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Five tips to understanding and selecting target date funds

By TRACY ST. JOHN

In my former career, one of my research projects was to analyze various mutual fund families Target Date fund offerings. As I dug into the details, I realized how different they were and there was no simple way to compare them. As I review target date funds from those that hire Financial Avenues, I realize there is a need to provide some education.

Target Date funds cannot be compared apples to apples. Some of the “big” fund families like Fidelity, Schwab, JP Morgan, T. Rowe Price, Vanguard and others all offer these. They have become a typical investment choice within a company retirement plan. For example, each of these fund families will offer a 2030 fund or a 2050 fund. The reason someone would choose to invest in a Target Date fund is because they do not want to manage their money on their own. Instead, they are willing to have a fund company make the decisions on how much should be in stocks versus bonds versus savings.

Here are five important aspects of understanding and selecting these funds.

1. The individual investments within the fund are not always of the same type. For example, the Fidelity Freedom funds are “fund of funds.” Fidelity will utilize a variety of their funds for various asset classes and put together an allocation. You may have 4 or 5 Fidelity bond funds, several Fidelity U.S. stock funds and some Fidelity international funds as part of the one Target Date fund you own.

Wells Fargo, on the other hand, invests their Target Date fund in a basket of securities. They will select a variety of individual bonds and a wide variety of U.S. and international stocks, monitoring them constantly and yet keeping a fixed allocation. It’s important to know what your Target Date fund buys — fund of funds or individual securities.

2. All Target Date funds and the specific year targeted do not mean you have the same amount of risk. Basically, if you own a 2015 fund, a big portion of your investment will be invested in bonds while a smaller allocation is invested in the stock market. Some are more conservative while some are more aggressive.

For example, the Fidelity Freedom 2015 fund has 57 percent invested in stocks, 33 percent in bonds and 10 percent cash. The Well Fargo Adv DJ Target Date 2015 fund is 33 percent in stocks, 63 percent inbonds and 4 percent in cash.

3. Determine whether a Target Date fund is “to” or “through” retirement. “To” refers to the person who expects to spend all or most of their money in the fund at the target date. “Through” funds are designed for those who plan to withdraw the value of their account in the fund gradually, throughout their retirement years.

Examples of “to” fund companies are JP Morgan, American Century, Blackrock and ING. “Through” fund companies include Fidelity, Vanguard, T. Rowe Price, Wells Fargo, American Funds and TIAA-CREF.

4. Target Date funds are best utilized as the only investment within an account. One of the most important things to ask yourself is whether you want to be involved in making the investment decisions for your money or whether you want someone else to “do it for you”. There are times where I will review someone’s retirement plan and they have selected two or more Target Date funds to be “aggressive” with a portion of their money and less aggressive with another portion of their money. What you are doing is buying the exact same thing twice, but in different portions. In a general comparison for example, let’s say you have 50% in the 2040 fund and 50% in the 2030 fund. The 2040 may have 90 % invested in stocks or stock funds and the 2030 may have 75 percent invested in the same stocks or stock funds. You have duplication that is not necessary and especially in a Target Date fund that is a “fund of funds” you are paying more in mutual fund fees.

5. There is no need to rebalance a Target Date Fund if that is the only investment within one account. Because the fund family is responsible for determining the overall allocation between stocks, bonds and cash, you have given up the option to make that decision.

Target Date funds can be very helpful for those who really do not have the desire or the time to learn about investing. The fund companies who offer these funds determine what asset allocation is appropriate based on your targeted date of retirement and the amount in stocks versus bonds and savings. If you have a small account balance or are just starting out at investing, this is a great way to get your feet wet and learn. Financial Avenues can assist you in determining which fund is right for you. We will also review your Target Date funds to determine whether you are utilizing them correctly within your overall investment portfolio as well as provide you with ideas as to which fund company's Target Date funds would best suit your needs.

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