

Morningstar Target Date Series Research Report 2011

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Background and Scope of Study

- ▶ Study published annually
- ▶ Broad perspective on key trends and data of target-date industry
- ▶ Captures full target-date universe, not just rated series
- ▶ Includes recurring datapoints and annual special topics
- ▶ Data drawn from Morningstar Direct and custom data studies

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Organization of Study

- ▶ Introduction examines industry flow patterns, based on Morningstar Direct Fund Flows
- ▶ Remainder follows Morningstar's five "P's"
 - ▶ Process (glide path)
 - ▶ Performance
 - ▶ Price
 - ▶ People
 - ▶ Parent
- ▶ The "P's" form basis of Morningstar Target Date Ratings, but used more broadly for the study



Trends in Target-Date Flows

- ▶ Target-date funds continue to attract strong flows relative to other mutual-fund categories
- ▶ Pace has slowed from previous years
- ▶ Decline in assets held in Direct distribution channels
- ▶ Big Three continue to dominate market share; organic growth slows
- ▶ Role of collective trusts a question mark



Target-Date Fund Growth Strong But Leveling

Annual Target-Date Fund Flows (\$mil)

	2004	2005	2006	2007	2008	2009	2010
Total Target-Date Fund Flows	14,149	22,114	35,274	58,452	43,071	45,030	47,445
Organic Growth Rate %	825	128	80	76	33	39	22



Inflow Rate Surpasses Comparable Fund Categories

Net Flows and Organic Growth Rate by Broad Asset Class, 2009-2010

US Broad Asset Class	Estimated Net Flow \$ 2009	Organic Growth Rate % 2009	Estimated Net Flow \$ 2010	Organic Growth Rate % 2010
Alternative	14,981,634,253	36.50	22,882,689,527	35.16
Balanced	271,451,749	0.05	12,418,861,488	1.84
Commodities	10,212,431,942	124.48	12,628,271,392	54.79
International Stock	22,944,555,636	2.80	42,406,536,672	3.67
Municipal Bond	72,772,682,063	21.95	12,042,550,986	2.63
Taxable Bond	290,417,135,355	27.54	216,651,244,566	14.22
U.S. Stock	(23,768,411,227)	(1.05)	(75,140,990,463)	(2.50)



Largest Families Maintain Dominance...

Market Share % for Largest Target-Date Series as of 12/31/10

	2007 Market Share %	2008 Market Share %	2009 Market Share %	2010 Market Share %
Fidelity Investments	48.06	43.01	38.83	36.52
Vanguard	17.40	21.24	22.12	23.27
T. Rowe Price	16.36	15.82	16.46	16.31
Principal Funds	6.01	5.87	5.60	5.03
Wells Fargo Advantage	1.27	1.47	2.36	2.68
American Funds	0.86	1.93	2.44	2.61
TIAA-CREF	0.80	1.19	1.59	1.99



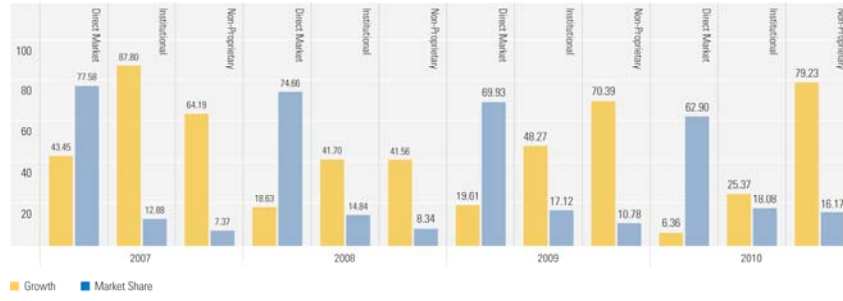
...But Some Competing Series Are Growing Quickly

Estimated Net Flows and Organic Growth Rates 2009-2010, Selected Fund Families

	2009 Est Net Flow (mil \$)	2009 Organic Growth Rate %	2010 Est Net Flow (mil \$)	2010 Organic Growth Rate %
JPMorgan	342.5	36.4	1,282	78.9
USAA	533.2	310.7	739.6	87.5
Maxim	161	--	904.7	549.2
Russell	216.3	71.1	165.57	25.7
Hartford	38.6	45.4	163.2	102.9



Growth Rates and Market Shares by Distribution Channel



Data as of 12/31/10. Source: Morningstar, Inc.

