



Advisor Alert

Not All Target Date Funds are Created Equal

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For Immediate Release

Target date funds have grown in popularity in recent years due to participant requests for advice and support from legislation for automatic programs in defined contribution plans. Also, the slow migration away from defined benefit plans to defined contribution plans, which has shifted investment risk to participants, has added to target date fund popularity. Many plan sponsors need a better understanding of the differences between fund family product offerings and their associated risks and rewards.

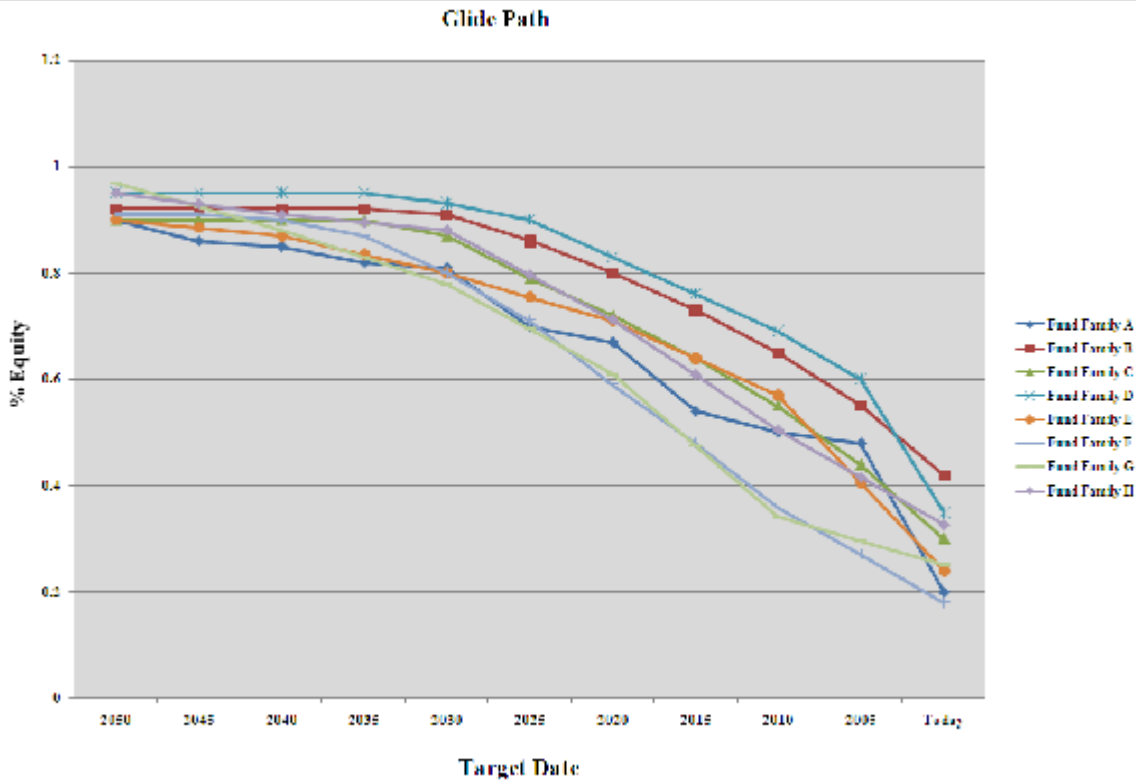
Evolution of Target Date Funds

Since 1994, the growth of target date fund providers has increased significantly from approximately five major providers to over 70 providers. It is estimated that total asset growth in target date funds has increased from its infancy state to approximately \$170 billion as of 9/30/2007, according to Financial Research Corporation. About 33% of plan sponsors are offering target date funds in their plans according to the Profit Sharing/401(k) Council of America. Of those plan sponsors that offer the products, about 45% of plan participants use one of the funds in the series in one way or another according to data from Hewitt Associates. Many plan sponsors have elected target date funds as the Qualified Default Investment Alternative (QDIA) for both newly eligible participants and existing participants who have not made prior investment elections under newly established Pension Protection Act (PPA) safe harbor guidelines. It is anticipated that target date fund usage will continue to increase as both plan sponsors and participants look for a user-friendly, risk-adjusted, diversified investment solution for their retirement savings.

