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Subject: **TARGET DATE FUNDS: Growth, Risk & New Analytics**

RETURNS & TARGET DATE FUNDS

Challenged by volatility, risk aversion, low growth, struggling economies and sovereign debt problems, **Global Market** returns were somewhat disappointing in 2011. Based on a robust 4th quarter rally in the U.S. equity markets, the **S&P 500** gained 2.1% while the **MSCI All Country World Ex-U.S.** lost 13.7%. Given the appetite for risk aversion, **U.S. Government** returns were in excess of 9.0% while **Long-Term U.S. Government** returns were more than twice that. The worst performing sector, **Financial Services**, dropped 16.5% and individual **Commodity** returns were all over the map.

The average **Target Date Fund** with four years to retirement fell 0.4%, trailing the small gain posted by the S&P 500. It is, however, important to note that the S&P 500 does not incur fees. Additionally, Target Date Funds hold meaningful positions in non-U.S. equities, categories off sharply in 2011.

Target Date Fund managers may not be beating their benchmarks, but Ignoring journalistic sensationalism, they are delivering the beef on a collective basis. In other words, Target Date Funds are **not** a strategy with failed execution.

FLOWS & TARGET DATE FUNDS

Outgunned by ETF flows of \$121 billion, Morningstar reported a \$56 billion **net** gain (after fund mergers & liquidations) in total **Long Term Mutual Fund flows** during 2011, the lowest inflows since the 2008 financial crisis. With \$99 billion in outflows, **U.S. Stock Funds took the biggest hit. Municipal Bonds and Passively Managed Funds were among the year's big winners.** With only 13% market share, passively managed funds still have a long way to go.

Not surprisingly, Vanguard's \$30 billion in total flow topped the list. PIMCO, JP Morgan, Dimensional and BlackRock also reported meaningful increases in net fund flows for the year. Contrastingly, the American Funds lost \$82 billion while Fidelity experienced outflows of \$28 billion.

Based on 383 funds and 46 families (at least one year of history) tracked by Ibbotson, **Target Date Fund flows** remain positive and respectable, but they trailed off late in the year. While the near \$400 billion held in Target Date Funds are double the 2008 level, the published data does **not** reflect the large plan movement towards custom solutions and alternative investment vehicles.

The largest **Target Date Fund family flows** remain positive, but the Fidelity Freedom funds appear to have experienced the most drop off late in the year while Vanguard and T. Rowe reported minor declines. In addition to the new assets captured by the major Target Date Fund families, JP Morgan and PIMCO reported meaningful increases in net assets when measured by percent growth. In contrast, Goldman Sachs, Alliance Bernstein and Putnam reported the largest percent decline in Target Date Fund assets. Based on Ibbotson's 3rd quarter report, the American Funds, JP Morgan, T. Rowe and Vanguard were the top rated Target Date Fund families.

For more information on Morningstar's *Fund Flow Update*, go to:
<http://corporate.morningstar.com/US/asp/subject.aspx?xmlfile=2955.xml>

For more information on ETF flows and assets, go to: <http://www.etf-ia.com/>

GLIDE PATH INSTABILITY

The implied glide path is one of the primary tools used to evaluate Target Date Fund families. When compared to other fund families, the peer comparison helps one ascertain the risk associated with a fund's management style. Unfortunately, the glide path of a fund family prudently selected by a plan sponsor may not be the same fund their participants are investing in.

It is well known that the equity exposure of funds with the same target date varies widely between fund families. However, as noted in the Ibbotson report on *Bait & Switch: Glide Path Instability*, **few realize that the glide path within a single fund family can change significantly over time.**

There are many reasons why a glide path might evolve, including a change in methodology, the addition of new asset classes, tactical overlay, volatility management and more. Nevertheless, the Ibbotson research noted that the changes in the glide path were *shocking*, including the major fund families like Fidelity, Vanguard and T. Rowe.

While major glide path changes could be justified, prudent risk management demands that glide path changes be monitored, evaluated and disclosed. The Ibbotson Glide Path Stability Score (GPSS) was designed to aid the process.

To view Ibbotson's September 12, 2011 report, *Bait & Switch: Glide Path Instability*, go to:
<http://corporate.morningstar.com/ib/asp/detail.aspx?xmlfile=1409.xml>.

TARGET DATE FUNDS POISED FOR GROWTH & DOMINATION

When talking to premier bundled and semi-bundled providers who provide award winning communications material in private, many will tell you that a significant portion of their materials are discarded or never used. These voices also tell us that while **participants want an easy solution, they do not want to learn.**

These voices are convinced that **Target Date Fund assets could grow to 70% of all participant directed DC type plan assets in the next five years.** Index and other low cost funds are also expected to gain in popularity for a variety of reasons, including risk mitigation.

Some equity exposure is widely viewed as preferable and it's important to note that **once participants are defaulted into a Target Date Fund – QDIA or auto enrollment – the assets remain sticky, i.e., few participants reallocate.**

Some within the CFDD's network have concluded that there is little merit in focusing on the Target Date Fund glide path beyond the required due diligence because the optimal glide path will always be market dependent. Experts can certainly look back and identify the preferred glide path, but few, if any, can predict the preferred glide path of the future.

