WHY TARGET DATE FUNDS?

WHY the U.S. Department of Labor approves the use of Target Date Funds as a default investment option in retirement savings plans.

WHY nearly all employers with "auto-enrollment" use Target Date Funds as *the* default investment option in their 401(k) plans.

FINANCIAL SECURITY PROJECT
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FOR INVESTING RETIREMENT SAVINGS

WHY TARGET DATE FUNDS?

Unless you have a good reason to do something else, a TARGET DATE FUND is a reasonable place to put *all* your retirement savings.

By Steven Sass, Alicia H. Munnell and Andrew Eschtruth

Art direction and design by Ronn Campisi, RONN CAMPISI DESIGN

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DECEMBER 2011

Your savings need to grow... and they need to be safe

Your retirement increasingly depends on how much you save and how you invest your savings.*

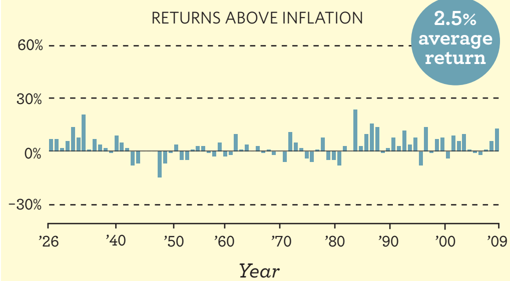
To have enough to pay the bills when you retire, your savings need to grow.

So the money is there when you need it, your savings need to be safe.

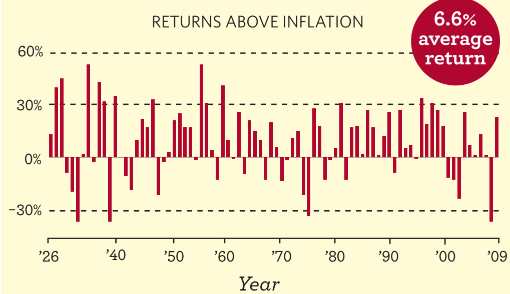
* Experts say how much you save is much more important than how you invest.

Experts say your most important investment decision is to strike a proper balance between growth and safety.

IF YOU INVEST YOUR SAVINGS IN BONDS, YOUR MONEY IS REASONABLY SAFE BUT WILL NOT GROW QUICKLY



IF YOU INVEST YOUR SAVINGS IN STOCKS, YOUR MONEY USUALLY GROWS FASTER BUT CAN ALSO FALL SHARPLY

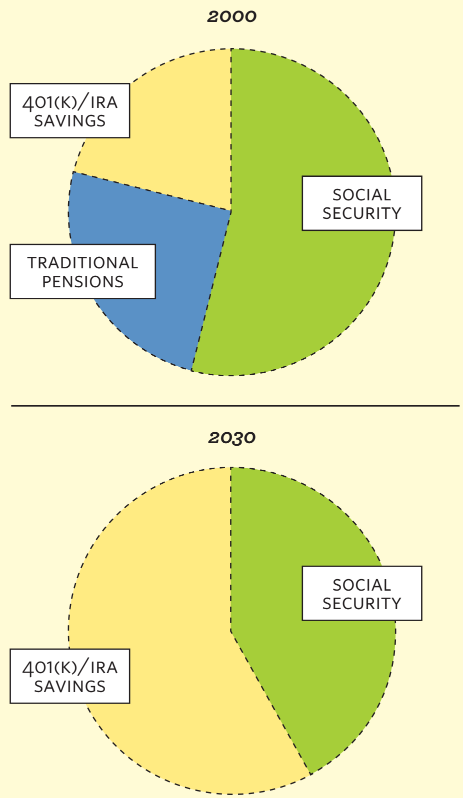


SOURCE: IBBOTSON ASSOCIATES. 2009. IBBOTSON SBBI CLASSIC YEARBOOK

Retirement saving is serious business

Retirees have received most of their income from Social Security and traditional employer pensions. But, as the illustration shows, workers retiring in the future must largely rely on their own retirement savings — if they want to maintain their pre-retirement living standards.

SOURCES OF RETIREMENT INCOME AVERAGE WORKERS NEED TO MAINTAIN PRE-RETIREMENT LIVING STANDARDS[1]



SOCIAL SECURITY will play a smaller role due to the rise in the program's Full Retirement Age, higher Medicare premiums (which are deducted from benefits), and more retirees paying tax on their benefits. Social Security will provide even less if Congress cuts benefits to close the program's funding shortfall.

