TARGET DATE FUNDS

Set It, But Don't Forget It

Abstract
An overview of the CMI RSP Vanguard Target Date Funds and selecting an option that is right for your situation.

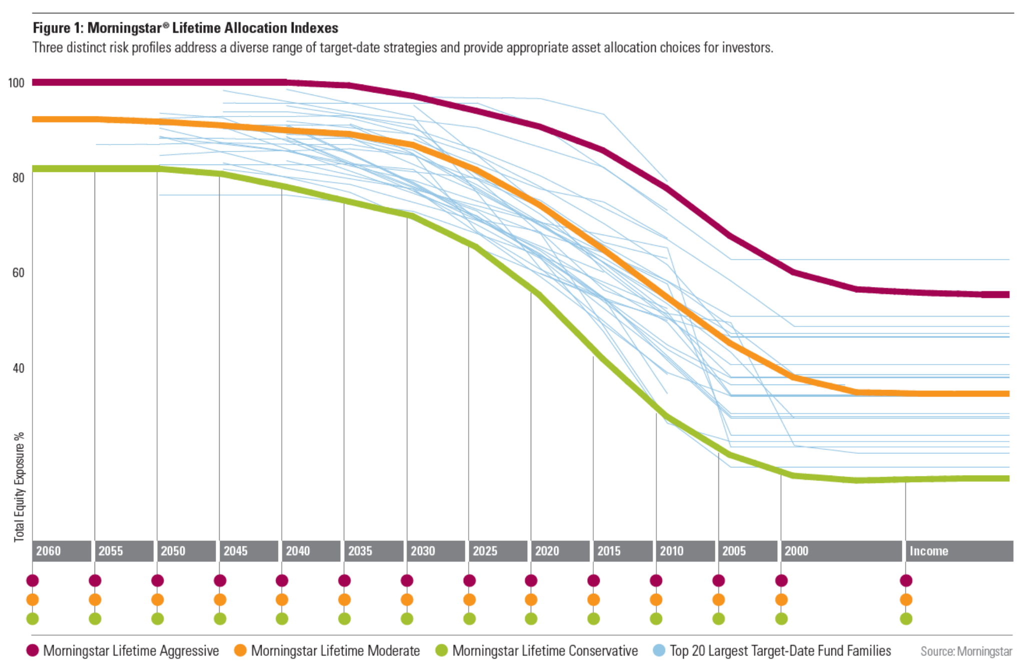
Jalene Thompson Hahn, CFP®
WWA Planning & Investments
427 Washington St.
Columbus, IN 47201
(812) 379-1120
www.wwafp.com

Target date funds first debuted in 1994 and received a major boost from the 2006 Pension Protection Act as more plan sponsors selected them for their Qualified Default Investment (QDI) option. The concern I have is that investors do not understand the mechanics of a Target Date Fund, the fees and the risks associated with this type of investment.

Target date funds consist of a mix of stocks, bonds, and other investments. Another name is a "lifecycle fund" because the investment mix shifts over time. The further away from the "target date" of these funds they provide more exposure to stocks and other alternatives. As the target date approaches, the fund's assets shift to more conservative less volatile asset classes. This shift to less volatile asset classes is known as the "Glide Path". Understanding the glide path is important for determining if a target date fund is "to" a retirement date or "through". Even though you may retire within 3 – 5 years of a funds target date, you will probably still have many years where you will still need your investments to grow.

Using a Target Date Funds for retirement savings can be beneficial if used correctly. Understanding the terminology and approach of target date funds will help minimize investment surprises.