Based on these observations, enticing participants into the plan and increasing contributions are the path to success. Managing risk through good governance will always remain essential. Nevertheless, **advisors who craft plans to maximize participation and contributions on a cost effective basis will have the strongest value proposition.** This is exactly why outcomes based consulting is the primary theme of the CFDD's 2012 Advisor Conference.

Flipping the coin over, these observers believe that **advisors focusing on participant education and asset allocation as cornerstones of their value proposition could lose market share.** Many who claim to provide these services, particularly in the small plan market, fail to deliver. The new regulations requiring advisors to list their services in writing could also impact the willingness to offer these services.

THE MARGIN PRESSURE HEADACHE:

The aforementioned scenario will lead to the further commodization of investments. **Investment costs will remain under pressure, recordkeepers will move to a per-head charge and advisors will move to stated flat fees.**

Before ultimately leading to higher prices, the new disclosure regulations will further pressure providers who are already margin poor, particularly those with older blocks of business. **Margin pressure will force providers to lower costs** as they fight to protect their margins. The need to reduce costs will impact revenue sharing agreements, increase outsourcing and require providers to move services to lower cost labor markets, trends already in motion.

In addition to pressuring providers, the new disclosure will also pressure margins for advisors, including their umbrella organizations. Based on constantly expanding wholesaler forces, the DCIO vendors do, however, appear to be holding their own. **The enhanced disclosure could also generate new litigation**, including school districts and plans improperly allocating participant account fees.

If interest rates remain low and yields continue to fall, the spreads on general account products and other fixed options will further contribute to margin pressure. With the U.S. viewed as the developed world's least dirty diaper, record demand for treasuries and record-low yields, this scenario is increasingly likely.

AHEAD OF THE TARGET DATE FUND CURVE

As they increase market share, the ability to evaluate Target Date Funds will become central to success and survival. To avoid going the way of Kodak, **advisors MUST get their arms around target date analytics and adapt to changing conditions**. Given the need, CFDD '12 will pioneer new ground with two game changing Target Date Fund breakout sessions by Allianz Global Investors and PIMCO.

Glenn Dial (Sr. VP, Head of Retirement, Allianz Global Investors) appears to be doing some interesting work with Shlomo Benartzi. As a result, Dial's presentation will feature the influence of behavioral finance and retirement income on Target Date Fund solutions. Contrastingly, PIMCO is going in a completely different direction.

PIMCO's presentation on *Shining A Light On Target Date Fund Analysis* will take a deep dive into why this most important asset class requires a greater level of due diligence, including increased glide path evaluation, underlying components and discussing how the glide path will perform under various economic scenarios. The presentation will also incorporate their new and soon to launch *RealPath*, **an analytic tool designed to facilitate meaningful glide path due diligence**.

The *RealPath* Target Date Fund analyzer is expected to roll out next month with much fanfare. It has certainly been built on other work, but **the RealPath analyzer appears to be the real deal and ahead of other tools**. PIMCO also claims that the analyzer will be subject to continual enhancement.

Most advisors seem excited about the *RealPath*, but some will always be skeptical of proprietary tools due to fund company biases, a perceived lack of objectivity, disclosure and evolving fund company business models.

PIMCO has not yet committed, but **the CFDD is attempting to facilitate wraparound training to provide advisors attending our October 22-24, 2012 Advisor Conference at the downtown Chicago Swissotel with hands on exposure to the new and innovative *RealPath* analyzer.**

TARGET DATE FUND STRATEGIES FOR A CRISIS-PRONE WORLD

Through diversification, asset classes, flexibility and hedging, PIMCO's Real Retirement Funds are quite different from other Target Date Funds.

Based on dynamic management, broad asset classes (including real return assets like TIPs, real estate & commodities), reduced equity exposure and tail-risk hedging, PIMCO's goal is to provide reasonable returns while mitigating the effects of inflation, volatility and a market meltdown.

PIMCO's strategies center around their *new normal* view of the world economies (high risk, volatility & low growth) and the fact that one big loss for those nearing retirement would make it difficult, if not impossible, to recover. On the other hand, hedging can be expensive and a drag on returns. Some note that historical equity market performance is a further challenge to the strategy, but ***black swan events occur far more frequently than generally recognized***. In other words, these shocks are like non-recurring expenses that occur with regularity.

Some view PIMCO's funds as idiosyncratic and all fund families experience periods of underperformance. Nevertheless, marginal underperformance and market meltdowns are very different scenarios. Indeed, in an insolvent, over populated and resource poor world lacking leadership, PIMCO's strategy makes sense. For additional combustion, consider the unprecedented spread of lethal weaponry and geopolitical adversaries – sovereign & non-sovereign - with Stone Age mentality and fatalistic cultures.

The world and the investment markets have never been more dangerous or crisis-prone. As a result, **the need for advanced risk management is irrefutable**. The questions, however, remain unanswered. Can the complex strategies be executed, are they affordable and will they work when investors need them? Given the limited track record, these answers can only be provided over time. If PIMCO's strategies do work, **a bull market in advanced risk management is on the horizon**.