TRADITIONAL EMPLOYER PENSIONS are increasingly rare as employers shift to 401(k)s, due to the decline of career employment and increased pension risks and costs.

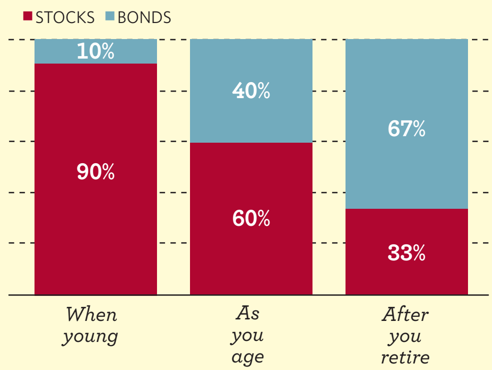
Target Date Funds shift your savings from growth to safety

Target Date Funds (TDFs) invest your 401(k) savings in a broadly diversified group of stocks and bonds, with the mix determined by a target retirement date.

When young — and your target retirement date lies far in the future — TDFs invest most of your savings in stocks for growth.

After you retire, TDFs invest more of your savings in bonds for greater safety.

HOW A TDF SHIFTS YOUR SAVINGS FROM STOCKS TO BONDS AS YOU AGE.



Why experts support the shift from growth to safety

As you age, you have fewer years of earnings and much more in retirement savings. Your finances become much more dependent on what you have in savings, and less on your remaining years of earnings. So your savings need to be safer.

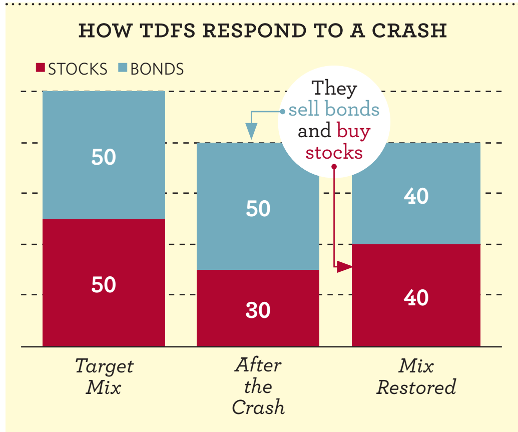
Your ability to offset financial downturns also declines. The size of financial losses rises as the amount you have in savings grows. And as you have fewer years of work remaining, it's much harder to offset these losses by working more or saving more.[2]

WHAT MOST PEOPLE DO If asked, most people would agree that it makes sense to shift their savings from growth to safety as they age. But very few do. When it comes to retirement saving, most people just "set it and forget it."

They restore the target mix of stocks and bonds when markets crash

Target Date Funds are hardly magic. They also lost value when the stock market crashed in 2008. But TDFs recovered somewhat better than most alternatives, due to their design: [3]

TDFs maintain a mix of stocks and bonds based on age. Say the mix for your age is ½ stocks and ½ bonds. After the value of stocks fell in the crash, the TDF held more bonds than stocks. To restore the mix, the TDF sold bonds and bought stocks.



Why experts support what TDFs did

Experts generally expect stocks and bonds to have the **same** returns and risks after a crash as they had before a crash. They also expect your retirement savings need the **same** balance between growth and safety, given your age and time to retirement. So after the crash of 2008 they would "rebalance" your savings so that the **same** portions are invested in stocks and bonds as before the crash — exactly what TDFs did.

WHAT MOST PEOPLE DID Most people did nothing. So after the crash reduced the value of stocks in their accounts they had a **smaller** portion invested in stocks.[4]

Of those who did something, most sold stocks. So after the crash they had an **even smaller** portion invested in stocks than those who did nothing.

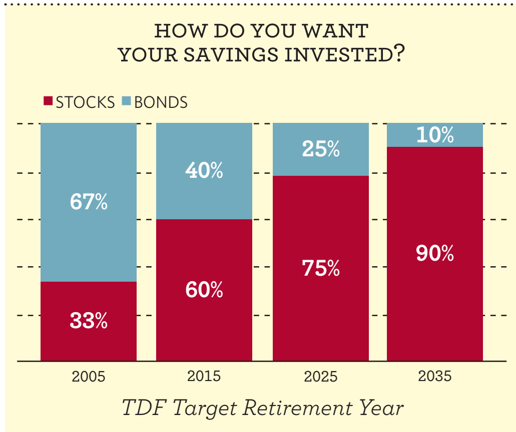
Stocks did bounce back. So those with savings in a TDF did better than those who did nothing – and much better than those who sold stocks.

