



# WHAT ARE TARGET DATE FUNDS?

*newkirk® proud*



# YOUR RETIREMENT PLAN INCLUDES TARGET DATE FUNDS.



They're the ones with 2020 or 2030 in their names. And they're an increasingly popular investment option. Indeed, target date funds are frequently the default investment option for plans.

**But what do you know about them?** How do they work? If you're drawing a blank, you're not alone. Studies show that a surprisingly large number of retirement plan participants don't understand target date funds.

This booklet will shed some light on the target date funds in your plan. Not specifically. The booklet's content is general. But after reading it, you will have a better understanding of what target date funds are and how they work. And you'll be able to better assess whether the target date funds in your plan are right for you.



## THE BASICS

Target date retirement funds or lifecycle funds — they go by a number of names — are designed to simplify investing, particularly investing for retirement. The target date is typically expressed as a year. Find the year that's closest to your anticipated retirement date among the target date funds offered in your retirement plan, and that's the fund for you. Simple enough.

A target date fund usually invests in a number of asset classes and mutual funds<sup>1</sup> within those asset classes.

That's one of the advantages of investing in a target date fund. It diversifies your retirement investments. When you invest in a target date fund, you avoid being “over invested” in a single investment option.

As the target date approaches, the target date fund's investments become more conservative. In general, the idea is to take more risk (and potentially earn a larger return) while the target date is far in the future and to take less risk as the date gets closer (so as not to risk big losses and to preserve capital).

### WHAT'S IN A NAME?

Target funds go by a number of names. Target retirement funds. Target maturity funds. Lifecycle funds. Age-based funds. Birth date funds. They all operate in a similar fashion. If you were born in January 1970 and were expecting to retire at age 65, an investment in a target maturity fund with 2040 or 2035 in its name might be appropriate. An age-based fund for 40-year-olds might do the trick, too.

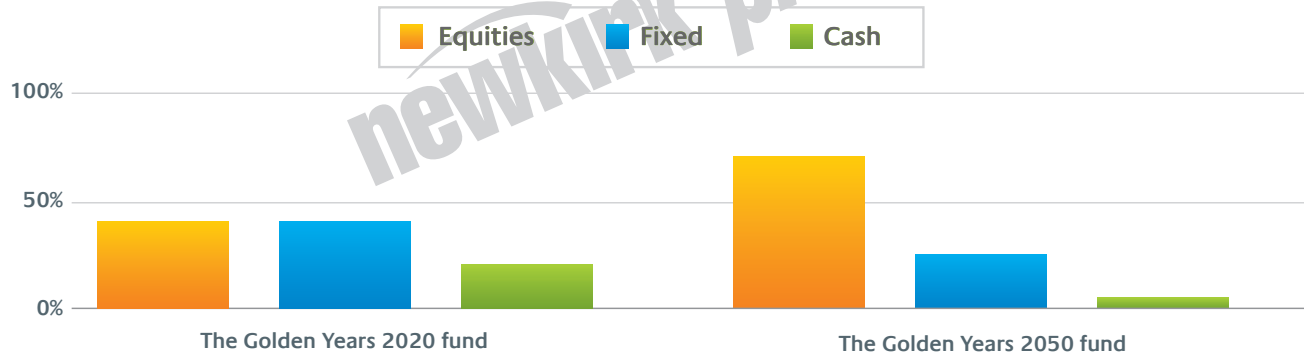
And lifestyle funds? Funds with “lifestyle” in their names often address an investor's appetite for risk. Lifestyle funds may be offered for conservative, moderate, and aggressive investors, with asset allocations reflecting the degree of risk. Generally, the asset allocation percentages of lifestyle funds do not change over time.



## HERE'S A SIMPLE ILLUSTRATION.<sup>2</sup>

Equities are generally regarded as a riskier investment — with a higher potential return — than fixed income investments and cash equivalents (presumably, the least risky investment). The 2020 fund has a more conservative

(i.e., less risky) allocation strategy than the 2050 fund. And that's appropriate if your retirement is within sight. You don't want to risk your retirement nest egg by assuming too much risk.