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Inflows Continue After the Retirement Date

Fund Flows for 2005 Target-Date Funds

Year	Total Net Assets \$	Estimated Net Flow \$	Organic Growth %
2004	673,384,129	592,934,628	1,289
2005	1,581,642,322	854,593,779	127
2006	2,503,414,080	749,069,412	47
2007	3,841,053,590	1,139,147,219	46
2008	3,311,476,295	340,482,809	9
2009	4,262,035,826	289,195,843	9
2010	4,824,472,358	120,009,837	3

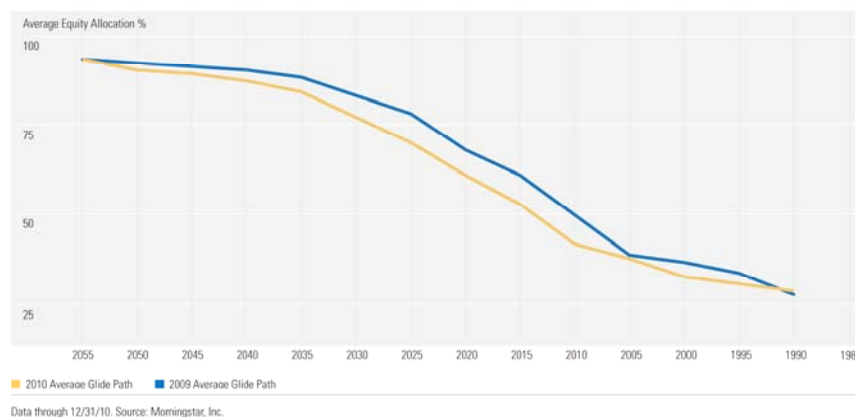
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Process: Providers Tinker with Glide Paths

- ▶ Adding Commodities/Real Assets: T. Rowe Price, Fidelity, Oppenheimer, Principal, and others
- ▶ Reducing equity exposure: Schwab, Oppenheimer, MassMutual
- ▶ Increasing international equity allocations: Vanguard, T. Rowe
- ▶ Volatility-management and tail-risk strategies: Invesco, AllianceBernstein, Legg Mason, PIMCO
- ▶ Adding absolute return: Putnam
- ▶ Moving from “stepped” glide path: ING

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Average Industry Equity Allocation % for 2009 and 2010



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Glide Paths Exhibit Range of Philosophies

Equity Allocation % per Target Year

	Average %	Minimum %	Maximum %	Number of Funds
2055	93	89	99	17
2045	89	38	100	36
2035	84	38	95	36
2025	70	38	86	36
2015	53	20	75	37
2010	42	20	67	38



No Consensus on "To" vs. "Through"

- ▶ Our survey of 41 glide paths found 22 in "through," 18 in "to"
- ▶ "To" glide paths accelerate more rapidly toward landing point
- ▶ Philosophies and glide paths don't always match up
- ▶ Prospectus language is often vague, confusing, or incomplete



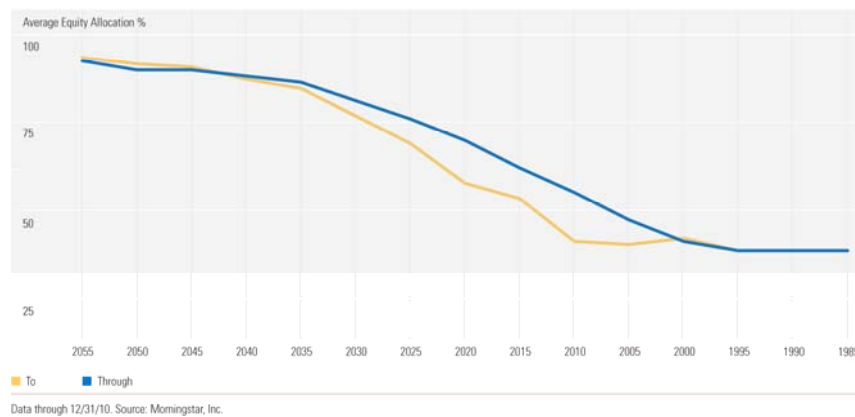
No Consensus on “To” vs. “Through”

Equity Allocations for “To” and “Through” Glide Paths

	2010 Target Allocations			Landing Point Allocations		
	Average %	Minimum %	Maximum %	Average %	Minimum %	Maximum %
“Through” Funds	50	25	67	33	24	50
“To” Funds	29	15	40	NA	NA	NA



Average Equity Allocations for “To” and “Through” Glide Paths



Performance: Range of Returns Narrows in 2010

Morningstar Category	2010 Annual Return %	2009 Annual Return %	2008 Annual Return %
Target Date 2041-2045	14.60	30.88	-38.11
Target Date 2031-2035	14.28	30.06	-37.04
Target Date 2021-2025	13.29	28.32	-34.15
Target Date 2011-2015	11.50	23.55	-27.76
Target Date 2000-2010	10.68	22.42	-22.46