TDFs buy stocks when stock prices fall and sell when stock prices rise: they buy low and sell high.

The Target Date: pick the Date that suits your needs

The TDF for your retirement date might not balance *your* need for growth and safety. If not, use the TDF with the Target Date that does.

Say you plan to retire in 2025 and the TDF for your retirement date invests 75% of your savings in stocks and 25% in bonds — but you need a different balance between growth and safety.



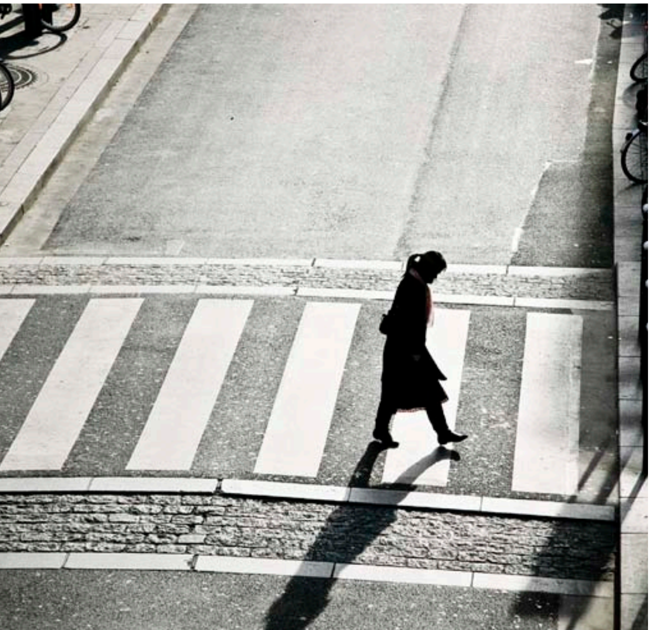
If you need more GROWTH, use the 2035 TDF, which puts more of your savings in stocks.

If you need more SAFETY, use the 2015 TDF, which puts more of your savings in bonds.

What could affect your need for growth and safety

JOB SECURITY: The less secure your job, the amount you earn, or your ability to respond to a downturn by working longer, the more you need to invest your savings for safety rather than growth.

OTHER SAVINGS OR DEBTS: Large amounts of stock in other accounts — or low Social Security or employer pension benefits — will shift the balance you need in a TDF toward safety. So will large debts, such as a big mortgage.

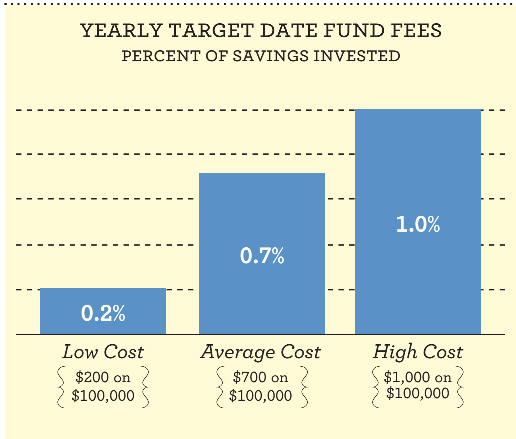


BUDGET FLEXIBILITY: The more you are able and willing to cut spending and save more in response to a downturn, the more you could invest your savings for growth rather than safety.

PERSONALITY: Some people will take more risk to get a reward. Others prefer safety. But saving for retirement is serious business — so don't let "personality" alone control how you invest your savings.

Fees: Are you getting your money's worth?

The fees charged by TDFs vary widely. If fees on TDFs are higher than the fees on other investment options, consider whether the services TDFs provide — which are valuable — are worth the added cost.



Most TDFs invest your savings in stock and bond mutual funds, and the fees these mutual funds charge are often the only fees you pay.

- **LOW-COST TDFS** use "index funds" — funds that track an index, such as the Standard and Poor's Index of the 500 largest U.S. corporations. [5]
- **AVERAGE-COST TDFS** typically use funds with managers who invest your savings in particular stocks and bonds and sometimes — but hardly always — out-perform index funds.
- **HIGH-COST TDFS** use funds with active managers, are often found in smaller 401(k) plans (which have higher administrative costs per participant), and often add a charge for shifting savings from one fund to another.