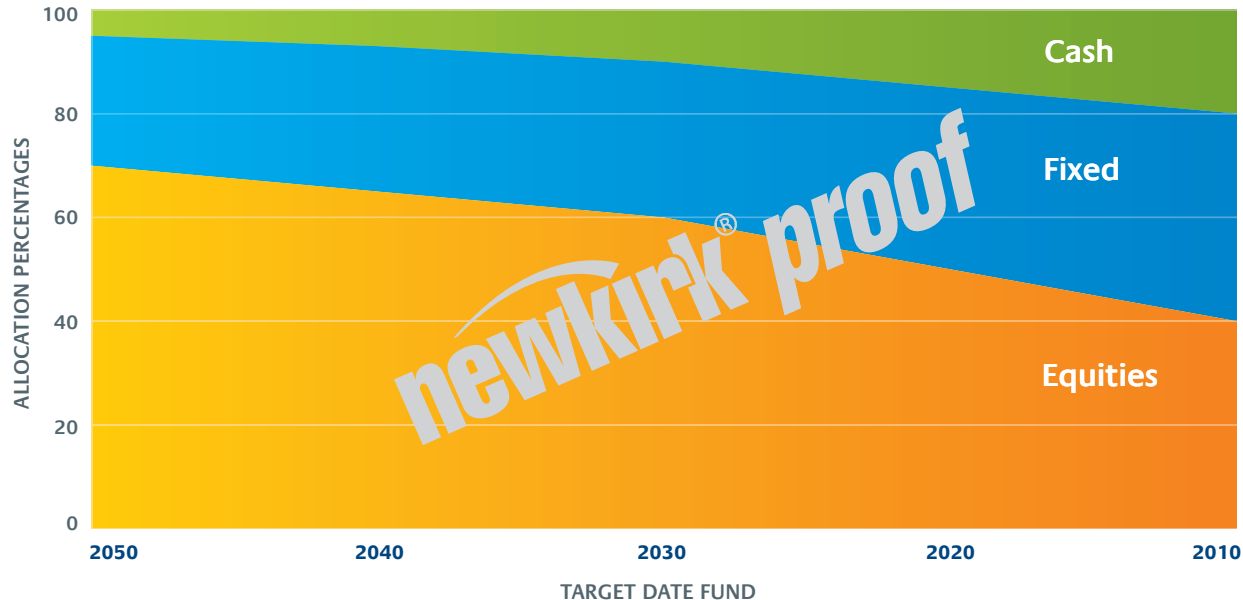
<sup>1</sup> Because mutual fund values fluctuate, redeemed shares may be worth more or less than their original value. Past performance won't guarantee future results. An investment in mutual funds may result in the loss of principal. Mutual funds involve risk and are offered by prospectus only, which you can get from your registered representative. Carefully consider investment objectives, risks, charges, and expenses of the investment company before investing. The prospectus will include this and other information; read it carefully before investing. Investing involves risks and there is no guarantee that any one strategy protects against a loss in a declining market. You should consult with your financial professional regarding your particular situation.

<sup>2</sup> Examples and illustrations in this booklet are greatly simplified to promote understanding. They may not reflect actual fund allocations.

**THE CHART BELOW MAY HELP.**

Note how the equity allocation (the riskier part of the fund) is largest in the 2050 target date fund and grows smaller as the target date approaches the present. The

riskier component declines the nearer you get to retirement. Correspondingly, the more conservative allocations increase the closer you get to retirement.



Target date funds in retirement plans are generally available in 5- or 10-year intervals. You may have the Golden Years 2020, 2030, 2040, and 2050 funds in your plan, for example. Or you may have the 2020, 2025, 2030, 2035, etc., funds. The selection process remains the same. Determine your retirement date and choose the fund that comes closest.

The managers of target date funds, who are investment professionals, reallocate the fund's investments as the years go by so that the fund gradually becomes more conservative as the target or retirement date approaches. Thus, the 2050 fund may have 70% or more in equities in the year 2020 (30 years from the target date) but will own a much smaller percentage of equities in the year 2049.

And that's another advantage of target date funds. Investment professionals implement an asset allocation

strategy that is appropriate for the retirement plan participant's retirement date. Studies show that asset allocation<sup>3</sup> may be the most important component of retirement investing. Still, many plan participants don't understand or appreciate its importance. With a target date fund, all you need to do is determine the year when you're planning to retire. Experts do the allocating for you.

