Ibbotson Target Risk Report 3Q 2013

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This is the second report in a series of quarterly reports that strive to summarize results for, and events around the U.S. target risk fund marketplace. We report on U.S. domiciled diversified funds that firms present to investors as "all-in" models, or models that could be appropriate for an investor's entire nest egg (based on our interpretation of each fund's prospectus and marketing). We exclude single, stand-alone offerings (many firms offer one diversified "Balanced" fund option that is not part of a traditional series of target risk funds) and sector specific "satellite" or "completion" portfolios. The majority of these products are funds-of-funds, but a few invest directly in individual stocks and bonds. Most target an equity level or range, but a few newer funds are targeting a stated volatility level or range. We report results for the oldest registered share class for each fund. Highlights from the report include:

- We currently track 306 open-end funds and 263 insurance product funds from 83 firms with aggregate AUM of $675.8 billion.
- Since last quarter, we added one new insurance lineup that includes a volatility control strategy, and two tactical open-end lineups. One small insurance lineup ($30 million AUM after seven years) closed.
- Target risk funds gained 4.7% on average for the third quarter and 11.1% over the past 12 months.
- Flows into target risk funds were healthy with over $3.9 billion flowing into the category during the quarter. Moderate funds gathered the majority of the flows.
- Target risk funds continue to see total assets climb to all-time highs. As of the end of Q3, total assets in target risk funds were near $676 billion, a 14% increase from a year ago.

In our report, we review performance results for target risk funds for the third quarter of 2013 and for the last 12 months. We investigate the drivers of performance and provide an update to industry assets under management (AUM) and flows for the past quarter and year.

Target Risk Performance Summary

On average, target risk funds posted positive returns in the third quarter—the average target risk fund gained 4.7%. For the 12-month period ending September 30, 2013, the average target risk fund posted even stronger performance, generating a return of 11.1%. During the quarter, returns were boosted by both equities and bonds as a large majority of asset classes commonly used in target risk programs were positive. Over the last 12 months, aggregate domestic fixed income securities (as measured by the Barclays U.S. Aggregate Index) are still negative, declining 1.7%.

Table 1: Target Risk Performance Summary

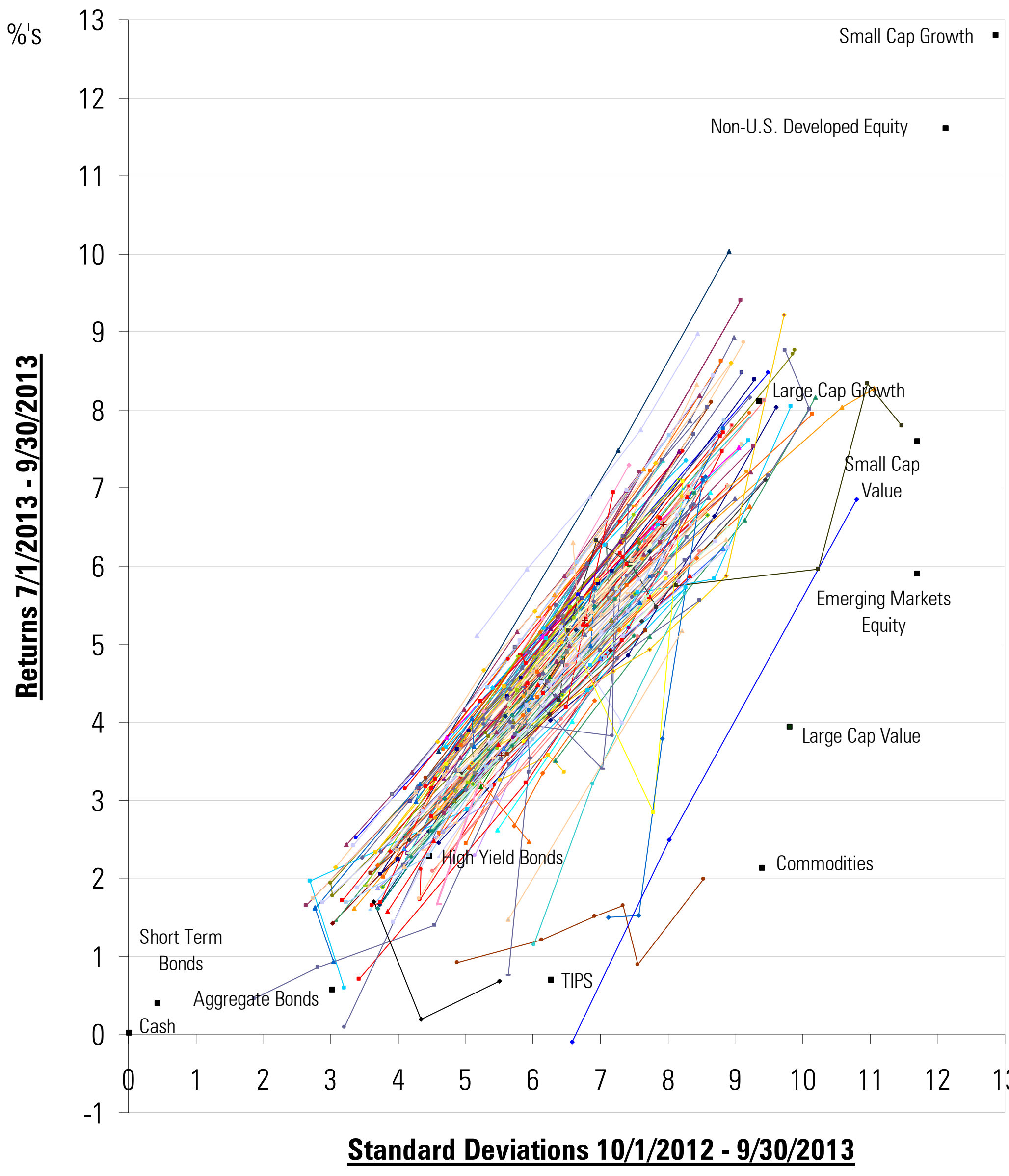
	Q3 Return	12-Month Return
Average Target Risk Fund*	4.7%	11.1%
Morningstar Aggressive Target Risk Index	7.1%	18.8%
Morningstar Moderately Aggressive Target Risk Index	6.0%	15.4%
Morningstar Moderate Target Risk Index	4.5%	10.7%
Morningstar Moderately Conservative Target Risk Index	3.2%	6.5%
Morningstar Conservative Target Risk Index	1.7%	2.0%
S&P 500 Index	5.2%	19.3%
MSCI EAFE GR USD	11.6%	24.3%
Barclays U.S. Aggregate Bond Index	0.6%	-1.7%

