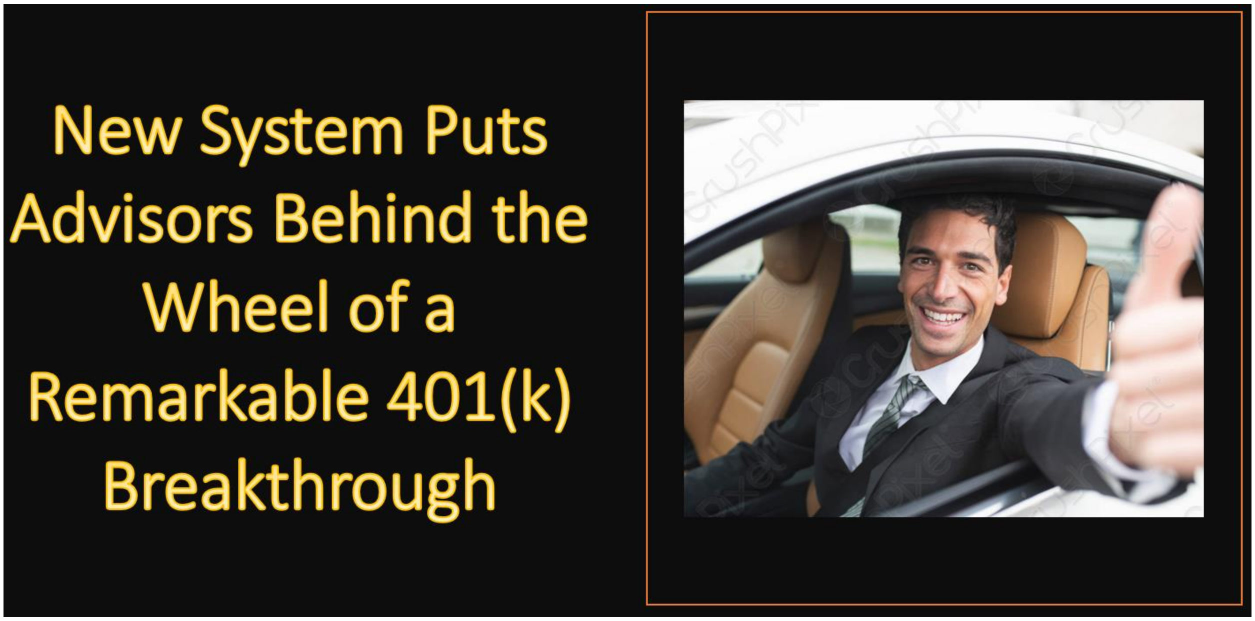
A Blossoming Opportunity for 401(k) Financial Advisors



At $3.5 trillion and growing, target date funds (TDFs) are the largest 401(k) investment, despite the general awareness that TDFs are flawed. Here are some of the shortcomings in TDFs, starting with the most critical.

<u>Target Date Fund Shortcomings</u>

- One-size-fits-all is a failed model.
- All investments are proprietary, managed by the TDF provider. No investment manager is skilled in all assets.
- High risk at the target date – 55% equities plus 40% long-term bonds.
- Old school, initiated 30 years ago.
- Oligopoly dominated. Just 3 firms manage 70% of the assets.
- Big loser in 2008 -- more than 30% loss - and 2022—more than 15%
- Grouped into 10-year target ranges.

It shouldn't surprise you to learn that there are solutions to these problems, and they're getting better. You haven't heard much about them because oligopolies stymie innovation. Fiduciaries own their decisions and want to believe they are wise, but fiduciaries can and should do better.

