Damage Control: Investment Lessons from the Coronavirus (so far)

- Now is the time to reassess target date funds because most are way too risky
- The Coronavirus has infected a million people, but its financial reach extends to 7 billion people. It would be a shame to not learn from this disaster.
- Retirement investors need to protect themselves, taking control of their wealth in both TDFs and IRAs. Both are 60/40 stocks/bonds for older people.

"*You can learn a lot from your mistakes when you aren't busy denying them.*"
— Oscar Auliq-Ice, Author

Fiduciaries have failed to protect their most vulnerable dependents before, in 2008. Now the Coronavirus has reminded us of what wasn't learned back then. "*Those who do not learn history are doomed to repeat it*." Most investors in the Risk Zone spanning the 5-10 years before and after retirement are taking more risk than they can afford because they rely on others to make this risk decision for them, and that decision has been imprudent. I present the details of the scandal in this article and in our recent Scandal Video.

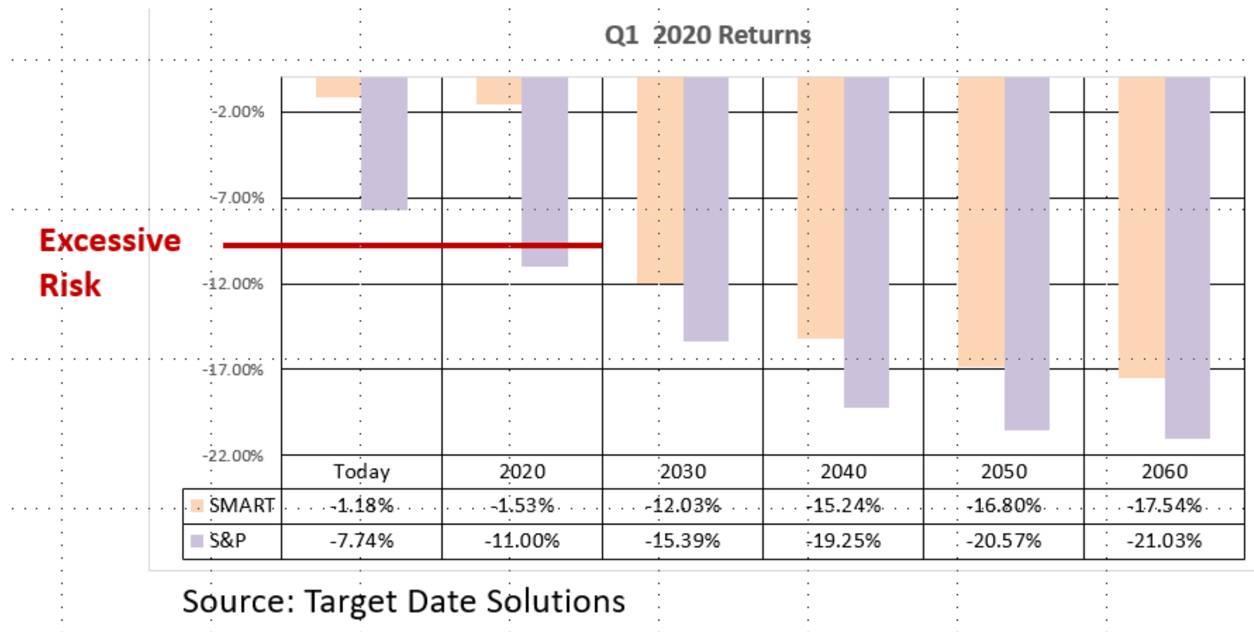
Coronavirus exposes scandal

A definition of "excessive risk" can be found in surveys. What do beneficiaries and their advisors want for those near retirement? Surveys of retirement beneficiaries and their advisors report that both consider a loss of 10% or more for those near retirement to be excessive. In other words, risk should be limited to guard against losses of 10% or more.

