# Most Target Date Funds are Dangerous for People Near Retirement

The 2008 lesson  is being re-learned

Only  3 TDFs are safe.

The rest are risky.

Thrift Savings Plan

# 3 Safe Target Date Funds

## TSP

The Federal Thrift Savings Plan is the largest savings plan in the world, with more than $800 billion.

OPEIU

Office & Professional Employees International Union

## OPEIU

The Office and Professional Employees International Union is one of the largest AFL-CIO unions

SMART Target Date Index

## SMART

The SMART target date fund index was a collective investment fund (CIF) from 2008-2021. It continues as an index now. It's a normative index – what should be.

# Protecting in the Risk Zone

Losses sustained in the 5-10 years before and after retirement can spoil the rest of life

# *“A TDF that fails to protect near the target date has failed its primary mission”* Professor Craig Israelsen

## Sequence of Return Risk in the Risk Zone transition from working life to retirement

### Sequence of Return Risk

This chart shows two 30-year income scenarios. The red line shows a withdrawal plan that started off with three years of negative returns in a row. The blue line represents a withdrawal plan with the negative years at the end.

Both plans started with $250,000 and both took out $12,500 per year ($1042/month) inflated by 3% for inflation. No other actions were taken to manage income withdrawals.

**Both plans had a 6.6% average annual rate of return on the underlying investment for the 30-year period, using standard performance reporting practices.**

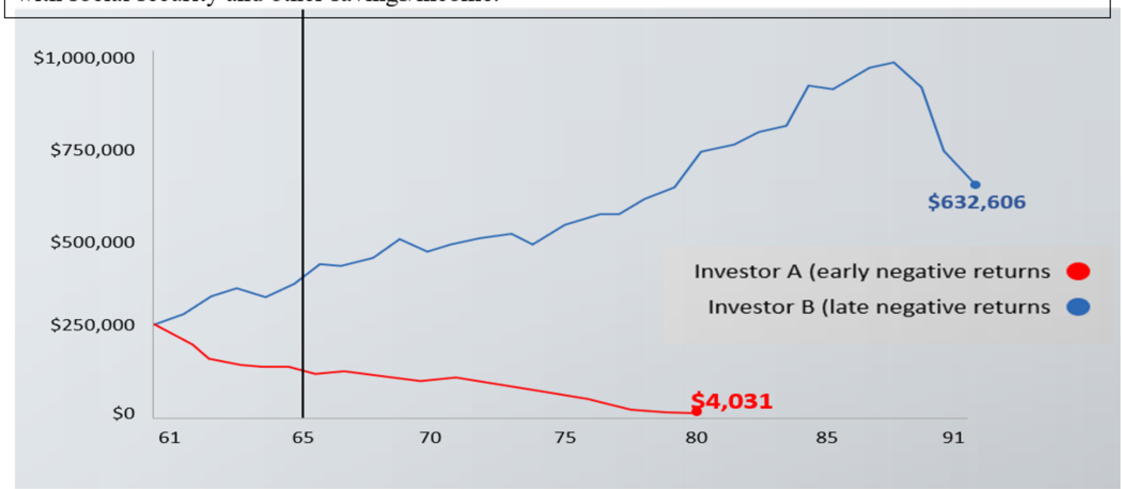
Source: MFS Research

**THE SAFE 3 PROTECT AGAINST SEQUENCE OF RETURNS RISK! OTHERWISE YOU ARE UNPROTECTED!**

***Suppose the Goal is to Purchase a Life Time Income Annuity at Age 65:***

**Investor A**: Lifetime Annuity generates only $670/month due to Sequence of Returns Risk and a lower Annuity crediting rate as the Federal Reserve cuts rates to stimulate the economy after the three-year stock market selloff. The Investor feels the planned dignified retirement slipping away accompanied with higher levels of stress and health concerns. $670 does not cover $1042/month planned spending.

**Investor B:** the Annuity pays $2000/month placing the investor on the path for a dignified retirement with social security and other savings/income.



