Target Date Funds Are Still Playing With Fire Despite 2008. Someone is Going to Get Burnt. Fiduciary Alert !!

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"***Don't worry, be happy***" is hardly a prudent theme song for target date fund (TDF) fiduciaries. It could lead you into the "***Burning ring of fire.***"

Just five short months ago the target date fund (TDF) industry declared a general pardon for any responsibility tied to 2008 portfolio losses, which averaged a steep 25% setback in near-dated (2010) funds. The industry reasoned that 2008 declines were recovered in the wake of the financial crisis. Chalk up 2008 as an unfortunate setback that happens from time to time, we're told. But an objective review of history begs to differ. Importantly, mutual fund companies are simply offering product, with little fiduciary liability on their part, whereas your selection carries great responsibility. You can't blame the fund company for your investment losses, however painful they may be at the target date, but you can guard against the pain by choosing a conservative glide path. This warning is all about you, the fiduciary, not the fund providers.

Sure, the future's always uncertain and so mere mortals can't really be blamed for not seeing what they couldn't know. But that's no excuse for sloppy risk management. In a world destined to suffer surprises, TDFs should be managed so that risk exposures wind down gradually, leaving portfolios with target dates in the near future at or near all-cash levels. That's the only intelligent strategy for managing market volatility in TDFs. Unfortunately, it's the exception rather than the rule.

Recent market losses portend yet another major setback – 2008 could happen again, perhaps soon. Are you prepared this time? Lessons ignored today set the stage for lawsuits— *loss*-suits – tomorrow. Why play with fire? In the next downturn, participant losses could be recovered from employers. You should know better now, and you've certainly had time to adapt. Disregarding the facts is imprudent and dangerous. **There is no fiduciary upside to risk taking at or near the target date, but there's plenty of downside.**

It’s the mother of all asymmetric risk profiles for the TDF industry. Fortunately, there’s an effective solution, and it starts by remembering 2008 and heeding its key lesson: fear the future by managing risk. After all, it’s a fiduciary liability.

Old habits, however, die hard. The strategic responses to 2008’s losses have been minimal. Some TDF providers have made minor adjustments, but few have reduced risk exposure at the target date. For example, Vanguard’s target date funds continue to terminate at 60% in equities, T. Rowe Price winds down at 55%, and Fidelity ends at 45%. ***Caveat emptor*** for TDFs can be loosely translated as “despite its convenience and popularity, entrusting TDF assets to your bundled service provider is a decision to expose retiring employees to excessive risk at the target date, approximately 55% in equities.“

In the aero-speak of “glide paths,” TDFs aren’t scheduled for touchdown on the tarmarc; instead, their flight plans call for landing well above the runway. We know how this movie ends – plop!

All TDFs have unnecessarily high equity exposure, i.e. risk, at the target date. Because lifestyles are at stake, there ought to be no risk at the target date. There is a risk zone that spans the 5-10 years before and after retirement, during which lifestyles can be devastated, as 2008 reminds. This vulnerability arises from the fact that a) account balances are at their highest for the newly retired; and b) re-entering the work force is not an option.

Contrary to popular belief, conventional TDFs do not protect the vulnerable from equity loss (even though they should). Most participants in TDFs are defaulted into these products, which means that most participants rely upon their employers to do the right thing. Most participants also believe that their investments in TDFs are safe, especially near retirement (even though they are not).

History tells us this is a risk that’s no mere theoretical danger. Indeed, the past five months have been dreadful, with US stock markets plummeting more than 15%, & foreign markets suffering 25% losses. A 2008-like shock is threatening again. It’s time to

worry, and this time fiduciaries are duty bound to seek solutions rather than settling for high-risk products that are oblivious to the history. Ignoring the past is not an option, and it's certainly not an enlightened view of risk management. Fiduciaries need to actually vet their TDF selections and establish objectives that are truly beneficial for employees— objectives such as:

1. Do not lose participant money, and
2. Earn as much as you can, but don't lose participant money.

Make sense? By contrast, conventional objectives are reckless. Replacing pay and managing longevity risk are foolhardy objectives for TDFs. For a sad but humorous examination of this frivolity, please see The Sad Comedy of Target Date Funds **.**

Happily, there is a unique target date fund offering that is managed to the two preservation objectives above – the SMART Fund® collective investment trust provided by Hand Benefits and Trust in Houston. SMART Funds follow the patent-pending Safe Landing Glide Path® developed by Target Date Solutions, my company. We expect all SMART Funds to outperform the industry on a risk-adjusted basis over a full market cycle because of their world-wide diversification and rigorous risk controls, ending almost entirely in TIPS and T-bills at the target date. Near-dated SMART Funds will likely underperform on a non-risk-adjusted basis during rising markets, of course, because there is an opportunity cost for safety.