There is no accepted standard for target date funds, but Target Date Fund Benchmarks discusses a few possibilities. The SMART Target Date Fund Index tracks the patented Safe Landing Glide Path. Its objective is to not lose beneficiary savings. SMART is a Substantive Prudence benchmark, doing what's best for beneficiaries. The S&P Target

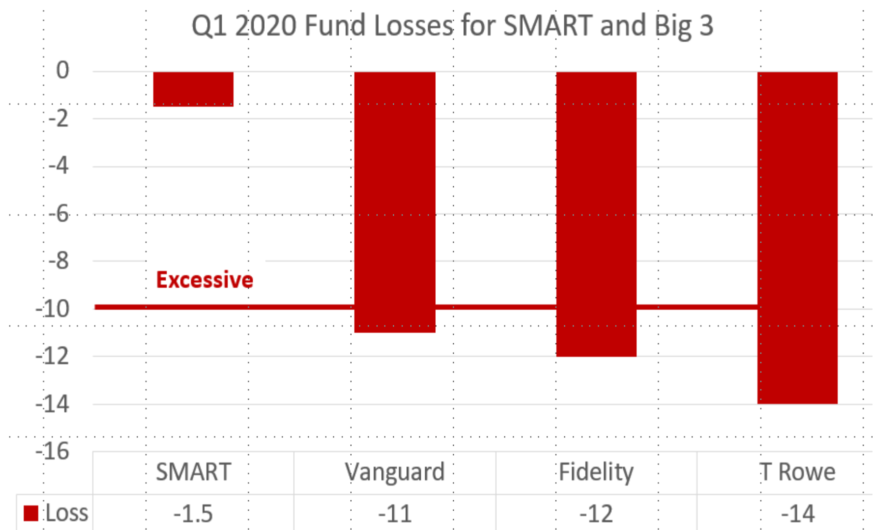
Date Fund Index is another possible standard that is a Procedural Prudence benchmark, following the herd as a composite of all TDFs

As shown in the following exhibit, the average (S&P) near dated 2020 TDF has lost 11%, which meets the survey definition of excessive risk, and this crisis is not yet over. By contrast, SMART's Today (for current retirees) and 2020 funds have defended well, losing very little.



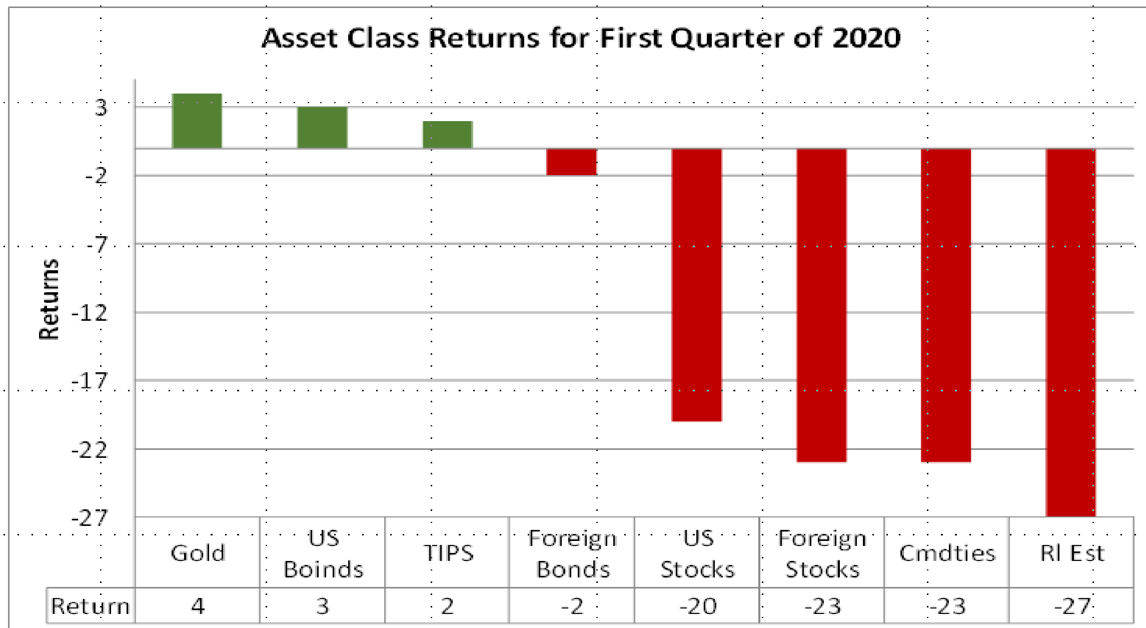
	Today	2020	2030	2040	2050	2060
SMART	-1.18%	-1.53%	-12.03%	-15.24%	-16.80%	-17.54%
S&P	-7.74%	-11.00%	-15.39%	-19.25%	-20.57%	-21.03%

Focusing on 2020 funds, the following exhibit compares the Big 3 2020 funds to each other, and to SMART. All of the Big3 funds have lost more than 10% so far, while the SMART 2020 Fund lost only 1.5%, well above the threshold for "Excessive."



