

TARGET DATE FUNDS

Charles Lucey with cited materials

A target-date fund or TDF, to investors, is a long-term investment account that is automatically adjusted typically based on age over the years (the glide path) as the investor approaches a specific life cycle (typically retirement), time related or educational milestone such as college. Employers may offer this investment instrument or even use it as default 401k retirement plan option. See, [What Is A Target Date Fund? – Forbes Advisor](#).

TDFs are designed to invest heavily in riskier/ higher growth stocks in the early years. This is intended to generate or produce gains while the investor has plenty of time to recover from any short-term losses. In the later years, the investment choices lean towards more conservative choices to consolidate gains and avoid untimely losses.

https://www.investopedia.com/terms/t/target-date_fund.asp

As an example, I have chosen 3 of the 11 target dates for federal employees to demonstrate how the funds slowly become more fixed income/conservative over time (the glide path). See the table below. They are labeled Lifecycle in place of TDF, as one is supposed to select the date closest to retirement.

Lifecycle funds (TDF) under Federal Government matching program - Thrift Savings Plan (TSP)

Each of the eleven L Funds is a diversified mix of the five individual funds (G, F, C, S, and I, as defined below). They were designed to let the saver invest his or her entire portfolio in a single L Fund and get the best expected return for the amount of expected risk that is appropriate for the age of the contributor and closet expected retirement date. The TSP sets the funds' glide paths, which is based on efficient frontier analysis using capital market assumptions over a 20-year time horizon and stochastic modeling projections for inflation, economic growth, salary growth, corporate profits, P/E ratios, interest rates, and exchange rates.

https://www.bogleheads.org/wiki/TSP_Lifecycle_funds.

Every quarter, the target allocations of all the L Funds except L Income are automatically adjusted, gradually shifting them from higher risk and reward to lower risk and reward as they get closer to their target dates. When an L Fund reaches its target date, it terminates existence and these funds becomes part of the L Income Fund, which generally keeps the same target allocation (holding some risk with stocks to protect against inflation). For example, in 2025, the L 2025 Fund will be rolled into the L Income Fund.

One of the important things about the L Funds is that they stick to their target allocations for a full quarter regardless markets conditions. Every trading day, some of the individual funds in an L Fund will perform better than funds. At the end of the day, the individual funds that perform better will make up a higher percentage of the L Fund than the ones that did not perform financially as well.

Unlike other Lifecycle Funds, to maintain L Income Fund's target allocation, TSP rebalances the component funds at the end of every trading day. TSP does this by buying and selling the individual funds that make up the L Fund so that the percentages go back to what they were at the beginning of the day. In effect TSP is buying low (the funds that did less well each day) and selling high (the funds that performed better) at the end of every trading day.

Funds	<u>L Income</u>	<u>L 2030</u>	<u>L 2040</u>
Objective	For participants born before 1960, are currently withdrawing from their TSP accounts, or who plan to begin withdrawing this year.	For participants born between 1965 and 1969 or will withdraw their money beginning 2028 through 2032.	For participants born between 1975 and 1979 or will withdraw their money beginning 2038 through 2042.
Return YTD 7/30/24	4.13%	6.92%	7.81%
1 year	8.04%	12.94%	14.56%
3 year	4.07%	4.95%	5.09%
5 year	4.70%	8.01%	8.94%
10 year	4.17%	6.99%	7.74%
Lifetime	4.34%	6.92%	7.51%
Inception date	8/1/2005	8/1/2005	8/1/2005
Risk	Low	Medium	Medium-high
Total expense ratio	0.050%	0.052%	0.053%
5 FUNDS	G Fund (Treasury Bills) 68.45% F Fund (Bond Fund) 5.55% C Fund (S&P 500)	G Fund 34.11% F Fund 5.77% C Fund	G Fund 21.20% F Fund 7.05% C Fund

Funds	<u>L Income</u>	<u>L 2030</u>	<u>L 2040</u>
	13.55%	31.20%	37.12%
	S Fund (Small Cap Stock)	S Fund	S Fund
	3.35%	7.88%	9.52%
	I Fund (International Stock)	I Fund	I Fund
	9.10%	21.04%	25.11%
Web site	https://www.tsp.gov		

The C Fund's investment objective is to match the performance of the S&P 500 Index, a broad market index made up of stocks of 500 large to medium-sized U.S. companies.

