Criticism of Target Date Funds is Misplaced

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Target date funds have received some criticism of late for being too aggressive. The funds, which adjust their allocations as a worker ages, lost money last quarter. Most are down year-to-date as well.

Here are three examples from our third-quarter Low Load Mutual Fund Update, which will soon be made available on our website to subscribers. Fidelity Freedom 2015 (FFVFX) lost 5.2% last quarter and is down 2.9% year-to-date (as of September 30, 2015). T. Rowe Price Retirement 2015 (TRRGX) lost 5.1% last quarter and is down 3.2% year-to-date. Vanguard Target Retirement 2015 (VTXVX) lost 3.9% last quarter and is down 2.6% year-to-date. The three funds, respectively, allocate 56.6%, 53.5% and 48.8% of their portfolios to domestic and international stocks. As the names suggest, they are designed for people who either have recently retired or are planning on retiring within the next two years.

None of these funds are taking excessive risk from an investing standpoint. Someone nearing retirement who is in fairly good health, blessed with good genes and at, or close to, retirement age could be looking at another 30 years or more of life. This type of potential lifespan requires either a large sum of current wealth or an ongoing significant allocation to equities to preserve the ability to buy goods and services. Life does not stop at retirement, and neither should a person's or a target date fund's investment horizon.

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A Few Words About Ben Bernake

Former Federal Reserve chairman Ben Bernanke was in Chicago on Tuesday to promote his new book, "The Courage to Act: A Memoir of a Crisis and Its Aftermath" (W.W. Norton & Company, 2015). He spoke with Martin Wolf (The Financial Times' chief economics commentator) for about an hour. While I won't rehash the entire conversation, I will share a few things I think will be of interest.

As would be expected, Bernanke defended the monetary policy actions taken during his tenure. In discussing the financial crisis, he said the Federal Reserve knew that housing prices were high and that subprime credit was a problem, but he and his colleagues didn't realize how dependent the financial industry was on short-term financing. Bernanke added that since that since the crisis, the Federal Reserve now does worst-case scenario analysis instead of trying to identify bubbles.

He is cognizant of the impact that low interest rates has had on those dependent on portfolio income, saying "I sympathize with savers." Bernanke rationalized, however, that if interest rates had been raised prematurely, the economic recovery would have been jeopardized. He also blamed fiscal policy, saying the Federal Reserve had to be aggressive in trying to spur growth because of the lack of assistance from the federal government and state governments.

During the question and answer session, Bernanke was asked where the current financial risks are. He said they are mostly in emerging markets. Falling oil and energy prices, decreasing demand from China for imported goods and materials, and the stronger dollar are all creating problems for emerging market countries. The stronger dollar is particularly problematic for emerging market companies that took out dollar-denominated loans and now face the prospect of having to make debt payments with local currencies that are now comparatively weaker against the U.S. dollar.

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- Target Date Funds: A Simple Premise, but Underlying Complexities – This 2012 *AAII Journal* article gives an in-depth look at target date funds and how their allocations evolve over time.
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