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Target-Date Series Research Paper: 2011 Industry Survey

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Morningstar Fund Research
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Executive Summary

In its annual Target-Date Industry Survey, Morningstar shines a sweeping light across target-date funds, which have become a primary tool for Americans' retirement savings. To produce this report, Morningstar draws on its qualitative understanding of target-date funds—developed through the Target-Date Series Ratings and Reports that it issues quarterly to 21 of the largest target-date series—as well as its extensive proprietary database on mutual funds.

Because the U.S. Department of Labor has designated target-date funds as Qualified Default Investment Alternatives, these funds are subject to regulation under the Employee Retirement Income Security Act of 1974, or ERISA, and extra attention from regulatory bodies. Many of the funds—especially those for near-retirees—were widely criticized after dropping sharply in the 2008 market crash. That criticism has ebbed recently; though in 2010, the SEC proposed new disclosure standards for target-date funds, and at the request of Senator Herb Kohl's Special Subcommittee on Aging, the Government Accountability Office produced a report on target-date funds in early 2011 with additional recommendations.

Meanwhile, healthy debate over the best investment practices for target-date series has continued apace. Much of that debate has centered on whether target-date funds should be designed to continue managing investors' assets during retirement. In the 2011 Industry Survey, Morningstar looks at this question from various angles, including whether investors have sent new money to the funds after their retirement date, and whether the fund series intends to change its asset allocation during the retirement years.

The 2011 Industry Survey updates much of the data from the 2010 edition while providing new features on asset allocation, performance attribution, and portfolio composition—particularly among retirement-income funds, the terminal funds in many target-date series.

Among key findings of the Industry Survey are the following:

- Target-date funds continued to see healthy inflows in 2010 relative to other mutual fund categories, though the growth rate of assets is slowing.
- While the largest target-date providers continue to dominate in terms of market share, some newer entrants to the marketplace have made appreciable gains.
- Funds in the 2010 and 2005 cohorts continue to see small positive net inflows, raising interesting implications for asset allocation postretirement.
- Morningstar found that dividing target-date series into "to" and "through" retirement classifications based on their stated glide paths produces confusing and conflicting results.
- Many of the much-maligned 2010 funds have nearly or fully recovered from their market losses during the financial crisis.
- Target-date funds are adding nontraditional asset classes, but only gradually. Nevertheless, there are several clear innovators that Morningstar identifies.

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- Retirement-income funds, viewed as the most conservative point in a series' glide path, still contain significant positions in what some investors would view as risky assets.
- Target-date expenses continue to decline—a positive industry trend.
- Managers of target-date funds have made significant changes to the underlying holdings over the past three years.

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Introduction

Target-date funds continued to attract investors' retirement assets in 2010. Target-date funds had net inflows of $47.5 billion in 2010, a small increase over the $45 billion net inflows of 2009. Total net assets in open-end target-date funds reached $341 billion. Morningstar tallies another $33.7 billion in collective investment trust, or CIT, target-date funds, but Morningstar's count of CIT assets is not a comprehensive accounting since firms report CIT assets voluntarily.

On an organic growth-rate basis, however, the 2010 results are not quite as impressive as in years past (see Table 1). The average organic growth rate for the target-date industry was 22%, off from 2009's 39%, and well below the 2007 high of 76%. Anecdotal evidence suggests that some open-end mutual fund assets are being redirected into CIT target-date funds, which would mitigate the degree of the decline for the target-date industry as a whole.

1. Annual Organic Growth Rate by Morningstar Target-Date Category

	2007		2008		2009		2010	
Morningstar Category	**Estimated Net Flow $**	**Organic Growth Rate %**	**Estimated Net Flow $**	**Organic Growth Rate %**	**Estimated Net Flow $**	**Organic Growth Rate %**	**Estimated Net Flow $**	**Organic Growth Rate %**
Retirement Income	1,562,026,192	27.45	885,658,494	11.73	1,817,223,958	24.60	2,759,762,007	24.12
Target Date 2000-2010	7,560,367,166	34.38	1,880,915,526	6.09	1,044,753,211	4.28	515,983,293	1.65
Target Date 2011-2015	7,728,553,668	61.90	5,418,519,125	25.55	5,063,850,378	25.62	5,272,924,081	17.43
Target Date 2016-2020	11,356,640,120	40.64	7,325,495,689	17.70	7,116,358,191	21.15	7,965,634,434	15.52
Target Date 2021-2025	7,853,773,865	70.00	6,747,791,165	33.74	7,517,153,191	40.54	7,363,294,829	22.67
Target Date 2026-2030	8,876,305,960	48.60	7,092,676,607	24.80	6,896,778,990	29.51	7,365,607,295	18.96
Target Date 2031-2035	4,981,038,735	74.66	4,973,647,320	40.72	5,166,590,268	45.11	5,284,157,334	24.98
Target Date 2036-2040	5,321,694,864	55.96	4,841,035,065	31.02	5,377,179,212	40.66	5,476,535,755	22.78
Target Date 2041-2045	1,977,836,200	97.08	2,323,418,215	55.56	2,797,657,064	63.35	3,173,891,829	34.61
Target Date 2050+	1,186,628,737	244.59	1,476,700,570	84.76	2,169,785,006	99.04	2,267,612,433	41.22
Average		76		33		39		22

Data as of 12/31/10. Source: Morningstar, Inc.

Still, those growth rates are impressive compared with the rest of the mutual fund industry. Table 2 shows asset growth across the industry by seven broad asset classes. Of those, the only categories to exceed target-date funds' percentage gains were alternative and commodities funds, both of which built off a smaller base and benefited from near-term investor concerns over volatility and inflation. Compared with the meager results of both the equity (negative 2.5%) and balanced (1.84%) asset classes, the latter of which excludes target-date funds, target-date fund growth is still a bright spot.

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2. Net Flows and Organic Growth Rate by Broad Asset Class, 2009-10

	2009		2010	
U.S. Broad Asset Class	**Estimated Net Flow $**	**Organic Growth Rate %**	**Estimated Net Flow $**	**Organic Growth Rate %**
Alternative	14,981,634,253	36.50	22,882,689,527	35.16
Balanced	271,451,749	0.05	12,418,861,488	1.84
Commodities	10,212,431,942	124.48	12,628,271,392	54.79
International Stock	22,944,555,636	2.80	42,406,536,672	3.67
Municipal Bond	72,772,682,063	21.95	12,042,550,986	2.63
Taxable Bond	290,417,135,355	27.54	216,651,244,566	14.22
U.S. Stock	(23,768,411,227)	(1.05)	(75,140,990,463)	(2.50)

Data as of 12/31/10. Source: Morningstar, Inc.

Target-date funds owe much of their growth to their designation since 2006 as qualified default investment alternatives, or QDIA, in defined-contribution plans, such as 401(k) plans. This QDIA designation means employers can automatically route retirement-plan participants' savings to a target-date fund if the participant doesn't choose otherwise. Morningstar's Ibbotson Associates also has analyzed target-date flows compared with other QDIAs and found that target-date funds are the increasingly popular default choice. Ibbotson found a widening gap over the past five years between the assets in target-date funds versus those in target-risk or managed-account vehicles. While all three investment types have continued to grow over that period, target-date funds have grown the fastest, from a net asset base that was smaller than target-risk funds in 2006 (prior to the passage of the Pension Protection Act) to a position where open-end target-date fund assets are more than double those of target-risk funds and nearly 5 times that of managed accounts. Looking at separate data from the Investment Company Institute, Ibbotson noted that target-date funds account for approximately 57% of all QDIA options.

Target-date funds have captured an impressive share of retirement assets in a relatively short amount of time. While they are unlikely to repeat the explosive growth that followed their designation as QDIAs in 2006, there are still several factors that favor target-date funds' continued growth. First, as default investments in retirement plans, assets flow in consistently and are less likely to leave. Second, there's still more market share available as target-date funds have not yet saturated the QDIA market. Finally, they are relatively easy for investors to use because their assets are well diversified, which should limit volatility and make investors more likely to stick with them.

Intra-Industry Flows: Where Are the Assets Going?

There are numerous ways to examine how the target-date assets are flowing within the target-date industry, including by Morningstar category, distribution channel, and fund family.

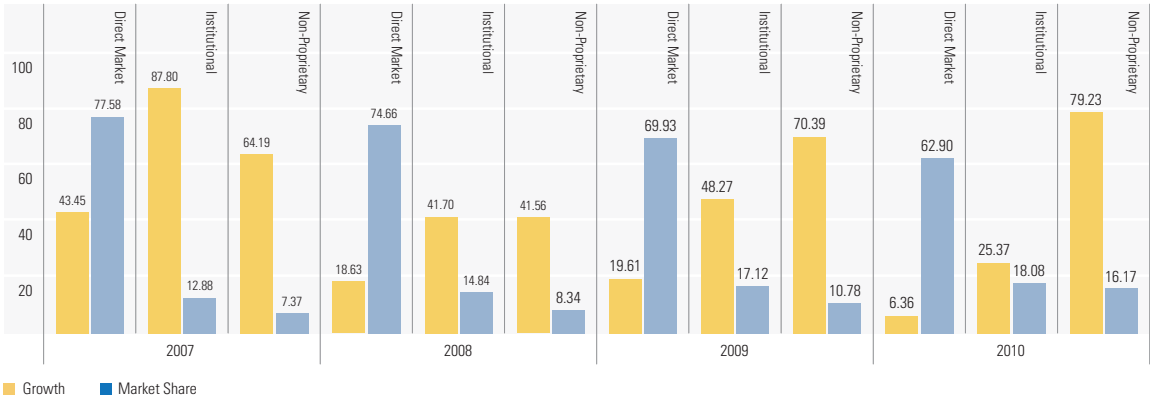
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As in previous years, most new cash in 2010 went to the longest-dated funds, in particular those with target retirement years of 2040 (34.6%) and 2045 (41.2%). All other categories, with the exception of the 2000-2010 funds, had growth rates in the range of 15% to 25%, a healthy showing. It's notable, however, that the shortest-dated funds continue to take in new money.

Morningstar also examined fund flows by distribution channel using Investment Company Institute criteria to assign various target-date share classes to corresponding distribution channels. This study focuses on the three largest categories, comprising 97% of industry assets:

- Direct: share classes sold directly to investors
- Institutional: lower-cost share classes requiring large initial investments
- Nonproprietary: funds sold through advisors

3. Growth Rates and Market Shares by Distribution Channel



Data as of 12/31/10. Source: Morningstar, Inc.

The data above (see Table 3) reveal an interesting trend. There is a noticeable decline in both market share and growth rate in the direct channel, which is dominated by the three industry behemoths—Fidelity, Vanguard, and T. Rowe Price. These fund companies largely serve the biggest retirement plans and have the industry's largest defined-contribution record-keeping operations. From a 77.6% market share in 2007, the direct assets have dropped 15 percentage points, and its organic growth rate dropped by roughly two thirds to 6.4% in 2010. Meanwhile, the institutional and nonproprietary channels have increased their market share commensurately, with the advisor-sold share classes claiming the largest gain.

One cause of this shift appears to be the proliferation of share classes aimed at distribution channels outside the direct channel traditionally served by Fidelity, Vanguard, and T. Rowe. For instance, T. Rowe Price now has $9

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billion in its Advisor shares, which have a distribution fee. Another $4 billion are in its lower-priced Institutional R shares, reserved for the largest retirement plans. Fidelity Freedom's K shares cause an even more pronounced effect. Launched in 2009, this lower-priced share class, which is classified as non-proprietary, has already gathered more than $25 billion in assets. In addition, providers such as Vanguard and T. Rowe Price have said that some of the decline in their direct assets comes from plans switching to collective investment trusts. It is difficult to independently confirm those claims, but it's certainly true that the CIT market has been growing. Many series outside the direct channel, such as JPMorgan and BlackRock, also have significant CIT businesses.

Those broader trends are evident when viewing target-date flows at the fund family level (see Table 4). Fidelity, Vanguard, and T. Rowe Price maintain their relative lock on industry assets. The Big Three control 76% of industry assets, down slightly from 81% in 2007. Fidelity has suffered the biggest absolute decline in market share, from 48% in 2007 to 37% at year-end 2010. T. Rowe stayed flat over that period, while Vanguard saw a market-share increase from 17% to 23%. Between 2009 and 2010, all three firms saw organic growth slow, with T. Rowe experiencing the biggest drop (from a 28% growth rate to 16%). T. Rowe Price says some of that loss stems from assets converting to collective investment trust structures, though other providers presumably have experienced similar changes. Another possibility is that in the wake of 2008, some plan sponsors, consultants and other gatekeepers have shied away from T. Rowe's high-equity glide path and actively managed target-date funds, even though they have held up relatively well considering their more aggressive positioning.

4. Net Assets of Target-Date Mutual Funds for 20 Largest Fund Companies

Fund Family	2007 Total Net Assets $	2008 Total Net Assets $	2009 Total Net Assets $	2010 Total Net Assets $	2010 Market Share %
Fidelity Investments	88,281,653,907	68,332,996,075	99,329,509,524	124,811,737,969	36.52
Vanguard	31,954,874,203	33,738,326,090	56,587,641,311	79,534,612,338	23.27
T. Rowe Price	30,049,545,411	25,139,972,438	42,092,035,956	55,725,536,745	16.31
Principal Funds	11,038,017,334	9,322,891,092	14,331,493,135	17,173,810,254	5.03
Wells Fargo Advantage	2,324,374,616	2,330,833,462	6,047,001,369	9,175,392,803	2.68
American Funds	1,578,076,746	3,063,731,589	6,243,796,979	8,915,738,921	2.61
TIAA-CREF Mutual Funds	1,473,639,811	1,885,134,873	4,060,581,773	6,784,400,853	1.99
ING Retirement Funds	2,694,988,745	2,430,062,939	3,935,895,203	4,870,308,447	1.43
John Hancock	708,580,996	1,372,989,017	3,272,432,926	4,829,398,570	1.41
BlackRock	2,305,123,509	1,549,648,071	2,893,686,396	4,050,044,315	1.19
American Century Investments	759,089,136	753,694,657	2,124,451,070	3,440,556,572	1.01
State Farm	2,176,642,129	1,610,584,609	2,654,748,612	3,305,066,664	0.97
JPMorgan	900,351,394	940,257,626	1,623,614,319	3,251,003,529	0.95
AllianceBernstein	1,298,763,846	1,350,232,325	2,029,963,148	2,217,206,753	0.65
Vantagepoint Funds	587,743,937	562,717,714	951,242,936	1,880,479,019	0.55

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4. Net Assets of Target-Date Mutual Funds for 20 Largest Fund Companies (continued)

Fund Family	2007 Total Net Assets $	2008 Total Net Assets $	2009 Total Net Assets $	2010 Total Net Assets $	2010 Market Share %
USAA		171,616,861	845,427,302	1,780,146,207	0.52
Schwab Funds	604,062,652	515,031,912	914,389,810	1,274,968,657	0.37
Maxim			164,724,825	1,168,170,797	0.34
MassMutual	1,998,501,452	1,134,346,550	1,086,954,735	1,105,897,121	0.32
Russell	266,053,908	304,124,242	643,083,634	911,879,412	0.27
Industry Total	**183,691,518,457**	**158,870,562,361**	**255,795,052,665**	**341,755,814,012**	**100.00**

Data as of 12/31/10. Source: Morningstar, Inc.

Given the dominance of the three largest players, it's hard for smaller or newer providers to significantly move the needle on a market-share basis. But when viewed through the lens of organic growth, smaller and midsize firms have been growing quickly, due to a number of factors such as strong distribution networks or innovative and appealing structures. Wells Fargo has made impressive progress, on the heels of its very conservative glide path's strong performance in 2008. Net flows in 2009 rocketed 129% and grew other 37% in 2010. The series just ahead of Wells Fargo in terms of net assets, Principal Lifetime, was almost flat in 2010 with organic growth of just 4%. A number of other relatively conservative series also have been among the top growers recently, including American Century, JPMorgan, and Vantagepoint (though more aggressive glide paths have not been shut out—John Hancock Lifecycle grew a healthy 30% in 2010).

Russell and Maxim (distributed by Great West) deserve notice as lesser-known firms that have grown to around $1 billion in assets relatively quickly. Both series feature money managers from a variety of firms, and Russell has touted its extremely conservative allocations at retirement.

Among the nearly 50 target-date families that Morningstar tracks, only seven lost assets in 2010. For many of those, including AllianceBernstein, DWS, and Goldman Sachs, weak performance is likely a contributing factor. Others, like Putnam and Invesco, use complex and unproven designs.

Although the largest players are unlikely to give up their market share in any significant way, there appears to be plenty of room in the target-date industry for smaller firms to build a decent business, if they have a solid distribution platform and a compelling investment premise. Certainly, there is a place for target-date strategies that don't conform to the predominant proprietary, fund of funds, traditional asset-allocation design. At the same time, there's good reason to be wary of trendiness. Many newer approaches are a result of responses to recent market volatility, inflation fears, or the attraction of particular asset classes; and these investment solutions are not yet proved. But whatever approach target-date funds use, their prominent role as QDIA options for retirement investors practically guarantees continued growth.

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Do Target-Date Flows Continue After the Retirement Date?

The shortest-dated funds present an interesting case study, as these are the first funds in the target-date market to have crossed their retirement dates. While asset managers have had several years to observe the contribution habits of investors saving for retirement using target-date funds, they've only had a brief period to observe how investors use the funds after the retirement date. Only two firms have funds with a 2000 retirement date (AllianceBernstein and Fidelity), and five firms have funds with a 2005 retirement date (AllianceBernstein, Fidelity, GuideStone, T. Rowe Price, and Vanguard). The 2010 funds offer a more diverse mix with 27 asset managers represented.

The industry hasn't agreed on how to best design target-date funds. Even so, how investors use the funds may not match up with the managers' intents. It's unclear, for example, whether target-date investors should withdraw their money at or near the retirement date, or remain in the funds for many years after the date. Those firms believing investors should remain invested "to" retirement feature asset allocations that do not change significantly following the retirement date. Those firms believing investors should remain invested in target-date funds following or "through" retirement feature glide paths that continue to shift and become more conservative in the five to 30 years following the retirement date. The Process section of this report provides a more detailed discussion of the "to" versus "through" debate.