# Out of Sequence: Is Sequence of Return Risk for Real?

Q. Do you care about losing 30% if you made 40% in the previous year? Risk is usually rewarded.

A. Yes you care. Whatever you have saved needs to be “enough.” You plan to live on “enough” as retirement approaches. Losses to “enough” diminish lifestyle plans and inflict emotional pain.

Recovery is just a hope, that might take longer than you have life. It’s better to not lose at all.

“Usually rewarded” is no guarantee.

# Win by not Losing

Baby Boomers do not have the luxury of time to recover

| Market crash | Maximum loss | Years to breakeven from -25% point |
|---|---|---|
| 1877 | -33% | 1.8 |
| 1893 | -25% | 4.0 |
| 1903 | -26% | 1.1 |
| 1907 | -34% | 1.2 |
| 1917 | -28% | 1.5 |
| 1929 | -82% | 15.2 |
| 1970 | -25% | 0.8 |
| 1974 | -39% | 2.0 |
| 1987 | -26% | 1.5 |
| 2001 | -42% | 4.1 |
| 2008 | -49% | 4.8 |
| **Median** | **-33%** | **1.8** |

| Portfolio Loss | Portfolio Gain To Recover Loss |
|---|---|
| -10% | 11% |
| -15% | 18% |
| -20% | 25% |
| -30% | 43% |
| -40% | 67% |
| -50% | 100% |
| -60% | 150% |
| -70% | 233% |
| -80% | 400% |
| -90% | 900% |

Exponential

# Management to Objectives

## Implied Objective

There is **only one demographic** that all defaulted beneficiaries have in common.

They are all financially unsophisticated. The financially naïve need protection.

## Stated Objective

Surveys of beneficiaries report that they **want to be protected** as they near retirement.

They want safety, not growth.

# Failure to Protect in the Risk Zone is a Product Failure

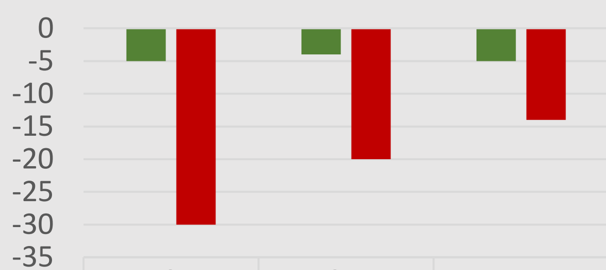
Retirees have been lucky so far, but now there are 78 million baby boomers in the Risk Zone, and $3.5 trillion in TDFs.

The 2008 failure prompted  joint SEC-DOL hearings, but nothing changed.

This time there is a Congressional inquiry into TDF risk, specifically why it’s so much higher than the TSP

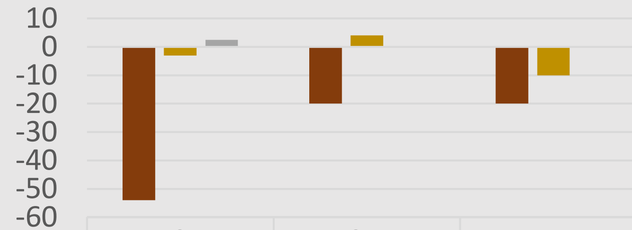
# 3 Tests of Protection at the target date. Industry fails all 3.

## Losses




| | 11/07-2/09 | 2/20-3/20 | 2022 YTD |
|---|---|---|---|
| Safe 3 | -5 | -4 | -5 |
| Industry | -30 | -20 | -14 |

## Asset Class Returns




| | 11/07-2/09 | 2/20-3/20 | 2022 YTD |
|---|---|---|---|
| Stocks | -54 | -20 | -20 |
| Bonds | -3 | 4 | -10 |
| T-bills | 2.5 | 0.2 | 0.2 |

