Ibbotson Target-Date Report 2Q 2015

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Global equity and fixed income markets were mixed during the quarter, as investors continued to closely watch the Federal Reserve inch closer to raising short-term interest rates. Domestic equities, as measured by the S&P 500, were nearly flat in the second quarter, posting a gain of just 0.3% and returning 7.4% over the last 12 months. Over the last year, the U.S. was the main driver of global growth as the MSCI EAFE Index lost -3.8%. However, international markets slightly outperformed U.S. markets in the second quarter as the MSCI EAFE Index returned 0.8%. The MSCI Emerging Markets Index rebounded alongside oil prices in April, then gave back most of its gains to finish the quarter up less than 1%. Bond markets were stung by rising yields. The Barclays U.S. Aggregate Bond Index lost 1.7% and gave back all of its first-quarter gains. Yields on 10-year Treasuries ended the quarter at 2.34%, up from 1.93% on March 31, 2015.

As target-date funds contain a mix of both stocks and bonds, performance of target-date funds was affected by the performance of both. Highlights from this quarter's report include:

- After two consecutive quarters of positive returns, average target-date fund performance reversed course with an average loss of -0.3%. Longer-dated funds outperformed shorter-dated funds, on average, but the gap was narrow. Over the last 12 months the average target-date fund gained 2.1%.
- Individual asset class performance was mixed during both the second quarter and last 12 months. In the U.S., growth equities continued to outperform value equities with small growth stocks among the best performing asset classes for the last 12 months. While diversification into non-U.S. equities hurt the performance of target-date funds over the last 12 months, larger exposures to developed foreign equities helped fund performance in the second quarter of 2015. Among alternative asset classes, commodities were the worst performing asset class over the last year and REITs were the worst performing asset class in the second quarter.
- In the second quarter, target date funds experienced $19.3 billion in positive inflows. The growth rate of target-date funds continues to slow but remains positive, as plan sponsors move to collective trusts and custom solutions. Total assets surpassed $760 billion at the end of the quarter.

In our Spotlight section of the report we provide an article that highlights the most interesting findings from Morningstar, Inc.'s 2015 Target-Date Fund Landscape report published by the Morningstar Manager Research Team.

Target-Date Performance Summary

During the second quarter of 2015 the average target-date fund lost 0.3%, underperforming the S&P 500 Index and outperforming the Barclays U.S. Aggregate Bond Index. In the last 12 months, target-date funds returned 2.1 % on average, which trails the S&P 500 Index.

Table 1: Target-Date Performance Summary

	Q2 Return	12-Month Return
Average Target-Date Fund*	-0.3%	2.1%
Morningstar Lifetime Moderate Index**	-0.1%	0.5%
S&P 500 Index	0.3%	7.4%
Barclays U.S. Aggregate Bond Index	-1.7%	1.9%

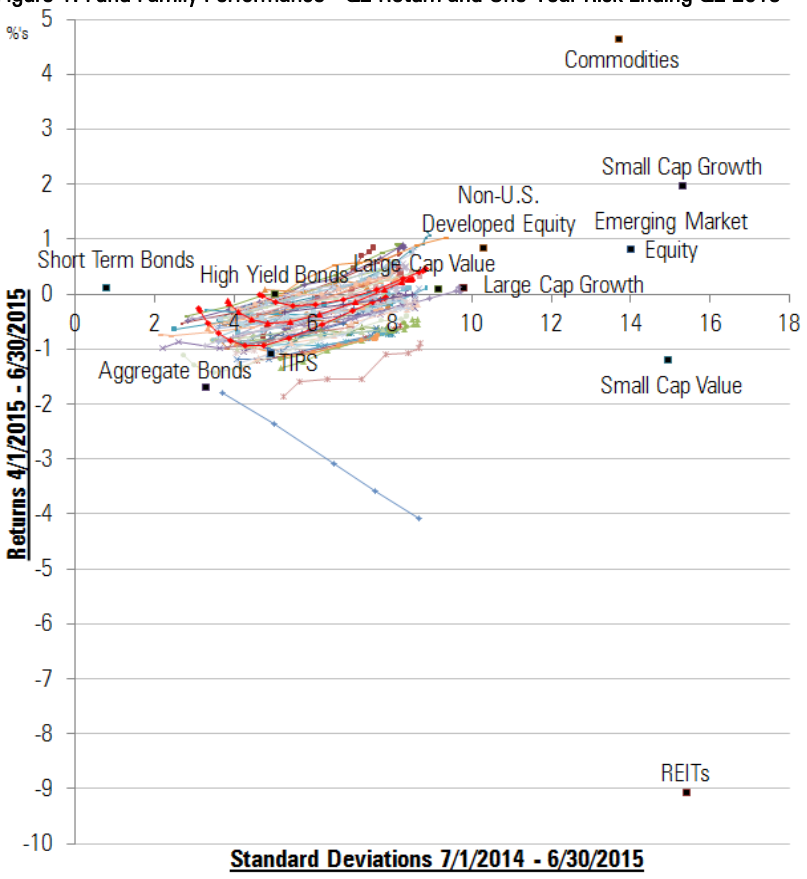
Source: Ibbotson Associates and Morningstar Direct℠ (see end for important disclosure)
*Average of all open-end target-date funds that are tracked by Morningstar.
**Average of Morningstar Lifetime Moderate Index series
Indexes shown are not available for direct investment. Past Performance is not a guarantee of future performance.

