

# *It's All About the Beneficiaries*



## **Fiduciary Best Practices in Target Date Funds**

# Our Crusade

Please join us in our efforts to reform the target date industry. You can sign on to be a member of our tribe at <http://www.targetdatesolutions.com/subscribe.php>.

Our credo is presented toward the end of this show: ***We Believe.***

At the Subscribe page above you can also integrate the Safe Landing Glide Path™ into your own target date funds in a variety of ways, including Collective Trusts, custom glide paths, model portfolios, and managed accounts.

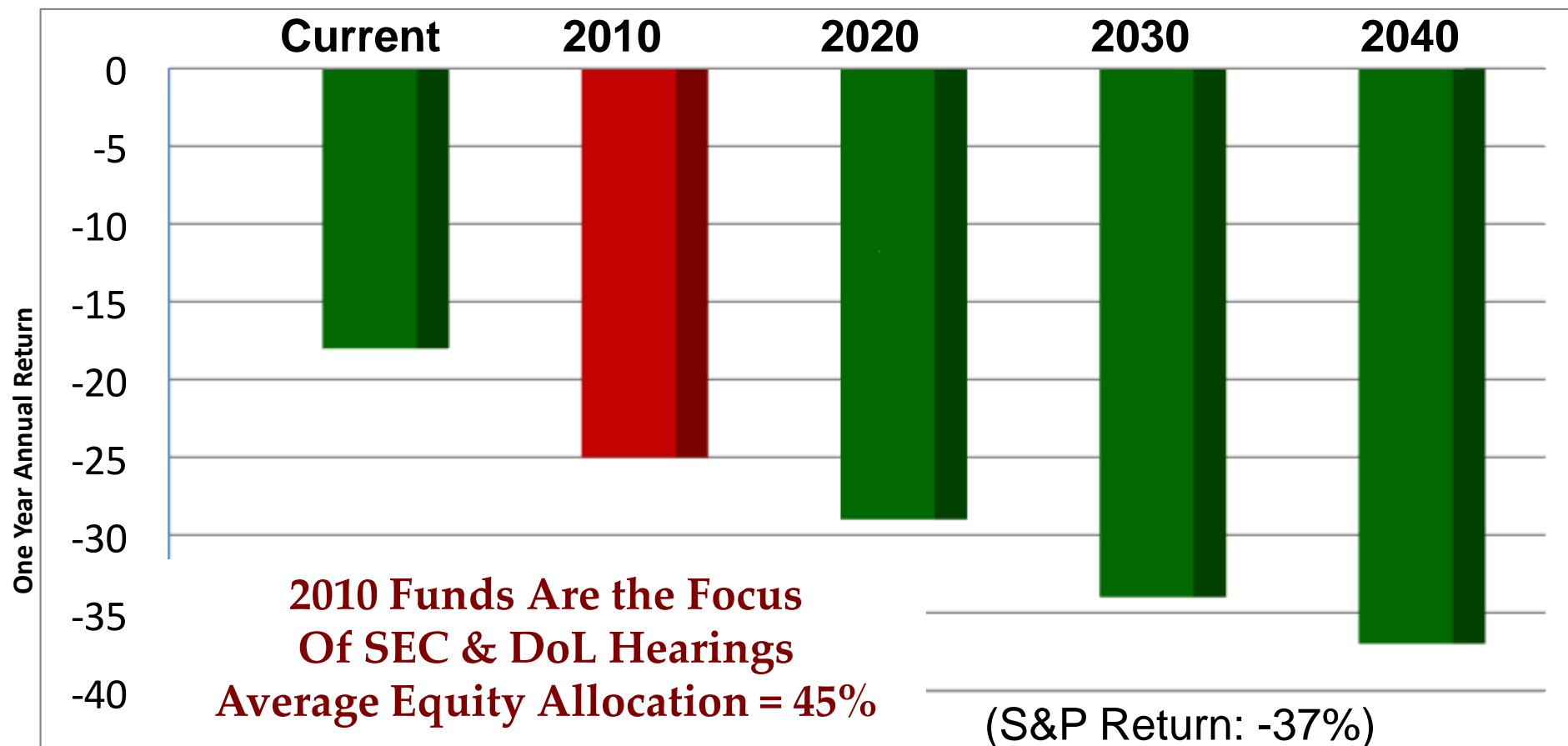
Thanks for your interest and support.



# Agenda

- SEC and DOL June 18, 2009 Hearings
- The Prudence and Wisdom of “TO” Funds
- Safe Landing Glide Path™
- Risks and Rewards of “TO” and “THROUGH” Funds
- Fiduciary Imperative

# 2008 Has Been a Safety Test Should Investors be Better Protected?



Fund companies assure all is OK

You can watch the hearings at [Hearings](#)

# Who wins?

- Closed architecture using proprietary products
- High equity allocation (high fees), especially near the target date

# The June 18, 2009 SEC and DOL Hearings

- Mutual funds are NOT Fiduciaries
- Plan sponsors have the responsibility of selecting and monitoring TDFs. Plan recordkeepers might not be the best choice.
- Most TDFs are “Through” funds, designed to last to death, so the target date is meaningless.
- Fiduciaries, not beneficiaries, must be better informed & educated.



# Fiduciary Choices

See “Target Date Fix”, 2/10 *Financial Planning*

## 1) Type of Qualified Default Investment Alternative (QDIA)

### ✓ Target Date Fund

- Balanced Fund
- Managed Account

## 2) Type of Target Date Fund

### ✓ To: Ends at target date

- Through: Continues beyond target date

## 3) Type of “To” Fund

### ✓ Zero equities at target because it actually ends at target date

- Flat equity exposure at target date and beyond because it’s a fake “To” fund

## 4) Glide Path of “To” fund that ends at zero equities

### ✓ Financially engineered Safe Landing Glide Path™

- No model: simple equity reduction through time



# THE Key Decision

Fiduciaries

## “TO” Target Date

- Glide path ends at target date
- Safety : Prudence**
- Standard is Safe Landing Glide Path™

## “Through” Target Date

- Glide path continues “forever”
- **Growth**
- No commonly accepted standard



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# Fred Reish, ERISA Attorney, says...