Only one target-date fund—Fidelity Freedom 2000—has existed for more than a decade since its investors' retirement date. That fund thus provides a useful test case (see Table 5). Combining all three Fidelity Freedom 2000 funds (Freedom, Freedom Index, and Freedom K, though only the first has existed since 2000) reveals that the strategy received steady inflows leading up to 2000. At retirement, some investors withdrew their money, but during the ensuing four years, others continued to add to the strategy. In fact, more than 10 years after the retirement date, the strategy's total net assets have continued to grow without any substantial outflows.

5. Fidelity Freedom 2000 Fund Flows (combines Freedom, Freedom Index, and Freedom K data)

Year	Total Net Assets $	Estimated Net Flow $	Organic Growth Rate %
1996	1,600,000.00	1,405,043.00	
1997	81,414,477.00	76,214,727.00	4,763.4
1998	502,102,299.00	378,445,253.00	464.8
1999	714,830,299.00	146,459,346.00	29.2
2000	648,299,625.00	(82,641,827.00)	(11.6)
2001	1,046,119,742.00	401,857,685.00	62.0
2002	1,194,771,283.00	172,222,232.00	16.5
2003	1,516,504,907.00	203,270,114.00	17.0
2004	1,612,507,142.00	30,390,514.00	2.0

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5. Fidelity Freedom 2000 Fund Flows (continued)

Year	Total Net Assets $	Estimated Net Flow $	Organic Growth %
2005	1,574,559,591.00	(94,709,978.00)	(5.9)
2006	1,647,894,002.00	(21,482,332.00)	(1.4)
2007	1,789,610,571.00	65,901,677.00	4.0
2008	1,492,584,459.00	(35,503,131.00)	(2.0)
2009	1,747,045,445.00	15,624,670.00	1.0
2010	1,932,334,788.00	52,026,600.00	3.0

Data as of 12/31/10. Source: Morningstar, Inc.

The funds with a 2005 retirement date thus far have followed a similar pattern. None of these funds was launched before 2003 (most series initially rolled out target-date funds dated every 10 years and later launched funds with five-year increments). The data reveal a trend of heavy inflows leading up to the retirement date, followed by several years of continued inflows at a slower, but still positive rate (see Table 6). Unlike the Fidelity 2000 fund, these funds collectively did not have any outflows at the retirement date. But AllianceBernstein 2005 Retirement Strategy has had outflows since 2009, consistent with outflows from across the entire AllianceBernstein target-date series.

6. Fund Flows for 2005 Target-Date Funds

Year	Total Net Assets $	Estimated Net Flow $	Organic Growth %
2003	45,982,947	38,278,273	
2004	673,384,129	592,934,628	1,289.47
2005	1,581,642,322	854,593,779	126.91
2006	2,503,414,080	749,069,412	47.36
2007	3,841,053,590	1,139,147,219	45.50
2008	3,311,476,295	340,482,809	8.86
2009	4,262,035,826	289,195,843	8.73
2010	4,824,472,358	120,009,837	2.82

Data as of 12/31/10. Source: Morningstar, Inc.

The 2010-dated funds provide the most diverse set of examples, but they've only recently passed their retirement date. The current trends, though, echo those seen with the 2000 and 2005 funds. Even funds designed for withdrawals at retirement (as determined by whether the fund's allocations remained level after the target date) continued to see inflows in 2010. (See Tables 7 and 8 and "Taking Stock of 'To' vs. 'Through,'" Pages 16-20, for details on how Morningstar divided up target-date series by this method.)

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7. Fund Flows for "To-Retirement" 2010 Target-Date Funds

Year	Total Net Assets $	Estimated Net Flow $	Organic Growth %
2005	5,084,955.00	1,507,140.00	
2006	55,389,925.00	46,687,777.00	918.16
2007	431,635,068.00	340,273,363.00	614.32
2008	607,143,759.00	350,926,155.00	81.30
2009	982,135,458.00	206,653,057.00	34.04
2010	1,346,935,757.00	223,632,393.00	22.77

Data as of 12/31/10. Source: Morningstar, Inc.

8. Fund Flows for "Through-Retirement" 2010 Target-Date Funds

Year	Total Net Assets $	Estimated Net Flow $	Organic Growth %
2000	2,441,632,373.00	693,655,430.00	
2001	3,674,666,890.00	1,349,138,041.00	55.26
2002	4,540,759,390.00	1,181,695,484.00	32.16
2003	7,350,673,804.00	1,887,496,667.00	41.57
2004	9,968,693,969.00	1,986,301,766.00	27.02
2005	12,844,487,892.00	2,212,815,913.00	22.20
2006	17,828,113,406.00	3,516,468,861.00	27.38
2007	25,080,075,950.00	6,022,329,951.00	33.78
2008	19,391,778,344.00	1,222,296,445.00	4.87
2009	24,509,817,010.00	550,300,356.00	2.84
2010	27,472,602,461.00	134,369,204.00	0.55

Data as of 12/31/10. Source: Morningstar, Inc.

There are several caveats regarding the fund flow data. For one, the data show dollar movement, rather than the change in the number of individuals investing in each target-date series, so it may be the dollar growth of larger accounts are obscuring the withdrawal of small accounts. In a recent Vanguard study of defined-contribution plan participant behavior, the authors found participants with small account balances averaging $20,000 are more inclined to cash-out their entire plan balance at or near retirement than participants with balances in the $150,000-$250,000 range (Stephen P. Utkus and Jean A. Young, "Distribution decisions among retirement-age defined contribution plan participants," December 2010). The report states these larger accounts are more inclined to remain in the plan or roll assets over to an IRA.

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Also, because the data do not account for individual investor behavior, it's entirely possible that shareholders of a fund with a target-retirement year of 2000, 2005, or 2010 did not actually retire during that year. What's more, some 401(k) platforms may have only recently started including target-date funds, which could cause inflows to overshadow investors withdrawing from their accounts. Partially offsetting those inflows are institutions that have shifted their target-date investments from open-end funds to collective investment trusts, or CITs.

Even with these caveats, however, the majority of assets invested in target-date funds appear to remain in the funds through the target year. These data could have several implications for target-date glide paths, specifically should they be designed to level off at the retirement date or continue to shift. The fund flow data suggest investors may benefit from a longer "through" glide path, but if there are many investors with small balances cashing out at retirement, then a "to" glide path may be a more prudent choice. If a plan or plan sponsor serves a constituency that tends to work longer or well beyond the stated retirement dates, a "through" glide path may be more appropriate. As target-date funds mature, trends in investor behavior may emerge, and they may shift over time as target-date funds grow in relative importance as core holdings in retirees' 401(k) balances.

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Process

The heat of the debate and the flurry of activity surrounding target-date glide paths that followed on the heels of 2008's market meltdown subsided somewhat in 2010. The market crash is further receding, and many firms put their major changes into place in 2009. A few target-date families did make notable alterations in 2010, however. John Hancock extended its glide path post-retirement, making it easier for investors to own that aggressive series through retirement, while Oppenheimer made management changes at several of its underlying funds and decided to dial back on stocks near retirement following a lengthy risk review of its series' awful 2008 results.

Most glide-path changes were minor and generally intended to improve a series' diversification. Quite a few firms have added (or are considering adding) commodities and/or real-return asset classes, including T. Rowe Price, Fidelity, Principal, ING, and Oppenheimer. (See the discussion later in the Portfolio section of this report on target-date funds' use of alternative investments.) Vanguard raised its international equity target from 20% to 30% of equity assets. Several firms, such as ING and John Hancock, have studied closely whether to adjust long-standing tactical overweightings in asset classes such as high-yield bonds.

In terms of the broader glide-path trends, little has changed since Morningstar reviewed this topic in 2010. The range of equity allocations in the longest-dated funds tends to be relatively narrow, while the range of allocations in shorter-dated funds is much wider, reflecting the more varied philosophies regarding allocations at and after retirement (see Table 9).

9. Equity Allocation % per Target Year

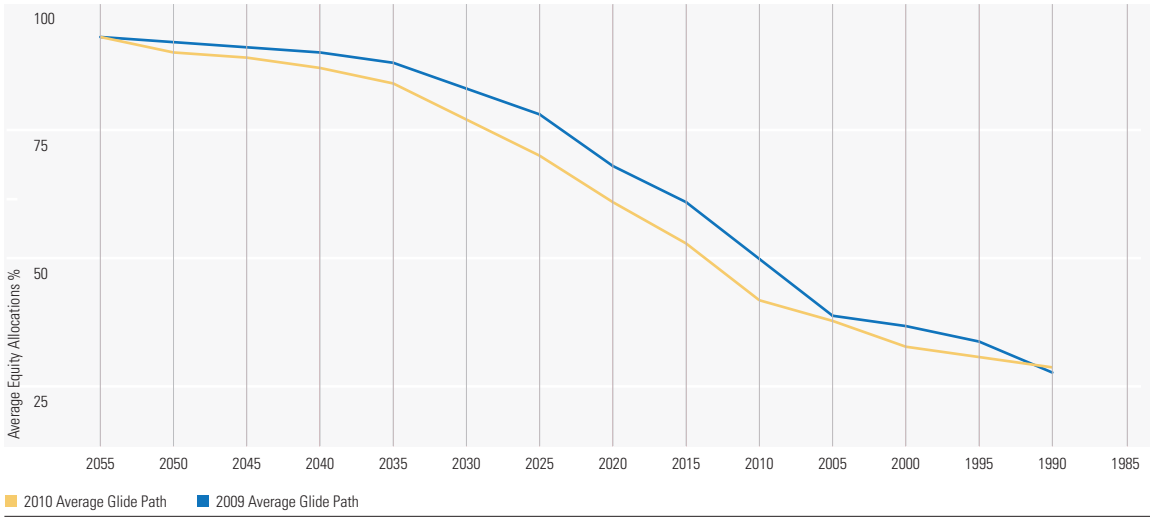
Year	Average %	Minimum %	Maximum %	Number of Funds
1985	29	20	40	6
1990	29	20	40	11
1995	31	20	45	20
2000	33	20	45	24
2005	38	15	55	31
2010	42	20	67	38
2015	53	20	75	37
2020	61	35	80	36
2025	70	38	86	36
2030	77	38	92	36
2035	84	38	95	36
2040	87	38	96	36
2045	89	38	100	36
2050	90	38	100	31
2055	93	89	99	17

Data as of 12/31/10. Source: Morningstar, Inc.

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In comparing the average industry glide paths of 2010 and 2009, it's notable that the equity allocations for shorter-dated funds (from target year 2035 on) are meaningfully lower than one year ago (see Table 10). One cause is the natural roll down of equities that takes place from year to year, and the rate of decrease is faster (as the curve is steeper) in the years leading up to retirement. In addition, the composition of target-date series in Morningstar's universe of eligible funds changes from year to year. In particular, Morningstar added the Invesco Balanced-Risk series, which uses a risk-parity approach that involves levering up the bond portfolio and thus produces an allocation heavily skewed toward bonds. This had the effect of lowering the average allocations very slightly, while introducing a more dramatic minimum-equity allocation. For instance, if not for the 38% equity allocation for the Invesco Balanced-Risk 2050 fund, the minimum-equity allocation for 2050 funds would be American Century 2050's 85%. Finally, it should be noted that Morningstar now uses 2010 as an investor's retirement date, as opposed to 2005 the previous year. This actually has the effect of producing a slightly higher equity allocation for investors at a series' target-retirement date.

10. Average Industry Equity Allocation % for 2009 and 2010



Data through 12/31/10. Source: Morningstar, Inc.

The Invesco series also points to the limitations of current target-date disclosure requirements. Proposals for improved disclosure typically focus on the equity/fixed-income mix. Funds that use asset classes that don't fit neatly into stock or bond asset classes, and those that may use derivatives to gain market exposure, have difficulty describing their strategies to investors using these conventional asset-class definitions. Unless regulators and the fund industry wish to shut out from the target-date industry asset managers who want to take more innovative or unconventional approaches, they will likely need flexible and sophisticated measures of glide-path risk and guidelines for disclosing them.

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phrases of the target-date industry is "to" versus "through." The idea is that some target-date series are built to manage the investors' asset allocation to the time of retirement, represented by the date on the fund, while other series are constructed to take the investor through retirement. Most recently, the issue of whether target-date funds should go "to" or "through" retirement has been revived in a report released by the U.S. Government Accountability Office at the request of Senator Herb Kohl's Special Committee on Aging. In that report, the GAO suggests that the Department of Labor requires plan sponsors to consider the suitability of a target-date series' asset allocation when choosing a provider because of the great variability among the asset-allocation glide paths.

The "to" versus "through" proposition sounds like an elegant division but is muddled in practice. Funds with unchanging glide paths after their target dates are said to be "to" because the target-date fund provider is not attempting to model investors' risk/return needs during the retirement period, and therefore, the series' asset allocation or glide path should not change. In contrast, those with glide paths that continue to change after their retirement date are said to be "through." Those fund series are modeling investors' needs during the years following retirement. Lacking clear statements from the target-date families as to whether their funds are intended as "to" or "through," plan sponsors or investors using target-date funds are forced to use their own judgment to determine which is which.

That process, however, is flawed, akin to an exercise in reverse-engineering. First, a fund series might decide that a static glide path is the best investment approach during retirement. Indeed, that's what Russell has decided. (Actually, the firm argues the merits of an upward-sloping glide path during the retirement period, but for discretion's sake settles for a less-radical approach.) Consequently, although Russell regards its series as a good choice for investors in retirement, it often is placed in the "to" camp. Second, there's a notion that "to" funds are regarded as "safer" when approaching the retirement date because they have a shorter time horizon, while "through" funds are expected to be more volatile as they maintain higher exposure to stocks for 20 years or more beyond the retirement date. This is not always so.

To shed light on the debate, Morningstar took a closer look at how the industry's glide paths are actually constructed in accordance with these (admittedly problematic) labels (see Table 11). Morningstar collects target-date funds' intended glide paths as detailed in the funds' prospectuses, and for the purposes of this study, divided them into "to" and "through" groups. The "to" group comprises those target-date series whose glide paths do not change after the retirement date, and the "through" group comprises those series whose glide paths continue to change following the retirement date. In some cases, the analysis required a degree of interpretation by Morningstar data and mutual fund analysts because of the challenges discussed above. While certain broad generalizations do differentiate the two groups, Morningstar found there is also a great deal of variability within each group, and more than a few cases are difficult to place altogether.

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11. "To" and "Through" Target-Date Series Based on Prospectus Glide-Path Disclosure

"To" Glide Paths	"Through" Glide Paths
Allianz Global Investors Solutions	AllianceBernstein Retirement Strategies
American Century LIVESTRONG	RiverSource Retirement Plus
American Funds Target Date Retirement	Fidelity Advisor Freedom
BlackRock LifePath	Fidelity Freedom
BlackRock Lifecycle Prepared	Goldman Sachs Retirement Strategies
DWS LifeCompass	Guidestone Funds MyDestination
Franklin Templeton Retirement	Harbor Target Retirement
ING Index Solution	Hartford Target Retirement
ING Solution	John Hancock Lifecycle
Invesco Balanced-Risk Retirement	Legg Mason Partners Target Retirement
JPMorgan SmartRetirement	MainStay Retirement
MFS Lifetime	Manning & Napier Target
American Independence NestEgg Dow Jones	MassMutual Destination Retirement
PIMCO RealRetirement	Maxim Lifetime
Putnam RetirementReady	Nationwide Target Destination
Russell LifePoints Target Date	Oppenheimer LifeCycle
State Farm Lifepath	Principal LifeTime
USAA Target Retirement	Schwab Target
	T. Rowe Price Retirement
	TIAA-CREF Lifecycle
	Vanguard Target Retirement
	Vantagepoint Milestone
	Wells Fargo Advantage DJ Target Date

Data through 12/31/10. Source: Morningstar, Inc.

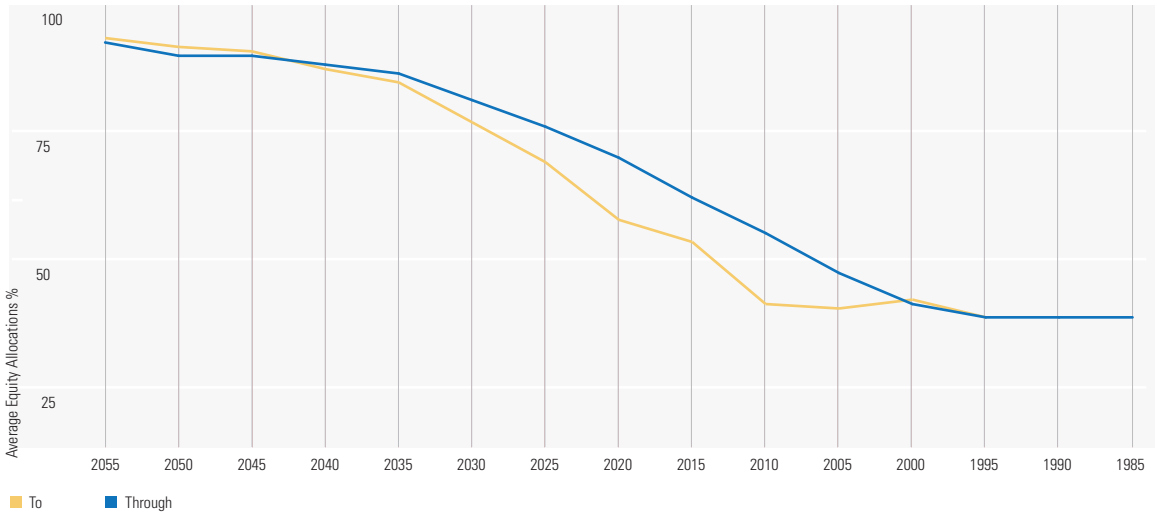
No Consensus

As one might expect, there is no asset-allocation consensus in the industry regarding the prevalence, superiority, or clear categorization of "to" or "through" glide paths. Of the 41 glide paths Morningstar examined, 22 fell into the "through" group, with the remaining 19 landing in the "to" camp. Even though the "through" glide paths are in the majority and several firms, such as John Hancock and Vantagepoint, have extended the phase during which they reduce the funds' equity exposure, there's no evidence that such glide paths have a lock hold on the industry's thinking.