Only 3 tests in the 14-year history of TDFs suggest that they're just noise – hiccups.
But now there are 78 million baby boomers in the Risk Zone and $3.5 trillion in TDFs.
We believe the biggest test has just begun. Stock & bond prices have just begun their plummets.
See next 3 pages


The Fed is at a Crossroad

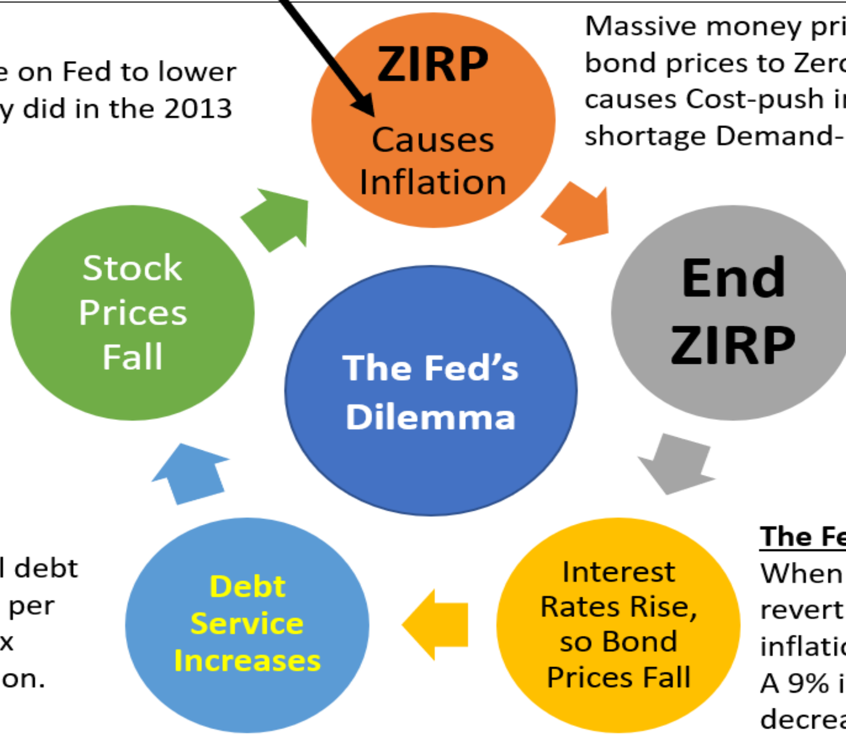
The Quantitative Easing (QE) experiment is coming to an end.

The Fed cannot control inflation without crashing the stock market

# Looking Ahead

## More Inflation and more investment losses

**A Vicious Cycle: We are HERE now. Will we come full circle again?**




Massive money printing is required to manipulate bond prices to Zero Interest Rate Policy (ZIRP). This causes Cost-push inflation that is added to supply shortage Demand-pull inflation.

Tapering bond buying reduces money printing, & inflation. And allows interest rates to return toward normal – without official rate hikes.

**<u>The Fed must keep some manipulation</u>**
When all manipulation ends, yields revert to inflation + 3%, or 10% when inflation is at 7%.
A 9% increase in yields generates a 54% decrease in bond prices

Interest on $30 trillion of federal debt increases from 1% ($300 billion) per year to 10% ($3 trillion). Total tax revenues in 2021 were $3.9 trillion.

Rising interest rates cause stock prices to fall because earnings are discounted at a higher rate and borrowing costs increase.

Stock market losses put pressure on Fed to lower interest rates, so they do, as they did in the 2013 Taper Tantrum.