*“It is critical that fiduciaries understand the competing philosophies of target-date managers... and identify high-quality target-date funds that are structured accordingly... target-date funds come in two "flavors": those that anticipate being cashed out at the plan's retirement age and those that do not. However, it seems to me that 401(k) plans mainly have one flavor: those that cash out at retirement...”*

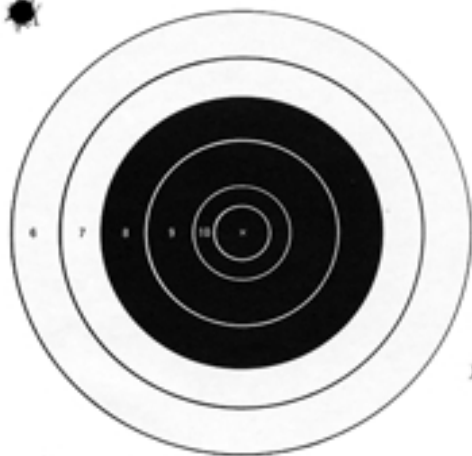
“Targeted Flavors”, July 30, 2009, **Plan Sponsor** magazine  
Fred is saying that as a practical matter all 401(K) investments are “To”.



# Most TDFs are “Through” Funds and this is a big mistake



Designed to Miss Their Target Date on Purpose Because They Target Death



The Purpose Cannot Be Served  
Because:

(1) Retirees Exit the Fund at Target Date



AND

(2) Longevity risk cannot be managed with a Glidepath



**TDS**  
Target Date  
Solutions



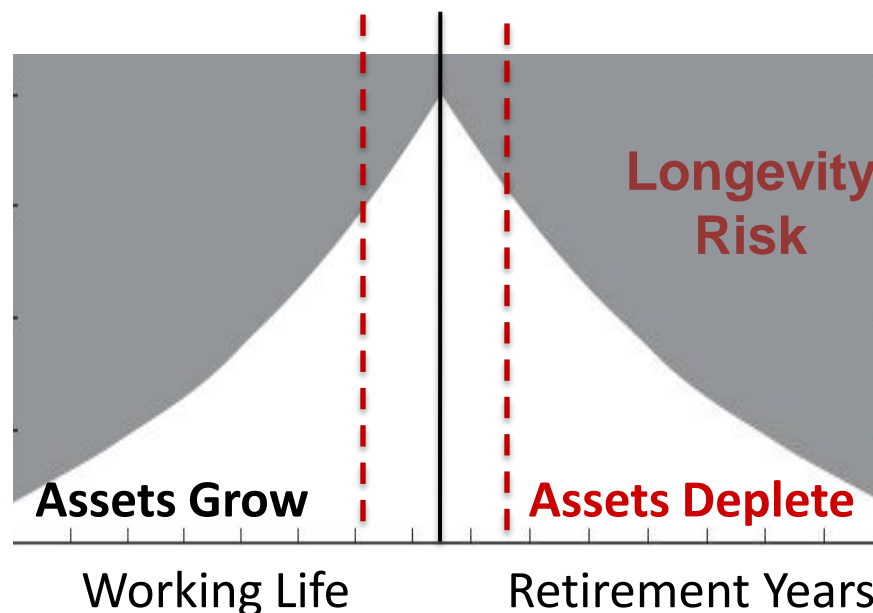
# The Transition from Accumulation to Distribution is Critical



Qualified Default Investment Alternatives (QDIAs) should protect as retirement approaches since savings are especially dear then.

With “To” funds, someone needs to make a decision during the Transition Phase

Accumulation



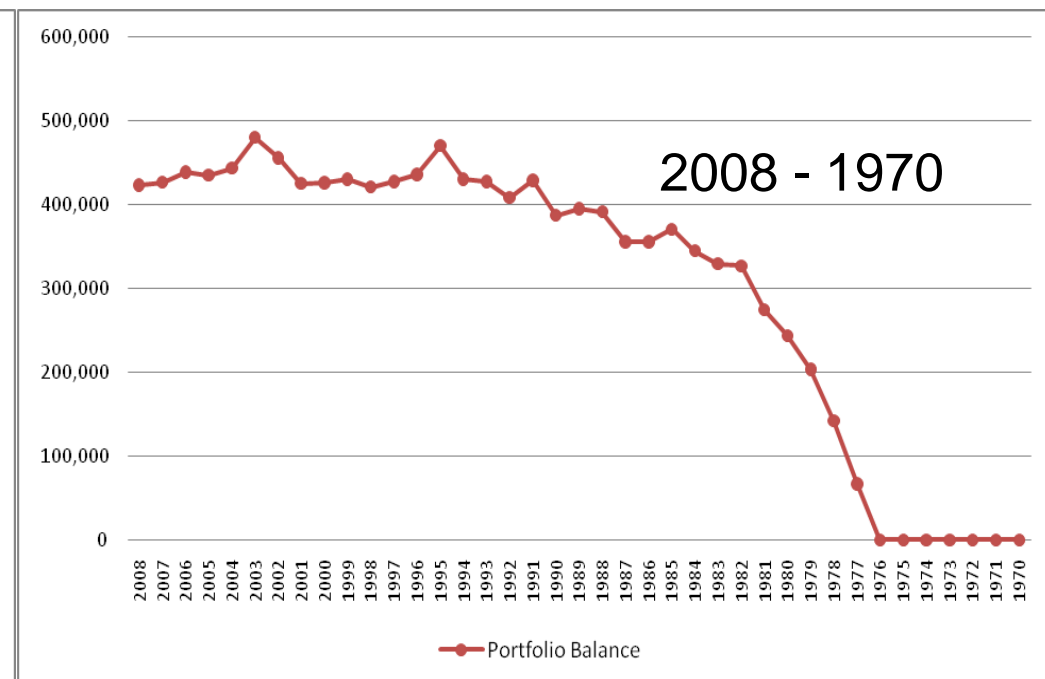
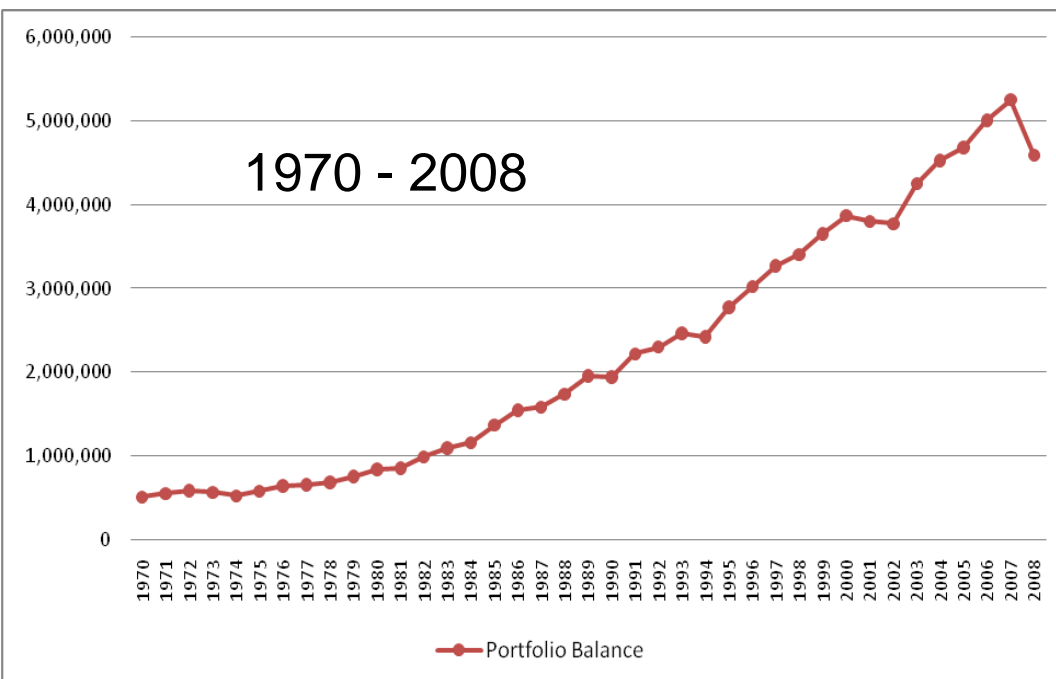
Distribution  
Annuities  
Guaranteed Payouts  
Etc.