Source: Ibbotson Associates and Morningstar Direct[SM] (see end for important disclosures)
*Average of all Open-end and Insurance Product target risk funds that are tracked by Morningstar
Indexes shown are not available for direct investment. Past Performance is not a guarantee of future performance.

Fund Family Performance

The performance of target risk fund lineups during the quarter is summarized in Figure 1. We are now tracking 536 unique target risk funds with at least a one-year track record that are managed by 81 fund companies. The lines in the graph connect funds from the same fund lineup. Third quarter net returns are plotted on the vertical axis and 12-month standard deviations are on the horizontal axis. As a group, returns for these funds were higher than their long run quarterly averages and we see a traditional upward sloping trend as riskier funds were rewarded with higher returns. Funds that allocated heavily to small growth and non-U.S. developed equities were rewarded with higher returns, as those asset classes had relatively high returns this quarter. We can imagine that results for these funds are "reaching" for the small growth and non-U.S. developed equity dots on the upper right part of the chart. Funds with large U.S. REIT, long term government bond, and preferred stocks allocations have lower lines on our chart this quarter, as those asset classes had negative returns.

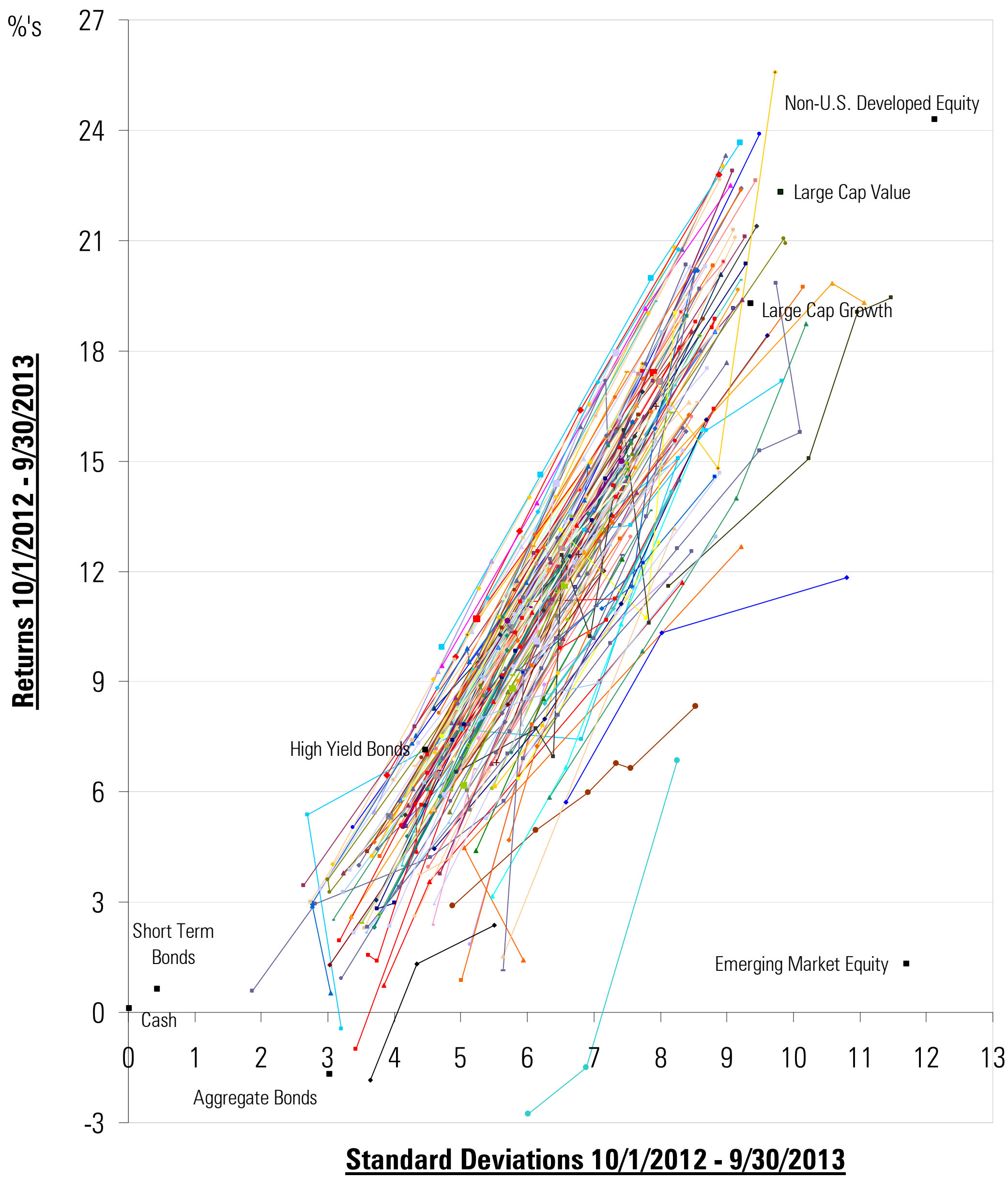
Figure 1: Target Risk Fund Lineup Performance – Q3 Return and One-Year Risk Ending 9/30/2013



Source: Ibbotson Associates and Morningstar Direct[SM] (see end for important disclosures)

The same risk/return information over the past 12 months is displayed in Figure 2. Here we see a steeply upward-sloping trend, as results have been strongly influenced by returns of over 20% for many U.S. equity asset classes. In our view, Great West (red diamonds) and MainStay / New York Life (light blue squares) had good performance and risk results that landed their lines in the upper left side of the cluster. During the quarter, MainStay's funds had relatively low durations, low emerging markets equity exposure and above average high yield bond exposure that helped relative performance. Great West's funds had higher than average mid and small cap equity holdings, low emerging markets equity exposure and good underlying manager performance that boosted returns. At the bottom right are Nuveen's Intelligent Risk series (light blue circles) and the Forward Funds (brown circles). The Nuveen funds had above average durations and exposure to commodities. Forward Funds had larger than average emerging markets equity and commodity exposure – traits that put a drag on performance over the last year. The five Morningstar Target Risk Indexes are difficult to pick out, but plot in the center of the cluster in a red line.

Figure 2: Target Risk Fund Lineup Performance – 12-Month Return and One-Year Risk Ending 9/30/2013



Source: Ibbotson Associates and Morningstar Direct℠ (see end for important disclosures)