The "to" and "through" samples look very similar in their asset allocation when investors are in their early earning years. For target dates 2055 through 2040 (intended for investors ages 20 to 35), the average equity allocations are nearly identical, roughly around 90%.

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12. Average Equity Allocations for "To" and "Through" Glide Paths



Data through 12/31/10. Source: Morningstar, Inc.

It's when investors get closer to retirement that the differences start to show up, as "to" series typically move more rapidly toward the lower final equity point. The 2020 funds show a 14 percentage-point difference in equity allocation, for instance, and that difference grows to 16 points by the retirement date. At retirement, the "through" funds average a 49% stock allocation while "to" funds land at 33%. It's not until 10 years later that the glide paths meet up again, as "through" glide paths hit an average allocation of 33%. Some "through" funds reduce their exposure to stocks over an additional five to 15 years.

So it's in that 20-year band around the retirement date that the differences are most stark. Clearly, "through" glide paths on average carry higher equity risk, fitting the belief that the risk of retirees outliving their nest egg requires more stock investments, over longer periods, in order to raise the probability of those assets lasting through retirement. "To" paths, as advertised, cut down equity to a more manageable level by retirement, reducing the risk that investors' assets will experience a catastrophic decline just prior to their time of need.

Devilish Details

The averages illustrated in Table 12 mask a number of exceptions and contradictions that make it difficult to distinguish between "to" and "through" glide paths. For example, look first at the minimum and maximum equity allocations for the "to" and "through" paths. The wide ranges expressed there—25% to 67% for the latter, 24% to 50% for the former—suggest that there are notable philosophical differences within each label (see Table 13). AllianceBernstein and Goldman Sachs, with stock targets in the high 60s for 2010 funds, clearly have more aggressive assumptions than, say, Schwab, which devotes only 40% of assets to stocks at the same stage.

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13. Equity Allocations for "To" and "Through" Glide Paths

	2007			Landing Point Equity Allocations		
	Average %	**Minimum %**	**Maximum %**	**Average %**	**Minimum %**	**Maximum %**
"Through" Funds	50	25	67	33	24	50
"To" Funds	29	15	40	NA	NA	NA

Data through 12/31/10. Source: Morningstar, Inc.

More pointedly, some fund series are blatantly misplaced using this method. One example is the Wells Fargo DJ Advantage series, which shows up in the "through" sample despite a 25% allocation to stocks for its 2010 fund. Wells Fargo is known for having one of the industry's most conservative target-date philosophies, so why did it end up in the "through" group, which is conventionally viewed as being more aggressive? Because its stated glide path extends beyond retirement, dropping equities to an extremely low 15% five years later. On the other side of the coin, the BlackRock Lifecycle Prepared series lands in the "to" camp in the analysis above, even though its 50% allocation to equities is more consistent with the "through" group. That's because its allocation does not change following the retirement date.

One could argue that Morningstar was overly literal in assigning Wells Fargo and BlackRock to their respective groups, though the classification is accurate by the terms of this exercise. Our analysis revealed a number of other cases where series' asset allocations were either more aggressive or more conservative than their "to" or "through" peer groups would suggest. The main point is that Morningstar's analysis debunks the assumption that investors can determine whether a series is in the "to" or "through" camp solely by the trajectory of its glide path.

Finally, there's also no consensus around the terminal investment for the series. Morningstar discerned no pattern as to whether a series used a retirement income fund or not. One might imagine that "to" paths don't require a retirement income fund because the glide path is not supposed to shift. However, 13 of the 18 glide paths do. And seven of the 22 "through" glide paths lacked a retirement-income fund. John Hancock, for example, extended its glide path and chose to manage the asset allocation of the terminal fund, rather than maintaining a separate income fund. In some cases, the glide-path illustration as detailed in a series' fund prospectus did not accurately describe further changes within the series' retirement-income fund.

The Future of the Debate

The main conclusion of the analysis above is that it remains very difficult for investors or plan sponsors to tell whether a target-date fund series is intended to be a "to" offering or a "through" offering simply by looking at the funds' asset allocation or glide path. That distinction is an important one because one type of offering may be more suitable for a plan sponsor than the other, given the unique characteristics of their plan participants. For the investor, the distinction is perhaps even more important because the distinction between a "to" and "though" glide path has a material impact on the potential risks of a target-date fund and should help determine whether a target-date fund remains appropriate for an investor who is entering or well into retirement.

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A second conclusion is that the "to" versus "through" decision for target-date fund providers is much more than an investment decision. Target-date fund providers have plenty of room for improvement when it comes to describing the rationale and construction of their target-date funds, whether they should be viewed as "to" or "through" offerings, and what the potential risks of either approach could be.

Investors need greater clarity to help ensure they use target-date funds effectively. For instance, "to" target-date funds are more appropriate for investors who expect to reorient their portfolios upon retirement and for plan sponsors whose participants are expected to withdraw their retirement savings at or near the stated retirement date. On the other hand, "through" target-date funds may be more appropriate for investors who choose to remain invested well beyond the retirement date or for the plan sponsor who wishes to keep retirees in the company's plan or whose participants tend to work further beyond the stated retirement date.

In Morningstar's view, the next chapter in the evolution of target-date funds will involve a mix of new investments and clearer investor communications. For instance, perhaps "to" series may automatically transfer investors to another investment vehicle at the retirement date because they are not necessarily intended for investors in the retirement period. "Through" series may provide greater clarity regarding the actuarial assumptions that shaped the series' asset allocation, so that investors, advisors, or plan sponsors could better gauge if the fund was an appropriate fit for an investor's individual circumstances.

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Performance

Bull-market gains in 2010 helped target-date funds perform well, as compared with standard market benchmarks. The range of returns among Morningstar categories for target-date funds was relatively narrow, with the average fund in Morningstar's 2000-2010 category, the most conservative of the target-date group, gaining 10.68%, while the 2050+ category averaged a 14.45% return. By comparison, the S&P 500 Index returned 15.06% in 2010, and the Barclays Capital US Aggregate Bond Index was up 6.54%.

Longer-dated categories (those with target years of 2035 and later) averaged returns of 14% and better (see Table 14). Those gains were in line with the return of the broad stock market, which is encouraging considering that most funds in that range carry some fixed-income allocation. The long-dated target-date category returns exceeded returns for comparable Morningstar allocation categories, which incorporate balanced funds of different risk levels.

Shorter-dated funds unsurprisingly surpassed the bond benchmark, owing both to sizable equity allocations and investments in high-yield and other types of securities not included in the benchmark. Differences were less extreme than in 2009's rally for riskier securities or in 2008's steep decline. The 10.68% gain in 2010 for the 2000-2010 category was slightly lower, however, than the Morningstar conservative-allocation category's 11.19% return.

14. Calendar-Year Returns for Morningstar Target-Date Categories and Benchmarks

Category or Benchmark Name	2010 Annual Return %	2009 Annual Return %	2008 Annual Return %	2007 Annual Return %
Target Date 2000-2010	10.68	22.42	-22.46	5.22
Target Date 2011-2015	11.50	23.55	-27.76	5.84
Target Date 2016-2020	12.27	24.25	-29.46	6.02
Target Date 2021-2025	13.29	28.32	-34.15	6.52
Target Date 2026-2030	13.47	28.87	-36.04	6.50
Target Date 2031-2035	14.28	30.06	-37.04	7.02
Target Date 2036-2040	14.37	30.90	-37.94	6.21
Target Date 2041-2045	14.60	30.88	-38.11	6.89
Target Date 2050+	14.45	32.20	-38.86	5.94
Morningstar Conservative Allocation	11.19	21.70	-20.74	5.24
Morningstar Moderate Allocation	12.05	24.04	-27.72	6.12
Morningstar Aggressive Allocation	12.66	30.65	-32.95	4.51
Morningstar World All-Cap	12.18	58.11	-43.77	3.93
S&P 500 Index	15.06	26.46	-37.00	5.49
BarCap US Aggregate Bond Index	6.54	5.93	5.24	6.97

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Although 2010 was a choppy year in the financial markets, returns were far less volatile than in the prior two years. As a result, the range of returns within categories was more constrained—though meaningful differences persisted.

2010 Funds Mounting a Comeback

The 2010 funds, which received a lot of attention in the wake of equities' October 2007-March 2009 bear market, have clawed much of their way back. Investors assumed these broadly diversified investment vehicles would hold up well in a downturn. But target-date 2010 funds, for example, lost an average of 37% in the bear market. That's less than most equity indexes, but it was a steep drop for investors very close to or just entering retirement.

There were two major issues that caused 2010 funds to suffer so badly. First, many of the fixed-income securities they own dropped nearly as far as stocks (even further in some cases), including high-yield bonds, convertible-debt, and disturbingly, nongovernment mortgage-backed and asset-backed securities rated investment grade. In addition, the funds tend to own non-U.S. stocks, which generally performed even worse than U.S.-based firms (which, as represented by the Wilshire 5000 Index, declined 55% in the bear market). For example, the MSCI EAFE Index dropped 59% and the MSCI Emerging Markets Index lost 60% during that bear-market period. True, many target-date funds ratchet down their foreign weightings before they reach their target date, but such exposure still dragged down the funds.

Second, many target-date funds were launched during equities' rally from late 2002 to late 2007. (Indeed, 19 of the 30 target-date 2010 funds were rolled out during this period.) This surge may have made equities more attractive to managers of target-date funds when they built asset-allocation models based on historical asset-class returns or as they were designing or tweaking the funds' glide paths. That confidence in equities also may have prompted the managers to focus less on market risk and more on longevity risk—the risk that investors outlive their savings. As a result, the typical 2010 fund had an equity weighting of 54% at the end of September 2007, shortly before equities' peak. (That weighting has since declined to 47%.)

Despite suffering a sharp loss, investors who held on to their target-date 2010 funds through 2008's crisis and the ensuing rally have generally emerged with gains—albeit modest ones. From stocks' Oct. 9, 2007, peak through Feb. 17, 2011, target-date 2010 funds gained a cumulative 5% on average. And 14 of the 23 funds that were in operation through the entire period posted a gain. Meanwhile, the S&P 500 declined 7% over that period, and the MSCI EAFE Index lost 17%. Fund-specific outcomes certainly varied, though. MFS Lifetime 2010, for example, limited its loss during the downturn with its conservative asset allocation, but it didn't perform well in the rebound. On the other hand, Oppenheimer Transition 2010 put investors through the wringer. A big stock weighting and the implosion of top holding Oppenheimer Core Bond led to a stomach-churning 54% loss in the downturn. The bond fund has since been revamped, so it didn't perform well during the rebound. Thus, Transition 2010 is still well underwater with a 21% loss since the market's peak.

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The 2010 funds that have performed best most recently—like those in series from Principal, Hartford, T. Rowe Price, and AllianceBernstein—benefited from some combination of higher-equity weightings and greater allocations to corporate bonds (see Table 15). Funds with weaker relative showings, such as Wells Fargo and Vantagepoint, tended to invest less in stocks and feature high-quality, benchmark-oriented fixed-income sleeves.

15. 2010 Target-Date Funds' Annual Returns, 3-Year Returns and 3-Year Category Rank

Name	2010 Annual Return %	2009 Annual Return %	2008 Annual Return %	Total Return Annualized 3 Yr %	3-Year Total Return Category Rank %
Principal LifeTime 2010 Instl	13.91	24.92	-30.27	-0.26	64
Hartford Target Retirement 2010 A	12.79	27.94	-27.75	1.40	34
T. Rowe Price Retirement 2010	12.70	27.95	-26.71	1.86	24
Fidelity Advisor Freedom 2010 A	12.20	25.64	-26.61	1.14	41
AllianceBern 2010 Retirement Strat A	12.02	29.25	-32.88	-0.95	80
JHancock2 Lifecycle 2010 A	12.01	30.79	-29.82	0.93	45
Fidelity Freedom K 2010	11.77				
Fidelity Freedom 2010	11.65	24.82	-25.32	1.34	37
Russell LifePoints 2010 Strategy R3	11.59	22.75	-21.88	2.28	19
JPMorgan SmartRetirement 2010 A	11.58	23.11	-21.49	2.55	14
TIAA-CREF Lifecycle 2010 Retire	11.53	19.36	-23.57	0.58	51
MassMutual Select Dest Retire 2010 A	11.45	24.56	-25.06	1.33	38
Vanguard Target Retirement 2010 Inv	11.43	19.32	-20.67	1.79	25
MainStay Retirement 2010 A	11.03	21.39	-22.03	1.67	27
Oppenheimer Transition 2010 A	10.81	23.44	-41.32	-7.06	97
TIAA-CREF Lifecycle Index 2010 Inst	10.77				
Fidelity Freedom Index 2010 W	10.65				
Columbia Retirement Plus 2010 A	10.54	19.53	-27.38	-1.37	89
Nationwide Destination 2010 A	10.26	16.24	-23.53	-0.67	75
Goldman Sachs Retirement Str 2010 A	10.12	25.65	-30.78	-1.43	92
PIMCO RealRetirement 2010 A	10.05	22.56			
Harbor Target Retirement 2010 Instl	10.03				
Schwab Target 2010	9.96	15.92	-23.69	-0.92	79
MFS Lifetime 2010 A	9.93	22.43	-14.29	4.88	3
Manning & Napier Target 2010 C	9.86	18.00			
American Funds Trgt Date Ret 2010 A	9.50	23.34	-27.45	-0.68	76
Wells Fargo Advantage DJ Target 2010 A	8.60	12.31	-11.24	2.68	11
Vantagepoint Milestone 2010	8.51	17.71	-17.34	1.83	25
Invesco Balanced-Risk Retire 2010 A	7.79	15.44	-19.11	0.22	55

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Furthermore, a look at target-date 2010 funds' volatility relative to that of market indexes demonstrates that their ups and downs weren't out of line, given the funds' makeup. The average standard deviation of their returns over the past three and five years fell almost precisely between those of the S&P 500 Index and the BarCap US Aggregate Bond Index—and those benchmarks don't include the more-turbulent small-cap and emerging-markets stocks or high-yield bonds that target-date funds typically hold.

Taking a Longer View

The controversy around the shorter-dated funds has not extended to the longest-dated funds, in part because the longest-dated funds tend to look very similar when it comes to asset allocation. Thus, more-subtle factors, such as style and sector biases or investment skill of the underlying managers, tend to drive relative returns. The funds that ranked at the top and bottom of the 2050+ category for 2010 performance exemplify those factors. Last year, small-cap, growth, commodities, and emerging-markets equities led the markets.

For example, Wells Fargo's 17.25% gain led the pack (see Table 16). It is an indexed series, so manager skill does not come into play, but its equal-weighted approach to indexing leads to higher weightings in small-cap stocks than peers. Allianz Global also did well, despite a slimmer 71% allocation to equities at year-end, primarily because of its heavy commitment to commodities. JP Morgan, also relatively light in stocks for a 2050 fund, benefited from several key holdings that outperformed, as well as exposure to emerging markets and real estate. With the weakest fund in the category still producing a 12% return, all funds in the category delivered respectable results on an absolute basis, and none of the funds badly underperformed or fantastically outperformed.

16. 2050 Target-Date Funds' Annual Returns, 3-Year Returns and 3-Year Category Rank

Name	2010 Annual Return %	2009 Annual Return %	2008 Annual Return %	3-Year Annualized Total Return %	3-Year Total Return Category Rank %
Wells Fargo Advantage DJ Target 2050 I	17.25	33.34	-35.78	0.14	6
Allianz Glbl Inv Solutions 2050 A	16.83	35.59			
JPMorgan SmartRetirement 2050 A	16.73	33.42	-33.78	1.03	3
USAA Target Retirement 2050	16.70	31.84			
Fidelity Advisor Freedom 2050 A	16.43	33.71	-42.44	-3.59	67
T. Rowe Price Retirement 2050 Adv	16.09	38.72	-39.03	-0.61	11
Principal LifeTime 2050 Instl	16.02	29.77	-39.04	-2.82	41
Principal LifeTime 2055 Instl	15.73	29.74			
Nationwide Destination 2050 A	15.66	29.92	-37.77	-2.21	29
American Century LIVESTRONG 2050 A	15.41	26.35			
Hartford Target Retirement 2050 R3	15.36	32.04			
TIAA-CREF Lifecycle 2050 Instl	15.32	28.35	-38.76	-3.22	53
Russell LifePoints 2050 Strategy R1	15.30	30.67			
MassMutual Select Dest Retire 2050 A	15.28	34.39	-39.53	-2.15	27

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16. 2050 Target-Date Funds' Annual Returns, 3-Year Returns and 3-Year Category Rank (continued)

Name	2010 Annual Return %	2009 Annual Return %	2008 Annual Return %	3-Year Annualized Total Return %	3-Year Total Return Category Rank %
Vanguard Target Retirement 2050 Inv	15.20	28.31	-34.62	-1.13	15
Fidelity Freedom K 2050	15.06				
Harbor Target Retirement 2050 Instl	15.04				
Oppenheimer Transition 2050 A	15.02	42.94			
Fidelity Freedom Index 2050 W	14.94				
Fidelity Freedom 2050	14.90	32.47	-40.61	-3.31	56
Legg Mason Target Retirement 2050 A	14.69	29.35			
PIMCO RealRetirement 2050 A	14.09	37.84			
MainStay Retirement 2050 A	14.06	29.16	-37.11	-2.51	35
BlackRock Lifecycle Prepared 2050 Inv A	13.90	28.07	-37.60	-3.09	47
Putnam RetirementReady 2050 A	13.82	31.02	-38.93	-3.07	44
TIAA-CREF Lifecycle Index 2050 Inst	13.79				
Manning & Napier Target 2050 C	13.24	33.43			
BlackRock LifePath 2050 Investor A	13.14	30.08			
Invesco Balanced-Risk Retire 2050 A	13.08	27.92	-37.51	-3.31	54
State Farm LifePath 2050 A	12.98	30.25			
American Funds Trgt Date Ret 2050 A	12.62	31.56	-35.62	-1.56	17
AllianceBern 2050 Retirement Strat A	12.40	33.51	-40.87	-3.91	77
Goldman Sachs Retirement Str 2050 A	12.06	29.45	-41.37	-5.25	97

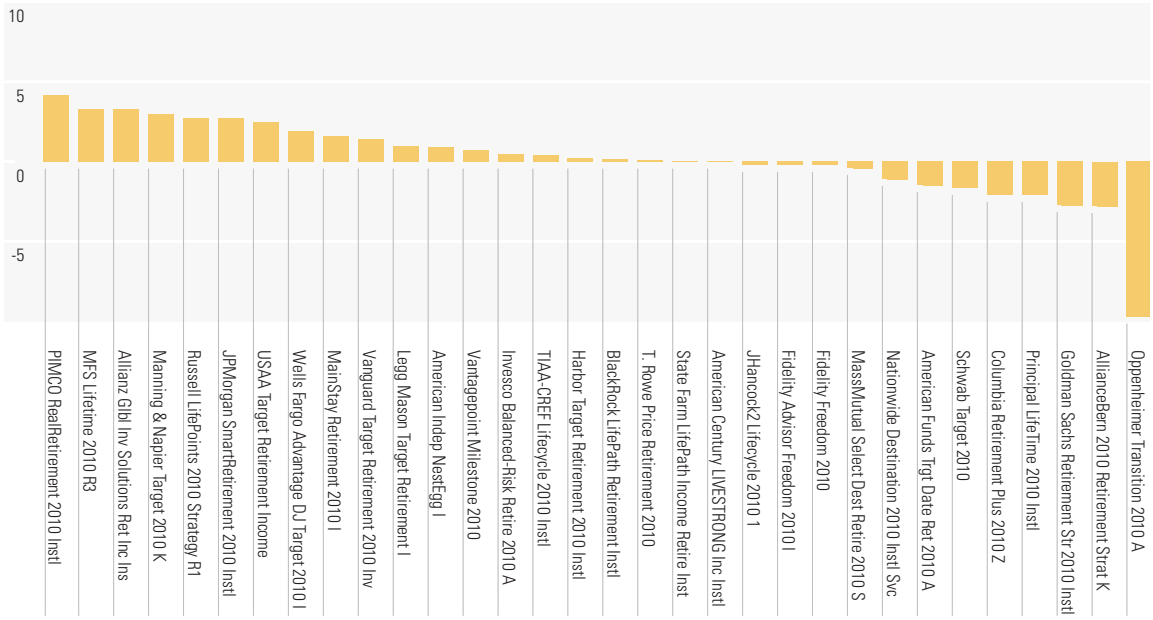
Data through 12/31/10. Source: Morningstar, Inc.