# Proof that the Transition Period is Critical

## Growth of a 40/60 Stock/Bond Well-diversified Portfolio over past 39 Years, in Actual Sequence, then Reversed.

Someone retiring in 1970 with \$500,000, and spending 5% per year, increasing by 4% per year, would have \$4.5 Million today. But if the market gods “Benjamin Buttoned” the return sequence, experiencing 2008 1<sup>st</sup>, the investor would have gone broke 7 years ago. Note that ending wealth would be identical if there were no withdrawals.



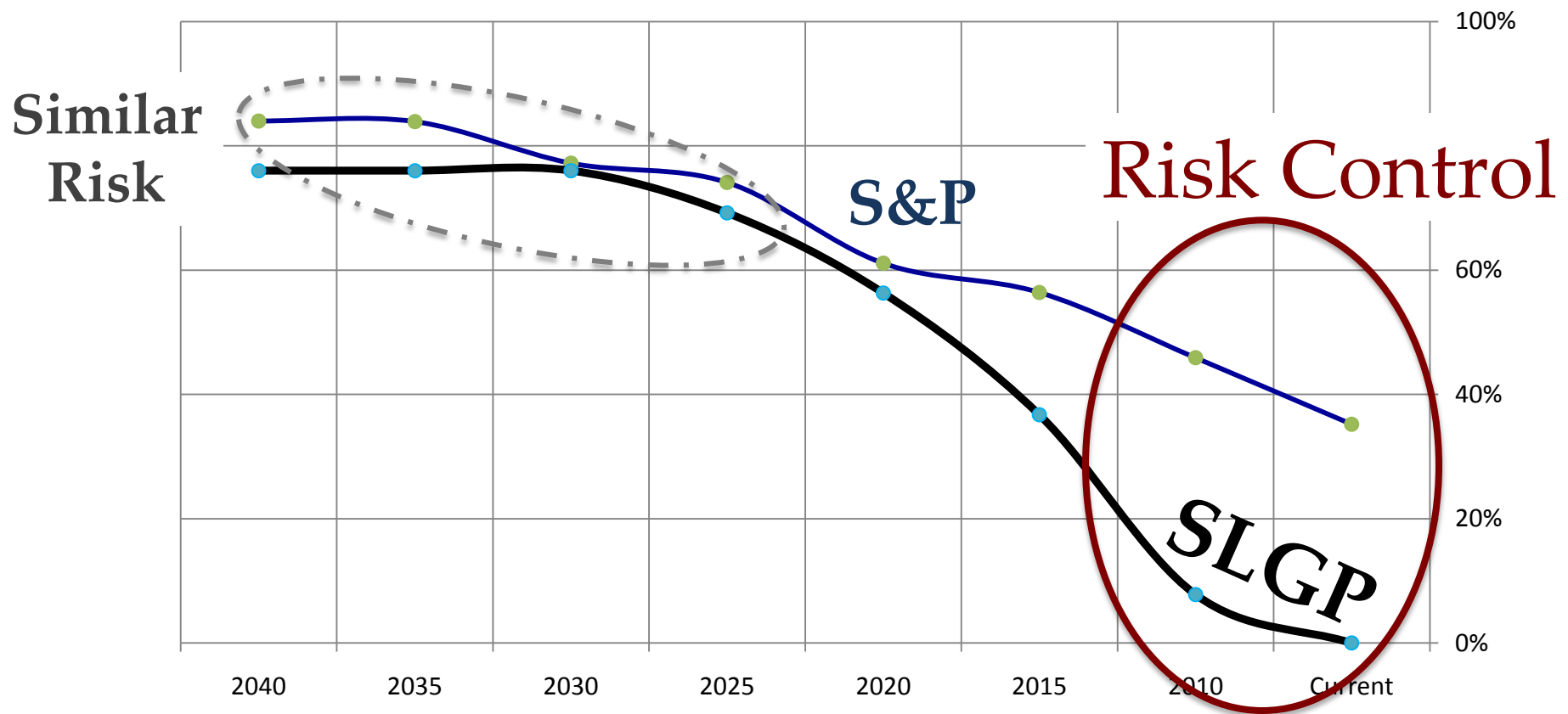
Dr. Craig Israelsen, Brigham Young University

Also see video of Prof. Moshe Milevski, York University, at [Return sequence risk](#)



# Glide Paths: Equity Allocations of “TO” versus “THROUGH”

Objective transitions from growth to preservation, with BIG difference near target date



S&P Target date index is an industry average of all target date funds.  
SLGP is our Safe Landing Glide Path™ – a “TO” Fund