Fund Family Performance

The performance of target-date fund families during the first quarter is summarized in Figure 1. We are now tracking 489 unique target-date funds with at least a one-year track record representing 54 target-date series. The lines in the graph connect funds from the same target-date series. Second quarter net returns are plotted on the vertical axis and 12-month standard deviations are plotted along the horizontal axis. Equity markets performed slightly better than fixed income markets which explain the slightly upward sloping lines for a majority of fund families. From an equity perspective fund families had a difficult time differentiating themselves because large cap value and growth performed similarly. However, from a small cap perspective those families with a bias towards small cap growth had slightly better results. Another source of fund family outperformance was from international markets as fund families with larger allocations to international markets performed better than those with larger allocations to U.S. equities. Commodities and Real Estate continue to be the most volatile asset classes we cover. Commodities were the best performing asset class, providing a tailwind for the quarter. However, Real Estate struggled in the second quarter, providing a large headwind. From the fixed income perspective, the second quarter was similar to the first. Families that moved down the credit scale in search of higher returns were rewarded compared to families that had exposures similar to the Barclays Aggregate Bond Index and Treasury Inflation-Protected Securities (TIPS).

The three Morningstar Lifetime Allocation Indexes, representing conservative, moderate, and aggressive glide paths, are displayed along the bolded red lines which are near the middle of the graphic. For the quarter, a majority of the retail target-date funds performed in line with their respective Morningstar Lifetime Moderate Index counterpart across all Morningstar Categories.

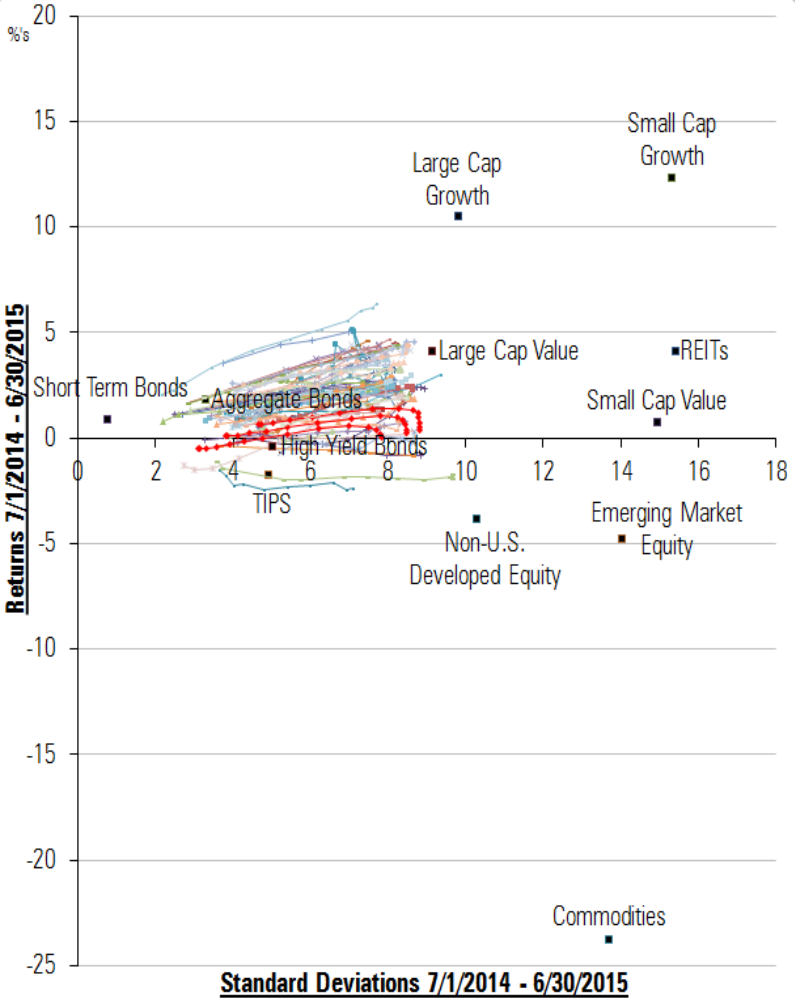
Figure 1: Fund Family Performance –Q2 Return and One-Year Risk Ending Q2 2015



Source: Ibbotson Associates and Morningstar Direct[SM] (see end for important disclosures)

The same risk/return information for the year ending June 30, 2015 is displayed in Figure 2. In this figure, we see a slight upward sloping trend representing how equity markets have outperformed fixed income markets over the last 12 months. Asset allocation decisions were a major factor in performance differentiation. Families with larger allocations to growth stocks and smaller allocations to value stocks continued to outperform their peers. Avoiding international markets in general continued to add value. The second quarter wasn't strong enough to erase commodities poor 12 month return. The three Morningstar Lifetime Allocation Indexes are displayed along the bolded red lines and are clustered toward the bottom third of the graphic. Much like in quarters past, fund families that largely avoided commodities had an easier time outperforming the Morningstar Indexes as the underlying commodity index used in the Morningstar Lifetime Allocation Indexes tends to be more aggressive than other commodity benchmarks.

Figure 2: Fund Family Performance – One-Year Return and One-Year Risk Ending Q2 2015

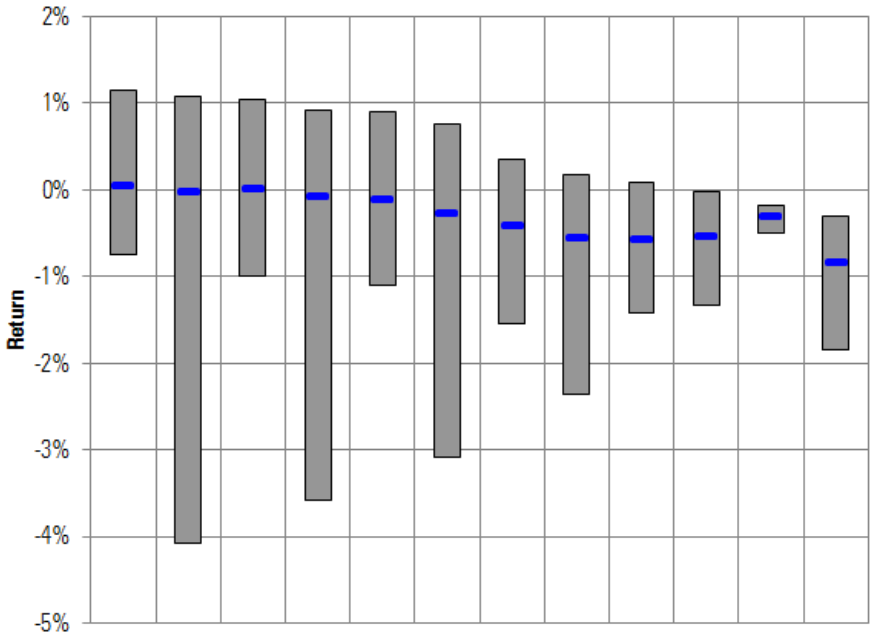


Source: Ibbotson Associates and Morningstar Direct[SM] (see end for important disclosures)

