay attention to the flight plan.

Table 1 lists all the major target date fund offerings. It groups target date funds by fund family, and within each group it lists the funds based on the target date, from the nearest date to the most distant.

This highlights the glide path over time, from a fixed-income emphasis in the nearest-term target date funds, to a high stock allocation in the distant target

Table 2. Performance of Target Date Funds

Fund Name	Ticker	Annual Return (%)			Total Risk Index	Yield (%)	Expense Ratio (%)	Notes
		1 Yr	3 Yr	5 Yr				
American Century								
LIVESTRONG Income	ARTOX	(16.4)	(1.7)	na	0.15	4.0	0.76	At target retirement date, allocation is fixed to match Income portfolio, but the funds are not denoted as combined.
LIVESTRONG 2015	ARFIX	(19.3)	(2.6)	na	0.17	3.9	0.80	
LIVESTRONG 2020	ARBVX	na	na	na	na	na	0.82	
LIVESTRONG 2025	ARWIX	(23.6)	(4.4)	na	0.20	3.3	0.85	
LIVESTRONG 2030	ARCVX	na	na	na	na	na	0.87	
LIVESTRONG 2035	ARYIX	(28.5)	(6.4)	na	0.24	2.7	0.90	
LIVESTRONG 2040	ARDVX	na	na	na	na	na	0.92	
LIVESTRONG 2045	AROIX	(31.5)	(7.7)	na	0.27	2.6	0.97	
LIVESTRONG 2050	ARFVX	na	na	na	na	na	0.94	
Fidelity								
Freedom Income	FFFAX	(10.1)	(0.6)	1.5	0.10	3.7	0.49	10 to 15 years after target date is reached, fund mimics Income fund and is combined with that fund.
Freedom 2000	FFFBX	(11.7)	(1.1)	1.4	0.11	3.9	0.51	
Freedom 2005	FFFVX	(21.4)	(4.6)	0.4	0.18	3.6	0.64	
Freedom 2010	FFFCX	(22.3)	(4.9)	0.3	0.18	3.7	0.65	
Freedom 2015	FFVFX	(23.9)	(5.6)	0.5	0.19	3.3	0.67	
Freedom 2020	FFFDX	(28.7)	(7.5)	(0.3)	0.20	2.9	0.72	
Freedom 2025	FFTWX	(30.1)	(8.2)	(0.5)	0.24	3.0	0.73	
Freedom 2030	FFFEX	(33.5)	(9.8)	(1.2)	0.25	2.6	0.76	
Freedom 2035	FFTHX	(34.4)	(10.2)	(1.4)	0.28	2.4	0.77	
Freedom 2040	FFFFX	(35.4)	(10.7)	(1.5)	0.29	2.6	0.78	
Freedom 2045	FFFGX	(35.7)	na	na	na	2.1	0.78	
Freedom 2050	FFFHX	(37.3)	na	na	na	2.2	0.80	
Schwab								
Retirement Income	SWARX	(8.6)	(1.4)	na	0.10	4.0	0.68	15 years after reaching the target date, allocation remains fixed at 20% stocks and remainder in money markets and fixed income. Fund should match Income fund allocation, but it is not denoted as turning into that fund.
Target 2010	SWBRX	(21.2)	(5.8)	na	0.18	4.0	0.92	
Target 2015	SWGRX	(21.8)	na	na	na	2.0	0.89	
Target 2020	SWCRX	(23.8)	(7.0)	na	0.21	3.4	0.92	
Target 2025	SWHRX	(23.6)	na	na	na	2.0	0.92	
Target 2030	SWDRX	(26.2)	(7.9)	na	0.23	3.0	0.96	
Target 2035	SWIRX	(26.5)	na	na	na	1.9	0.92	
Target 2040	SWERX	(28.3)	(8.8)	na	0.25	2.8	0.96	
T. Rowe Price								
Retirement Income	TRRIX	(15.4)	(1.9)	2.0	0.15	3.9	0.55	30 years after target date is reached, allocation remains fixed at 20% stocks and remainder in fixed income. Fund is not denoted as either combining with the Income fund or mimicking it.
Retirement 2005	TRRFX	(19.0)	(3.2)	1.9	0.18	3.8	0.58	
Retirement 2010	TRRAX	(22.7)	(4.8)	1.3	0.21	3.3	0.61	
Retirement 2015	TRRGX	(25.7)	(6.0)	0.8	0.24	3.2	0.65	
Retirement 2020	TRRBX	(28.4)	(7.3)	0.4	0.26	2.6	0.68	
Retirement 2025	TRRHX	(30.6)	(8.3)	(0.0)	0.28	2.3	0.70	
Retirement 2030	TRRCX	(32.3)	(9.1)	(0.3)	0.30	2.1	0.70	
Retirement 2035	TRRJX	(33.3)	(9.7)	(0.6)	0.30	2.0	0.72	
Retirement 2040	TRRDY	(33.2)	(9.6)	(0.6)	0.30	1.9	0.73	
Retirement 2045	TRRKX	(33.2)	(9.6)	na	0.30	1.9	0.73	
Retirement 2050	TRRMX	(33.3)	na	na	na	1.7	0.73	
Retirement 2055	TRRNX	(33.3)	na	na	na	1.8	0.73	
Vanguard								
Target Retirement Income	VTINX	(10.3)	1.1	2.7	0.12	4.0	0.19	7 years after target retirement date, fund mimics Income fund, but it is not denoted as turning into that fund.
Target Retirement 2005	VTOVX	(14.7)	(0.7)	2.0	0.15	4.4	0.18	
Target Retirement 2010	VTENX	(19.2)	na	na	na	3.9	0.19	
Target Retirement 2015	VTXVX	(22.4)	(4.2)	0.7	0.20	3.8	0.18	
Target Retirement 2020	VTWVX	(25.3)	na	na	na	3.3	0.19	
Target Retirement 2025	VTTVX	(28.1)	(6.7)	(0.4)	0.25	3.5	0.18	
Target Retirement 2030	VTHRXX	(30.9)	na	na	na	3.0	0.19	
Target Retirement 2035	VTTTHX	(32.6)	(8.9)	(1.0)	0.28	3.3	0.18	
Target Retirement 2040	VFORX	(32.4)	na	na	na	2.8	0.19	
Target Retirement 2045	VTIVX	(32.5)	(8.9)	(0.6)	0.28	3.2	0.18	
Target Retirement 2050	VFIFX	(32.4)	na	na	na	2.8	0.19	