In addition to the *Shining A Light On Target Date Fund Analysis* breakout session, Neel Kashkari (Managing Director, Head of Global Equities, PIMCO) will deliver a conference keynote on *DC Plan Investment Trends: Death of The Style Box*.

CFDD 2012 ADVISOR CONFERENCE

The CFDD's October 22-24, 2012 Advisor Conference, *Outcomes Based Consulting, Higher Margin Business & Increased Efficiency*, is the premier education and networking event for the retirement plans advisory industry.

Hosted at the convenient downtown Chicago Swissotel, the two and one-half day, Monday-Wednesday conference offers **more VALUE, CONTENT, CONVENIENCE, ATTENDANCE and GROWTH SOLUTIONS** than any other event. Our advisor audience continues to expand and **over 1,200 retirement plan specialists will attend CFDD '12.**

Known as the *King of Content*, the CFDD's broad, diverse and bottom-up agenda remains at the top of the food chain. The *fifty* different breakout sessions are populated by the industry's **most sought after speakers and accomplished advisors.**

Providing actionable takeaways, **prestigious research organizations** will also participate in the CFDD '12 agenda, including Spectrem Group, Chatham Partners, LIMRA & Brightwork Partners.

The **seven blockbuster keynotes** include Fred Reish's exclusive and game changing presentation on *Benchmarking Advisor Fees From A Legal Perspective*. Other keynotes, including *DC Plan Investment Trends: Death Of The Style Box* by Neel Kashkari, Managing Director and Head of Global Equities at PIMCO. Sponsored by Allianz Global Investors, Shlomo Benartiz & Glenn Dial will return with a new presentation, *Save More Tomorrow: Practical Behavioral Finance Solutions to Improve 401(k) Plans*.

The fragile economic recovery and the investment markets remain challenging. With the retirement plans market and the financial services industry maturing, full compliance has become almost impossible. Competition has intensified, differentiation is increasingly difficult and margins are compressing. At the same time, clients are demanding more and tax code changes could have a major impact on the industry.

Given the changing dynamics, **advisors must increase their volume, improve efficiency through scalable solutions, diversify and develop higher margin business.** Because **advisors cannot participate in consolidation without influencing positive outcomes, differentiating with a more holistic approach and reducing risk through good governance,** CFDD '12 will provide the applicable deliverables.

In addition to the aforementioned, CFDD '12 will *Emphasize Investment Approaches With Pricing Power, Returns Beyond Performance, Model Portfolios, IAR Distribution Of Participant Elected Managed Accounts, ERISA Vs. Non-ERISA Fiduciary Standards, Who's Winning & Losing In The Nonprofit Markets, The Impact Of Tax Code Changes, Qualifying RIA/IARs Providing Participant Level Advice, Success Metrics and Behavioral Finance.*

Hiring, training, succession planning and scalability remain the biggest business challenges facing advisors. Practices can't grow without staffing and they can't be monetized without succession planning. To enrich their practice, **advisors may bring one immediate team member at a 50% discount.**

To add value and increase efficiency, the CFDD's Advisor Conference provides a **single source solution for unmatched core CE credits**, including IMCA, CFP, fi360, ASPPA, NIPA, IBF, CFA, SPARK, The American College, the College for Financial Planning and more. As an added bonus, **conference attendees can earn the Accredited Investment Fiduciary (AIF®) designation by attending fi360's discounted pre-conference training.**

Attendees further benefit from early registration discounts, a fiduciary insurance discount program, a **conference CD-ROM and online access to ALL prior year conference presentations, including the audio files of each presentation.** To access the 2011 conference presentations and MP3 audio files, go directly to: <http://www.thecfdd.com/CFDDconf2011presentations>.

In addition to **FREE wireless** in the guest rooms, the meeting rooms and the exhibit area, the hotel's **cell phone reception is excellent.** A **charging station** and **cyber café** are also available and spouses may attend the conference at NO additional cost.

Complimentary food, beverages, snacks, cocktails and a NASCAR themed Kick-Off Party are all included in the registration fee. Sponsored by Allianz Global Investors, Simulated **Racecar Gameplay Competition with meaningful cash prizes** is also included.

NASCAR will be the marketing theme and feature a TIAA-CREF sponsored **Primary Grand Prize Box Seat Package To The Daytona 500**, including beachfront accommodations. A **Secondary Grand Prize Package To The Charlotte ALL-Star May Race** will also be offered, including a hot pit pass (access to everything except the race car) and behind the wheel **Racing School Classes.** To qualify for the grand prizes and the cash prizes, registrants must stay at the conference venue, the downtown Chicago Swissotel.

Recognizing the urgency to act now, CFDD '12 will provide **UNBIASED guidance and exclusive GROWTH SOLUTIONS** to elevate your practice. For more information on the CFDD's 2012 Advisor Conference, go to the conference homepage at: <http://www.thecfdd.com/CFDDconference2012>. To register early, **SAVE MONEY**, find out what is working from your peers and benefit from business building takeaways, register online by going directly to: <http://www.regonline.com/Register/Checkin.aspx?EventID=1026462>.

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