

Pensions&Investments

11th Annual West Coast

DEFINED CONTRIBUTION CONFERENCE

International Business Forum



October 20, 2008

The Evolution of Target-Date Strategies

Introductions

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Target-Date Strategies Overview

Target-Date Strategies

Overview

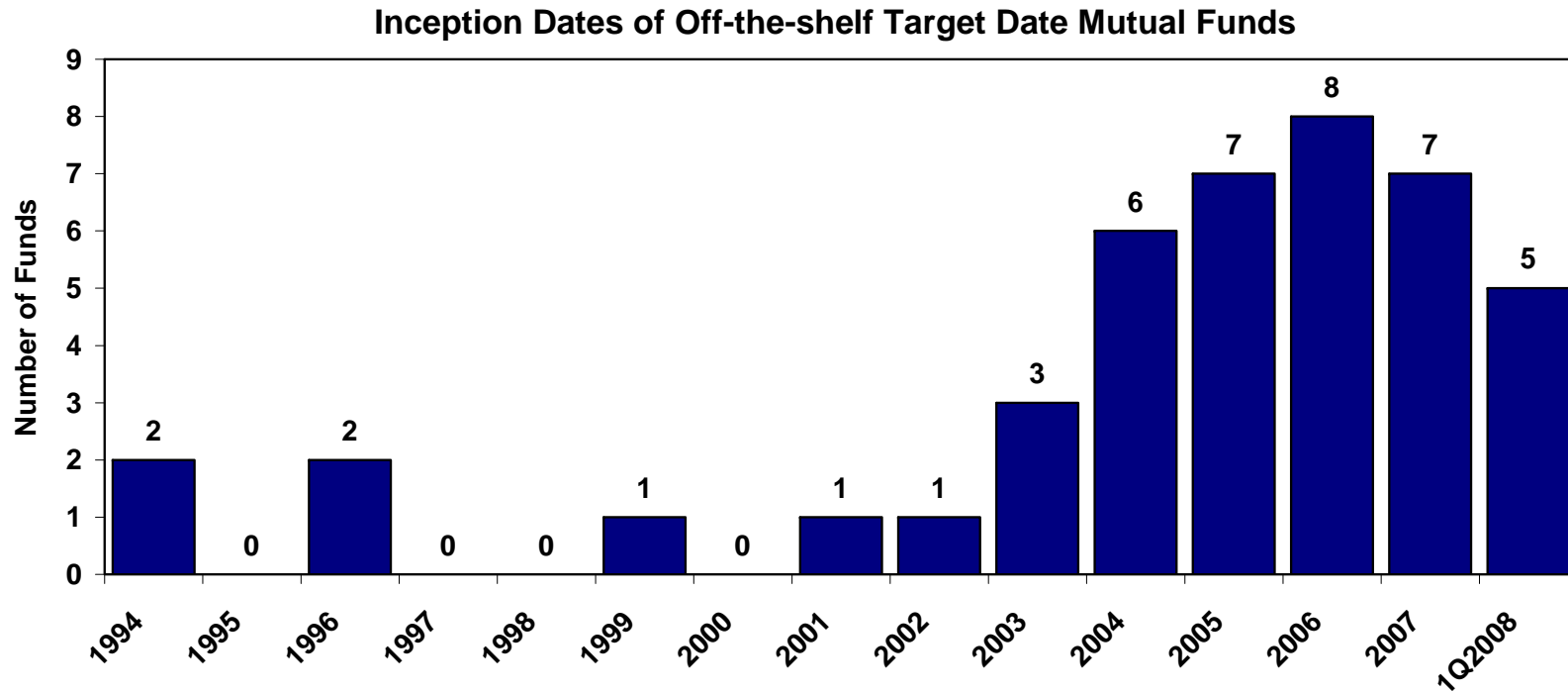
- TDFs follow broad economic concepts introduced in the 1950s¹:
 - individuals will go through various stages over their lifetime, where their investment needs are different; and,
 - in general, individuals can seek higher expected returns with corresponding higher expected risk levels when retirement is many years away and can steadily reduce risk as retirement nears
- In the early 1990s, investment professionals moved from theory to practical application with the creation of pre-packaged TDFs
- TDFs involve four fundamental investment decisions:
 - Establishing the asset allocation (i.e., mix between broad asset classes)
 - Portfolio structure and implementation of underlying investments
 - Periodic rebalancing actions
 - Gradual risk-reduction by changing the asset allocation decision over time become more conservative (as known as the “glide path”)