Target-Date Fund Performance

Figure 3 shows the range of first-quarter performance for target-date funds within their respective target-date vintage and in relation to the Morningstar Lifetime Allocation Moderate Index. The floating gray bars within the chart show the range of quarterly returns for the 12 target-date vintages included in our analysis. The blue line within each bar identifies the average performance for each vintage. For most of the vintages, there are large differences between the best-performing funds ("Max" row within the table below) and the worst-performing funds ("Min" row within the table below). The range of returns within each vintage was primarily due to differences in equity and fixed income as equity outpaced fixed income, albeit by a moderate amount. Within the second quarter of 2015, 10 of the 12 target-date fund vintages shown experienced an average negative return, marking a break from the previous two quarters in which all vintages had positive average returns. Only 36% of target-date funds outperformed their respective Morningstar Lifetime Allocation Moderate Index. These indexes outperformed the majority of target-date funds because the indexes have above-average allocations to commodities and below-average allocations to REITs. The former enhanced returns while the latter detracted from returns in the second quarter of 2015.

Figure 3: Target-Date Vintage Performance Q2 2015



Category	2055	2050	2045	2040	2035	2030	2025	2020	2015	2010	2005	Income
Max	1.1%	1.1%	1.0%	0.9%	0.9%	0.8%	0.3%	0.2%	0.1%	0.0%	-0.2%	-0.3%
Average	0.0%	0.0%	0.0%	-0.1%	-0.1%	-0.3%	-0.4%	-0.5%	-0.6%	-0.5%	-0.3%	-0.8%
Min	-0.7%	-4.1%	-1.0%	-3.6%	-1.1%	-3.1%	-1.6%	-2.4%	-1.4%	-1.3%	-0.5%	-1.9%
# of Funds (vs. Index)												
Outperformers	13	15	12	14	16	20	23	24	19	10	6	0
Underperformers	28	33	34	35	30	29	23	25	21	15	3	34
Total	41	48	46	49	46	49	46	49	40	25	9	34
Index												
Aggressive	0.4%	0.4%	0.4%	0.4%	0.4%	0.3%	0.1%	-0.1%	-0.2%	-0.2%	-0.2%	0.0%
Moderate	0.3%	0.3%	0.3%	0.2%	0.1%	-0.1%	-0.4%	-0.5%	-0.5%	-0.5%	-0.3%	-0.1%
Conservative	-0.1%	-0.1%	-0.1%	-0.3%	-0.6%	-0.8%	-0.9%	-0.9%	-0.9%	-0.7%	-0.5%	-0.2%

Source: Ibbotson Associates and Morningstar, Inc. (See end for important disclosures.)

Asset Class Performance

Quarterly performance for some of the most common asset classes that comprise target-date funds are displayed in Table 2. This data allows us to determine which asset classes were the primary drivers and detractors from performance during the first quarter of 2015.

Table 2: Asset Class Performance – Q2 2015

Asset Class	Q2 2015 Return	12-Month Standard Deviation
U.S. Large Growth Equity	0.1%	9.8%
U.S. Large Value Equity	0.1%	9.1%
U.S. Small Growth Equity	2.0%	15.3%
U.S. Small Value Equity	-1.2%	14.9%
Non-U.S. Developed Equity	0.8%	10.3%
Emerging Market Equity	0.8%	14.0%
Real Estate	-9.1%	15.4%
Commodities (Futures)	4.7%	13.7%
High-Yield Bonds	0.0%	5.0%
U.S. Aggregate Bonds	-1.7%	3.3%
U.S. Short-Term Bonds	0.1%	0.7%
TIPS	-1.1%	4.9%
Cash	0.0%	0.0%

Source: Ibbotson Associates and Morningstar Direct℠
Indexes shown are not available for direct investment. Past Performance is not a guarantee of future performance.

The long rally in the domestic equity market stalled in 2015's second quarter. The S&P 500 Index managed to eke out a positive gain of 0.3% for the quarter, but this return marks the lowest for the Index since 2012. Domestic economic growth was steady on several fronts in the second quarter, with employment growth and the Institute for Supply Management's gauge of manufacturing activity rebounding after sluggish readings in March. However, first-quarter corporate earnings came in flat due to steep earnings declines from the energy sector, a strong dollar weighing on exports, and consumers who proved reluctant to spend their savings from lower gasoline prices. While equity returns were not as dispersed as previous quarters, small-cap equities outpaced large-cap equities, with the Russell 2000 Index gaining 0.4% for the quarter against the Russell 1000 Index's 0.1% return. As yields on 10-year Treasuries rose, REITs experienced the largest trend reversal from previous quarters by plummeting 9.1%; this was the first negative return since 2011 for the asset class. Largely due to April's surge in oil prices, commodities experienced one of the best quarters in recent years by gaining 4.7%.

