On Pointe Email Bulletins!

ALPHA POINTE CAPITAL

What you need to know about your 401k Target/Retirement Date Funds

A 401k participant from Reno, NV wrote me an email the other day….

“Hey, I’ve been investing in my 401k account all year with my Target Date fund and it doesn’t really seem to keep pace with the markets? Can you please look into this for me?”*

Ah, this is actually my favorite question and I’ve actually gotten several emails asking this same question from other 401k participants.

So I’m dedicating this On Pointe to helping answer this question.

Oh, BTW if you haven’t read our On Pointe emails you can visit HERE for “Wealth Topics with a Twist.” This page can be a great resource for you to learn retirement and investing concepts.

Now for the answer and I’m going to warn you it not as easy as switching to another fund so let’s get to it.

First, what is a Target Date fund?

Target-date funds are mutual fund or exchange-traded funds (ETFs) structured to grow assets in a way that is optimized for a specific time frame. The structuring of these funds addresses an investor's capital needs at some future date—hence, the name "target date." Most often, investors will use a target date fund to apply to their onset of retirement.

That’s easy enough as most Target Date funds in 401k’s are designed for your expected, future retirement date. Plus, in my experience these funds are generally easy enough to understand… at least on the surface.

So, how do they work? Now we’re getting into it….

The fund will invest in a combination of stocks, international stocks, bonds, and cash based on the investors current age. As the investor (or in this case 401k participant) ages the fund will adjust the portfolio to help build a portfolio that is generally appropriate for someone’s age.

More specifically, the younger the fund owner, the fund will own more stocks. The older the fund owner, more bonds and cash are invested.

Why?

The general rule of thumb for investing is younger investors can invest more in stocks because they can generally tolerate more risk and volatility associated with stocks. Should a younger investor encounter volatile and lengthy down markets they have more time on their side to recoup those losses and get back on track for retirement.

This is why Target Date funds generally invest more in stocks for younger investors.

Older investors who are nearing retirement will have more exposure to bonds and cash. This is because it is generally accepted that bonds and cash are less volatile and as a person nears retirement their ability to withstand losses decreases as they have less time to recoup losses.

How does this affect performance?

One way to look at this is risk versus reward. Or you can look at it another as volatility in the market can work for you (reward) or against you (risk).

So, if you're an older investor you will have more bonds/cash in the portfolio thus with a strong stock market rally such as what we're witnessing now the fund likely will not perform at the same level.

Even for younger investors, Target Date funds generally still have some exposure although it won't be quite as much as an older investors, performance won't be the same as if they invested in the S&P 500.

Why is this favorite question?

This is my favorite question because it goes to the very core of my services. My investment services seek to find solutions such as finding alternatives solutions for investors. We at APC love to tailor portfolios for the clients that engage with us.

I generally like having Target Date funds in 401k Investment menus because of their simplicity but they don't necessarily solve all problems for investors.

When I build an investment menu for a retirement plan I will often have a robust menu the will include all equity/stock funds, investments that target specific industries, balanced funds that invest in a balance of stocks and bonds, international funds, emerging market funds, bond funds, and perhaps some alternatives.

My purpose for building diverse investment menus is multi-fold, but for the purposes of this email we find that some participants want alternatives to meet their goals. We also come across participants that have investment experience and want more robust selections.

When we are advising participants we as advisors need these different investments as we find different funds will often rotate in and out of favor so we want to be able to invest in funds exhibiting positive trends.

I hope this helps to explain Target Date Funds purpose and perhaps some of their limitations.

Take care,

Jim Gibbons

Are Target Date Funds right for you? Let's chat!

The best way to determine a good fit is to start with talking. No statements or lengthy presentations just start with a chat and we'll see where it goes. Remember, we want to know you before we accept your business…. Reserve your Time Slot!

Or… Educate yourself, Invest in Yourself, Invest in Strength!!! Visit On Pointe for more Wealth Topics with a Twist…

Or... Suggest a Topic for upcoming On Pointe email bulletins at info@alphapointecap.com

*Target date funds are mutual funds that periodically rebalance or modify the asset mix (stocks, bonds, and cash alternatives) of the fund's portfolio and change the underlying fund investments with an increased emphasis on income and conservation of capital as they approach the target date. Different funds will have varying degrees of exposure to equities as they approach and pass the target date. As such, the fund's objectives and investment strategies may change over time. The target date is the approximate date when investors plan to start withdrawing their money, such as retirement. The principal value of the funds is not guaranteed at any time, including at the target date. More complete information can be found in the prospectus for the fund.

*Mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges and expenses carefully before investing. The prospectus, and, if available, the summary prospectus, which contains this and other information, can be obtained by calling your financial advisor. Read the prospectus and, if available, the summary prospectus carefully before you invest.

*The planning process discussed may not be suitable for your personal situation, even if it is similar to the example presented. Past performance is no guarantee of future results. Investing involves risk including the possible loss of principal.

Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns. The investment(s) discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Additional information is available upon request.