¹ *Life-cycle theories of Franco Modigliani and Richard Brumberg (1954) and Albert Ando and Milton Friedman (1957).*

Target-Date Strategies

Overview

- Assets in TDFs are projected to be \$277MM at the end of 2008
- TDFs are likely to have more than \$1.1TR in defined contribution assets by the end of 2012 (*source: Cerulli Associates*)
- A proliferation of TDFs products have been introduced to the marketplace



Source: Data compiled by Mercer Investment Consulting, Inc. from open-end mutual fund families.

Target-Date Strategies

Overview

Investments and Financial Planning



**“I retire on Friday and I haven’t saved a dime.
Here’s your chance to become a legend!”**

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Target-Date Strategies
Panelist Discussion

Target-Date Strategies

Panelist Discussion

- Major trends in TDFs (greater use of passive strategies, commingled funds, annuity/retirement income component)
- Off-the-shelf vs. customized TDFs
- Adding risk tolerance features
- Glide path considerations in challenging market environments
- Introduction of new asset classes – role of alternative investments

Target-Date Strategies

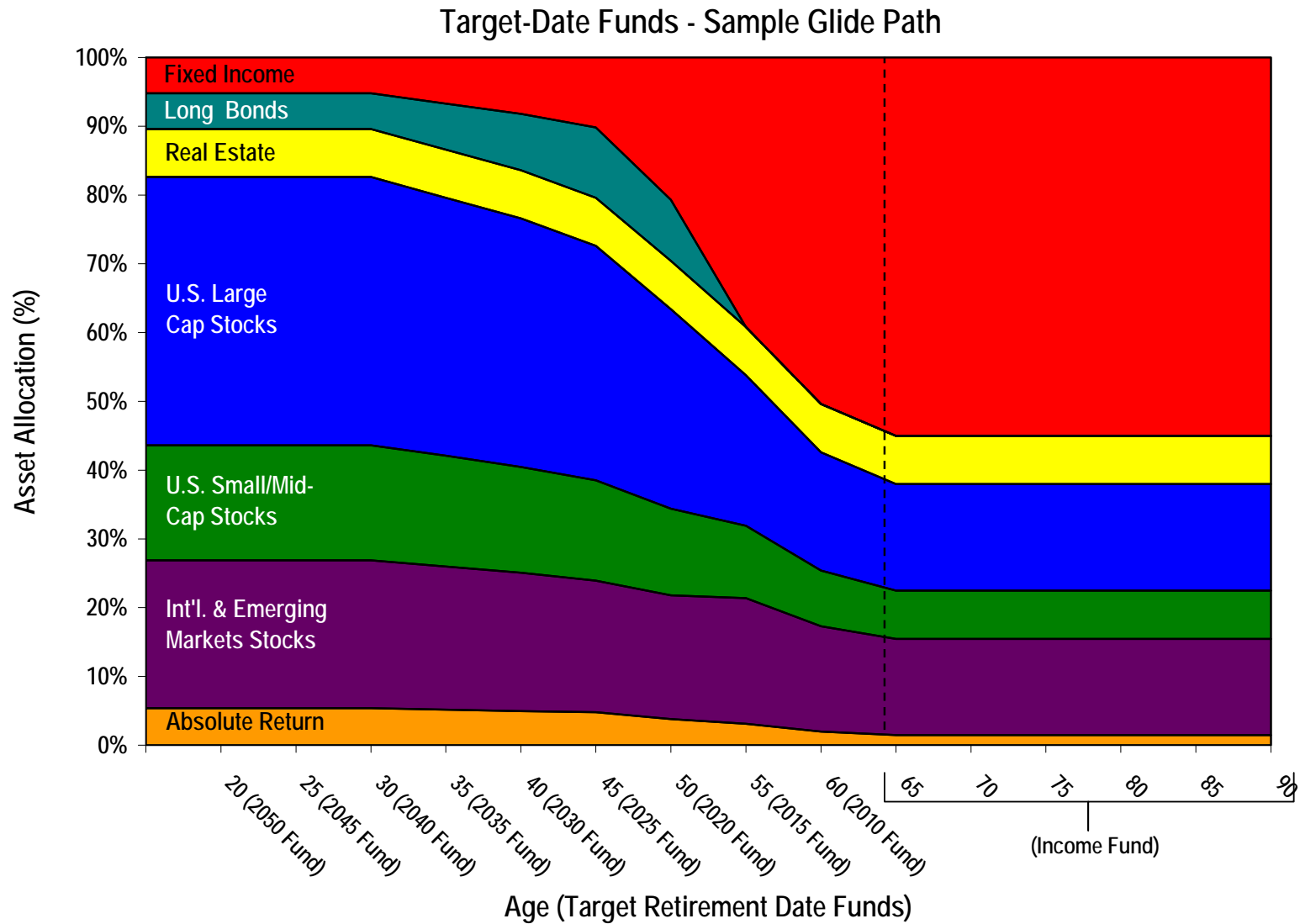
Off-the-shelf vs. Customized

Target Date Funds		
Considerations	Off-the-Shelf Funds	Customized Portfolios
Description	<ul style="list-style-type: none"> Select pre-built funds where glide path creation & underlying investment selection outsourced to a single investment manager 	<ul style="list-style-type: none"> Build custom portfolios using customized glide path & investments specifically designed for plan sponsor
