

## Morningstar's Target Date Research

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### Target-Date Funds are Big Business

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**Annual Target-Date Fund Flows (\$mil)**

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	2003	2004	2005	2006	2007	2008	07-2009
Total Target-Date Fund Flows	5,132	11,795	18,720	28,674	49,663	56,805	35,056
% of Total Mutual Fund Flows	2	5	7	10	13	49	14

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## Issues

- × Assets are linked to distribution, not necessarily merit
- × Performance has been uneven
- × Very different approaches
- × Need for greater scrutiny

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## Morningstar's Approach to Rating Target-Date Series

- × Process (not rated)
- × Performance
- × Portfolio
- × People
- × Parent
- × Price

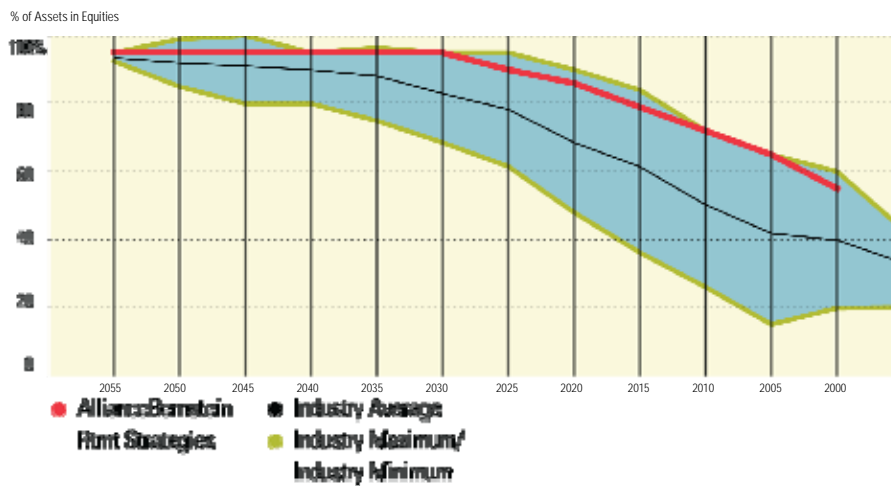
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## Process: Glide Paths

- × Capital appreciation vs. capital preservation
- × Plain-vanilla vs. exotic asset allocation
- × Target date vs. lifetime allocation

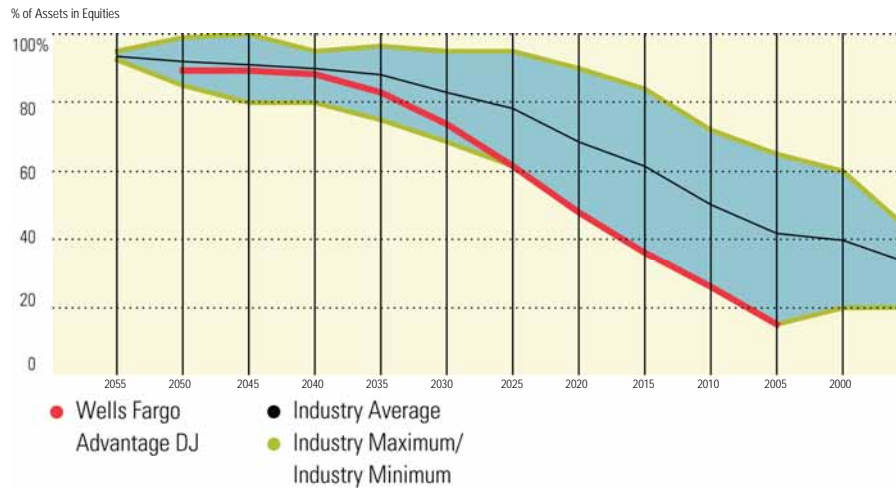
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## Process: Some Asset Allocations are Aggressive



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## Process: Others are Taking a Conservative Approach



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## Performance: Methodology

- × Measuring risk-adjusted performance
- × 3-year and 5-year records (when available)
- × Peer-based comparisons

