Target-Date Series Research Paper: 2010 Industry Survey

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Contents

Abstract 3

Introduction 4

History 5

Process 8

Performance 17

Portfolio 23

Price 29

People 32

Parent 36

Morningstar Target-Date Fund Series Ratings 43

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Abstract

Target-date funds have been the subject of unprecedented criticism in the wake of 2008's market slide, but that has not deterred millions of investors from making these funds the centerpiece of their retirement savings. New cash continues to pour into these offerings, and for the most part, investors have earned better relative returns with target-date funds than they have with traditional mutual funds. The funds have structural advantages over traditional mutual funds, including generally lower costs and dynamic asset allocation that automatically grows more conservative as investors age.

Investors may have turned a deaf ear to criticism of target-date funds, but the industry that runs them certainly hasn't. Morningstar found that in the past year several target-date providers have cut shareholder fees and made their series' asset allocations more conservative. Cutting shareholder fees is a direct benefit to investors, but going more conservative could leave the industry open to charges that it's fighting the last market battle and not positioning the funds for the future. Indeed, some funds that were aggressively positioned in 2008 were whipsawed when they turned conservative prior to the market rebound in 2009.

Finally, Morningstar also investigated some of the chief complaints against target-date funds, including the risks of "closed architecture" series and the level and quality of disclosure among target-date firms. Morningstar found that "open architecture" series, which feature managers who are independent of the funds' advisor, have offered no performance advantage during the period under study. However, the low absolute levels of manager investments in target-date offerings and flimsy public descriptions of how target-date funds are run remain concerns for investors in these vehicles.

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Introduction

Target-date funds stand alone.

No other fund of any flavor has attracted so much criticism, and no other type of equity mutual fund has sold so well in recent years.

The criticism has indeed been fierce. Throughout 2009, the Senate Special Committee on Aging raised concerns about target-date funds, ranging from critiques of their asset-allocation policies (specifically, that the funds held too much in stocks and high-yield bonds) to calls for greater disclosure, to arguments that target-date funds should be held to a higher fiduciary standard than other mutual funds. The Department of Labor and the SEC held a one-day hearing on target-date funds. This marked the first occasion in recent memory in which Washington held up a mutual fund category for public scrutiny. Several consulting and research firms have issued white papers taking target-date funds to task.

But by most measures, target-date funds have been a smashing success. In contrast with other funds that contained large amounts of stocks, target-date mutual funds picked up new assets throughout the late 2000s. Morningstar estimates net new inflows into target-date mutual funds at $58 billion for 2007, dipping moderately during the steep 2008 bear market to $43 billion, and notching another $45 billion in 2009. In each of those years, every single category of target-date funds enjoyed positive inflows, from Retirement Income funds on the short end to Target-Date 2050+ funds on the long end.

The strength of the inflows stems from target-date funds' position as the default investment of choice in defined-contribution plans. According to Fidelity, the industry's largest provider of target-date funds, half of all large plans (5,000+ participants) are now opting for automatic-investment features when setting up their 401(k)s. Among that subgroup of plans that chose an automatic-investment feature, a whopping 96% selected target-date funds to be the feature's default choice. Fidelity reported that the vast majority of the defaulted assets stay right where they are—the participants neither withdraw from the plan nor change the investment allocation.

However, it would be inaccurate to portray target-date funds as growing solely because of captive assets. Redemption rates in target-date funds are below the fund-industry average, despite press coverage that often suggests that participants have been deeply unhappy with their returns. In addition, many participants bought target-date funds of their own accord—that is, outside of a default investment program. Clearly, most target-date investors are either unaware of the attacks that were levied on their funds or heard the barbs but did not share the opinion. Investors' willingness to stick with target-date funds has led to stronger returns with target-date funds than with other mutual funds. Morningstar Investor Returns, which reflect the returns earned by cash flows in and out of funds each month, exceed total returns in all but one target-date category and exceed total returns from other types of mutual funds over the past three years.

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The Target-Date Series Research Paper: 2010 Industry Survey seeks a balanced, impartial view of target-date funds. As will be evidenced by this report, Morningstar's position is roughly in between that of the industry's critics and that of the mutual fund industry's trade group, the Investment Company Institute. Unlike the ICI, Morningstar believes that target-date funds could improve significantly, especially when it comes to public disclosure and manager investment in fund shares. Unlike the critics, Morningstar does not regard the current version of target-date funds as being deeply flawed; rather, Morningstar views the target-date framework as being a useful, logical starting point for a default investment.

The goal of this report is to shed light on the current state of the target-date fund industry and to highlight both the industry's successes and its areas of potential improvement.

History

Target-date mutual funds debuted in the early 1990s. From the beginning, target-date funds were aimed at employees in defined-contribution plans, as opposed to general retail investors. The idea was that employees could simplify their lives by selecting a single target-date fund that matched their anticipated retirement dates, as opposed to putting in the work to learn about investments and assembling a portfolio. Today, many target-date funds (though not all) have opened their doors to outside investors, but the vast majority of assets in target-date funds continue to come from employee-sponsored plans. Target-date funds remain heavily associated with 401(k) plans (and other defined-contribution schemes) and therefore draw particular scrutiny from Washington politicians and regulators. Unlike other mutual funds, target-date funds are primarily regarded as a company benefit.

Like exchange-traded funds, also introduced in the early 1990s, target-date funds premiered with a whimper rather than a bang. The initial marketplace reception was modest, as target-date funds faced stiff competition for their role as a one-stop shop. Balanced, asset-allocation, and "target-risk" funds, which defined themselves by labels such as aggressive, moderate, and conservative, already vied for one-stop monies. In addition, the sale of target-date funds to retirement-plan sponsors required further explanation because, unlike other mutual funds, target-date funds change their asset allocations over time. Ultimately, however, these dynamic characteristics helped target-date funds differentiate themselves with the promise that they, unlike other funds, would reshape themselves over time to conform with their shareholders' changing circumstances.

Once the case for target-date funds became known, they quickly overran the competition. Investors liked the notion of funds that seemed to be built just for them. Also, they found it easier to determine their expected retirement date than to identify which target-risk fund they wished to purchase. Beginning in the early 2000s, cash started flooding into target-date funds. The category gained a net $7 billion in 2003, $14 billion in 2004, $22 billion in 2005, $35 billion in 2006, and $57 billion in 2007, before settling into slightly more-modest cash flows of just more than $40 billion in 2008 and 2009. (See Table 1.)

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1. Net Assets, Target-Date Mutual Funds, 15 Largest Fund Companies

Fund Family	Total Net Assets 2005	Total Net Assets 2006	Total Net Assets 2007	Total Net Assets 2008	Total Net Assets 2009	2009 Market Share %
Fidelity Investments	43,109,726,477	63,643,759,218	88,281,653,907	68,332,996,075	99,329,305,385	38.73
Vanguard	8,343,449,216	16,448,166,558	31,954,874,203	33,738,326,090	56,587,641,311	22.06
T. Rowe Price	8,305,268,065	17,257,266,495	30,049,545,411	25,139,972,438	42,092,035,956	16.41
Principal Funds	2,740,671,753	5,282,361,282	11,038,017,334	9,322,891,092	14,331,493,135	5.59
American Funds	–	–	1,578,076,746	3,063,731,589	6,242,575,789	2.43
Wells Fargo Advantage	1,146,956,773	1,286,716,723	2,324,374,616	2,330,833,462	6,047,001,369	2.36
TIAA-CREF Mutual Funds	39,508,911	424,749,391	1,473,639,811	1,885,134,873	4,060,581,773	1.58
ING Retirement Funds	30,717,678	1,235,385,973	2,694,988,745	2,430,062,939	3,935,895,203	1.53
John Hancock		15,552,803	708,580,996	1,372,989,017	3,272,432,926	1.28
BlackRock	1,293,073,727	1,550,923,821	2,306,419,961	1,552,145,182	2,898,643,292	1.13
State Farm	821,428,723	1,335,511,823	2,176,642,129	1,610,584,609	2,654,748,612	1.04
American Century Investments	235,815,541	513,005,160	759,089,136	753,694,657	2,124,451,070	0.83
AllianceBernstein	10,306,337	341,053,831	1,298,763,846	1,350,232,325	2,029,963,148	0.79
JPMorgan		349,917,743	900,351,394	940,257,626	1,623,614,319	0.63
MassMutual	1,235,655,892	1,675,133,328	1,988,459,522	1,134,346,550	1,086,954,735	0.42
Industry Total	**69,401,055,835**	**114,509,886,291**	**184,321,977,120**	**159,500,016,668**	**256,470,272,637**	**100.00**

Data as of 12/31/2009

Fidelity remains the largest target-date mutual fund provider, with 38.7% of total industry assets; however, its lead in market share over rivals Vanguard and T. Rowe Price is shrinking. Vanguard has more than tripled in assets and T. Rowe more than doubled since December 2006, while Fidelity's growth has been a more modest 50%. Overall, though, the target-date business remains very concentrated by mutual fund standards, with the three largest target-date families accounting for more than 75% of industry assets.

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Net inflows continue to be positive into all categories of target-date funds. The heaviest flows are into the near- and intermediate-dated funds, those ranging from 2016 to 2030, which are held by workers in their 40s and 50s. However, even the longest-dated funds, those extending to 2050 or beyond, are beginning to attract significant inflows from their 20-something owners. On the other end of the age spectrum, retirement-income funds are also growing. Although such funds lose assets as their owners begin to tap into their accumulated wealth, they gain even more monies from "past-date" target-date funds that merge into them. (For example, when a target-date 2000 fund is no longer changing its asset allocation, it will likely be merged into a retirement-income portfolio.) (See Tables 2 and 3.)