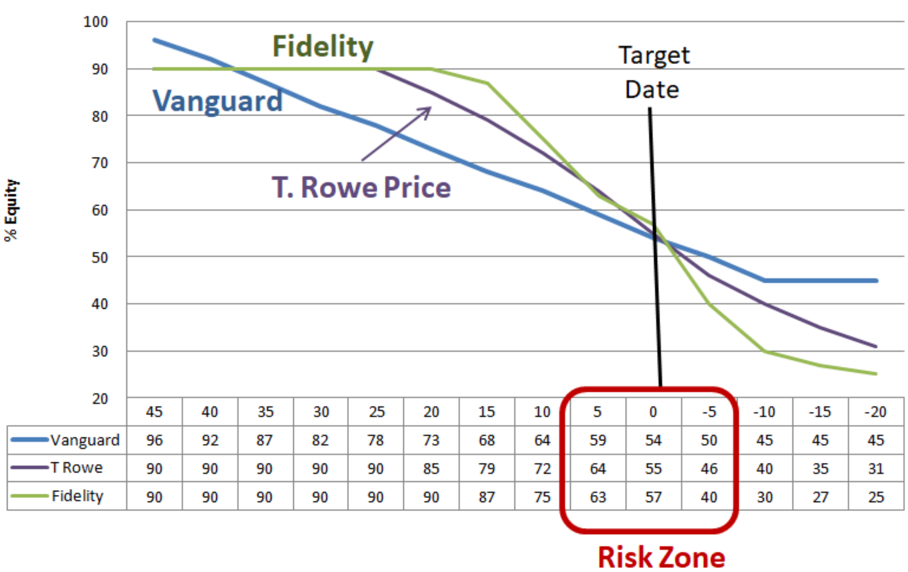
One of the pitfalls of a target date fund is not knowing it's glide path. The same target date may have widely varying allocations to the underlying funds. Morningstar mapped out the top 20 fund families funds against an aggressive, moderate and conservative allocation path.



One of the things that I noticed about the above graph, besides it being woefully out of date, is the wide disparity in allocations and glide paths. It also highlights that some glide paths are smooth and others have defined cliffs.

Figure 2 compares the three largest target date fund families. Figure 2 also points out a concept of the "Risk Zone". The 3-5 years immediately before and following your retirement date have a significant impact on your ability to meet your financial needs over an anticipated 30 to 40-year period. All three families have similar allocations in the "Risk Zone", the difference is how they get to the target date and what happens after the date is reached. The Vanguard Family follows a smooth glide path from inception to termination and ends with the largest stock allocation. It has the most conservative glide path until after the Target Date and then it maintains a higher stock allocation. It is what is known as a "Through" glide path. From inception, Fidelity has the longest period of high stock allocation but also has the most rapid transition from stocks to fixed income and ends up with the most conservative allocation the soonest. It continues a steep transition to Fixed Income after the Target Date. This path is known as a "To" glide path. T. Rowe Price has a glide path that matches Fidelity from inception, but starts transitioning sooner. It has a steeper smoother middle section before joining with the other fund families at the target date. It continues it's middle ground path through the end of the fund's termination. This middle path combines the "Through" and "To" concept.