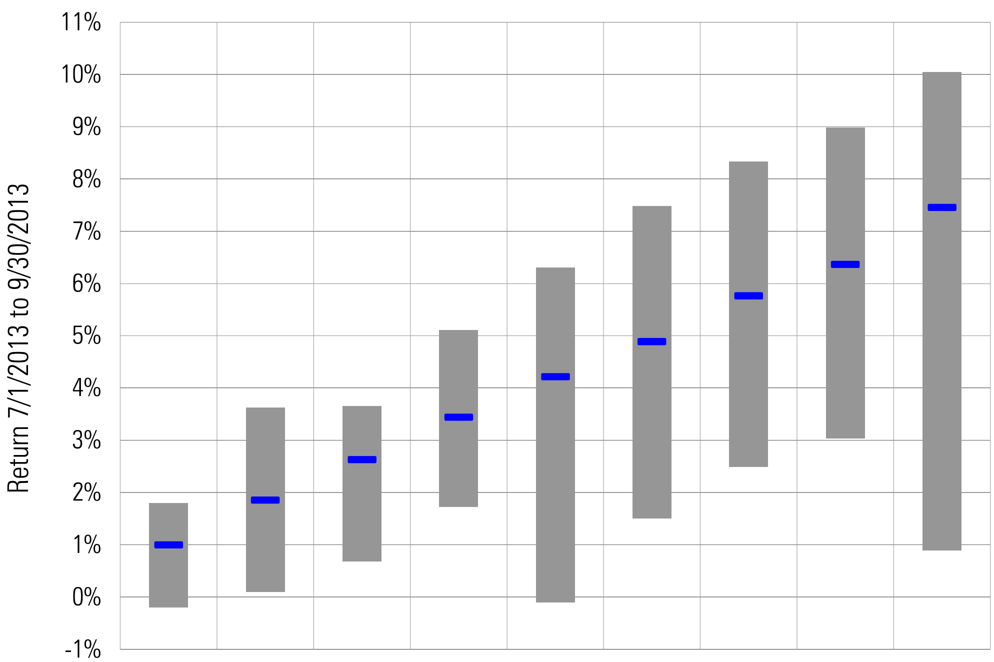
Target Risk Fund Performance

The majority of the target risk funds covered in this report are assigned to one of four Morningstar Categories:

- U.S. Conservative Allocation - 10 to 50% equity
- U.S. Moderate Allocation - 50 to 70% equity
- U.S. Aggressive Allocation - 70 to 90% equity
- U.S. Large Blend - 90 to 100% equity

For the purpose of this report, we are subdividing these broad categories into more granular, 10 percent range groups (i.e. 15 to 24.9% equity). We used average recent historical equity exposure information from Morningstar Direct to make these assignments (for funds with high "Other" exposure and for very young funds, we used a multi-factor daily return regression analysis). This will allow us to make more specific statements about each peer group. Figure 3 offers performance data relative to each fund's equity group. The floating gray bars within the chart show the range of quarterly returns for our nine peer groups. The blue line within each bar identifies the average fund performance for that group. Meaningful differences can be observed between the best-performing funds ("Max" row within the table below) and the worst-performing funds ("Min" row within the table below) in each group, reflecting "intra-category" differences in equity levels, granular asset class differences, and underlying security and/or fund exposures.

Figure 3: Target Risk Peer Group Performance Q3 2013



Category	Under 15 Equity %	15 to 24.9 Equity %	25 to 34.9 Equity %	35 to 44.9 Equity %	45 to 54.9 Equity %	55 to 64.9 Equity %	65 to 74.9 Equity %	75 to 84.9 Equity %	85 to 100 Equity %
Max	1.8%	3.6%	3.6%	5.1%	6.3%	7.5%	8.3%	9.0%	10.0%
Average	1.0%	1.9%	2.6%	3.4%	4.2%	4.9%	5.8%	6.4%	7.5%
Min	-0.2%	0.1%	0.7%	1.7%	-0.1%	1.5%	2.5%	3.0%	0.9%
# of Funds (vs Group Avg)									
Outperformers	8	22	26	32	36	50	44	37	38
Underperformers	9	19	31	39	37	42	34	33	29
Total	17	41	57	71	73	92	78	70	67

Source: Ibbotson Associates and Morningstar, Inc. (see end for important disclosures)

Asset Class Performance

Quarterly performance for some of the most common asset classes that comprise target risk funds are displayed in Table 2. This data allows us to determine which asset classes were the primary drivers and detractors from performance during the third quarter.

Table 2: Asset Class Performance – Q3 2013

Asset Class	Q3 2013 Return	12-Month Standard Deviation
U.S. Large Growth Equity	8.1%	9.4%
U.S. Large Value Equity	3.9%	9.8%
U.S. Small Growth Equity	12.8%	12.9%
U.S. Small Value Equity	7.6%	11.7%
Non-U.S. Developed Equity	11.6%	12.1%
Emerging Market Equity	5.9%	11.7%
Real Estate	-2.6%	13.6%
Commodities (Futures)	2.1%	9.4%
High-Yield Bonds	2.3%	4.5%
U.S. Aggregate Bonds	0.6%	3.0%
U.S. Short-Term Bonds	0.4%	0.4%
TIPS	0.7%	6.3%
Cash	0.0%	0.0%

Source: Ibbotson Associates and Morningstar Direct[SM]
Indexes shown are not available for direct investment. Past Performance is not a guarantee of future performance.

Global equity markets, excluding domestic REITs, generated positive returns during the third quarter. Aside from large cap growth stocks in Q4 2012, domestic equity markets have now seen gains in each of the past five quarters. Further, the S&P 500 has now posted gains in 15 of the last 20 months. Non-U.S. equities bounced back from a recent tough stretch with a very solid quarter. During the most recent period, emerging markets was the highest-performing asset class that we typically see included in target risk programs, returning 11.6%. Within the United States, growth stocks outperformed value stocks, while investors realized a premium from smaller capitalization companies. Commodities recovered with a positive quarter; however, the asset class continued to lag longer-term.