Risk-Adjusted Returns Present Broader Picture

Total returns are only one measure of performance. Morningstar uses Morningstar Risk-Adjusted Return, or MRAR, to determine its ratings for target-date series. MRAR penalizes a fund's returns for excess downside volatility. The period used depends on the history of the fund. Funds with at least three years of performance but fewer than five years use the three-year period. Funds with a five-year history use a weighted average where 40% is derived from the three-year record and 60% from the five-year record. Table 17 shows the MRAR for 2010 funds in the sample group relative to the category averages. The funds with bars above the zero line have MRARs that exceed the category average, while those with bars below the zero line have MRARs that fall short of the category average. For younger funds, the volatile markets of 2008 and 2009 are more prominent in the overall calculation. Funds that were positioned more defensively in 2008 still look, on a risk-adjusted basis, better than those that imploded under the weighting of stocks and riskier bonds. Oppenheimer Transition 2010 includes Oppenheimer Core Bond, which nose-dived in 2008 and has since been remade, but its overall MRAR remains an outlier with a 9.75% loss.

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17. Morningstar Risk-Adjusted Return Deviation from Fund Category, 2010 Funds



Data through 12/31/10. Source: Morningstar, Inc.

Parsing Performance

Performance attribution analysis provides another lens for analyzing performance. Morningstar's attribution analysis separates relative performance into three components:

- Allocation: performance driven by the equity/fixed-income glide path
- Selection: performance driven by security, sector, and style allocations
- Cost: impact of fund expenses on fund performance

This analysis uses a peer-generated allocation benchmark rather than the specific target weightings or prospectus benchmarks of each series, so Morningstar's attribution data are most useful for comparing series to one another. An index-based return is then generated for each asset class in the customized benchmark. Morningstar's attribution analysis can help fiduciaries understand how much of a series' underperformance or outperformance stemmed from strategic glide-path decisions versus manager selection and other factors.

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Table 18 shows the target-date series' three-year performance attribution, ranked by the selection factor, so as to focus on how well the underlying funds have performed (the selection factor also takes into account tactical allocation decisions and style or sector biases outside the broad stock/bond glide path). Only six series have shown positive attribution for selection over the thee-year period. This isn't surprising, given that active managers have failed to keep up with benchmark returns over the past three years. Poor performance by underlying strategies has sharply hurt returns at series such as Oppenheimer, Goldman Sachs, DWS, and AllianceBernstein.

18. 3-Year Performance Attribution, 1/1/08 through 12/31/10

Name	Cost %	Allocation %	Selection %	Total Attribution %
T. Rowe Price Retirement Series	0.15	-0.27	1.00	0.87
JPMorgan SmartRetirement Series	0.03	0.63	0.92	1.59
Vanguard Target Retirement Series	0.69	-0.39	0.62	0.92
Wells Fargo Advantage DJ Target Date Ser	0.36	0.57	0.60	1.54
MFS Lifetime Series	-0.25	0.33	0.60	0.68
Guidestone Funds MyDestination Series	-0.22	-1.03	0.31	-0.94
American Funds Trgt Date Rtrmt Series	0.07	-0.88	-0.05	-0.85
John Hancock Lifecycle Series	-0.01	-0.85	-0.12	-0.99
MainStay Retirement Series	-0.29	-0.12	-0.20	-0.62
Massachusetts Mutual Life Insurance Co.	-0.08	-0.41	-0.23	-0.72
State Farm Lifepath Series	-0.18	-0.30	-0.33	-0.81
BlackRock Lifecycle Prepared Series	-0.38	0.07	-0.39	-0.71
American Century LIVESTRONG Series	0.19	0.96	-0.46	0.69
Vantagepoint Milestone Series	-0.14	0.29	-0.46	-0.31
BlackRock LifePath Series	0.01	0.37	-0.49	-0.12
Schwab Target Series	0.04	1.16	-0.82	0.37
Fidelity Freedom Series	0.15	0.19	-0.89	-0.56
Nationwide Target Destination Series	0.00	0.10	-0.98	-0.88
NestEgg Dow Jones Series	0.13	0.61	-1.11	-0.38
TIAA-CREF Lifecycle Series	0.42	-0.26	-1.20	-1.04
Fidelity Advisor Freedom Series	0.10	0.16	-1.29	-1.03
Invesco Balanced-Risk Retirement Series	-0.13	0.05	-1.38	-1.46
Russell LifePoints Target Date Series	0.08	0.48	-1.45	-0.90
ING Solution Series	0.02	0.47	-1.65	-1.17
Principal LifeTime Series	0.07	0.33	-1.71	-1.32
Putnam RetirementReady Series	-0.06	0.38	-1.76	-1.45
AllianceBernstein Retirement Str Series	-0.10	-0.86	-2.00	-2.94

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18. 3-Year Performance Attribution, 1/1/08 through 12/31/10 (continued)

Name	Cost %	Allocation %	Selection %	Total Attribution %
DWS LifeCompass Series	-0.10	-0.39	-2.06	-2.55
Goldman Sachs Retirement Str Series	-0.05	-0.15	-3.39	-3.58
Columbia Retirement Plus Series	0.06	0.16	-3.62	-3.41
Oppenheimer LifeCycle Series	-0.58	-2.19	-4.68	-7.31

Data through 12/31/10. Source: Morningstar, Inc.

Two of the series with positive selection attribution are indexed series, Vanguard Target Retirement and Wells Fargo Advantage. Of course, these series' "selection" advantage does not result from selection of managers but from the series' design. Wells Fargo, for instance, has a significant small-cap bias relative to the benchmark. Both series have minimal exposure to low-quality bonds, a huge advantage in 2008 that has subsided during the market rebound but still helps over the three-year period.

Selection has had a big impact on returns, but so has allocation, or the series' glide path. To be sure, allocation's effect is less prominent now than it was a year or two ago, when the 2008 market conferred a powerful advantage to bond-heavy series. Those series still have a performance advantage, but to a lesser degree. The target-date series with the best allocation scores all fall into the more-conservative camp of glide-path philosophies, particularly around the retirement date. Those clustered near the bottom inhabit the more-aggressive camp, some notably so. As the effects of 2008's crisis begin to recede, those perceived advantages may begin to shift as well, especially as conservative series with large fixed-income allocations navigate what may be a rising interest-rate environment in coming years.

It's worth noting that historical glide-path results aren't always a reliable guide to the future. Many series—Schwab, Oppenheimer, John Hancock, and American Funds, among them—have altered their glide paths since 2008. Moreover, a negative allocation score is not necessarily a red flag for a series—though it can indicate an extreme asset allocation. Rather, it's useful to view allocation in context of a series' other scores. For example, T. Rowe's ability to generate a positive total attribution score (essentially, the series' total-return percentage plus or minus the benchmark) despite a negative score for allocation (owing to its stock-heavy glide path) indicates how well it's made up ground through Selection and Cost.

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Portfolio

Target-date series also show their stripes through their portfolios. Active versus passive management, open versus closed architecture, quality and range of available strategies—particularly among proprietary series, or those using a single firm's underlying funds—and how much tactical latitude is allowed to managers all can profoundly affect the way a given glide path is implemented.

Active Funds Still Dominate, but Index Funds Growing

Beyond the glide path, a fundamental decision any target-date architect must make is whether to use active or passively managed portfolios, or to opt for a combination of the two strategies. Although indexed series are clearly on the rise, actively managed series remain dominant, as shown in Table 19. More than half of all series can be labeled entirely or almost entirely active (at least 90% of assets in actively managed strategies). Nine series are a mix of active and passive, ranging from series such as BlackRock LifePath and John Hancock Lifecycle that index about 40% of their assets overall, to those such as Principal (only 11% passive) that remain mostly active. In these case, firms have chosen index funds to help rein in expenses and to gain low-cost access to areas of the market, such as large-cap U.S. stocks, generally deemed efficient.

The number of fully passive funds is still a distinct minority, but it's growing. Vanguard, the second-largest target-date series, is the most prominent example. Over the past 18 months, a number of large target-date providers have either launched or announced plans to launch a fully passive target-date series, including Fidelity, TIAA-CREF, Maxim, BlackRock, and John Hancock. Those newer strategies remain small on an asset basis. But clearly the industry is responding to demand for less-expensive strategies.

19. Target-Date Fund Series by Percentage of Assets in Active Strategies

Name	% Active
AllianceBernstein Retirement Str Series	100.0
American Century LIVESTRONG Series	100.0
American Funds Trgt Date Rtrmt Series	100.0
BlackRock Lifecycle Prepared Series	100.0
Goldman Sachs Retirement Str Series	100.0
Harbor Target Retirement Series	100.0
ING Solution Series	100.0
Invesco Balanced-Risk Retirement Series	100.0
JPMorgan SmartRetirement Series	100.0
Manning & Napier Target Series	100.0
MassMutual Destination Rtrmt Series	100.0
MFS Lifetime Series	100.0
Oppenheimer LifeCycle Series	100.0
Putnam RetirementReady Series	100.0

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19. Target-Date Fund Series by Percentage of Assets in Active Strategies (continued)

Name	% Active
RiverSource Retirement Plus Series	100.0
Russell LifePoints Target Date Series	100.0
TIAA-CREF Lifecycle Series	100.0
Allianz Global Investors Solutions Series	98.7
Guidestone Funds MyDestination Series	96.8
Franklin Templeton Retirement Series	94.0
USAA TARGET RETIREMENT FUNDS Series	93.5
Fidelity Advisor Freedom Series	90.7
Fidelity Freedom Series	90.6
MainStay Retirement Series	89.9
Principal LifeTime Series	88.9
T. Rowe Price Retirement Series	82.5
Vantagepoint Milestone Series	79.8
Maxim Lifetime I Series	74.3
Schwab Target Series	70.6
Legg Mason Partners Target Retirement Se	67.2
DWS LifeCompass Series	67.1
State Farm Lifepath Series	63.8
John Hancock Lifecycle Series	62.3
BlackRock Inv LifePath Series	60.7
Nationwide Target Destination Series	7.7
Vanguard Target Retirement Series	2.6
TIAA-CREF Lifecycle Index Series	1.5
ING Index Solution Series	0.0
Wells Fargo Advantage DJ Target Date Ser	0.0

Data through 12/31/10. Source: Morningstar, Inc.

Quality of the Underlying Funds

One basic measure to assess the quality of target-date series' underlying portfolios is the Morningstar Rating for mutual funds. The star rating is a quantitatively calculated risk-adjusted measure of historical performance versus category peers. Morningstar uses the star rating as the basis for one of the five scoring components of its ratings for target-date series. While the star rating is only one way to measure a fund's quality, it nevertheless provides a useful snapshot. A minimum three-year history is required to earn a star rating, but Morningstar uses alternative share classes with a longer history if a target-date series has selected a newer (often cheaper) share class. Firms that do not use a fund of funds structure, such as Wells Fargo and AllianceBernstein, are

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excluded from the calculation. The star ratings are dollar-weighted by a fund's position in a portfolio, then averaged across the funds in the series.

20. Average Star Rating of Underlying Funds by Target-Date Series

Name	2010 Morningstar Rating (stars)	2009 Morningstar Rating (stars)	# Holdings w/Rating	% Holdings w/Rating
Manning & Napier Target Series	5.00	5.00	4	100.0%
Franklin Templeton Retirem Series	4.14	3.94	19	95.4%
Allianz Global Investors Solutions Series	4.01		29	85.9%
American Funds Trgt Date Rtrmt Series	3.84	4.06	20	97.1%
Harbor Target Retirement Series	3.82		12	95.8%
PIMCO RealRetirement Series	3.82	3.62	9	58.0%
ING Solution Series	3.80	3.47	28	93.8%
BlackRock Lifecycle Prepared Series	3.76	3.21	17	99.9%
Vanguard Target Retirement Series	3.75	3.00	10	73.1%
JPMorgan SmartRetirement Series	3.66	3.54	19	95.2%
T. Rowe Price Retirement Series	3.51	3.45	16	94.7%
MFS Lifetime Series	3.46	3.67	18	91.1%
Oppenheimer LifeCycle Series	3.44	2.79	20	96.0%
Vantagepoint Milestone Series	3.42	3.18	9	100.0%
Columbia Retirement Plus Series	3.39	3.04	27	94.3%
USAA Target Retirement Funds Series	3.35		13	99.6%
TIAA-CREF Lifecycle Series	3.35	3.23	15	98.8%
MainStay Retirement Series	3.32	3.81	27	99.9%
John Hancock Lifecycle Series	3.30	3.31	36	86.1%
Fidelity Freedom Series	3.26	3.26	15	43.9%
Schwab Target Series	3.24	3.31	22	94.1%
Nationwide Target Destination Series	3.22	3.40	13	98.3%
American Century LIVESTRONG Series	3.21	3.47	13	95.4%
Russell LifePoints Target Date Series	3.21	2.82	10	95.3%
MassMutual Destination Retirement	3.21	3.20	34	93.1%
BlackRock LifePath Series	3.20	3.48	9	35.9%
State Farm Lifepath Series	3.19	3.44	9	36.2%
Legg Mason Partners Target Retirement Se	3.09		18	91.6%
Principal LifeTime Series	3.01	3.02	26	80.6%
Putnam RetirementReady Series	3.00	3.52	3	58.8%
Guidestone Funds MyDestination Series	2.94	2.95	10	91.7%

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20. Average Star Rating of Underlying Funds by Target-Date Series (continued)

Name	2010 Morningstar Rating (stars)	2009 Morningstar Rating (stars)	# Holdings w/Rating	% Holdings w/Rating
Fidelity Advisor Freedom Series	2.89	2.88	12	44.0%
DWS LifeCompass Series	2.81	2.90	45	99.0%
Goldman Sachs Retirement Str Series	2.49	2.59	19	89.1%

Data through 12/31/10. Source: Morningstar, Inc.

Since a 3-star rating indicates a funds' risk-adjusted return is near the peer-group average, most target-date funds are doing better than average. In fact, the mean star rating for all target-date series at year-end 2010 was 3.39. This is positive, though not terribly surprising: The series' managers are ostensibly picking the best-of-breed funds available at their firms. In some cases, managers have the ability to search across the fund universe, so target-date series' portfolios should look better than the norm.

The top-scoring series, Manning & Napier, is something of an aberration, with its assets spread across just a few underlying allocation funds (all versions of the same portfolio with varying allocations) each of which earns a 5-star rating. Most of the highest-rated portfolios source their funds internally from solid asset-management enterprises. Harbor and ING are the two highest-rated open-architecture series. (Harbor relies heavily on PIMCO for fixed-income exposure, while ING uses a mix of ING-run and external subadvisors.) The highest-rated indexed series belongs to Vanguard.

Several series contain a relatively low percentage of funds that receive star ratings from Morningstar, making their overall star rating less meaningful. The reasons for this can vary. The Fidelity funds, for instance, have increasingly used the Series versions of their funds, which lack a three-year record. The BlackRock and State Farm (subadvised by BlackRock) Lifepath series have a significant portion of their funds invested in private accounts. (For its target-date rating methodology, Morningstar provides only scores for series that have at least 50% of assets receiving star ratings, but we have expanded the list in this Industry Survey.)

The ratings on series' underlying funds can shift significantly from year to year owing to a number of factors: replacement of lower-rated funds by higher-rated ones; a rating change within one or two large holdings; or, in rare cases, a wholesale restructuring of a series' holdings. More-moderate changes likely owe to normal shifts in ratings that may take place among a broadly diversified portfolio of mutual funds.

Several changes between the tallies of 2009 and 2010 are of note. Both ING Solution and BlackRock Lifecycle Prepared boosted their star ratings by replacing several poor-performing funds with better-rated options. One wouldn't necessarily expect large changes from an indexed series, but Vanguard Target Retirement increased its aggregate star rating by a whopping 0.75 stars. That occurred when it replaced three separate international funds with the Total International Stock Index fund, a 4-star vehicle, compared with 2-star and 3-star ratings for

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the funds it replaced. Finally, Oppenheimer Transition, in the midst of a major overhaul of its struggling series, raised its rating by the largest amount, from a relatively weak 2.79 to an above-average 3.44.