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# Objectives and Policies



Hippocratic Oath for Target Date Funds: ***First, lose no money***

## Objectives

### 1. Safety

Preserving value is primary goal

### 2. Growth

Increasing value is secondary goal

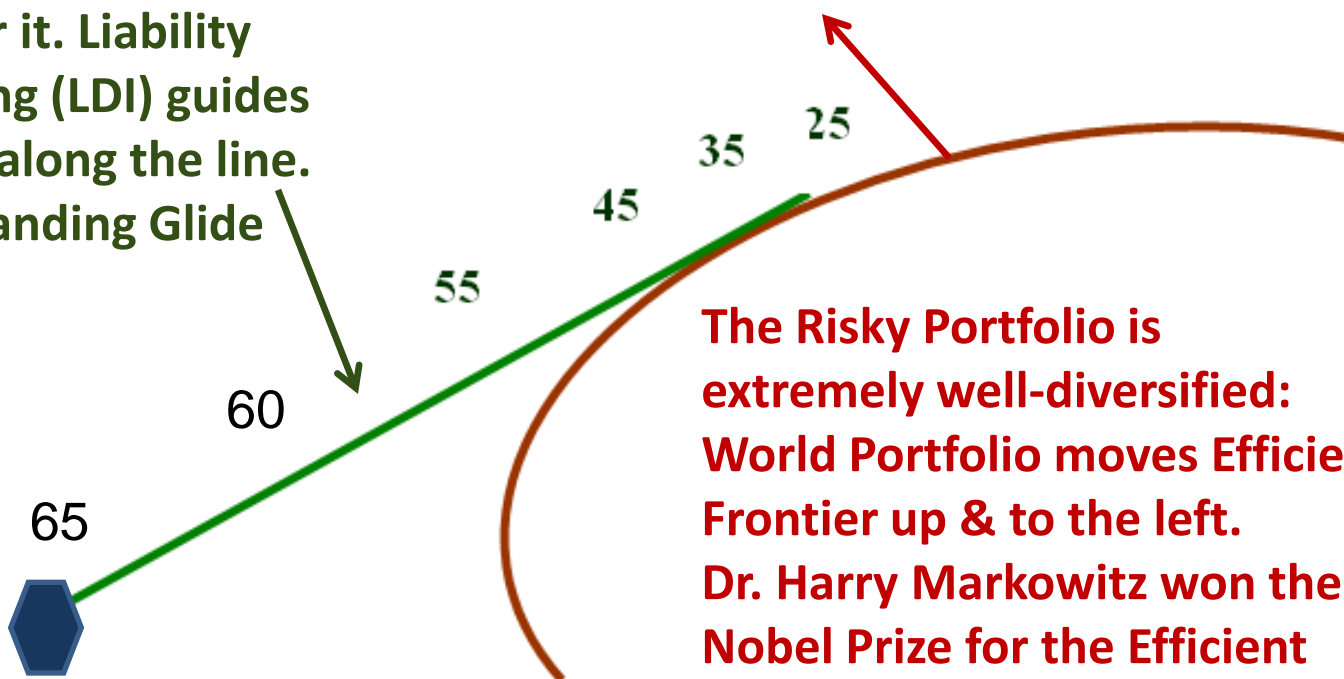
## Policies

- ✓ Diversification
- ✓ Risk Control
- ✓ Sound Theory
- ✓ Low cost



# Recordkeepers Keep Records. Financial Engineers Design Safe Glide Paths.

The “Capital Market Line.”  
Dr. William F. Sharpe won a  
Nobel Prize for it. Liability  
Driven Investing (LDI) guides  
the allocation along the line.  
It is the Safe Landing Glide  
Path™.



The Risky Portfolio is  
extremely well-diversified:  
World Portfolio moves Efficient  
Frontier up & to the left.  
Dr. Harry Markowitz won the  
Nobel Prize for the Efficient  
Frontier.

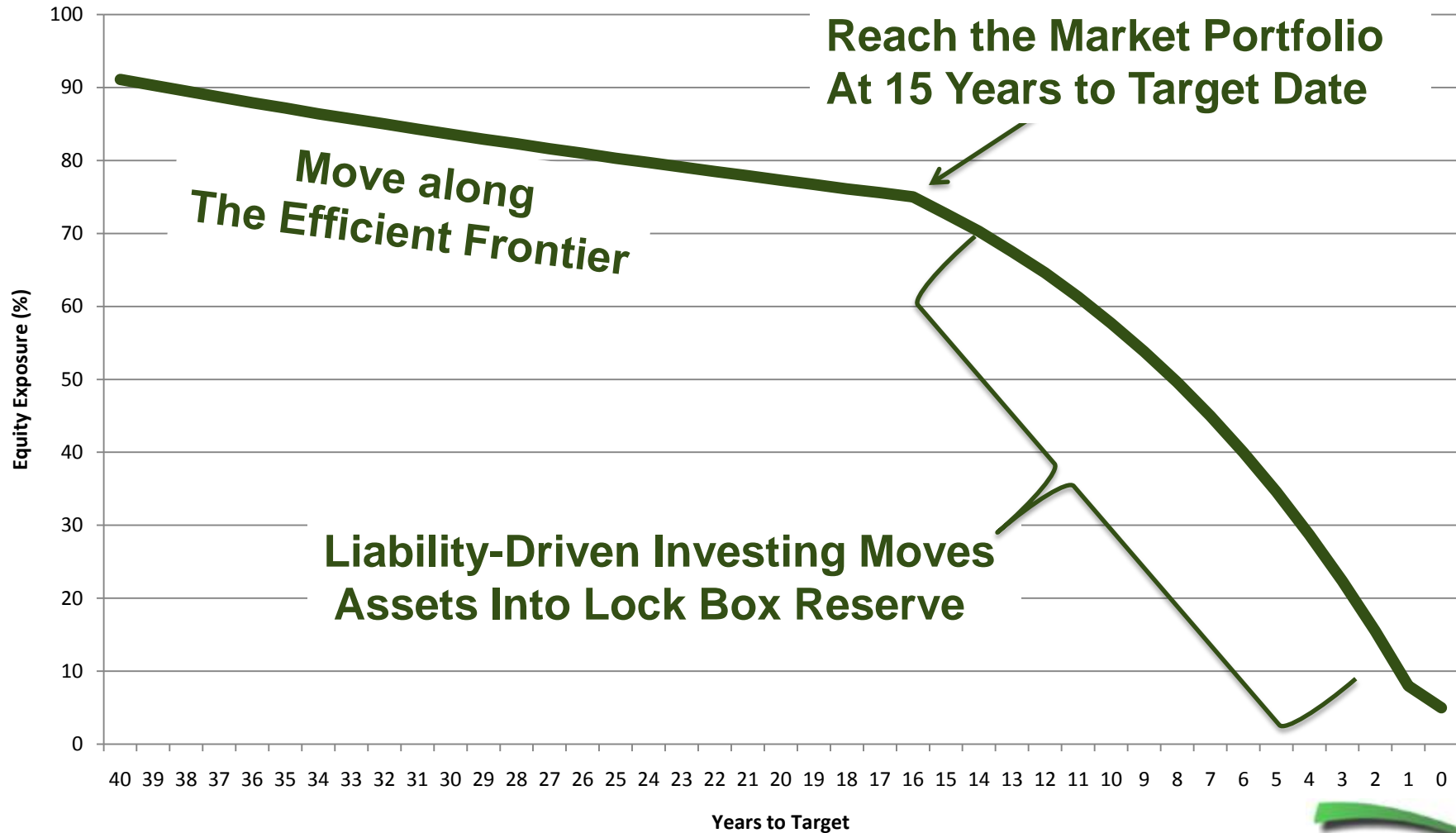
The Reserve Asset protects against losses,  
both absolute & against inflation:  
TIPS and Treasury Bills