Fixed income securities returned to positive territory in the third quarter. The Federal Reserve surprised markets by continuing its bond purchase program with no taper. Intra-quarter yields on 10-year government bonds had risen to 2.98%; however following the Federal Reserve decision, rates fell to 2.64% by the end of September. High yield bonds, as measured by the Barclays U.S. Corporate High Yield Index, returned 2.3% for the quarter, while cash continued to provide investors with little return.

Similar to Table 2, asset class returns and standard deviations for the past 12 months are displayed in Table 3.

Table 3: Asset Class Performance – 9/30/2013 Trailing 12 Months

Asset Class	12-Month Return	12-Month Standard Deviation
U.S. Large Growth Equity	19.3%	9.4%
U.S. Large Value Equity	22.3%	9.8%
U.S. Small Growth Equity	33.1%	12.9%
U.S. Small Value Equity	27.0%	11.7%
Non-U.S. Developed Equity	24.3%	12.1%
Emerging Market Equity	1.3%	11.7%
Real Estate	6.2%	13.6%
Commodities (Futures)	-14.3%	9.4%
High-Yield Bonds	7.1%	4.5%
U.S. Aggregate Bonds	-1.7%	3.0%
U.S. Short-Term Bonds	0.6%	0.4%
TIPS	-6.1%	6.3%
Cash	0.1%	0.0%

Source: Ibbotson Associates and Morningstar Direct SM
Indexes shown are not available for direct investment. Past Performance is not a guarantee of future performance.

Equities continued to look strong over the prior year, with returns ranging from 1.3% up to 33.1% in the list of stock benchmarks included above. Developed international equities outperformed U.S. large cap equities, while smaller cap equities were the highest performing developed equity asset classes. Emerging market equities were at the low end of the equity spectrum, posting the lowest return among commonly used asset classes. REITs have contributed positive results on an absolute basis, but they have underperformed many equity asset classes on a relative basis. Target risk funds that allocated heavily to REITs and emerging market equities over the past year have no doubt been hurt by their performance. Commodities have produced negative returns for three of the last four quarters and have been far and away the worst-performing asset class that we monitor. The inclusion of commodities over the past year not only detracted value on a relative basis, but also on an absolute basis.

Fixed income returns remained mixed over the past year. High yield bonds have had a remarkable run, posting positive returns in seven of the last eight quarters, benefitting target risk funds with overall lower credit quality. A very poor second quarter this year led to TIPS posting a negative one-year return. Rates on 10-year government bonds rose a full percent over the past year, which has weighed heavily on aggregate bonds as a whole. As a result, shorter duration securities have outperformed longer duration bonds generally resulting in a benefit to target risk funds with a lower than average duration.

Fund Flows

During the third quarter, inflows were positive overall with $3.9 billion entering target risk funds. However, funds with more conservative positioning saw outflows. Funds that held less than 35% equity saw $2.6 billion in outflows during the quarter as investors shied away from fixed income asset classes that have struggled over the past year. Lincoln National, Transamerica, and Advanced Series Trust were the firms with the largest inflows, all exceeding $830 million for the quarter. John Hancock had the largest outflow, shedding $1.1 billion.

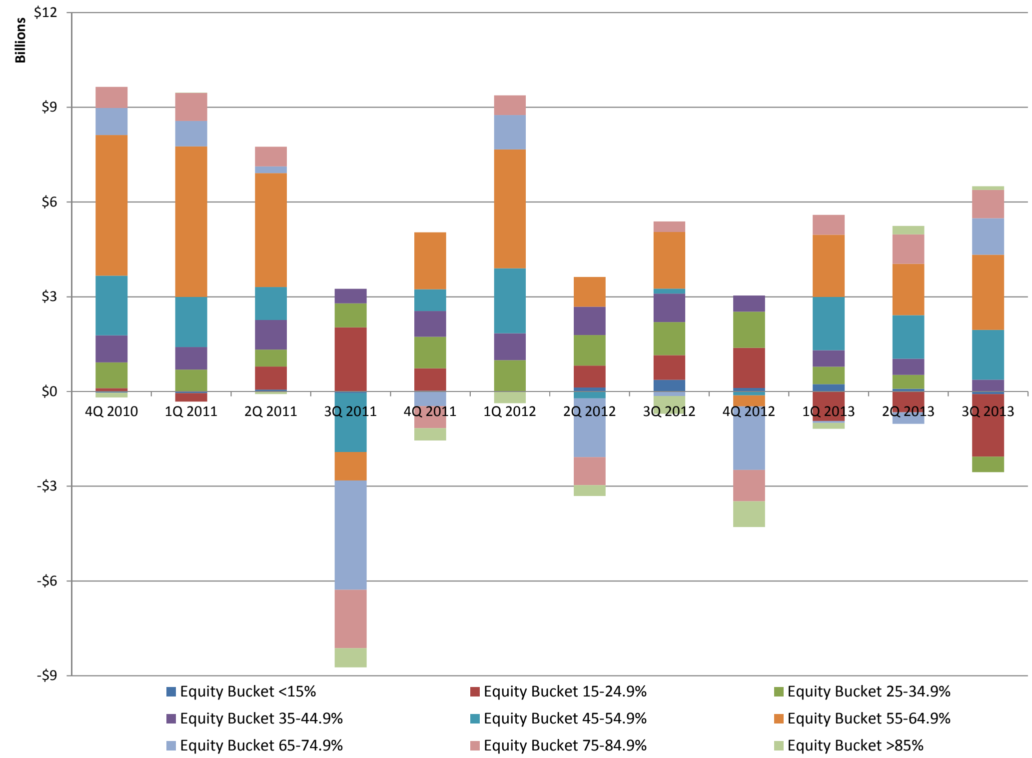
As of the end of Q3, total assets in target risk funds were up over 14% from a year ago and 55% over the past three years. Variable annuity ("VA") programs account for a majority of registered target risk assets, representing 61% of the overall AUM in the target risk products we are tracking. For the quarter, VA programs grew by $3.4 billion while the remaining $0.5 billion flowed into open-end retail portfolios. Outflows aside, John Hancock continues to be the largest fund family in terms of total AUM, accounting for approximately 11% of total assets ($75 billion); however, Columbia, Advanced Series Trust, Pacific Life, and Met Life all have over $40 billion in assets.