The F Fund tracks the Bloomberg U.S. Aggregate Bond Index, a broadly diversified index of the U.S. bond market. On December 31, 2023, the index included 13,334 notes and bonds.

The G Fund rate is calculated by the U.S. Treasury as the weighted average yield of approximately 191 U.S. Treasury securities on the last day of the previous month. Its investment objective is to ensure preservation of capital and generate returns above those of short-term U.S. Treasury securities.

The I Fund's investment objective is to match the performance of the MSCI EAFE (Europe, Australasia, Far East) Index.

Top ten holdings as of 12/31/2023

NOVOB Novo Nordisk Class B
NSRGF Nestle S.A.
ASML ASML Holding NV
LVMH LVMH
SHEL Shell PLC
AZN AstraZeneca PLC
NVSEF Novartis AG
RHHBF Roche Holding Par AG
TOYOF Toyota Motor Corp
BHP BHP Group Ltd

The S Fund's investment objective is to match the performance of the Dow Jones U.S. Completion Total Stock Market Index, a broad market index made up of stocks of small-to-medium U.S. companies not included in the S&P 500 Index.

Top ten holdings as of 12/31/2023

SNOW Snowflake Class A

CRWD Crowdstrike Holdings Inc Class A
WDAY Workday Inc Class A
KKR Kkr And Co Inc
MRVL Marvell Technology Inc.
SQ Block Inc Class A
APO Apollo Global Management Inc
LNG Cheniere Energy Inc
FERG Ferguson Plc
TEAM Atlassian Corp Class A

The Pros and Cons: (See [Pros and Cons of Target-Date Funds \(investopedia.com\)](https://investopedia.com/pros-and-cons-of-target-date-funds/))

Target Fund Positives:

1. Allows for a passively structured, simplified approach to investing for people uninterested or lacking time to learn the complexities of investing.
2. Low cost of using passive funds in a TDF wrapper.
3. Diversification in each sector with multiple stocks, bonds or T-Bills.
4. Periodic rebalancing to keep allocation near goals.
5. Easy payroll or other monthly contribution to dollar cost average.
6. Discourages emotional change in investment choices by putting this in autopilot mode.
7. Often qualified for employer matching contributions.

Target Fund Negatives for common style of using passive tracking funds:

1. TDFs have been criticized for making investment choices too conservative thereby creating a large opportunity cost relative to making long-term aggressive allocations.
2. Passive funds may overweight and encourage more concentration such as the current “Magnificent 7” that makes up approximately 35% of S&P market weight index fund.
3. As Passive Funds/ETFs become dominant investments, may further overweight the largest stocks, adding to their momentum by feedback mechanism, where buying is increased to meet weighting requirements.
4. Most do not allow for stock, sector selection or other investments instruments like option trading, or covered call writing.
5. Does not allow a person to follow personal convictions or religious beliefs to forgo buying specific certain types of investments, though some advisors may do this for a fee.
6. They may make optimizing the overall portfolio to ensure they are synergistic with other investments more challenging.
7. May layer more fees on top of the underlying funds fees. For more discussion, <https://smartasset.com/retirement/the-pros-and-cons-of-target-date-funds-for-retirement>.
8. It is a challenge to consolidate TDFs into your overall portfolio to see your true asset allocation on a regular basis e.g. monthly (though quarterly may be often enough for most).

My Comment and Perspective:

One could simply choose one TSP lifecycle fund or diversify by investing a portion in each of the 5 component funds and to choose multiple retirement funds to spread out over the retirement

years. One can also look at your preferred allocation to choose the 2040 Fund to more closely reflect a 60/40 stock/bond fund. One might also select different targets if married to a mate of different age or lifespan expectation. Taking the bucket approach, I might choose 3% in G fund for emergency plus 1% F; 5% L Income for 2nd bucket, 7% 2025 for third bucket, 30% 2030 for 4th bucket, 20% 2035 for 5th bucket, and 25% 2040 for wife bucket, etc.

Please note that TSP funds have a very low cost in part due to size and also that employees who don't vest (leave employment early) forfeit part of their contribution. It does allow participants to transfer money in and recently started a plan that allows one to pay a yearly fee to choose mutual funds offered by outside companies.