Glide Path	<ul style="list-style-type: none"> Constructed by manager & generic for all clients who invest in their pooled investment vehicles 	<ul style="list-style-type: none"> Plan sponsor customized based on specific demographics & objectives (i.e., desired placement ratio); glide path is consultant developed or outsourced to investment manager
Underlying Investments	<ul style="list-style-type: none"> Typically entirely invested in investments managed by the manager with no flexibility to alter 	<ul style="list-style-type: none"> Comprised primarily of core investments already available in the option array (sometimes supplemented to provide diversification)
Pros & Cons	<ul style="list-style-type: none"> Plan sponsor perceived safety by avoiding construction issues (time and complexity) Administrative ease; single NAV that needs to be captured by the recordkeeper (reduces certain administrative costs and probability of errors) Significant communications support; prospectuses, fund fact sheets, website support, etc. already created and maintained by provider Generic glide path may not match sponsor's needs No control of underlying investments; risk of inclusion of underlying funds that do not meet the same standards for the stand-alone funds offered in the core lineup Tend to have higher fee structures 	<ul style="list-style-type: none"> Achieve significant economies of scale : <ul style="list-style-type: none"> Lower fees; leveraging existing funds Reduce monitoring effort; reviewing same core funds Ease of communication message to participants; create your own portfolio or sign-up for pre-packaged solution Utilized by large plan sponsors; common in the marketplace Greater implementation and maintenance steps necessary; custody and daily NAV creation Creation of customized communications (i.e., fact sheets) Some plan sponsors have concerns about greater fiduciary accountability



