

## Target date turnover troubles big firms

Advisers need to question why managers churn funds, industry observer says

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Target date funds run by MFS Investment Management, Putnam Investments and other big mutual fund companies exhibit higher-than-average turnover, raising concerns over whether investors, or their advisers, are aware of the funds' composition.

Over the past three years, Putnam's target date fund series has experienced fund turnover of 83.2%, according to data culled for *InvestmentNews* by BrightScope Inc. Meanwhile, MFS' target date fund family experienced turnover of 37.7%.

Other fund companies with higher-than-average turnover in their target date fund lineup include DWS Investments Inc. (35.6%), Fidelity Investments (24.3%); GuideStone Financial Resources (36%), J.P. Morgan Asset Management (24.1%) and Principal Financial Group (31.1%), BrightScope found.

The average turnover of a target date fund is 23.5% a year, the data show.

Any target date fund with more than a 30% turnover warrants closer inspection, said Josh Charlson, an analyst at Morningstar Inc.

“Once you are getting to more than a third of the portfolio being involved in some kind of change during a short period of time, you need to ask why so much change is happening,” he said.

Turnover is a measure of how much of their portfolio assets managers buy or sell every year. When it comes to target date funds, high turnover is worrisome because it can suggest a fund is not following a disciplined investment strategy — which would contradict the funds' role in investors' retirement portfolios.

“High fund turnover [in target date funds] can mean that there is going to be a lack of consistency in the way the funds are managed and in their investment returns,” said Marcia Wagner, an attorney with the Wagner Law Group who specializes in the Employee Retirement Income Security Act of 1974. “Financial advisers that are helping retirement plan sponsors determine if a target date fund is appropriate for their lineups definitely need to be on top of this.”

High turnover could also indicate that managers are adding underperforming funds to their target date lineups to gain assets, said Roger Wohlner, a consultant with Asset Strategy Consultants LLC, which advises retirement plans.

Specifically, Mr. Wohlner has concerns about Fidelity's Freedom Funds.

Mr. Wohlner said his assessment is that at least one of the funds within the portfolio should be replaced and nine others don't have enough history to be evaluated properly.

“It doesn't appear to me that they put their top funds into their target date funds,” he said.

Fidelity doesn't comment on outside reports or findings, but the firm stands by the process it uses to construct its target date funds, said Michael Shamrell, a company spokesman.

“Changes in the underlying portfolio structure of the Freedom Funds have historically been implemented to achieve enhanced risk efficiency, broader diversification and greater alignment to long-term structural changes in both the investment marketplace and with regard to investor characteristics,” Mr. Shamrell said.

Putnam's high turnover rate is a result of the firm's decision to revamp its Retirement Ready funds after chief executive, Robert Reynolds, came on board in 2008, said Jeffrey Knight, head of global asset allocation at Putnam.

In response to the market crash of 2008, the firm last September incorporated its Absolute Return funds into the target date funds as underlying portfolios to provide more downside protection, Mr. Knight said.

“We don't anticipate changing the asset allocation in the future,” he said.

Similarly, MFS' high fund turnover numbers are due to the fact that the firm added a number of funds to its Lifetime Funds target date series in 2009.

“MFS enhanced the funds by adding greater diversification through more underlying funds in the fixed income, international equity and alternative asset classes in 2009,” spokesman Daniel Flaherty wrote in an e-mail.

Christy Smith, a spokeswoman for GuideStone, had not returned calls by press time.

Mayura Hooper, a spokeswoman for DWS, and Charlotte Powell, a spokeswoman at J.P. Morgan, declined to comment. Jaimie Naig, a spokeswoman for Principal, had not returned calls by press time.

To be sure, a little turnover within a target date fund isn't bad, Morningstar's Mr. Charlson said.

“Certainly a fund is going to change over 30 years, but that doesn't mean the basic asset allocation is changing,” Mr. Charlson said.

Given the controversy over the aggressive glide paths used by many target date funds before the 2008 financial crisis, it's not surprising that many of them made significant changes over the past couple of years, he said.

Still, advisers need to keep a close eye to understand why managers churn funds, industry experts said.

“The biggest concern would be if there is some kind of underlying performance issue across the series that is leading to a lot of replacement of funds within the portfolio,” Mr. Charlson said. “Turnover in and of itself isn't a bad thing, but it could be a flag to a bigger issue.”

Lawmakers and fund providers have been looking for ways to lower risks in target date funds since short-horizon funds — those for people nearing retirement — lost an average of 25% in 2008. Most of the scrutiny has been on the glide paths of the 2010 funds because of their stock-heavy allocations.

In June, the Securities and Exchange Commission proposed rules that would require target date fund managers to disclose to investors more information about their glide paths.

“In general, it's getting harder to do due diligence on these funds and know what the strategy is,” said Ryan Alfred, president and co-founder of BrightScope. “This is something that you are supposed to hold on to for 30 years, but you have no idea what they are going to look like in three.”