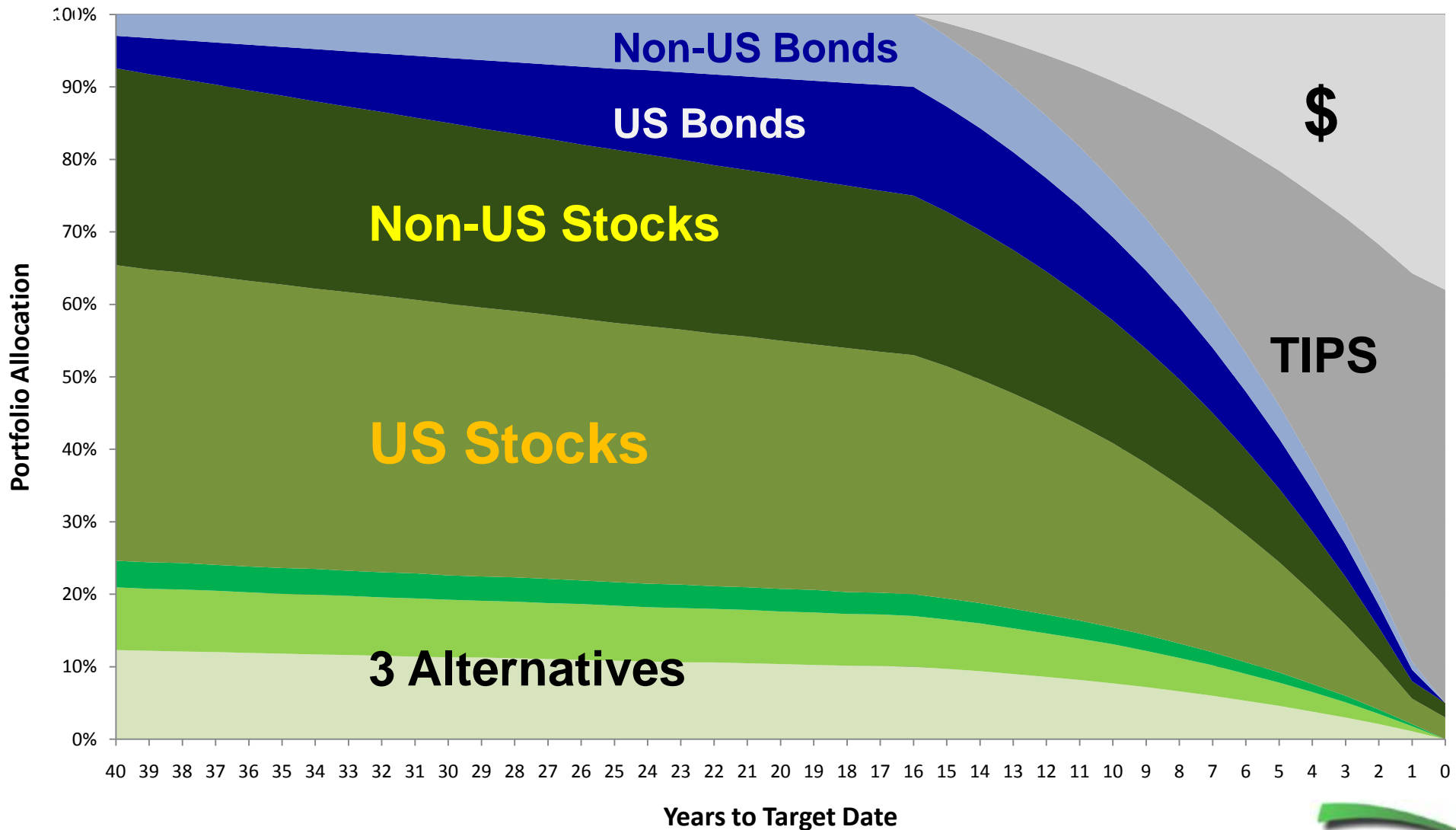
# The Safe Landing Glide Path™



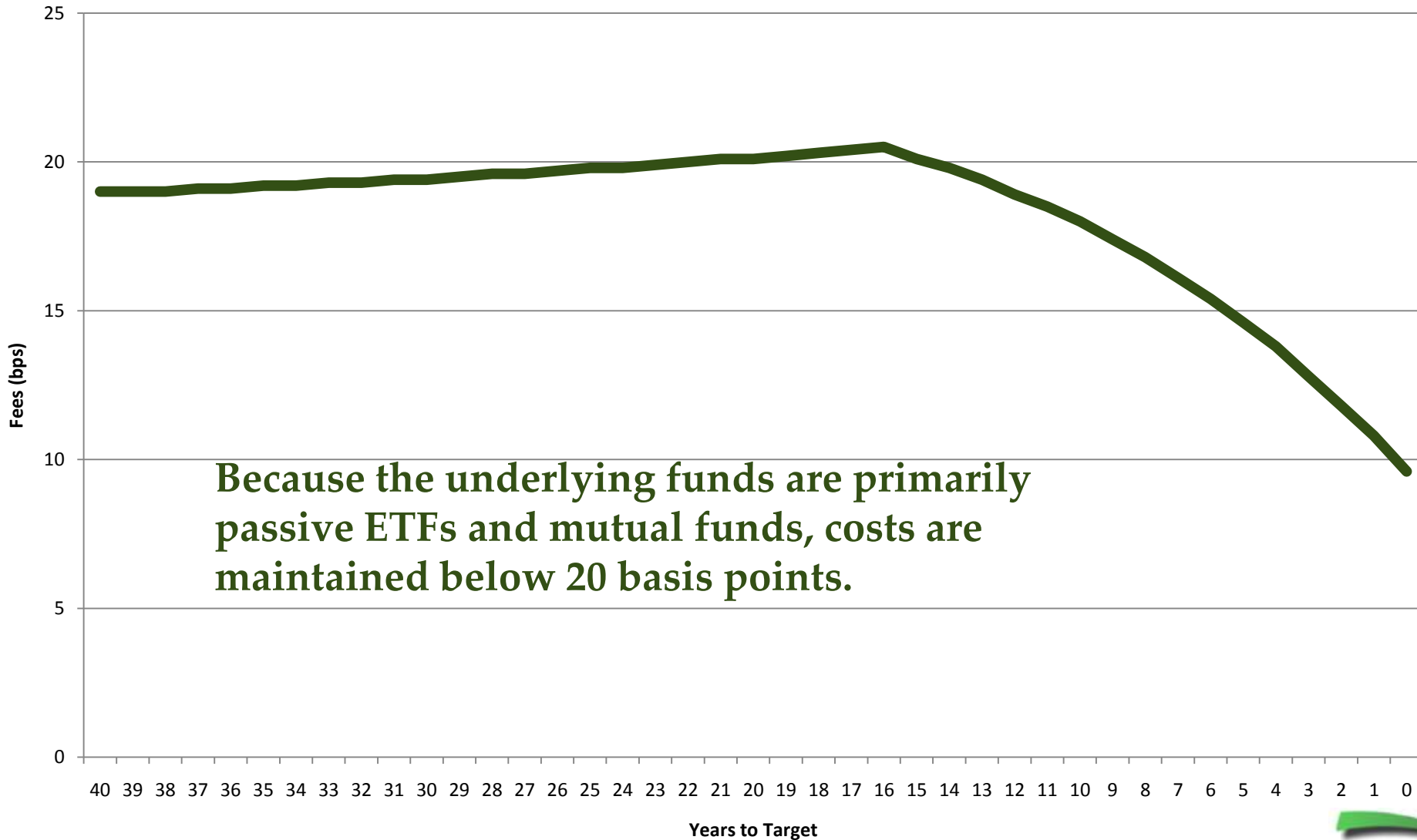
## Equity Allocation



# A closer look at The Safe Landing Glide Path™



# Underlying costs of the Safe Landing Glide Path™



Because the underlying funds are primarily passive ETFs and mutual funds, costs are maintained below 20 basis points.

# Benefits of The Best Glide Path



Diversification

+