2. Annual Fund Flows by Target-Date Category, in $ millions

Morningstar Category	Estimated Net Flow 2003	Estimated Net Flow 2004	Estimated Net Flow 2005	Estimated Net Flow 2006	Estimated Net Flow 2007	Estimated Net Flow 2008	Estimated Net Flow 2009
Retirement Income	643	1,130	895	847	1,600	879	1,815
Target-Date 2000–2010	2,123	2,602	2,978	4,297	7,556	1,881	1,078
Target-Date 2011–2015	–74	1,561	3,585	5,552	7,715	5,471	5,039
Target-Date 2016–2020	2,329	3,573	4,346	7,062	11,364	7,364	7,123
Target-Date 2021–2025	36	1,309	3,499	4,985	7,866	6,753	7,531
Target-Date 2026–2030	1,274	2,035	2,468	4,559	8,880	7,098	6,918
Target-Date 2031–2035	20	622	1,880	3,289	4,984	4,978	5,174
Target-Date 2036–2040	625	1,150	1,872	3,323	5,325	4,845	5,385
Target-Date 2041–2045	6	133	503	1,141	1,979	2,325	2,797
Target-Date 2050+	25	35	89	220	1,184	1,475	2,169
Total Target-Date Fund Flows	**7,006**	**14,149**	**22,114**	**35,274**	**58,452**	**43,071**	**45,030**

Data as of 12/31/2009

3. % Growth in Flows

Morningstar Category	2005 %	2006 %	2007 %	2008 %	2009 %
Retirement Income	–21	–5	89	–45	106
Target-Date 2000–2010	14	44	76	–75	–43
Target-Date 2011–2015	130	55	39	–29	–8
Target-Date 2016–2020	22	63	61	–35	–3
Target-Date 2021–2025	167	42	58	–14	12
Target-Date 2026–2030	21	85	95	–20	–3
Target-Date 2031–2035	202	75	52	0	4
Target-Date 2036–2040	63	78	60	–9	11
Target-Date 2041–2045	279	127	73	18	20
Target-Date 2050+	150	148	439	25	47
Total Target-Date Fund Flows	**56**	**60**	**66**	**–26**	**5**

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Process

Each target-date series has an asset-allocation "glide path" that it follows as the fund matures. For all series, the longer-dated funds are predominantly invested in common stocks, and in all series the percentage of stocks declines over time. However, the rate of decline varies among the series, sometimes dramatically, as does the final resting point of the glide path. These differences are virtually impossible to discern from the prospectuses or marketing materials of target-date series, which invariably offer vague, general language such as "investments are adjusted from more aggressive to more conservative as a target-retirement year approaches."

The distinctions among target-date funds came abruptly to light in the 2008 bear market, as the gap between the best- and worst-performing target-date funds of a given maturity range widened to as high as 30 percentage points. Most, though not all, of this performance gap could be explained by the simple fact that some target-date funds owned considerably more common stocks than did others. Understandably, the funds that held more equities and therefore trailed were roundly criticized, while the more cautiously positioned funds were praised. That the aggressive funds had previously been praised for their superior performance and the conservative funds questioned was an irony that was mostly left unsaid.

In the aftermath of 2008, many argued that target-date funds had overemphasized equities so as to boost fees, as equity funds typically command higher management fees—and thus higher revenues for fund companies—than do bond or cash funds. Morningstar is not convinced. It is certainly true that fund companies pay close attention to revenues when designing target-date funds. However, it is unlikely that they would compromise their views on asset allocation to pull the relatively small lever (from the viewpoint of revenues) of equities versus bonds when they can pull the larger levers of opting for proprietary funds rather than outsourcing and choosing active management rather than indexing.

In Morningstar's view, based on dozens of conversations with target-date series personnel, target-date funds were steered toward equities for other reasons besides fee maximization. First, the top-performing target-date funds during the industry's boom in the mid-2000s were those that featured above-average stock allocations. Consequently, consultants and retirement-plan sponsors pushed fund companies to become more aggressive when designing target-date series. Second, the long stock bull market encouraged investment professionals to build models that featured high expected stock returns, thereby boosting the allocations given to equities. Third, fund companies were influenced by new research touting the necessity of owning more stocks so as to avoid "longevity risk"—the danger that investors would outlive their savings. In some cases, fund companies adjusted their glide path because of their own investors' feedback.

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For 2010 funds, equity allocations ranged from 65% to 26% as of late 2009. (American Funds has a listed allocation of 67%, but that figure substantially overstates the series' commitment to stocks because American fills that allocation with funds that have high cash stakes. In practice, American Funds' stock allocation is in the 50s.) Performance for the 2010 funds over the past has generally but not universally followed the equity allocations, with, for the most part, the high-equity funds lagging in 2008 but leading in 2009. (See Table 4.)

4. 2010 Target-Date Fund Equity Allocation % with 2008 and 2009 Performance

	Target Equity Allocation	Annual Ret 2009	Annual Ret 2008
American Funds Trgt Date Ret 2010 A	**67**	23.34	–27.45
Columbia Retirement 2010 A	**65**	23.15	–27.41
Oppenheimer Transition 2010 A	**65**	23.44	–41.32
AllianceBern 2010 Retirement Strat A	**62**	29.25	–32.88
T. Rowe Price Retirement 2010	**60**	27.95	–26.71
Goldman Sachs Retirement Str 2010 A	**58**	25.65	–30.78
MainStay Retirement 2010 A	**56**	21.39	–22.03
MassMutual Select Dest Retire 2010 A	**55**	24.56	–25.06
Vanguard Target Retirement 2010	**55**	19.32	–20.67
Nationwide Destination 2010 A	**53**	16.24	–23.53
BlackRock Lifecycle Prepared 2010 Inv A	**52**	23.87	–25.29
RiverSource Retirement Plus 2010 A	**52**	19.53	–27.38
TIAA–CREF Lifecycle 2010 Retire	**52**	19.36	–23.57
JHancock2 Lifecycle 2010 A	**51**	30.79	–29.82
Fidelity Freedom 2010	**50**	24.82	–25.32
Fidelity Advisor Freedom 2010 A	**49**	25.64	–26.61
Principal LifeTime 2010 Instl	**47**	24.92	–30.27
Vantagepoint Milestone 2010	**44**	17.71	–17.34
Hartford Target Retirement 2010 A	**42**	27.94	–27.75
Schwab Target 2010	**41**	15.92	–23.69
Manning & Napier Target 2010 C	**37**	18.00	–
AIM Balanced–Risk 2010 A	**36**	15.44	–19.11
JPMorgan SmartRetirement 2010 A	**35**	23.11	–21.49
PIMCO RealRetirement 2010 A	**35**	22.56	–
Russell LifePoints 2010 Strategy R3	**34**	22.75	–21.88
MFS Lifetime 2010 A	**30**	22.43	–14.29
Putnam Retirement Ready 2010 A	**27**	25.30	–26.19
American Indep NestEgg 2010 I	**26**	7.34	–9.11
Wells Fargo Advantage DJ Target 2010 A	**26**	12.31	–11.24

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Exceptions include the following: Oppenheimer got clocked in 2008 because of a highly aggressive bond position, then cut back on its risk so that it failed to take complete advantage of the 2009 rally. Vanguard has a relatively conservative asset mix, so that its funds tend to trade in both up and down markets as if they owned fewer stocks than they actually do. John Hancock, Hartford, and Putnam are the converse of Vanguard in behaving more aggressively than their glide paths imply. Also noteworthy is Wells Fargo's outgaining American Independence by nearly 5 percentage points in 2009 despite holding the same percentage in common stocks, thereby demonstrating that the glide path is a valuable method for evaluating target-date performances, but this is far from the full story.

5. 2050 Target-Date Fund Equity Allocation % with 2008 and 2009 Performance

	Target Equity Allocation	Annual Ret 2009	Annual Ret 2008
BlackRock LifePath 2050 I	**99**	30.35	–
State Farm LifePath 2050 A	**98**	30.25	–
PIMCO RealRetirement 2050 A	**98**	37.84	–
AllianceBern 2050 Retirement Strat A	**95**	33.51	–40.87
American Funds Trgt Date Ret 2050 A	**95**	31.56	–35.62
MassMutual Select Dest Retire 2050 A	**95**	34.39	–39.53
Nationwide Destination 2050 A	**95**	29.92	–37.77
Oppenheimer Transition 2050 A	**95**	42.94	–
Putnam Retirement Ready 2050 A	**95**	31.02	–38.93
MainStay Retirement 2050 A	**93**	29.16	–37.11
Principal LifeTime 2050 Instl	**93**	29.77	–39.04
T. Rowe Price Retirement 2050 Adv	**93**	38.70	–39.03
BlackRock Lifecycle Prepared 2050 Inv A	**90**	28.07	–37.60
Goldman Sachs Retirement Str 2050 A	**90**	29.45	–41.37
Russell LifePoints 2050 Strategy R1	**90**	30.67	–
TIAA-CREF Lifecycle 2050 Instl	**90**	28.35	–38.76
Vanguard Target Retirement 2050	**90**	28.31	–34.62
Fidelity Freedom 2050	**89**	32.47	–40.61
Wells Fargo Advantage DJ Target 2050 I	**89**	33.34	–35.78
Fidelity Advisor Freedom 2050 A	**88**	33.71	–42.44
American Century LIVESTRONG 2050 Instl	**85**	27.07	–
JPMorgan SmartRetirement 2050 A	**85**	33.42	–33.78
Manning & Napier Target 2050 C	**84**	33.43	–

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There is less diversity with 2050 funds, which almost universally carry equity allocations between 80% and 95%. Nearly all 2050 funds fell along the lines of the overall stock market in 2008, sustaining losses between 35% and 40%. Most regained roughly half their losses in 2009 (investment mathematics being such that a 30% gain recoups almost exactly half of a 38% decline). That said, the 2009 performances were considerably more varied than were those of 2008, with returns for the larger fund series ranging from 27% on the low end for American Century to nearly 43% for Oppenheimer. (See Table 5.)

6. Equity Allocation % per Target Year

Year	Average	Minimum	Maximum
1990	**28**	20	40
1995	**34**	20	45
2000	**37**	20	55
2005	**39**	15	65
2010	**50**	26	75
2015	**61**	36	84
2020	**68**	48	90
2025	**78**	61	95
2030	**83**	67	95
2035	**88**	73	97
2040	**90**	80	95
2045	**91**	80	100
2050	**92**	84	99
2055	**93**	93	93

Data as of 12/31/2009

Providers Don't Set It and Forget It

Plan sponsors and investors should not assume that the asset allocations present in target-date series today are what they were yesterday, nor should they assume that the series won't alter the glide path going forward. In 2009 alone, at least five series significantly changed their series asset allocations. Fidelity, for example, diversified its series' asset mix by upping the funds' exposure to non-U.S. equities, and it added exposure to Treasury Inflation-Protected Securities and commodities. Schwab reduced its series' weight in equities to make its glide path more conservative. Vantagepoint extended the period in which its asset allocation glides after investors' retirement. To curb volatility, Putnam added its new absolute return funds to its target-date series, while Invesco AIM revamped its target-date offerings in an attempt to balance risk between its target-date funds' equity, fixed-income, and commodities allocations. Even more recently, AllianceBernstein announced it would introduce a volatility-management tactical asset-allocation technique that attempts to shelter some of the target-date funds' assets when it expects markets will be volatile.

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Given the complexity of target-date funds and their relative youth, it's not surprising to see providers tinkering with their contents. Morningstar expects such adjustments to continue. But it's impossible to say whether these changes truly improve the target-date series. Some may be reactions to competitors' glide paths—a desire to be similar to or much different from peers. Others may be responses to past market conditions or new research. Plan sponsors would do well to press providers for details regarding the rationale, nature, and performance expectations resulting from changes in target-date funds' glide paths or asset mixes, then try to gauge over time if those changes have resulted in improved performance or a better investor experience.