Despite growing instability in Greece and China in June 2015, international equity markets ended with decent returns in the second quarter of 2015. Hopes for a recovery in Japan brightened after its Gross Domestic Product, or GDP, grew 3.9% in the first quarter, and Japanese equities rose 3.1% for the quarter, as measured by the MSCI Japan Index. Moreover, positive news from Europe prompted the International Monetary Fund (IMF) to raise its full-year GDP forecast for the region. However, Greece's debt crisis exacerbated when Greece missed a critical debt payment to the IMF at the end of the quarter, opening up the possibility of exiting the Eurozone. Despite heavy losses to European markets in June surrounding the Greek crisis, steady gains earlier in the quarter enabled European stocks to nevertheless gain 0.7% for the quarter, as measured by the MSCI Europe Index. Buoyed by early second-quarter gains in Japan and Europe, non-U.S. developed markets overall didn't become unglued in the second quarter of 2015, with the MSCI EAFE gaining 0.8% for the quarter. Performance among emerging-market countries was decent as well with the MSCI EM Index rising 0.8%. Both Brazil and Russia posted returns above 7%, as measured by the MSCI Brazil and MSCI Russia Indexes, respectively.

The MSCI China Index ended the quarter with a solid 6.2% gain, but this return came with extreme volatility. After reaching near-record highs intra-quarter, the Chinese stock market endured a severe correction in June as investors began selling shares in droves. While target-date funds tend to not have much exposure to Greek and Chinese equities, investors should be apprised of potential contagion effects of these countries' crises on the global economy in the months to come.

Bond markets were stung by rising yields. The Barclays U.S. Aggregate Bond index lost 1.7% and gave back all of its first-quarter gains. Yields on 10-year Treasuries ended the quarter at 2.34%, up from 1.93% on March 31, 2015 (rising yields cause prices on existing bonds to fall). Investors continued to closely watch the Federal Reserve inch closer to raising short-term interest rates. High-yield bonds, which are somewhat shielded from risings rates, finished flat for the quarter.

Similar to Table 2, asset class returns and standard deviations for the past 12 months are displayed in Table 3.

Table 3: Asset Class Performance – 6/30/2015 Trailing 12 Months

Asset Class	12-Month Return	12-Month Standard Deviation
U.S. Large Growth Equity	10.6%	9.8%
U.S. Large Value Equity	4.1%	9.1%
U.S. Small Growth Equity	12.3%	15.3%
U.S. Small Value Equity	0.8%	14.9%
Non-U.S. Developed Equity	-3.8%	10.3%
Emerging Market Equity	-4.8%	14.0%
Real Estate	4.1%	15.4%
Commodities (Futures)	-23.7%	13.7%
High-Yield Bonds	-0.4%	5.0%
U.S. Aggregate Bonds	1.9%	3.3%
U.S. Short-Term Bonds	0.9%	0.7%
TIPS	-1.7%	4.9%
Cash	0.0%	0.0%

Source: Ibbotson Associates and Morningstar Direct℠
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Over the past 12 months, U.S. stocks performed well with the S&P 500 Index returning 7.4%. However, this return marks the lowest 12-month rolling return for domestic equities in three years; the average 12-month rolling period return over the last three years is over 19%. Within domestic equity, both large-cap growth stocks and small-cap growth stocks trounced their value-oriented counterparts. Notably, small-cap growth stocks achieved the largest 12-month return of the asset classes we cover, with the Russell 2000 Growth Index gaining 12.3% against small-cap value stocks' meager return of 0.8%. REITs gained just over 4% over the last twelve months, but this 12-month return dropped significantly from the first quarter of 2015, in which REITs landed as the top performing segment of the market. Despite a positive second quarter, commodities were the lowest performing asset class with a 12-month return of -23.7%. Foreign equities have not performed well from a 12-month perspective, as developed foreign stocks lost 3.8% and emerging market equities lost 4.8%. While non-U.S. equities fared positively in the first half of 2015, they have yet to recover lost ground from a tumultuous second half of 2014.

Within fixed income, U.S. aggregate bonds posted the largest return at 1.9% over the past year. This was followed by short-term bonds, which returned 0.9%. Compared to recent quarters, intermediate and longer-term bonds' 12-month trailing returns decreased the most, as yields on 10-year Treasuries rose approximately 0.4% in the second quarter of 2015. Short-term bonds did not experience such a large marginal decrease as short-term interest rates stayed relatively the same. With a -1.7% return 12-month return, TIPS performed the most poorly within fixed income, followed by high-yield bonds at -0.4%.

Morningstar Lifetime Allocation Indexes

Table 4 presents the performance figures for the complete Morningstar Lifetime Allocation Index family, which is based on Ibbotson's Lifetime Asset Allocation methodology. The majority of the Morningstar Lifetime Asset Allocation Aggressive Indexes had a positive quarterly return, whereas the majority of the more moderate and conservative variations of the indexes posted negative returns. This is because the more aggressive indexes hold a higher percentage of their assets in equities, which outperformed fixed income in the second quarter. Within Figure 1 of this report, one may observe a marginally negative drop in performance of the indexes as the indexes initially increase in risk (i.e., as the indexes progress from Income to further-dated vintages). This trend results from the indexes peaking in their exposure to long-term bonds within the 2015-2025 vintages (depending on the index) and then decreasing as the indexes approach the 2060 vintage. Since yields on 10-year Treasuries rose in the second quarter, long-term bonds in particular detracted from returns for these particular vintages. The trailing three- and five-year returns data illustrate that these indexes have fared well over longer periods of time.