Not All Target Date Funds are the Same

When evaluating target date funds, there are many differences to consider not limited to the following: asset allocation, active vs. passive management, proprietary vs. non-proprietary fund selection, expense ratios, series increment and risk posture. One of the main differentiators in target date funds is the glide path for a particular series. The glide path represents the allocation between equity and non-equities at various points in time during the investment life of a participant. As seen from Exhibit 1, all firms have a high equity exposure at the retirement date of 2050 due to the ability for an individual to take on more risk with a long-term time horizon. All firms also steadily decrease equity exposure as a retirement date approaches. The main difference in the glide paths is that some firms carry a significantly higher exposure to equity throughout the term of the glide path. Higher equity exposure can lead to good returns when the market is performing well, but can also expose participants to unwanted downside risks should the market enter a downturn.

Exhibit 1

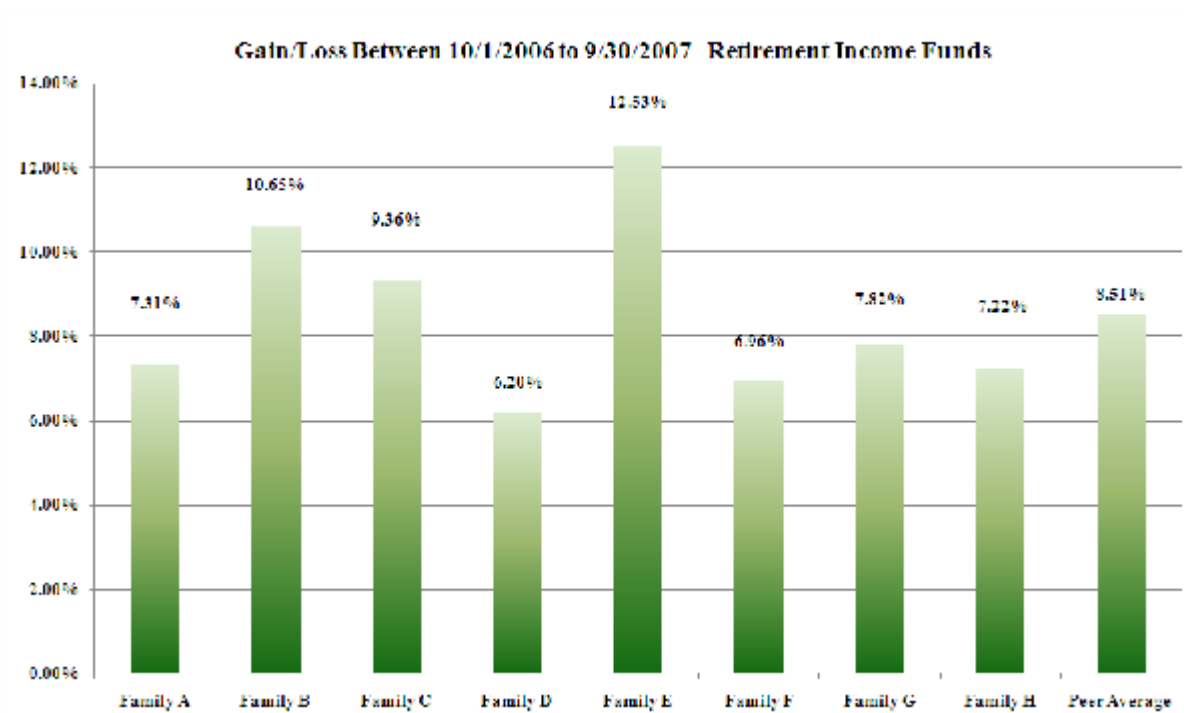


Source: Global Index Advisors

Understanding the Risks

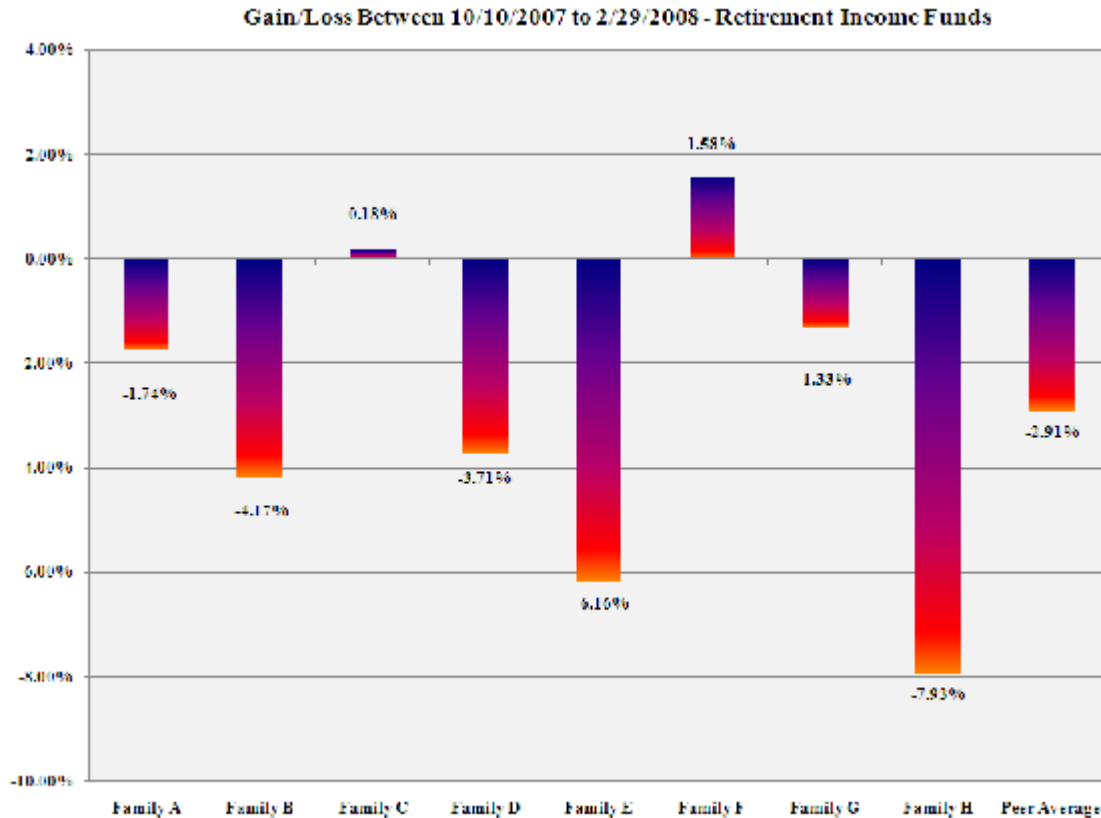
Because of these differences and glide path methodologies, it is important to note that fund risk characteristics and performance can vary substantially in comparing one fund family's series to another. From a glance at historical performance through 12/31/2007 for trailing 1, 3 and 5 year returns, the variation might not seem as evident during an up-market, however, during a period of market volatility and a continued down-market, the return variation can be alarming especially to unknowing participants and plan sponsors. For our evaluation, we compared historical returns from several target date fund providers who have established track records over these periods. Exhibit 2 is an example of what a participant would have experienced during a representative upturn in the markets for the three years ending September 30, 2007 (showing fund up-capture experience). Exhibit 3 is an example of what a participant would have experienced during the recent market downturn from October 9, 2007 to February 29, 2008 (showing fund down-capture experience).

Exhibit 2



Source: Morningstar

Exhibit 3



Source: Morningstar

Performance Benchmarking

