

# Market Turmoil Tests Target Date Lifecycle Funds

The last four months have been troubling times for most investors with the S&P 500 losing 14% of its value. But this is just the kind of period that we want to use to test certain types of funds, like hedge funds and target date funds. In this very short commentary we take a close look at how target date funds have fared recently.

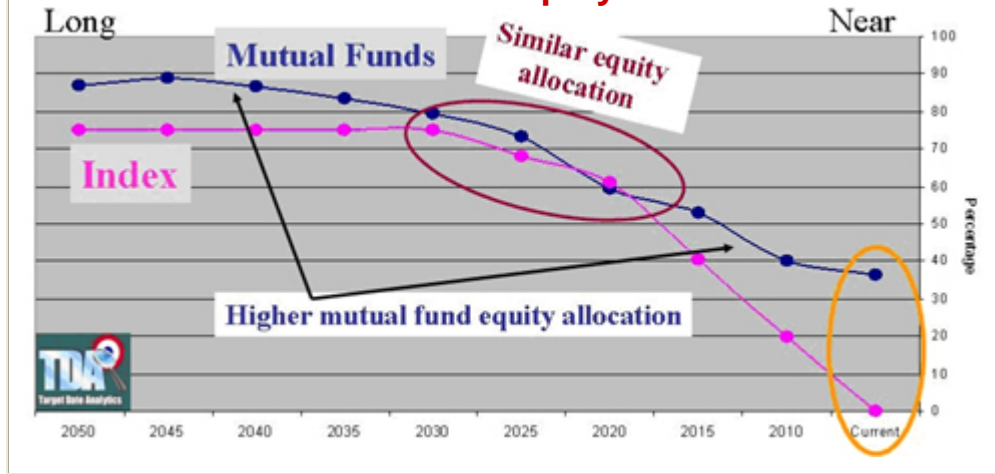
The answer to the question "Is performance good?" requires an answer to a different question: "Relative to what?" Our firm, Target Date Analytics, has spent considerable time and effort thinking about and developing benchmarks for target date funds (TDFs). The challenges to benchmarking TDFs lie in the lack of common practices and the use of what has come to be known as a *glide path*, which shifts allocations through time to reduce risk as the target date nears.

Starting with near-dated funds, our view is that an appropriate benchmark is invested entirely in safe inflation-protected assets such as Treasury bills and TIPS. An investor at target date (presumed to be his/her retirement date) shifts from asset accumulation to asset distribution. These are materially different life phases that are creating materially different suites of investment products. TDFs are accumulation funds and as such should keep the retired investor insulated from market moves while (s)he is making the transition to distribution. After all, these folks cannot readily go back into the workforce to make up investment losses - what's gone is gone.

Extending out to far-dated funds, our view is that these funds should be striving for real (above inflation) growth in assets and can afford to take risks because the horizon is long. We differ though from industry practices by including real return assets in our benchmark, such as real estate, natural resources and TIPS. We also differ in our view that fixed-rate long-term bonds are risky; we take this view because these bonds are poor inflation hedges, although they do help diversify equity risk.

These differing views put our benchmarks on a somewhat different glide path than the average mutual fund, as shown in the exhibit below.

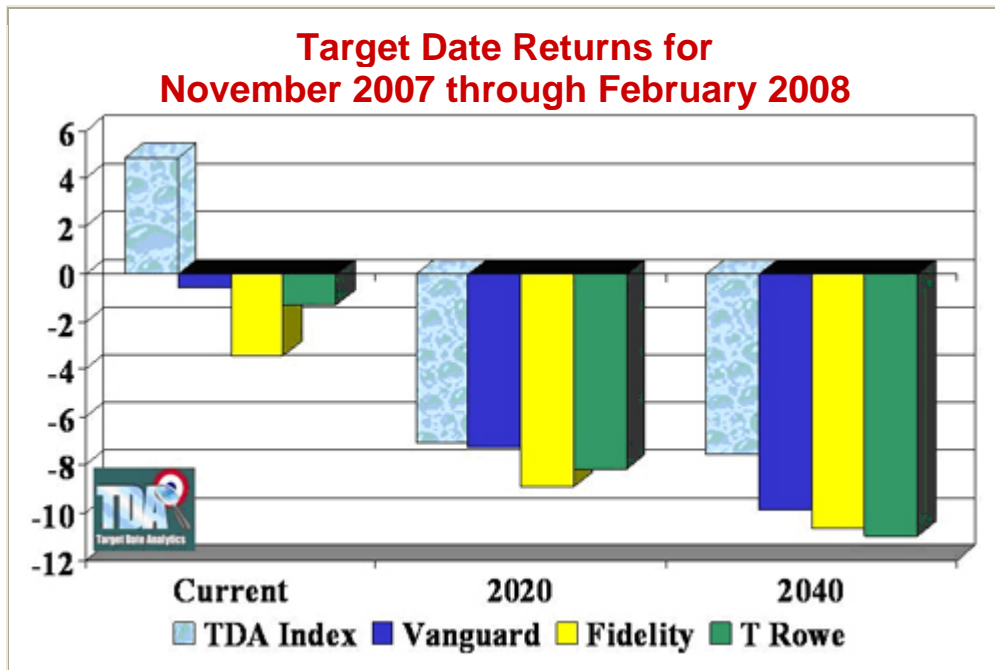
## Target Date Mutual Fund Equity Allocation vs. TDA Benchmark Equity Allocation



