InvestmentNews

NEWS Mutual Funds

Retirees in target-date funds still recovering from 2022

Morningstar's Target-Date Strategy Landscape report also shows that costs are going down and that CITs are about to surpass mutual funds.

March 26, 2024 *By Emile Hallez*

Target-date funds for people in or near retirement saw their performance rebound last year – but not nearly enough to make up for the losses the products experienced in 2022.

On average, target-date funds with a 2025 vintage saw net returns of 12.8 percent in 2023, compared with -15.2 percent in 2022, according to ***Morningstar's 2024 Target-Date Strategy Landscape*** report published Tuesday. Meanwhile, people far away from their expected retirement who invested in target dates fared better, with average returns of 19.7 percent last year, up from -18.1 percent in 2022.

The findings cast more light on the vulnerability of investors who count on target-date funds as a source of income early in retirement, as sequence-of-returns risk has a much more significant impact on their assets than for people who will remain in the workforce for decades.

In the wake of the 2008 financial crisis, many asset managers made substantial changes to the asset allocation strategies of products, particularly to make them less equities-heavy for near retirees. Since then, some companies have brought equities exposure back up, with the argument that people who will spend many years in retirement need strong returns to make their money last long enough.

Last year, "most [target-date strategies] did not net even, because some of the returns were even lower [in magnitude] than what they lost in 2022," said Megan Pacholok, senior analyst in multi-asset manager research at Morningstar Manager Research. "That is something to be aware of for people near or in retirement. They didn't win back everything they lost in the previous year – but it was movement in a positive direction."

That said, ***2022 was an unusual year,*** with poor performances by both stocks and bonds.

Although asset managers have not made substantial changes to near- or in-retirement vintages of products since then, some have added customized glide paths or guaranteed income components to their series, Pacholok said.

The returns for near-retirement vintages in 2022 could support more interest in annuities, which are increasingly being paired with target dates. There are at least seven such products on the market, with an additional one from BlackRock expected to launch this year, according to the report.

WHERE THE MONEY IS GOING

A theme for years has been the proliferation of ***collective investment trusts,*** which in the target-date world has been fueled by demand from 401(k) fiduciaries for low-cost options.

At the end of last year, assets in ***CIT target-date*** series reached 49 percent of the total ***$3.5 trillion*** in the market, Morningstar found. Those products received two-thirds of the money going into target-date products in 2023 and are expected to surpass their mutual fund counterparts in total assets this year.

"There is such fee pressure in the industry. Everyone is looking for lower-cost options," Pacholok said. "That is really prevalent in target-date funds and CITs."

Morningstar's report covers off-the-shelf products and does not include custom target-date strategies, she noted.

Across products, the average asset-weighted expense ratio dropped from 32 basis points in 2022 to 30 bps last year, according to the report. That's down from 42 bps in 2018.

Competition on cost drove sales to the lowest-fee product lines, with the biggest flows going to Vanguard Target Retirement ($24.5 billion in new sales), American Funds Target Date Retirement ($21.2 billion), BlackRock LifePath Index CIT ($19.7 billion), Vanguard Target Retirement CIT ($19.6 billion), and State Street Target Retirement CIT ($19.5 billion).

Vanguard, with a total of nearly $1.3 trillion in target-date assets, remained the biggest provider, accounting for 37.2 percent of the market. Fidelity, the second biggest, accounted for 14.3 percent, while T. Rowe Price's target-date assets represented 11.3 percent. Behind them were BlackRock (9.6 percent) and American Funds (8.2 percent).
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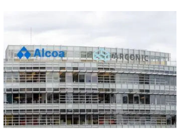

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