Tom Mullooly: In episode 255, we address the question, are you using a target date fund correctly?

Tom Mullooly: Welcome to The Mullooly Asset Show. I'm your host, Tom Mullooly. And this is episode number 255. Thanks for tuning in. Target date funds were created about 25 years ago. You may know them as a lifecycle fund or freedom funds or a lifestyle fond or just target date fund. The thing they all have in common is they all have a year in the name. So 2025 fund, a 2030 fund, 2035 fund, stuff like that.

Tom Mullooly: So Vanguard recently reported that more than a third of 401k investors are using target date funds improperly. They're just doing it differently. So what's happening is that they're investing in target date funds and other funds along with it. So the reason why this matters is this. If you look at your 401k account and you own a target date fund and an S&P fund, and some other funds that are in there, you have a really aggressive allocation and that may not be appropriate for you.

Tom Mullooly: With target date funds, all the allocation you're going to need is in one fund, that target date fund. The investments inside the target date fund will get more conservative as you get older. So as you approach, what do you want to do is you want to own a fund that's going to... The year is going to match up with the time you plan to retire or the time around the time you're going to be turning say 65 years old. So, as you get closer to that date, the investments in the fund get more conservative. That's really important.

Tom Mullooly: Now we hear from folks all the time that say, "Well, wait a minute. I don't want to put all my eggs in one basket. I don't want to own just one fund. So I diversify and I own an S&P fund. Well, I own a target date fund, and I own an S&P fund, a bond fund, a small cap fund, a mid-cap fund. You know, that international fund was up a lot last year. So I own some of that too." All of those other funds are already built in to your target date fund.

Tom Mullooly: So if you own a target date fund in your 401k, this is literally the only fund that you are going to need. If you look under the hood at your target date fund that's inside your 401k, you're going to find that there's seven, eight, nine, 10 different mutual funds built into that fund. It's technically called a fund of funds. So when 401k investors own a target date fund, plus an S&P fund, and all these other funds, they're adding so much risk, more risk than you might even realize. And that's really important because a lot of folks will say, "Hey, I really want to grow my retirement accounts. I'm going to be relying on this money in retirement." But you know what happens two or three years before you're ready to retire and you own target date fund and all these other growth funds that are in your plan, and everything goes down the drain right before you're ready to retire?

Tom Mullooly: You may have over-allocated yourself towards growth, just by layering on all these other funds that are available in your plan. If you take the route of being in a target date fund, it's the only one you're going to need. And that is the message for episode 255. Thanks for tuning in.