Target-Date Strategies

Off-the-shelf vs. Customized, continued

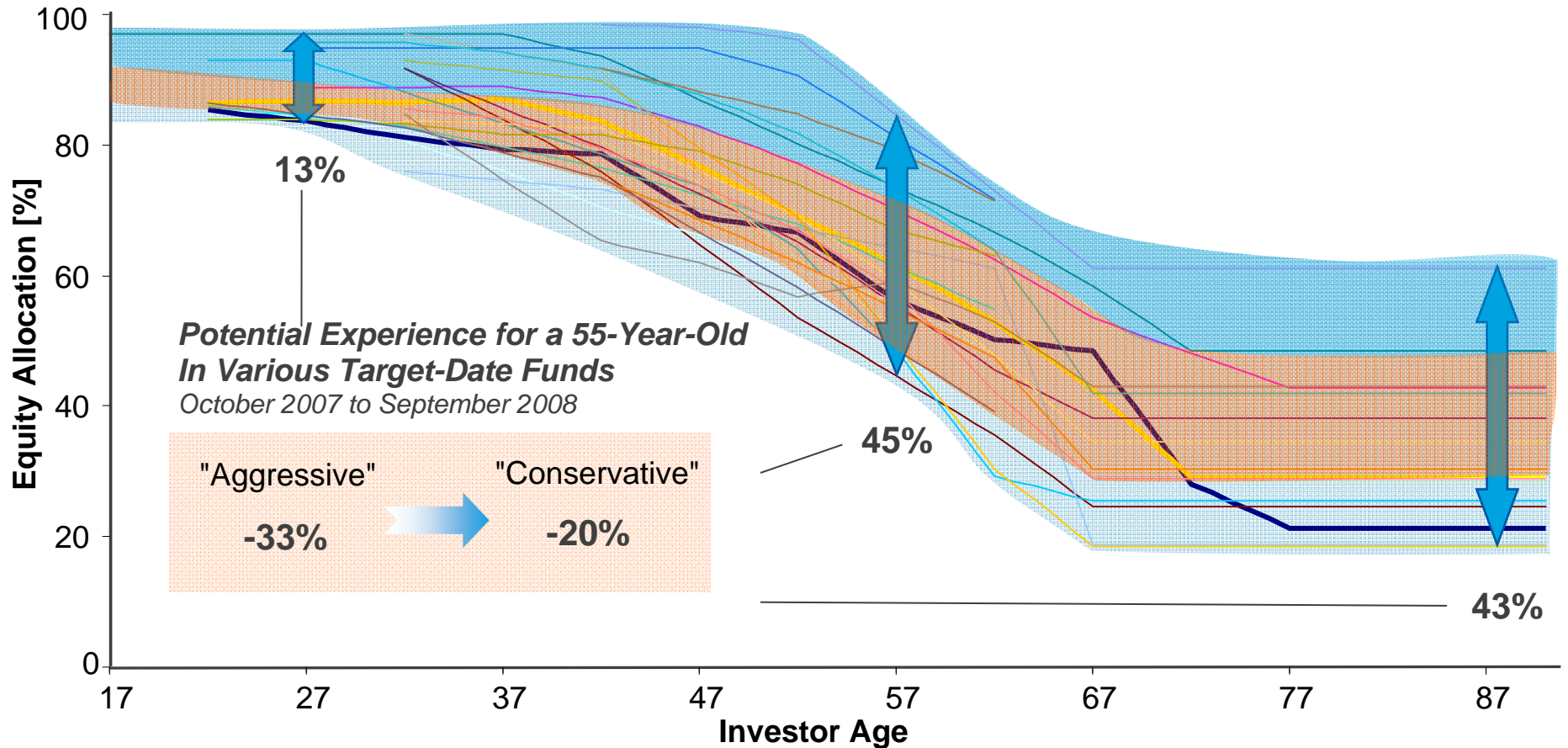




Target-Date Strategies

Target Date Funds Vary Significantly In Asset Allocation and Volatility

Asset Allocation Glidepaths of Largest Target-Date Fund Families



Source: Ibbotson, Old Mutual Analysis Information as of December 2007.

For illustrative purposes only. Using overall equity allocation as a measure, "Aggressive" is based on the 2015 target-date fund with the highest equity allocation in the marketplace, and "Conservative" is based on the 2015 target-date fund with the lowest equity allocation. Assumes \$150,000 Balance as of October 9, 2007 (market peak). The simulation was run from 10/9/2007 to 9/30/2008, in order to capture the experience from the peak of the Dow Jones Industrial Average on 10/9/2007 until the end of Q3 2008.

