What People Know about Target-Date Funds: Survey and Focus Group Evidence

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NOVEMBER 19, 2010
WASHINGTON, D.C.

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**Vanguard Center for Retirement Research
Background

- Target-date funds offer in a single investment option broad asset class diversification and rebalancing over time

- Target-date funds are intended to simplify investors’ asset allocation decisions

- Target-date funds overcome frequently made asset allocation mistakes often attributed to behavioral biases (such as inertia) and/or lack of financial literacy

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The Size of the Market Has Grown Significantly

**Estimated Size of Target-date Market**

- **2002**: $15 Billion
- **2009**: $256 Billion

Source: Brady, Holden and Short, 2010

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Target-date Funds are an Increasingly Popular 401(k) Plan Option

Plan Adoption of Target-date Funds
Vanguard Defined Contribution Plans

Source: Pagliaro and Young, 2010

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Target-date Funds Typically Chosen as Plan Defaults

1/5 of all Vanguard plans have adopted automatic enrollment

Adoption of automatic enrollment quadrupled in Vanguard plans from 2005 to 2009

Source: Vanguard, 2009. Pagliaro and Young, 2010
Not All Target-date Investors Invest Exclusively in One Fund

- Two or more target-date funds only, 2%
- One target-date fund, 46%
- One target-date plus other funds, 46%
- Two or more target date funds plus other funds, 6%

Source: Pagliaro and Young, 2010

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Goal: To better understand the determinants (rational, psychological and literacy related) of participant portfolio allocations to target-date funds

Phase One: Focus Groups (Distillery, Inc)
- Conducted four focus groups during in the spring of 2010

Phase Two: Telephone Survey (AUS Marketing Research Systems)
- Surveyed approximately 2,000 Vanguard participants enrolled in plans offering target-date funds during Sept./Oct. 2010
- Targeted three groups based on actual asset allocation (Mixed, Pure and Non-target)
Focus Group Results: Feelings about Retirement Savings

“This is how I felt when the market started to crash. I felt like I had a knife to my throat. I was in the hands of other people and I felt totally powerless.”
(Male, Unaware)

“I feel like him – if I make the wrong choice, I’m going to be hurting myself, cutting myself, losing a lot. But I can’t tell which choices are right and which are wrong. It’s very scary. I’d like to be able to understand what’s going on but I just don’t.”
(Female, Unaware)

“I think the barber represents the managers who are doing your mutual funds. You are the guy in the seat and that blade is kind of like them managing your money: if he’s good at it, then you will get a good shave. But if he’s not so good, you might have some nicks there. And that makes me feel uneasy – how that shave turns out is completely out of my control.”
(Male, Unaware)

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Drivers of Allocation Strategies

- Trust in financial managers and financial institutions
- Understanding (or misunderstanding) of target-date product
- Desire for control or no control
- Information overload
- Diversification heuristic

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Some Pure Investors Liked the All-In-One Feature

- “There are a lot of options that folks have and if you’re really financially savvy then I’m sure you can choose different funds but this all in one captures me. I’m not financially savvy so it’s who I am.”

- “You’re letting professionals handle it and you feel comfortable and you don’t have to make the decision yourself as well. I mean, they’re making the changes for you. As it gets closer to that target its getting more conservative and you’re not taking a risk. And less worrying”
Diversification Heuristics

- While participants seemed to understand that diversification is desirable, many did not seem to understand that one target-date fund is sufficient.

- When asked how they invest in target-date funds one investor said...
  - “...what I did was I took about 10 funds and then I put 10% of my contribution onto those 10.”

- When asked why he didn’t invest everything in the target-date fund, the investor said...
  - “I just wanted to be diversified”

- Another said...
  - “I wouldn’t put all of my eggs in one basket. No matter how good the basket is supposed to be”
Lack of trust in financial managers and financial institutions also appeared to drive interest in diversification

- “No, because fundamentally it’s just another mutual fund which is managed by a small set of people or maybe even just one person. And, of course, I would not trust all my money in one person. It just goes against the whole diversification thing.”
- “I mean, yeah, it would be ideal if you could invest in multiple target-date funds managed by different people with different underlying assets.”
PRELIMINARY Survey Results: The Sample

