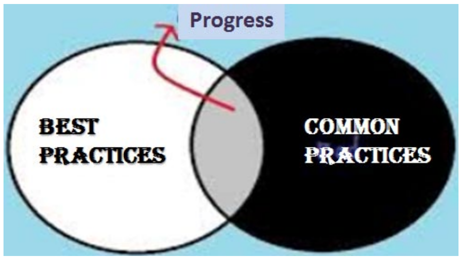


Target Date Fund Benchmarks Come in Two Colors: Black and White

- TDF common practices are gradually evolving into best practices
- Fiduciaries can choose between common practice benchmarks and best practice.
- Common practice TDF benchmarks are provided by S&P and Morningstar. These consensus indexes are appropriate for evaluating procedural prudence
- The SMART Safe Landing Glide Path® is a best practices index that is appropriate for evaluating substantive prudence,

If I had asked them what they wanted they would have said buggywhips. Henry Ford

Fiduciaries are obligated to monitor and evaluate the performance of their TDFs, but relative to what? Choosing the "right" index is complicated by the fact that that the asset allocation, and therefore risk, of TDFs changes through time. But this challenge can be distilled down to a simple black or white decision when viewed from a fiduciary perspective because there are only two types of prudence – procedural and substantive. A TDF benchmark can measure common practices encapsulating procedural prudence, i.e. following the herd, or it can measure best practices embodying substantive prudence, doing the best you can.

The S&P and Morningstar target date fund indexes are the most popular choices. Both are composites of TDF mutual funds, so they are consensus indexes that reflect procedural prudence. By contrast, there's another, albeit less popular, index that captures substantive prudence. The SMART target date fund index incorporates best practices, doing what is right for beneficiaries, rebuffing most common practices. This may sound like a high and mighty benchmark, but it's not. Its derivation ties directly to something quite simple, namely determining the appropriate objectives for a TDF.

Best Practice Objectives

Common practice objectives for TDFs are to replace pay and manage longevity risk. These are not objectives at all – they're mere hopes, and even worse they're hypes. An objective without a reasonable course of action is a hope. One-size-fits-all-set-it-and-forget-it TDFs cannot achieve these objectives. Saving enough is the right course of action for these common practice objectives. By contrast, reasonable objectives that represent best practices are capital preservation (don't lose money) and earn as much as you can without losing money. These substantive prudence objectives can be met by excelling at low cost diversification and risk control. Risk control near the target date is especially critical.

Contrary to popular participant belief, TDFs do not protect the vulnerable from investment loss. They sure didn't in 2008, and risk has actually increased since (it's shocking!). Most participants in TDFs are defaulted into these funds, which means that most participants rely upon their employers to do the right thing by protecting participant savings, especially near retirement (even though they are not). Substantive prudence argues for serious protection.

Fiduciaries are duty bound to seek solutions rather than settling for high-risk products that are oblivious to history. Ignoring the past and hoping it's different the next time is not an option, and it's certainly not an enlightened view of risk management. Fiduciaries are obligated to actually vet their TDF selections and to establish objectives that are truly in the best interests of employees.

Best Practice Protection

Most TDFs are too risky at the target date because they aspire to serve participants beyond retirement. Even "to" funds hope to keep assets in retirement. So risk is the medicine these "doctors" serve up to folks who haven't saved enough to last them for their long lives. The problems with this view are: (1) most participants withdraw their accounts at retirement, and (2) there is no one-size-fits-all-set-it-and-forget-it asset allocation that can possibly serve to manage longevity risk or compensate for inadequate savings.