Diversification Through Alternatives

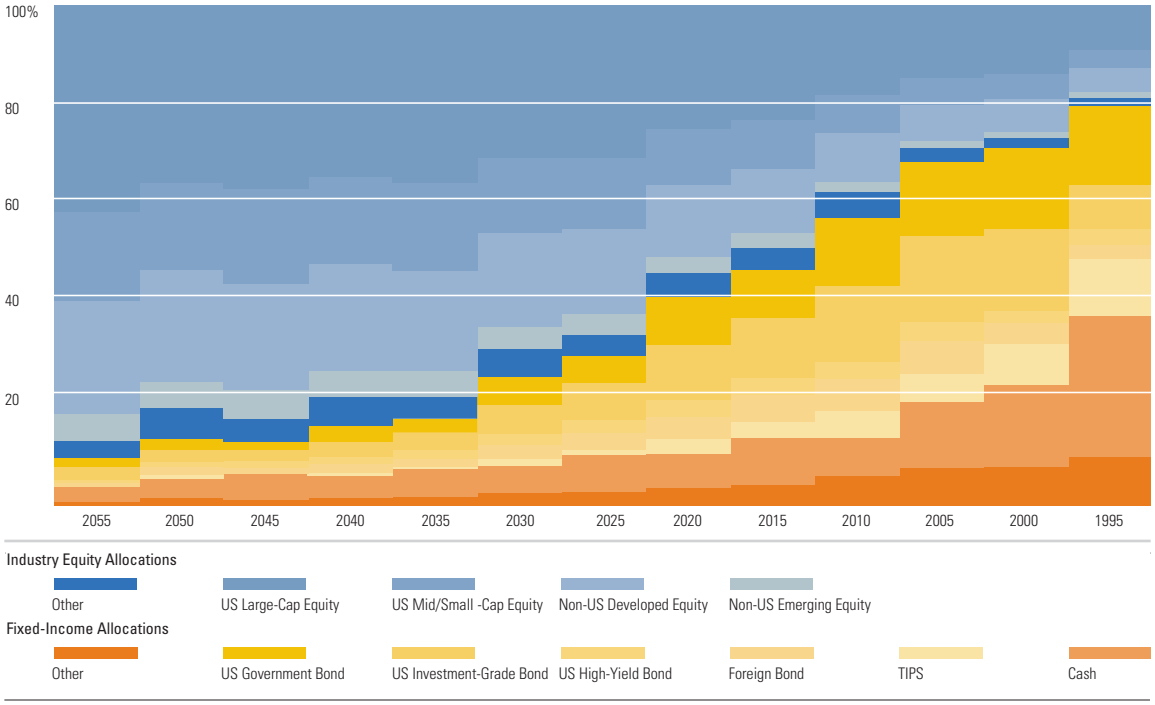
While the industry has moved toward passive investing, at the same time it has explored diversifying into nontraditional asset classes. To be sure, the industry as a whole has been slow to adopt new asset classes and investment types. More recently, however, there have been signals of change, driven in part by the late-2007 to early-2009 bear market, which for many reaffirmed the importance of having less-correlated investments in a portfolio. Some of the largest providers have been incrementally expanding their strategic allocations and underlying funds into less-traditional areas, while some newer entrants to the target-date scene have taken fairly bold steps into alternatives.

While "alternative investments" is a cloudy term to begin with, it contains even greater ambiguity when it comes to target-date funds. Because these investments are constrained by both the structure of the Investment Company Act of 1940 and the QDIA requirements established under the Employee Retirement Income Security Act of 1974, or ERISA, target-date funds work within a more limited framework than institutional managers or advisors for high-net-worth individuals.

Some target-date fund asset allocators view ventures into more-specialized areas of traditional asset classes, such as high-yield bonds or Treasury Inflation-Protected Securities, as alternatives. Other firms, modeling their target-date allocations as mini-defined-benefit or pension models, would label as alternative only the asset classes or strategies that offer lower correlations to traditional asset classes, such as commodities, real estate, derivatives, or hedging-type strategies. Definitions will differ from firm to firm, but Morningstar's security-level X-ray of all target-date funds reveals very low average allocations to alternative investments by any definition (anything labeled as "Other" in Table 21 may be within the alternatives bucket).

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21. Average Target-Date Fund Asset Allocations



Data through 12/31/10. Source: Morningstar, Inc.

Academic research generally suggests that adding diverse investments to a portfolio can improve its risk/reward profile, and institutional investors have eagerly adopted alternatives over the past decade, hoping to replicate the success of institutional money managers, such as David Swensen of Yale University's endowment fund. Why, then, have target-date funds been so reluctant to adopt this investment trend?

There are at least three central factors that have accounted for the relative timidity of the industry.

1. Operational obstacles

Even when a strong case for adding a new asset class or investment strategy exists, not all target-date series providers offer funds that invest in that asset class. A proprietary, or closed-architecture, firm (which uses only managers available from its firm's fund universe) may be particularly hamstrung. Even an open-architecture series, which can hire third-party subadvisors, requires significant lead time to do a manager search, get board approval, make necessary SEC filings, and launch a brand-new fund.

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2. Investor behavior

Many of the largest target-date providers such as Fidelity are also large record keepers, and they're extraordinarily sensitive to the demographics and behavior of plan participants. Because investors defaulted into target-date funds are generally less sophisticated and knowledgeable about financial markets, asset allocators have been biased toward simplicity, de-emphasizing asset classes and financial products that may be unfamiliar or appear risky to investors.

3. Fiduciary considerations

Plan sponsors are a key link in the chain between those who construct target-date funds and those who invest in them. Although the Department of Labor has provided safe harbor to employers who use target-date funds as a default investment option in their plan lineups, they remain obligated to prudently select and monitor funds in their plans (adhering to the "prudent person" principle). Thus, plan sponsors may be cautious in introducing unusual or trendy funds that investors might misuse or misunderstand. In turn, target-date funds have likely been inclined to limit alternative-asset classes to better attract plan-sponsor clients. Although plan sponsors and target-date fund providers may cite fiduciary concerns to support their mainstream investment lineups, perhaps plan sponsors simply lack education as to the benefits of alternative investments and their diversifying properties.

Picking Up Steam

Despite all these frictions slowing down the adoption of alternatives in target-date funds, there are several powerful countervailing forces. In just the past year, several well-established target-date funds added new asset classes to their glide paths. Meanwhile newer, nimbler series have taken bolder steps to expand use of alternatives. This trend is likely to continue for several reasons:

► Efficient frontier research

Conventional asset-allocation research continues to support the benefits of diversifying through less-correlated strategies, and most target-date firms believe in the bigger story. They just need the right products to help them implement alternative strategies.

► Growth of exchange-traded funds

New ETFs covering a vast range of market segments have proliferated, which will allow more asset allocators to tap previously underutilized asset classes. While most target-date funds prefer active management, some series, such as BlackRock Lifepath, DWS LifeCompass, and Nationwide Destination, are incorporating ETFs.

► Growth of alternative mutual funds

For target-date funds seeking active management, a slew of new alternative mutual funds have launched in the last few years, including market-neutral, arbitrage, and managed futures strategies in liquid, 1940 Act structures.

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- Growth of collective investment trusts

In recent years, large employers have increasingly used collective investment trusts for their retirement plans. Because they are not subject to 1940 Act restrictions, CITs have greater flexibility to employ alternatives in their target-date allocations. JP Morgan, for instance, uses REITs in the mutual fund version of its target-date funds but uses direct real estate in its collective trusts.

- Marketing muscle

The biggest players in the target-date industry have something of an arms race at work: If one adds commodities as an asset class, another is sure to follow. Smaller, newer target-date funds, in order to acquire any market share at all, must do something to stand out, and they've often used alternatives to do so.

- The 2008 hangover

The financial crisis was in some ways a setback for diversification, in that any number of asset classes previously thought to be lightly correlated all posted steep losses. That said, the market crash also prompted many managers to search farther afield for investments that could zig while others zagged. Thus interest in alternative strategies has increased among target-date managers, even if few have actually pulled the trigger on significant changes.

Given these factors and the evolving conversations around asset allocation, downside protection, and investor use of target-date funds, Morningstar expects to see a growing number of target-date fund providers consider the use of alternatives and/or include alternatives in their offerings in coming years.

Traditionalists, Incrementalists, and Innovators: Alternatives in Target-Date Funds Today

It's difficult to come up with an industrywide view of alternatives because target-date funds are not required to disclose their strategic allocations at the subasset-class level. Most describe their glide paths in prospectuses by the broadest categories of stocks, bonds, and cash. Nevertheless, Morningstar has found target-date managers can be grouped into one of three camps based on their approach to alternatives: traditionalists, incrementalists, and innovators.

Traditionalists are those target-date series that stick primarily to the traditional asset classes, perhaps extending allocations to one or two less-traditional areas. While traditionalists are a declining presence in the target-date landscape, several of the larger providers still fall into this camp. Among actively managed series, both TIAA-CREF and American Funds land here. Two of the major index-based series, Vanguard and Wells Fargo, also have been very cautious about adding new asset classes. The Wells Fargo Dow Jones Target Date Series entirely avoids REITS, TIPS, high-yield bonds, commodities, and other alternatives in the belief that small additions to the glide path do not meaningfully affect returns. Vanguard Target Retirement does introduce its actively managed TIPS fund as investors near retirement but otherwise eschews alternatives.

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Incrementalists probably represent the broadest swath of target-date funds today. They are believers in the benefits of broad diversification and actively conduct research into the costs and benefits of adding new strategies. Typically these target-date series incorporate three or more less-traditional asset classes and are more willing to explore less-correlated sectors such as commodities and long-short funds, albeit in relatively small slices. Target-date series that fall into this camp include (but aren't limited to) JP Morgan, American Century, ING, Goldman Sachs, John Hancock, Principal, and T. Rowe Price. JPMorgan SmartRetirement, for instance, in addition to strategic allocations to REITS, high-yield bonds, and TIPS (added in 2009), also has used a 130/30 fund from the JP Morgan fund platform—JPMorgan US Dynamic Plus—as part of its large-blend allocation.

Recently, target-date series also have been adding commodities exposure. In the past two years, Fidelity, ING, Principal, Oppenheimer, and T. Rowe Price have either launched or announced plans to implement a strategic allocation to commodities. These efforts often entail the creation of new funds specifically designed to fill a role within the retirement suite, as with T. Rowe Price's Real Assets. Because such funds often end up in diverse categories, it's hard to track them systematically. Table 22 lists the largest underlying positions, by target-date family, in funds that land in Morningstar's long-short, market-neutral, commodities broad-basket, natural-resources, energy, and precious-metals categories.

22. Largest Underlying Alternative Target-Date Holdings

Target-Date Fund Name	Underlying Fund Name	% of Assets
Commodities Broad-Basket Category		
Fidelity Advisor Freedom 2050 Fund	Fidelity Series Commodity Strategy	9.44
Allianz Global Investors Sltns 2050 Fd	PIMCO Commodity Real Ret Strat	7.43
Russell LifePoints 2030 Strategy Fund	Russell Commodity Strategies	6.08
Goldman Sachs Retirement Strategy 2050	Goldman Sachs Commodity Strategy	5.89
PIMCO RealRetirement 2050 Fund	PIMCO Commodity Real Ret Strat	5.88
Natural-Resources Category		
Franklin Templeton 2045 Retiremt Target	Franklin Natural Resources	4.72
Allianz Global Investors Sltns 2050 Fd	Allianz RCM Global Resources	4.35
John Hancock II Lifecycle 2040 Fund	JHancock2 Natural Resources	2.82
Equity-Energy and Equity Precious-Metals Categories		
Franklin Templeton 2045 Retiremt Target	Franklin Gold and Precious Metals	5.73
USAA Target Retirement 2050	USAA Precious Metals and Minerals	5.04
BlackRock Lifecycle Prepared 2045 Port	BlackRock All-Cap Engy & Res	2.82
Long-Short Category		
Vantagepoint Milestone Retirement Fund	Vantagepoint Diversifying Strategies	20.09
MFS Lifetime 2010 Fund	MFS Diversified Target Return	2.00

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22. Largest Underlying Alternative Target-Date Holdings (continued)

Target-Date Fund Name	Underlying Fund Name	% of Assets
Goldman Sachs Retirement Strategy 2050	Goldman Sachs Absolute Return Tracker Fund	3.63
Market-Neutral Category		
DWS LifeCompass Retirement Fund	DWS Disciplined Market Neutral	0.25

The final group—innovators—hews to no single model. What connects them is a greater emphasis on alternatives, from both a philosophical and an allocation perspective, and an ambition to express those views in modes other than the traditional target-date structure (such as fund of funds wrapper, Markowitz mean-variance optimization, or nondynamic asset allocation). Here are snapshots of how some of these firms are integrating alternatives into their target-date funds.

Series: DWS LifeCompass
Philosophy: Ultradivesification across 27 distinct asset classes
Representative holdings: DWS Disciplined Market Neutral and Energy SelectSector SPDR

Series: Putnam Retirement Ready
Philosophy: Dynamic asset allocation with absolute-return emphasis
Representative holdings: Putnam Absolute Return 500 (18% in 2020 fund as of 6/30/10)

Series: Invesco Balanced-Risk Retirement and PIMCO RealRetirement
Philosophy: Both firms emphasize generating real return and limiting tail risk close to retirement
Representative holdings: Invesco uses a risk-parity approach that relies on derivatives, including a one-third allocation to commodities; PIMCO Real Return, PIMCO Commodity Real Return Strategy, active hedging strategy

Series: Vantagepoint Milestone
Philosophy: A multistrategy, volatility-dampening sleeve
Representative holding: Vantagepoint Diversifying Strategies

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Looking Ahead

It's unclear whether these innovative approaches will become more widely adopted. From a risk-management and investment-philosophy perspective, many of these strategies certainly look compelling, and the appeal of alternatives is not going away. At the same time, these approaches are quite new and have not been battle-tested. Skeptical plan sponsors will probably need to see evidence that innovative structures can perform as advertised before they'll embrace alternatives-heavy strategies. Target-date providers will also need to ensure that they can implement such strategies, often costly, without causing overall series expenses to rise prohibitively. Moreover, the diversification benefits of nontraditional asset classes may not be truly evident until a decade or more down the road. In addition, there is no guarantee that asset classes that are currently viewed as diversifiers will continue to be so, should market conditions or the traditional relationships between asset classes evolve in coming decades.

Portfolio Close-Up: What's in Retirement-Income Funds?

Most of the attention on target-date funds has focused on the period leading up to retirement, but retirement nest eggs are treated differently among series after retirement as well. Morningstar took a closer look at retirement-income funds—the terminus offering of many target-date series. Morningstar's analysis reveals a wide range of strategies, asset allocations, and return patterns. (There are some fund types, such as managed-payout funds, that fall into Morningstar's retirement-income category, but for the purposes of this study, Morningstar focused on 29 retirement income funds that are part of a target-date series.)

The dispersion in approaches starts up front: Not every target-date series even offers a retirement-income fund. A number of series simply take the last dated fund in the series (in most cases right now a 2010 or 2015 fund) and turn that into a terminal fund, continuing to manage the allocations as necessary through retirement. Moreover, there is no consistency as to when assets may merge into the income fund. Most prospectuses provide vague descriptions stating that such transitions require board approval and may take place several years after the target-year is reached. Thus, it's difficult to know for any given retirement-income fund where it actually falls in a series' glide path.

Heterogeneity, Lack of Consensus Mark Retirement-Income Construction

Investors and plan sponsors would be wrong to assume that all retirement-income funds are the same; that any such fund is a safeguard against capital losses; or that a retirement-income fund will provide a guaranteed level of income necessary to support retirement spending.

Retirement-income funds vary a great deal in their asset allocation. Equity allocation is one basic measure, and there's a wide gap between the lowest stock allocation of 15% and the high of 45%. The broad differences in equity exposure among retirement-income funds will affect the funds' relative performance and volatility. And while in some cases the allocations correspond to the broader profile of the target-date series, that wasn't always the case. For instance, American Century, which owns the highest stock weighting for a retirement-

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income fund, is generally thought to be a conservative-leaning target-date series. Even so, the retirement income fund's flat allocation of 45% equities ends up being more aggressive than most peers. Fidelity Freedom, which generally hugs the averages across its glide path, has the second-lowest stock weighting of the retirement income funds at 18%.

Retirement-income funds also vary by their asset mix, particularly in the mix of their fixed income holdings. Vanguard, Fidelity Freedom Index, ING Index Solution, and Wells Fargo are each index-based, and the Barclays Capital U.S. Aggregate Bond Index contains only investment-grade bonds. At the other end of the spectrum, some series such as John Hancock and Fidelity Freedom contain significant exposure to high yield, or below-investment-grade, bonds. Such bonds can be useful from both a diversification and yield perspective, but they can also lead to greater losses during recessions or other equity-market downturns. However, keeping in mind that bonds only make up a portion of the overall portfolio (cash levels tend to be higher in many of these funds), the actual allocations to below-investment-grade bonds look less concerning.