- Survey respondents drawn from a population of one million actively contributing participants
- Respondents could be chosen from 1,500 401(k) plans offering target-date funds
- Sampled three different groups based on their asset allocations

<table>
<thead>
<tr>
<th>Pure</th>
<th>Mixed</th>
<th>Non-Target</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>652 respondents</td>
<td>662 respondents</td>
<td>679 respondents</td>
<td>1,993 respondents</td>
</tr>
</tbody>
</table>

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Survey Results: Allocations

- Many people were not aware of their specific 401(k) allocations

  ![Pie chart showing allocation percentages]

- This could be a result of automatic enrollment or other sponsor actions

- However, some voluntarily enrolled, pure target-date investors reported that they had never heard of the product

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Time and Mental Accounting

Less than ½ reported spending more than little bit of time

- Initial Time Spent Choosing Funds
  - Do not Recall: 6%
  - No Time: 6%
  - A Little Bit of Time: 40%
  - A Moderate Amount of Time: 41%
  - A Great Deal of Time: 7%

- Took into Account Other Assets
  - Don't Recall: 3%
  - No: 46%
  - Yes: 51%

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# Top 3 Reasons for Pure Allocations

<table>
<thead>
<tr>
<th>Pure Investor</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is an easy way to diversify (88%)</td>
</tr>
<tr>
<td>It is a simple investment option (87%)</td>
</tr>
<tr>
<td>You are not familiar with investing so you liked that the Target Retirement Funds did it for you (70%)</td>
</tr>
<tr>
<td>Reasons for Mixed Allocations</td>
</tr>
<tr>
<td>------------------------------</td>
</tr>
<tr>
<td><strong>Mixed Investor</strong></td>
</tr>
<tr>
<td>You think you need to hold other investments with Target Retirement Funds to be adequately diversified (75%)</td>
</tr>
<tr>
<td>You wanted to hold other, more aggressive, investments besides Target Retirement Funds (70%)</td>
</tr>
<tr>
<td>You wanted to customize your portfolio beyond what a Target Retirement Fund allows (69%)</td>
</tr>
</tbody>
</table>

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### Top 3 Reasons for Non-target Allocations

<table>
<thead>
<tr>
<th>Non-target Investors</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>You want to make your own investment choices (60%)</td>
<td></td>
</tr>
<tr>
<td>You do not want to have all your money in one fund (57%)</td>
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</tr>
<tr>
<td>Target Retirement Funds were not an option when you joined (36%)</td>
<td></td>
</tr>
</tbody>
</table>

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Most Individuals Grasp Basic Concepts

- Agree with become more conservative as approach target year: 73%
- Agree with offer diversified mix of stock and bond investments: 66%
- Disagree with guaranteed against losses: 72%

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Advanced Topics are More Challenging

Agree with allocation will continue to change after target year

Agree with you can keep your investments beyond target year

Disagree with you have to draw income by target year

Target-date holders (mixed and pure) answer ALL questions with more accuracy
Pure Investors More Likely To Believe One Target-date Fund Offers Adequate Diversification

A Person Only Needs to Invest in One Target Retirement Fund to Get Enough Diversification

<table>
<thead>
<tr>
<th></th>
<th>Disagree</th>
<th>Neither</th>
<th>Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>41%</td>
<td>38%</td>
<td>21%</td>
</tr>
<tr>
<td>Pure</td>
<td>25%</td>
<td>41%</td>
<td>34%</td>
</tr>
<tr>
<td>Mixed</td>
<td>49%</td>
<td>31%</td>
<td>19%</td>
</tr>
<tr>
<td>Non-Target</td>
<td>44%</td>
<td>40%</td>
<td>16%</td>
</tr>
<tr>
<td>Not Sure</td>
<td>39%</td>
<td>46%</td>
<td>15%</td>
</tr>
</tbody>
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Prepared by Dr. Julie Agnew- Preliminary Results
Conclusion

- The preliminary results provide further insights into the basic reasons for different target-date allocations
  - Pure investors like the simplicity and diversification offered by one target-date fund
  - Mixed investors wish for more diversification than they believe is offered by one target-date fund and want to use the fund as only a part of their portfolio
  - Non-target date investors want to make their own decisions
- While investors seem to have a basic understanding of the funds, there are opportunities for education related to more advanced features
- Future work will examine in a quantitative framework the role of trust, literacy measures and information overload