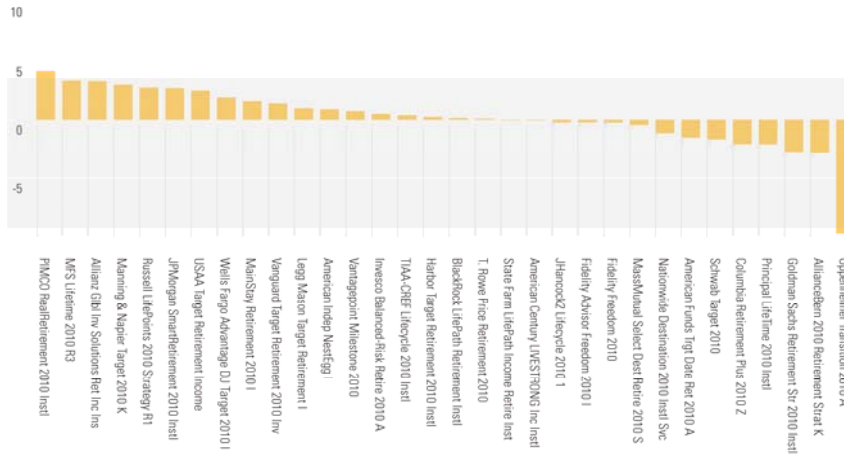
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Performance: 2010 Funds Mount a Comeback

- ▶ 2010 funds disappointed in 2008
 - ▶ High equity allocations (average 54% in Sept. 2007, since declined to 47%)
 - ▶ Exposure to riskier fixed-income sectors
- ▶ From October 9, 2007 through February 17, 2011 average 2010 fund gained 5%
- ▶ More-conservative funds still tend to lead over that period.

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Performance: Morningstar Risk-Adjusted Return



Performance Attribution Provides Another Lens

Series That Added Value Through Selection, 1/1/08 – 12/31/10

	Cost %	Allocation %	Selection %
T. Rowe Price Retirement	0.15	-0.27	1.00
JPMorgan Smart Retirement	0.03	0.63	0.92
Vanguard Target Retirement	0.69	-0.39	0.62
Wells Fargo Advantage DJ Target Date	0.36	0.57	0.60
MFS Lifetime	-0.25	0.33	0.60
Guidestone Funds MyDestination	-0.22	-1.03	0.31



Performance Attribution Provides Another Lens

Series That Detracted Most Value Through Selection, 1/1/08 – 12/31/10

	Cost %	Allocation %	Selection %
Putnam RetirementReady	-0.06	0.38	-1.76
AllianceBernstein Retirement Strat	-0.10	-0.86	-2.00
DWS LifeCompass	-0.10	-0.39	-2.06
Goldman Sachs Retirement Strat	-0.05	-0.15	-3.39
Columbia Retirement Plus	0.06	0.16	-3.62
Oppenheimer LifeCycle	-0.58	-2.19	-4.68



Portfolio: Key Issues

- ▶ Active funds still predominate
 - ▶ More than half of all series have >90% of assets in active strategies
 - ▶ About one-fifth of series have mixed approaches
 - ▶ Fully passive series still in minority, but growing (Fidelity, TIAA-CREF, BlackRock, John Hancock, Maxim)
- ▶ Overall quality of underlying funds solid
 - ▶ Average Morningstar Rating of 3.39 stars
- ▶ Open-architecture strategies remain in minority
 - ▶ But newer open-architecture series gaining traction (Russell, Maxim, Guidestone)



Open-Architecture Series Take Varied Approaches

% of Externally Subadvised Assets in Rated Open-Architecture Series

Wells Fargo Advantage	100
John Hancock Lifecycle	72
ING Solution	64
Principal Lifetime	49
MassMutual Destination Retirement	47
Schwab Target Retirement	14



Portfolio: Alternatives, a Work in Progress

- ▶ Definitions of “alternative” vague and inconsistent
 - ▶ Target-date providers tend to define alternatives more broadly than hedge funds or other asset managers
- ▶ Use of alternatives in target-date funds remains small, but growing
- ▶ Commodities and real assets most notable trend
 - ▶ Oppenheimer, T. Rowe Price, Principal, and Fidelity among those to add commodities/real assets funds
 - ▶ Varied approaches: Futures, stocks, active-allocation
 - ▶ Less common: Market-neutral, absolute-return strategies
- ▶ Most providers have made modest allocations, some have been bolder and more innovative
 - ▶ Examples: Putnam, PIMCO, Invesco



