

Target-Date Funds OK, but Keep Your Eyes Open



Q: I started a new job with a 401(k) retirement plan. I was advised to select a target date fund for my initial investments. Are there better options?

A: If you're starting out with a small account a target date fund (TDF) provides immediate diversification. TDFs are designed to make investing for retirement easier and encourage plan participation.

Target date funds are also known as 'life cycle funds' or 'age-based' funds. They have a mix of stocks, bonds, and other investments that automatically adjust over time. TDF's include a year in their name that is typically the retirement year. The term 'glide path' describes how the asset allocation changes over time.

These funds may be the answer if you want a periodic adjustment and rebalancing of your account. But don't think you can set it and forget it. The investment mix and philosophy may change. For

example, some TDFs have recently added alternative investments.

TDF fund performance and returns aren't guaranteed and depend on market performance. Check the TDF prospectus fund goals, objectives, investments, and fees. Morningstar is an independent investment research firm where you can find objective information.

Compare the TDF fund fees to a balanced mutual fund option in your plan. Higher fees reduce your investment return.

Compare the asset allocation for a fund with your retirement date to a current year TDF. This will show you the asset allocation to expect as your TDF approaches your retirement date.

For example, the Vanguard Target Retirement 2010 fund is currently 39% stocks and the Vanguard Target Retirement 2040 fund is currently 89% stocks. The T. Rowe Price Target Retire 2010 fund is currently 49% stocks and the T. Rowe Price Target Retire 2040 fund is currently 78% stocks.

In the 2008 financial crisis, several of the 2010 TDFs declined more than 25%.

Depending on your response (or lack of) along with your other savings, this may have been okay since most of the decline was made up over the next few years. Will you be able to wait it out?

A TDF may be right for you now because you are starting your new 401(k). But don't become complacent as it may not always be your best investment choice. Compare the fund performance and fees to other funds in your plan. Review your goals and your quarterly statements. Ensure the TDF asset allocation meets your investment goals and objectives. And don't forget to take advantage of the company match!

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