SHOULD YOU BOTHER WITH TARGET DATE FUNDS ANYMORE?

The recent market shock should remind all investors that there's no such thing as a single solution investment product that works for everyone. One particular category of investments that became a target of scorn is target date funds, which are mutual funds with investments tailored to the particular retirement date of the account holder.

According to U.S. News and World Report, funds that were designated for individuals retiring in 2010 lost an average of 25 percent of their value in 2008, obviously rewriting the retirement plans of millions who mainly held these funds in their 401(k) plans. Despite the fact that these supposedly diversified investments are supposed to shift most assets into conservative investments as the individual gets closer to retirement, critics have said managers still keep too much stock in these funds near the end.

Over the decade, money has been gushing into these funds, according to the Investment Company Institute. By year end 2006, this fund category held $114.3 billion in assets, up from $12.3 billion in 2001. By the end of 2008, that number had receded to $109 billion. Why the demand? The whole "check it and forget it" mentality made target funds a natural choice for individuals who didn't want to actively manage their own 401(k) accounts at work. Also, the Pension Protection Act of 2006 gave employers the right to put 401(k) participants in target funds as the "default" choice if the employees don't make their own selection.

Ibbotson Associates reported in July that after an industry average of six quarterly losses, target date funds finally posted a solid gain at the end of the second quarter. So does that mean it's time to go back on autopilot again?

It might be a better idea to take a thorough look at your finances. A visit to a CERTIFIED FINANCIAL PLANNER™ professional should be the first step in determining whether target funds – or other investments – should be part of your retirement rebuilding effort. For instance, some critics say life-expectancy issues are not adequately addressed in target-date plans, and they definitely don't address scenarios in which you plan to work in retirement or spend your assets in unconventional ways. Also, some critics say that many people may underfund such plans without realizing the correct amounts they should invest to meet their goal. A planner's job is to advise individuals on an ongoing basis about meeting such goals.

That said, how should you evaluate a target-date fund? Here are some questions you should ask:

Do you know how much money you'll need to retire? A successful retirement is not all about the retirement date. It's about the quality and activities you'll prefer in retirement and how much it will cost to afford them. It is one thing to invest in a fund that promises consistent growth until a scheduled retirement date, but what if you need more growth? What if there are specific tax and spending issues that might interfere with putting the right amount of money into such funds each year? This is why individual advice makes sense.

What about the target funds your employer has selected? Obviously, most employers want to make the right fund choices for employees, but just because they're offering target funds doesn't mean they're offering the right target funds for you and your needs. Keep in mind that most fund choices offered to companies are heavily marketed and might not be the cheapest or most efficient investment choices out there. Always check the Morningstar rating of any fund your 401(k) invests in. Morningstar is a major ratings agency for mutual funds. It's wise to check the performance of all the funds within your company retirement accounts.

What if you leave your job and take your 401(k) with you? What happens to your targeted investment plan then? You can roll over these assets into another tax-advantaged retirement plan, but what will happen to your annual retirement savings strategy at that point?

What are you paying for a targeted fund? Granted, the investment choices are being made for you, but what are you paying for those choices? Often, these funds are constructed based on a fund-of-funds structure that layers a fee on top of the fees incurred by the individual funds. Always understand the fee structure of any fund you invest in.

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