Clearbrook Perspectives

June, 2010

Target Date Funds: *But These Go To 11...*

Headlines in early 2009 were less than positive for Target Date funds as investors experienced mounting losses during the 2008 financial crisis. In the institutional world, Target Date funds are not a new concept, but to individual investors, they are fast becoming a prevalent investment in 401K plans and are viewed by many individual investors as an auto-pilot path to retirement savings. Since the recent crash, performance has rebounded and, as a result, these types of funds are no longer making headlines. That said, last year's news and subsequent investor losses struck a cord with Congress, the Securities and Exchange Commission, and the Department of Labor. Consequently new legislation is being introduced with regard to the disclosure of fees, the types of investments in these funds, and importantly, how these funds are classified. In order to better understand the new legislation, let's take a closer look at the issues regarding Target Date funds.

Why The Negative Press?

Investors seem to like the idea of selecting a fund based on their retirement year and, once invested, the fund does the rest—making asset allocation and risk tolerance decisions based on a typical investor with that retirement year. As the date approaches, the fund automatically adjusts its allocation to lessen the risk profile of the portfolio. This "set it and forget it" model is at the core of these funds.

So what were the issues with these funds and why so much negative press? For one, many of the fund families developing these strategies simply use an amalgam of their

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own funds which, although desirable from the fund family's perspective, does not necessarily benefit the investor, particularly if some of those funds have lackluster performance. This has been a topic of recent Congressional debate.

The larger issue, however, revolves around the purpose of these funds. There is a lack of consensus about what a Target Date fund is supposed to accomplish. Careful reading of the prospectus is required to understand precisely what the target date actually means. Some funds are classified as 'to' funds, meaning once they hit that target date, they primarily hold very liquid short-term debt instruments. Others are considered 'through' funds, which assumes that investors retire at the specified target date but still plan on living another twenty to thirty years. These 'through' funds continue to have a healthy portion of risk assets upon reaching their target date. A lack of guidelines distinguishing 'to' funds from 'through' funds has been cause for concern as determination of the fund type can only be achieved through a careful examination of the prospectus and marketing materials.

In thinking about the semantics of the classifications of Target Date funds I am reminded of the infamous scene from the 1984 rockumentary *This Is Spinal Tap*. For those of you who may have missed the film, one of the more memorable scenes has the band's lead guitarist, Nigel Tufnel (Christopher Guest), showing the film's 'director,' Marty Dibergi (Rob Reiner), a special amplifier. It's special because all the dials go to eleven instead of to the standard ten. Tufnel's explanation is that when you need an extra burst of volume, you turn the knob up to eleven. Dibergi retorts "why don't you just adjust the scale so that the numbers go to ten. Tufnel, looking confused replies, "but these go to eleven…" If Mr. Tufnel were explaining the differences between 'through' and 'to' funds he would say that 'through' funds go to 'eleven.' All kidding aside, there is clearly a need for consistency with regard to the classification of Target Date funds. In our view the target date should be extended past retirement age.

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So How Were Investors Hurt?

'Through' funds that had target dates in the near term have been in the spotlight the past couple of years because, as previously mentioned, they maintained exposure to risk assets and performance suffered. Investors incorrectly assumed the funds were predominantly in conservative short-term assets. This was not the case and investors lost more than they expected. These investors were not cognizant of the fact that their portfolios would need to continue to grow to meet their objectives as they entered retirement. This raises the question of the fund name, 'Target Date' and whether it should in fact be redefined.

That said, we'll stop short of calling them Target Death funds choosing instead to call them "Life Stage Portfolios." As risky as 'through' funds have been for uninformed investors, they do a far better job at meeting the needs of clients than 'to' funds. An article in the September 20, 2009, issue of *Investment News* lambasted 'to' funds for essentially misrepresenting themselves. We believe the 'to' funds are performing a greater disservice to investors because they hinder overall portfolio growth by concentrating in liquid short-term investments whose time horizon could extend for another 20 to 30 years—in our view this seems imprudent.

Furthermore, with medical advances continuing to increase the average life expectancy, individuals must consider maintaining some amount of risk assets (such as equities, high yield, REITs, etc.) well into their retirement years in an effort to keep pace with inflation and their increased life expectancy. A 'Life Stage' portfolio's glide path (the rate at which the asset allocation adjusts over the life of the fund) is much smoother and longer than a 'to' fund's glide path, meaning the 'through' fund's allocation to bond investments occurs at a slower pace.

Investing in Target Date funds has become increasingly complicated due to the number of Target Date fund providers, the need to profile and classify the funds, and the ability to evaluate the fund that may be appropriate for your portfolio. At Clearbrook, we believe working with a consultant is the best 'first step' an investor can take to fully understand the nature of their investment .

Sources:
1. J.P.Morgan, "Target date funds update", 3/5/2010, www.jpmorgan.com
2. JANE J. KIM, "Riskier Than Expected, Funds for Novices Get Revamped", Wall Street Journal, 2/6/2010
3. Jessica Toonkel Marquez, "Labor Dept., SEC to issue alert on target date funds" Investment News, 3/7/2010

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A Message from Clearbrook's Leadership team…

In·teg·ri·ty Function: *noun* Date: 14th century **1 :** firm adherence to a code of especially moral or artistic values
2 : the quality or state of being complete or undivided

In 1759 Dr. Samuel Johnson, a British author and linguist was quoted as saying, "Integrity without knowledge is weak and useless, and knowledge without integrity is dangerous and dreadful."

At Clearbrook integrity is one of our core principles. Whether coming up with innovative client solutions, resolving internal conflicts, or deciphering operational issues, Clearbrook employees are working together to build a world class organization, and doing so with integrity to the benefit of all of our clients. Again, we hope this *Perspectives* series is helpful and that this information continues to provide you with positive insight and perspective on Clearbrook.

Sincerely,

John Morris	*Robert Mooney*	*Elliott Wislar*
Chairman	*Chief Executive Officer*	*President*

Who We Are

We are an independent investment advisory firm whose core business is to provide investment and strategic advice, investment solutions, and related wealth advisory services to institutions, individuals and financial intermediaries worldwide. As of December 31, 2009, Clearbrook Investment Consulting, a subsidiary of Clearbrook, had more than $30 billion in client assets under advisement.

What We Do

We offer a range of investment services and solutions to institutions, family offices and private clients, and financial intermediaries. We focus on professionalism, innovation and transparency for our clients.

- **Investment Consulting and Advisory Services**
- **Strategic Advisory Services**
- **Institutional Quality Manager Research**
- **Implemented Investment Solutions**
- **Access to a Broad Array of Money Managers**
- **Turnkey Operational and Administrative Support**

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