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Vanguard Targets Twenty-Somethings

Just as Vanguard revealed it was closing and merging one of its Target Retirement funds into another, the firm announced an addition to the lineup in Target Retirement 2060, set to open early in 2012.

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The 2060 fund is geared toward investors who plan to retire around the year 2060 and, like all of the Target Retirement roster, it will invest in a mix of Vanguard's stock and bond index funds. As each fund gets closer to its target date, it will gradually shift more assets into bonds and cash. At launch, Target Retirement 2060's asset allocation will be virtually identical to that of the 2040, 2045, 2050 and 2055 funds, which currently are allocating assets as follows:

- 63% in Vanguard Total Stock Market Index
- 27% in Vanguard Total International Stock Index
- 10% in Vanguard Total Bond Market II Index

The new fund will carry an expense ratio of just 0.18%, which is well below the average expense ratio of 0.60% for this fund category (according to Lipper). With a minimum of just \$1,000 on all of the Target Retirement funds, any of the more aggressive funds could be a good entry into investing for someone just starting out who can't afford a higher-minimum fund, although we do not recommend them as long-term holdings.

As mentioned above, Vanguard also announced plans to merge Target Retirement 2005 into Target Retirement Income. The two funds now have a nearly identical asset allocation, with approximately 30% in stocks, 65% in bonds and 5% in Prime Money Market. The merger will take place in February 2012, though Target Retirement 2005 was closed to new investors in mid-October.

Target Retirement 2005 is the first of Vanguard's funds to reach the final destination along its glide path into the Target Retirement Income portfolio, so it's a natural

evolution. As other Target Retirement funds reach and surpass their target dates, expect more mergers of this kind approximately every five years.

We've covered the topic of Vanguard's Target Retirement funds and Fidelity's similar target-date, lifecycle funds a number of times in the past--we continue to view them as a poor replacement for a diversified, actively-managed portfolio. While funds of this sort are gaining popularity in 401(k) and other retirement savings accounts (Vanguard's Target Retirement funds counted over \$82 billion in assets at the end of September), we believe investors can do much better than idly investing in a one-size-fits-all option.

Vanguard's Florida Fund Shifts Focus

Last week, Vanguard notified the SEC of its intention to change the name of Florida Long-Term Tax-Exempt to Florida Focused Long-Term Tax-Exempt. Why the change? The SEC requires 80% or more of a fund's assets to be held in securities implied by its name, which is no longer in line with the fund's revised mandate allowing it to invest up to 50% of its assets in non-Florida bonds.

As of the end of June (the most recent holdings data currently available), the fund held 9.9% of its assets outside of the state, but we expect that percentage will increase. The reason is that, with the repeal of the Florida intangibles tax in January 2007, Sunshine State residents no longer derive any additional tax benefits from investing in Florida-issued bonds. And, because there is no state income tax, Floridians have no other reason to invest exclusively in Florida municipal bonds.

It's unclear why it took Vanguard so long to change the fund's mandate, but now that it's done, expect the fund to further diversify into high-quality bonds issued by other state and local governments, as well as regional governmental authorities.

On the surface, with the state-tax break long gone and a heavy reliance on bonds issued by Florida and its agencies and municipalities, Florida Focused Long-Term Tax-Exempt doesn't appear to have much to recommend it over a more diversified, national muni fund like Vanguard's Long-Term Tax-Exempt. That said, historically, the Florida fund outperformed Long-Term Tax-Exempt over multi-year periods, which may be why Vanguard kept it open instead of merging it into the national fund. Whether that remains the case as the fund shifts its focus away from Florida will be worth watching for current investors.

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