

INVESTING FOR THE LONG TERM:

TARGET DATE FUNDS

As you plan your course toward retirement, one approach has proven to be a reliable compass for many investors. It's called a target-date fund. These funds aim to simplify the journey toward retirement by striking a balance between risk and reward based on your desired retirement date.



What are Target Date Funds?

Target date funds (TDF) are a type of investment fund designed to simplify long-term retirement planning for investors. The primary feature of a target date fund is that it automatically adjusts its asset allocation over time based on a specified retirement date.

The objective is to help investors save for a specific retirement date. Once you enroll in your 401K account and choose a target date fund close to your retirement year—the fund manager selects and manages a diversified mix of assets: stocks, bonds, and cash to balance potential growth and risk based on that target date. Target Date Funds start with a more aggressive asset allocation with a higher percentage of stocks when the target date is further in the future. As the target date approaches, the fund gradually shifts towards a more conservative allocation with a higher percentage of bonds and cash equivalents. This adjustment aims to reduce exposure to market volatility as investors near retirement.

Pros and Cons of Target Date Funds

Target date funds offer certain advantages, such as ease of use and diversification, but it's important to recognize that they are not without their drawbacks. You should always talk with a financial advisor to ensure they're the right choice for your retirement portfolio.

PROS

- 1 Broad diversification.** This diversification helps spread risk and reduces the impact of a poor-performing asset on the overall portfolio. These funds are managed by professional portfolio managers who make investment decisions on behalf of investors. The managers follow a predetermined strategy that adjusts asset allocation according to the fund's target date.
- 2 Average risk tolerance.** TDFs are designed to align with the average investor's risk tolerance. Risk tolerance varies from person to person, but TDFs aim to reduce risk as retirement approaches. During market fluctuations, target date funds automatically rebalance within the retirement portfolio to maintain the target asset allocation.
- 3 Automatic investing.** Investors select a fund with a target date that corresponds to their expected retirement, and the fund does the rest, adjusting the portfolio as needed over time. When selecting a TDF, consider your retirement goals, risk tolerance, and investment timeline. Different fund providers may have variations in their strategies and asset allocations, so it's crucial to review the fund's prospectus and compare options.

CONS

- 1 Limited Customization:** Target date funds are designed to be a one-size fits all solution, which means they may not align perfectly with your specific financial goals, risk tolerance, or investment preferences. If you have unique circumstances or preferences, a more customized approach might be better. If you want to invest in specific companies, industries, or asset classes, consider alternate investments.
- 2 Fees:** Like any mutual fund, target date funds come with management fees and expenses. These fees can vary, and it's important to compare the expense ratio of different funds. As a "fund of funds"- which is a fund that invests in other mutual funds or exchange-traded funds- you will pay the expense ratio for those underlying assets, as well as the fees associated with the target date fund.
- 3 Lack of Control:** When you invest in a target date fund, you're essentially handing over control of your investment decisions to the fund manager. This lack of control may be a disadvantage if you prefer to be more hands-on with your investments. Many target date funds are passively managed, meaning they aim to match the performance of a benchmark index rather than actively seeking to outperform the market. This approach may not suit investors who believe active management can add value.

Target date funds offer a simplified and convenient way for investors to plan for retirement. Their automatic asset allocation adjustments can help mitigate risk and ensure a smoother path toward retirement. However, as with any investment, it's crucial to weigh the pros and cons before committing to a particular strategy.

By understanding the advantage and disadvantages of target date funds, you can make a well-informed decision that aligns with your unique financial circumstances and retirement aspirations.