	SMART	Vanguard	Fidelity	T Rowe
Loss	-1.5	-11	-12	-14

These performance results can be better understood by reviewing asset class performance in the quarter, as shown in the following graph.

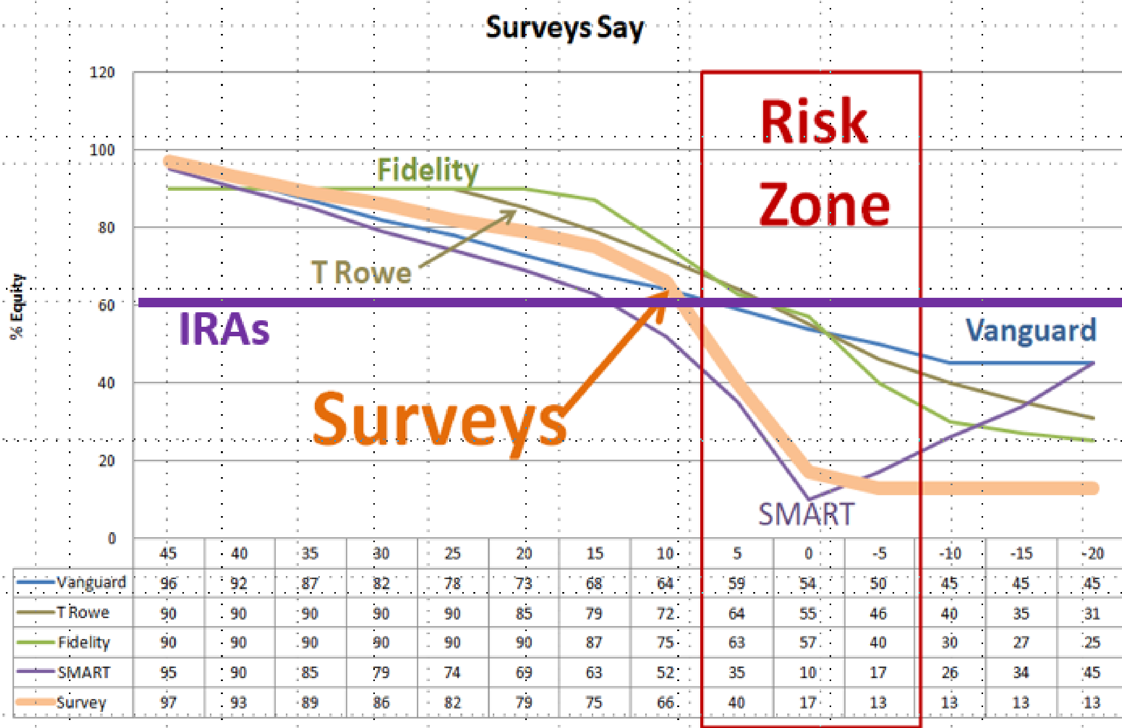


As you can see, the only places to hide in the quarter were gold and US bonds.

Glidepaths

Asset allocation explains all of performance. Glidepaths of the Big 3 and SMART are shown in the next exhibit, along with the glidepath derived from surveys. .

Surveys of Beneficiaries and Consultants Report a Strong Preference for Safety in the Risk Zone