Price: Key Issues

- ▶ Downward pressure on prices continued in 2010, if less acutely
- ▶ New index-only series enter marketplace
- ▶ Firms continue to use mix of active and passive (or enhanced-index) funds
- ▶ Some series gather more assets in lower-cost share classes (TIAA-CREF), cut overlay fees (MFS), or use cheaper underlying share classes (MassMutual, 2011)
- ▶ Influence of cheaper CIT products



Price: Wide Disparity in Costs

Target-Date Series Asset-Weighted Average Expense Ratios, December 2010

	Asset Weighted Expense Ratio %	Total Assets in Millions \$
Vanguard Target Retirement Series	0.18	78,880,347
TIAA-CREF Lifecycle Series	0.66	6,154,645
Fidelity Freedom Series	0.74	88,774,937
T. Rowe Price Retirement	0.78	55,725,536
American Funds Target Date Retirement	1.00	8,915,739
ING Solution Series	1.18	4,098,848
MFS Lifetime Series	1.35	421,204
Oppenheimer LifeCycle Series	1.68	497,290



People: Key Issues

- ▶ Manager tenure expected to keep creeping up as industry matures
- ▶ Named series managers likely to churn underlying holdings



People: Some Managers are Experienced and Likely to Stay

Average Fund Manager Tenure of and Retention Rates

	Average Manager Tenure for underlying target-date holdings (Years)	Firm-wide Manager Retention Rate as of 12-30-2010 (5-Yr Avg %)
Wells Fargo Advantage	15.80	89.37
American Funds Target Date	11.88	98.00
Vanguard Target Retirement	9.53	91.72
AllianceBernstein Retirement	9.12	86.31
T. Rowe Price Retirement	7.84	94.08
Schwab Target Series	5.37	88.16
JPMorgan SmartRetirement	5.16	90.22
Putnam RetirementReady	3.97	82.52
American Century LIVESTRONG	3.84	86.49
Fidelity Freedom	3.43	88.77
DWS	3.37	80.01



People: Managers Frequently Change Underlying Assets

Distinct Underlying Fund Assets Added and Subtracted from Series Over Past 3 Years

	Underlying Fund Assets Added to Series over past 3 years %	Underlying Fund Assets Subtracted from Series over past 3 years %	Total Change in Underlying Fund Assets %
Invesco Balanced-Risk Retirement	52.69	42.68	95.37
PIMCO RealRetirement	34.66	20.54	55.20
Vanguard Target Retirement	14.03	20.25	34.28
JPMorgan SmartRetirement	16.40	17.61	34.00
Fidelity Freedom	11.98	9.23	21.21
T. Rowe Price Retirement	11.01	3.02	14.03
Industry Average	13.66	9.52	23.18



Parent: Key Issues

- ▶ March 2011 Morningstar Stewardship Study shows investor-focused funds are likely to deliver good outcomes for fund shareholders.
- ▶ Target-date disclosure continues to improve, but shortfalls remain.



Parent: Partner with Good Stewards

Fund Series	Corporate Culture Grade	Board Highly Independent	Board Invests Meaningfully in Fund Shares	Board Serves Shareholders Well
AllianceBernstein	D	Yes	Yes	Partial Credit
American Funds	A	Yes	No	Partial Credit
Fidelity Freedom	C	No	Yes	Partial Credit
JPMorgan	B	Yes	Yes	Partial Credit
MFS Lifetime	B	Yes	Yes	Partial Credit
Oppenheimer	C	Yes	Yes	Partial Credit
Putnam	D	Yes	Yes	Partial Credit
T. Rowe Price	A	No	Yes	Full Credit
Vanguard	A	No	Yes	Full Credit
Wells Fargo	C	Yes	No	Partial Credit



Parent: Good Stewardship Leads to Good Shareholder Experiences

3-Year Morningstar Success Ratios by 2007 Corporate Culture, Board Quality and Overall Stewardship Grades

Letter Grade in 2007	Corporate Culture, 3-Yr M* Rating Success Ratio	Board Quality, 3-Yr M* Rating Success Ratio	Overall Stewardship, 3-Yr M* Rating Success Ratio
A	87	73	85
B	66	74	84
C	68	65	65
D	56	N/A	54
F	N/A	N/A	52



Parent: Disclosure Improving, but Shortfalls Remain

Target-Date Series Transparency Survey Factors, December 2010

	Series Disclosing Criterion	Series Not Disclosing Criterion
Asset Allocation Illustration	20	1
Withdrawal Intentions	15	6
Shows Credit Quality/Maturity	15	6
Underlying Funds' Performance Relative to Benchmark	14	7
Subasset Classes in the Glide Path	12	9
Investment Rationale for Asset Allocation Path	10	11
Degree of Tactical Allocation	1	20



Overall Ratings, June 2011

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



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