

# Four Components for Plan Sponsors to Consider When Evaluating Your DC Plan's Target Date Funds

Plan sponsors often find the target date fund (TDF) selection process understandably daunting. Evaluating TDFs is a multi-faceted process that requires a deep dive into the four components of TDF design — **glide path design, asset allocation, selecting underlying managers, and portfolio construction.**

## 1. Glide Path Design

The most important factor in the lifecycle of TDFs is the design of its glide path. Each target date manager uses their own unique approach to glide path design, which results in a wide variety of equity allocations across the industry.

Glide path design should seek to avoid “sequence of return” risk (the risk of selling during or immediately following periods of poor performance) as participants enter retirement. Retirees are particularly vulnerable to this risk, due to lack of employment income, the need to make withdrawals, and the length of time that their retirement savings must support them. If the markets suffer a major downturn in the early years of a participant's retirement, it will have a much more drastic effect on their savings than at any other time.

To illustrate this risk, Exhibit 1 shows a hypothetical scenario of three investors who have the same average rate of return throughout retirement but experience a 20% loss at different ages (age 66, 75, and 85). As the exhibit shows, a retiree who experiences a 20% loss at age 66 depletes their assets almost eight years earlier than a retiree who experiences a 20% loss at age 85.

**Exhibit 1. Investment losses have a disproportionately negative impact on younger retirees**

Age	Portfolio Value (\$)	Portfolio Value (\$)	Portfolio Value (\$)
	20% loss at age 66	20% loss at age 75	20% loss at age 85
Retirement Age 65	\$500,00	\$500,00	\$500,00
66	\$380,000	\$491,506	\$491,506
74	\$265,474	\$412,022	\$412,022
75	\$248,830	\$309,618	\$400,472
84	\$70,447	\$153,115	\$276,670
85	\$47,026	\$132,567	\$201,336
86	\$22,792	\$111,305	\$182,464
87	\$0	\$89,304	\$162,936
88		\$66,538	\$142,792
89		\$42,982	\$121,820
90		\$18,607	\$100,184
91		\$0	\$77,797
92			\$54,632
93			\$30,661
94			\$5,858
95			\$0
Age when experienced -20%	66	75	85

This is a hypothetical example. Assumptions used in this analysis include: account balance at retirement of \$500,000, annual return of 3.5% based on an equity/bond mix of 35%/65%, annual withdrawal rate of \$25,000 (5% of the initial account balance) and a shock amount of -20%.

Source: Voya Investment Management

## 2. Asset Allocation

---

Portfolio management of TDFs requires more than just finding the ideal balance of stocks and bonds for a participant's lifecycle. It's also important to decide which sub-asset categories to add to the mix, and to understand how to adjust those sub-assets to manage the risks participants face. As with glide path design, target date managers diverge significantly when it comes to asset allocation. The number of asset classes that TDFs invest in can range from as few as five to up to fifteen or more.

Asset class correlations also matter. Combining asset classes that have low correlation to each other can minimize the highs and lows of a portfolio's returns, compared with the return of each asset class on its own.

TDFs span a participant's entire life cycle and must adjust to the changing risks participants face as they work, save, and retire. We believe TDFs should feature an active approach to asset allocation in managing sub-asset class exposures to reduce these different risks as they rise and fall over time.

## 3. Selecting Underlying Investment Managers

---

When evaluating a TDF's underlying investment managers, plan sponsors may want to consider these three points:

- To what extent are the underlying managers diversified across investment philosophies and firms?
- What is the due diligence process for selecting and monitoring managers?
- Is there a dedicated team responsible for underlying manager research?

Few plan sponsors would ever consider constructing their core investment menu using just one investment manager. Most sponsors recognize that an investment menu offering a diversified roster of managers, including both active and passive styles, can help them better serve their participants and meet their fiduciary responsibility. This line of thinking is equally applicable when considering TDFs. We believe this approach offers the following advantages:

- Access to top managers
- Reduction of single-manager risk
- No capacity constraints
- Easy addition of new asset classes

### **A multi-manager approach to TDFs: The steps to successful implementation**

- Identifying managers that deliver consistent alpha, which requires in-depth analysis, establishment of objectives, and a repeatable selection process
- Performing ongoing monitoring of selected managers and their portfolios
- Constructing the portfolio thoughtfully across multiple managers and strategies, and then integrating into the asset allocation framework
- The ability to closely coordinate between asset allocation and manager selection
- The flexibility to replace underlying managers due to loss of conviction or due to portfolio construction reasons (such as changes in asset allocation or changes in outlook on the performance of active versus passive management)

## 4. Portfolio Construction: Putting It All Together

---

### Active or passive? Depends on the asset class — and the economic cycle

Passive (or index) funds are often seen as a more attractive investment option due to their lower expenses.