Fees have a large effect on what you'll have in retirement

Say you contribute to a 401(k) from age 25 to retirement at age 65. In retirement, you decide you could safely draw 4% — including fees — out of your savings each year.

→ **If your mutual fund fee is:**	**0.2% of assets**	*not*	**1% of assets**
AT RETIREMENT			
You'd have about 20% more in savings: [6]	Say \$1.2m	*not*	\$1m
IN RETIREMENT			
After paying fees, you'd keep 3.8%, not 3%.	\$1.2m *x* 3.8%	*not*	\$1m *x* 3.0%
Income:	\$45,600	*not*	\$30,000

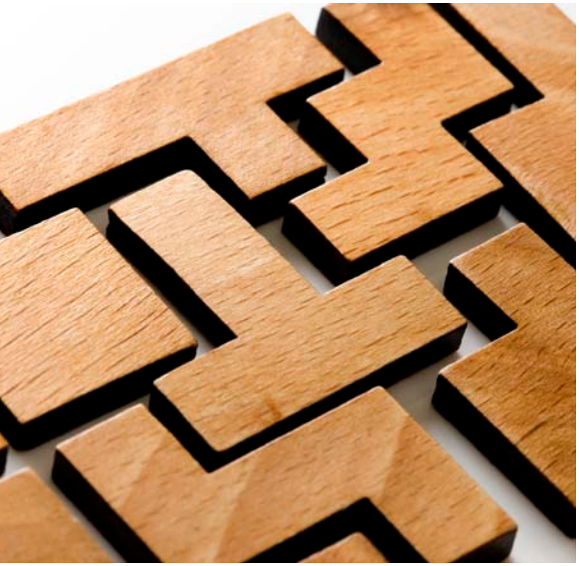
Your income in retirement would be about 50% higher

If you pay 0.8% more in fees, your fund needs to earn 0.8% more for you to break even.

Just one fund?
It's your choice

TDFs invest in a *broadly diversified* mix of stocks and bonds suited to when you're young, middle-aged, or retired. They put your eggs in *many* different baskets.

- But make sure the fees are reasonable. And choose the TDF with the target retirement date that suits your need to balance growth and safety.



A Target Date Fund is *generally* a reasonable place to put all your retirement savings.

Go online

http://fsp.bc.edu
For an expanding set of useful tools and information

If you need more information — get more.

Explanations

1 Illustration assumes a) retirees currently need 75% of pre-retirement earnings to maintain their standard of living; b) the "average worker" retiring at age 65 in 2000 got 39% of pre-retirement earnings from Social Security net of Medicare premiums, which are deducted from benefits; and will get 33% in 2030 due to the rise in Social Security's Full Retirement Age and higher Medicare premiums; c) the "average worker" in 2000 got an employer pension equal to ½ their Social Security benefit; and d) due to the increased taxation of benefits, workers in 2030 will need an additional 3% of pre-retirement earnings to pay income taxes on their benefits. Social Security figures based on Alicia H. Munnell. 2003. "The Declining Role of Social Security." Center for Retirement Research at Boston College. Employer pensions currently provide about ½ the income Social Security provides to households age 65 and over. Social Security Administration. 2008. *Income of the Aged Chartbook.*

2 For technical discussions of TDFs, which also highlight their limitations, see Zvi Bodie and Jonathan Treussard. 2007. "Making Investment Choices as Simple as Possible, But Not Simpler," *Financial Analysts Journal;* and Francisco J. Gomes, et al. 2008. "Optimal Life-Cycle Investing with Flexible Labor Supply," *American Economic Review.*

3 Margaret Collins. 2010. "Target-Date Funds Outperform Peers, Morningstar Says," *Bloomberg Business Week*. (March 15).

4 Of those who did nothing, those with their savings in a TDF had their savings rebalanced by the TDF. This was also true for those with their savings in other funds that maintain a target mix of stocks and bonds.

5 Majority Staff, U.S. Senate Special Committee on Aging. 2009. *Target Date Retirement Funds: Lack Of Clarity Among Structures And Fees Raises Concerns.* Low, average, and high-cost TDFs hold about 20%, 55%, and 25% of TDF assets, respectively.

6 This 20% difference is valid over a wide range of plausible rates of earnings growth and investment returns.

For Investing Your Retirement Savings

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