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## Performance: Wide Ranges of Approaches, Outcomes

### 2010 Target-Date Fund Equity Allocation % with 2008 Performance

	Target Equity Allocation %	2008 Performance %
AllianceBernstein 2010 Retirement Strategy	72	-32.79
Oppenheimer Transition 2010	70	-41.17
American Funds Target Date 2010	67	-27.34
Vanguard Target Retirement 2010	55	-20.58
Fidelity Freedom 2010	50	-25.22
Putnam Retirement Ready 2010	27	-25.88
Wells Fargo Advantage DJ Target 2010	26	-10.70



## Performance Ratings, June 2009

Top	Above Average	Average	Below Average	Bottom
American Century	Vanguard	American Funds	John Hancock	AllianceBernstein
Wells Fargo	JP Morgan	T. Rowe Price	MassMutual	Oppenheimer
	Vantagepoint	TIAA-CREF	DWS	
	MFS	Fidelity Freedom	Fidelity Adv Freedom	
	Schwab	Putnam	Principal	
		ING Retirement		



### **Portfolio: Methodology**

- × Weighted average star rating of underlying funds
- × Using extended performance when available
- × No rating for pooled-security approach



### **Portfolio**

- × Passive vs. active
- × Open vs. closed architecture
- × Varying quality of underlying funds
- × Fund of funds vs. master pooling



## Portfolio Ratings, June 2009

Top	Above Average	Average	Below Average	Bottom
American Funds	T. Rowe Price	Vanguard	Fidelity Adv Freedom	
American Century	JP Morgan	Fidelity Freedom	Principal	
	Vantagepoint	Schwab		
	TIAA-CREF	John Hancock		
	MFS	MassMutual		
		Putnam		
		DWS		
		Oppenheimer		

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## People: Methodology

- × Primarily evaluating managers of underlying funds, but asset allocators also factor in
- × Rating quality of management based on tenure, turnover, analysts' opinion of underlying funds
- × Examining target-date managers' incentives
  - × Pay plans
  - × Manager ownership of fund shares

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## People: Some Managers are Experienced and Likely to Stay

### Average Fund Manager Tenure and Retention Rates

	Average Manager Tenure for underlying holdings of target-date funds, as of 06-2009 (Years)	Firm-wide Manager Retention Rate as of 12-30-2008 (5-Yr Avg %)
American Funds	23.04	98.67
Vanguard	10.74	93.31
JPMorgan	8.05	85.68
T. Rowe Price	6.44	93.39
MFS	6.44	86.54
Putnam	5.61	78.88
Fidelity Freedom	4.62	86.28
Oppenheimer	3.40	91.04
American Century	3.27	87.70
AllianceBernstein	2.46	89.78
DWS	2.42	82.06



## People: Managers Who Invest in Funds Outperform Peers

Ownership Level (SAI data as of July 2009)	Average Rank Category: 5 yrs	# of Funds
More than \$1 million	42	413
Between \$500,001 and \$999,999	44	197
Between \$100,001 and \$500,000	46	679
Between \$50,001 and \$100,000	50	285
Between \$10,001 and \$50,000	50	393
Between \$1 and \$10,000	52	159
\$0	54	2,257





## People Ratings, June 2009

Top	Above Average	Average	Below Average	Bottom
Vanguard	American Century	Wells Fargo	Fidelity Freedom	DWS
American Funds	JP Morgan	MassMutual	Schwab	Principal
T. Rowe Price	Vantagepoint		Putnam	
	TIAA-CREF		Fidelity Adv Freedom	
	MFS		ING Retirement	
	John Hancock		AllianceBernstein	
			Oppenheimer	

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## Parent: Methodology

- × Evaluating corporate culture to see if investors come first
- × Look for highly independent fund board with investments in fund shares and track record of serving shareholders well
- × Examine disclosure for clear explanations of target-date funds
- × Reduce ratings of series with regulatory problems

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## Parent: It's Tough to Partner with Poor Stewards

Stewardship Grades for Funds as of December 2004	% of domestic equity funds killed off since December 2004
<b>A</b>	2%
<b>B</b>	8%
<b>C</b>	6%
<b>D</b>	25%
<b>F</b>	38%



## Parent: Partner with Good Stewards

How do the Largest 10 Fund Families Stack Up?