Table 4: Target Risk Fund Flows Q3 2013

	Asset Under Management ($Mil)		**Estimated Net Flow ($Mil)**	
Peer Group Equity Range	End Q2 2013	End Q3 2013	Q2 2013	Q3 2013
< 15%	8,269	8,313	89	-82
15%-24.9%	31,805	31,582	-659	-1,977
25%-34.9%	39,220	39,801	436	-497
35%-44.9%	59,056	61,367	513	372
45%-54.9%	137,109	144,928	1,378	1,575
55%-64.9%	155,310	164,601	1,624	2,379
65%-74.9%	105,205	112,754	-365	1,161
75%-84.9%	70,689	75,387	938	896
85%-100%	34,380	37,062	282	89
Total	**641,038**	**675,795**	**4,235**	**3,917**

Source: Morningstar Direct[SM]

Figure 4: Quarterly Estimated Net Flows by Peer Group as of 9/30/13



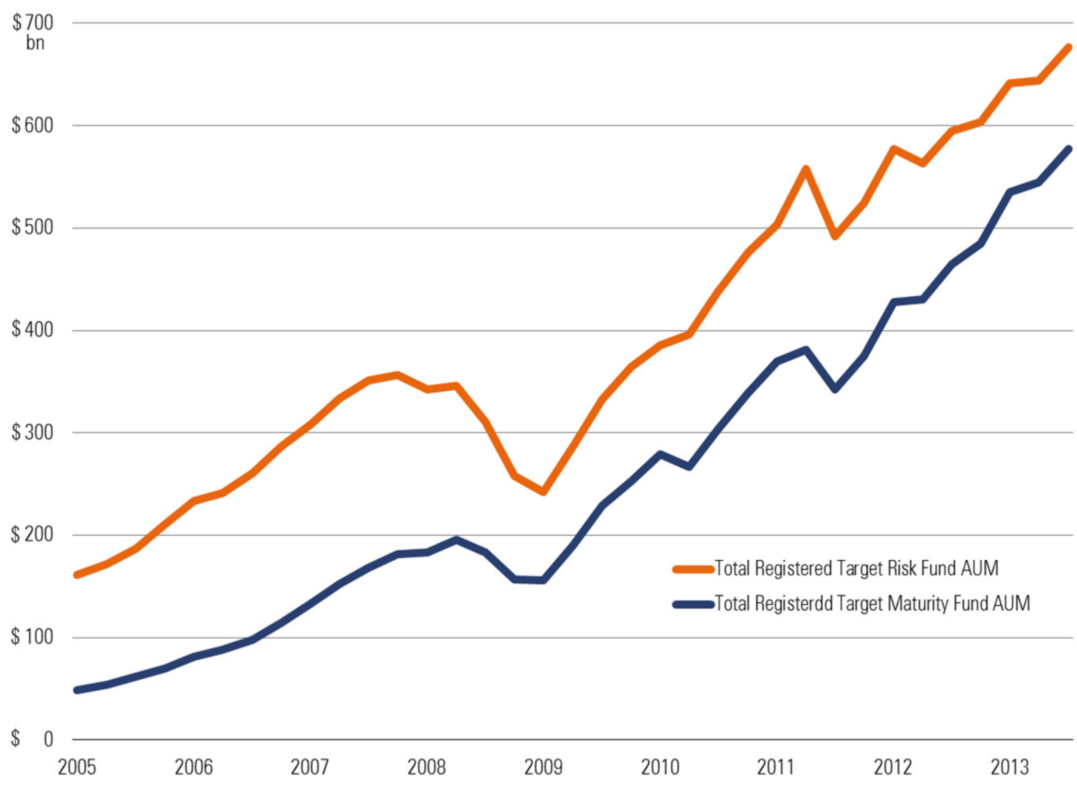
Source: Morningstar Direct[SM]

Spotlight – Target Risk vs Target Maturity

Target maturity funds are very similar to target risk funds, but offer a twist in their moving stock–bond glidepath that generally ratchets down each year as workers approach retirement. These funds have been receiving a lot of press in the last few years as they have become more popular, particularly as a defined contribution fund option. Our firm produces a sister publication to this report that covers target maturity lineups with 408 individual registered funds offered by 46 firms at the end of 2Q.