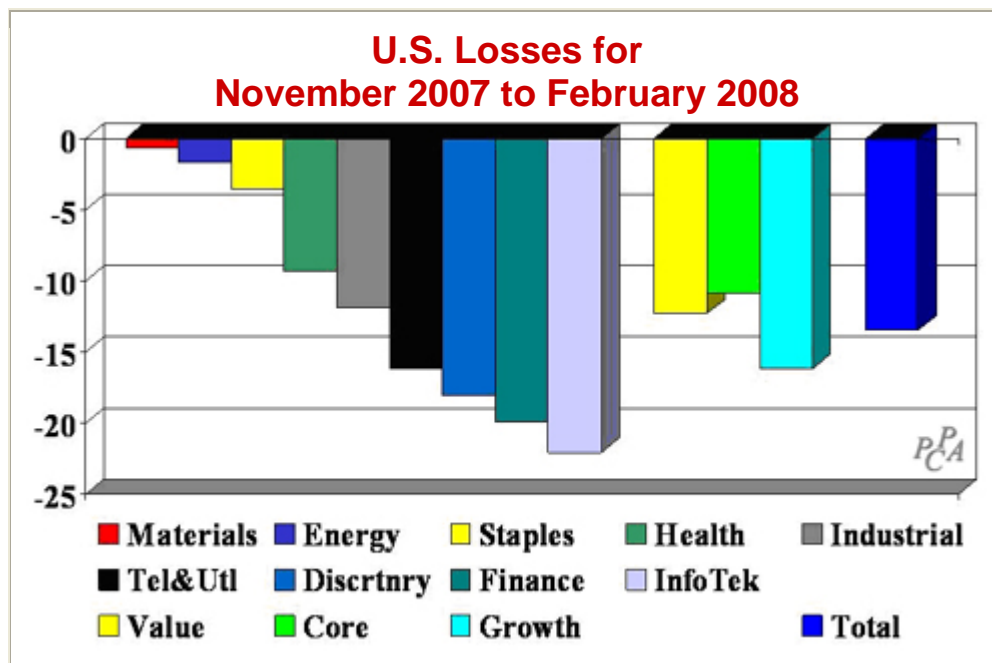
On average, our indexes have lower equity exposure at the long- and near-dated ends of the glide path spectrum, but we're near the average fund for mid dates, like 2020-2030.

Now we're ready to evaluate recent target date fund performance. The following exhibit shows the performance of the major fund families for the four months 11/1/07 to 2/28/08, and contrasts them to our indexes for each target date. As you can see, these funds have not fared well in this market climate, underperforming our benchmarks in every instance, although the 2020 funds have performed close to their index. Of course, you can argue that it's the benchmarks that are wrong, not the funds, but we urge you to visit us at [www.TDBench.com](http://www.TDBench.com) before making this judgment. You'll find plenty of justification as well as great analyses of specific funds.

## Target Date Returns for November 2007 through February 2008



performance. Current funds are in line with the better performing Materials and Energy sectors. 2020 funds have delivered mid-range sector performance, in line with the Health Care sector. 2040 funds have delivered returns that are similar to Industrial stocks. Of course target date funds are balanced portfolios, not stock portfolios, so the more meaningful comparisons are to the TDA indexes.



Ron Surz  
 Email: [ron@tdbench.com](mailto:ron@tdbench.com)  
 Target Date Analytics  
 Phone: (949) 488-8339