Table 4: Morningstar Lifetime Allocation Indexes

(As of 6/30/2015; multiyear periods annualized)	1 Month	3 Month	1 Year	3 Year	5 Year
Income					
Conservative Income	-0.8%	-0.2%	-0.5%	3.2%	5.2%
Moderate Income	-1.0%	-0.1%	0.1%	5.3%	6.9%
Aggressive Income	-1.1%	0.0%	0.6%	7.1%	8.5%
2000					
Conservative 2000	-0.8%	-0.3%	-0.5%	3.3%	5.4%
Moderate 2000	-1.0%	-0.2%	0.1%	5.4%	7.2%
Aggressive 2000	-1.1%	0.0%	0.7%	7.3%	8.8%
2005					
Conservative 2005	-0.9%	-0.5%	-0.5%	3.7%	5.9%
Moderate 2005	-1.1%	-0.3%	0.1%	5.9%	7.7%
Aggressive 2005	-1.3%	-0.2%	0.7%	8.0%	9.5%
2010					
Conservative 2010	-1.1%	-0.7%	-0.4%	4.3%	6.5%
Moderate 2010	-1.2%	-0.5%	0.2%	6.6%	8.4%
Aggressive 2010	-1.4%	-0.2%	0.8%	8.9%	10.3%
2015					
Conservative 2015	-1.2%	-0.9%	-0.3%	5.0%	7.2%
Moderate 2015	-1.3%	-0.5%	0.3%	7.5%	9.2%
Aggressive 2015	-1.5%	-0.2%	1.0%	10.0%	11.2%
2020					
Conservative 2020	-1.3%	-0.9%	-0.2%	5.9%	8.0%
Moderate 2020	-1.5%	-0.5%	0.5%	8.7%	10.2%
Aggressive 2020	-1.6%	-0.1%	1.2%	11.3%	12.2%
2025					
Conservative 2025	-1.4%	-0.9%	0.0%	7.0%	9.0%
Moderate 2025	-1.6%	-0.4%	0.7%	10.2%	11.3%
Aggressive 2025	-1.7%	0.1%	1.4%	12.6%	13.1%
2030					
Conservative 2030	-1.6%	-0.8%	0.2%	8.5%	10.1%
Moderate 2030	-1.7%	-0.1%	0.9%	11.6%	12.3%
Aggressive 2030	-1.8%	0.3%	1.4%	13.5%	13.6%
2035					
Conservative 2035	-1.7%	-0.6%	0.4%	10.0%	11.2%
Moderate 2035	-1.8%	0.1%	1.0%	12.6%	12.9%
Aggressive 2035	-1.8%	0.4%	1.3%	13.8%	13.7%
2040					
Conservative 2040	-1.8%	-0.3%	0.6%	11.2%	11.9%
Moderate 2040	-1.8%	0.2%	1.0%	13.0%	13.1%
Aggressive 2040	-1.9%	0.4%	1.2%	13.8%	13.6%
2045					
Conservative 2045	-1.8%	-0.1%	0.5%	11.6%	12.2%
Moderate 2045	-1.9%	0.3%	0.8%	13.0%	13.1%
Aggressive 2045	-1.9%	0.4%	0.9%	13.6%	13.5%
2050					
Conservative 2050	-1.9%	-0.1%	0.4%	11.8%	12.2%
Moderate 2050	-1.9%	0.3%	0.6%	12.9%	13.0%
Aggressive 2050	-1.9%	0.4%	0.7%	13.5%	13.3%
2055					
Conservative 2055	-1.9%	-0.1%	0.2%	11.7%	12.1%
Moderate 2055	-1.9%	0.3%	0.4%	12.8%	12.8%
Aggressive 2055	-1.9%	0.4%	0.5%	13.3%	13.1%
2060					
Conservative 2060	-1.9%	-0.1%	0.0%	11.5%	11.9%
Moderate 2060	-1.9%	0.3%	0.2%	12.6%	12.6%
Aggressive 2060	-1.9%	0.5%	0.4%	13.2%	13.0%

Source: Ibbotson Associates and Morningstar Direct[SM]

Indexes shown are not available for direct investment. Past Performance is not a guarantee of future performance.

Fund Flows

New assets continued to pour into target-date funds in the second quarter of 2015. This past quarter saw $19.3 billion in net flows following the first quarter's $20.6 billion in net flows. These values are well above the three-year quarterly average net flow of $13.6 billion. One of the major contributors to the strong flows this past quarter was Vanguard receiving $11.2 billion of new assets into its target-date funds. That's the firm's largest quarterly net flow in the history of its target-date funds. While the absolute numbers for flows continue to be large for the target-date industry, its organic growth rate has continued to fall over the past decade. The industry grew at 2.6% in the second quarter of 2015, down from a 3.5% growth rate five years ago and well below the 10.7% growth rate 10 years ago. The quarterly growth rates have declined as most retirement plans at this point have made the shift to target-date funds, and an increasing number of plans have been moving assets out of retail target-date funds and into collective trusts or custom target-date strategies.

The order of largest beneficiaries of asset inflows has been relatively consistent the past few quarters. In the second quarter of 2015, Vanguard led the pack with $11.2 billion, followed by T. Rowe Price with $3.0 billion, JPMorgan with $2.9 billion, and American Funds with $2.2 billion. Meanwhile, an increasingly larger number of plans have seen outflows over the past few quarters. In the second quarter, 17 plans saw outflows. Fidelity suffered the worst with $2.3 billion leaving its target-date funds, marking the seventh consecutive quarter in which the firm's funds have seen outflows. Manning & Napier had $164 million leave its target-date funds, and the Wells Fargo target-date funds had $118 million in outflows.