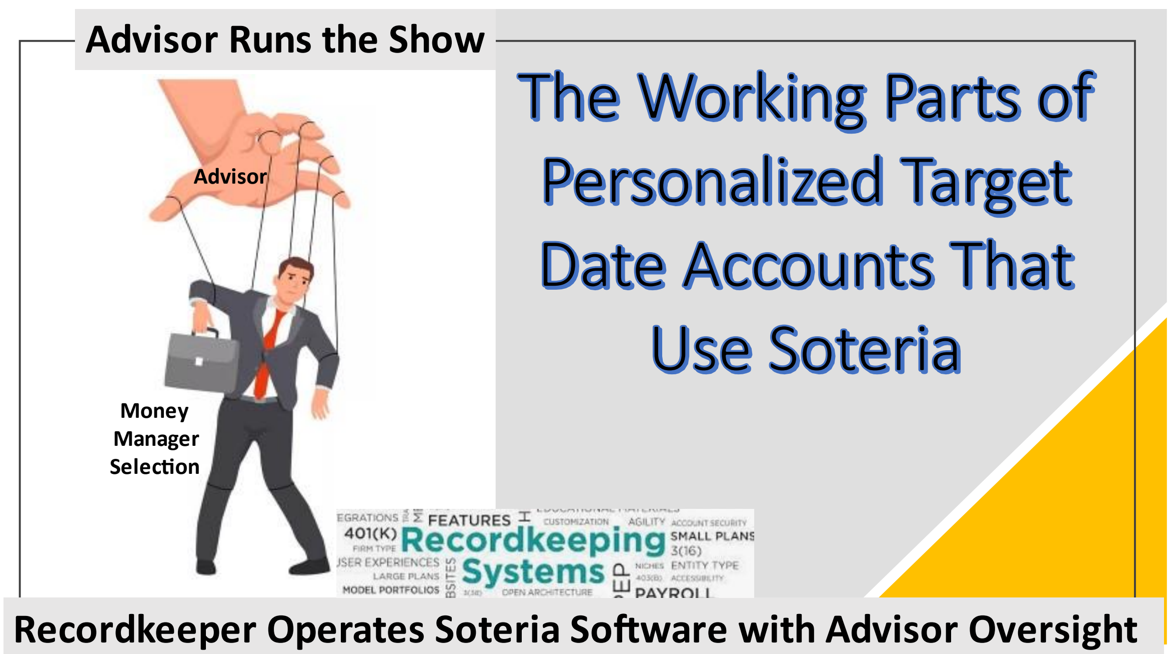
Importantly investment advisors can play a key role in the better way. Under the right structure, advisors run the show. All they need is the right software.

A better way

Done right, personalized target date accounts (PTDAs) solve the problems with TDFs. PTDAs marry TDFs with managed accounts. This marriage keeps getting better. PTDAs have been around for a while, provided by non-oligarchs like Empower and PIMCO.

I recently released a new entrant called Soteria that places the advisor in the driver's seat. Soteria is software that enables the plan's recordkeeper to manage separate accounts along lifecycle glidepaths that solve the shortcomings in TDFs. Soteria is named after the goddess of deliverance from harm because it protects in the Risk Zone spanning the 5 years before and after retirement.

The plan's advisor runs the show.



How it works

Personalization cannot be provided for defaulted participants because they do not want to engage, so the Qualified Default Investment Alternative – QDIA – is best left to the plan sponsor. The sponsor chooses the target date for defaulted participants. This specification is by age (like the day the participant turns 65) rather than a 5-year or 10-year grouping. The sponsor also chooses the risk of the glidepath. Low, middle and high risk glidepaths are provided, and these can be blended.

Self-directed participants do want to engage so they value the ability to personalize. About a third of the $3.5 trillion in TDFs is from non-defaulted participants. These participants choose their risk and their target date, and they can change these at will.

The glidepaths provided by the PTDA are the most important consideration. At least one of these paths should defend against Sequence of Return Risk, something that most TDFs don't do.

Conclusion

Investors who have $3.5 trillion in TDFs deserve better. Advisors have a blossoming opportunity to jump into the Soteria driver's seat. PTDAs are blossoming because personalization is the ultimate customization. One-size-fits-all won't do.