Risk Control

+



Sound Theory

+



Low Fees

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= Safe Landing Glide Path<sup>TM</sup>

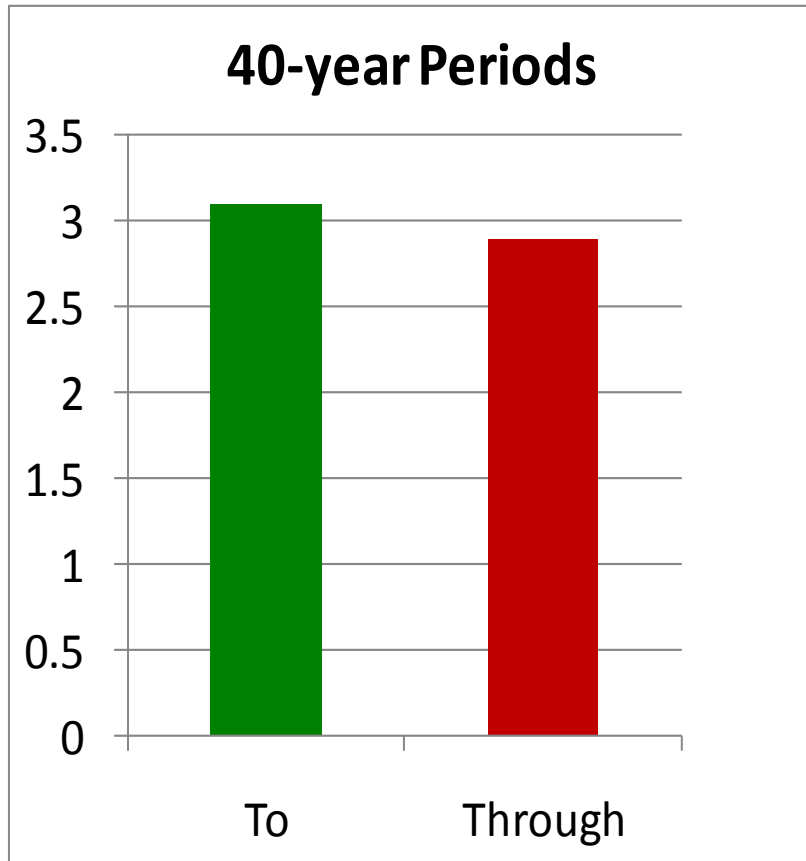
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Target Date  
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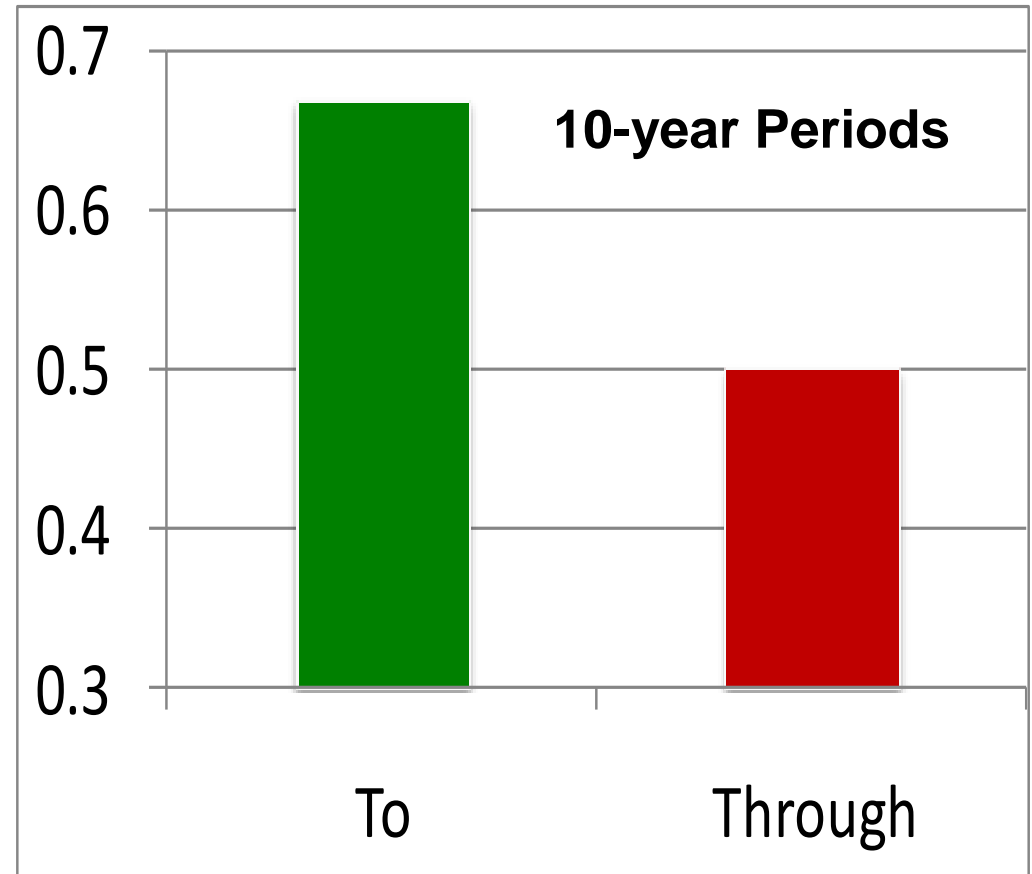
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# Reward-to-Risk Ratios 1926-2008



