The First To-AND-Through Target Date Fund Defends Against Sequence of Return Risk

- Every article about choosing target date funds begins with the "To" or "Through" choice.
- Sequence-of-return risk is highest as we transition from working life to retirement. Lifestyles can be devastated, even if markets recover.
- There's a new design that is both a "To" fund and "Through" fund that is designed specifically to defend against sequence of return risk.
- Importantly this "To-and-Through" fund is very good at being both.

In its 2013 **Target Date Retirement Funds -Tips for ERISA Plan Fiduciaries**, the DOL recommends: *Be sure you understand the fund's glide path, including when the fund will reach its most conservative asset allocation and whether that will occur at or after the target date.*

Funds that reach their most conservative allocation at the target date are called "To" funds while those that don't are called "Through" funds. The basic idea is that "To" funds end at the target date, with a focus on getting participants safely To retirement, whereas "Through" funds are intended to serve Through to death – they are target death funds .

But now there is the first "To-and-Through" target date fund that protects participants To their retirement date AND serves them in their retirement years. Most importantly, it defends against sequence-of-return risk, a very serious risk although most don't comprehend its gravity.

Let's start with the "To" part of the glide path. Most TDF glide paths are similar until the target date approaches, and then they diverge. Equity allocations at the target date range from a low of 10% to a high of 70%. We believe in the 10% allocation because:

1. There is no fiduciary upside to taking risk at the target date. Only downside. The next 2008 will bring class action lawsuits.

2. There is a "risk zone" spanning the 5 years preceding and following retirement during which lifestyles are at stake because of sequence-of-return risk. Account balances are at their highest and a participant's ability to work longer and/or save more is limited. You only get to do this once; no do-overs.

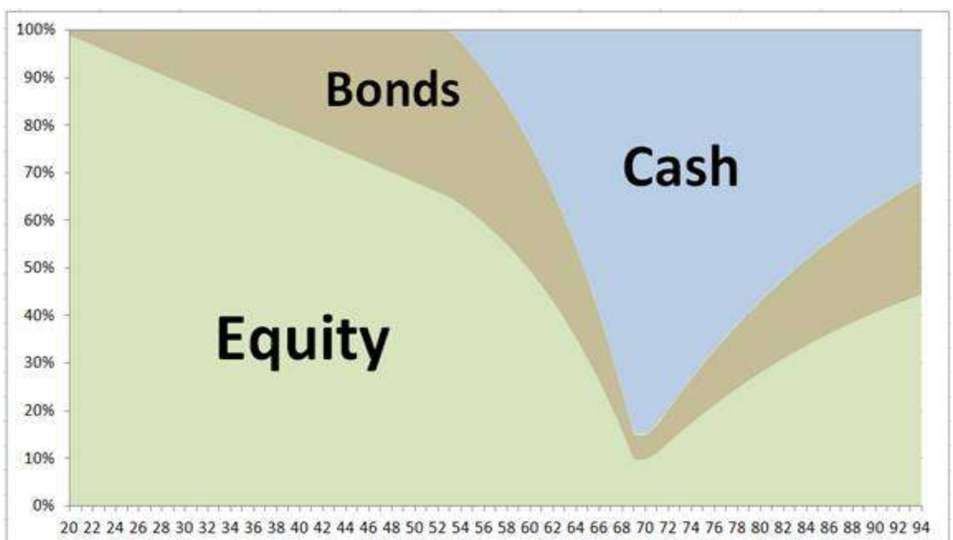
3. Most participants withdraw their accounts at the target date, so "target death" (i.e., "Through") funds are absurd, and built for profit. All TDFs are *de facto* "To" funds.

4. Save and protect. The best individual course of action is to save enough and avoid capital losses. Employers should educate employees about the importance of saving, and report on saving adequacy.

5. Prior to the Pension Protection Act of 2006, default investments were cash. Has the Act changed the risk appetite of those nearing retirement? Surveys say no.

But retirees generally cannot live on safe investments, as explained in Dr Wade Pfau and Michael Kitces' [Reducing Retirement Risk with a Rising Equity Glide path](). So beyond the target date, the "Through" part of the glide path needs to be increasing in equities. Pfau and Kitces conclude: ***the results reveal that rising glidepaths are even more effective, especially when they start off conservatively. The most favorable (i.e., least adverse) shortfall actually occurs with a glidepath that starts at only 10% in equities and rises to "only" 50% in equities***.

So here is what a "To-and-Through" glide path looks like:



Note that this is a "To" target date fund because the definition of "To" is "reaches its lowest equity allocation at the target date." In addition, note that it is also a "Through"

TDF because it continues on beyond the target date to serve participants through to death. It morphs into a target death fund. Most importantly, it defends against sequence-of-return risk during the 5 years before and after retirement. For now, there is only one “To-and-Through” TDF: the SMART Target Date Fund Index on Hand Benefit & Trust, Houston.

Target date funds are still in their infancy, effectively launching in 2006 with the Pension Protection Act. Look for more innovations and improvements in the future.