Target Date Funds - Transcript

Tom Mullooly: In episode 120, we're going to talk about target date funds.

Welcome to The Mullooly Asset Show. I'm your host, Tom Mullooly, and this is episode number 120. Thanks for tuning in. There's a good article recently in the Wall Street Journal, and we'll link to it in the show notes, about how there's a big mistake that target date investors make, and we actually see this happening a lot in our office when new clients bring in accounts from other firms.

What's happening is we're discovering, as was mentioned in the Wall Street Journal article, that folks that own target date funds, own target date funds, plus they own other funds in addition to this target date fund ... Let me just back up a second. A target date fund is a fund that'll come with a date on it, and the date ideally is something like when you need the money for college or when you need the money when you're turning 65, when you're retiring. They give you a built-in allocation. They already own funds in the target date fund, so it's a fund of funds, and they're trying to jigger the allocation so that it's right for the period of time until you reach the target date.

The entire concept of target date funds is to give you all the diversification and the allocation that you're going to need in one fund. That's really important, but what happens, what happens with a lot of investors, they'll own a target date fund, plus they'll own a large cap fund and a small cap fund, a mid-cap fund, an international fund. They'll own bond funds on top of it.

While the target date fund they picked might have, I don't know, a 70/30 allocation, meaning 70% for growth, 30% for something conservative, safe. They've then added more bond fund, more stock funds, you name it, on top of it. This just wrecks the allocation and the whole idea of a target date fund. The whole thing with the target date fund, as I mentioned earlier, is that as you approach that target date fund, say, when you're going to retire or when you're turning 65, is that the allocation will come in for a smooth landing, and you'll have less in the stock market at-risk, and you'll have most or nearly all of the allocation out of the market when you're going to need that money.

One of the things that was also mentioned in this article too is, hey, if you don't like the allocation, that if you don't feel like, hey, it's got enough exposure to the stock market or enough exposure to the bond market, you can always change the target date and the target date fund that you're looking for. If you want to be more conservative, fund a target date fund that has a shorter maturity. If you're looking for something with more growth, you can actually find funds that have longer dates. It doesn't really mean maturity, but it means this is how they're going to manage the allocation. Now, it's really important. The allocation is really important.

What happens though is we see a lot of individuals that own these target date funds in a mix of all these other mutual funds, and so they're tending to just over-allocate or wreck the allocation. You know what we hear from clients? They'll say, "Somebody told me a long time ago to buy this target date fund. It doesn't do very well. When the market goes up, it doesn't go a lot, and when the market goes down, it goes down too." The whole idea with the target date fund is that this should be the only thing in some accounts, and that's the whole concept behind target date funds. Good tool, very misunderstood in our industry.

Thanks for watching episode 120. Catch you next time.