It's also good to see broad diversity in approaches to asset allocation, in Morningstar's view. Investors, plan sponsors, and other fiduciaries can seek target-date series that most closely match their individual preferences. These preferences include demographic factors that distinguish among different defined-contribution plans. Indeed, certain fund companies, such as TIAA-CREF and Vantagepoint, construct their glide paths to align with the needs of their particular investor bases.

That said, it is all the more crucial for fund companies to improve the transparency around their glide paths so that investors can better understand the nature of their investments. Making such improvements would reduce the chances of mismatches between the expectations of investors and the reality of how their investments are structured. The fact that 2010 target-date funds lost assets in 2009 despite the overall popularity of the target-date concept is strong evidence that those expectations were not always properly aligned.

There are several major areas in which significant philosophical and pragmatic differences exist among the target-date series. These areas, outlined over the next five pages, are critical in fully comprehending the potential risks and performance behavior of a given target-date series and how that series compares with others in the target-date universe. Yet the disclosure and transparency on these subjects is in most instances inadequate. Even for Morningstar, it can be a struggle to get consistent information on basic glide-path allocations, never mind more sophisticated data.

Longevity Risk vs. Market Risk

Longevity risk and market risk are the primary concerns for any target-date allocator. Longevity risk is the danger that the shareholder will outlive the investment, while market risk is the danger that the investment will decline in value. Those series that emphasize longevity risk will tend to invest more in stocks through an investor's lifetime, including during retirement, in order to build sufficient capital to battle inflation and avoid outliving the investor's money during retirement. Conversely, those series that emphasize market risk will generally invest more heavily in fixed-income securities, as ballast against market declines.

That said, every target-date series provider is strongly concerned with longevity risk when constructing its longer-date funds. All target-date series place at least 85% of an investor's assets in stocks in those funds dated from 2045 onward. The highest allocate close to 100%. (See Table 6.)

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Close to and past the retirement age, however, the range expands markedly. Firms that are more concerned about market risk begin to decrease stock allocations and raise bond holdings more rapidly in the 10 to 15 years before retirement. Such families include Wells Fargo, JP Morgan, and DWS. In contrast, target-date series that believe longevity risk is a greater concern, such as T. Rowe Price, AllianceBernstein, and Oppenheimer, maintain sizable equity weightings well past the target date.

Shape of the Glide Path

Even among firms that share similar philosophies about longevity or market risk, the approach to shifting allocations can vary. Many glide paths roll down equity allocations in a gradual, linear fashion, producing a consistent slope. Firms that feature such glide paths include TIAA-CREF and Vanguard. Other firms maintain a steeper slope to the glide path, in which equities are kept near or above the averages in the longer-dated funds but in the decade before retirement are dramatically slashed. Finally, ING uses a stepped glide path, in which equity weightings are kept at their original target level over each 10-year period.

Active vs. Passive

Target-date series providers also determine whether to use passive or active management of the series' assets. Understandably, the series often reflects the providers' own management style: Vanguard offers a mostly passive series, while nearly half the series employ exclusively active strategies. Some series, such as T. Rowe Price's, index a portion of the series' assets to keep costs low. And Fidelity and TIAA-CREF recently launched indexed series in addition to their actively managed series. (See Table 7.)

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7. Target-Date Fund Series by Percentage of Assets in Active Strategies

Name	% Active
Massachusetts Mutual Life Insurance Co.	100.00
MFS Lifetime Series	100.00
American Funds Trgt Date Rtrmt Series	100.00
American Century LIVESTRONG Series	100.00
AllianceBernstein Retirement Str Series	100.00
BlackRock Lifecycle Prepared Series	100.00
Columbia Retirement Portfolios	100.00
Franklin Templeton Retirem Series	100.00
Goldman Sachs Retirement Str Series	100.00
JPMorgan SmartRetirement Series	100.00
Manning & Napier Retirement Target Series	100.00
Oppenheimer LifeCycle Series	100.00
Putnam RetirementReady Series	100.00
RiverSource Retirement Plus Series	100.00
Russell LifePoints Target Date Series	100.00
TIAA-CREF Lifecycle Series	100.00
Principal LifeTime Series	98.88
ING Solution Series	97.24
Guidestone Funds MyDestination Series	96.81
Fidelity Advisor Freedom Series	95.00
Fidelity Freedom Series	93.11
MainStay Retirement Series	88.81
T. Rowe Price Retirement Series	81.17
Schwab Target Series	77.00
Vantagepoint Milestone Series	76.89
DWS LifeCompass Series	68.69
State Farm Lifepath Series	60.67
John Hancock Lifecycle Series	60.25
AIM Independence Series	59.62
Nationwide Target Destination Series	7.91
Vanguard Target Retirement Series	2.45
Seligman TargetHorizon ETF Series	0.63
Wells Fargo Advantage DJ Target Date Series	0.00
ING Index Solution Series	0.00

Data as of 12/31/2009

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Subasset Classes

There is little consensus among target-date series about how to approach allocating among the subasset classes. Some firms take a basic approach, starting with domestic and foreign stocks, fixed income, and cash and then divvying up domestic stocks along Morningstar Style Box criteria. Others introduce specialized subasset classes, such as emerging-markets stocks, foreign bonds, high-yield bonds, commodities, and real estate, among others. A new wrinkle is to incorporate low-correlation or absolute return funds that may employ a variety of complex strategies.

Typically, the specialized asset classes are intended either to provide greater diversification, and thus smooth a target-date fund's volatility, or to combat the effects of inflation (as is the case with TIPS). Those assuredly are benefits. However, the presence of these asset classes also generates concerns. For one thing, most firms don't adequately explain their holdings—what subasset classes they use, how much they hold in each, or why they have made their decisions. Most prospectuses show allocations only for stocks, bonds, and cash.

Moreover, the new asset classes raise questions about management's expertise. Does the target-date provider have the necessary skill to manage these asset classes? If not, can it hire outside talent to do so? To be sure, adding specialized asset classes can offer benefits in terms of building an efficient frontier, but the individual asset classes may contain substantial risk, as firms with large allocations to high-yield bonds, real estate, and commodities discovered in 2008. In addition, the touted diversification benefits of subasset classes, which may hold up over longer periods, definitely broke down in 2008's downturn, to costly effect.

Tactical Allocation Methods

Target-date fund series adopt three general approaches to tactical allocation, or deviations from the strategic glide path. 1) No tactical allocation is allowed. These firms—including TIAA-CREF, Vanguard, and Wells Fargo—draw a clear line in the sand: They stick to the stated glide path, with virtually no deviation. 2) Modest deviations are allowed. Some companies, such as American Century and Principal, use their rebalancing periods as an avenue to engage in limited deviations around the strategic targets. One firm, for instance, allows its managers to delay or move up monthly rebalancing by several months, allowing under- or overweighted asset classes to persist within 5 percentage points of the target allocation. 3) Active tactical allocation is allowed. These companies set aside a portion of their portfolios for active tactical allocation of the sort engaged in by some institutional money managers and hedge funds. This sleeve may be managed by a separate group that specializes in such investing and generally is kept within the boundaries of a certain level of tracking error. T. Rowe Price, Putnam, ING, DWS, and JP Morgan are among the target-date firms that employ some, if not a great degree, of tactical allocation.

As with other aspects of the glide path, there are valid reasons behind each approach. The practitioners of active tactical asset allocation, however, present particular challenges and concerns. First, such strategies are inherently risky. They may employ derivatives or attempt to make short-term market-timing decisions, which offer opportunities for loss as well as gain. Second, such strategies require highly specialized expertise to execute successfully, which presents a challenge for a fiduciary that must judge whether the target-date company possesses such expertise. It is difficult for an outsider to evaluate whether a target-date provider has the right skills in place. Third, transparency around tactical policies is wanting. Most investors in target-date series that use tactical allocation are unaware that such strategies are in place or

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are unaware of their potential risks. As with other areas of transparency, target-date providers have a lot of room for improvement in how they utilize tactical asset allocation and how they communicate the role and impact of such strategies to investors.

Target To or Target Through?

A final area of differentiation, and one that generated a great deal of discussion at the target-date hearings in Washington, concerns whether a target-date series is created to terminate at the time of retirement or intended to provide for the rest of the investor's life. This dichotomy is sometimes referred to as "target date or target death" but more properly should be called "target to or target through." That is, the target date itself unambiguously refers to the investor's intended retirement date; there can be no argument about that. But whether the fund series is built to take the investor to the point of retirement or to follow the investor through that stage is less clear.

If a target-date series is structured as target to, then its allocations will typically level out once an investor retires. If, on the other hand, the series is target through, then its glide path will generally continue to evolve past retirement, typically reaching its landing point anywhere from 10-20 years after the target date. The different approaches taken by fund companies for glide paths during retirement may stem from several sources—philosophies about longevity risk, divergent expectations about an investor's actions at retirement, or simply the lack of a methodology that addresses the postretirement phase of the glide path. Finally, the tide appears to be turning—plan sponsors appear more willing to hold target-date assets beyond an employee's retirement.

Looking forward, more target-date fund series will extend their asset-allocation research to the postretirement phase, thereby altering their target-date series to reflect glide-path updates. A number of firms are also exploring or beginning to offer target-date products that offer annuitylike guaranteed income or Guaranteed Minimum Withdrawal Benefits. Some large plan sponsors have integrated such solutions into their existing plans, but anecdotally, such products have thus far garnered more interest than assets. There are many challenges associated with integrating a guaranteed income component, ranging from concerns around potential liabilities for plan sponsors, counterparty risk, and portability. There's also the formidable task of educating plan participants on the mechanics, risks, and expenses involved in such options. Given the shortcomings in current target-date series' disclosures, those challenges are significant, and firms' responses to those challenges bear watching.

In the meantime, fund companies can and should do a better job of communicating their current approaches to investors. As a best practice, Morningstar suggests that fund companies query investors in middle-dated funds (say, 10 years from the target date) about their preference for a target to or target through fund, and then direct them to the appropriate option. That way, conservative investors with a short time horizon may be more likely to avoid the steep losses of short-dated funds during down markets, while more aggressive investors who expect to hold target-date funds over the remainder of their lifetimes will not be so dismayed by missing gains during up markets.

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Conclusion

Glide paths play a highly influential role in the performance of target-date funds. There are numerous permutations of glide paths and marked differences from one target-date series to the next. Fund companies must do a better job of disclosing to investors the nature of their glide paths, along with the attendant risks and performance expectations. Glide paths will continue to evolve over the coming years as fund companies conduct more research and add newer, potentially more complex asset classes and strategies. It will be all the more critical, then, that investors, advisors, plan sponsors, and other fiduciaries gain a full understanding of glide paths' defining role in target-date funds.