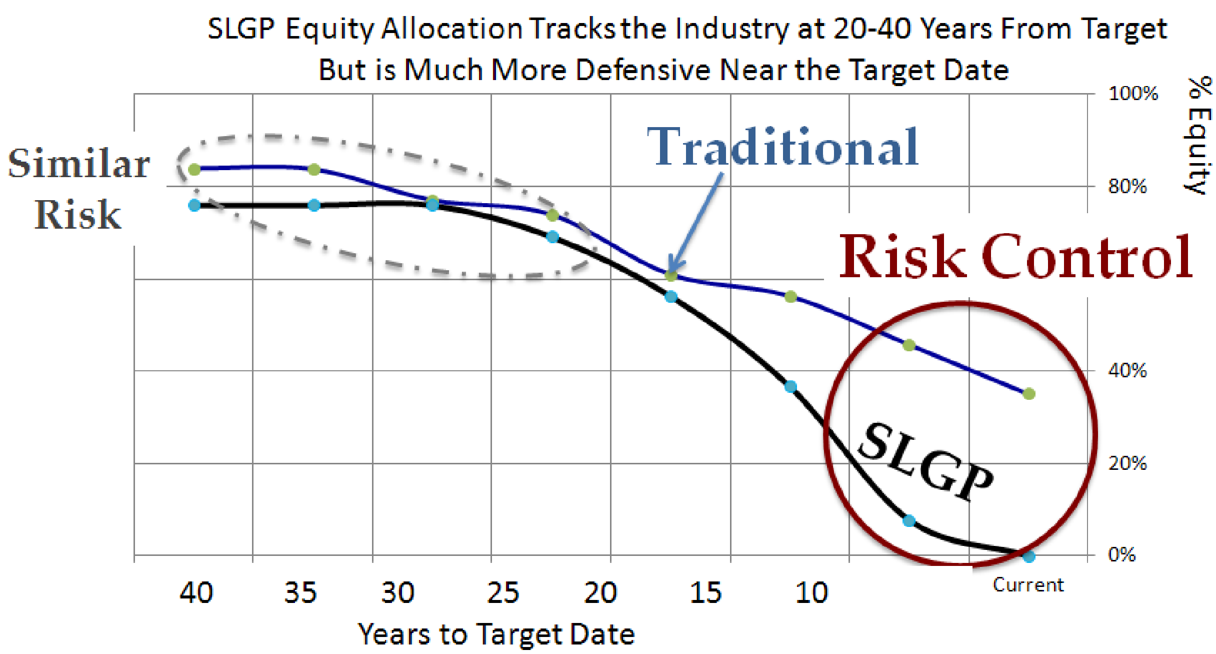
Fortunately, there is an alternative view that the sole mission of a TDF is to get the beneficiary safely to the target date. Attempts to do more lead to excessive risk. Specifically, meaningful objectives for TDFs are:

(1) Don't lose participant savings, and
(2) Make as much as you can but don't lose participant savings

These create real reform to protect the vulnerable.

Taking a lesson from 2008, the course of action for achieving these objectives is the [patented Safe Landing Glide Path®] (SLGP) that integrates the tenets of Modern Portfolio Theory (MPT) with the disciplines of Liability Driven Investing (LDI). Yes, this one-size-fits-all-set-it-and-forget-it glide path is the plan for achieving these straightforward objectives. The SLGP is a concept, a blueprint, for target date funds. It's like an "ideal gas" in physics. Fortunately, it is also a reality in the SMART Funds® Target Date Fund Index, a collective investment trust that follow the SLGP, offered by Hand Benefit & Trust, Houston.

Importantly, the emphasis is placed on safety, as it should be, so asset allocation at target date is mostly TIPS and T-bills, as shown in the following graph.



Summary

Fiduciary choices for benchmarking TDFs are:

1. S&P and Morningstar Target Date Indexes representing Procedural Prudence
2. SMART Fund Target Date Fund Index representing Substantive Prudence

The biggest differences between these two choices occur near the target date. Substantive prudence argues for greater safety for the following reasons:

1. There is no fiduciary upside to taking risk at the target date. Only downside. The next 2008 will bring class action lawsuits.
2. There is a "risk zone" spanning the 5 years preceding and following retirement during which lifestyles are at stake. Account balances are at their highest and a participant's ability to work longer and/or save more is limited. You only get to do this once; no do-overs.
3. Most participants withdraw their accounts at the target date, so "target death" (i.e., "Through") funds are absurd, and built for profit. Prominent ERISA attorney Fred Reish says All TDFs are *de facto* "To" funds.
4. Save and protect. The best individual course of action is to save enough and avoid capital losses. Employers should educate employees about the importance of saving, and report on saving adequacy.
5. Prior to the Pension Protection Act of 2006, default investments were cash. Has the Act changed the risk appetite of those nearing retirement? Surveys say no.
6. Substantively prudent best practices will eventually become common practices, but it will be too late for too many.