23. Selected Performance Statistics, Retirement-Income Funds

Name	Asset Allocation Equity %	Asset Allocation Bond %	Asset Allocation Cash %	Average Eff Duration	Below Investment Grade
American Century LIVESTRONG Inc A	45.18	40.71	13.98	5.23	13.84
T. Rowe Price Retirement Income	41.78	48.59	9.28	4.91	21.95
TIAA-CREF Lifecycle Index Ret Inc Inst	40.28	58.40	1.24	5.27	5.30
TIAA-CREF Lifecycle Retire Inc Instl	39.53	49.33	11.04	5.01	9.91
State Farm LifePath Inc Retire Legacy A	39.18	52.40	8.13		0.00
Legg Mason Target Retirement A	37.90	58.27	2.91	4.90	15.08
BlackRock LifePath Retirement Instl	37.88	53.44	8.39		0.49
DWS LifeCompass Retirement S	35.99	61.74	2.02	4.51	11.95
JPMorgan SmartRetirement Income A	32.18	54.33	12.13	4.78	21.57
MassMutual Select Dest Retire Inc A	31.47	55.80	12.32	3.68	9.70
ING Index Solution Income I	30.58	59.01	10.30	4.22	0.61
Vanguard Target Retirement Income Inv	29.84	62.06	7.86	4.95	0.00
USAA Target Retirement Income	29.00	62.25	5.15	3.32	4.27
Nationwide Retirement Income C	28.32	56.56	11.00	4.51	8.31
Russell In Retirement R1	27.72	52.29	19.04	3.93	14.65
MFS Lifetime Retirement Income A	26.89	64.09	8.85	3.96	7.86
ING Solution Inc I	26.75	64.69	6.45	4.11	21.21
Vantagepoint Milestone Retirement Income	25.27	56.43	15.35	3.58	1.99
Principal LifeTime Strategic Inc Instl	23.69	72.43	2.50	5.01	15.85
Manning & Napier Target Income C	23.23	68.83	7.84	4.44	4.71
Allianz Glbl Inv Solutions Ret Inc A	22.03	76.57	-3.26	4.40	5.28
Fidelity Freedom Income	20.55	51.08	27.89	3.29	10.13

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23. Selected Performance Statistics, Retirement-Income Funds (continued)

Name	Asset Allocation Equity %	Asset Allocation Bond %	Asset Allocation Cash %	Average Eff Duration	Below Investment Grade
Fidelity Freedom K Income	20.53	51.04	27.95	3.29	10.12
Fidelity Advisor Freedom Inc A	19.90	51.70	27.68	3.30	2.03
Harbor Target Retirement Income Instl	19.72	54.68	24.92	4.93	7.13
Putnam RetirementReady Maturity A	18.59	58.32	21.76	4.91	18.05
Fidelity Freedom Index Income W	17.84	37.46	44.64	4.36	0.30
Wells Fargo Advantage DJ Target Today A	14.61	76.80	7.84	5.54	0.00
Minimum	14.61	37.46	-3.26	3.29	0.00
Average	28.80	57.47	12.68	4.40	8.65
Median	28.02	56.49	9.79	4.47	8.09
Maximum	45.18	76.80	44.64	5.54	21.95

Data through 02/28/11. Source: Morningstar, Inc.

Retirement-income funds also vary in their exposure to non-U.S. bonds. T. Rowe Price, American Century, MFS, and Wells Fargo gain between one fifth and one fourth of their bond exposure from abroad, while firms such as Manning & Napier, Fidelity, and Vanguard, scarcely invest in foreign bonds at all. Investing in foreign bonds doesn't necessarily entail greater risk; much depends on the specific composition of those foreign investments. However, a number of asset managers and asset allocators are paying greater attention to the potential diversification benefits of international bond and/or currency exposure.

How Did They Hold Up?

The differences in asset allocation and asset mix have had a pronounced impact on the performance of retirement-income funds. Eighteen of the 29 retirement-income funds included in Morningstar's analysis have three-year records that encompass the 2008 downturn. On average they performed better than their 2010 kin, but all of them experienced losses, some quite substantial. The group on average lost nearly 16% in 2008, while the worst offenders, Putnam and DWS, dropped a startling 24%. (Putnam has since substantially revamped its target-date series.) Wells Fargo performed best, losing only 3.65%, while Fidelity Freedom had the next-best showing, with a much bigger 12.14% loss.

Fortunately, with the subsequent two years of recovery, every fund except DWS is in the black for the three-year period through Dec. 31, 2010, which is somewhat encouraging. Still, it's likely that many investors in these funds were unprepared for the magnitude of their losses during the financial crisis. The average standard deviation for the group over that period was 9.87%, more than twice that of the BarCap US Aggregate Bond Index. The range of standard deviations in the group runs from 6.57% (Wells Fargo) to 12.56% (Putnam).

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24. Selected Performance Metrics, Retirement-Income Funds

Name	2008 Annual Return %	3 Yr Annualized Total Return %	3 Yr Total Return Category Rank %	10-01-2007 to 03-01-2009 Return %	1 Yr Standard Deviation %	3 Yr Standard Deviation %
MFS Lifetime Retirement Income A	-12.19	5.99	3	-9.75	5.59	8.09
Wells Fargo Advantage DJ Target Today A	-3.65	4.15	13	-5.41	4.12	6.57
JPMorgan SmartRetirement Income A	-17.23	3.66	17	-16.68	7.11	10.44
Vanguard Target Retirement Income Inv	-10.93	3.65	19	-10.96	5.27	8.69
BlackRock LifePath Retirement Instl	-15.04	3.18	25	-15.96	7.29	10.88
Fidelity Freedom Income	-12.14	3.17	26	-11.25	4.44	7.18
T. Rowe Price Retirement Income	-18.39	3.13	27	-17.70	8.50	11.33
MassMutual Select Dest Retire Inc A	-16.47	3.10	28	-15.51	6.77	10.38
Fidelity Advisor Freedom Inc A	-13.64	3.06	31	-12.21	4.54	7.63
State Farm LifePath Inc Retire Legacy A	-15.36	2.76	40	-16.39	7.31	10.95
ING Solution Inc I	-16.49	2.57	47	-16.98	6.40	10.76
Vantagepoint Milestone Retirement Income	-13.76	2.43	50	-12.93	5.23	8.59
TIAA-CREF Lifecycle Retire Inc Instl	-17.26	2.13	58		7.47	10.56
American Century LIVESTRONG Inc A	-16.79	1.99	62	-17.70	8.87	11.23
Nationwide Retirement Income C	-11.97	1.68	69	-12.97	6.09	9.28
Putnam RetirementReady Maturity A	-24.38	0.82	75	-21.09	3.24	12.56
Principal LifeTime Strategic Inc Instl	-22.29	0.80	77	-21.41	5.57	10.78
DWS LifeCompass Retirement S	-24.28	-0.27	95	-21.81	7.54	11.77
ING Index Solution Income I					5.41	
Fidelity Freedom Index Income W					3.51	
Fidelity Freedom K Income					4.42	
TIAA-CREF Lifecycle Index Ret Inc Inst					7.18	
Manning & Napier Target Income C					4.98	
Allianz Glbl Inv Solutions Ret Inc A					5.13	
Legg Mason Target Retirement A					8.93	
USAA Target Retirement Income					6.09	
Harbor Target Retirement Income Instl					4.62	
Russell In Retirement R1					6.44	
Minimum	-24.38	-0.27	3.00	-21.81	3.24	6.57
Average	-15.68	2.67	42.33	-15.10	6.00	9.87
Median	-15.91	2.91	35.50	-15.96	5.84	10.50
Maximum	-3.65	5.99	95.00	-5.41	8.93	12.56

Data through 02/28/11. Source: Morningstar, Inc.

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Income generation often is a far higher priority during retirement, so it's useful to know what kind of yield retirement-income funds offer investors. The current yield can provide indications about a fund manager's view on the value of income versus capital appreciation, as well as the risks the fund may take. On balance, a higher yield requires taking on either greater interest-rate or credit-quality risk, which can lead to capital losses even as income is paid out.

The retirement-income funds' yields range from around 1% to approximately 4.62% (see Table 25). The average for the group was 2.63%. (These figures are based on 12-month yield through February 2011, which looks back at how much income the fund has distributed over the previous year. For the purposes of this comparison, Morningstar also used institutional or lowest-cost share classes, as higher expenses have an inordinately large impact on yield.)

25. Target-Date Series Asset-Weighted Average Expense Ratios

Fund Name	12-Month Yield
Harbor Target Retirement Income Instl	4.62
Russell In Retirement R1	4.57
Allianz Glbl Inv Solutions Ret Inc Ins	4.02
ING Solution Inc I	3.40
Invesco Balanced-Risk Retire Now Instl	3.33
Legg Mason Target Retirement I	3.30
Manning & Napier Target Income I	3.29
Putnam RetirementReady Maturity Y	3.23
USAA Target Retirement Income	3.18
Principal LifeTime Strategic Inc Instl	3.13
JPMorgan SmartRetirement Income Instl	2.95
MassMutual Select Dest Retire Inc S	2.64
TIAA-CREF Lifecycle Retire Inc Instl	2.62
MFS Lifetime Retirement Income R2	2.47
American Century LIVESTRONG Inc Instl	2.41
Vanguard Target Retirement Income Inv	2.37
T. Rowe Price Retirement Income	2.35
DWS LifeCompass Retirement S	2.30
TIAA-CREF Lifecycle Index Ret Inc Inst	2.19
Wells Fargo Advantage DJ Target Today I	2.19
Nationwide Retirement Income Instl	2.11
BlackRock LifePath Retirement Instl	1.96

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25. Target-Date Series Asset-Weighted Average Expense Ratios (continued)

Fund Name	12-Month Yield
Fidelity Advisor Freedom Inc I	1.70
State Farm LifePath Income Retire A	1.67
Fidelity Freedom K Income	1.56
Vantagepoint Milestone Retirement Income	1.43
Fidelity Freedom Index Income W	1.11
ING Index Solution Income I	1.09
Average	**2.61**

Data through 02/28/11. Source: Morningstar, Inc.

The lower-yielding funds in general have a bias toward high-quality bonds and/or shorter-duration strategies. For instance, Vantagepoint's average effective duration of 3.58 years is more than a year shorter than that of Harbor Target Retirement, which has the highest yield. The higher-yielding funds generally will offer greater exposure to riskier bond sectors and perhaps a slightly more adventurous interest-rate stance.

Conclusion

Morningstar's survey of retirement-income funds reveals a wide range of asset allocations, approaches to portfolio construction, and return patterns. Sometimes those risk profiles diverge from management's philosophy earlier on the glide path. Moreover, investors' needs and risk tolerances may change dramatically in retirement. In general, the funds' approach is conservative, which is reasonable given the broad participant base, but some series clearly take greater risks. By paying close attention to these shifts postretirement, investors—and their fiduciaries—can be confident that the funds are suitable investment options.

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Price

Target-date fees continued to decline in 2010, though not at quite the same level as over the previous two years. In general, target-date funds are reasonably priced. Some of the larger target-date fund families enjoy economies of scale due to the wide distribution and institutional use of their funds, and many use cheaply priced institutional shares for the underlying funds in their portfolios to keep costs down. Many also use passively managed index funds—either partially or wholly—to help contain costs. Lastly, several firms have eliminated a layer of costs so that investors are paying only the expenses of the underlying funds.

There's no straightforward way to compare fees across target-date firms, owing to the proliferation of share classes designed for retirement plans and the lack of consistency in how they are designated or organized. Certain share classes wrap in services provided by an asset manager to the plan sponsor, while other expense ratios are affected by revenue-sharing arrangements between asset managers, record keepers, and/or plan sponsors. Generally speaking, the expenses of such situations are not reported transparently, which makes comparison of various share classes more difficult. Ultimately, investors need to examine the fee level of the specific target-date choices available from their employer. Plan sponsors and gatekeepers, however, are in a stronger position to comparison-shop and demand a reasonably priced target-date series.

Within this section of the Industry Survey, Morningstar shows two methods for comparing fees. The first uses the asset-weighted expense ratio for the series, a dollar-weighted calculation across all the funds and all the share classes in a given series. This approach provides the best approximation of what most investors actually pay to invest in the series. The second method serves as the basis for the price score in Morningstar's Target-Date Ratings, which are issued quarterly to 21 of the industry's largest target-date series. This methodology seeks the lowest-cost share class in a series that holds at least 10% of series assets, averaged across all the funds in that share class. This approach seeks to assess series in their best light, while establishing a minimum threshold to assure that a meaningful number of investors are actually benefiting from that price. In both cases, Morningstar uses a fund's net prospectus expense ratio, which best captures the total expenses, including those of the underlying funds.

Between the two methods, the calculated expense ratios may differ for the same fund series, at times significantly, but the relative sweep of the rankings changes little. For the purposes of clarity, the discussion below refers to asset-weighted expenses unless otherwise specified.

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26. Target-Date Series Asset-Weighted Average Expense Ratios

Name	Asset-Weighted Expense Ratio %	Total Assets
Vanguard Target Retirement Series	0.18	78,880,347,848
Wells Fargo Advantage DJ Target Date Ser	0.63	9,175,392,803
USAA TARGET RETIREMENT FUNDS Series	0.65	1,780,146,207
TIAA-CREF Lifecycle Series	0.66	6,154,645,956
Harbor Target Retirement Series	0.71	119,706,463
NestEgg Dow Jones Series	0.74	129,150,363
Fidelity Freedom Series	0.74	88,774,937,693
T. Rowe Price Retirement Series	0.78	55,725,536,745
Schwab Target Series	0.83	1,109,056,972
Columbia Retirement Plus Series	0.85	170,692,212
John Hancock Lifecycle Series	0.89	4,770,358,341
ING Index Solution Series	0.89	771,460,351
American Century LIVESTRONG Series	0.89	3,440,556,572
Barclays Global Inv LifePath Series	0.92	3,968,585,604
Principal LifeTime Series	0.93	17,569,047,012
JPMorgan SmartRetirement Series	0.95	3,251,003,529
Vantagepoint Milestone Series	0.99	1,858,278,082
American Funds Trgt Date Rtrmt Series	1.00	8,915,738,921
AllianceBernstein Retirement Str Series	1.01	2,217,206,753
Russell LifePoints Target Date Series	1.02	900,481,284
Allianz Global Investors Solutions Series	1.06	37,120,338
Guidestone Funds MyDestination Series	1.08	722,095,409
Fidelity Advisor Freedom Series	1.08	12,216,481,558
Massachusetts Mutual Life Insurance Co.	1.09	1,105,897,121
Putnam RetirementReady Series	1.11	323,587,765
Invesco Balanced-Risk Retirement Series	1.16	187,112,720
Goldman Sachs Retirement Str Series	1.17	97,027,617
Manning & Napier Target Series	1.18	340,356,393
DWS LifeCompass Series	1.18	587,321,957
ING Solution Series	1.18	4,098,848,096
Nationwide Target Destination Series	1.18	729,396,626
PIMCO RealRetirement Series	1.20	36,147,928
MainStay Retirement Series	1.25	289,958,574
Legg Mason Partners Target Retirement Se	1.32	31,405,151

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26. Target-Date Series Asset-Weighted Average Expense Ratios (continued)

Name	Asset-Weighted Expense Ratio %	Total Assets
State Farm Lifepath Series	1.34	3,305,066,664
BlackRock Lifecycle Prepared Series	1.34	81,458,711
MFS Lifetime Series	1.35	421,203,064
Franklin Templeton Retirem Series	1.50	130,130,723
Oppenheimer LifeCycle Series	1.68	497,290,092
Average	**1.02**	

Data through 12/31/10. Source: Morningstar, Inc.

27. Target-Date Series Expense Ratios by Lowest-Cost Method

Name	Average Expense Ratio
Vanguard Target Retirement Series	0.18
TIAA-CREF Lifecycle Series	0.44
Wells Fargo Advantage DJ Target Date Ser	0.50
USAA TARGET RETIREMENT FUNDS Series	0.52
American Century LIVESTRONG Series	0.67
Harbor Target Retirement Series	0.71
Fidelity Freedom Series	0.71
T. Rowe Price Retirement Series	0.72
NestEgg Dow Jones Series	0.73
Legg Mason Partners Target Retirement Se	0.74
Fidelity Advisor Freedom Series	0.76
Allianz Global Investors Solutions Series	0.76
Russell LifePoints Target Date Series	0.78
Principal LifeTime Series	0.79
American Funds Trgt Date Rtrmt Series	0.79
Columbia Retirement Plus Series	0.80
ING Index Solution Series	0.80
Schwab Target Series	0.82
JPMorgan SmartRetirement Series	0.83
ING Solution Series	0.84
Barclays Global Inv LifePath Series	0.85
Nationwide Target Destination Series	0.86

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27. Target-Date Series Expense Ratios by Lowest-Cost Method (continued)

Name	Average Expense Ratio
John Hancock Lifecycle Series	0.87
PIMCO RealRetirement Series	0.88
Goldman Sachs Retirement Str Series	0.91
Putnam RetirementReady Series	0.92
Massachusetts Mutual Life Insurance Co.	0.94
AllianceBernstein Retirement Str Series	0.96
DWS LifeCompass Series	0.96
Invesco Balanced-Risk Retirement Series	0.99
Vantagepoint Milestone Series	1.00
State Farm Lifepath Series	1.04
Guidestone Funds MyDestination Series	1.08
MFS Lifetime Series	1.11
Manning & Napier Target Series	1.13
MainStay Retirement Series	1.15
BlackRock Lifecycle Prepared Series	1.24
Franklin Templeton Retirem Series	1.34
Oppenheimer LifeCycle Series	1.44
Industry Average	**0.86**

Data through 12/31/10. Source: Morningstar, Inc.

Vanguard remains the cheapest series by a long stretch, with its 0.18% average expense ratio, though Fidelity's newer indexed series now matches that expense ratio (the series is too young to be included in the table above). Oppenheimer remains the most expensive, with a 1.68% asset-weighted expense ratio.

Index-only or significantly indexed series tend to rank among the cheapest, but there are notable exceptions. TIAA-CREF Lifecyle funds are technically 100% active, but they make considerable use of enhanced-index funds. Fidelity Freedom, Columbia Retirement Plus, and Harbor Target Retirement are all priced well below the median despite predominantly active underlying managers. The latter two, with tiny asset bases, are keeping expenses down through significant fee waivers, a common practice.

Several series are notable for expenses above the median despite among the larger asset bases, including ING Solution and State Farm Lifepath. This suggests that investors don't always benefit from the potential economies of scale. Target-date series typically sold through financial advisors do tend to have higher expenses. American Funds—both actively managed and advisor-sold—bucks that trend, however.

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When comparing expenses from 2009 and 2010, about half of the series had higher expenses in 2010 compared with 2009 and about half had lower. But in general, the differences were tiny—in some cases a single basis point. A few series experienced more significant shifts. The Putnam RetirementReady funds' expenses went up in 2009 when the series added Putnam's Absolute Return funds to the mix of underlying funds. But then Putnam made across-the-board fee cuts, and the series' expenses declined 0.11% on average. Elsewhere, TIAA-CREF and MFS both saw their asset-weighted expense ratios drop. MFS eliminated its annual overlay fee of 10 basis points, while TIAA-CREF benefited not because it lowered expenses but because more assets moved to cheaper share classes. Morningstar views such shifts as a positive trend for investors.