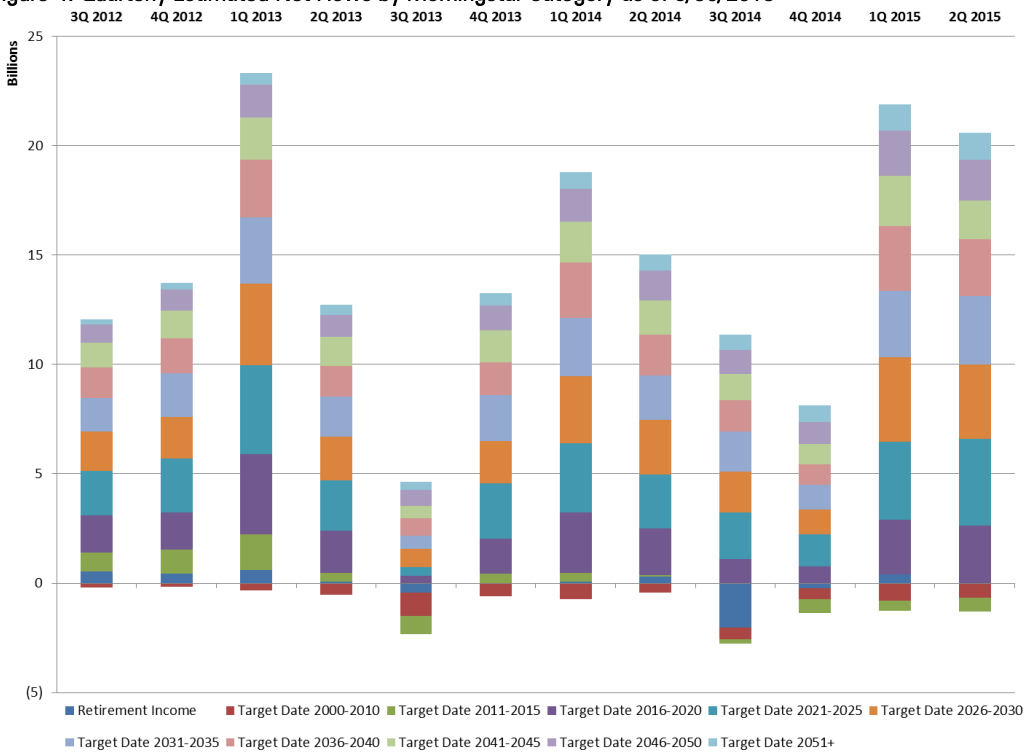
The total assets under management for retail target-date funds rose to $760 billion at the end of the second quarter, up $18 billion from the prior quarter. The average target-date fund returned just under 0% this past quarter, so nearly all of the asset growth came from net inflows. Vanguard increased its lead as the largest provider of retail target-date funds with $214 billion in total assets, representing a market share of 28%. Fidelity's target-date assets fell to $189 billion (25% market share), and T. Rowe Price's funds grew to $134 billion (18% market share).

Table 5: Target-Date Fund Flows Q2 2015

	Asset Under Management ($Mil)		**Estimated Net Flow ($Mil)**	
Target Date	End Q1 2015	End Q2 2015	Q1 2015	Q2 2015
Income	27,002	26,723	403	(36)
2000-2010	32,921	32,170	(797)	(621)
2011-2015	62,974	62,075	(469)	(635)
2016-2020	128,686	130,943	2,493	2,645
2021-2025	110,064	113,770	3,566	3,954
2026-2030	120,059	123,503	3,853	3,402
2031-2035	83,228	86,482	3,040	3,130
2036-2040	84,771	87,600	2,984	2,604
2041-2045	48,249	50,128	2,277	1,773
2046-2050	34,679	36,602	2,075	1,842
2051+	9,100	10,350	1,193	1,243
Total	**741,734**	**760,346**	**20,617**	**19,300**

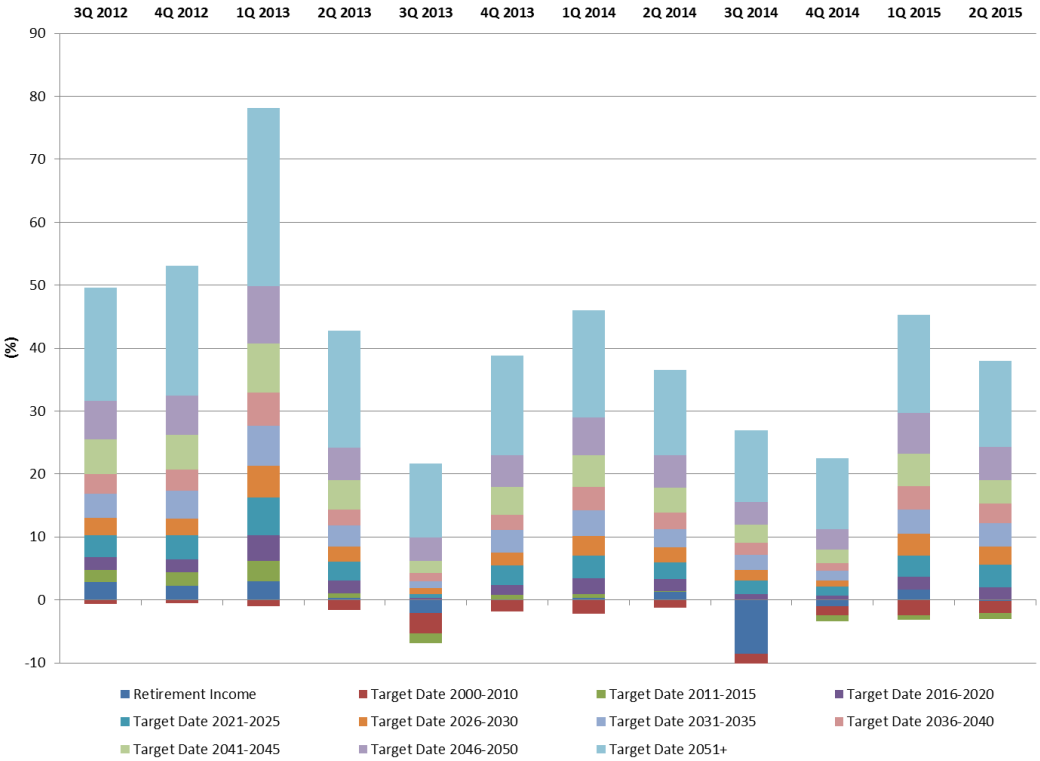
Source: Morningstar Direct℠. Universe includes funds with a less than one-year track record. Please refer to Morningstar® Cash Flow Methodology report for important methodology notes. (See end for important disclosures)

