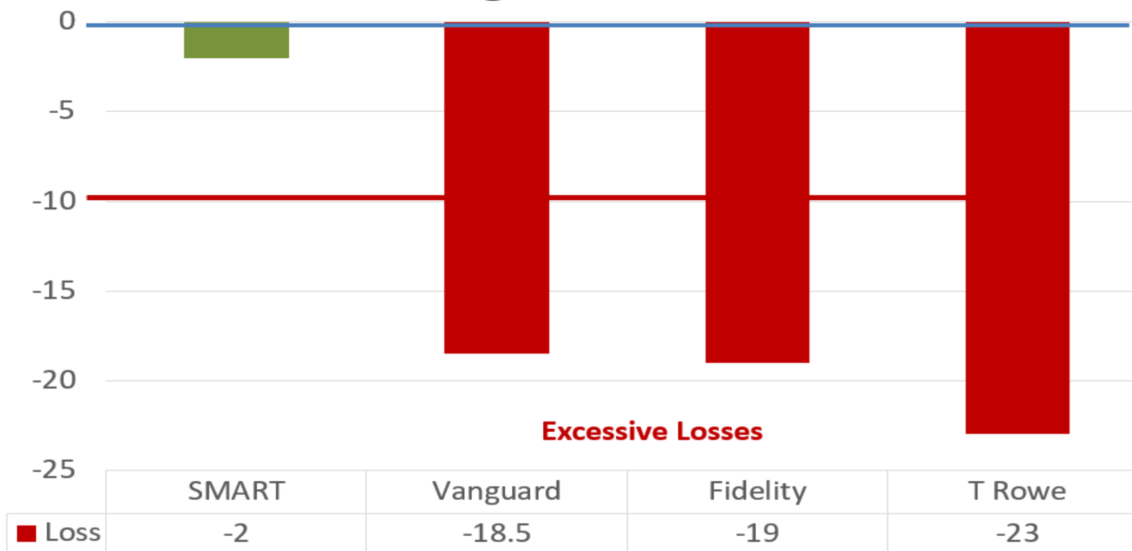
Pandemic Heightens Concerns About Target Date Fund Risk: Most Are More than 85% in Risky Assets at Their Target Date

- Target date funds (TDFs) have grown tenfold since 2008, when they lost 30%, from $200 billion to $2.5 trillion.
- Recent Covid-induced losses have alerted investors to the risk in TDFs. Baby boomers cannot afford this risk.
- An accurate appraisal of TDF risk includes all risky assets – equities, long term bonds, etc. Most TDFs are more than 85% in risky assets at their target dates.

Just because nobody complains doesn't mean all parachutes are perfect. Benny Hill

Until now, it seemed that stock and bond markets would always go up in value so any target date fund (TDF) would do. In practice, the Big 3 – Vanguard, Fidelity, and T. Rowe Price – have garnered 70% of the $2.5 trillion invested in TDFs creating an oligopoly. Procedural prudence pretty much dictates that you have to hire who everyone else is hiring, but substantive prudence became an issue when these megafunds set off alarms by losing 20% in just 30 days due to the Covid-19 pandemic.

Investment consultant surveys report that losing more than 10% for those near retirement is unacceptably excessive. The following graph shows the losses sustained in 2020 funds intended for people retiring this year who cannot afford losses at this critical time in their lives.



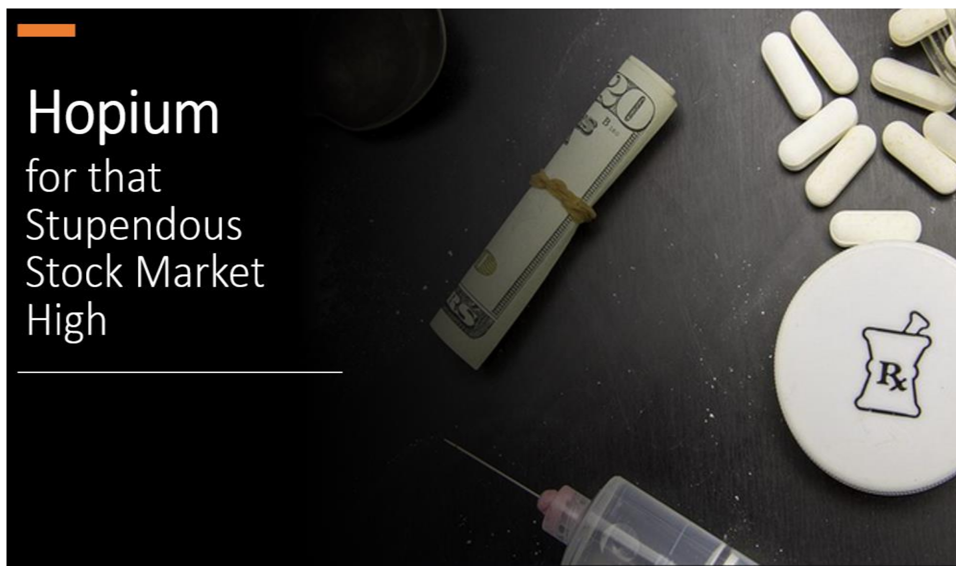
As shown in the graph, the SMART Target Date Fund Index defended in this meltdown, as it did in 2008, 2011, and 2018. In the following we use the SMART Fund as the "Safe" TDF and the Big 3 as the "Industry" TDF.