Free lunches, in other words, are as elusive as ever, although strategic-minded risk management speaks for itself.

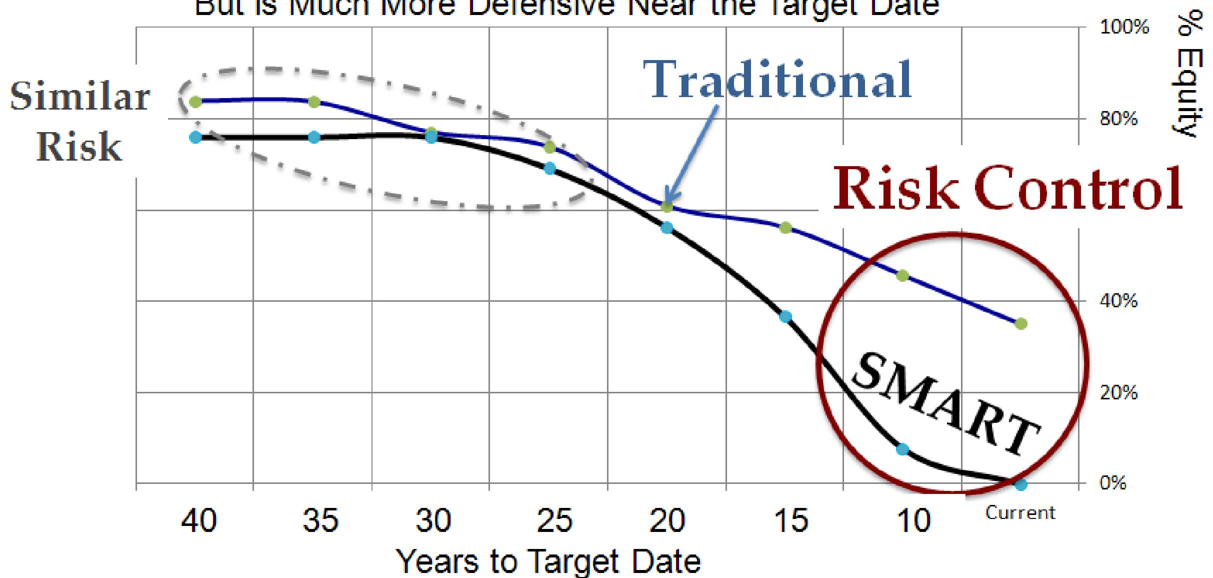
Indeed, SMART Funds stand apart from the rest of the industry in both form and substance. The substance is the Safe Landing Glide Path, otherwise known as financial engineering for prudent growth. The form is a collective investment trust which, unlike a mutual fund, serves as a fiduciary to the plan. According to Jessica R. Flores, Managing Partner, Fiduciary Compliance Center, LLC (**How Long Can You Get Away With Fraud?** Money Media, 9/28/11):

> *Mutual funds offer the greatest opportunity to commit self-dealing and fraud without consequence of any of the structuring options.*