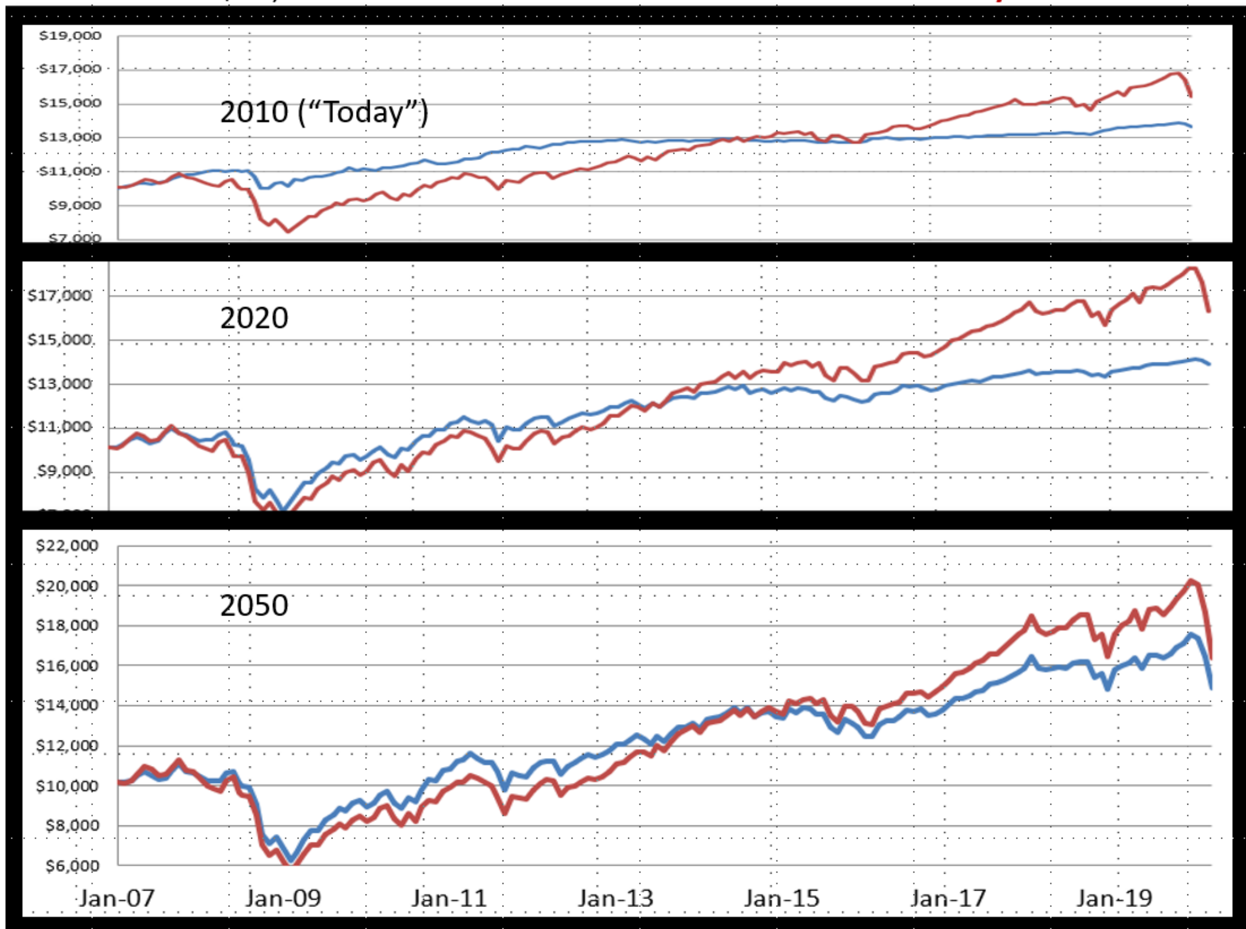
	45	40	35	30	25	20	15	10	5	0	-5	-10	-15	-20
Vanguard	96	92	87	82	78	73	68	64	59	54	50	45	45	45
T Rowe	90	90	90	90	90	85	79	72	64	55	46	40	35	31
Fidelity	90	90	90	90	90	90	87	75	63	57	40	30	27	25
SMART	95	90	85	79	74	69	63	52	35	10	17	26	34	45
Survey	97	93	89	86	82	79	75	66	40	17	13	13	13	13

Here are the main points in this exhibit:

- The Big 3 are 55% in equity in the Risk Zone. Most of the balance is in risky long-term bonds (not shown)
- IRAs are even riskier than TDFs in the Risk Zone
- Surveys (orange line) reveal that respondents (consultants and beneficiaries) want low risk in the Risk Zone.
- Consultants say one thing in surveys – be safe in the Risk Zone -- but do not follow their own advice when they select unsafe Big 3 TDFs.
- There is a safe TDF, shown as “SMART” in the exhibit. It’s the SMART Target Date Fund Index, discussed in the next section.
- The SMART Funds re-risk in retirement, following the recommendations of Dr. Wade Pfau and Michael Kitces. The Big 3 cannot re-risk because they begin retirement at the height of post-retirement investment risk.

Win by not losing

The SMART Funds have a history of defending. They were the best performing funds in 2008, 2011, 2018 and now 2020. But they lagged the industry in general during the unprecedented 12-year stock market rebound that started in 2009. Imprudence was rewarded during this longest stock market rebound in history. But, as shown in the next exhibit, SMART has performed in line with the industry over the history of TDFs, but with far less volatility.



