Buck Financial Advisors, LLC

"Helping you Determine your Financial Future"

Target Date Funds-Misunderstood, But Not Lonely

Vol.3 Issue 7 August 2009

At the end of 2008, $109 billion invested in target date mutual funds was held in defined contribution plans, such as 401(k) plans, according to the Investment Company Institute. Fewer than 65% of investors can explain what target date funds do, even though over one-third contribute to such funds. What does Target-Date Fund mean? It is a category of mutual funds that automatically shift the asset allocation (stocks, bonds, cash equivalents) in its portfolio according to a selected time frame. A target-date fund is structured to address some date in the future, such as retirement. For example, the Vanguard Target Date 2040 is 90% Stocks and 10% Bonds and the 2010 version is 60% Stocks and 40% Bonds. In 30 years the 2040 will have altered its allocation so it looks like the current 2010. Of course the 25 year old investor will be 55 by that time.

These funds have become popular with 401(k) plans. While proponents cite the convenience to investors of putting their investing activities on autopilot in one fund, critics are wary of these funds' one-size-fits-all approach. Personally I agree with both. I recommend them to young investors, because they provide a well diversified portfolio with a small investment. On the other hand, they serve the same purpose if you have a small account that can not be consolidated, typically a small IRA account that you no longer are eligible to contribute to either because you have an employer plan, or your income is too high for a Roth IRA.

An Envestnet survey shows a low understanding of the risk of Target funds. About 38% thought that target date funds provided a guaranteed return, and 57% percent felt that over a 10 year period, they could lose money. Almost 30% thought they would have to save less to meet their retirement goals than with regular mutual funds. A full 62% felt they could retire on the target date. All of these are not necessarily true. As stated above they are simply a diversified portfolio of stocks and bonds.

My suggestion when using these funds is to look at the distribution of the assets to see which date has the right amount of stocks versus fixed income. Once you determine that, pick the fund that meets your risk tolerance and needs. Next look at the other dates in the family to see how the allocation changes as you get closer to your goal. You can always change to a different date of the fund without penalty if it is in a tax sheltered (retirement) account. If you have a choice, pick a fund family that has low fees.

Of interest and unfortunately sad in terms of understanding investor behavior, the majority of survey participants chose the most aggressive fund from a list of seven target date funds, because of the expected higher return. A 2040 target date fund may be right for my 30 year old son, but it is definitely not right for dad.

Target Date Funds play an excellent role for investors, but only if you know what they are and how they operate.

Buck Financial Advisors provides independent, commission-free financial advice for people from all walks of life. When you or someone you know needs help, Buck Financial Advisors is there. See www.buckfinancial.com for more information.

Charles Buck CFP®

"If you would be wealthy, think of saving as well as getting."

Benjamin Franklin

Ask the CFP®?

When is the best time to invest in the market?

The best time to invest was March 9th 2009. It may be the best time this year and hopefully for years to come. Unfortunately stock investments, didn't look very good on that date. The S&P 500 Index stood at 676 having completed a 15 month fall from 1500. Trying to time the bottom of the market is a guessing game at best - not a way to invest your money. Your best strategy is to stay invested during downturns, that way you won't miss the bottom of the market or the gains on the upside.

It is difficult to watch the value of your portfolio drop in a down market, but study after study have shown that staying invested with a well-balanced portfolio is the best strategy. The smart and brave hearted investor rebalances their portfolio back to their pre-determined allocation when the markets move and change the allocation drastically. Typically you should rebalance at least once per year. Personally, 5% away from my percent allocation triggers a rebalance.

Today and everyday is the best time to invest in the market.