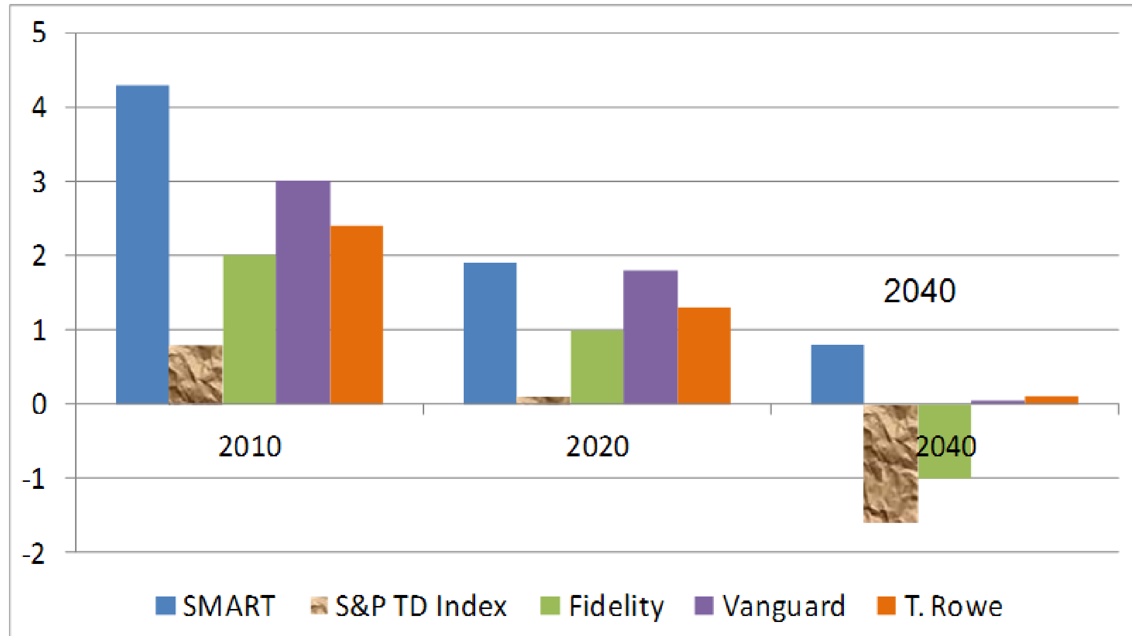
Target Date Funds organized as collective investment trusts and separately managed accounts fall under ERISA's reign. This is significant because the investment managers are fiduciaries under ERISA and therefore liable for dealing in their own self-interests and acting imprudently without care or regard. For some managers of Target Date Funds, this ERISA fiduciary standard is welcomed and even desired as they have chosen to organize their funds to fall into this category. However, those same funds tend to be managed very differently than their mutual fund cousins.

The proof of the pudding is in the tasting. The following 4 exhibits compare and contrast SMART Fund performance to the leading providers and to the S&P target date indexes. Now is the time to protect beneficiaries, before matters get worse. The good news is that you have a compelling alternative to the status quo. Don't wait. Unlike 2008, participant losses in the future could become your losses the next time.

It's not too late to change, but don't wait too long. To subscribe, contact Steve Hand or Jesus Herrera at Hand Benefits & Trust at (800)444-1311.