Plan sponsors, investment committees and participants need to be careful when evaluating and comparing target date funds. Many target date series do not have a long-term performance history making it difficult to perform a thorough and meaningful analysis. Morningstar and Lipper Analytics are two independent research firms that provide access to data for peer analysis and benchmarking purposes. However, due to the many differences in equity allocations, philosophy of management process and others, it can be difficult to accurately benchmark these products against one another. Many firms do offer proprietary benchmarks that will compare their series' performance to a custom index with similar equity weightings. Having a documented, consistent and repeatable process is well-advised for the ongoing monitoring and analysis of all plan investments including target date funds.

Other Important Considerations

Perhaps one of the more important considerations in selecting the appropriate target date series is the actual participant demographics of the plan. A target date series with a conservative risk posturing methodology might be more appropriate for a plan with a greater percentage of its participants at or near retirement or with a significant portion of their overall retirement assets invested in the company plan. A younger participant base may benefit from a target date series with a greater allocation to equities throughout the glide path, or a participant base with high incomes that has a larger percent of overall retirement assets

outside the company plan. How does the target date series adjust for those who have reached retirement? Will the portfolio be adjusted to minimize against market downside risk while still providing upside potential through equities? We have found that the asset allocation mix between equities and non-equities will vary significantly between target date fund offerings when comparing funds with similar retirement timelines. Other risk measurements such as standard deviation and Sharpe Ratio should be evaluated to determine suitability.

Conclusion

Target date funds offer both plan sponsors and participants an effective investment alternative to save for retirement. It is important to consider the many differences when selecting an appropriate target date fund series and plan sponsors should be aware of the inherent risks and reward opportunities. Unfortunately, in the past, many plan sponsors have selected the target date series that is proprietary to their provider; however, this may not be in the best interest of plan participants. Further scrutiny is necessary to select the best option. Many providers now offer the ability to choose from an open architecture which will allow a plan sponsor to choose among various providers to best match the product to their participant demographics.

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