Performance

Target-date funds were subject to a maelstrom of investor ire and governmental scrutiny over the past year, and none more so than 2010 funds. At issue has been the funds' 2008 losses, which were an ungainly 23% on average. All target-date 2010 offerings provide some exposure to the equity markets, and those that are most concerned with longevity risk tend to invest upward of 50% of assets in stocks. Losses among these funds should not have been a big surprise, but the magnitude of some losses (with the hardest-hit fund cratering with a 41% loss) was certainly alarming.

While governmental agencies and Senate subcommittees were convening hearings on the target-date industry in 2009, many 2010 funds were making back a good chunk of their investors' money. In 2009, the average target-date 2010 fund returned a healthy 22.4%, with the top performer rising nearly 31%. It's no surprise to see that the funds at the top of the list are those that are trying to offset longevity risk with above-average equity weightings and, thus, those that incurred significant losses in 2008. John Hancock Lifecycle 2010, AllianceBernstein 2010 Retirement Strategy, Hartford Target Retirement 2010, and T. Rowe Price Retirement 2010 all fit this description.

Predictably, those fund companies that make guarding against market risk their first priority held up best in 2008 but were laggards in 2009. Wells Fargo Advantage DJ Target 2010 and American Independence NestEgg 2010, for example, which had the two best results in the group in 2008 (losing 11% and 9%, respectively), occupied the bottom two slots in 2009. Vanguard Target Retirement 2010, which plots a fairly defensive but not extreme glide path, was modestly behind the averages at 19.3%.

There are several implications of this group's performance patterns over the past two years. One clear takeaway is that a glide path should not be judged solely on the basis of its short-term, or even intermediate-term, performance. Critics were too quick in 2009 to label longevity-oriented glide paths a failure and to assume that glide paths intended to preserve capital near retirement were the only sensible approach. Similarly, prior to 2007, the drumbeat around longevity risk was loudest, while those worrying about the potential of market collapses could scarcely be heard above the din of the bull market. It will require full, multiyear cycles to determine the true worth of the varied approaches to glide-path construction.

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A corollary to the previous point is that, over time, a lot of these performance differences will tend to even out. Early evidence shows that the most conservative 2010 funds protect capital well on the downside but lag as markets rise, while the funds with more-aggressive glide paths endure greater losses but can make it back quickly. Performance variations will persist from year to year, but spans between winners and losers witnessed in 2008 won't be the norm.

It's instructive to look at the returns of target-date 2010 funds since Oct. 1, 2007, roughly the peak preceding the bear market. Through Dec. 30, 2009, the average 2010 fund has lost about 3.97% over that stretch. While any loss is unpleasant for investors approaching retirement, a 4% drop is far from catastrophic. And if one were to exclude the 14.6% loss by Oppenheimer Transition 2010, which experienced devastating risk-control problems in its fixed-income funds during the financial crisis, the range of returns narrows considerably. AllianceBernstein, with its aggressive glide path, lost 7% over the period, while MFS Lifetime 2010 tops the group with an in-the-black 2.55% return. By comparison, the average moderate-allocation fund lost 5.6% over the same time frame.

Of course, there's no guarantee that stocks will rebound that quickly after subsequent bear markets. Losses over multiyear periods would certainly prove challenging for retirees, so investors should keep in mind that, as currently constructed, no target-date fund is risk-free, even once the target date has been reached.

Pay Attention to Outliers

Usually, target-date funds follow predictable patterns, driven largely by their glide paths. But sometimes funds depart quite a bit from their expected behavior. Often, this should be a red flag to investors and plan sponsors.

Oppenheimer Transition, for example, hit rock-bottom in 2008 in large part because its bond funds imploded, but it didn't charge to the front of the pack in 2009 as riskier assets took off. That's because Oppenheimer cleaned house extensively, moving to less-risky fixed-income securities while reconsidering its overall glide path.

On the flip side, Putnam Retirement Ready 2010 has one of the most conservative strategic allocations, with only 27% of assets devoted to equities, yet the 2010 fund is near the top of the group this year with nearly a 24% return. Because its management will allow the asset allocation to deviate significantly from the policy weights based on its assessment of market conditions, this target-date series has the flexibility to try to take advantage of market opportunities. As a result, however, it's much harder for investors to know with certainty how their money is being managed at any given point.

Sometimes a fund bucks the trends for good reasons. T. Rowe Price has long advocated high equity weightings to fend off longevity risk, and its 2010 fund was near the top in 2009. Yet in 2008, its 27% loss was only a few percentage points worse than the group average. Through strong security selection by the underlying fund managers, the fund has managed to outpace what one would expect based purely on its glide path.

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8. Average Returns % by Morningstar U.S. Open-End Category, through Dec. 31, 2009

	Annual Ret 2009	Annual Ret 2008	Total Ret Annlzd 3 Yr	Investor Return 3 Yr	Total Ret Annlzd 5 Yr
US OE Target-Date 2000-2010	22.42	-22.46	-0.97	–1.23	2.19
US OE Retirement Income	18.36	-18.06	0.86	1.34	2.48
US OE Conservative Allocation	20.29	-18.91	0.68	–0.64	2.63
US OE Target-Date 2011-2015	23.55	-27.76	-2.32	–0.90	2.04
US OE Target-Date 2016-2020	24.25	-29.46	-3.09	–2.05	1.52
US OE Moderate Allocation	24.13	-28.01	-1.97	–2.77	1.98
US OE Target-Date 2021-2025	28.32	-34.15	-3.88	–1.70	1.84
US OE Target-Date 2026-2030	28.87	-36.04	-4.46	–2.71	1.17
US OE Target-Date 2031-2035	30.06	-37.04	-4.68	–1.93	1.39
US OE Target-Date 2036-2040	30.90	-37.94	-5.07	–2.15	1.01
US OE Target-Date 2041-2045	30.88	-38.11	-5.12	–0.14	1.20
US OE Target-Date 2050+	32.20	-38.86	-5.66	–0.02	0.96
US OE World Allocation	24.49	-28.98	-1.21	–2.23	3.55
S&P 500 TR	26.46	-36.94	-5.63	–	0.42
BarCap US Agg Bond TR USD	5.93	5.23	6.04	–	4.97

Data as of 12/31/2009

It's clear from the controversy over 2010 funds that a misalignment exists between investor expectations and the actual design of many target-date series, particularly when it comes to the allocations close to retirement. The investor return figures calculated by Morningstar for the target-date 2000-2010 category—a measure of how much of an investment's return investors typically have captured on a dollar-weighted basis—confirm this. Over the past three years, it's the only target-date category to show a net disadvantage to investor returns. The biggest challenges facing target-date fund companies are devising ways to effectively communicate their glide-path philosophies to investors and properly setting expectations for performance. Fund companies, plan record keepers, and employers still have a lot of work to do in this area. (See Table 8.)

Superior Investor Experiences

Shortcomings with 2010 funds shouldn't obscure the bigger success story at hand with target-date funds: Other than the 2010 target-date category, Morningstar's investor-return data indicates that target-date shareholders' returns have exceeded the funds' actual total returns over the past three years, in some cases quite substantially. That bucks the prevailing trend of the fund industry, in which investors tend to pull their money at market lows and chase investments close to their peaks.

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What accounts for investors' success in owning target-date funds? Certainly, much of it can be attributed to target-date funds' prominence in employer-sponsored retirement plans, in which participants contribute on a regular basis and thus have reaped the benefits of dollar-cost averaging. Nevertheless, it seems likely that shareholders like the set-it-and-forget-it nature of target-date funds, and as a result, they did not panic during the crisis. This investor-returns trend also bodes well for target-date funds providing a good investor experience over the long term. Mutual fund assets tend to stick in funds in which shareholders are rewarded with strong risk-adjusted returns, low fees, and good stewardship practices. Those are winning funds for shareholders, as well as for the fund industry.

Performance Attribution Highlights Strengths and Weaknesses

The 2010 funds' performance trends in recent years aren't too dissimilar from the broader trends among entire target-date series. As Morningstar's attribution analysis shows, funds' glide paths had a big bearing on performance, but other factors were also important. The figures in the table below show the percentage points of performance beyond the peer-group norm that a series added and/or subtracted based on three factors: Cost (the series' expense ratios); Allocation (the fund's glide path); and Selection (decisions made by the fund's managers, such as security selection and sector weightings). Series with total attribution figures greater than zero outperformed a combination of benchmarks, while those with negative total attribution figures underperformed. (See Table 9.)

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9. Attribution Analysis by Target-Date Series

Name	**Cost**	**Allocation**	**Selection**	**Total Attribution**
Wells Fargo Advantage DJ Target Date Series	0.40	1.58	0.14	**2.14**
JPMorgan SmartRetirement Series	0.11	0.90	0.65	**1.67**
American Century LIVESTRONG Series	0.22	1.30	-0.44	**1.07**
Vanguard Target Retirement Series	0.72	-0.18	0.38	**0.92**
Schwab Target Series	0.19	0.50	0.04	**0.73**
T. Rowe Price Retirement Series	0.18	-0.89	1.25	**0.52**
BlackRock LifePath Series	0.05	0.14	0.22	**0.41**
MFS Lifetime Series	-0.31	0.61	0.09	**0.38**
NestEgg Dow Jones Series	0.23	1.70	-1.67	**0.23**
Vantagepoint Milestone Series	-0.10	0.03	0.26	**0.19**
State Farm Lifepath Series	-0.14	0.21	-0.28	**-0.21**
MainStay Retirement Series	-0.14	-0.11	-0.21	**-0.46**
American Funds Trgt Date Rtrmt Series	0.11	-1.26	0.65	**-0.51**
Fidelity Freedom Series	0.21	0.98	-1.90	**-0.74**
BlackRock Lifecycle Prepared Series	-0.34	0.31	-0.81	**-0.85**
Nationwide Target Destination Series	0.08	-0.10	-1.17	**-1.19**
Massachusetts Mutual Life Insurance Co.	0.02	-0.82	-0.41	**-1.21**
Putnam RetirementReady Series	-0.12	1.26	-2.38	**-1.27**
Russell LifePoints Target Date Series	0.11	0.98	-2.69	**-1.63**
John Hancock Lifecycle Series	-0.05	-1.39	-0.50	**-1.93**
ING Solution Series	-0.17	0.70	-2.52	**-2.00**
Guidestone Funds MyDestination Series	-0.20	-1.25	-0.66	**-2.10**
Fidelity Advisor Freedom Series	-0.07	0.78	-2.84	**-2.15**
Columbia Retirement Portfolios	0.08	-1.17	-1.12	**-2.20**
TIAA-CREF Lifecycle Series	0.21	-0.27	-2.16	**-2.23**
Principal LifeTime Series	0.12	0.32	-3.31	**-2.89**
Seligman TargetHorizon ETF Series	-0.30	-2.74	-0.09	**-3.11**
DWS LifeCompass Series	-0.07	-0.56	-2.70	**-3.31**
AllianceBernstein Retirement Str Series	-0.06	-1.32	-2.51	**-3.86**
Goldman Sachs Retirement Str Series	0.02	-0.21	-4.24	**-4.42**
RiverSource Retirement Plus Series	0.06	0.80	-5.48	**-4.67**
Oppenheimer LifeCycle Series	-0.54	-3.18	-6.92	**-10.37**

Data as of 12/31/2009

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The series with the best performance over the custom benchmark over the past two years, Wells Fargo Advantage DJ Target Date, was helped primarily by the series' Allocation, but its low expense ratio added 0.40% of outperformance, and Selection also helped modestly (even though this series is indexed). Only three other series—JP Morgan SmartRetirement, Schwab Target, and Barclays Global Investors LifePath—had positive attribution in all three areas.