Source: Target Date Solutions

# Two Types of Inflation

Inflation raises interest rates, which reduces stock prices

Supply shortages create

## Demand-Pull Inflation

**<u>Transitory</u>**

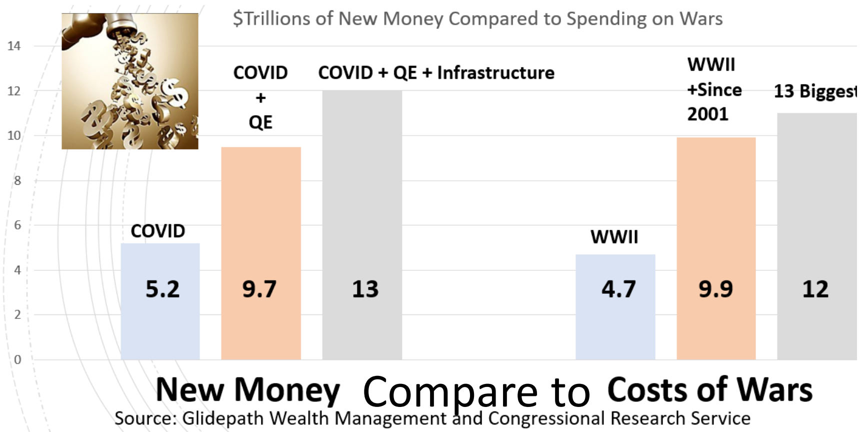
Supply ships will get unloaded

People will return to work

Solving our energy crisis will take awhile

Massive money printing creates

## Cost-Push Inflation




**<u>Long term problem</u>**

The Fed is complicit, so hard to solve

The printing hasn't stopped

No political will to curtail. Blame the Fed.

# Classic Math Predicts a Stock Market Loss Greater Than 50%

Matrix of returns based on end of year P/E and earnings growth

## The Stock Market Bubble Will Burst Because it Has to


### Return Forecasts

Next 12 months: 50% loss

| | | Earnings Growth | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | End P/E | -4 | -2 | 0 | 2 | 4 | 6 | 8 | 14 | 24 |
| | 10 | -71 | -71 | -70 | -69 | -69 | -68 | -68 | -66 | -63 |
| | 15 | -57 | -57 | -56 | -55 | -54 | -53 | -52 | -50 | -45 |
| | 20 | -44 | -43 | -41 | -40 | -39 | -38 | -37 | -33 | -28 |
| End P/E | 25 | -30 | -29 | -27 | -26 | -24 | -23 | -21 | -17 | -10 |
| | 30 | -16 | -15 | -13 | -11 | -9 | -8 | -6 | -1 | 8 |
| | 35 | -3 | -1 | 2 | 4 | 6 | 8 | 10 | 16 | 26 |

Next Decade (Annualized): 1% loss per year

| | | Earnings Growth | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | End P/E | -4 | -2 | 0 | 2 | 4 | 6 | 8 | 14 | 24 |
| | 10 | -14 | -12 | -10 | -9 | -7 | -5 | -3 | 2 | 11 |
| | 15 | -10 | -8 | -7 | -5 | -3 | -1 | 1 | 6 | 15 |
| | 20 | -8 | -6 | -4 | -2 | 0 | 2 | 4 | 9 | 19 |
| End P/E | 25 | -6 | -4 | -2 | 0 | 2 | 4 | 6 | 12 | 21 |
| | 30 | -4 | -2 | 0 | 2 | 4 | 6 | 8 | 14 | 24 |
| | 35 | -3 | -1 | 2 | 4 | 6 | 8 | 10 | 16 | 26 |

**Components of Return**

Earnings Growth
+ Dividends
**+ Price/Earnings Expansion or Contraction: Investor Sentiment**

Yellow shading indicates normal P/Es

# GLIDEPATHS

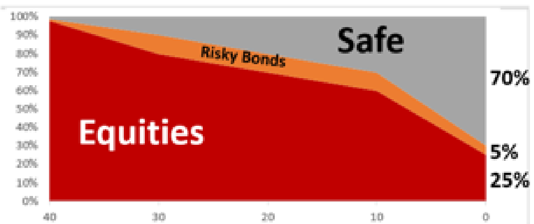
The Industry is 85% risky at the target date to compensate for inadequate savings

