ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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Schwab Takes Aim at Fidelity & Vanguard's Target-Date Investors
Last week, Charles Schwab Corp. announced a new suite of target-date retirement funds (TDFs) whose lowest-cost share class charges 0.08%, undercutting similar options from Vanguard and Fidelity by 0.02%. The least expensive shares are only available through defined-contribution plans, but retail versions of the same funds charge 0.13%, also offering savings over comparable investor-share TDFs from the two fund giants.

While two-hundredths of a percent may not seem like a big deal, it gives Schwab an edge in the lucrative, $6.8 trillion defined-contribution retirement savings marketplace, where target-date funds have been widely adopted. According to the Investment Company Institute, as of year-end 2014 (the most recent data available), 72% of 401(k) plans offered target-date funds, 48% of 401(k) investors owned one and 18% of all 401(k) assets (approximately $830 billion) were invested in TDFs.

You've heard us mention the lengthy and ongoing fee war between Vanguard and Fidelity to provide investors with the lowest-cost passive management. We've covered it at length. With this move, Schwab has fired a shot across Vanguard's and Fidelity's bows, taking the lead in offering the TDF marketplace's lowest expense ratios.

Vanguard Institutional Target Retirement funds and Fidelity Freedom Index funds, the two companies' analogous passively managed TDFs, each carry 0.10% expense ratios.

Feeding the competition to be a low-cost—if not the lowest-cost—TDF option is the host of lawsuits filed by retirement plan participants against their plan providers over the last year for offering sub-par or expensive options, which they claim harmed their retirement savings—this summer, a group of U.S. universities faced such litigation. In conjunction with the new Fiduciary Rule, which goes into effect in April 2017, legal firms will have strong motivation to pursue more of these class actions, and lawsuit-conscious employers and plan sponsors are sure to take notice as they periodically review and revamp their plans. Fund companies that can point to low-cost solutions will likely have a strong advantage when employers attempt to build better plans and avoid the lawyers.

What Are Target Date Funds?
As a refresher, target-date, or "lifecycle," funds usually own baskets of other mutual funds (in Schwab's case, the underlying investments are exchange-traded funds), and the fund name will include a year that corresponds with the shareholder's planned (or actual) retirement date. The funds periodically rebalance along a "glide path," slowly shifting allocations from stocks to bonds as the date nears. Once the date passes, the glide path generally continues to slide down to a bond-heavy portfolio focused on preserving assets and providing income.

Our view on target-date funds is that they are acceptable choices for an investor with limited options in their retirement savings plan, or for someone who is just beginning their investment career, but in general, they represent the lowest common denominator of hands-off investment management. TDF funds don't take your risk tolerance or investment goals into consideration (other than your desired year of retirement), and not all lifecycle funds are created equal, either. Each fund family offers its own interpretation of how aggressive or conservative the mix of underlying funds and glide paths should be, so expenses are not the only consideration when choosing a lifecycle fund.

For uninformed or starter investors, we can see the appeal of target-date funds. With their low minimums and set-it-and-forget-it design, they provide entry-level retirement savings to just about any investor under the sun. Plus, when combined with a defined-contribution plan, they put the power of tax-deferred or tax-free compounding and dollar-cost averaging to work, which can pack a fantastic investment punch over time. Even though we typically do not recommend these funds to our clients, we see it as a good thing for the retirement savings landscape that they are available at rock-bottom expenses and get people investing for their future. We'll be watching to see if and how Fidelity and Vanguard respond to Schwab's challenge.

About Adviser Investments
Adviser Investments and its subsidiaries operate as an independent, professional money management firm with particular expertise in Fidelity and Vanguard mutual funds. We advise more than 2,500 clients and have over $3 billion under management. Our investment professionals focus on helping individual investors, trusts, foundations and institutions meet their investment goals. Our minimum account size is $350,000. In 2016, Adviser Investments was named to *Barron's* list of the top 100 independent financial advisers nationwide and its list of the top advisory firms in Massachusetts for the fourth consecutive year. We have also been recognized on the *Financial Times* 300 Top Registered Investment Advisers list in 2014, 2015 and 2016.

For more information, please visit www.adviserinvestments.com or call 800-492-6868.

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