The elements of success

Pros and cons of target-date funds

Rebalancing your portfolio as you get closer to retirement is one of those financial upkeep tasks that goes undone for many investors each year. Some don't know how to rebalance their portfolio or even that they should be doing it. Others just can't decide what the best asset allocation is for their age.

Target date funds attempt to solve this problem. Generally, as you near retirement you'll want your portfolio to become more conservative as your focus shifts to protecting your money instead of generating significant returns. A target date fund is a mutual fund designed to change over the years in accordance with an investor's changing needs.

To select an appropriate fund, the first step is to choose the one that aligns with your prospective year of retirement, and the fund manager will rebalance periodically to create an ideal mix of assets. When you're first starting out and you have many years until retirement, your target date fund will have a large portion in equities. This will shift throughout your career, and some will continue to change even after your retirement date—the target date is your retirement date, not the date you will necessarily cash out. Target date funds can have various asset mixes that include foreign and domestic stocks, bonds and cash; funds differ in how much of each asset class is included at a given time, and how this ratio changes over time—their "glide path." Fund managers will run simulations to try to predict future risk and return and create the fund's glide path accordingly with the goal of making sure investors don't outlive their investment.

As with any investment vehicle or strategy there are pros and cons, and target date funds aren't for everyone.

Pros

Simplicity. Figuring out how to invest for your retirement, which may be several decades away, can be a complicated process. Rebalancing every year can also be onerous to many investors. Using a target date fund simplifies the process.

Diversification. The fund is diversified for you with a blend of assets that is theoretically ideal for your life stage. With a target date fund, you have the benefit of investing in both stocks and bonds.

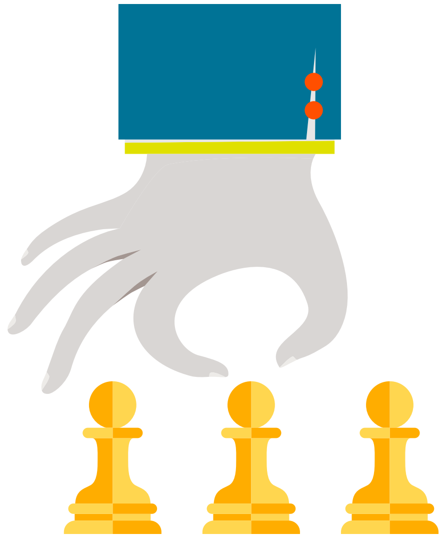
Designed for long-term investments. You're less likely to make decisions based on emotion or knee-jerk reactions to market fluctuations if your portfolio is rebalanced for you. The "set it and forget it" approach is not only convenient, but also beneficial to many investors.

Cons

Less flexibility. The simplicity of target date funds may seem attractive, but it can also be detrimental. The one-size-fits-all approach may mean that your retirement account is not actually balanced well for your unique needs.

Not all funds are the same. You probably shouldn't just select a target date fund with your retirement year assigned to it without doing research first. That's because one firm's fund for a given year may differ drastically from another's. It's not as simple as merely picking a date; before you choose, you still need to research each fund's asset allocation and glide path, the fund manager and its historical performance as compared to other target-date funds. You should also look at what types of stocks and bonds are within a fund, not only the ratio.

Could be too risky. Some funds expose investors to more risk than others as they near retirement, and the fund you choose may be too risky for your situation. According to Morningstar, target date funds set for 2010 lost an average of 37 percent between March 2008 and February 2009. In a target date fund the choices aren't yours, but the risks are.



Your Options

If you're not sure a target date fund is right for you, research your options to see if you like the makeup of funds available to you. Check your company's fund with a target date coming up soon to see how you can expect yours to look as your near retirement. You can at least use a target date fund as an example for building your own tailored retirement fund. A target date fund may be a good fit for you as you begin your retirement savings, but as you approach retirement, you may want something that meets your specific needs. One way to get a better fit target date fund is to choose a year other than your retirement year—choose a fund with a later target date if you want a more aggressive mix, and choose an earlier date for a more conservative portfolio. If a target date fund sounds promising but doesn't quite meet your needs, you can also supplement your target date fund with other investments to get an even more customized plan.

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