Based on the large amount of recent press on target maturity funds (good and bad), many people assume that registered target maturity funds have surpassed target risk funds in size, but this is not the case. The chart below shows the size in total assets under management (AUM) for registered funds of each type. It is surprising to see how both product types are highly correlated in the direction and magnitude of their size changes each quarter. Both asset flows and market performance affect AUM, and while target maturity funds have had larger contributions in the last few years, overall flows and performance typically move in the same direction each quarter for both products.

It should be noted that both product types have unregistered counterparts with significant assets that are not included in this report. Many plan sponsors offer unregistered target maturity collective investment trusts (CITs) and many broker-dealers offer unregistered target risk wrap model lineups.



Source: Ibbotson Associates and Morningstar Direct[SM]

Funds Included In This Report

The table below contains a list of the firms that offer the target risk funds that were included in this report. We list the fund count and the most recent AUM reported by Morningstar Direct.

Table 5: Target Risk Firms, Fund Count and AUM by Channel

Firm Name	Total AUM ($ Mil)	Ins Prod Count	Ins Prod AUM	Open End Count	Open End AUM
John Hancock	74,706	9	33,938	5	40,768
Columbia	55,404	8	49,811	5	5,592
Advanced Series Trust	46,461	8	46,461		
Pacific Life	44,262	8	40,542	5	3,720
MetLife	42,498	11	42,498		
AXA Equitable	36,937	14	36,937		
Fidelity Investments	33,696	8	14,504	7	19,192
Vanguard	31,053	2	204	4	30,849
Transamerica	30,209	20	20,444	17	9,765
Jackson National	27,311	14	27,311		
Nationwide	22,670	23	22,670		
Thrivent	18,956	4	14,384	4	4,571
Lincoln National	15,365	12	15,365		
T. Rowe Price	14,724			5	14,724
Principal Funds	14,172	5	1,904	5	12,269
MFS	13,315			4	13,315
JPMorgan	12,392			4	12,392
ING	10,874	8	10,557	5	317
Russell	9,396	5	611	5	8,785
Allianz Life	9,201	12	9,201		
American Century	6,794			8	6,794
Franklin Templeton	5,556			3	5,556
Manning & Napier	5,553			4	5,553
MassMutual	5,439	5	4,420	4	1,018
MainStay	5,402	4	3,699	4	1,703
Lord Abbett	4,206			5	4,206
Dimensional Fund Adv	5,215			3	5,215
Vantagepoint Funds	5,197			4	5,197
OppenheimerFunds	5,037			4	5,037
GuideStone Funds	4,223			8	4,223
Sun Life of Canada	3,638	3	3,638		
USAA	3,595			6	3,595
Putnam	3,551			3	3,551
Wells Fargo Adv	3,549			8	3,549
AllianceBernstein	3,458			5	3,458
Great-West Funds	2,998	5	496	5	2,502
Goldman Sachs	2,786			4	2,786
Ivy VIP Funds	2,393	8	2,393		
Invesco	2,352			3	2,352
TOPS	2,247	5	14	3	2,233
Schwab Funds	2,023	3	123	4	1,899
Curian Series Trust	1,923	18	1,923		
Hartford Mutual Funds	1,922			3	1,922
Legg Mason	1,920	3	299	4	1,622
American Gen Life	1,920	8	1,920		
AdvisorOne Funds	1,809			9	1,809
GuidePath	1,796			7	1,796
SEI	1,536			12	1,536
VALIC	1,326	3	1,326		
Pioneer Investments	1,039	2	417	4	622
Janus	837			3	837
ALPS	805	5	610	4	195
Ultra	795	3	795		
Penn	781	5	781		
Nuveen	769			7	769
Stadion Funds	735			4	735
Prudential Investments	633			4	633
Delaware Investments	582			3	582
Mutual of America	576	3	576		
Fund X	507			4	507
Touchstone	492	4	92	4	400
Calvert Investments	382	3	30	3	352
New Covenant	366			2	366
Waddell & Reed	361			3	361
Flex-funds	341			4	341
BlackRock	322			4	322
RidgeWorth	307			4	307
Madison Funds	264			3	264
Compass EMP	249			3	249
Allianz Funds	245			3	245
TIAA-CREF	192			5	192
New Century Portfolios	180			2	180
Forward Funds	167			6	167
Timothy Plan	158	2	61	2	97
Wilmington Funds	146			3	146
HSBC	132			4	132
Dreyfus	113			3	113
MMA Praxis	111			3	111
Sterling Capital Funds	80			3	80
Strategic Income Mgmt	49			2	49
Huntington	42			3	42
Pax World	40			3	40
Pathway Advisors	35			3	35
Totals		263	410,954	306	264,842