They also do necessary rebalancing. Suppose the fund's target allocation for a particular year is 65% equities, 25% fixed income, and 10% cash. Thanks to a stock market rally, the equity percentage of the fund climbs to 70%. To rebalance, the fund manager takes money out of the equity portion so as to get the asset allocation percentages back in line with the target percentages. Rebalancing is important if you're managing your own retirement account investments. With a target date fund, rebalancing is taken care of for you.

---

<sup>3</sup> Diversification and asset allocation won't guarantee a profit or ensure against a loss but may help reduce volatility in your portfolio.



## COMMON MISCONCEPTIONS

**While target date funds simplify investing, many retirement plan participants remain unclear about such funds. Studies suggest that misconceptions abound.**

- 1. A target date fund guarantees that you'll have enough money to retire comfortably.**

### **NOT TRUE.**

There is no government guarantee with target retirement funds. There is no fund guarantee, either. Target date funds address asset allocation concerns. They do not address contribution amount issues (whether you are deferring a large enough percentage of your pay into your retirement account). Nor are they immune from changes in market conditions.

newkirk®

**2. You can't lose money if you invest in a target retirement fund.**

**YES YOU CAN.**

These funds invest in the same types of investments available to you if you managed your own retirement portfolio: equity funds and bond funds. The value of these investments can go up or down, depending on market conditions. Sure, there's a knowledgeable professional managing the fund and the asset allocation may be reasonable. But be prepared to see the value of your target date investment go up and down. What you *can* expect is that the swings (up and down) should be smaller as the target date approaches.

**3. All target date funds with the same year in their name are the same.**

You may think, for example, that the Golden Years 2020 Fund is the same as the Nifty Retirement 2020 Fund.

**THAT'S NOT TRUE.**

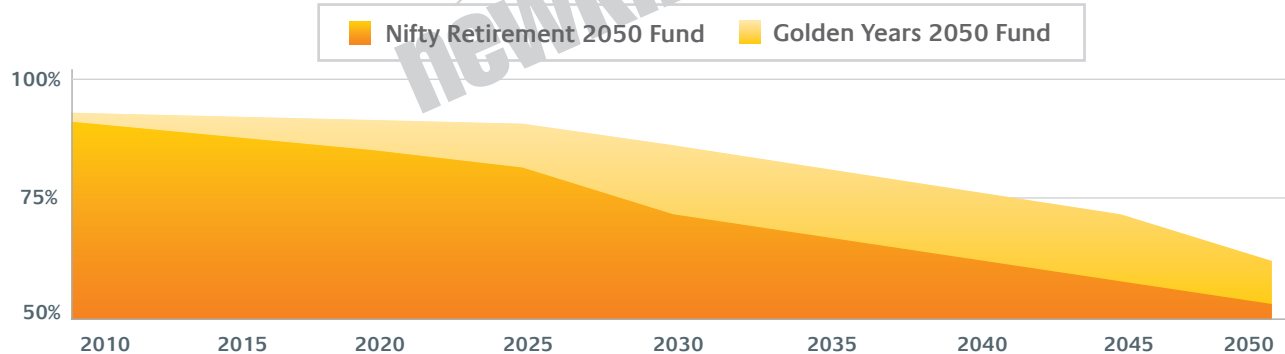
2020 target retirement funds (and their 2030, 2040, etc., siblings) may have the same target date but may have very different asset allocation strategies. And the target date in the name may have a different meaning. Let's explore these points further.

## THE GLIDE PATH

We've seen that the asset allocation for target date funds becomes more conservative as the target date approaches. That doesn't mean, though, that every 2050 fund has the *same* asset allocation as that date

approaches. The percentage the Golden Years 2050 Fund invests in equities in any given year, for example, may differ from the percentage invested in equities by the Nifty Retirement 2050 Fund. Consider this hypothetical example:

### Equity Allocation Percentage at Different Points



How a target date fund's equity allocation changes is sometimes referred to as its "glide path" — as the years pass, the equity allocation glides to a more conservative point. The Golden Years 2050 Fund has a distinctly different asset allocation strategy (or glide path) for equities than the Nifty Retirement 2050 Fund has. The Golden Years Fund, in our example, is consistently more aggressive than the Nifty Retirement Fund.