Big concerns

Several recent articles have urged fiduciaries to reassess their TDF risk exposure, See these warnings for example:

- **What the Pandemic is Revealing About Target Date Funds**
- **Are Your Target Date Funds a Prudent Investment? COVID-19 Puts a Spotlight on Fiduciary Choices**
- **Covid-19 Infects Target Date Funds**

There is a fairly good chance that the days of lucrative investment returns are over even though the Fed is doing all it can to keep the party alive. For now, the stock market is recovering because investors are overdosing on Hopium, believing the markets will soon return to where they were in 2019.

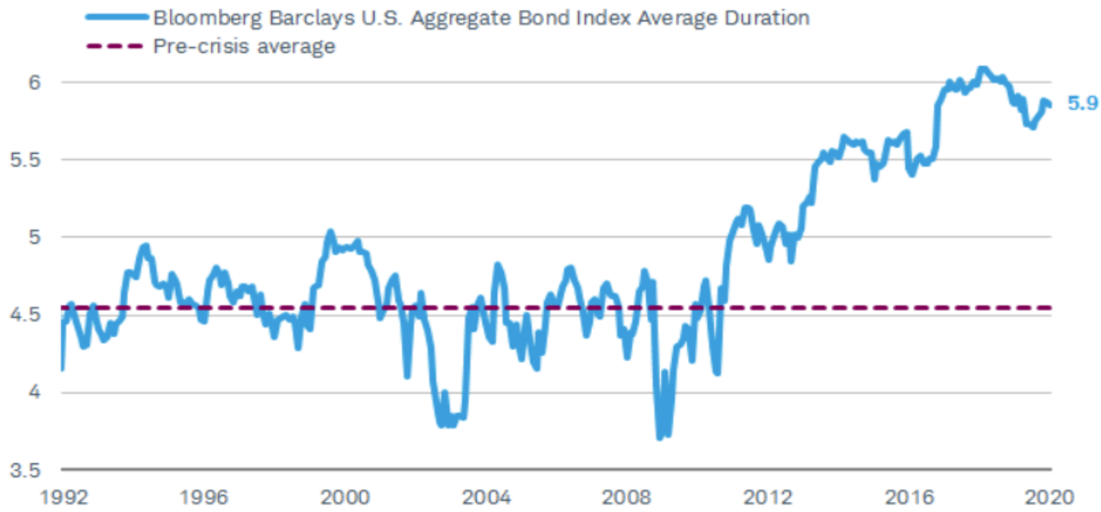


Now is a good time to reassess your TDF's risk, before Hopium wears off.

Assessing the risk

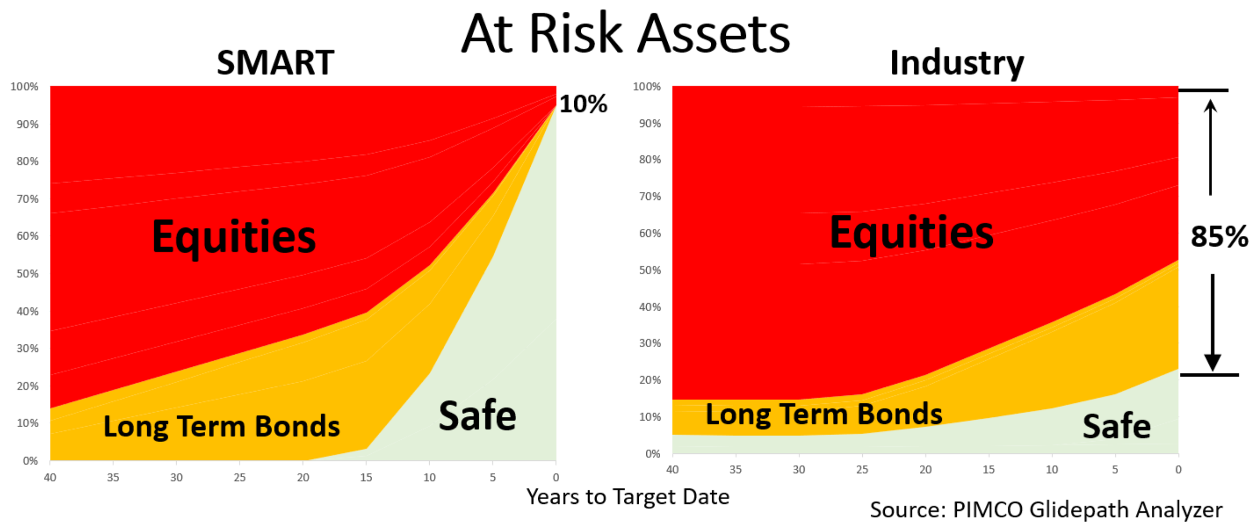
Risk analyses of TDFs usually define equity exposure as risk, but this misses a lot of the true risk exposure. The fact is that long-term bonds are risky too, especially since bonds currently have exceptionally low yields. Even a modest 5% increase in interest rates will generate a 30% loss in bond values because as interest rates have declined bond duration has increased. Duration is the multiplier to apply to interest rate changes. A duration of 6 says bond prices will decline by 6% for every 1% increase in interest rates.

