PENSION UPDATE

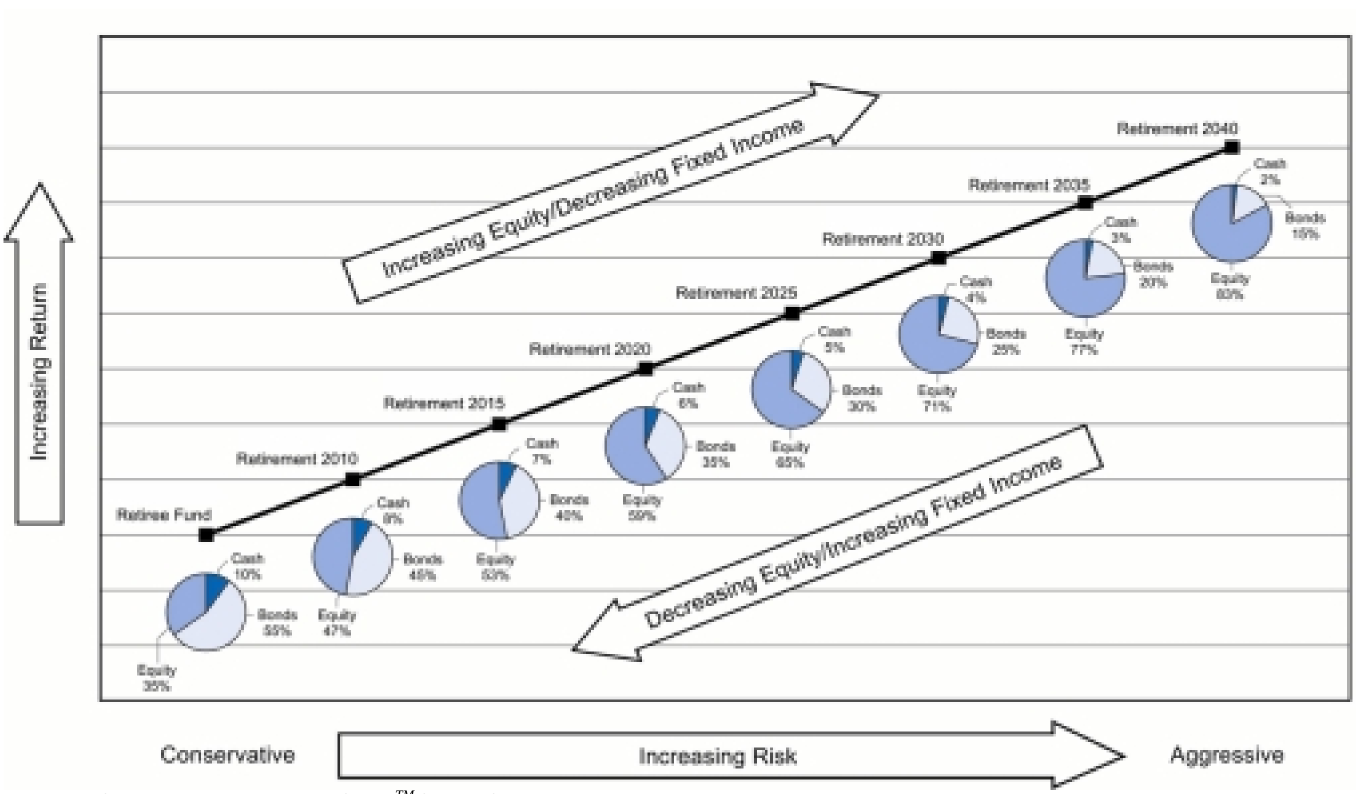
March 2008

Target Date Funds in CAP Plans

The latest addition to the Lifecycle category of investment funds, **Target Date Funds** are a 'one-stop' diversified investment product designed to make saving for retirement easier. Target Date Funds go beyond the traditional balanced fund and use a multi-asset class approach that adjusts the asset mix according to the plan member's investment time horizon or 'target date'.

General investment theory and historical experience teach us that the longer an individual's investment time horizon, the more 'risk' they can carry in their investments because short-term volatility is mitigated over time. Looking at the recent market experience, equity markets have been bouncing up and down with swings occurring almost daily. This is referred to as *volatility*. However, over time, this volatility – *risk* – smoothes out and equity markets tend to increase. The key here is having a long enough time horizon to be able to 'ride it out'. In fact, a full market cycle from top to bottom back to top again may take up to 10 years.

When a member is still 25 years away from retirement and not needing the funds, they can afford more exposure to riskier investments such as equities (versus



**Adapted from the McLean Budden LifePlan™ family of Target Date Funds.*

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bonds) because they have plenty of time to ride out the ups and downs. As a member approaches retirement however, they tend to require more safety in their investments to ensure the funds will be available when they need them. This safety is achieved by increasing the amount of fixed income (i.e. bonds) exposure while starting to decrease the amount in equities. Until recently, a member would have to monitor this exposure themselves and adjust their portfolio as necessary (or with the advice of an advisor). With the introduction of Target Date funds, the member no longer needs to worry about this adjustment.

With a Target Date Fund, the investor chooses the fund with a 'target date' closest to their retirement (or other stated goal). For example, a member aged 40 would select the 2030 or 2035 fund as the best match for a typical retirement at age 65. As time progresses, the fund automatically adjusts the asset mix, making it more conservative by increasing less risky (but lower yielding) fixed income for higher risk (but higher return potential) equities.

So, why Target Date Funds? Studies have shown that most investors are fairly passive and, while intentions may be good, often fall victim to setting up their initial investments and rarely revisiting them. Over time, the portfolio can gradually drift away from the intended mix and leave a member with either far more risk than initially intended or far lower returns due to lack of equity exposure. A Target Date fund provides a member with a fully diversified single investment option that dynamically adjusts the asset mix over time without any action from the member. This means a member can have minimal involvement besides periodic performance monitoring. The asset mix is adjusted and managed by investment experts in order to meet the fund's objectives. Some Target Date funds offer the member the ability to choose a fund that not only matches the member's time horizon, but incorporates the individual member's risk tolerance (i.e. conservative to aggressive). As well, some incorporate a multi-manager 'fund-of funds' approach or provide guarantees to protect growth at maturity.

Target Date funds can be an effective and simple tool in a retirement program that helps both the plan sponsor and plan member meet their goals. However, they are not always appropriate for every situation. Because members have traditionally been told to diversify their investments, there is normally a hesitancy to put all their investments into one fund. A well-designed communication strategy to introduce them, along with proper education can show members that the purpose of Target Date funds is to ensure that professionally managed diversification takes place *within* the fund and adjusts automatically over time.

To find out if Target Date funds are appropriate in your plan, contact Proteus.

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