



## ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments



February 15, 2013

### **Vanguard Opening International Bond Fund**

It took well over a year, but Vanguard is finally opening one of the two international bond funds it originally announced in the fall of 2011, Total International Bond Index. The fund will get immediate prominence in Vanguard's lineup upon its second-quarter introduction, as the firm concurrently revealed that it will be added to the portfolios of the LifeStrategy, Managed Payout and Target Retirement funds-of-funds series, as well as to two annuities--20 funds in all.

Total International Bond Index will track a mouthful of a benchmark: The Barclays Global Aggregate ex-USD Float Adjusted RIC Capped Index (USD Hedged), which includes about 7,000 high-quality corporate and government bond issues from 52 countries across the globe. The "RIC" in the name stands for "regulated investment company" and has to do with tax requirements--what it boils down to is the index won't allocate more than 20% of assets to any single bond issuer (either government or corporate).

Vanguard has argued that the currency piece of foreign bonds is what adds the most risk. Removing that component leaves investors with a more "bond-like" experience. While we agree with the premise, we're not sure what return or risk edge the new fund will bring over Vanguard's other broad bond market index offering, the U.S.-focused Total Bond Market Index.

Over the past 20 years, Total Bond Market Index returned 6.2% a year, while Total International Bond Index's bogey gained 6.4% a year. Given that Total Bond Market Index is net of fees and the foreign index has none, they look close to even. On the risk side, as you might expect, the foreign bond index was a bit more volatile, with a maximum cumulative loss (MCL) of 6.3% compared to Total Bond Market's MCL of 5.0%.

But in the interests of diversification, Vanguard plans to allocate 20% of the bond portion of each of the fund-of-fund portfolios to Total International Bond Index. Based on the above risk and return metrics, it's hard to say what benefit its addition will bring to the affected funds, but it doesn't seem as though it will have much of a negative impact either--we doubt investors will notice much of a difference.

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## **Vanguard Changes Target Retirement Lineup**

In the interests of additional diversification, Vanguard is also adding newcomer Short-Term Inflation-Protected Securities Index to a few of its Target Retirement funds (2015, 2010 and Income) as a replacement for the older, actively managed Inflation-Protected Securities. At the same time, Prime Money Market will be removed from Target Retirement 2010 and Target Retirement Income's portfolios.

This second move seems to confirm something we posited about Short-Term Inflation-Protected Securities Index when Vanguard first announced it in August, 2012, namely that some investors may regard it as a replacement for a money market fund based on its short duration and more generous yield. For more on Short-Term Inflation-Protected Securities Index, please read our [Adviser Fund Update from August 3, 2012](#).

These changes should not significantly change the character of the three funds, but we also believe investors can do better than "all-in-one" offerings like Vanguard's Target Retirement series.

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