Sources: Morningstar Inc. and fund family Web sites. Data as of 4/30/2009.

date funds. For example, the Vanguard Target Retirement 2010 has 52% total in stock and 48% in bonds. In contrast, the Vanguard 2050 fund has 72% in domestic stocks and 17.9% in international stocks, for a total of 89.9% in stock and 10.1% in bonds.

All of these target date funds have similar progressions, but vary the percentages in domestic versus international stocks or bonds versus cash (where cash translates to money market mutual funds, or similar short-term fixed-income investments).

For example, the T. Rowe Price 2030 fund allocates 85.4% to stocks (64.2% to domestic and 21.2% to foreign) while American Century LIVESTRONG 2030 allocates 66.5% to stocks (53.5% to domestic and 13.0% to foreign). In addition, some families include foreign bonds in the mix (American Century, Schwab and T. Rowe Price), while others do not. [Ironically, the families that do allocate to foreign bonds, which typically are viewed as riskier than domestic bonds, actually increase their foreign bond commitments as the target date approaches, since the overall bond commitment is increasing.]

These portfolio allocation variations among target groups will produce different risk and performance figures beyond the differences in the specific investments within the asset allocation categories.

What Exactly Is the “Target”?

A significant difference among the fund families centers on when these target funds finally touch down and become, essentially, income funds. Most investors would probably assume that the touch-down date is the target date of the particular fund. However, this is typically not the case.

All of the families offer a retirement income fund for investors who are beyond their “target” dates. However, within the Vanguard target date family, a target date fund’s allocations converge with the asset allocation of the income fund seven years *after* the target date is reached. Fidelity’s final touchdown is

10 to 15 years *after* the target date, T. Rowe Price’s is 30 years, and Schwab’s is 15 years.

Only the American Century funds are designed to touchdown to an income portfolio *at* the target date.

Investment Characteristics

Table 2 details the performance of these target date funds, along with information on yield, expenses and, importantly, risk.

Performance

The performances of these target date funds follow from their strategy. Not surprisingly, the most distant target date funds with the most stock exposure incurred the greatest losses in the recent down market, while funds with closer target maturities sustained smaller losses.

Over the last five years, the losses for these well-diversified target date funds were small, with the nearest target date and income funds providing positive returns over what was an extremely difficult time period for stocks.

Risk

The total risk index measures the relative return volatility of a fund over three years compared to all funds. The total risk index for the average fund is 1.00, with a risk index above 1.00 indicating greater than average risk. For example, a fund with a risk index of 1.50 would be 50% more volatile than the average fund, while a fund with a total risk index of 0.50 would only be half as volatile as the average mutual fund. An “na” in the total risk index column results if the fund has been in operation for less than three years, and therefore has an insufficient return basis to calculate a total risk index.