Because near dated Today and 2020 SMART Funds defended well in 2008, their performance exceeded the Industry for about 7 years, but nobody knew. Then the Industry's concentration in US stocks overtook SMART. But the Coronavirus put SMART long-term performance back in line with the Industry, literally overnight. The trend indicates the Industry crossing below the SMART asset level in the near furure.

The long-dated SMART 2050 Fund has a similar story, but it's been its broad diversification that has made a difference, integrating alternatives like commodities and precious metals.

There are only three other TDFs with performance histories that are similar to SMART. All the other TDFs are "me too" copies of the Big 3.

Looking forward

At the time of this writing, the Coronavirus was expected to peak at the end of April in the US. It was far from over. Accordingly, results for the first quarter are just the beginning. The worst is likely ahead of us.

Drastic government interventions could have drastic consequences. The world experienced stagflation in the 1970s when inflation spiked during a recession; throwing money at the problem backfired. Central banks have responded to the Coronavirus by injecting $ trillions into their economies, which will generate Demand-Pull Inflation because "too many dollars will be chasing too few goods." Until now, such "Quantitative Easing" did not generate inflation because most of the money went into stock and bond markets rather than consumer goods, so "velocity" was low. But this new money will be spent on food and other necessities. Inflation could trigger The Debt Spiral that economists have worried about for decades. It could get very ugly.

No one knows how much deeper market losses from this virus will extend, but one thing is certain: there is excessive risk in TDFs in the Risk Zone as well as in IRAs, as evidenced by current losses in excess of 10%.

In **Coronavirus Shock Is Destroying Americans' Retirement Dreams** , ***Bloomberg Business Week*** reports that " *For older people, the coronavirus crisis has been an appalling shock. Their life savings are melting as the global economy shuts down and financial markets plummet. The pain may be particularly acute in the U.S., where Americans rely on a retirement system that was broken well before a pandemic dashed it to pieces."* The article tells the sad real life story of a person who has been hurt badly by recent investment losses in her 401(k). Older people suffer the most.

“Stay the Course” is stupid

Most investment professionals have pulled out their old playbooks and are advising investors to stay the course, but this is bad advice for two reasons: (1) our 78 million baby boomers do not have the requisite time horizon to recover from market losses, and (2) it really is different this time.

The advice to stay the course is based on the observation that stock markets have always recovered from crashes. The problem is that some recoveries have taken decades. Baby boomers cannot wait that long, plus they are spending their savings so they will not participate fully in a recovery.

At times like these someone always says “It’s different this time.” We believe that statement is true for this current situation. Here’s what’s different:

- 78 million baby boomers
- $8 trillion & growing QE in a $10 trillion economy
- Social Security & Medicare on brink
- Pandemic (every pandemic is different) inducing penalty free early withdrawals
- Bubbles in stocks, bonds, real estate (all 3 simultaneously has never happened before)
- Imminent debt spiral
- Etc. etc

Importantly, now is the time to reassess target date funds because they are way too risky at the target date with more than 90% in risky assets – 55% in equities plus 40% in risky ling-term bonds. Thee are a few TDFs that are safe, like the SMART Fund Target Date Fund Index that has a 12 year history of protecting beneficiaries, which is longer than all other safe TDFs.

Conclusion

Like all previous pandemics, this one will end, and financial markets will recover somewhat, but there will be other market crashes in the future, as we warn in our 2/18/20 Ten Threats to US Stock and Bond Markets. Coronavirus is one of the 10 threats we warned about; there are 9 more, each capable of causing another market crash. Stock and bond markets have teetered on the brink of collapse for some time. The

Coronavirus precipitated the inevitable. Now is the time to protect your retirement savings, and to stop the scandal. The scandal is excessive risk near retirement.

For more detail on what to do now, see our Smart Investing video, the Four Pillars of Smart Investing article, and the Smart Investing Infographic . This is not about market timing. It's all about risk management. People near retirement cannot afford much risk because losses result in lifestyle sacrifices and a reduction in the length of time that savings last.

Reliance on others to make a prudent risk decision has been a mistake. Fool me once, shame on you. Fool me twice, shame on me. Despite a recent stock market recovery at the time of this writing, the Coronavirus is just beginning in the US and Europe. It would appear that investors believe/hope a cure is near but scientists tell us that will take at least 6 months, although there are medications that might alleviate some of the symptoms, without stopping the spread. Coronavirus is not over yet. And when it's gone, we should not forget the investment lesson it has taught us.

Stop the excessive risk taking now.

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The opinions expressed in this document are Ron's.