Figure 4: Quarterly Estimated Net Flows by Morningstar Category as of 6/30/2015



Source: Morningstar Direct[SM]

Figure 5: Quarterly Organic Growth Rate by Morningstar Category as of 6/30/2015



Source: Morningstar Direct[SM]

Morningstar Manager Research 2015 Target-Date Fund Landscape Report

For our quarterly Spotlight, we encourage readers to take a look at Morningstar, Inc.'s 2015 Target-Date Fund Landscape report published by the Morningstar Manager Research Team. This annual study provides detailed analyses and key insights of trends in the target-date industry. You can access the 2015 Target-Date Fund Landscape report here.

In the second quarter, Janet Yang, Morningstar, Inc.'s director of manager research for multiasset strategies, North America, published an article highlighting some of the most interesting findings from her team's report. The following is a copy of Janet's article:

Investors Reap the Gains of Target-Date Funds

Janet Yang, CFA

Morningstar's newly released annual study of the target-date-fund landscape shows the funds to be among the most effectively used investments in the fund industry. Investors' success with target-date funds refracts most brilliantly through the lens of the funds' Morningstar Investor Returns. Those returns take into account cash inflows and outflows to measure an investor's actual experience with a fund. They often differ from--and lag--funds' published total returns because investors tend to mistime their investments, pumping cash into funds after markets rise and pulling money out after they fall. (For the past few years, my colleague Russ Kinnel has looked at this discrepancy in returns across major investment categories in his "Mind the Gap" studies.)

By the end of 2014, more than 10 target-date series had amassed a decade or more of investor-return history, making for an opportune moment to take a closer look at how investors have fared with the funds. The news is good: Target-date funds' annualized asset-weighted investor return during the last 10 years through December 2014 stood at 6.1%, 1.1 percentage points greater than the category's 5.0% gain. In contrast, as shown in Exhibit 1, most broad investment categories, such as U.S. equity, international equity, and taxable bond, had negative investor-return gaps.

Exhibit 1 Total Return and Investor Return for Select Category Averages

Category	Average 10-Year Total Return (%)	Asset-Weighted 10-Year Investor Return (%)	Returns Gap (%)
Target-Date	5.03	6.13	1.10
Allocation (non-target-date)	5.55	5.19	–0.36
Intl Equity	5.74	4.55	–1.19
Municipal Bond	3.66	2.36	–1.30
Sector Equity	7.16	7.18	0.02
Taxable Bond	4.44	3.75	–0.69
US Equity	7.47	6.49	–0.98
All Funds	**5.75**	**5.21**	**–0.54**

Source: Morningstar, Inc. Data as of 12-31-2014.

Target-date investors have collectively reaped all of target-date funds' gains, and then some. That's largely due to the discipline inherent in regularly setting aside a portion of each paycheck into retirement savings accounts--the predominant means of investing in these funds. Instead of stopping their contributions or even redeeming out of funds, investors benefited from steadily adding to their accounts through all parts of the market cycle, including 2009 and 2011's market troughs.

Target-Date Funds Vital to Fund Companies

Asset managers have benefited from those regular savings flows into target-date funds as well. True, the years of consistent double-digit organic growth have passed, but target-date funds have nevertheless become crucial sources of new assets for their firms. Target-date-originated flows accounted for about one third of overall flows to the firms concerned in 2014.

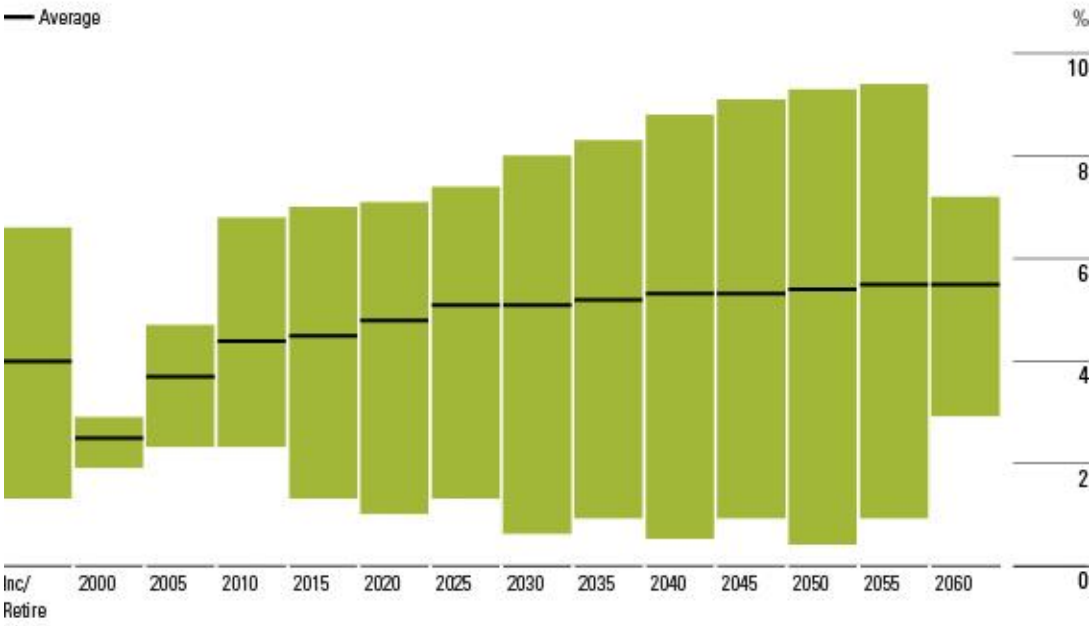
They made up an even bigger chunk of flows to active funds. Within the investment industry in general, actively managed mutual funds have experienced modest (and often negative) net new flows for more than a decade. Many firms that rely primarily on actively managed strategies would have been in net outflows last year absent target-date-originated inflows. Without the more-than $7 billion infusion from its target-date offerings, for instance, American Funds would not have been able to break its six continuous years of firm-level outflows (American saw an overall $345 million gain in mutual fund assets in 2014). Target-date flows similarly buoyed T. Rowe Price, which saw overall mutual fund inflows of $11.2 billion and $14.4 billion of net inflows from its target-date funds.

