Pick a retirement date; fund managers call the plays

By Julie H. Case
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Playing with money, especially your retirement fund, can be scary.

Enter the recently popular retirement funds commonly known as lifecycle funds. A lifecycle fund is a diversified mutual fund set up to automatically become more conservative over time.

Lifecycle funds

What they are: Also known as target-date funds and life-stage funds, these are mixes of cash, bonds and stocks, including in many cases some foreign stocks. The fund's name includes the retirement year, and the funds are usually spaced five years apart (e.g., 2010, 2015, 2020, etc.)

Some are funds of funds, while others own individual securities outright.

All share the goal of first growing and then preserving your portfolio appropriate for investors who plan to retire in a specific year.

PROS

They can help eliminate the confusion many employees and investors feel when faced with too many mutual-fund choices in the typical 401(k).

They enable investors to diversify their investments and avoid the temptation to chase the hottest sector.

A study by Manulife USA, the parent company of John Hancock, found that among 401(k) participants those who contributed to a life-stage fund between 1999 and 2003 earned better returns than those who selected their own investments; this was largely because investors tended to stick with them through market swings, according to Manulife.

CONS

One size doesn't necessarily fit all.

They're not as "brainless" as some think; if you don't pick consciously, you could end up with an approach you're not comfortable with: Each fund family is different; some are more conservative than others. The asset allocation of a particular fund won't suit the risk tolerance of all individuals who plan to retire in that year.

Vanguard's target-retirement funds, for example, are considered fairly conservative in terms of how they allocate between equities and bonds, while T. Rowe Price funds are on the aggressive side and Fidelity is in the middle, according to Kerry O'Boyle, a fund analyst with fund tracker Morningstar.

Too often, employees don't use target-date funds properly. They're designed to be one-stop shopping but if you have additional funds you have to be sure there's not duplication.

Sources: bankrate.com; smartmoney.com

The further the investor is from his target retirement date, the more money invested in stocks and the greater the risk. The closer the fund gets to that target date, the more conservative the mix becomes.

Take, for example, Vanguard's Target Retirement 2035 fund, designed for someone who expects to retire in 30 years. Today the largest allocation — about 80 percent — sits in stocks, the other 20 percent sits in bonds. In 15 years, the split is closer to 60-40. Five years from retirement the allocation switches entirely, with only about 30 percent left in stocks, the rest in bonds.

For an inexperienced investor lifecycle funds offer ease and peace of mind as he simply chooses a fund to invest in based on a projected retirement date and the fund managers make all the decisions about asset allocation, diversification and rebalancing.

That is exactly what attracted Katherine Miller, the employee-benefits and retirement-plans manager for her company, Costco.

"I chose a retirement date fund because I am lazy," says Miller, who invested in a T. Rowe Price retirement fund through her company's 401(k) program.

"I don't have the time, I want it diversified for me, I want it taken care of by someone else, and I didn't want to spend the money on a financial planner managing it for me. So, it seemed like the right thing."

The downside of these investments is that they can be less rewarding than more aggressive and informed investing, says Edmonds chartered financial consultant Mike Koenig. Still, he says, he'd rather have people investing in something than nothing.

Jake Engle, a Seattle fee-only certified-financial planner, adds:

"Lifecycle or target-retirement funds are a progressive development in investing, and have their place — especially in a 401(k), where they are a vastly better choice than just putting your money into the money-market investment option, or into your employer's stock."

While they may not have as high returns as a more aggressive and more tailored investment plan, he says, they do typically have returns. For people who tend to invest in a 401(k) and then forget their investment — not spending time rebalancing or tracking performance of their funds — lifecycle funds may also be a better option. So, how to choose a retirement fund?

TWO GOOD ONES

For those looking on their own, Engle says he is a fan of Vanguard and T. Rowe Price because they typically have the lowest price. He urges investors to look for a low expense ratio — the annual percentage of the fund's assets that are paid to the company to manage the fund.

Those fees are detailed in the enormous prospectus each company sends out, but they can often also be found by researching the fund on the company's Web site.

However, investors should also look at the investment returns of these funds. Sometimes consistently better returns could justify slightly higher costs.

Risk and reward: Lifecycle funds can also be compared based on their asset-allocation percentages to stocks versus bonds. Meaning that, for a given target date, some fund families have a higher percentage of the money in stocks vs. bonds than other companies — equaling more risk, but more potential reward.

Stay the course: Once an investor gets into a fund, they typically need to stay long enough to see some reward, too — and that's particularly true if you buy a loaded fund.

Koenig says no matter what the investment — including these seemingly effortless lifecycle funds — investors need to pay attention to their investments and check their accounts regularly. While it may pay to stick with a fund if it has a good track record, good management that hasn't changed, and a solid and longstanding approach to money management, if your lifecycle fund isn't performing, it may be time to switch investments.

Still, that kind of rigid attention to investments isn't the mindset of archetypal lifecycle-fund investors, who are looking for a retirement plan they don't have to aggressively manage.

Mini profile: Easy planning

Katherine Miller

Employee-benefit and retirement-plan manager, Costco

Age: 45

Years until retirement: 22

Why she chose a lifecycle fund: To have a retirement fund she doesn't have to look at, rebalance or do anything to.

How she chose it: Based on her age, she should have chosen a plan with an end date in 2025, but, looking for more rewards, she set an end date of 2030. "I'm more of a risk-taker, so I chose a plan that was further out from the retirement date." She hopes to get more growth on the front end that will compound later. (That's a smart strategy to combat the tendency of many lifecycle funds to be on the cautious side, with a greater degree of bonds than one might be comfortable with, say some planners.)

Management: She looks at her returns when she gets her quarterly statement. That's about it.

What she does instead: She has a 12-year old daughter and she has a life. She can spend her money instead of worrying about how to best save for retirement.

More about pros/cons of lifecycle funds at: www.seattletimes.com/yourmoney

If your employer has a retirement plan, that may be the place to start. Whatever they do, investors shouldn't just choose a fund based on size or advertisements. Koenig suggests looking for funds with good track records and a consistent approach and results.

Currently, approximately 27 companies offer hundreds of different funds. Investment-research firm Morningstar (www.morningstar.com) offers analysis of individual funds. It's easiest to investigate companies with a ticker symbol.

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