The Safe 3 are 30% risky (70% safe) to protect lifetime savings

# To-Through is a Distinction Without a Difference
# Safe or Risky at the target date makes more sense

Procedural prudence dictates a Risky choice

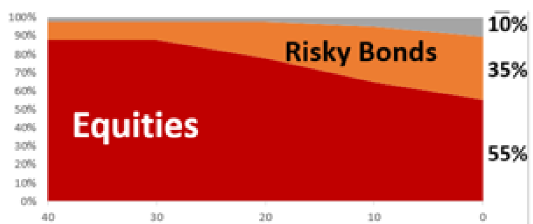
Safe "SMART Group" Ends 70% Safe





**Safe**

**Substantive Prudence:**
Doing what is right (safe) regardless of common practice

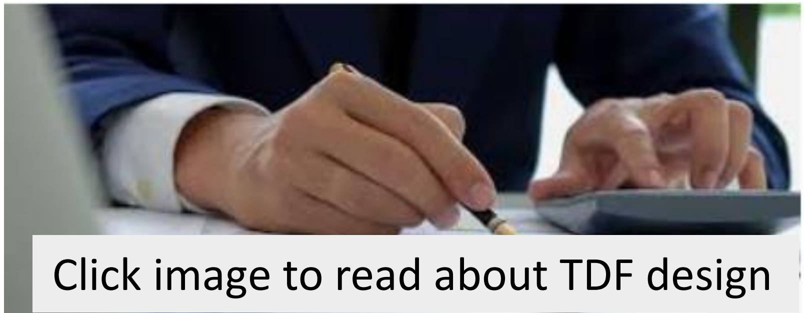



Typical "Big 3 Group" is 90% Risky Throughout

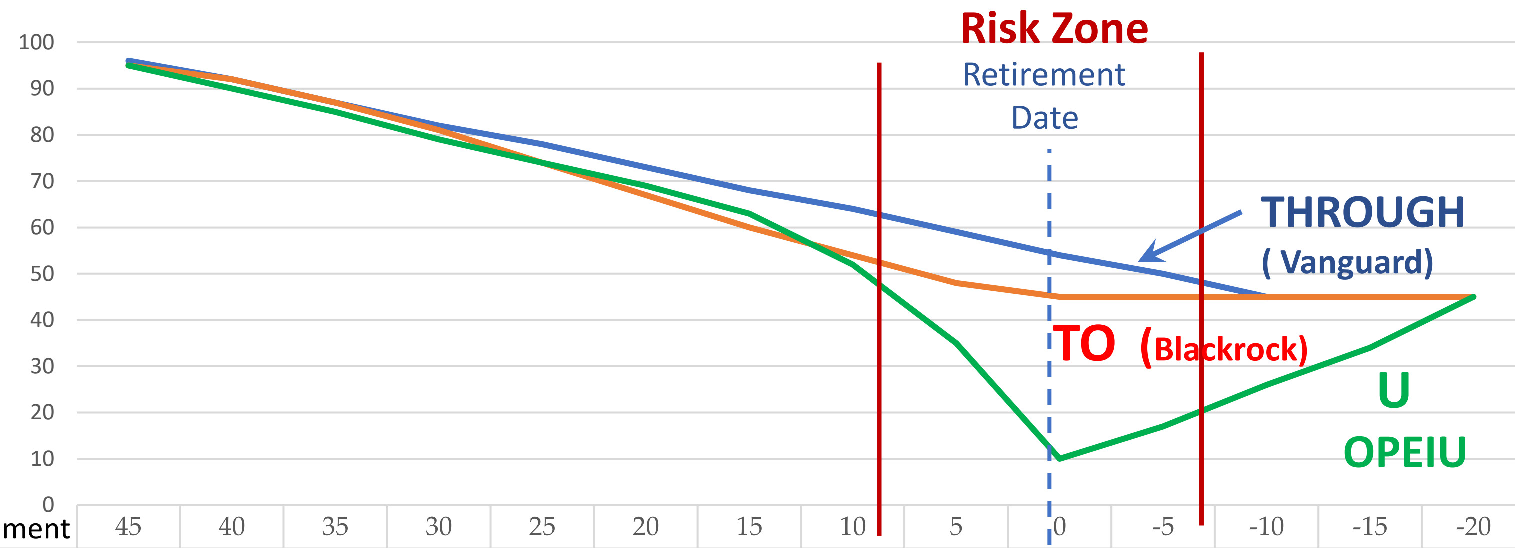

**Risky**

**Procedural Prudence**
Acting as others in a similar capacity. Follow the herd

"Safe" for TSP is Government Guaranteed Fund G.
