MAGAZINE COVER by Angie C. Marek (Author Archive) Published April 20, 2009 | A A A

Stretch Your Nest Egg: Target-Date Fund Facts

Editor's Note: Retirement-planning in normal times is like home maintenance—with a little bit of effort and expense, applied regularly over time, you keep your structure sound. But planning right now is like figuring out what to do after a tornado blows your kitchen and garage into the next county. Despite the market's recent rally, many people's nest egg portfolios remain mangled beyond recognition. In this special report, SmartMoney features advice that can help investors roll up their sleeves and rebuild.

TARGET-DATE FUNDS are designed to get defensive over time, moving investors' assets from stocks to bonds and cash so that the portfolios become less risky as the funds (and the investors) get older. In 2006, Congress passed a law allowing retirement-plan sponsors to make target-date funds a "default" option for workers' savings, and over the next two years their assets rocketed up 76 percent. But last year's crash marked their first real test, and many of them failed it—especially those that should have been the most conservative. The average 2010 fund, supposedly designed for someone who would retire next year, lost almost 25 percent in 2008, according to the research firm Lipper. And the most aggressive funds in this group, like **Oppenheimer's Transition 2010** (OTTBX), fell more than 40 percent. (An Oppenheimer spokesperson says that "one-year results are not a true assessment of long-term performance.") Talk about a turnabout: Less than three years after green-lighting the funds' wider use, a Senate committee is now investigating their risks.

Investors within a year or two of retiring typically slash their exposure to the stock market to avoid just this kind of problem. "There's no reason a 2010 fund should be swinging for the fences," says Brigham Young professor Israelsen. But investors can't assume funds that share their hoped-for retirement date will match their risk tolerance. Israelsen says it comes down to competition. As the target-date field got more crowded, many funds took on more equity, presumably to generate higher returns. With titans Fidelity, Vanguard and T. Rowe Price making up about 85 percent of the market, funds from smaller companies were especially prone to doing this so they could stand out. Alan Sparer, a San Francisco–based securities lawyer who has been studying the funds, says their bond holdings can be dicey too; he has seen big allocations of risky derivatives such as commercial mortgage-backed securities in some portfolios.

The result: big disparities in returns. An investor who put $1 million three years ago in **AllianceBernstein's 2010 Retirement Strategy fund** (LTDAX) would have seen decent gains for two years. But the latest market turmoil would have knocked her balance down to nearly $750,000, because the fund had 68 percent of its assets in stock and real estate trusts when the market started to crash last fall. Had she invested that money in the **Wells Fargo Advantage Dow Jones Target 2010 fund** (STNRX), she would still have $970,000 today—in part because that fund holds only 27 percent of its assets in stocks. Seth Masters, chief investment officer with AllianceBernstein, says high equity percentages are necessary to help a portfolio last the 30 years people are likely to live in retirement. "Any fund with a longer-term investment perspective did poorly in 2008," he says.

Investors shouldn't necessarily give up on target-date funds. For current shareholders, for example, selling now would mean locking in losses. For those who are several years away from retirement, some planners say that a balanced

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Nasdaq	1799.73 ▲	6.52	0.36%
S&P 500	905.84 ▲	4.79	0.53%
Russell 2000	496.52 ▲	3.21	0.65%
10 Yr Bond	3.47 ▲	0.12	3.58%
DJ Total Market Index	9273.50 ▲	55.10	0.60%
S&P 400	564.99 ▲	4.60	0.82%
Nasdaq 100	1452.84 ▲	5.14	0.36%
DJ Transportation	3186.42 ▲	41.81	1.33%

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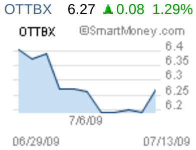
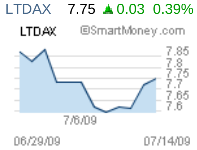
OTTBX 6.27 ▲0.08 1.29% LTDAX 7.75 ▲0.03 0.39%





STNRX 11.14 ▼-0.02 -0.18%

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OTTBX,LTDAX,STNRX

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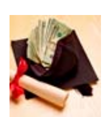

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portfolio with a 60-40 ratio of stocks to bonds can do the same job as a target-date fund, with fewer surprises. Across the fund industry in general, balanced funds are slightly less expensive than target-date funds. T. Rowe Price says its research shows that over the long term, target-date funds and 60-40 portfolios can be expected to deliver almost identical returns. One important caveat: Once you're within five years of retiring, a 60 percent stock allocation may be more risky than you want—just ask some of those target-date fund owners.

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