In fact, out of the roughly 40 firms offering target-date mutual funds, only seven saw net outflows from those funds in 2014. Fidelity led that group in absolute terms, seeing about $7.7 billion in outflows (representing about 4% of its target-date funds' asset base) last year. Its flagship Fidelity Freedom series has struggled for multiple years to distinguish itself from peers, and retirement plan sponsors' increasing reluctance to automatically choose or stay with their record-keepers' proprietary offerings has exacerbated the situation. As a result, in July 2014, the firm ceded its 16-year reign as the largest target-date mutual provider to Vanguard. Together with T. Rowe Price, the three fund companies account for more than two thirds of target-date mutual fund assets.

Varying Approaches Led to Surprises in 2014

Among these broad trends, it's still important to recognize that target-date funds aren't homogenous; 2014 offered another reminder of that. To illustrate, Exhibit 2 lays out the average 2014 return of each target-date vintage, as well as the range of returns.

Exhibit 2 Range of Target-Date Funds' 2014 Returns by Vintage Year



Source: Morningstar, Inc. Data as of 12-31-2014.

Given last year's rally in U.S. stocks and bonds, the fact that every target-date vintage and fund notched positive returns was not unexpected. Moreover, given that U.S. stocks beat bonds, it makes sense that more equity-heavy target-date series, such as the longer-dated vintages, would post higher returns than nearer-dated vintages, explaining the upward slope of the average returns shown in Exhibit 2.

What might surprise some investors, however, is that the differences weren't starker. Consider that U.S. stocks, as represented by the S&P 500, rose 13.7% last year, or more than double the Barclays U.S. Aggregate Bond Index's 6.0% return. Yet, the average 2050 target-date fund, which had a roughly 90% equity stake at the end of 2014, delivered only about 1 percentage point over the average 2015 fund, which had close to a 40% stock stake. Even more unusual, a number of series saw their funds with shorter-dated vintages outpace their longer-date counterparts, a pattern more often associated with periods of market stress, such as 2008 and 2011. Target-date series' widely varying approaches to international equities and fixed-income subasset classes drove much of the variation in performance not only last year but also over longer periods.

This year's target-date paper, the seventh installment of a series that started in 2009, as well additional target-date fund-related articles coming this week and next, delves into more of the factors and nuances behind some of those surprising results. Knowing each series' quirks and placing them in the context of the broader target-date fund landscape can help investors set expectations in a more informed way. As target-date funds cement their place as the retirement vehicle of choice for American workers, that insight should prove especially helpful in ensuring that savers continue to reap the full rewards of investing for the long haul.

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Appendix: Index Definition

Morningstar Lifetime Allocation Indexes are a family of multi-asset class target maturity indexes available in three risk tracks: Aggressive, Moderate, and Conservative. Each risk track consists of 13 indexes ranging from a 2055 index to an income index. The glide paths and strategic asset allocations of the

indexes is based on Ibbotson's Lifetime Asset Allocation methodology. Security selection for each sub-asset class in the index family is provided by a matching Morningstar market index.

Standard & Poor's 500 Index: Market-capitalization-weighted index of 500 widely held stocks. Member companies are chosen based on market size, liquidity, and industry group representation. Included are the stocks of industrial, financial, utility, and transportation companies.

Barclays Capital US Aggregate Bond Index – Broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS.

BofA Merrill Lynch US 3-Month Treasury Bill - Comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month that issue is sold and rolled into a newly selected issue. The issue selected at each month-end rebalancing is the outstanding Treasury Bill that matures closest to, but not beyond, three months from the rebalancing date. To qualify for selection, an issue must have settled on or before the month-end rebalancing date. While the index will often hold the Treasury Bill issued at the most recent 3-month auction, it is also possible for a seasoned 6-month Bill to be selected.

Barclays Capital Global Inflation Linked US TIPS Index – Includes securities which offer the potential for protection against inflation as their cash flows are linked to an underlying inflation index. The index represents a standalone multi-currency index exposed to the real yield curve for each relevant currency.

Barclays Capital US 1-3 Year Government/Credit Bond Index – An unmanaged market value weighted performance benchmark for government and corporate fixed-rate debt issues with maturities between one and three years.

Barclays Capital US Corporate High Yield Index – Covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

DJ-UBS Commodity Index – A broadly diversified index composed of futures contracts on physical commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME).

FTSE NAREIT Equity REITs Index – Spans the commercial real estate space across the US economy. The index series provides investors with exposure to all investment and property sectors.

MSCI EAFE Index – Measures international performance and comprises 21 MSCI country indexes, representing the developed markets outside of North America: Europe, Australia and the Far East.

MSCI Emerging Markets Index – A market capitalization weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin.

Russell 1000 Growth Index – Measures the performance of the 1,000 largest companies in the Russell 3000 Index, with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index – Measures the performance of the 1,000 largest companies in the Russell 3000 Index with lower price-to-book ratios and lower forecasted growth values.

Russell 2000 Growth Index – Measures the performance of the 2,000 smallest companies in the Russell 3000 Index with higher price-to-book ratios and higher forecasted growth values.

Russell 2000 Value Index – Measures the performance of the 2,000 smallest companies in the Russell 3000 Index with lower price-to-book ratios and lower forecasted growth values.