For SMART & OPEIU it's T-bills & Intermediate TIPS.



# TO, THROUGH or U Target Date Glidepaths
# “U” is both “To” and “Through”




| Years to retirement | 45 | 40 | 35 | 30 | 25 | 20 | 15 | 10 | 5 | 0 | -5 | -10 | -15 | -20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Through | 96 | 92 | 87 | 82 | 78 | 73 | 68 | 64 | 59 | 54 | 50 | 45 | 45 | 45 |
| To | 95 | 92 | 87 | 81 | 74 | 67 | 60 | 54 | 48 | 45 | 45 | 45 | 45 | 45 |
| U | 95 | 90 | 85 | 79 | 74 | 69 | 63 | 52 | 35 | 10 | 17 | 26 | 34 | 45 |

**To**: Ends at the target date. Reaches lowest equities at the target date

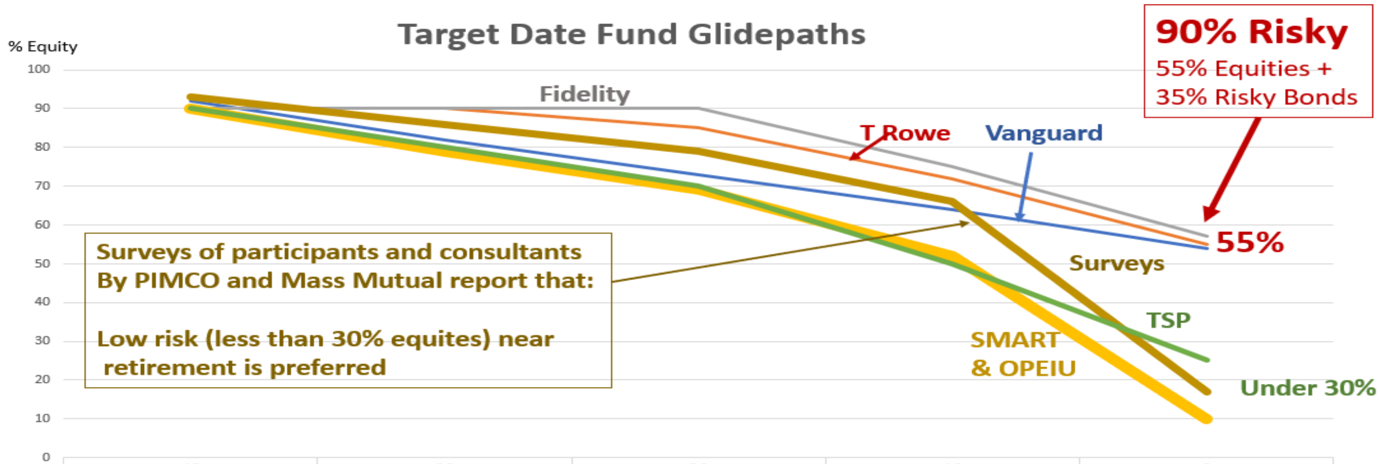
**Through**: Ends at death. Reaches lowest equities after the target date.

