Managed Investment Choices

Many employers want to give you a simple 401(k) investment solution. They know with the many investment choices you are offered that you may feel overwhelmed or you may not want to devote the time to learn how best to choose funds and/or allocate among them for your retirement planning needs. Employers also recognize the need to provide you with quality investment choices that offer proper risk and reward trade-offs as well as the opportunity for portfolio diversification. Today, the law supports your employer's decision to include a professionally managed investment alternative in your 401(k) plan so that you can choose one fund that will handle all of your plan investment needs.

While the investment options discussed in this chapter provide you diversification and automatic rebalancing, each does so in a different manner. You will need to understand the goals of each approach to best assess if you can meet your retirement needs with such a fund. Also, these funds are diversified in and of themselves-you do not need to combine these investments with other fund offerings to diversify. Actually, if you combine these types of investments with other funds, you may defeat their purpose.

You should not confuse the use of one of these approaches as financial planning for retirement. They are only meant to simplify your involvement in the management of your 401(k) investments. At some point you should make a financial plan. Please see Chapters 13 and 18 for your overall retirement planning process.

The types of investments discussed in this chapter can be arranged by investment style based on your age (investment horizon) and/or assessment of risk:

- *Balanced Fund.* A Balance fund maintains a specific investment allocation over time. It does not consider your age or personal assessment of risk.
- *Risk Based.* A Lifestyle Fund diversifies to meet different risk-based tolerances. It does not consider your age today and maintains the same risk-based investment allocation as you move toward retirement.
- *Age Based.* A Target-Date Retirement (or Lifecycle) Fund assumes you accept the risk tolerance as deemed appropriate based on your age today. More importantly, the fund automatically
adjusts the risk of your investment allocation as you move toward retirement.
- *Individual Risk/Age Based.* A Managed Account personalizes your 401(k) investment approach by taking into consideration individual factors. These factors may include details such as your age today, your risk tolerance, and your retirement assets. It will adjust your investment allocation as you move toward retirement.

Balanced Fund

A balanced fund broadly invests in a combination of stocks and bonds. The goal of the fund is to provide growth while avoiding excessive volatility. The fund will have an objective of maintaining a balanced portfolio of stocks and bonds, such as 60 percent stocks and 40 percent bonds. A maximum amount of movement away from the objective allocation is allowed. If the market volatility changes and the fund moves too far from the objective allocation, such as 80 percent stocks and 20 percent bonds, the fund manager will sell stocks and buy bonds to rebalance the portfolio to the objective of 60 percent/40 percent. Balanced funds should be able to manage a downturn in the market better than pure stock funds. On the other hand, the balanced fund will not perform as well as a pure stock fund in a rising market. Fund fees should be within the reasonable range for all balanced style mutual fund.

Each balanced fund will have a different objective allocation and may invest in a variety of stocks and bonds. The balanced fund does not consider your age, your risk tolerance, your investment timeframe, your other investments, or your individual needs. Prior to deciding to invest your 401(k) assets in a balanced fund you need to assess whether the asset allocation objective fits your investment needs. And, as you move toward retirement, you should periodically reconsider the balanced fund's allocation objective to determine whether it continues to be appropriate for you.

Lifestyle Fund

Similar to a balanced fund, a lifestyle fund will invest in stocks, and bonds using a predetermined range of weightings. However, the lifestyle fund sets these asset allocation weightings based on a measured risk and return profile. Typically, the style of investing will be mentioned in the name of the fund, such as Aggressive, Moderate or Conservative. The fund manager will select individual stocks and bonds or conversely other stock and bond funds that together meet the investment objective (i.e., level of volatility) of the fund. In selecting a particular lifestyle fund, you will need to identify how much investment risk you can tolerate with respect to your investment return needs. Thus, if you are young and consider an aggressive investing approach is best, you would choose an Aggressive Lifestyle fund. As you age and determine a more conservative investment style is best, you would choose the Moderate or Conservative Lifestyle fund. Over time you may move your money from one lifestyle fund to another as your risk and reward needs change. However, you should choose one fund style and only move to another fund style when your risk and reward needs change. These funds are not meant to be combined with other investment options and you will likely diminish their intended effect if you invest your 401(k) in a lifestyle fund as well as other plan investments.

Target Date Retirement Fund

A target date retirement invests in stocks and bonds but changes the percentage allocated to each over time targeting a specific timeframe. The timeframe is generally defined by your expected retirement date. Often, the name of the fund will include the target date, such as Target Retirement 2035. The risk and reward exposure will change over time as you remain invested in the fund and move toward the target date. Initially the investment allocation will be more aggressive (a greater percentage will be allocated to stocks) becoming increasingly conservative with increasing age or time.

Fund managers may use a group of underlying mutual funds as the basis of the target date fund. If so, the fund manager may change the selection of these underlying funds without your knowledge. The fees charged by the fund will reflect the fees charged by each underlying mutual fund and may include an additional overlying fee. Some employers create their own 401(k) target date funds within a collective trust.

Different target date funds may take different approaches to investing for the same target date. For example, each fund may move from aggressive in early years to conservative in later years at a different pace. Some funds will make adjustments for market changes; others may adjust strictly by the dates. After retirement, some target date funds will invest with higher stock allocations than other funds.

To properly use the target date fund, you will need to determine your target date, when you expect to retire. Then simply select the fund that best corresponds with your chosen target date. As you move toward retirement, you should periodically reconsider when you expect to retire as it may have changed.

Managed Account

Another 401(k) investment option that you may be offered is a managed account. In a managed account, the asset allocation appropriate for you will be determined by an independent investment manager. The degree to which your 401(k) investment allocation is personalized will depend upon the amount of information either available to the independent investment manager or as provided by you (i.e., by completing an online questionnaire). However, personal information may not be required. If this information is not available, then the manager will allocate your funds taking into account some or all of the following: your age, the number of years until you reach full retirement, your 401(k) assets, your projected Social Security, your accrued pension benefit, etc. The manager assembles your portfolio from the investment funds offered in your 401(k) plan and rebalances your portfolio periodically. The independent investment manager is selected by your employer. The fees for the managed account will reflect the fees charged by each underlying fund used, and generally include an additional overlying fee.

As with a target date fund, as you approach retirement you should reconsider the appropriateness of the investment allocation in your managed account. Your investment needs may have changed over time.