Source: Ibbotson Associates and Morningstar, Inc. (see end for important disclosures)

About Ibbotson

Ibbotson Associates is part of the Morningstar Investment Management division of Morningstar and is a leading independent provider of asset allocation, manager selection, and portfolio construction services. The company leverages its innovative and ground-breaking academic research to create customized investment advisory solutions that help investors meet their goals. Founded by Professor Roger Ibbotson in 1977, Ibbotson Associates is a registered investment advisor and a wholly owned subsidiary of Morningstar, Inc.

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Important Disclosures

Unless specifically noted, the performance data shown are net of administrative, management, and other on-going fees, but do not account for sales or transaction charges. Results for the oldest share class were presented for each fund. Returns may be substantially less from the returns shown. The performance data shown represents past performance. Past performance does not guarantee future results. The above commentary is for informational purposes only and should not be viewed as an offer to buy or sell a particular security. The data and/or information noted are from what we believe to be reliable sources, however Ibbotson has no control over the means or methods used to collect the data/information and therefore cannot guarantee their accuracy or completeness. The opinions and estimates noted herein are accurate as of a certain date and are subject to change. The indices referenced are unmanaged and cannot be invested in directly. Ibbotson Associates subadvises and consults on a number of the funds that are included in this report.

This commentary may contain forward-looking statements, which reflect our current expectations or forecasts of future events. Forward-looking statements are inherently subject to, among other things, risks, uncertainties and assumptions which could cause actual events, results, performance or prospects to differ materiality from those expressed in, or implied by, these forward-looking statements. The forward-looking information contained in this commentary is as of the date of this report and subject to change. There should not be an expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.

Appendix: Index Definition

Morningstar Target Risk Indexes are a family of multi-asset class target risk indices. There are five risk levels ranging from 20% Equity to 95% Equity. The risk levels and strategic asset allocations of the indices are based on Ibbotson's Lifetime Asset Allocation methodology. Security selection for each sub-asset class in the index family is provided by a matching Morningstar market index.

Standard & Poor's 500 Index: Market-capitalization-weighted index of 500 widely held stocks. Member companies are chosen based on market size, liquidity, and industry group representation. Included are the stocks of industrial, financial, utility, and transportation companies.

Barclays Capital U.S. Aggregate Bond Index – Broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS.

BofA Merrill Lynch U.S. 3-Month Treasury Bill - Comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month that issue is sold and rolled into a newly selected issue. The issue selected at each month-end rebalancing is the outstanding Treasury Bill that matures closest to, but not beyond, three months from the rebalancing date. To qualify for selection, an issue must have settled on or before the month-end rebalancing date. While the index will often hold the Treasury Bill issued at the most recent 3-month auction, it is also possible for a seasoned 6-month Bill to be selected.

Barclays Capital Global Inflation Linked U.S. TIPS Index – Includes securities which offer the potential for protection against inflation as their cash flows are linked to an underlying inflation index. The index represents a standalone multi-currency index exposed to the real yield curve for each relevant currency.

Barclays Capital U.S. 1-3 Year Government/Credit Bond Index – An unmanaged market value weighted performance benchmark for government and corporate fixed-rate debt issues with maturities between one and three years.

Barclays Capital U.S. Corporate High Yield Index – Covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

DJ-UBS Commodity Index – A broadly diversified index composed of futures contracts on physical commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME).

FTSE NAREIT Equity REITs Index – Spans the commercial real estate space across the U.S. economy. The index series provides investors with exposure to all investment and property sectors.

MSCI EAFE Index – Measures international performance and comprises 21 MSCI country indices, representing the developed markets outside of North America: Europe, Australia and the Far East.

MSCI Emerging Markets Index – A market capitalization weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin.

Russell 1000 Growth Index – Measures the performance of the 1,000 largest companies in the Russell 3000 Index, with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index – Measures the performance of the 1,000 largest companies in the Russell 3000 Index with lower price-to-book ratios and lower forecasted growth values.

Russell 2000 Growth Index – Measures the performance of the 2,000 smallest companies in the Russell 3000 Index with higher price-to-book ratios and higher forecasted growth values.

Russell 2000 Value Index – Measures the performance of the 2,000 smallest companies in the Russell 3000 Index with lower price-to-book ratios and lower forecasted growth values.