Fund Family	Fund Mergers Since 2005	Funds Launched Since 2005	Manager Retention Annualized Since 2004	Corporate Culture Grade
Vanguard	1	12	93.15	A
American Funds	0	3	98.64	A
Fidelity Investments	9	<b>35</b>	<b>86.18</b>	B
PIMCO Funds	0	22	90.54	B
Franklin Templeton	12	16	91.89	B
T. Rowe Price	3	14	94.13	A
John Hancock	34	<b>35</b>	88.80	C
OppenheimerFunds	9	16	89.15	C
Dodge & Cox	0	1	96.09	A
Columbia	<b>45</b>	7	<b>86.68</b>	C



## Parent Ratings, June 2009

Top	Above Average	Average	Below Average	Bottom
Vanguard	American Funds	American Century	Schwab	ING Retirement
T. Rowe Price	Fidelity Freedom	JP Morgan	MassMutual	
	Fidelity Adv Freedom	Vantagepoint	Putnam	
		Wells Fargo		
		TIAA-CREF		
		MFS		
		John Hancock		
		DWS		
		AllianceBernstein		
		Principal		
		Oppenheimer		

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## Price: Methodology

- × Look for cheapest share class with at least 10% of fund's assets
- × Average expense ratios across target-date funds in series
- × Rank from cheapest to most expensive

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## Price

- × Fees are an important predictor of performance
- × Expense ratios compound over decades of ownership
- × Huge disparity in cost



## Price: Wide Disparity in Costs

Target-Date Series Asset-Weighted Average Expense Ratios, July 2009

	Asset Weighted Expense Ratio %	Total Assets in Millions \$
Vanguard Target Retirement Series	0.19	41,051
TIAA-CREF Lifecycle Series	0.69	2,674
Fidelity Freedom Series	0.69	71,835
American Funds Target Date Retirement	0.98	4,321
ING Solution Series	1.15	2,746
MFS Lifetime Series	1.38	208
Oppenheimer LifeCycle Series	1.73	187



## Price: Fees Matter for Domestic Equity Funds

Category Expense Quintile	% Surviving Past 10 Years	Average Category Rank	Average Std Dev Rank
Cheapest Quintile	74	48	51
2	66	48	48
3	61	46	52
4	60	56	52
Most Expensive Quintile	46	54	53



## Price Ratings, June 2009

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Vanguard	American Funds	John Hancock	Vantagepoint	MFS
	American Century	MassMutual	Fidelity Adv Freedom	Oppenheimer
	T. Rowe Price	Putnam	ING Retirement	
	JP Morgan	DWS		
	Wells Fargo	AllianceBernstein		
	TIAA-CREF	Principal		
	Fidelity Freedom			
	Schwab			



## Summary

- × Don't assume that one target-date series is the same as the next
- × Differences in approach to glide path can dramatically shape risk and performance
- × Quality of management and underlying funds is inconsistent
- × Stewardship practices, price of series are key long-term considerations
- × Morningstar Target-Date Series Reports and Ratings allow for quick filtering as well as deep dive into differentiating factors



## Overall Ratings, June 2009

Top	Above Average	Average	Below Average	Bottom
Vanguard	JP Morgan	MFS	John Hancock	Principal
American Funds	Vantagepoint	Fidelity Freedom	MassMutual	Oppenheimer
American Century	Wells Fargo	Schwab	Putnam	
T. Rowe Price	TIAA-CREF		DWS	
			Fidelity Adv Freedom	
			ING Retirement	
			AllianceBernstein	



## Future Plans

- × Update reports quarterly
- × Industry survey in early 2010, then annually
- × Monitor best practices

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