All of these target date funds have significantly low total risk indexes—with the highest only 0.30—due to their mix of domestic and international stocks and bonds, along with their holdings of money market funds. In addition, the total risk indexes for each fund within a family declines as the target date ap-

proaches. For example, the T. Rowe Price Retirement 2045 fund has a total risk index of 0.30, while the T. Rowe Price Retirement Income fund has a total risk index of only 0.15.

For risk comparison, the average large-cap stock fund has a total risk index of 1.04, foreign stock funds average 1.34, long-term general bond funds average 0.50, and international bond funds average a total risk index of 0.59. Combining different types of funds into a portfolio—the strategy of a target maturity fund—creates a lower total risk index than that of the riskiest of the individual funds.

Yields

As would be expected, the yields of these funds—interest and dividends after expenses divided by average net asset value—increase as the target date approaches maturity. Generally the highest yields are generated by the nearest-term target maturity funds, which have the highest concentration of fixed-income investments.

Currently, the retirement income funds are generating an average yield of 4.0% in spite of the very low current money market yields. The yield figure is particularly important for retirees dependent on portfolio income flows.

Expense Ratios

The expense ratio is expressed as a percentage of the value of fund investments, and expenses reduce return dollar-for-dollar. Since expenses are netted against income, higher expenses reduce total return, but reduce yield first.

Since all of these target date funds are, in turn, composed of mutual funds (in other words, these are funds of funds), the expense ratios are a dollar-weighted average of the expense ratios of the underlying funds plus, in some cases, an added administration fee. Stock funds have higher expenses than bond funds, and foreign investments are more expensive than domestic investments.

Vanguard’s target retirement funds have expense ratios that are, in some instances, only about a fifth as high as comparable target date funds from the

Target Fund Family Web Sites

American Century

www.americancentury.com

Click on Individual Investors, then Funds and Performance.

Fidelity

www.fidelity.com

Click on Mutual Funds under Top Links on the left side of the home page. The Freedom funds are listed with the Allocation and Specialized group.

Schwab

www.schwabfunds.com

Choose the Fund Performance or Prospectus and Reports tab; the target funds are listed under Asset Allocation Funds.

T. Rowe Price

www.troweprice.com

Click on Individual Investors, then Mutual Funds.

Vanguard

www.vanguard.com

Click on Personal Investors, then Vanguard funds and All-in-one funds.

other families. That's because the underlying Vanguard funds are all index funds, which typically have very low expenses because they are not actively managed, but instead are designed to mirror the performance of an index such as the S&P 500 index of large-cap stocks.

Fidelity's 2020 target fund holds 27 individual Fidelity funds, of which only one is an index fund and the others are actively managed. Vanguard's 2020 fund holds five funds, all index funds.

Actively managed funds also trade more often and incur more transaction costs, which reduce total return.

And because actively managed funds trade more they tend to be less tax-efficient—something to consider if the target date fund is not going to be held in a 401(k), IRA or other tax-sheltered account.

Taking Aim

Having waded through these statistics and strategies, what is the final conclusion on target date funds?

A “take aim at a target date and invest” approach is simple to do and simple to maintain, and it is an all-in-one package. All these funds are well-diversified and have acted as expected according to their target dates and asset mixes: risk declined and income increased for all these target date funds as the target dates approached the current period. All are well-positioned for their mission of mimicking the general individual inves-

tor preference for less risk and more income at increasing ages.

However, one difficulty in investing in these funds is picking among the various fund family “final touchdown” strategies. Remember that the target date is not necessarily the time at which the fund turns into an income fund, and that the glide path of these funds and the landing point vary considerably.

If you want to err on the conservative side with respect to risk, a target date that is shorter than your actual retirement may make some sense. For example, if you have 40 years until your actual planned retirement date and the target fund you have selected does not touchdown into a retirement income fund until 10 years after the target date, the conservative play would be to select a retirement date target fund only 30 years in the future. This strategy might minimize the impact of an extreme stock market downturn on your portfolio value if one occurs just about when you hit retirement and intend to start withdrawing money to meet post-retirement needs.

These families of target funds are not identical in risk, return, yield, expenses, or strategy. So make sure you do your research before you invest.

The accompanying box lists the Web sites for these funds. If you take the time to get a good focus on your target, you are more likely to hit the bull's eye at your retirement—or at least come close. ▲

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