**U**: Defends with low equities at the target date and re-risks in retirement

More Glidepath Comparisons

# TSP is the Federal Thrift Savings Plan:

The Largest Savings Plan in the World




| Years to Retirement | 40 | 30 | 20 | 10 | 0 |
|---|---|---|---|---|---|
| Vanguard | 92 | 82 | 73 | 64 | 54 |
| T Rowe | 90 | 90 | 85 | 72 | 55 |
| Fidelity | 90 | 90 | 90 | 75 | 57 |
| SMART | 90 | 79 | 69 | 52 | 10 |
| Survey | 93 | 86 | 79 | 66 | 17 |
| TSP | 90 | 80 | 70 | 50 | 25 |

Surveys of beneficiaries and their advisors report a strong preference for safety near the target date

Safe separates from Risky at about 15 years to the target date

# FIDUCIARY SCRUTINY

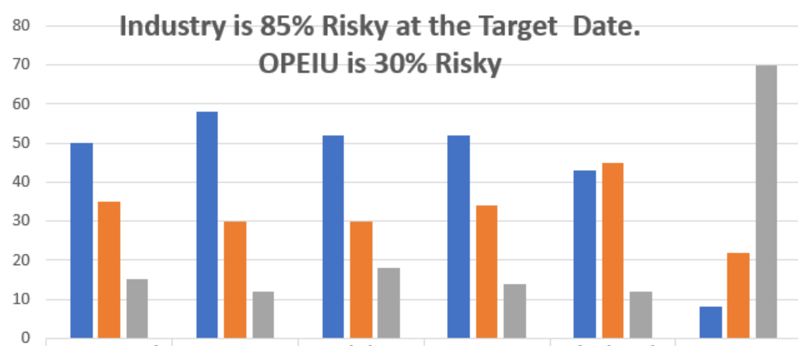
The duty of care rests on the duty to know.

“Pure heart but empty head” never works as a defense in court

# When fiduciaries choose TDFs they are choosing these

# Asset Allocations at the Target Date

Are these really the risks fiduciaries want for their defaulted beneficiaries??

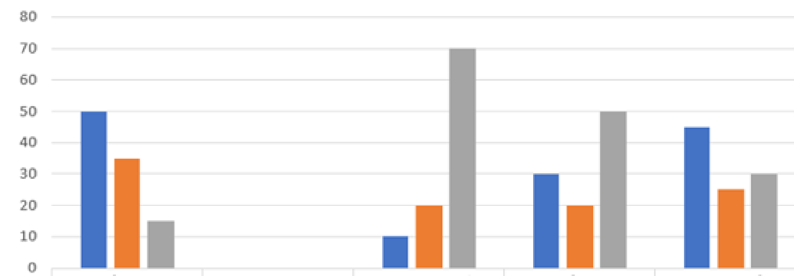



| | Vanguard | T Rowe | Fidelity | American | Blackrock | OPEIU |
|---|---|---|---|---|---|---|
| Equity | 50 | 58 | 52 | 52 | 43 | 8 |
| Bond | 35 | 30 | 30 | 34 | 45 | 22 |
| Safe | 15 | 12 | 18 | 14 | 12 | 70 |

Source: PIMCO Glidepath Analyzer

**85% Risky at the Target Date is**

**Shocking**




| | Industry | OPEIU: | Conservative | Moderate | Growth |
|---|---|---|---|---|---|
| Equity | 50 | | 10 | 30 | 45 |
| Bond | 35 | | 20 | 20 | 25 |
| Safe | 15 | | 70 | 50 | 30 |
| **%Risky** | **85** | | **30** | **50** | **70** |

# Objectives Explain Differences

| | Safe | Risky |
|---|---|---|
| Beneficiary preference | Protect lifetime savings | Compensate for inadequate savings |
| Provider revenue | Reasonable compensation | Maximize profits |

# Anthology of Target Date Fund Imprudence
## Click on titles to read articles

### The Crime

- Crime
- Warning
- Cause
- Analogy
- Culprits


### The Harm

- Risk
- Magnitude
- Damage, with Update
- Danger: It will get worse

### Prudent Choice

- Standard
- Improvement
- Global perspective
- Congressional inquiry

Help.

Please tell everyone.