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New report specifies best and worst of the TDF universe

By Editor Test *Wed, Jul 18, 2012*

BrightScope and Target Date Analytics have released the highlights of Popping the Hood V, the latest in their series of reports on target date funds, fund families and companies.

In the fifth and latest iteration of their *Popping the Hood* series, BrightScope and Target Date Analytics analyze and grade 49 fund families from 41 different fund companies, including 420 target date funds. Each fund series receives an overall score and ranking as well as a five-part evaluation covering company/organization, strategy, performance, risk, and fees.

Investments in TDFs continue to grow, the report shows. The product category saw only a modest 9.3% increase in assets under management in 2011 due to poor market performance in second half of the year, but BrightScope projects that target date assets will reach $2 trillion in 401(k) plans by 2020.

The primary distribution channel for TDFs is likely to remain defined contribution plans, for at least two reasons: first, 401(k) participants prefer a 'buy and forget' strategy that doesn't require regular portfolio rebalancing and, second, TDFs are approved by the Department of Labor as a qualified default investment alternative (QDIA).

BrightScope and Target Date Analytics published the following highlights of the report, which sells for $1,200 per copy ($20,000 for group distribution):

- American Century received an "A" ranking for the second year in a row. American Century LIVESTRONG Portfolios have received an A grade in every report since *Popping the Hood II*.
- JPMorgan and MFS are also top performers, receiving an overall "A" for the second straight year.
- Putnam jumped up to an "A" in 2012 after earning a "C" in *Popping the Hood IV*. They switched from a "Through" strategy to a "To" strategy in 2010 and began investing in alternative asset classes.
- The number of target date fund families is no longer increasing. New entrants include BlackRock LifePath Index and Lincoln Financial Group's Presidential Protected Profiles. Columbia (F in *Hood IV*, D in *Hood V*), Oppenheimer (F in *Hood IV*, C in *Hood V*), and Goldman Sachs (F in *Hood IV*, F in *Hood V*) all recently announced that they would be closing down their target date funds in 2012.
- Some fees have dropped significantly since the last study. Allianz reduced fees from an average of 0.91% to 0.64% Nationwide reduced fees from an average of 0.64% to 0.42% PIMCO reduced fees from 0.88% to 0.80%.
- The standard to be a truly low cost, index TDF fund series is now under 20 basis points thanks to Vanguard (0.18%), TIAA-CREF Lifecycle Index (0.18%) and Fidelity Freedom Index (0.19%). BlackRock LifePath Index (0.28%) and iShares (0.31%) are close behind.
- Fees as a whole are still high – 72 basis points is the average institutional TDF fund – but that has come down 3 basis points since last year.
- The percentage of equity held in TDFs at the target date appears to have stabilized at about 42% in 2011 after increasing from 40% to 43% from December 2007 to December 2010.

In 2011, *Popping the Hood IV* noted that number of funds with a “To” the target date strategy was increasing.

- At the end of 2010, 40% of the funds were using a “To” compared with 30% at the end of 2007.
- The db-X TDFs switched to a “To” strategy in 2011, and the new BlackRock LifePath Index funds also use a “To” strategy, so the percentage was up to 42% by the end of 2011.
- With Columbia, Oppenheimer, and Goldman Sachs closing down their TDFs (all of which use a “Through” strategy), that percentage should rise to nearly 45%, or 21 out of 47, by the end of 2012.

Performance and risk metrics in *Popping the Hood* are based on three years of performance data, which no longer include 2008. Fund families that sustained big losses in 2008 therefore got a fresh start in this year’s report. Fund families that take more risks and hold higher amounts of equities may benefit. New strategies are being utilized, for example:

- ETF usage in TDFs is growing. iShares (100% ETF), Lincoln’s Presidential Protected Profile (over 90% ETFs), BlackRock LifePath, BlackRock LifePath Index, and State Farm all have at least 50% allocation to ETFs. Four other fund companies increased their allocations to ETFs in 2011. Fourteen fund companies invest in ETFs, representing 28% of the fund families in the study.
- There are now 11 all-index-fund TDFs. BlackRock LifePath Index and Presidential Protected Profiles were created in 2011 and both utilize index funds exclusively. BlackRock is following the trend set by Fidelity, ING, TIAA-CREF, and John Hancock in launching an index fund alternative to its standard TDFs.
- Invesco and PIMCO both utilize absolute-return, volatility management strategies that include alternative assets such as futures and derivatives. They are having success with both fund families receiving an Overall “A” in *Popping the Hood V*.
- Non-traditional asset classes such as TIPS, real estate, and commodities are slowly gaining traction in the TDF marketplace. Those three asset classes now comprise about 6% of the underlying holdings of target date funds, compared to about 4.5% at the end of 2009. AllianceBernstein, Allianz, and Fidelity are particularly notable for increasing their allocations to these asset classes, to the point where they commonly comprise 15%-50% of the portfolios of their TDFs.