Target-Date Strategies

Glide Path Considerations in Challenging Environments

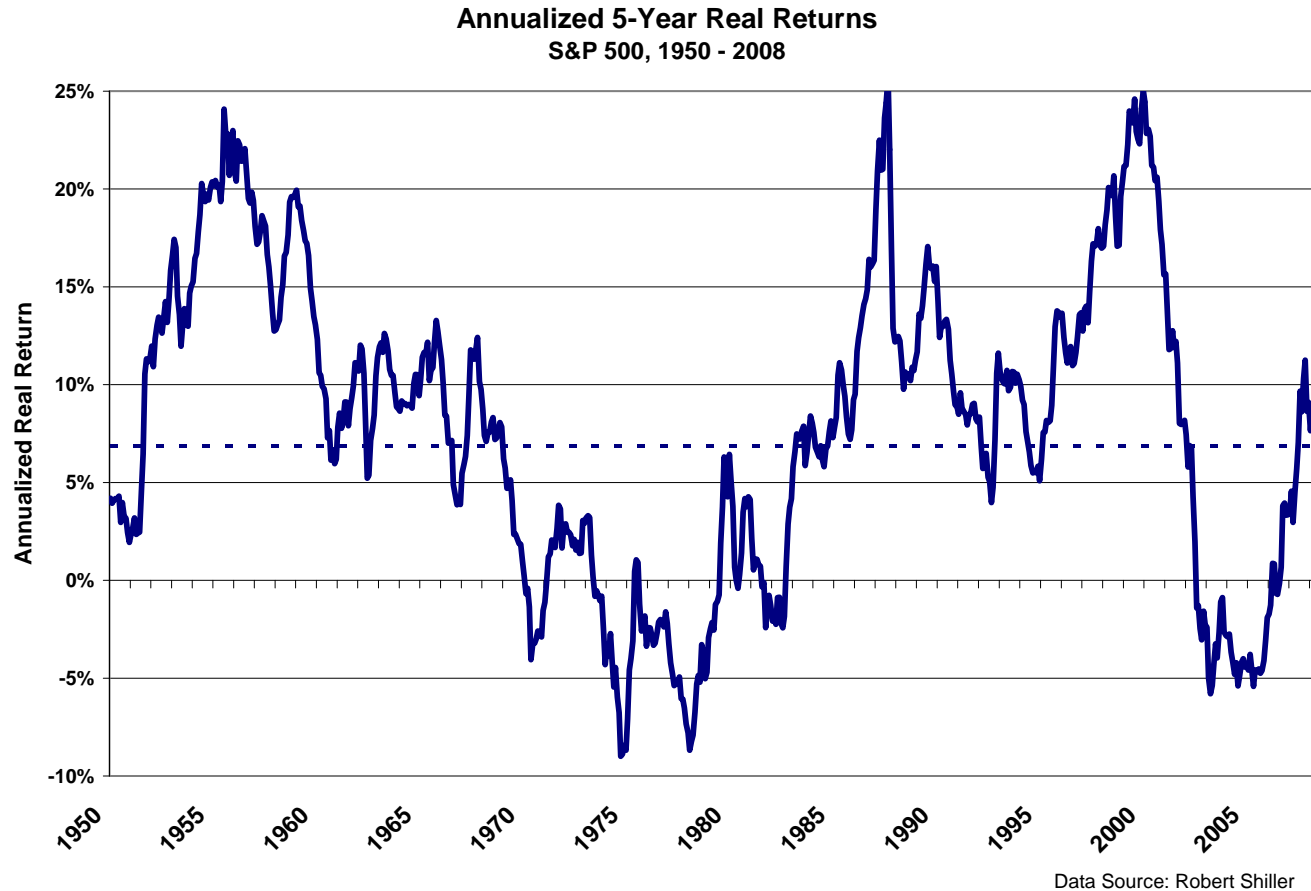
© Cartoonbank.com



"If we take a late retirement and an early death, we'll just squeak by."

