Morningstar Analyst Rating® and Research Reports for Target-Date Fund Series

Investor Benefits

- Shines a light on best practices in target-date funds, which will be many investors' primary means of retirement savings.
- Gives investors the ability to quickly and easily assess a fund company's lineup of target-date funds with an overall rating.
- Allows investors to evaluate target-date series in five key areas: Process, Price, Performance, People, and Parent.
- Provides investors with insight into how a target-date series' asset allocation may differ from category norms.

Purpose

Morningstar Target-Date Fund Series Ratings and Research Reports ("The Reports") are designed to help individual investors, financial advisors, plan sponsors, and other interested fiduciaries make informed decisions when evaluating a series of target-date funds.

Target-date funds are marketed as a one-decision, comprehensive investment option for investors' retirement savings. The funds tend to invest heavily in equities in the decades before retirement and shift their asset mixes to short-dated bonds and cash in the years immediately preceding and following retirement. The mutual fund industry refers to this shift in assets as a fund's "glide path." Target-date funds are by no means a uniform investment type. Depending on the glide-path philosophy, the subasset classes used, the nature and quality of the underlying investments, and a host of other factors, target-date funds can display markedly different risk-and-return characteristics. The Reports intend to illuminate these differences, so that fiduciaries can have the best possible information on hand for determining plan suitability.

Morningstar Target-Date Fund Series Rating and Research Reports use both quantitative and qualitative assessment methods to analyze target-date funds. The Reports:

- Make meaningful comparisons across the target-date universe.
- Provide insight into the factors most relevant to target-date fund series performance.
- Assess the suitability of target-date fund series for investors with widely varying needs.

Scope

Morningstar conducts quantitative scoring across all open-end target-date series that meet our minimum standards for history and comprehensiveness. Currently, we assign qualitative ratings and create reports for 22 target-date fund series.

Rating

The Morningstar Analyst Rating® for Target-Date Series is the summary expression of our forward-looking analysis of a target-date series. Morningstar Analyst Ratings are assigned on a five-tier scale: Gold, Silver, Bronze, Neutral, and Negative. The top three ratings, Gold, Silver, and Bronze, all indicate that our analysts think highly of a target-date series' parent organization, management team, and investment process and that the series' quantitative scores of price, portfolio, and performance beat those of peer offerings. We review the Analyst Rating for Target-Date Series quarterly when we update the text and analyze the data associated with each target-date fund series.

Pillar Ratings

As with the Morningstar Analyst Rating for Funds, Morningstar analysts evaluate the following components to determine an overall rating:

Process
Price
Performance
People
Parent

These are the same areas rated by Morningstar analysts when evaluating mutual funds, but the Pillar ratings of target-date series include unique quantitative metrics.

Process

The Process rating evaluates the asset-allocation and fund-selection process of a target-date series. It includes both a qualitative and quantitative component.

Process: Approach (10% of overall rating)

We look for investment options with an asset-allocation approach, performance objective, and investment process (for both manager selection and portfolio construction) that are sensible, clearly defined, and repeatable. The process must also be implemented effectively. In addition, the portfolio should be constructed in a manner that is consistent with the investment process and performance objective. Morningstar analysts are agnostic to an investment manager's overall style. For multi-asset-class funds such as target-date series, a wide range of approaches to asset allocation can succeed.

Process: Portfolio (10% of overall rating)
The Process: Portfolio score examines the quality of the underlying holdings in each target-date series, based on the Morningstar Rating for mutual funds (the "star rating") of those underlying funds. The star rating compares a fund's risk-adjusted performance with its peer group, as defined by its Morningstar open-end fund category. We calculate a weighted average star rating for the holdings in all funds in a target-date series.

Price (20% of overall rating)
Morningstar and independent academic research have shown that investment expenses are one of the better predictors of future outperformance, even when evaluating net-of-fee returns. Given this, costs cannot be ignored. To determine the Price score, Morningstar calculates the asset-weighted Morningstar Fee Level – Distribution Percentile Rank for all share classes in the series. Note that prior to 2013, a series' Price rating was based on the ratio of a selected share class expense ratio (that is, the lowest-cost share class with at least 10% of series assets) with the industry average expense ratio.

The Morningstar Fee Level – Distribution measures fund expenses compared with other funds' in the same asset class and distribution channel. Crucially, the Morningstar Fee Level – Distribution includes retirement share classes, which are heavily represented in the target-date industry.

Performance (20% of overall rating)
This criterion assesses how well a target-date fund has performed historically relative to its peers. Backward-looking views of target-date fund performance can be skewed by the relatively short performance histories of many series. Nevertheless, Morningstar believes that it is important to evaluate past performance because it can give clues as to how funds may perform in future market cycles.

Morningstar compares each target-date fund series' overall Morningstar Risk-Adjusted Returns with the average MRAR of the target-date universe. MRAR adjusts a fund's total return by deducting a "risk penalty" based on its month-to-month variation in return. Before assigning the Performance rating, the methodology normalizes series' aggregate risk-adjusted performance based on the dispersion of market returns.

People (20% of overall rating)
The overall quality of the investment managers running the target-date series is a significant key to the investments' ability to deliver superior performance relative to their benchmarks and/or peers. The People rating is a qualitative assessment of those individuals who make the key asset-allocation, manager-selection, and portfolio-construction decisions for the series; management teams' approach to conflict resolution; and managers' available resources.

Parent (20% of overall rating)
We believe the parent organization—in this case, the fund firm offering the series—is of utmost importance in evaluating investments. Although other factors may have more immediate impact, they would not be sustainable without backing from the fund firm. Further, the fund firm and its management set the tone for key elements of our evaluation, including capacity management, risk management, recruitment and retention of talent, and compensation.

We believe that assessment of the parent organization is particularly important for target-date series, as investors are potentially entering into a lifelong investment. For this reason, the Parent rating for the Target-Date Ratings and Reports uses the same methodology and analysis as the Parent rating for the Morningstar Analyst Rating for Funds.

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