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Plan participants' use of target funds varies, study shows

More than half of 'mixed investors' allocate to other categories

By **Sue Asci**
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Many defined contribution plan participants who use target date funds invest only a portion of their assets in the funds, rather than use them as a single solution, according to a study recently released by The Vanguard Group Inc.

Of 1.24 million participants in 1,300 DC plans who used Malvern, Pa.-based Vanguard as their record keeper Dec. 31, 2007, 357,000 were putting money into target date funds. Of those, just half used a single target date fund for their entire portfolio, while the remainder used a target date fund in combination with other investments, the study found.

Furthermore, the so-called mixed investors allocated an average of only 30% of their retirement assets to the target date funds, according to the study.

"This suggests they are using the target date fund not as a core investment but a supplemental one," said Stephen P. Utkus, director of the Vanguard Center for Retirement Research, also in Malvern. "People are either doing it for rational reasons or naive reasons."

One reason may be that investors haven't gotten the message that target date funds are intended to manage an entire retirement portfolio by investing in a broad spectrum of securities, Mr. Utkus said.

Another is that investors may be following a so-called core satellite strategy, which involves allocating a substantial portion of a portfolio to one investment strategy and spreading smaller portions across a variety of potentially higher-yielding strategies, he said.

Finally, investors may also be investing outside the target date funds in an effort to mitigate risk, Mr. Utkus said.

Vanguard launched its first target date fund in 2003 and now has a lineup of 11 such funds, which had $33.5 billion in assets at the end of last year.

At least one adviser questioned Vanguard's motives for putting out the study.

"Vanguard has come out with a number of these target date funds," said Neil Elmouchi, president of Summit Financial Consultants Inc. of Westlake Village, Calif., an affiliate of LPL Financial of Boston that has $125 million in assets under management. "You have to be a little cautious. No matter who is putting out the study, they have a bias. There is no one-size-fits-all solution."

Vanguard insists that the study does not draw any conclusions about how investors should be using target date funds.

"We are only reporting the data from the system," Mr. Utkas said. "We are not selectively picking the plans. The report is based on actual behavior. People can draw their own conclusions from the data."

The study also found that of the non-target-date-fund investors, nearly half used extreme allocations. For example, 30% invested only in stocks, while 16% avoided stocks altogether.

"I think of all the financial professionals who for years have pounded the notion of diversification," said Jeff Keil, president of Keil Fiduciary Strategies LLC of Littleton, Colo. "Either people weren't listening or they believe equities are the only place to be, or not to be. I think it shows there is a lot of education that needs to be done."

Given how many target date funds have performed recently, it's not surprising that investors are hesitant to put all their retirement assets in a single fund, he said.

"The allocations vary quite a bit," Mr. Keil added. "And their success through this tumultuous period has been all over the board. These funds are not all created equal. You need to know what you are buying."

William Howell, president of Howell Financial Advisors Inc. of Indianapolis, which has $15 million in assets under management and whose clients are nearing retirement or are retired, also has concerns about target date funds.

"The problem with target date funds is, they are a moving target," he said. "Each year, the asset allocation changes. The asset allocation [investors] should be in may not always align with the target date fund."

That said, target date fund investors who also invest in retirement assets outside those funds may be defeating the purpose of using them to begin with, said Mr. Howell.

"They are spreading assets around a lot of different choices to diversify," he said. "But are they following up to figure out how much money is in stocks or in bonds to determine the actual asset allocation of the total? If not, they should be."

Nearly 80% of target date investors were in plans that designate the funds as the default option, according to the Vanguard study.

The idea behind the default is to protect investors from making those extreme choices, said Ron Surz, principal of Target Date Analytics, a target date fund index provider based in San Clemente, Calif.

"Target date funds put investors in the general ballpark," Mr. Surz said. But investors should still know what they are investing in, he said.

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