



Performance Results for Target Date Funds

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The Department of Labor's (DOL's) new rules for Qualified Default Investment Options (QDIAs) advance three investment options: Target Date Funds, Balanced Funds and Managed Accounts. "Managed Accounts" in this context means that a service provider creates diversified portfolios of the plan's mutual funds (and/or other offerings) on behalf of the participants.

Managed accounts hold the most promise for advisors but they require adherence to an audited prudent investment process, a process that could take years to achieve scale. Thus, Target Date Funds (TDFs) are the immediate play. Advisors will be called upon to find the best TDFs. But unfortunately, or perhaps fortunately for the opportunistic, current offerings are not as good as they could be.

The target date industry is still in its infancy and is likely to evolve very rapidly, if for no other reason than the probable stampede into these funds. The potential growth in assets committed to target date funds over the next 5-10 years is astounding. For example, at year-end 2006, there were 168 distinct target date mutual funds with \$109 billion in total assets (if counting all share classes, the total number of funds was over 1,200). As of October 31, 2007 there were 226 target date funds with \$164 billion in assets. This represents a 35% increase in the number of funds and a 50% increase in total target date fund assets in just 10 months.

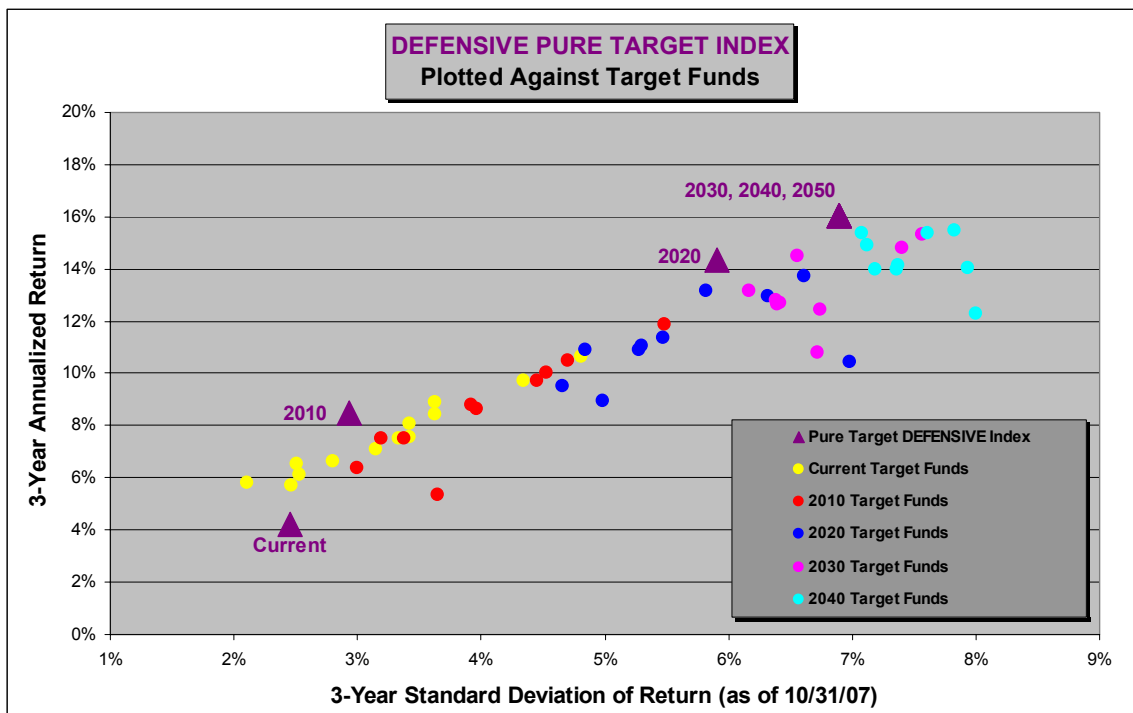
Even so, the ability to separate the wheat from the chaff is extremely difficult, primarily because there are no good yardsticks for gauging performance. That is the reason Target Date Analytics (TDA) was formed: to develop benchmarks for evaluating the performance of TDFs. You can visit TDA at www.TDBench.com, where among other things you'll find free analyses of target date mutual funds.

The appeal of a good target date fund is simple sophistication. Investors in good target date funds are like Lexus car buyers – they don't want to look under the hood. TDA's Defensive Pure Target Index is simple and sophisticated in the following two ways. First, an investor who enters at any time is highly likely to earn a positive real (above inflation) return if he or she stays in the index to the



target date. Second, subject to this first primary objective, the index delivers the most return per unit of diversified risk that it can.

Some say that if “best practices” are not common practices they are merely someone’s opinion of how things ought to be. You be the judge. The exhibit below shows the risk-return profiles of all target date mutual funds with 3 years of data, and contrasts these to comparable risk-return profiles of our recommended benchmark series, which sets a separate index for each target date. The dots in the exhibit are mutual funds, color coded by target date. The indexes are shown as purple triangles, with target dates indicated above the triangles. As you can see, the further the target date the higher the risk and the return of the mutual funds, so they have behaved as expected, reducing risk as target date nears, with the attendant reduction in reward. You can also see that the recommended index series has earned higher returns for the same levels of risk as the mutual funds. The fact that the indexes have performed better on a risk-adjusted basis is an indication that there is room for improvement in target date mutual funds, in our humble opinion.



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