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2017 Target-Date Fund Update

Morningstar Answers FAQs

In late April, Morningstar released its "2017 Target-Date Fund Landscape – Answers to Frequently Asked Questions". The review, which covers topics from asset growth and cash flows to fund fees and investor experience, presents several important findings for 401(k) plan sponsors and participants alike. For a detailed explanation of target-date funds (TDFs), please see our Ekon Explains segment here.

Target-Date Fund Growth

Target-date funds have seen significant growth since their inclusion in the list of acceptable default investment alternatives in the Pension Protection Act of 2006. In 2016, this class reached its all-time high with $880 billion in assets and proves to be a vital component to the overall success of a mutual fund family. The three families with the largest market share are Vanguard, Fidelity, and T. Rowe Price, all three of which started their target-date funds early on. These three fund families together have more than 70% of the TDF market share.

2016 saw an increase in assets in target-date funds due to positive returns ranging from 5.1% to 8.2% in the specific retirement date categories and positive cash flows from investors. Vanguard and American Funds saw the biggest inflows, but not all fund families faired so well. Fidelity saw its third straight year of TDF outflows at nearly $3 billion in 2016. Principal and John Hancock also experienced TDF outflows for the year.

Are TDF's the right choice?

When analyzing if target-date funds are effective long-term investments, Morningstar points out that TDFs have a "relatively short track record" and that "it is still anyone's guess" if the funds can fulfill the goal of obtaining a successful retirement. They do give hope, however, by pointing to the funds that have been in existence for the past decade demonstrating that the buy-and-hold strategy (hands-off approach taken by typical TDF investors) has proven advantageous. When compared to balanced funds, Morningstar shows lower total returns with higher volatility for TDFs, but ultimately a higher simulated account balance in the more future dated target-date funds when compared to the average balanced alternative.

Also, fees for target-date funds continue to decline. In 2009, asset-weighted TDF fees averaged a hefty 1.03% compared to 0.71% in 2016. As plan sponsors focus more on investment fees, an even further decline may occur.

Conclusion

Target-date funds are complex investment alternatives which have gained assets at a record pace. As these funds become more popular as an investment choice and used as a default fund, they require more scrutiny. Plan Sponsors must analyze these investments to fulfill their fiduciary oversight responsibilities.