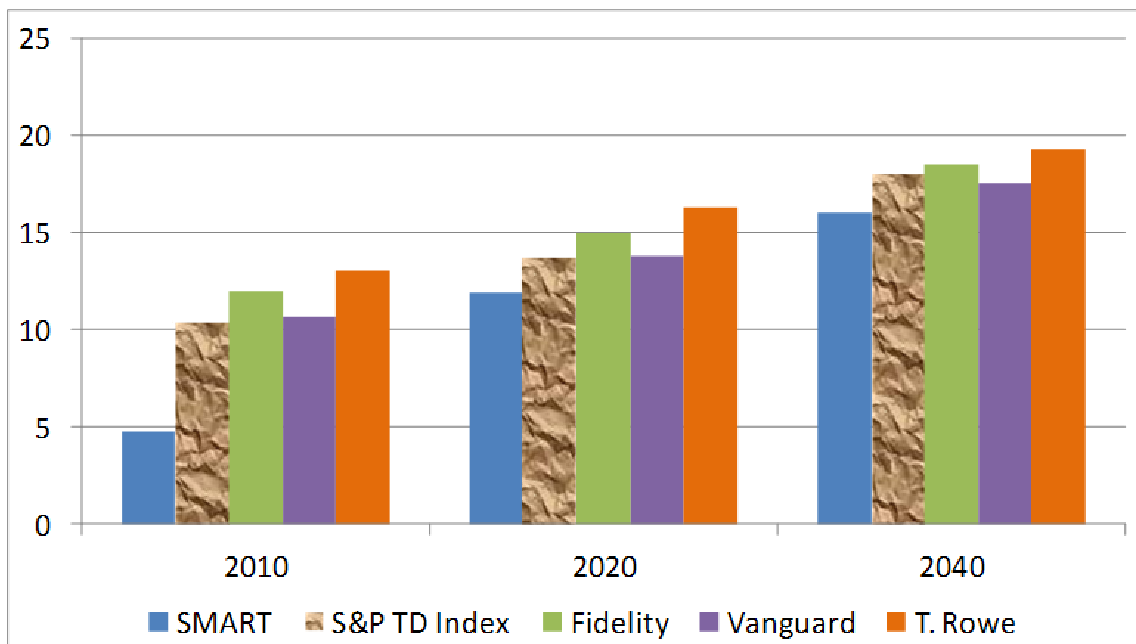


Annualized Returns for the 5 Years Ending 9/30/2011

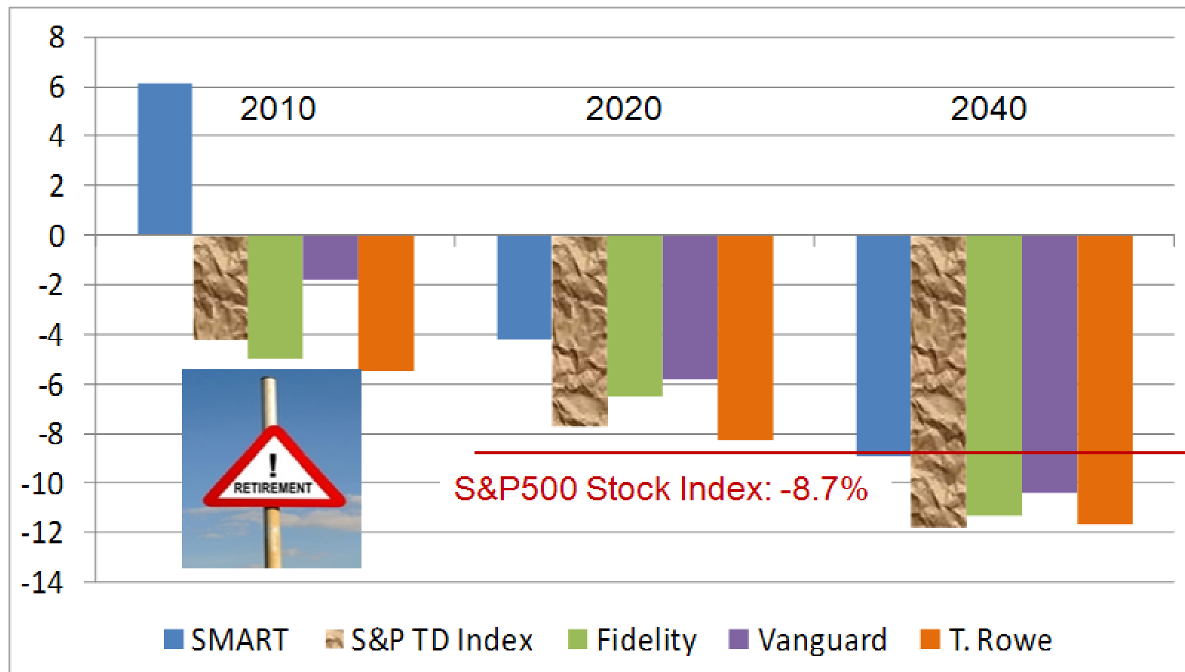


SMART track record is Brightscope On-Target Index, developed by Ron Surz, for 10/2006-10/2008
And live SMART collective investment funds for 11/2008-forward

Standard Deviation for the 5 Years Ending 9/30/2011



Returns for the 9 Months Ending 9/30/2011



The SMART Funds® are subject to financial market volatility, including equity and fixed income investments in the U.S. and abroad. Principal invested is not guaranteed at any time, including at or after their target dates.

Past Performance is no guarantee of future results and the actual performance of the Index and the Fund may be lower or higher than the past performance shown above. Investment return and principal value of the portfolio will fluctuate causing units of the Fund, when redeemed, to be worth more or less than their original cost. Performance prior to November 1, 2008 is back-tested while performance after November 1, 2008 is based on actual results. Returns are net of all estimated expenses and assume that all dividends received during a year are reinvested monthly. Actual performance will vary from that of investing in the underlying funds because it may not be invested in exactly the proportions indicated and may not be fully invested at all times. It is important to note that the Funds may underperform their Benchmark, the S&P Target Date Indexes, in certain years and may produce negative results.