Allocation was the biggest driver behind other series' poor performance. Oppenheimer LifeCycle Series and Seligman TargetHorizon ETF lost 3.18 and 2.74 percentage points of performance, respectively, relative to the benchmark. But Oppenheimer's Selection was even worse, subtracting 6.92 percentage points of performance, primarily because of the steep dive of its Core Bond fund in 2008.

Management Subtracts from Returns

Broadly speaking, Selection was a detractor for 23 of the 32 series for which the data are available. Eleven of those series with negative Selection subtracted more than 2 percentage points of performance. Those managers' decisions represented more of a drag on performance than the funds' expense ratios, and in many cases had more of an impact on returns relative to the benchmark than the funds' glide paths. Thus, it's critical to look beyond the asset allocation to the quality of the underlying funds—and their management teams—when evaluating target-date series. Compromising on quality in this area can lead to inferior returns.

As target-date funds age, Morningstar will conduct its attribution analysis over longer periods to better evaluate the strengths and weaknesses of various target-date fund series. The past two-year period has included truly extraordinary market conditions. Even so, attribution analysis ought to provide another tool that can help plan sponsors and investors form reasonable expectations for the funds' future performance.

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Portfolio

Although glide paths have received most of the attention, they are not the only investment decision facing target-date funds. All funds must translate their asset-allocation choices into actual portfolio allocations. As with glide paths, there are several possible—and potentially appropriate—approaches that target-date fund series may take.

The first decision is whether to adopt a fund-of-funds structure. The roots of the industry lie in that direction, as the Big Three of Fidelity, Vanguard, and T. Rowe Price, which represent more than 70% of industry assets, each populate its target-date funds with existing single-strategy mutual funds. For the most part, the funds-of-funds model has been adopted by later entrants as well, although often the newer players have lacked a full stable of appropriate in-house funds from which to select. So in many cases the target-date families have populated their target-date funds with new shares of old funds or even newly created funds that clone institutional accounts.

Quality of the Underlying Funds

The quality of the funds included in the target-date series varies when measured by past risk-adjusted returns. The target-date series sporting underlying funds with the highest Morningstar Rating for funds (known informally as the "star rating") is Manning & Napier Retirement Target Series, which has an unusual structure in that it typically invests in just one or two of the firm's successful Pro-Blend allocation funds. The next highest-rated set of underlying funds, employing a more traditional structure, belongs to the American Funds Target Date Retirement series. The series with the lowest-rated underlying funds as of Dec. 31, 2009, was RiverSource Retirement Plus. (See Table 10.)

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10. Average Underlying Star Rating

Name	Star Rating	# Funds w/Star Rating
Manning & Napier Target Series	5	4
American Funds Trgt Date Rtrmt Series	4.06	20
Franklin Templeton Retirem Series	3.94	15
MainStay Retirement Series	3.81	20
MFS Lifetime Series	3.67	17
PIMCO RealRetirement Series	3.62	9
JPMorgan SmartRetirement Series	3.54	20
Putnam RetirementReady Series	3.52	4
Barclays Global Inv LifePath Series	3.48	7
American Century LIVESTRONG Series	3.47	15
ING Solution Series	3.47	24
T. Rowe Price Retirement Series	3.45	15
State Farm Lifepath Series	3.44	7
Nationwide Target Destination Series	3.40	11
Schwab Target Series	3.31	15
John Hancock Lifecycle Series	3.31	34
Fidelity Freedom Series	3.26	16
TIAA–CREF Lifecycle Series	3.23	11
AIM Independence Series	3.22	23
BlackRock Lifecycle Prepared Series	3.21	9
Massachusetts Mutual Life Insurance Co.	3.20	32
Vantagepoint Milestone Series	3.18	8
Columbia Retirement Portfolios	3.04	12
Principal LifeTime Series	3.02	28
Vanguard Target Retirement Series	3.00	5
Seligman TargetHorizon ETF Series	2.98	10
Guidestone Funds MyDestination Series	2.95	10
DWS LifeCompass Series	2.90	53
Fidelity Advisor Freedom Series	2.88	11
Russell LifePoints Target Date Series	2.82	8
Oppenheimer LifeCycle Series	2.79	15
Goldman Sachs Retirement Str Series	2.59	10
RiverSource Retirement Plus Series	2.33	9

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Open vs. Closed Architecture

Over the past year, there has been public debate as to whether shareholders are best served by target-date series that exclusively feature the advisor's own fund managers. Few advisors employ best-in-class management teams across strategies and asset classes typically featured in a target-date series. What's more, investors of these closed-architecture series face considerable single-firm risk—particularly if all of a defined-contribution plan participant's retirement assets are invested in a single target-date fund.

Advisors have plenty of incentive to include their own managers in a target-date series. They often are more familiar with and have more control over the managers' investment process, and they don't have to contend with subadvisory contracts and the regulatory burden of monitoring an outsider's trading and compliance effort. Perhaps the biggest incentive to use the advisors' own fund managers is financial: The advisors retain all of the funds' management fees, rather than sharing with a subadvisor.

In fact, closed-architecture target-date offerings are susceptible to conflicts of interest. The advisor may select its own inferior managers or overweight asset classes that often generate higher returns in order to beef up profits. Some critics have gone so far as to suggest that "self-dealing" may be in play in such cases, and that the Employment Retirement Income Security Act of 1974 guidelines exempting mutual fund companies from fiduciary responsibility should be revisited.

While criticisms of closed-architecture target-date funds are valid, it's important to consider who is being critical of these funds. Consultants and asset managers who provide custom, nonproprietary, indexed or other types of target-date investments are often the most vocal opponents, and they have their own business interests associated with open-architecture options. It's also worth noting that most plans that feature subadvisors are not exclusively subadvised. Among the largest open-architecture target-date series, the advisor typically has kept 30% to 60% of the series' assets with its own in-house managers.

Interestingly, Morningstar's analysis of both open- and closed-architecture target-date series indicates that open-architecture series have not demonstrated a performance advantage over closed-architecture target-date series. Morningstar analyzed several factors, including risk-adjusted returns, performance attribution, underlying Morningstar ratings, and overall Morningstar Target-Date Fund Series Ratings (the last rating is limited to 20 series), and open-architecture series did not have a meaningful edge by any measure.

A look at three-year risk-adjusted returns through Dec. 31, 2009, shows that, among the 10 series with the best performance, only three are either partially or wholly run by subadvisors. Moreover, two of the three (Wells Fargo and ING Index Solution) are index-based offerings that employ a single external subadvisor. Vantagepoint Milestone Series, also among the top 10, is exclusively run by subadvisors and taps managers from a wide range of firms. Among the bottom 10 performers on a risk-adjusted basis, five use at least some nonproprietary holdings. (See Table 11.)

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11. Risk-Adjusted Return Rank and Series Architecture

3-Year Risk-Adjusted Return Rank	Target-Date Series	Architecture
1	Manning & Napier Target	Closed
2	PIMCO RealRetirement	Closed
3	ING Index Solution	Mixed
4	MFS Lifetime	Closed
5	American Century LIVESTRONG	Closed
6	Wells Fargo Advantage DJ Target Date	Open
7	Franklin Templeton Retirement Trgt	Closed
8	Vantagepoint Milestone	Open
9	BlackRock Lifecycle Prepared	Closed
10	JPMorgan SmartRetirement	Closed
11	MainStay Retirement	Mixed
12	Vanguard Target Retirement	Closed
13	American Funds Trgt Date Rtrmt	Closed
14	Schwab Target	Mixed
15	American Independence NestEgg	Open
16	Fidelity Freedom	Closed
17	BlackRock LifePath	Closed
18	Nationwide Target Destination	Open
19	T. Rowe Price Retirement	Closed
20	DWS LifeCompass	Closed
21	Russell LifePoints Target Date	Open
22	TIAA-CREF Lifecycle	Closed
23	State Farm Lifepath	Open
24	Fidelity Advisor Freedom	Closed
25	MassMutual Select Destination Ret	Mixed
26	Columbia Retirement	Mixed
27	Guidestone Funds MyDestination	Open
28	AIM Balanced-Risk	Mixed
29	John Hancock Lifecycle	Mixed
30	Principal LifeTime	Mixed
31	Putnam RetirementReady	Closed
32	ING Solution	Mixed
33	Seligman TargetHorizon ETF	Open
34	RiverSource Retirement Plus	Closed
35	AllianceBernstein Retirement Str	Closed
36	Goldman Sachs Retirement Str	Closed
37	Oppenheimer LifeCycle	Closed

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The three-year risk-adjusted returns are heavily influenced by the series' glide paths. Funds with equity-heavy asset allocations were among the worst performers in 2008's market slide, and those results are reflected in risk-adjusted returns. To take the glide path out of the performance equation, it's helpful to consider Morningstar's analysis of performance attribution. The attribution analysis measures the drivers of a series' performance gap relative to the peer-group norm. That outperformance or underperformance can be attributed to three factors: Glide Path (the series' asset allocation), Cost (the expense ratio), and Selection (the impact of management's sector weights, security selection, and tactical asset allocation). By isolating the Selection factor, one can determine how much of a series' outperformance or underperformance can be attributed to the managers of the underlying funds or strategies.

Once again, the data reveal no advantage to open-architecture series or nonproprietary target-date lineups. Of the nine series that have positive attribution for Selection over the two-year period, two have nonproprietary structures—Wells Fargo and Vantagepoint. Of the 23 series with negative Selection attribution, about half are completely or partially subadvised. (See Table 12.)