Target-Date Strategies

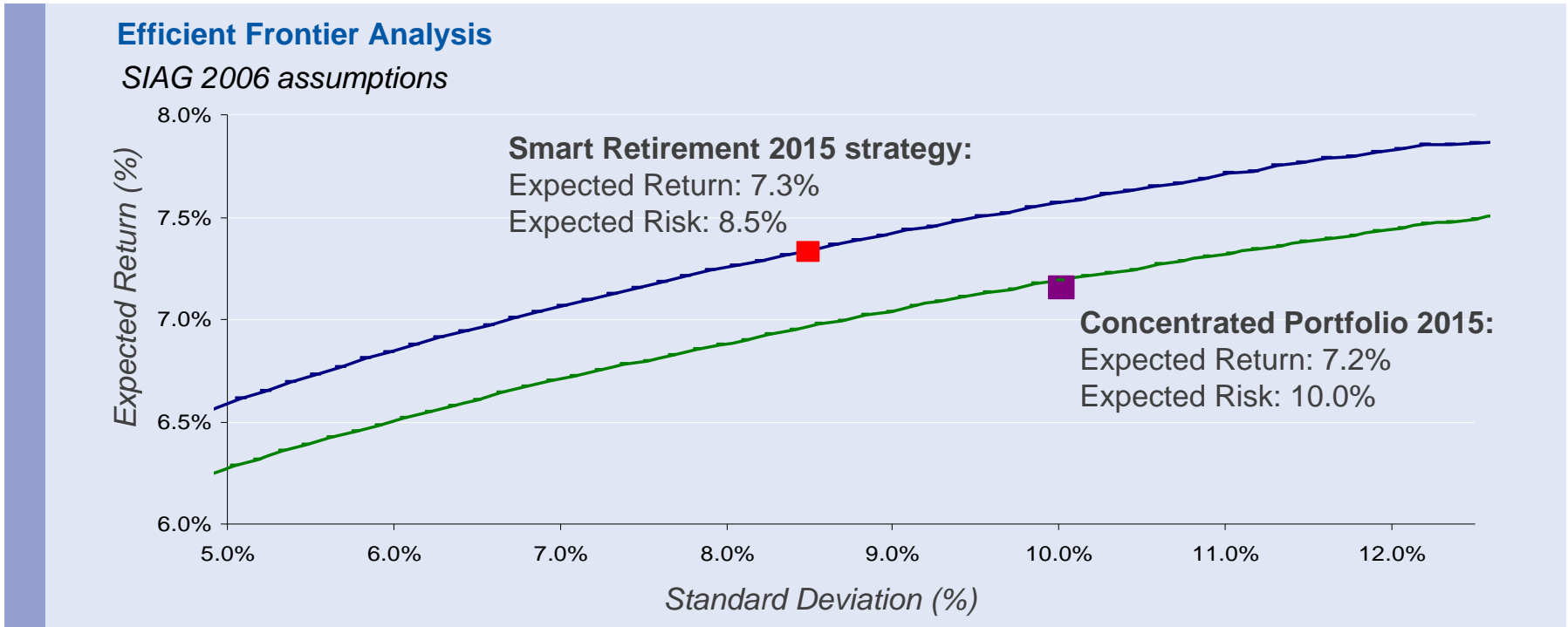
Glide Path Considerations in Challenging Environments, continued



- Typically the glide path reflects long-term expectations of risks, returns and correlations
- However, market performance is not always in line with long-term expectations

Target-Date Strategies

Role of Alternative Investments – Power of Diversification



- Concentrated Frontier includes:
 - Domestic large and small cap equities
 - International & emerging markets equity
 - US Fixed Income
- Diversified Frontier also includes:
 - US REITs
 - High Yield Fixed Income
 - Emerging Markets Debt
 - Direct Real Estate