In Conclusion, TDF funds are automatic savings plans that rebalance daily, quarterly or yearly thereby removing any emotional decisions, which savers commonly experience in volatile markets. While one can still move funds with a day's notice, TDF encourages participants to set a course and stick to it. It certainly helps to encourage monthly payroll savings when employers offer a match such that the employee has the option to contribute more. It now has a Roth option. This also avoids state taxes until withdrawal, so that one may move to a lower tax state to save even more.

While passive indexing predominates and keeps expenses low, there are actively managed funds that can choose components and their weighting. T. Rowe Price does this using both active and passively managed component funds, Vanguard and other investment companies offer similar plans which may have different allocations. Using Vanguard as an example, for my wife's IRA we chose 2035 as Target Date and then to save a fraction of a percent, split the money into the individual funds as Vanguard adds small fee to the TDF above the charges of the funds inside. My wife can then rebalance each year using the 2035 allocation to adjust and become more conservative.

Please also note that more risk may result in greater returns, though we have had long periods in the past where stocks did not appreciate. The TSP plan has considered adding a REIT Fund but their analysis has stuck to this basic 5 approach, recently deciding to exclude China from its international fund. Note that the 3-year return comparison of TDFs is quite close as it includes the recent down year for U.S. stocks and bonds.

While passive indexing predominates and keeps expenses low, there are actively managed funds that can choose components and their weighting. T. Rowe Price does this using both active and passively managed component funds, with their funds charging a higher fee and possibly having higher expenses due to investment turnover. See <https://finance.yahoo.com/quote/TRRDX/performance/> for their 2040 TDF. TDF have been preceded by Balanced Funds which actively managed and allocated both stocks and bonds. See, Vanguard Wellington Fund which dates from 1929. [VWELX-Vanguard Wellington Fund Investor Shares | Vanguard](#).

Footnote: Funds quote annualized rates of return without specifying if they are using the calendar year, their financial year, or other time period. This can make fund comparison between

companies or TSP more difficult to understand. Funds may also take on more risk which can be harder to measure though Morningstar does try in its fund review.

T. Rowe Price TDF example:

Average Annual Total Returns			
	1 Year	5 Years	10 Years
Retirement 2040 Fund (Investor Class)	21.43%	10.36%	8.38%
Russell 3000 Index (Regulatory Benchmark)	27.58	15.00	12.09
S&P Target Date 2040 Index (Strategy Benchmark)	18.88	9.82	7.74





























































Prospectus Express - Annual Report (broadridge.com), Dated July 24, 2024

Further Reading:

<https://www.morningstar.com/funds/best-target-date-funds-2024>

<https://www.forbes.com/advisor/retirement/best-target-date-funds/>

Appendix (partial screen shot from Morningstar link above)

Strategy Name	Morningstar Medalist Rating	Pillar Rating ↑ Upgrades ↓ Downgrades		
		People	Process	Parent
American Funds Target Date Retirement	 Gold	 High	 High	 High
T. Rowe Price Retirement	 Gold	 High	 High	 High
T. Rowe Price Retirement Blend	 Gold	 High	 High	 High
BlackRock LifePath Index	 Gold	 High	 Above Average	 Above Average
Fidelity Freedom Index	 Gold ↑	 High ↑	 Above Average	 Above Average
Pimco RealPath Blend	 Gold	 High	 Above Average	 Above Average
MassMutual Select TRP Retirement	 Silver	 High	 High	 Average
BlackRock LifePath Dynamic	 Silver	 High	 Above Average	 Above Average
Fidelity Advisor Freedom	 Silver	 High	 Above Average	 Above Average
Fidelity Freedom	 Silver	 High	 Above Average	 Above Average
Fidelity Freedom Blend	 Silver ↑	 High ↑	 Above Average	 Above Average
JPMorgan SmartRetirement Blend	 Silver ↑	 Above Average	 Above Average	 Above Average
State Street Target Retirement	 Silver	 Above Average	 Above Average	 Above Average
Vanguard Target Retirement	 Silver	 Above Average	 Above Average	 High
MFS Lifetime	 Bronze	 Above Average	 Above Average	 High