In addition to considering risk-adjusted returns and performance attribution, Morningstar considered the Morningstar ratings associated with the series' underlying funds. The Morningstar rating considers a fund's risk-adjusted performance relative to peers on a three-, five-, or 10-year basis. By averaging these ratings across the underlying funds in a target-date series on an asset-weighted basis, one can quickly assess the quality of those funds. (See Table 10.)

In theory, an open-architecture series with the flexibility to choose any manager would have a higher-quality portfolio. Other factors may mitigate that—for example, the desire to include funds with out-of-favor strategies or asset classes that sport lower ratings. But overall, open-architecture series did not sport higher average asset-weighted Morningstar ratings.

As a final test of open- and closed-architecture series, Morningstar looked to its latest Target-Date Fund Series Ratings, which were issued to 20 series based on Dec. 31, 2009, data. These ratings are more holistic and comprehensive, covering both quantitative and qualitative aspects of a series' performance, fees, management quality, and stewardship practices. A series earns one of five ratings: Top, Above Average, Average, Below Average, or Bottom.

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12. Performance Attribution and Architecture

Target-Date Series Name	Cost	Allocation	Selection	Architecture
T. Rowe Price Retirement Series	0.18	-0.89	**1.25**	Closed
JPMorgan SmartRetirement Series	0.11	0.90	**0.65**	Closed
American Funds Trgt Date Rtrmt Series	0.11	-1.26	**0.65**	Closed
Vanguard Target Retirement Series	0.72	-0.18	**0.38**	Closed
Vantagepoint Milestone Series	-0.10	0.03	**0.26**	Open
BlackRock LifePath Series	0.05	0.14	**0.22**	Closed
Wells Fargo Advantage DJ Series	0.40	1.58	**0.14**	Open
MFS Lifetime Series	-0.31	0.61	**0.09**	Closed
Schwab Target Series	0.19	0.50	**0.04**	Mixed
Seligman TargetHorizon ETF Series	-0.30	-2.74	**-0.09**	Open
MainStay Retirement Series	-0.14	-0.11	**-0.21**	Mixed
State Farm Lifepath Series	-0.14	0.21	**-0.28**	Open
MassMutual	0.02	-0.82	**-0.41**	Mixed
American Century LIVESTRONG Series	0.22	1.30	**-0.44**	Closed
John Hancock Lifecycle Series	-0.05	-1.39	**-0.50**	Mixed
Guidestone Funds MyDestination Series	-0.20	-1.25	**-0.66**	Open
BlackRock Lifecycle Prepared Series	-0.34	0.31	**-0.81**	Closed
Columbia Retirement Portfolios	0.08	-1.17	**-1.12**	Mixed
Nationwide Target Destination Series	0.08	-0.10	**-1.17**	Open
NestEgg Dow Jones Series	0.23	1.70	**-1.67**	–
Fidelity Freedom Series	0.21	0.98	**-1.90**	Closed
TIAA-CREF Lifecycle Series	0.21	-0.27	**-2.16**	Closed
Putnam RetirementReady Series	-0.12	1.26	**-2.38**	Closed
AllianceBernstein Retirement Str Series	-0.06	-1.32	**-2.51**	Closed
ING Solution Series	-0.17	0.70	**-2.52**	Mixed
Russell LifePoints Target Date Series	0.11	0.98	**-2.69**	Open
DWS LifeCompass Series	-0.07	-0.56	**-2.70**	Closed
Fidelity Advisor Freedom Series	-0.07	0.78	**-2.84**	Closed
Principal LifeTime Series	0.12	0.32	**-3.31**	Mixed
Goldman Sachs Retirement Str Series	0.02	-0.21	**-4.24**	Closed
RiverSource Retirement Plus Series	0.06	0.80	**-5.48**	Closed
Oppenheimer LifeCycle Series	-0.54	-3.18	**-6.92**	Closed

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Among the 20 series, seven include subadvisors not affiliated with the series' advisor. None of those seven series earned a Top rating; two earned Above Average (Vantagepoint and Wells Fargo); three earned Average (John Hancock, MassMutual, and Schwab); and two earned Below Average (ING Retirement and Principal).

Several factors may explain why open-architecture target-date series haven't demonstrated a performance edge. For one, it can be expensive to hire subadvisors—especially truly exceptional ones—and the series' subsequent expense ratio may be higher and act as a further drag on performance. Also, several open-architecture series, including ING, Principal, and John Hancock, feature more-aggressive glide paths that performed dismally in 2008's downturn. Finally, it's not easy to choose and combine subadvisors that together will consistently outperform. Such portfolio construction is an art that's perfected over years and decades.

It's worth noting that while the data do not suggest open-architecture series have a performance advantage, they also don't seem to have a consistent disadvantage. Theoretically, the open-architecture series should be superior at risk management, though that hasn't played out so far across the peer group. That said, one open-architecture standout is Vantagepoint, which has benefited from strong manager selection, a relatively conservative glide path, reasonable (though recently increased) fees, and a stellar and experienced investment culture.

Recently, target-date providers have introduced new open-architecture target-date series, and even Fidelity—one of the largest target-date series advisors—reportedly is considering a series featuring non-Fidelity managers. As target-date fund performance records lengthen, open-architecture series may demonstrate superiority, but for now, Morningstar can't make a strong argument in favor—or against—this open-architecture target-date series' management model.

Price

When it comes to predicting a fund's future performance, there may be no better indicator than cost. Morningstar's research consistently has shown a correlation between lower expense ratios and better returns. This is particularly relevant for target-date funds, which investors are expected to hold for decades. Over those years of ownership, fees eat into shareholders' nest eggs, allowing less capital to compound, and over several decades there are very few examples of high-cost funds that have outperformed their peers.

Target-date providers certainly have incentive to keep fees higher, but even so, several series—including those offered by Principal, Schwab, and Wells Fargo—cut their expense ratios in 2009. Others introduced lower-cost alternatives. Fidelity and TIAA-CREF, which each offer actively managed target-date series, announced they would launch lower-cost indexed strategies. Finally, Allianz said in February 2010 that it would lower its target-date series' expense ratio to 0.88% from 1.09% by seeding the series with institutional trusts instead of mutual funds. Firms such as AllianceBernstein have also shied away from a

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traditional fund-of-funds structure to keep fees in check. (The AllianceBernstein target-date series owns pools of securities instead of mutual funds or trusts.) These types of moves helped drive the average expense ratio for a target-date fund down to 0.90% as of Dec. 31, 2009, from 0.91% at midyear.

Competitive pressures are likely prompting these fee cuts. Vanguard, which controlled 22% of the target-date fund market at the end of 2009, charges its investors just 0.19% per year. The other target-date market leaders, Fidelity Freedom and T. Rowe Price, charge 0.69% and 0.73%, respectively. For those with many billions to invest in target-date funds, a defined contribution plan can get an even lower fee for participants by creating collective investment trusts that may (or may not) mirror a mutual fund run in the same strategy. These types of investments have grown quickly in recent years and may charge less than half Vanguard's competitive retail mutual fund fee.

Comparing Costs

Comparing target-date funds' fees can be straightforward. For the Target-Date Series Rating methodology, Morningstar identifies a series' cheapest share class that also has at least 10% of the series assets, and then compares those expense ratios across the universe of roughly three-dozen target-date series. This selection process attempts to weed out inexpensive share classes that are launched but never sold and therefore aren't representative of a shareholder's experience owning the fund. The methodology clearly rewards series that have kept their costs low relative to peers.

One could also compare series' fees by calculating an asset-weighted expense ratio, in which a series' largest share class carries the most weight when comparing series' fees. This calculation tends to favor direct-sold target-date series with a single share class, such as those offered by Vanguard and Fidelity, though the peer-rank distribution is roughly the same. (See Table 13.)

Smaller Plans, Bigger Fees

It's also worth noting that there is some relationship between target-date series' expenses and the size of the defined-contribution plan that invests in the series. While ultracheap collective investment trusts are available to mega defined-contribution plans, those series targeting smaller defined-contribution plans tend to be more expensive because they spread their costs over fewer participants. These series' expense ratios also may include plan administrative fees that otherwise would be levied beyond the expense ratio through a per-account fee.

Thus, one cannot assume that the series' expense ratio captures a shareholder's total cost of owning a target-date series through a 401(k) or other defined-contribution plan. An investor may pay a lower expense ratio as well as an annual administrative fee, which together may cost the same as another series' higher fund expense ratio. Since per-account administrative fees aren't uniformly reported to regulators or other researchers, such as Morningstar, one can't compare actual costs beyond the expense ratio.

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13. Target-Date Series Asset-Weighted Average Expense Ratios

Name	Asset-Weighted Expense Ratio %	Total Assets	Industry Target-Date Assets %
Vanguard Target Retirement Series	**0.19**	56,172,466,946	22.46
Wells Fargo Advantage DJ Target Date Ser	**0.62**	6,047,001,369	2.42
TIAA-CREF Lifecycle Series	**0.69**	3,934,078,658	1.57
NestEgg Dow Jones Series	**0.69**	108,598,784	0.04
Fidelity Freedom Series	**0.71**	85,694,489,156	34.26
Schwab Target Series	**0.72**	775,796,290	0.31
T. Rowe Price Retirement Series	**0.79**	42,092,035,956	16.83
Columbia Retirement Portfolios	**0.85**	24,953,752	0.01
JPMorgan SmartRetirement Series	**0.85**	1,623,614,319	0.65
ING Index Solution Series	**0.87**	478,907,405	0.19
RiverSource Retirement Plus Series	**0.88**	146,142,319	0.06
American Century LIVESTRONG Series	**0.90**	2,124,451,070	0.85
BlackRock LifePath Series	**0.92**	2,837,075,918	1.13
Principal LifeTime Series	**0.92**	14,668,530,701	5.87
John Hancock Lifecycle Series	**0.96**	3,262,421,792	1.30
Vantagepoint Milestone Series	**0.99**	951,242,926	0.38
AllianceBernstein Retirement Str Series	**1.00**	2,029,963,148	0.81
Massachusetts Mutual Life Insurance Co.	**1.04**	1,086,954,735	0.43
PIMCO RealRetirement Series	**1.04**	22,699,855	0.01
American Funds Trgt Date Rtrmt Series	**1.05**	6,242,575,789	2.50
Russell LifePoints Target Date Series	**1.05**	634,297,213	0.25
Goldman Sachs Retirement Str Series	**1.07**	98,175,635	0.04
Fidelity Advisor Freedom Series	**1.07**	9,724,963,299	3.89
Guidestone Funds MyDestination Series	**1.09**	575,043,913	0.23
Nationwide Target Destination Series	**1.11**	433,929,321	0.17
MainStay Retirement Series	**1.13**	229,778,961	0.09
Manning & Napier Retirement Target Series	**1.15**	160,953,670	0.06
ING Solution Series	**1.17**	3,456,987,798	1.38
DWS LifeCompass Series	**1.21**	579,790,096	0.23
Putnam RetirementReady Series	**1.22**	324,539,732	0.13
AIM Independence Series	**1.24**	58,734,084	0.02
State Farm Lifepath Series	**1.31**	2,654,748,612	1.06
BlackRock Lifecycle Prepared Series	**1.34**	61,567,374	0.02
Franklin Templeton Retirem Series	**1.44**	79,017,832	0.03
MFS Lifetime Series	**1.48**	285,431,861	0.11
Seligman TargetHorizon ETF Series	**1.54**	132,556,016	0.05
Oppenheimer LifeCycle Series	**1.71**	279,733,925	0.11
		250,094,250,230	

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People

The average manager tenure for a target-date series stood at 4.3 years at the end of 2009—not far off from the mutual fund industry's 4.9-year average tenure. But relative to most strategies represented among open-end mutual funds, target-date funds are still youthful, and the teams executing their dynamic asset-allocation strategies are relatively untested. Thus, when evaluating the management skill behind target-date series, it's instructive to look at the experience of the managers running the underlying funds used in the series. These managers can have a significant impact on the series performance through their selection decisions, as Morningstar's attribution analysis shows.