The average duration of the Agg is still near its all-time high



Source: Bloomberg, using monthly data as of 1/31/2020.

Accordingly, the following graph shows a holistic view of TDF risk as equities plus bonds.

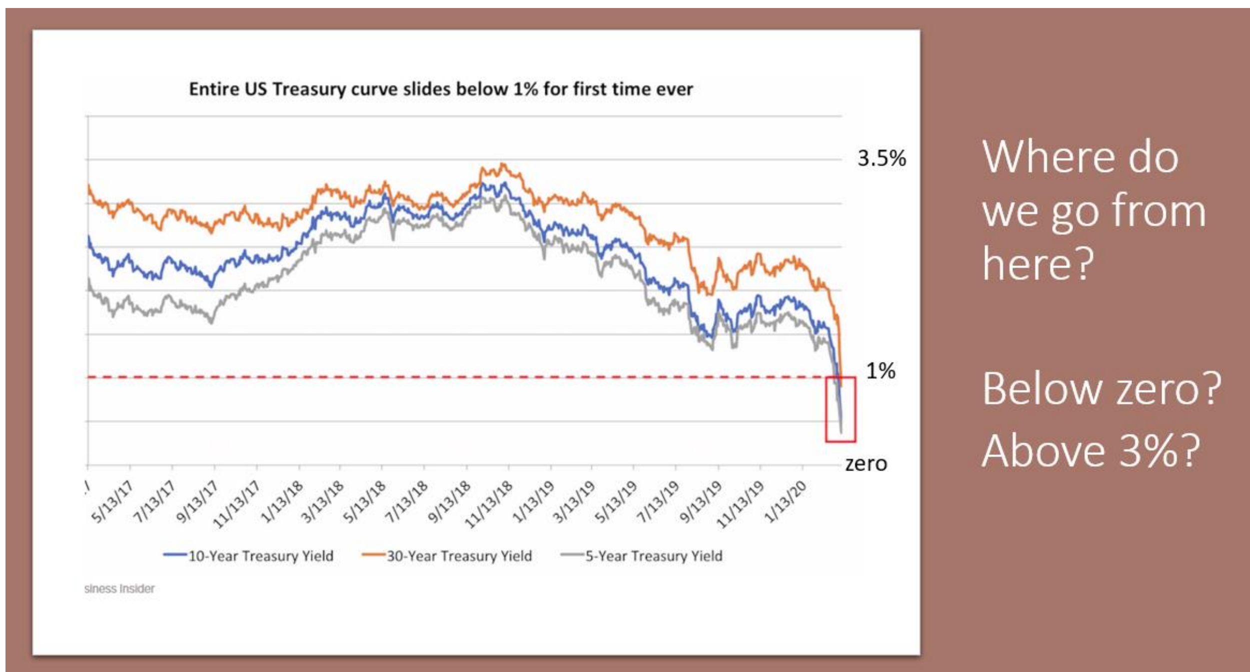


The typical TDF is 85% in risky assets at the target date. This compares to 10% in risky assets in the SMART Funds. Stated another way, the typical TDF is more than eight times as risky as SMART. Safe assets are short term bonds like T-bills and stable value.

Conclusion

Risk is more than just equity allocation, the customary metric in target date fund profiles. Risk is the possibility of losing money. Long term bonds will lose money when interest rates rise. You can be the judge of this risk, but ignoring it is tantamount to ignoring more than a third of the true risk in the typical TDF.

Fiduciaries really should reassess the risk in their TDFs and when they do, they should look at all the risk. The best fiduciary protection is beneficiary protection.



Ron Surz is sub-advisor of the [SMART Target Date Fund Index,](#) co-host of [The Baby Boomer Investing Show](#) and CEO of [Target Date Solutions](#), [Age Sage Advisor](#) and [GlidePath Wealth Management](#). You can reach him at Ron@TargetDateSolutions.com