Still, a passive approach tends to work better in some asset classes than in others. Within core fixed income, for example, active managers have demonstrated an ability to outperform an index over long periods of time.

In the search for alpha opportunities, however, active core fixed income managers tend to overweight credit relative to their index benchmarks. This credit bias may lead many active core fixed income managers to outperform the index during an economic expansion — but may also present a challenge when the economy contracts, particularly in the initial stages, when managers are likely to hold onto credit for too long.

Building an effective portfolio involves more than just including top-performing strategies. To get the ideal balance of portfolio managers for each asset class — and for the portfolio as a whole — the TDF manager should consider all aspects of design that we've discussed here. They should also weigh the overall risk relative to the portfolio's goals and restrictions.

According to our research, some equity and alternative asset classes have more potential to exceed their respective benchmarks (or **alpha potential**) than others. That's why some TDFs allocate more to passive strategies in asset classes like U.S. large- and mid-cap equities that historically have had low alpha potential. Conversely, these same TDFs tend to favor active managers in small cap equities, international developed equities, emerging markets, real estate, and commodities — asset classes that historically have provided more alpha potential for active managers, even when accounting for higher fees.

## Conclusion

---

In our view, a disciplined approach to each of the below four components should help participants prepare for a successful retirement:

- **Glide path design** that seeks to maximize risk-adjusted returns during the accumulation phase and to protect assets in the preservation and withdrawal phases of participants' lifecycle
- **Asset allocation** across a variety of asset classes to maximize returns and minimize risk over the long term, while considering participant retirement age and other factors
- **A range of underlying portfolio managers** to provide an additional layer of diversification that may benefit participants
- **Thoughtful portfolio construction** that balances all aspects of target date design with the changing risks that participants face through an entire lifecycle

[Click here](#) to read our full commentary on holistic TDF design.

### Investment Risks

There are no guarantees a diversified portfolio will outperform a non-diversified portfolio. Diversification does not guarantee a profit or ensure against loss. **Past performance is no guarantee of future results.**

Inherent in all investing are the risks of fluctuating prices and the uncertainties of rates of return and yield. A target date is the approximate date when investors plan to start withdrawing their money; principal value fluctuates and there is no guarantee of value at any time, including at the target date.

Price volatility, liquidity and other risks accompany an investment in equity securities of foreign, smaller capitalized companies. International investing poses additional, special risks, including currency fluctuation, economic and political risks not found in solely domestic investments. For investments in emerging markets, such foreign investing risks are generally intensified.

A target date is the approximate date that investors plan to start withdrawing their money. Glide path refers to the ways that a target date strategy's underlying asset mix (equities and bonds) changes over the life of the strategy, i.e., from the initial investment to the target date. Principal value fluctuates and there is no guarantee of value at any time, including the target date.

### Important Information

This paper has been prepared by Voya Investment Management for informational purposes. Nothing contained herein should be construed as (i) an offer to sell or solicitation of an offer to buy any security or (ii) a recommendation as to the advisability of investing in, purchasing or selling any security. Any opinions expressed herein reflect our judgment and are subject to change.

Certain of the statements contained herein are statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (1) general economic conditions, (2) performance of financial markets, (3) changes in laws and regulations, and (4) changes in the policies of governments and/or regulatory authorities. The opinions, views and information expressed in this commentary regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Fund holdings are fluid and are subject to daily change based on market conditions and other factors.

Investment-related documents, such as prospectuses, may not be available to prospective investors in some jurisdictions where such investments are prohibited for sale.

The opinions, views and information expressed in this presentation regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Portfolio holdings are fluid and are subject to daily change based on market conditions and other factors.

Products and services are offered through the Voya family of companies. Please visit us at <http://voya.com> for information regarding other products and services offered through the Voya family of companies. Not all products are available in all states.

**Please consider the fund's investment objectives, risks, charges and expenses carefully before investing. The prospectus contains this information and other information about the fund. Check with your financial advisor to determine which funds are available for sale within their firm. Not all funds are available for sale at all firms. For more complete information, or to obtain a prospectus on any Voya fund, please call (800) 992-0180 or visit us at [www.voyainvestments.com](http://www.voyainvestments.com). Please read all materials carefully before investing.**

**Past performance does not guarantee future results.**

©2023 Voya Investments Distributor, LLC • 230 Park Ave, New York, NY 10169 • All rights reserved.

Not FDIC Insured | May Lose Value | No Bank Guarantee  
IM2944107 • 221373 • CMMC-4COMPONENTSTDF • 061223

[voyainvestments.com](http://voyainvestments.com)