Figure 2: Big 3 Glide Paths

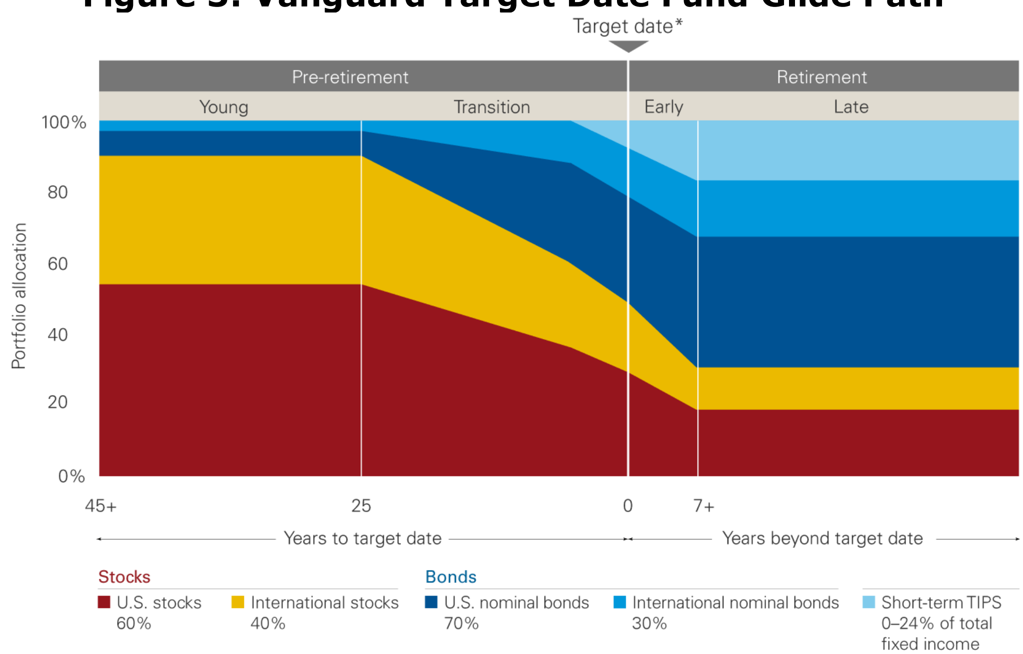


	45	40	35	30	25	20	15	10	5	0	-5	-10	-15	-20
Vanguard	96	92	87	82	78	73	68	64	59	54	50	45	45	45
T Rowe	90	90	90	90	90	85	79	72	64	55	46	40	35	31
Fidelity	90	90	90	90	90	90	87	75	63	57	40	30	27	25

Cummins RSP offers the Vanguard suite of Target Date Funds. Characteristics include low fees, broad diversification, use of index funds, professionally managed portfolio, automatic risk adjustment and rebalancing. While these funds are well suited for a passive investment style, those wishing to have a different asset allocation may wish to pursue creating their own portfolio with the options the Cummins RSP provides. Common reasons to create your own allocation are extra growth early in one's career or a desire to manage the risk zone in a different manner than what is set by the Fund Manager.

Figure 3 contains details of the various Target Date Fund portfolio allocations. Digging a little deeper will uncover the level of risk each fund carries as seen in Table 1.

Figure 3: Vanguard Target Date Fund Glide Path



Source: Vanguard.

*Target date is the year stated in the fund name and assumes retirement at age 65.

Table 1: Vanguard Target Date Fund Allocations

		VTXVX	VTWNX	VTTVX	VTHRX	VTTHX	VFORX	VTIVX	VFIFX	VFFVX	VTTSX	VLXVX
	Target Date Year	2015	2020	2025	2030	2035	2040	2045	2050	2055	2060	2065
VTSMX	Stock Market Index	24.5%	32.3%	37.7%	42.2%	46.7%	51.2%	54.1%	54.0%	54.0%	53.9%	53.9%
VGTSX	International Stock	16.3%	21.5%	25.1%	28.0%	31.0%	33.9%	35.9%	35.9%	36.0%	36.1%	36.1%
VTIBX	Intl Bond Index Fund	14.2%	12.3%	11.1%	8.9%	6.6%	4.4%	7.1%	7.1%	7.1%	7.1%	7.0%
VTBIX	Bond Market II Index	33.1%	28.9%	26.1%	20.9%	15.7%	10.5%	2.9%	3.0%	2.9%	2.9%	3.0%
VTIPX	Short-Term Inflation-Protected Securities Index	11.9%	5.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

So, if you wish to continue using a Target Date Fund, it may be more appropriate for your situation to use a fund not tied to your anticipated retirement date. It may prove beneficial to change target dates as your situation changes. Best practice is to only invest in one target date fund at any given time. Holding multiple funds defeats the goal of having a professionally managed allocation and may cause a mismatch to your risk capacity. If you are thinking of hedging your bets, it may be more beneficial to create your own allocation and adjust annually.