



On Target

Investing in Target-based funds

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In this age of wicked market volatility, a dour economic backdrop and abounding political uncertainty, investors are craving simplicity. We want our money safe and earning a decent return. That's not too much to ask – is it? Well, mutual fund and insurance companies are people pleasers (or at least they attempt to be) and responded in kind. In recent years, proliferations of Target or Aged-Based mutual funds have exploded. Once touted as the 'no-brainer' investment vehicle, pundits either misunderstood their uses or underestimated the effects of a market meltdown. Let's take a quick tour of Target Funds and help determine if they deserve consideration in your investment plan.

What is a Target Fund?

Quite simply, a Target Fund is a collection of multiple mutual funds within the same family of funds (Vanguard, for example). The mutual funds are bundled as one fund with a date on it. This date is to signify when you will begin withdrawing the funds for a defined purpose such as retirement or college funding. What's unique about the fund is that as your date nears, its mix of funds becomes more conservative as theoretically, preservation of funds becomes most important. In effect, the fund lowers the volatility as the participant's investment horizon shortens. So basically, you 'set it and forget it'. Unfortunately, with apologies to Ron Popeil¹, this investment pot roast isn't always perfectly cooked.

Investment Example

Let's say Paul is 35 years old and would like to retire in 2040 at age 65. He would simply choose the 2040 Target Fund which is offered in his company's 401k plan. The mix of funds in this Target Fund is heavily weighted in equities but as he ages, bond and money market funds begin to take over. By the time he is 65, the fund should almost be entirely invested conservatively in cash and short term, stable bond funds to ensure capital preservation. This investment migration is done automatically and without any investment decision by Paul. All he has to do is diligently add funds.

So what's the problem?

In theory, Target Funds really simplify the investment process. They remove the timing and emotional aspect of investing. That's good. Unfortunately, not all funds are created equal. A 2040 Target Fund offered by T Rowe Price may be markedly different from Vanguard's which may be different than John Hancock's. One may have an international equity weighting of 25% while another may have 18%. One may have no bonds while the other might have 10%. These differing approaches can dramatically affect the overall Fund performance. To further complicate matters, a fund family may offer varying risk (conservative, balanced, or aggressive funds) within the same target date. In our experience, most Target Funds invest too aggressively – especially true for College 529 plans where preservation should be of highest priority. The Target Fund convenience also doesn't come free. Usually, you will be paying a bundled price for these 'Funds of Funds': the underlying funds' expense ratio plus a Target Fund fee on top of that. Higher fees=lower performance.

Possible Uses

We have found the best uses for Target Funds to be the *conservative*, low expensed 529 College plans. They weathered the recent market turmoil very well. For investors who have them offered in their company sponsored retirement plans, we would advocate checking under the hood to see how the funds are really invested, what their track record is in good and bad markets and how expensive they are. When in doubt, err on the conservative side and as your investment time frame draws near, begin to shift the funds on your own. There is little need to pay a layered expense for something you can just as easily replicate. There is nothing magical about what these funds do; you are simply paying for a convenience that can be mimicked in just a few minutes time.

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¹ Founder of Ronco Rotisserie and infomercial cheese ball.