In some cases, the manager-tenure figures for the underlying funds understate a fund manager's experience running a strategy used in a target-date series. For example, target-date series offered by ING, MassMutual, Principal, and Vantagepoint have hired tested, well-known subadvisors to manage at least a portion of their target-date series, yet these veteran managers may have been named to the target-date series' constituent funds relatively recently.

To determine the likelihood that the managers at both the series and the underlying funds are likely to stay, it's informative to look at the fund family's five-year manager-retention rate. As is the case for average manager tenure at the underlying funds in the target-date series, the American Funds is also the clear leader when it comes to the firmwide five-year manager-retention rate. Firms that have a history of high manager-retention rates are less likely to have disruptive management changes on the funds used in the target-date series, which could lead to better outcomes for investors. (See Table 14.)

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14. Average Fund Manager Tenure and Retention Rates

Fund Series	Avg Manager Tenure of Target-Date Series, in years as of Dec. 31, 2009	Avg Manager Tenure for Underlying Holdings of Target-Date Funds, in years as of Dec. 31, 2009	Firmwide Manager-Retention Rate, 5-year average as of Dec. 31, 2009
DWS	7.8	7.8	81.7
Vanguard	6.3	9.7	92.6
Putnam	5.3	3.0	81.9
Fidelity Advisor Freedom	4.5	1.7	85.6
T. Rowe Price	4.3	9.5	94.6
MFS	4.3	4.6	86.4
Vantagepoint	3.9	3.2	90.6
TIAA-CREF	3.8	4.1	86.3
Fidelity Freedom	3.6	2.4	85.6
Wells Fargo	3.6	14.6	90.9
Principal	3.4	3.4	88.4
JPMorgan	3.2	5.6	85.4
American Funds	3.0	11.6	98.7
AllianceBernstein	2.7	2.7	88.2
MassMutual	2.6	3.5	87.3
ING	2.4	2.4	88.0
American Century	2.3	3.7	87.2
Oppenheimer	2.1	3.6	88.9
Schwab	1.3	3.9	89.6
John Hancock	0.1	2.9	88.7
Industry Average	**4.3**	**4.9**	–

Data as of 12/31/2009

Paying for Performance

The criteria used to determine a fund manager's bonus compensation—usually the bulk of a manager's annual pay—can indicate whether a fund manager's own financial incentives are aligned with target-date shareholders'. Because most investors presumably will hold target-date funds for decades, a pay plan that would reward managers who deliver peer-beating returns over longer periods would put the managers' incentives in line with shareholders'.

Nine of the 20 series that Morningstar studied most closely met this pay-for-longer-term-performance criterion as of Dec. 31, 2009. Four series—ING, MassMutual, Principal, and Wells Fargo—made no mention of paying for strong long-term performance in their descriptions of their pay plans in the funds' Statement of Additional Information filings with the SEC. (See Table 15.)

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15. Main Criterion of Pay Plans

Long-Term Performance	Shorter-Term Performance	Gathering Assets or Criterion Unclear
American Funds	AllianceBernstein	ING
American Century	John Hancock	MassMutual
DWS	MFS	Principal
Fidelity	Putnam	Wells Fargo
Fidelity Advisor	Schwab	–
JP Morgan	TIAA-CREF	–
Oppenheimer	Vanguard	–
T. Rowe Price	Vantagepoint	–

Data as of 12/31/2009

Much Skin in the Game?

Another way to gauge a fund manager's personal interest in a target-date series' success is to examine the manager's own investments in mutual fund shares. It stands to reason that managers who make meaningful investments in the funds they manage demonstrate conviction in the investment process and in fees charged. The data below suggests that managers who make sizable investments in the funds they manage are more likely to outperform their peers. (See Table 16.)

16. Manager Ownership Levels and Relative Fund Performance as of July 31, 2009

	Average Category Rank 5 years	Number of Funds
More than $1 million	42	413
$500,001 to $1 million	44	197
$100,001 to $500,000	46	679
$50,001 to $100,000	50	285
$10,001 to $50,000	50	393
$1 to $10,000	52	159
$0	54	2,257

Data as of 12/31/2009 Source: Morningstar, SEC

Unfortunately, just two of the 44 target-date managers at the 20 series included in Morningstar's Target-Date Fund Series Rating and Research Reports—Jerome Clark of T. Rowe Price and Hans Erickson of TIAA-CREF—have made investments greater than $500,000 in the target-date series they manage. (Within Morningstar's Stewardship Grades for mutual funds, managers who invest between $500,000 and $1 million in a core fund earn partial credit for manager ownership; managers who invest more than $1 million earn full credit.) Meanwhile, 25 of the 44 fund managers have invested nothing in mutual fund shares, according to disclosures in the most recent Statements of Additional Information on file with the SEC. (See Table 17.)

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17. Manager Investments in Target-Date Fund Shares as of the Most Recent Regulatory Disclosure

	$0	**$1 to $10,000**	**$10,001 to 50,000**	**$50,001 to $100,000**	**$100,001 to $500,000**	**$500,001 to $1 million**	**More than $1 million**
Target-Date Fund Managers	25	2	5	3	10	1	1

Data as of 12/31/2009

To be sure, it can be difficult or impossible for managers to buy mutual fund shares at four of the series Morningstar studied. In each of these cases, the managers are able to invest in the strategy through non-mutual-fund investment vehicles, often as part of their employer's 401(k) plan. Managers of the series offered by ING, MassMutual, and Vantagepoint have maximized—or nearly maximized—their eligible contributions to their strategies and thus earn partial credit for manager investments.

It remains to be seen whether managers who make sizable investments in the target-date funds they run produce superior results, but some early data suggests that series run by managers with skin in the game do deliver stronger risk-adjusted returns. Among the series with at least one manager invested $100,000 or more in mutual fund shares, the average three-year Morningstar Risk-Adjusted Return was a loss of 6.92. For series where manager ownership of mutual fund shares was less than $50,000, the aver-age three-year MRAR was a steeper 8.31 decline. Table 18 notes cases where Morningstar is aware that management invests in a version of the target-date strategy but in a form other than a public mutual fund.

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18. Maximum Fund Manager Ownership and Risk-Adjusted Performance

Fund Series	Maximum Fund Ownership Range	3-Yr Weighted MRAR	Performance Rating
TIAA-CREF	More than $1 million	-7.89	Average
T. Rowe Price	$500,000 to $1 million	-7.2	Average
DWS	$50,000 to $100,000	-7.76	Below Average
MFS	$100,000 to $500,000	-3.73	Above Average
American Century	$100,000 to $500,000	-4.07	Top
JP Morgan	$100,000 to $500,000	-5.71	Above Average
American Funds	$100,000 to $500,000	-6.55	Above Average
Fidelity Freedom	$100,000 to $500,000	-6.89	Average
Fidelity Advisor Freedom	$100,000 to $500,000	-8.04	Average
John Hancock	$100,000 to $500,000	-8.82	Below Average
Schwab	$1 to $10,000	-6.6	Above Average
Principal	$10,000 to $50,000	-9.39	Below Average
Schwab	$1 to $10,000	-6.6	Above Average
Wells Fargo	$0	-5.07	Above Average
Vantagepoint	$0*	-5.51	Average
Vanguard	$0	-6.2	Average
MassMutual	$0*	-8.11	Average
Putnam	$0	-9.39	Below Average
AllianceBernstein	$0	-11.13	Bottom
Oppenheimer	$0	-13.41	Bottom

Data as of 12/31/2009 *Managers own non-mutual-fund forms of target-date strategy.

Parent

A fund company's corporate culture can influence the way it treats shareholders and can contribute to the long-term success (or failure) of its target-date series. Morningstar routinely evaluates fund companies' corporate culture as part of its Stewardship Grades for mutual funds, examining both qualitative and quantitative measures as part of its review. Industry-leading corporate cultures are those that are focused on serving investors well through well-established investment processes used at funds that investors are likely to own well because they don't chase volatile trends. (Investors often chase performance, buying funds after they've begun to post attractive gains and selling just after a sizable decline.)

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Three data points that inform a fund family's corporate-culture grade are fund mergers, fund launches, and manager retention. The number of fund mergers and launches can be a window into whether a fund family's lineup is stable and plays to the firm's strengths, whether the fund family is clearing out funds that haven't been successful or are redundant, or whether it is launching new funds in an effort to attract assets. Another sign of a stable, investor-focused investment culture is a high five-year manager-retention rate. Fund families with such retention rates that are higher than 90% have very little manager turnover that's ultimately disruptive to fund shareholders. (See Table 19.)

19. Culture Grades and Fund Mergers, Launches, Manager Retention of Top Mutual Fund Families

Fund Family	Fund Mergers since 2005	Funds Launched since 2005	Manager Retention % annualized since 2005	Morningstar Corporate-Culture Grade
Vanguard	1	19	92.6	A
American Funds	0	4	98.7	A
Fidelity Investments	9	52	85.6	B
PIMCO Funds	0	25	90.1	B
Franklin Templeton	12	16	91.2	B
T. Rowe Price	5	14	94.6	A
John Hancock	40	38	88.7	N/A
OppenheimerFunds	12	16	88.9	C
Dodge & Cox	0	1	97.2	A
Columbia	45	7	84.9	C

Data as of 12/31/2009

Board Oversight

Mutual funds are structured like corporations, with independent boards of directors overseeing their operations. Fund boards have important duties, including approving fund launches and mergers, monitoring funds' performance, approving the funds' management contract with the advisor, and negotiating the funds' fees.