Although segments of the target-date market remain expensive, and there is a disappointing lack of transparency around the costs of certain share classes, overall the leaders in the industry have set a high standard on the expense front. Morningstar's research consistently shows fees to be an important predictor of future performance, indicating that investors should emphasize low costs when choosing a target-date provider, alongside other factors such as asset-allocation design and investment quality.

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People

Target-date funds can be difficult to analyze because they contain multiple layers of management. At the series' core are the managers of the constituent funds, but often a second team of managers—the named managers of a target-date series—sets the funds' asset allocation and selects the constituent funds, or underlying funds, included in the series. Both layers of management need to be successful for the series to perform well for fundholders. Strong underlying funds can be undermined by poor asset allocation, and brilliant asset allocators have been tripped up by poor fund selection.

On average, the managers of the underlying funds have longer tenures than the asset allocators who are named managers of the target-date series. The average manager tenure for an underlying fund was 5.4 years, while the average series manager's tenure was 4.3 years. That's not surprising given that most target-date funds are relatively young, and many series managers have selected experienced managers to feature within the series.

28. Average Manager Tenure of Underlying Funds and Series by Target-Date Series

Target-Date Series Name	Average Manager Tenure Underlying Funds Years	Average Manager Tenure Series Years
Wells Fargo Advantage DJ Target Date Ser	15.80	2.87
American Funds Trgt Date Rtrmt Series	11.89	4.03
Manning & Napier Target Series	9.82	2.72
Vanguard Target Retirement Series	9.53	7.29
AllianceBernstein Retirement Str Series	9.13	4.17
Franklin Templeton Retirem Series	7.93	4.53
T. Rowe Price Retirement Series	7.85	5.36
MainStay Retirement Series	7.41	2.74
Legg Mason Partners Target Retirement Se	6.85	2.45
Harbor Target Retirement Series	6.77	2.11
Allianz Global Investors Solutions Serie	5.55	2.12
Schwab Target Series	5.37	4.30
Goldman Sachs Retirement Str Series	5.21	2.80
JPMorgan SmartRetirement Series	5.17	3.43
BlackRock Lifecycle Prepared Series	5.14	3.81
Oppenheimer LifeCycle Series	4.98	3.07
USAA Target Retirement Funds Series	4.94	2.34
RiverSource Retirement Plus Series	4.92	2.36
MFS Lifetime Series	4.88	5.37
Russell LifePoints Target Date Series	4.59	6.11
Massachusetts Mutual Life Insurance Co.	4.30	4.42
TIAA-CREF Lifecycle Series	4.25	5.19

Data through 12/31/10. Source: Morningstar, Inc.

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28. Average Manager Tenure of Underlying Funds and Series by Target-Date Series (continued)

Target-Date Series Name	Average Manager Tenure Underlying Funds Years	Average Manager Tenure Series Years
PIMCO RealRetirement Series	4.22	2.72
Nationwide Target Destination Series	4.09	3.46
Putnam RetirementReady Series	3.98	5.06
ING Solution Series	3.96	4.79
Guidestone Funds MyDestination Series	3.90	4.12
American Century LIVESTRONG Series	3.85	3.92
Vantagepoint Milestone Series	3.82	5.48
NestEgg Dow Jones Series	3.53	2.42
John Hancock Lifecycle Series	3.47	2.87
Fidelity Freedom Series	3.44	9.50
DWS LifeCompass Series	3.38	11.88
Principal LifeTime Series	3.21	5.21
State Farm Lifepath Series	3.10	4.32
ING Index Solution Series	2.81	2.57
Fidelity Advisor Freedom Series	2.52	6.18
Invesco Balanced-Risk Retirement Series	2.40	1.88
BlackRock LifePath Series	2.11	6.08

Data through 12/31/10. Source: Morningstar, Inc.

In some cases, the manager tenure figures for the underlying funds understate a fund manager's experience running a strategy used in a target-date series. For example, target-date series offered by ING, MassMutual, Principal, and Vantagepoint have hired tested, well-known subadvisors to manage at least a portion of their target-date series, yet these veteran managers may have been named to the target-date series' constituent funds relatively recently.

To determine the likelihood that the managers at both the series and the underlying funds are likely to stay, it's informative to look at the fund family's five-year manager retention rate. Firms with high manager-retention rates--those exceeding 90%--have very little turnover among the named managers on their funds, giving shareholders in the target-date series confidence that the managers featured in the series today are likely to be named on the fund in the years to come.

The series run by firms with higher manager-retention rates have slightly outperformed those with lower retention rates, on a risk-adjusted basis. Morningstar compared the asset-weighted three-year Morningstar Risk-Adjusted Return for series with five-year manager-retention rates of 90% or higher, and the average MRAR was -4.15%. The average for the other series, from firms with 5-year manager-retention rates less than 90%, was -4.48% (see Table 29).

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29. Average Manager Tenure, 5-Year Manager-Retention Rate, and Asset-Weighted 3-Year Morningstar Risk-Adjusted Returns for Target-Date Series

Target-Date Series Name	Average Manager Tenure for Underlying Funds Years	5-Year Firm-Wide Manager Retention Rate %	Asset-Weighted 3-Year Target-Date Series MRAR%
Wells Fargo Advantage DJ Target Date Series	15.80	89.37	-2.33
American Funds Target Date Rtrmt Series	11.88	98.00	-5.44
Manning & Napier Target Series	9.82	96.00	-1.73
Vanguard Target Retirement Series	9.53	91.72	-3.71
AllianceBernstein Retirement Str Series	9.12	86.31	-8.56
Franklin Templeton Retirem Series	7.92	93.02	-3.19
T. Rowe Price Retirement Series	7.84	94.08	-4.27
MainStay Retirement Series	7.41	85.70	-4.32
Legg Mason Partners Target Retirement Se	6.84	86.95	-7.31
Harbor Target Retirement Series	6.77	92.45	-5.52
Allianz Global Investors Solutions Serie	5.54	88.88	5.44
Schwab Target Series	5.37	88.16	-3.07
Goldman Sachs Retirement Str Series	5.20	84.33	-8.77
JPMorgan SmartRetirement Series	5.16	90.22	-2.16
BlackRock Lifecycle Prepared Series	5.14	84.79	-4.53
Oppenheimer LifeCycle Series	4.97	85.87	-11.24
USAA TARGET RETIREMENT FUNDS Series	4.93	88.08	4.63
RiverSource Retirement Plus Series	4.91	81.55	-8.22
MFS Lifetime Series	4.87	91.12	-3.56
Russell LifePoints Target Date Series	4.58	80.99	-4.74
Massachusetts Mutual Life Insurance Co.	4.29	86.50	-5.52
TIAA-CREF Lifecycle Series	4.24	85.16	-5.77
PIMCO RealRetirement Series	4.21	89.44	-1.21
Nationwide Target Destination Series	4.08	85.32	-4.54
Putnam RetirementReady Series	3.97	82.52	-5.86
ING Solution Series	3.95	86.52	-6.37
Guidestone Funds MyDestination Series	3.89	86.16	-5.52
American Century LIVESTRONG Series	3.84	86.49	-2.06
Vantagepoint Milestone Series	3.81	86.79	-2.88
NestEgg Dow Jones Series	3.52	79.62	-3.93
John Hancock Lifecycle Series	3.47	88.77	-6.44
Fidelity Freedom Series	3.43	87.19	-4.81

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29. Average Manager Tenure, 5-Year Manager-Retention Rate, and Asset-Weighted 3-Year Morningstar Risk-Adjusted Returns for Target-Date Series (continued)

Target-Date Series Name	Average Manager Tenure for Underlying Funds Years	5-Year Firm-Wide Manager Retention Rate %	Asset-Weighted 3-Year Target-Date Series MRAR%
DWS LifeCompass Series	3.37	80.01	-5.01
Principal LifeTime Series	3.20	90.16	-5.96
State Farm Lifepath Series	3.09	86.54	-4.70
ING Index Solution Series	2.80	86.52	-2.57
Fidelity Advisor Freedom Series	2.51	87.19	-5.62
Invesco Balanced-Risk Retirement Series	2.39	81.19	-4.62
Barclays Global Inv LifePath Series	2.10	84.79	-3.95

Data through 12/31/10. Source: Morningstar, Inc.

The named managers of the target-date series usually have hiring and firing authority over the underlying fund holdings included in the series. Morningstar examined how often the series' managers used that authority. Morningstar looked at the distinct funds added and subtracted to a series over the past three years, and summed the assets represented in those holdings to arrive at a total percentage of the series' assets that were changed over the period. If an existing constituent fund's weighting changed during the period, Morningstar disregarded that change.

Morningstar found that some managers change their series' underlying holdings little from year to year, but the industry has added and subtracted a total of 23% of the underlying funds' assets, on average, within each series over the past three years. (See Table 30.) The series' managers have added to the series (about 14% of fund assets, on average) more often than they've subtracted (about 10% of fund assets, on average). The data support anecdotal evidence that suggests many series have added holdings in an effort to further diversify the target-date funds into assets that they expect will have returns that are less-correlated with the returns from traditional, core stock and bond holdings.

The data also may help set expectations for target-date investors when it comes to the rate of change within each series. Some series stand out because the constituent funds have rarely changed. This is the case with the American Funds series, which draws on American's relatively limited number of funds, and Manning & Napier, which also has few funds in its family. Meanwhile, other series with high change rates went through a redesign during the period, so the change rate may be much lower going forward. This is the case with the Invesco and Putnam series, for example.

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30. Distinct Underlying Fund Assets Added and Subtracted from Series Over Past 3 Years

Target-Date Series Name	Underlying Fund Assets Added to Series over past 3 years %	Underlying Fund Assets Subtracted from Series over past 3 years %	Total Change in Underlying Fund Assets %
Allianz Global Investors Solutions Serie	25.99	14.58	40.57
American Century LIVESTRONG Series	13.88	13.57	27.45
American Funds Trgt Date Rtrmt Series	3.48	3.35	6.82
BlackRock Lifecycle Prepared Series	20.83	17.91	38.74
BlackRock LifePath Series	17.25	6.98	24.23
Columbia Retirement Portfolios	1.51	12.01	13.52
DWS LifeCompass Series	15.67	9.12	24.78
Fidelity Advisor Freedom Series	13.04	6.45	19.49
Fidelity Freedom Series	11.98	9.23	21.21
Franklin Templeton Retirem Series	10.73	4.94	15.68
Guidestone Funds MyDestination Series	17.41	18.14	35.55
Harbor Target Retirement Series	7.82	8.44	16.27
ING Index Solution Series	16.43	0.00	16.43
ING Solution Series	20.17	12.42	32.59
Invesco Balanced-Risk Retirement Series	52.69	42.68	95.37
John Hancock Lifecycle Series	14.70	2.64	17.34
JPMorgan SmartRetirement Series	16.40	17.61	34.00
Legg Mason Partners Target Retirement Se	4.26	0.00	4.26
MainStay Retirement Series	21.23	10.55	31.78
Manning & Napier Target Series	4.17	0.00	4.17
MFS Lifetime Series	13.66	4.61	18.26
Nationwide Target Destination Series	9.52	0.00	9.52
NestEgg Dow Jones Series	20.00	10.00	30.00
Payden/Wilshire Target Date Series	9.08	9.38	18.45
PIMCO RealRetirement Series	34.66	20.54	55.20
Principal LifeTime Series	29.70	25.83	55.53
Putnam RetirementReady Series	13.95	11.27	25.22
RiverSource Retirement Plus Series	12.22	0.00	12.22
Russell LifePoints Target Date Series	11.43	6.12	17.55
Seligman TargetHorizon ETF Series	26.02	21.25	47.27
State Farm Lifepath Series	11.76	5.23	16.99
T. Rowe Price Retirement Series	11.01	3.02	14.03
TIAA-CREF Lifecycle Series	18.46	7.13	25.59
Vanguard Target Retirement Series	14.03	20.25	34.28

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Vantagepoint Milestone Series	5.72	2.63	8.35
Industry Average	13.66	9.52	23.18

Data through 12/31/10. Source: Morningstar, Inc.

Paying for Performance

The criteria used to determine a fund manager's bonus compensation—usually the bulk of a manager's annual pay—can indicate whether a fund manager's own financial incentives are aligned with target-date shareholders'. Since most investors presumably will hold target-date funds for decades, a pay plan that would reward managers who deliver peer-beating returns over longer periods would put the managers' incentives in line with shareholders'.

Seven of the 21 series that Morningstar studied most closely met these pay-for-longer-term-performance criteria as of Dec. 31, 2010. Two series—MassMutual and Wells Fargo—made no mention of paying for strong long-term performance in their description of their pay plan in the funds' Statement of Additional Information filing with the SEC.

31. Main Criteria of Pay Plans

Long-term Performance	Short-term Performance	Gathering Assets or Criterion Unclear
American Century LIVESTRONG Series	AllianceBernstein Retirement Str Series	Massachusetts Mutual Life Insurance Co.
American Funds Trgt Date Rtrmt Series	Blackrock LifePath Series	Wells Fargo Advantage DJ Target Date Ser
DWS LifeCompass Series	Fidelity Advisor Freedom Series	
ING Solution Series	Fidelity Freedom Series	
JPMorgan SmartRetirement Series	John Hancock Lifecycle Series	
T. Rowe Price Retirement Series	MFS Lifetime Series	
Vanguard Target Retirement Series	Oppenheimer LifeCycle Series	
	Principal LifeTime Series	
	Putnam RetirementReady Series	
	Schwab Target Series	
	TIAA-CREF Lifecycle Series	
	Vantagepoint Milestone Series	

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Much Skin in the Game?

Another way to gauge a fund manager's personal interest in a target-date series' success is to examine the managers' own investments in mutual fund shares. It stands to reason that managers who make meaningful investments in the funds they manage demonstrate conviction in the investment process and in fees charged.

Unfortunately, just two of the 44 target-date managers at the 21 series included in Morningstar's Target-Date Fund Series Ratings and Reports—Jerome Clark of T. Rowe Price and Hans Erickson of TIAA-CREF—have made investments greater than $500,000 in the target-date series they manage. (Within the Morningstar Stewardship Grades for mutual funds, managers who invest between $500,000 and $1 million in a core fund earn partial credit for manager ownership; managers who invest more than $1 million earn full credit.) Just four of the 21 series--ING Solution, MassMutual, TIAA-CREF Lifecycle, and T. Rowe Price Retirement--earn partial credit for manager ownership, and none of the series earn full credit.

To be sure, it can be difficult or impossible for managers to buy mutual fund shares at four of the series Morningstar studied. In each of these cases, the managers are able to invest in the strategy through non-mutual-fund investment vehicles, often as part of their employer's 401(k) plan. Managers of the series offered by ING, MassMutual, and Vantagepoint have maximized—or nearly maximized—their eligible contributions. That's how those series earned partial credit for manager investments.

Studying Incentives

Morningstar recently studied whether managers who have their own incentives aligned with shareholders' have outperformed in the subsequent years. Morningstar found that this was the case, particularly among equity funds, where manager ownership is more common--particularly in the greater-than-$1-million range. Morningstar looked to see whether funds earning top grades were more successful than those with lower grades as defined by the funds' Morningstar Rating success ratio. Funds with Morningstar Ratings of 3 or more stars were considered successful, while those earning 2 or fewer stars, as well as those that didn't survive, were considered unsuccessful.

Morningstar found that equity funds that earned A's for the manager-incentives portion of the Morningstar Stewardship Grades for mutual funds in 2007 were very successful over the subsequent three years (see Table 32). More than three fourths of the funds had Morningstar Ratings of 3 or more stars, meaning they performed competitively on a risk-adjusted basis relative to peer funds. Among the fixed-income funds, fewer than 20 funds earned A's or F's, so Morningstar didn't consider their results. But 84% of the bond funds earning B's were successful over the subsequent three years.

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32. Morningstar Rating Success Ratio by Letter Grade for Manager Incentives Portion of the Stewardship Grade

Letter Grade in 2007	Success Ratio % Equity Funds	Success Ratio % Fixed-Income Funds
A	79	N/A*
B	62	84
C	67	75
D	59	68
F	N/A*	N/A*

Data through 12/31/10. Source: Morningstar, Inc.

The results of this broader study suggest that target-date managers that have their own financial incentives aligned with fundholders' are likely to deliver competitive returns going forward. The series that get the highest combined scores for their pay plans and manager-ownership of fund shares are ING Solution and T. Rowe Price Retirement.

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Parent

An investment in a target-date fund is a long-term partnership with the fund's investment advisor, so it's important to partner with a parent asset-management company that puts fundholders' long-term interests before its own profits. Morningstar analyzes the degree to which the target-date series' parent is investor-focused as part of the Target-Date Series Ratings and Reports, which are issued quarterly on 21 of the industry's largest target-date series. The specifics of this methodology draw heavily on the Morningstar Stewardship Grades for mutual funds, which intend to measure how well a fund will care for investors' capital.

Specifically for the target-date series' Parent rating, Morningstar analyzes the corporate culture of a fund's parent organization, the quality of the board of directors overseeing the fund, and the fund firm's regulatory history. Morningstar also studies the series' transparency—specifically how well the series explains itself to shareholders in public documents. (See more in the Transparency section below.) The scores for each of these criteria are combined to arrive at the series' Parent rating of Top, Above Average, Average, Below Average, or Bottom.

The corporate-culture score, displayed as a letter grade below, carries the most weight in arriving at the final Parent rating. Four of the 21 series that Morningstar has rated—those from American Funds, T. Rowe Price, Vanguard, and Vantagepoint—get a top corporate-culture grade because these funds' parents have consistently acted in fund shareholders' best interests. The series with the worst corporate-culture score is that from Putnam, which earned a D as of Dec. 31, 2010. That firm's corporate-culture grade has since been raised to a C (see Table 33).