"So what," you say. "My retirement plan only offers a single family of target date funds. I don't have a choice between two 2050 funds." That's true for many retirement plan participants. Plans don't offer multiple target date fund options. But that doesn't mean you should simply accept the fund in your plan that has the most suitable date. Ask for information about the fund's asset allocation strategy.

Almost every retirement plan with target date funds also has other investments that a participant can choose from. You still have the ability to implement your own asset allocation strategy using the plan's other investment alternatives (at the cost, of course, of losing the insight and experience of the investment professional managing the target date fund).

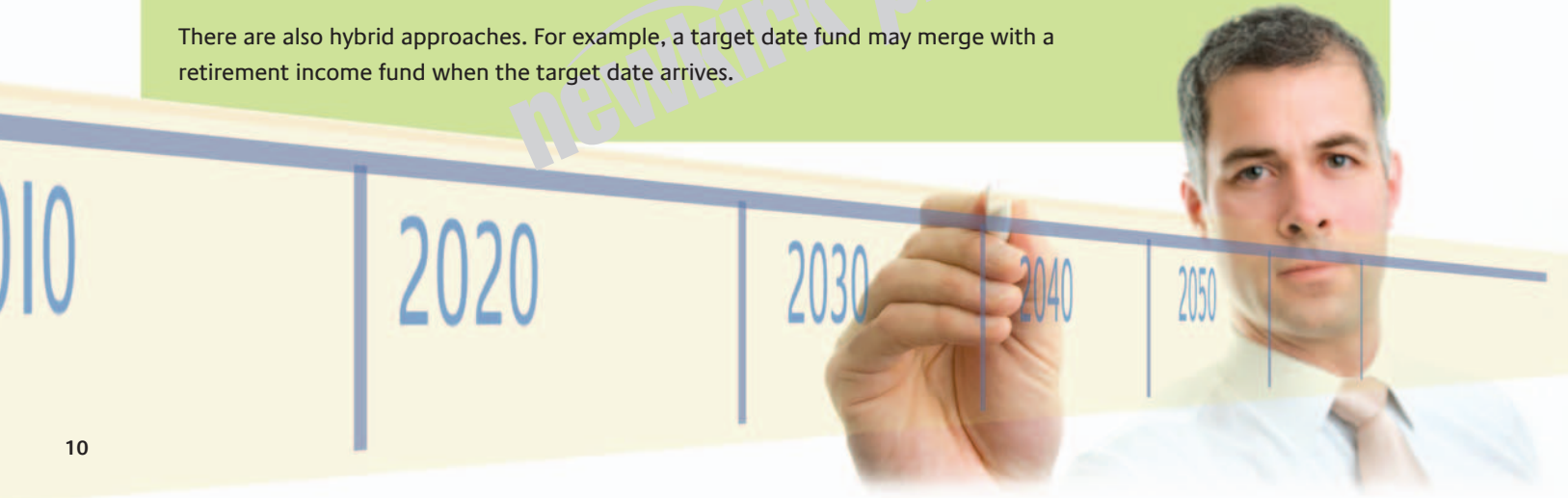
Another option might be to select a target date fund in your plan that has an earlier or later target date than the one that most closely matches your retirement date. In short, invest in the 2040 fund instead of the 2050 fund if you're looking for a more conservative allocation. Or select the 2060 fund if you want a more aggressive allocation.

## TO OR THROUGH?

The year in the names of most retirement plan target date funds is the retirement year. What happens when that year is reached, however, can differ from fund to fund. For some funds (the “to” group), asset allocation remains generally fixed (often with a relatively low allocation to equities) once the target date arrives. For other funds (the “through” group), the glide path continues, with allocation to equities often being larger at the target date and continuing to decline as years pass in your retirement.

In short, 2050 may mean the end of asset allocation changes for the Nifty Retirement 2050 Fund, while the Golden Years 2050 Fund continues to make adjustments over the next 10 to 20 years.

There are also hybrid approaches. For example, a target date fund may merge with a retirement income fund when the target date arrives.





## OTHER CONSIDERATIONS

### **Adding other investments to your target date option.**

One advantage of target date funds is having asset allocation determinations made by professional investors. And yet, a surprising number of plan participants place some money in a target fund and then allocate the remainder to other plan investment options. *Why?* If you're secure in your own asset allocation decisions, you probably don't need a target date fund. If you're not, why second guess the target date fund pros? If you're investing in a target date fund, placing your entire account balance in that fund probably makes sense.