Source: JPMorgan Asset Management Capital Market assumptions — 2006, using arithmetic returns, JPMorgan Asset Management, and industry prospectuses. The assumptions are presented for illustrative purposes only. They must not be used, or relied upon, to make investment decisions. The assumptions are not meant to be a representation of, nor should they be interpreted as JPMorgan investment recommendations. Allocations, assumptions, and expected returns are not meant to represent any JPMorgan portfolio. Please note all information shown is based on assumptions, therefore, exclusive reliance on these assumptions is incomplete and not advised. The assumptions should not be relied upon as a recommendation to invest in any particular asset class. *The individual asset class assumptions are not a promise of future performance. Note that these asset class assumptions are passive-only; they do not consider the impact of active management.*

Target-Date Strategies

Role of Alternative Investments - Bringing Institutional Investing to Participants

	Average defined contribution plan	Average defined benefit plan	Average endowment and foundation
U.S. Large Cap	63.8%**	41.9%	29.4%
U.S. Small Cap	3.0	3.0	7.0
International Equity	4.8	15.5	15.0
Emerging Markets Equity	0.0	1.0	2.0
U.S. REITs	0.0	0.0	0.0
U.S. Fixed Income	28.4	27.6	19.6
Direct Real Estate	0.0	4.0	4.0
Private Equity / Hedge Funds*	0.0	7.0	23.0
Total portfolio	100.0%	100.0%	100.0%
Expected Compound Return	7.0%	7.4%	7.6%
Volatility	11.0%	10.1%	10.6%
Sharpe Ratio	0.25	0.31	0.32

Source: Greenwich Associates

*Includes private equity, hedge funds and other investments such as active common stock and traditional balanced funds

** 22.1% allocated to company stock

The manager seeks to achieve the stated objectives. There can be no guarantee those objectives will be met.

Target-Date Strategies

Role of Alternative Investments

What do we mean when we say “alternatives?”

- Alternative Assets — a term referring to any non-traditional asset with potential economic value that would not be found in a standard investment portfolio. Due to the unconventional nature of some of these investment assets, valuation may be a problem.
(www.investopedia.com)
- Commonly cited “alternative assets” include:
 - Direct Real Estate
 - Commodities
 - Hedge Funds
 - Private Equity / Venture Capital
 - Infrastructure

Target-Date Strategies

Role of Alternative Investments

- Alternative asset classes should be used as a tool to enhance return and reduce risk of an overall portfolio due to their low correlations with traditional asset classes

	Expected Return (%)	Standard Deviation	US Large Cap Equity	Correlation of Total Return		
				International Equity	US Fixed Income	Inflation
US Inflation	2.5%	1.2%	-0.1	0.0	-0.1	1.0
US Large Cap Equity	8.0	14.8	1.0	0.8	-0.2	-0.2
US Small Cap Equity	8.3	19.7	0.7	0.7	-0.2	-0.2
International Equity (unhedged)	8.8	14.7	0.8	1.0	-0.2	0.0
Emerging Markets Equity	9.5	24.1	0.7	0.8	-0.2	0.2
US Fixed Income	5.3	3.5	-0.2	-0.2	1.0	-0.1
High Yield	7.5	7.3	0.5	0.5	0.1	-0.3
TIPS	4.5	5.1	-0.2	-0.2	0.8	0.3
Real Estate — Private	6.8	7.1	0.3	0.2	0.3	-0.1
Real Estate — REITS	7.0	14.5	0.3	0.3	0.1	0.0
Hedge Funds (FoF)	7.3	6.3	0.5	0.6	-0.1	0.0
Private Equity	9.0	23.0	0.6	0.6	-0.2	-0.1

Source: JPMorgan Asset Management 2008 Capital Market Assumptions

Index returns: SP500 Index, Russell 2000 Index MS REIT, MSCI EAFE Index, MSCI EM Free Index, Lehman Aggregate Bond Index, JPM EMBI Bond Index, Lehman High Yield Index, US T-bills, NCREIF Index, Lehman US TIPS Index, GS Commodity Index, Headline CPI