33. Series' Component Scores for Parent Criteria

Fund Series	Corporate-Culture Grade	Board Highly Independent	Board Invests Meaningfully in Fund Shares	Board Serves Shareholders Well	Regulatory History
AllianceBernstein Retirement Str Series	C	Yes	Yes	Partial Credit	Full Credit
American Century LIVESTRONG Series	C	Yes	Yes	Partial Credit	Full Credit
American Funds Trgt Date Rtrmt Series	A	Yes	No	Partial Credit	Full Credit
Blackrock LifePath	B	Yes	Yes	Partial Credit	Full Credit
DWS LifeCompass Series	C	Yes	Yes	Partial Credit	Full Credit
Fidelity Advisor Freedom Series	C	No	Yes	Partial Credit	Full Credit
Fidelity Freedom Series	C	No	Yes	Partial Credit	Full Credit
ING Solution Series	C	Yes	No	Partial Credit	Subtract Credit
John Hancock Lifecycle Series	C	Yes	No	Partial Credit	Full Credit
JPMorgan SmartRetirement Series	B	Yes	Yes	Partial Credit	Full Credit
Massachusetts Mutual Life Insurance Co.	C	Yes	No	Partial Credit	Full Credit
MFS Lifetime Series	B	Yes	Yes	Partial Credit	Full Credit
Oppenheimer LifeCycle Series	C	Yes	Yes	Partial Credit	Full Credit
Principal LifeTime Series	C	No	Yes	Partial Credit	Full Credit

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33. Series' Component Scores for Parent Criteria (continued)

Fund Series	Corporate-Culture Grade	Board Highly Independent	Board Invests Meaningfully in Fund Shares	Board Serves Shareholders Well	Regulatory History
Putnam RetirementReady Series	D	Yes	Yes	Partial Credit	Full Credit
Schwab Target Series	C	No	No	Partial Credit	Subtract Credit
T. Rowe Price Retirement Series	A	No	Yes	Full Credit	Full Credit
TIAA-CREF Lifecycle Series	C	Yes	Yes	Partial Credit	Full Credit
Vanguard Target Retirement Series	A	No	Yes	Full Credit	Full Credit
Vantagepoint Milestone Series	A	Yes	No	Full Credit	Full Credit
Wells Fargo Advantage DJ Target Date Ser	C	Yes	No	Partial Credit	Full Credit

Data through 12/31/10. Source: Morningstar, Inc.

As of Dec. 31, 2010, none of the fund boards overseeing the rated series earns perfect scores for independent leadership, board investment in fund shares, and serving shareholders well, although several series got full credit for two of the three criteria.

On the regulatory history front, most of the series Morningstar rated have had clean regulatory records or have made amends for past infractions. The exceptions are ING, a division of which was accused in 2006 of not disclosing a promotional agreement it arranged with a New York teachers' union. And the Schwab series also has been tarnished by allegations of wrongdoing with regard to some of its fixed-income funds. Regulators have said that Schwab YieldPlus was marketed as money market alternative, even though it held relatively risky securities and subsequently posted steep losses in the 2008 liquidity crisis.

Good Stewardship, Good Shareholder Experiences

These stewardship criteria of Morningstar's target-date methodology may be considered by some fiduciaries to be less important that the series' past performance, asset allocation, or cost. But Morningstar recently studied whether stewardship these criteria are predictive of a good shareholder experience as part of a March 2011 study of its Stewardship Grade methodology. (The full results of the Stewardship Grade study can be found here: http://corporate.morningstar.com/us/documents/methodologydocuments/MethodologyPapers/StewardshipGradeMethodology.pdf)

Morningstar found that the corporate-culture portion of the methodology did predict good outcomes for shareholders, as did the overall grades. The results for the board section were less conclusive. Table 34 shows the Morningstar Rating success ratios for the corporate culture, fund board quality, and overall Stewardship Grades issued in 2007. The Morningstar Rating success ratio considers funds successful if their Morningstar Rating is three stars or higher, and unsuccessful if they earned fewer than three stars or didn't survive. These results suggest that target-date investors who choose series with good stewardship characteristics are more likely to be successful, as measured by peer-based risk-adjusted returns, in the subsequent years.

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34. 3-Year Morningstar Success Ratios by 2007 Corporate Culture, Board Quality and Overall Stewardship Grades

	3-Year Morningstar Rating Success Ratio		
Letter Grade in 2007	**Corporate Culture**	**Board Quality**	**Overall Stewardship**
A	87	73	85
B	66	74	84
C	68	65	65
D	56	N/A	54
F	N/A	N/A	52

Data through 12/31/10. Source: Morningstar, Inc.

Transparency

Along with the other stewardship-related criteria for the Parent section of the target-date rating methodology, Morningstar also analyzes the quality of target-date series' descriptions of their funds. The fund companies behind target-date series have the difficult task of explaining these complex and dynamic investments to shareholders and fiduciaries. If shareholders are to own these funds successfully for decades, investors should understand how the funds are structured and how they can help investors meet their financial goals. It is also critical that the funds provide enough information to fiduciaries—the advisors, consultants, and plan sponsors choosing target-date funds for defined-contribution and other savings plans—so these shareholder representatives can adequately assess the funds' potential risks and rewards.

Morningstar's research has shown that the quality of this public disclosure varies considerably. Some firms include thoughtful explanations of their target-date funds in public documents and on their websites, while others have very little helpful information.

As part of its research effort into funds' disclosure, Morningstar looked to see which fund series met the suggested target-date disclosure criteria put forth by the Investment Company Institute, or ICI, the trade group for the mutual fund industry, in a paper issued in mid-2009: http://www.ici.org/pdf/ppr_09_principles.pdf. Specifically, the ICI suggested fund series prominently disclose:

1. The relevance of the "target date" used in a fund name, including what happens on the target date.
2. The fund's assumptions about the investor's withdrawal intentions after reaching the target date.
3. The age group for whom the fund is designed.
4. An illustration of the asset-allocation path (or glide path) that the target-date fund follows and the degree from which management may change the allocation tactically.
5. A statement of the risks associated with the series.

Table 35 that follows outlines which series currently meet the ICI's five standards.

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35. Target-Date Series Meeting 2009 ICI Standards for Public Disclosure

Fund Series	Relevance of Target Date	Withdrawal Intentions	Age Group	Asset Allocation Illustration	Degree of Tactical Allocation	Risk of Loss Statement	Where to Get More Information
MassMutual	•	•	•	•	•	•	•
BlackRock LifePath	•	•	•	•		•	•
Fidelity Freedom	•	•	•	•		•	•
ING	•	•	•	•		•	•
Principal	•	•	•	•		•	•
Putnam	•	•	•	•		•	•
Schwab	•	•	•	•		•	•
T. Rowe Price	•	•	•	•		•	•
Vanguard	•	•	•	•		•	•
Wells Fargo	•	•	•	•		•	•
American Century	•	•	•	•		•	
MFS	•	•	•	•		•	
Oppenheimer	•	•	•	•		•	
TIAA-CREF	•	•	•	•		•	
Vantagepoint	•	•	•	•		•	
AllianceBernstein	•		•	•		•	•
JPMorgan	•		•	•		•	•
Fidelity Advisor Freedom	•		•	•		•	
John Hancock	•		•	•		•	
American Funds	•		•	•		•	
DWS	•		•			•	

Data through 12/31/10. Source: Morningstar, Inc.

The ICI's suggestions are a good place to start, but Morningstar asserts that further disclosure is necessary to fully and adequately evaluate the quality and risk profile of a target-date series. Specifically, target-date series should be required to disclose publicly and prominently to shareholders:

1. The investment rationale behind the strategic asset-allocation path used in the target-date series.
2. The subasset classes likely to be represented in the funds' strategic asset-allocation path and their intended percentage of assets.
3. In cases where the target-date series uses a fund of funds structure, a list of the underlying funds included in the target-date series, as well as:

a. The percentage of assets allocated to each underlying fund, and

b. The underlying funds' asset allocation, including market-cap size for stock funds; credit quality, maturity, and sector information for fixed-income funds; and both for multi-asset-class funds.

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4. The underlying funds' performance relative to its prospectus benchmark over the past one-, three-, five-, and 10-year periods.
5. In cases where the target-date series owns individual securities, a list of the investment strategies represented by the securities, including references to similar strategies run by the advisor, such as a public mutual fund.

Tables 36 and 37 show which series already meet Morningstar's suggested standards listed above.

36. Public Disclosure of Rationale, Glide Path, and Performance

Fund Series	Investment Rationale for Asset Allocation Path	Subasset Classes in the Glide Path	Target-Date Funds' Performance
BlackRock LifePath	•	•	•
Fidelity Freedom	•	•	•
ING	•	•	•
JPMorgan	•	•	•
Principal	•	•	•
T Rowe Price	•	•	•
Vanguard	•	•	•
MassMutual	•		•
Schwab	•		•
Wells Fargo	•		•
AllianceBernstein		•	•
American Funds		•	•
Fidelity Advisor Freedom		•	•
Oppenheimer		•	•
TIAA-CREF		•	•
American Century			•
DWS			•
John Hancock			•
MFS			•
Putnam			•
Vantagepoint			•

Data through 12/31/10. Source: Morningstar, Inc.

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37. Public Disclosure of Target-Date Series' Underlying Holdings and Their Attributes

Fund Series	Lists Underlying Funds	Shows % of Assets Allocated to Each Fund	Shows Market-cap	Shows Sector Weights	Shows Credit Quality	Shows Maturity	Underlying Funds' Performance Relative to Benchmark	Lists Similar Strategies for Indiviual Securities
American Century	•	•	•	•	•	•	•	
DWS	•	•	•	•	•	•	•	
Fidelity Advisor Freedom	•	•	•	•	•	•	•	
JPMorgan	•	•	•	•	•	•	•	
MFS	•	•	•	•	•	•	•	
Principal	•	•	•	•	•	•	•	
Schwab	•	•	•	•	•	•	•	
T. Rowe Price	•	•	•	•	•	•	•	
TIAA-CREF	•	•	•	•	•	•	•	
Vanguard	•	•	•	•	•	•	•	
Oppenheimer	•	•	•	•	•	•		
Fidelity Freedom	•	•		•	•	•	•	
John Hancock	•	•		•	•	•	•	
American Funds	•	•		•	•	•		
Putnam	•	•			•	•	•	
ING	•	•	•	•				
Vantagepoint	•	•		•			•	
BlackRock LifePath	•	•						
MassMutual	•	•						
Wells Fargo	N/A	N/A					N/A	•
AllianceBernstein	N/A	N/A					N/A	

Data through 12/31/10. Source: Morningstar, Inc.

Morningstar is not the only organization calling for more-thorough target-date disclosure. Regulators took a hard look at this issue in 2010 as well. Both the SEC and the Department of Labor, which oversees the disclosure and investments commonly included in retirement plans, sought public comment on proposals to improve the disclosure associated with target-date funds. (Morningstar commented on the SEC's proposed disclosure rule in August 2010, forwarding some of the ideas listed above. http://www.sec.gov/comments/s7-12-10/s71210-44.pdf)

Meanwhile, the industry has made some improvement on its own. In 2009, none of the series met all of the ICI's guidelines for disclosure, but in 2010, MassMutual met all of the requirements. And six series that Morningstar studied met all of Morningstar's additional disclosure requests.

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Series also have improved their discussion of how they expect shareholders to use their funds upon reaching the target year. Some series are designed to be held through retirement, while others are built to take investors up to retirement whereupon the assets are intended to move elsewhere. Series that explicitly state how they expect shareholders to withdrawal their retirement savings--gradually, during retirement, or a lump sum at retirement--should improve the chances that investors will use the funds as designed. The ICI made a similar suggestion in a January 2011 letter (http://www.ici.org/pdf/24878.pdf) responding to the Department of Labor's November 2010 proposals to improve target date disclosure (http://webapps.dol.gov/federalregister/HtmlDisplay.aspx?DocId=24466&AgencyId=8&DocumentType=1).

Table 38 shows which series address the withdrawal intentions described above. Several series' public documents mention the withdrawal process but discuss it so broadly that one can't determine how the series expects shareholders to tap their savings. In these cases, the series don't receive a checkmark.

38. Public Disclosure of Rationale, Glide Path, and Performance

Fund Series	Gradually During Retirement	All or Most at Retirement
American Century	•	
Fidelity Freedom	•	
ING	•	
MassMutual	•	
MFS	•	
Oppenheimer	•	
Principal	•	
Putnam	•	
Schwab	•	
T Rowe Price	•	
TIAA-Cref	•	
Vanguard	•	
Vantagepoint	•	
BlackRock		•
Wells Fargo		•
AllianceBernstein		
American Funds		
DWS		
Fidelity Advisor Freedom		
JHancock		
JPMorgan		

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An area that many series could still improve is publicly disclosing the investment rationale for the asset-allocation path. While several fund shops have embraced the complexity of target date funds by posting explanatory videos, brochures, and research on their websites, most others report minimal information. Informing investors about what these series own and how they are constructed would go a long way toward getting investors to best use the funds.

To be sure, many firms do provide this level of disclosure privately to research organizations such as Morningstar, defined-contribution plan sponsors and consultants, and other interested parties. In addition, fund companies often provide more details to defined-contribution plan participants through private password-protected websites that participants may access. While Morningstar does review those private disclosures when they're made available, only public information is reflected in the table above. Such private disclosure is uneven—one can't be sure whether all investors actually have access to this information, and some fiduciaries may end up with more resources for their due diligence than others.

Morningstar maintains, however, that the information should be broadly and prominently displayed—preferably in documents filed with the SEC and other regulators—to eliminate the risk that this critically important information is unavailable to shareholders and fiduciaries seeking it. If investors are well-informed, they're more likely to own target-date funds well and avoid costly mistakes, such as buying funds with unsuitable risk profiles or selling out of funds during bouts of underperformance that are reasonable given the series' strategy. For example, many 2010 fund shareholders—along with lawmakers and other industry watchdogs—seemed surprised by the extent to which their funds owned equities and were subject to sizable damage during 2008's market crash. Those who sold during the worst of the sell-off locked in losses that may have been recovered in part during the market rebound that began in 2009. Investors who understand what they own are much more likely to own their funds well and avoid what can be costly mistakes.

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Morningstar Target-Date Fund Series Ratings

When it comes to assessing specific strengths and weaknesses of target-date series, Morningstar has developed a methodology to evaluate series based on the same themes outlined in this report: Process, Performance, Portfolio, Price, People, and Parent. Each area but Process receives a rating based on a combination of quantitative and qualitative analysis. Morningstar then combines those five section ratings to come up with an overall rating for 21 of the largest target-date series. Morningstar updates these ratings, and the reports that accompany them, quarterly. (For more on Morningstar's target-date rating methodology, click here: http://corporate.morningstar.com/us/documents/MethodologyDocuments/MethodologyPapers/TargetDateFundSeries_RatingMethodology.pdf.)

The series' ratings for each of those five sections follows, as do the series' overall ratings. As of Dec. 31, 2010, the target-date series that reflected the most industry best-practices were American Funds, T. Rowe Price, and Vanguard. Each earned a Top rating for their series. Four of the 20 series earned ratings of Below Average and Bottom. In Morningstar's view, these series have plenty of room for improvement when it comes to series construction, returns, fees, management, and stewardship.

39. Performance Ratings, December 2010

Top	Above Average	Average	Below Average	Bottom
American Century	JP Morgan	American Funds	DWS	AllianceBernstein
	MFS	BlackRock LifePath	ING Solution	Oppenheimer
	Schwab	Fidelity Freedom	John Hancock	
	Wells Fargo	Fidelity Adv Freedom	Putnam	
		MassMutual		
		Principal		
		T. Rowe Price		
		TIAA-CREF		
		Vanguard		
		Vantagepoint		

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40. Portfolio Ratings, December 2010

Top	Above Average	Average	Below Average	Bottom
American Funds	JP Morgan	American Century	DWS	
ING Solution	MFS	John Hancock		
Vanguard	Oppenheimer	MassMutual		
	T. Rowe Price	Principal		
	Vantagepoint	Putnam		
		Schwab		
		TIAA-CREF		

Data through 12/31/10. Source: Morningstar, Inc.

41. Price Ratings, December 2010

Top	Above Average	Average	Below Average	Bottom
TIAA-CREF	American Century	American Funds	AllianceBernstein	MFS
Vanguard	Fidelity Freedom	BlackRock LifePath	DWS	Oppenheimer
Wells Fargo	Fidelity Adv Freedom	ING Solution	MassMutual	
	T. Rowe Price	John Hancock	Putnam	
		JP Morgan	Vantagepoint	
		Principal		
		Schwab		
		TIAA-CREF		

Data through 12/31/10. Source: Morningstar, Inc.

42. People Ratings, December 2010

Top	Above Average	Average	Below Average	Bottom
American Funds	ING Solution	American Century	Principal	AllianceBernstein
T. Rowe Price	John Hancock	BlackRock LifePath	Putnam	DWS
Vanguard	JP Morgan	Fidelity Freedom	Schwab	Oppenheimer
	MFS	Fidelity Adv Freedom		
	TIAA-CREF	MassMutual		
	Vantagepoint	Wells Fargo		

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43. Parent Ratings, December 2010

Top	Above Average	Average	Below Average	Bottom
T. Rowe Price	American Funds	AllianceBernstein	ING Solution	
Vanguard	BlackRock LifePath	American Century	Schwab	
	JP Morgan	DWS		
	MFS	Fidelity Freedom		
	Vantagepoint	Fidelity Adv Freedom		
		John Hancock		
		MassMutual		
		Oppenheimer		
		Principal		
		Putnam		
		TIAA-CREF		
		Wells Fargo		

Data through 12/31/10. Source: Morningstar, Inc.

44. Overall Ratings, December 2010

Top	Above Average	Average	Below Average	Bottom
American Funds Target Date Retirement	American Century LIVESTRONG	BlackRock LifePath	DWS LifeCompass	AllianceBernstein Retirement
T. Rowe Price Retirement	JP Morgan SmartRetirement	Fidelity Freedom	Putnam RetirementReady	Oppenheimer LifeCycle
Vanguard Target Retirement	TIAA-CREF Lifecycle	Fidelity Adv Freedom		
	Vantagepoint Milestone	ING Solution		
	Wells Fargo Advantage DJ Target Date	John Hancock Lifecycle		
		MassMutual Destination Retirement		
		MFS Lifetime		
		Principal LifeTime		
		Schwab Target		

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