### **Comparing results.**

Target date funds are sometimes touted as "buy and forget" options. Just invest your money, and wait for your retirement date. Don't do it. Keeping a watchful eye on your investments is always a good idea. But how? Comparing performance is one way. While that can be difficult, given the differences between such funds, the Dow Jones Target Date Indexes at [www.djindexes.com](http://www.djindexes.com) provide some help. You'll have to work your way through some text, but the information is free. Performance information may also be found in a fund's prospectus.

### Considering costs.

The fees an investor pays for participating in a fund can have a major impact on the fund's performance over time. And that includes target date funds.

Generally, the management fee for a target date fund should be low — especially where the target date fund is investing exclusively in other funds offered by the same investment company. That's because the fund family is already charging a fee for those underlying funds.

Additionally, fixed income investments generally have lower fees than equity investments, and target date funds usually have a considerable amount allocated to bonds. Fees should actually decline as the target date approaches and the fixed income allocation of the fund increases.

Even with a low management fee, the overall fees associated with target date funds may be higher. That's because of the "layered" fee structure, with fees paid for investing in the underlying funds as well as for investing in the target date fund.

Fund A Fees

Fund B Fees

Fund C Fees

Fund D Fees

Target  
Date Fund

Total Fees

Are the possibly higher fees associated with target date funds “worth it”? It depends. How high are those costs? How has the fund performed historically? How knowledgeable are you about investing? If the additional cost is modest, though, the answer may well be “yes.”

### Getting more info.

Target date funds are offered by a variety of financial institutions — mutual funds, banks, trust companies, and insurance companies. Most often, they are mutual funds and, as such, have a prospectus filed with the U.S. Securities and Exchange Commission (SEC). That prospectus will provide significant information about the fund, including its asset allocation and glide path.

Target date funds may also be collective trusts or separate accounts. Collective trusts are tax-exempt

pooled investments managed by a financial institution and established almost exclusively for use in retirement plans. Prospectuses may be available for these types of target date investments, too, although they are not required to be filed with the SEC.

Ask your HR department or plan administrator for the prospectus for the target date fund in which you’re invested or thinking of investing. While it’s not particularly user-friendly, the SEC website ([www.sec.gov](http://www.sec.gov)) contains a wealth of information, including prospectuses for those target date funds that are required to file.

The fund manager’s website and/or the retirement plan recordkeeper’s website are also likely to provide helpful information.



## WHAT IF I WANT GUARANTEED INCOME?

### Guaranteeing income.

One misconception about target date funds is that you can't lose money. That's generally not true. Like most other investments, target date funds usually fluctuate in value, depending on the investment markets. There are, however, a number of target date funds, usually offered by insurance companies, that provide for principal preservation or guaranteed income for life. The trade-off? There's a fee, sometimes hefty, associated with these features.

### Selecting the target date funds.

As a participant in a retirement plan, you have little say about what target date funds are offered by your plan. You can move your account balance into or out of the available target date options, but that's it. (Many plans have an automatic enrollment feature, with target date funds as the default investments. In such a plan, you may not have elected to participate in the target date fund initially — although you have the right to opt out of that investment or even participation in the plan.)

So who chooses the target date funds? In most cases, an investment committee appointed by the plan sponsor

selects the investments that will be available to plan participants. The parties that select plan investments for your plan are fiduciaries. As such, they have an obligation to carefully review investments before they are selected and to monitor those investments over time. Given this responsibility, it's possible that the target date funds offered in your plan could be replaced by a newly selected target date family if the investment committee felt the current funds were not meeting plan provisions. If that happens, your investment in one target date fund could be moved to a fund with the same target date in a newly selected target date family. In such a circumstance, you will be notified about the change before it is made.

## WRAPPING UP

Target date funds offer clear advantages to retirement plan participants:

- Professional investment management.
- Automatic rebalancing.
- Defined asset allocation strategy leading up to — and possibly through — retirement.

And peace of mind? Maybe. Remember that target date funds still involve risk. And they do not guarantee that you'll have sufficient income for a comfortable retirement. They're a valuable addition to your retirement planning tool kit. Indeed, they may make your retirement investing much easier. The need for planning, however, remains.



**newkirk<sup>®</sup> proof**

