# The Brilliant Gimmickry of TDFs

By Editor Test *Sun, Jul 18, 2010*

*TDFs have always been a sales strategy more than an investment strategy, and we should recognize that.*

Back in the 1990s, when the first target date retirement funds were launched, I didn't think they'd be a runaway success. Frankly, the concept smelled like a marketing gimmick. Brilliant, but reeking of gimmickry.

The decision-makers at the fund company in whose catacombs I worked at the time seemed to share my skepticism. Vanguard put more faith in its "life strategy" funds, a still-available stable of funds-of-funds that aimed for a target risk level, not a target retirement date.

Focusing on target-risk, I think may still be a more defensible idea than focusing on target-dates. As we have since learned, there is no magic in the target date concept. It was not a formal concept. It was not standardized. It had no track record to commend it. But it had much more sizzle than the target-risk concept.

I don't have the mathematical or economic chops to tell you exactly why the TDF concept didn't strike me as technically sound. But it seemed to resemble a blind form of market timing. Regardless of your thoughts on market timing, you must agree that it's not pin-the-tail-on-the-donkey.

Putting a date on a fund didn't seem right. In my experience, the equities market doesn't behave like a railroad line, with stations neatly placed five years apart. No conductor strides the aisle, shouting "New Rochelle" or "Rye" and reminding riders to gather up their bags. Only Social Security works that way.

In any case, the smarter investors don't think of themselves as ticketed passengers on the market train. They think more like members of Butch Cassidy's Hole in the Wall Gang, who arranged to jump on and off the train (with greenbacks and gold) while it was *between* stations.

Nonetheless, investors began pouring money into Fidelity's (with all due respect) pioneering target date Freedom funds. Other fund companies, including Vanguard, soon introduced their own fleets of TDFs. The rest is history.

By enshrining TDFs as qualified default investment in qualified plans, the Pension Protection Act of 2006 introduced an element of moral hazard into the equation. The government stamp of approval, with no manufacturing standards attached, was an invitation for negligence if not abuse.

The market crash of 2008 and 2009 demonstrated however that TDFs wore no clothes of invisible magic thread. But magic had been implied. Though fund managers may never have explicitly promised that TDFs were a panacea for retirement savers, many investors clearly believed (as Senate hearings last year revealed) that TDFs would provide them with a soft-landing into a pillowy retirement.

The very fact that the TDFs were dated fostered the belief that they would eliminate the terrible sequence risk that millions of people face as they approach the so-called retirement “red zone” and try to lock down a secure nest egg. That’s what made TDFs so successful. But the financial crisis showed that TDFs did no such thing.

Sure, TDFs rebounded in the past 12 months, along with other balanced funds. But they provided no special service to their owners (especially not to those who paid five percent loads when they bought them).

Subsequently we witnessed the inevitable federal inquiry and now (see cover story) the inevitable proposals for new regulation. The regulations will undoubtedly lead to disclosures that nobody will bother to read and that future SEC commissioners won’t bother enforcing (other than to enforce the publication of the disclosures).

I have no beef with financial innovation, as long as it doesn’t cost much. TDFs have generated lots of business for the funds industry. And they may eventually produce better outcomes for individual investors and plan participants than those folks would or could have achieved on their own.

But TDFs have always been more a sales strategy than an investment strategy, and we should recognize that.

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