To is 7% Higher



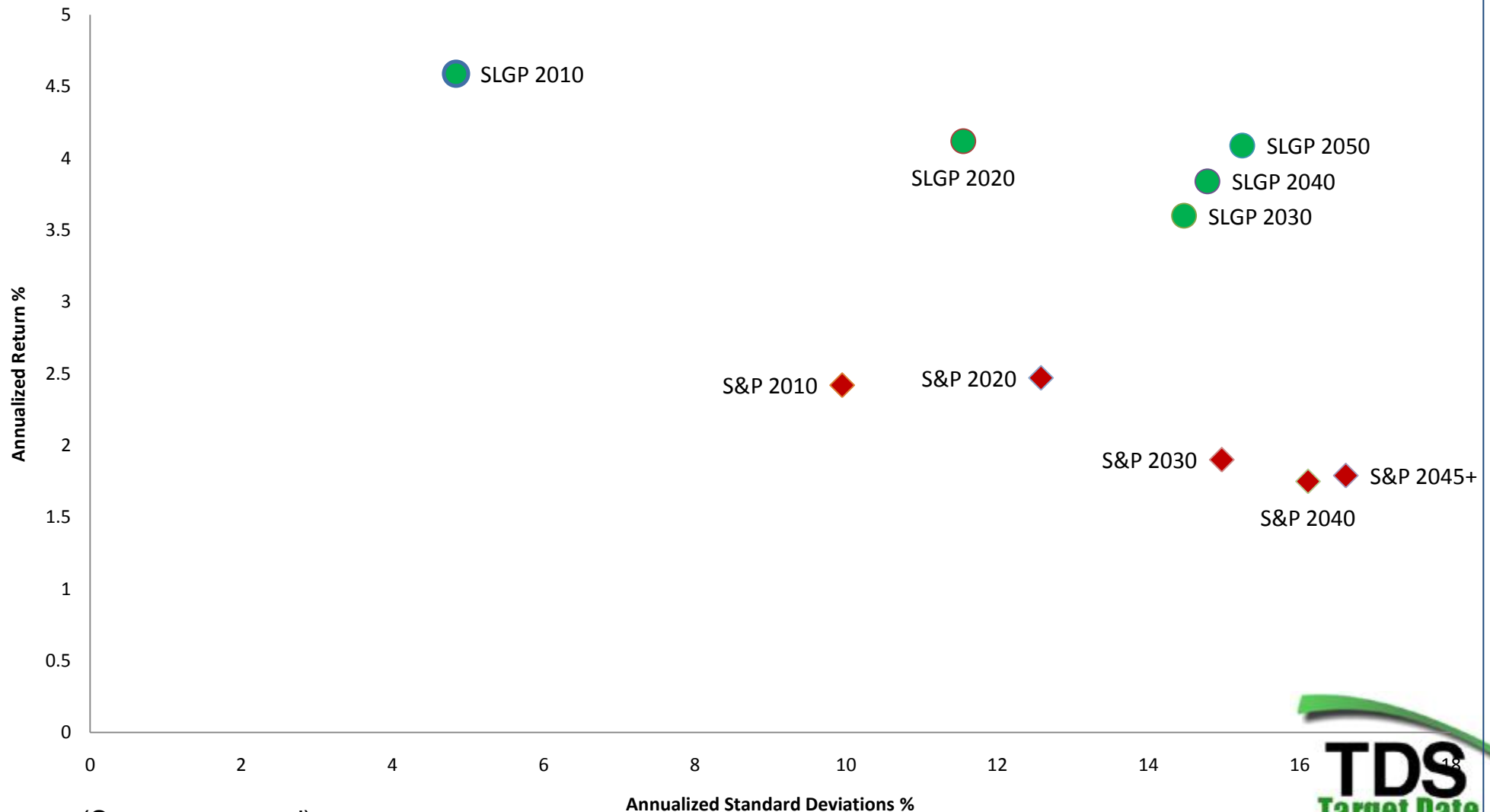
To is 34% Higher

Please see *Getting THROUGH TO Fiduciaries*  
in the Fiduciary's Corner



# The Proof of the Pudding

## 5-Years Ending 12/31/09 Risk/Return Diversification & Risk Control Work

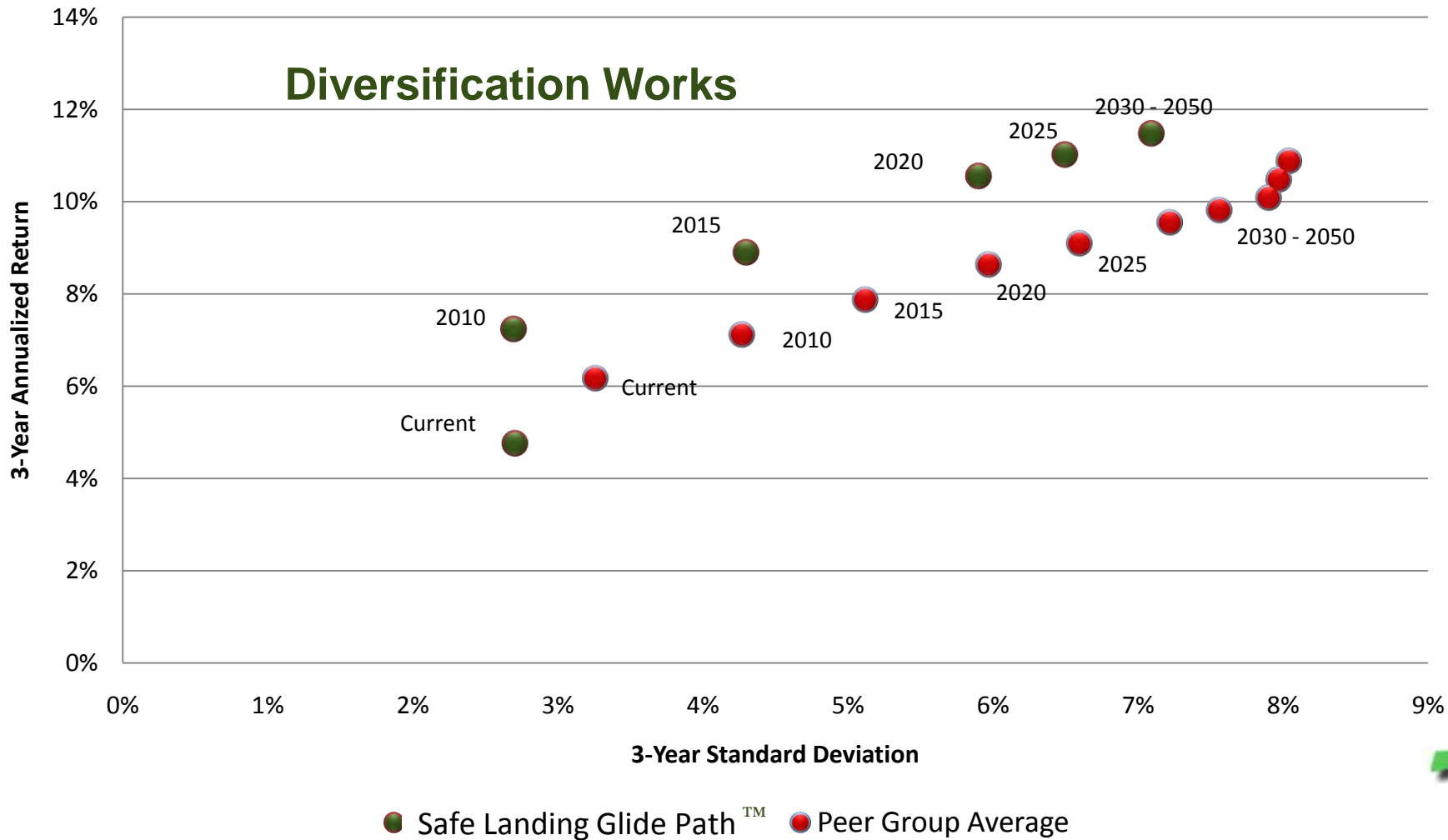


(See notes at end)



# Looking Back to Better Times: 3 Years Ending 12/31/2007

**3-Year Risk/Return**  
as of December 31, 2007



(See notes at end)



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# Fiduciary Considerations

- Current common practice: “Through” funds
  - Procedural prudence
  - 35% Equity at target date is OK?
- Safety First: “To” Funds
  - Substantive prudence
  - Duty of Care: Participant expectations
  - 35% at target date is probably too much

# Target Date Fund Choices for Consultants: Fiduciary or Salesman

(1) **Best** or **Worst** practices

(2) Paid by investment firm ( **Fee** or **No Fee**)

## Objectives

Best	Worst
1) Safety First to Target Date	Growth to Death (Longevity risk)
2) Growth	

## Policies

Best	Worst
Liability-driven investing	Growth focused using closed architecture
Broad diversification	US-centric mostly stocks
Low costs	High fees and sales commissions
Financially engineered glide path	Ad hoc rules, like "some # minus age"

## Salesman/Suitability



## Advisor/Fiduciary

# Summary

1. The key decision is “**To**” or “**Through**” target date: Safety or Growth
2. Investment managers are mostly providing “Through” products. Profits are a probable reason.
3. Plan sponsors are responsible for selecting & monitoring. Convenience and familiarity with the plan’s recordkeeper are not suitable criteria.
4. **Enlightened Fiduciaries choose the Safe Landing Glide Path™**



# A Key Decision: Choosing a GOOD Target Date Fund

Plan sponsors have a fiduciary duty to select and monitor target date funds.

*It's All About the Beneficiaries*



Recordkeepers might not be the best choice.



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# WE BELIEVE

1. Target date funds (TDFs) are a reasonably good idea but with pathetic execution, at least so far.
2. TDFs should end at the target date -- a “To” fund – entirely in safe inflation-protected assets.
3. “Through” funds, that target death rather than retirement date, are sold, not bought. They’re good for fund companies, but awful for beneficiaries.
4. Recordkeepers keep records. Financial engineers design Safe Landing Glide Paths™.