Fund boards can reduce inherent conflicts of interest between the fund board and the funds' management through independent leadership, specifically an independent chairman and at least 75% independent directors. As is the case with fund managers, independent fund board directors can align their own financial interests with fund shareholders by investing directly in fund shares. Specifically, Morningstar looks to see whether fund managers invest at least one year's compensation for serving on the board directly in mutual fund shares. Lastly, there should be evidence that the board has taken concrete steps in the best interests of shareholders by negotiating lower fees, merging redundant or unsuccessful offerings, or pushing for management changes or a subadvisory contract if a fund hasn't been run well.

Among the 20 target-date fund series that Morningstar has evaluated, no board satisfied all of these best-practices criteria. Some scored highly for their independence and investments but could be doing more to serve shareholders. Others have produced good results for shareholders but fall short of independence or personal investment in the funds they oversee.

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Disclosure Falling Short

The fund companies behind target-date series have the difficult task of explaining these complex and dynamic investments to shareholders and fiduciaries. If shareholders are to own these funds successfully for decades, investors should understand how the funds are structured and how they can help investors meet their financial goals. It is also critical that the funds provide enough information to fiduciaries—the advisors, consultants, and plan sponsors choosing target-date funds for defined-contribution and other savings plans—so these shareholder representatives can adequately assess the funds' potential risks and rewards.

Industry regulators have said in recent months that they are considering new standards for public disclosure of target-date funds' attributes. Morningstar's research has shown that the quality of this public disclosure varies considerably. Some firms include thoughtful explanations of their target-date funds in public documents and on their websites while others have very little helpful information.

As part of its research effort into funds' disclosure, Morningstar looked to see which fund series met the suggested target-date disclosure criteria put forth by the Investment Company Institute, the trade group for the mutual fund industry, in a paper issued in mid-2009: http://www.ici.org/pdf/ppr_09_principles.pdf. Specifically, the ICI suggested fund series prominently disclose:

1. The relevance of the "target date" used in a fund name, including what happens on the target date.
2. The fund's assumptions about the investor's withdrawal intentions after reaching the target date.
3. The age group for whom the fund is designed.
4. An illustration of the asset-allocation path (or glide path) that the target-date fund follows and the degree from which management may change the allocation tactically.
5. A statement of the risks associated with the series.

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The table below outlines which series currently meet the ICI's five standards.

20. Target-Date Series Meeting ICI Standards for Public Disclosure

Fund Series	Relevance of Target-Date	Withdrawal Intentions	Age Group	Asset Allocation Illustration	Risk of Loss Statement	Where to Get More Information	Degree of Tactical Allocation
JP Morgan	•	•	•	•	•	•	
Putnam	•	•	•	•	•	•	
T. Rowe Price	•	•	•	•	•	•	
Vanguard	•	•	•	•	•	•	
American Century	•	•	•	•	•		
MFS	•	•	•	•	•		
Vantagepoint	•	•	•	•	•		
Wells Fargo	•	•	•	•	•		
Fidelity Freedom	•		•	•	•	•	
ING	•		•	•	•	•	
Principal	•		•	•	•	•	
Schwab	•		•	•	•	•	
AllianceBernstein	•		•	•	•		
American Funds	•		•	•	•		
Fidelity Advisor Freedom	•		•	•	•		
John Hancock	•		•	•	•		
Oppenheimer	•		•	•	•		
DWS	•		•		•		
TIAA-CREF	•			•	•		
MassMutual							

Data as of 12/31/2009

The ICI's suggestions are a good place to start, but Morningstar asserts that further disclosure is necessary to fully and adequately evaluate the quality and risk profile of a target-date series. Specifically, target-date series should be required to disclose publicly and prominently to shareholders:

1. The investment rationale behind the strategic asset-allocation path used in the target-date series.
2. The subasset classes likely to be represented in the funds' strategic asset-allocation path and their intended percentage of assets.
3. In cases where the target-date series uses a fund-of-funds structure, a list of the underlying funds included in the target-date series, as well as
   a. The percentage of assets allocated to each underlying fund, and
   b. The underlying funds' asset allocation, including market-cap size for stock funds; credit quality, maturity, and sector information for fixed-income funds; and both for multi-asset-class funds.
4. The underlying funds' performance relative to its prospectus benchmark over the past one-, three-, five-, and 10-year periods.
5. In cases where the target-date series owns individual securities, a list of the investment strategies represented by the securities, including references to similar strategies run by the advisor, such as a public mutual fund.

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Tables 21 and 22 show which series already meet the standards described on Page 39.

21. Public Disclosure of Rationale, Glide Path and Performance

Fund Series	Investment Rationale for Asset-Allocation Path	Subasset Classes in the Glide Path	Target-Date Funds' Performance
Fidelity Freedom	•	•	•
ING	•	•	•
JP Morgan	•	•	•
Principal	•	•	•
T. Rowe Price	•	•	•
Vanguard	•	•	•
Putnam	•		•
Schwab	•		•
AllianceBernstein		•	•
American Funds		•	•
Fidelity Advisor Freedom		•	•
MFS		•	•
Oppenheimer		•	•
American Century			•
DWS			•
John Hancock			•
TIAA-Cref			•
Vantagepoint			•
Wells Fargo			•
MassMutual			

Data as of 12/31/2009

To be sure, many firms do provide this level of disclosure privately to research organizations such as Morningstar, defined-contribution plan sponsors and consultants, and other interested parties. In addition, fund companies often provide more details to defined-contribution plan participants through private password-protected websites that participants may access. While Morningstar does review those private disclosures when they're made available, only public information is reflected in the table above. Such private disclosure is uneven—one can't be sure whether all investors actually have access to this information, and some fiduciaries may end up with more resources for their due diligence than others.

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22. Public Disclosure of Target-Date Series' Underlying Holdings and Their Attributes

Fund Series	Lists Underlying Funds	Shows % of Assets Allocated to Each Fund	Shows Market Cap	Shows Sector Weights	Shows Credit Quality	Shows Maturity	Shows Underlying Funds' Performance Relative to Benchmark	If Series Owns Individual Securities, Lists Strategies and Similar Funds
American Century	•	•	•	•	•	•	•	
Fidelity Advisor Freedom	•	•	•	•	•	•	•	
JP Morgan	•	•	•	•	•	•	•	
Principal	•	•	•	•	•	•	•	
Putnam	•	•	•	•	•	•	•	
Schwab	•	•	•	•	•	•	•	
T. Rowe Price	•	•	•	•	•	•	•	
TIAA-CREF	•	•	•	•	•	•	•	
Vanguard	•	•	•	•	•	•	•	
Oppenheimer	•	•	•	•	•	•		
Fidelity Freedom	•	•		•	•	•	•	
John Hancock	•	•		•	•	•	•	
MFS	•	•		•	•	•	•	
DWS	•	•		•	•	•	•	
American Funds	•	•		•	•	•		
Vantagepoint	•	•		•			•	
ING								
MassMutual								
Wells Fargo	N/A							•
AllianceBernstein	N/A							

Data as of 12/31/2009

Morningstar maintains, however, that the information should be broadly and prominently displayed—preferably in documents filed with the SEC and other regulators—to eliminate the risk that this critically important information is unavailable to shareholders and fiduciaries seeking it. If investors are well-informed, they're more likely to own target-date funds well and avoid costly mistakes, such as buying funds with unsuitable risk profiles or selling out of funds during bouts of underperformance that are reasonable given the series' strategy. For example, many 2010 fund shareholders—along with lawmakers and other industry watchdogs—seemed surprised by the extent to which their funds owned equities and were subject to sizable damage during 2008's market crash. Those who sold during the worst of the sell-off locked in losses that may have been recovered in part during the 2009 market rebound. Investors who understand what they own are much more likely to own their funds well and avoid what can be costly mistakes.

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Law-Abiding Series

In addition to analyzing a Parent's corporate culture, fund board, and target-date transparency, Morningstar also considers whether it's met industry regulatory requirements in recent years. Fund companies that have run afoul of regulators have their Parent ratings reduced depending on the severity of wrongdoing and the steps taken to ensure such incidents aren't repeated. Parents with strong Regulatory Histories earn perfect scores of zero, on the notion that firms shouldn't be rewarded simply for following the law.

In past reports, Morningstar decreased the Regulatory History scores for AllianceBernstein, MFS, Putnam, and DWS based on the firms' involvement in the 2003-04 industry market-timing scandal, in which hedge funds or other investors were allowed to quickly trade in and out of mutual funds, even though the funds' prospectuses said such trading wouldn't be allowed. Each firm has made significant improvements to their compliance processes and culture since the trading incidents occurred. And in all of these cases, senior management has also turned over since the regulatory action. Thus, Morningstar removed the Regulatory History penalty for these series as of Dec. 31, 2009.

What's clear about manager-ownership trends thus far is most target-date fund managers have failed to demonstrate conviction in these funds through their own personal investments. If the fund industry is positioning these funds as a one-stop solution for retirement savings, Morningstar would expect fund managers to do the same with their portfolios.

Morningstar Target-Date Fund Series Ratings

When it comes to assessing specific strengths and weaknesses of target-date series, Morningstar has developed a methodology to evaluate series based on the same themes outlined in this paper: Process, Portfolio, Performance, Price, People, and Parent. Each area but Process receives a rating based on a combination of quantitative and qualitative analysis. Morningstar then combines those five section ratings to come up with an overall rating for 20 of the largest target-date series. Morningstar updates these ratings, and the reports that accompany them, quarterly. (For more on Morningstar's target-date rating methodology, click here: http://corporate.morningstar.com/US/documents/MethodologyDocuments/MethodologyPapers/TargetDateFundSeries_RatingMethodology.pdf.)

The series' ratings for each of those five sections follows, as do the series' overall ratings. As of Dec. 31, 2009, the target-date series that reflected the most industry best-practices were American Funds, American Century, T. Rowe Price, and Vanguard. Each earned a Top rating for their series. Seven of the 20 series earned ratings of Below Average and Bottom. In Morningstar's view, these series have plenty of room for improvement when it comes to series construction, returns, fees, management, and stewardship.

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23. Performance Ratings, December 2009

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

Data As of 12/31/2009

24. Portfolio Ratings, December 2009

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

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25. Price Ratings, December 2009

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

Data as of 12/31/2009

26. People Ratings, December 2009

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

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27. Parent Ratings, December 2009

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

Data as of 12/31/2009

28. Overall Ratings, December 2009

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

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