5. The Hippocratic oath of TDFs is “First, lose no money, especially as the target date approaches.”
6. Common practices in TDFs are currently far from best practices.
7. Fiduciaries choose TDFs, not plan participants
8. Qualified Default Investment Alternatives (QDIAs) should emphasize safety as retirement approaches.
9. The transition period, from 5 years before retirement to 5 years after, is the most critical for maintaining lifestyle in the long run.
10. Longevity risk cannot be managed with a glide path. Annuities and managed payout funds might work. Saving enough is the best approach. *“You have to use the right tools for the job.”* Bob the Builder
11. The date in the target date fund name should mean something.



# IMPORTANT NOTES

## About the Data and Figures Displayed in This Document

- Return and risk results for periods prior to January 2009 are based on the PLANSPONSOR On-Target Defensive Indexes (OTDI), designed by Ron Surz, our founder. Thereafter, return and risk are based on the Safe Landing Glide Path™, which is a redesign of the OTDI by Target Date Solutions.
- Total Returns have been calculated using the widely reported returns of the underlying indexes and funds which constitute the glide path. The glide path and allocation model do not change with market fluctuations thus providing additional support for the use of back-tested returns. Nevertheless, the decisions made by Target Date Solutions with regard to the models are not necessarily the same decisions they would have made at the theoretical inception of the glide path.
- All of the underlying funds which constitute the Safe Landing Glide Path™ (SLGP) are commercially available investment funds. The returns for the SLGP reflect the full cost of the underlying funds which constitute the SLGP. That is, the reported returns are net of all expenses of the underlying funds.
- Prior to January 2009, return and risk for the peer group averages in this report were obtained by aggregating across funds on Morningstar Principia®. Thereafter, return and risk are based on the S&P Target Date Indexes, which are aggregations of target date funds.
- Nothing in the above should be interpreted as an offer to sell investment securities, nor a solicitation of an offer to sell or purchase investment securities.
- Target Date Solutions makes every effort to ensure accuracy in these reports but cannot guarantee completeness or accuracy.
- Past performance is not a guarantee of future performance.

