RESEARCH SUMMARY

OFFICE OF RETIREMENT POLICY
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Recent Life-Cycle Fund Performance

April 2013

Life-cycle fund performance from 2006 through 2012 was similar to overall stock market performance

From January 2006 until November 2012, a representative life-cycle fund [1] for a worker targeting retirement in 2020 had an average annual return of 4.6 percent, compared with 4.2 percent for the S&P 500.

During the period the stock market experienced the largest losses, bond returns boosted life-cycle fund performance

The U.S. Bond market returned an average annual return of 6 percent since January 2006; high by recent historical standards. For life-cycle funds, high bond returns mitigated some of the losses that stocks suffered in 2008.

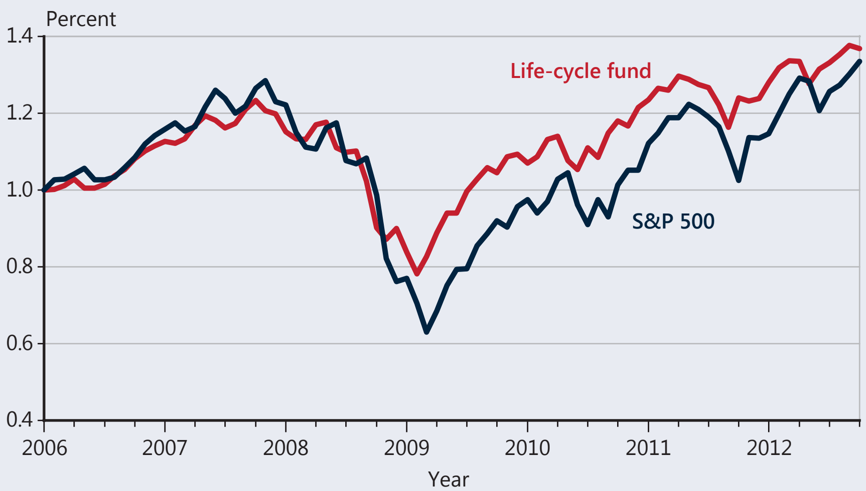
A recovering stock market over the past two years has also contributed to positive life-cycle fund returns, but not at the same rate as the S&P 500

The S&P 500 averaged an annual return of 16.1 percent from January 2009 to November 2011 compared with 11.7 percent for a representative life-cycle fund over the same period.

Life-cycle fund performance since 2006 is substantially better than simulations using historical returns, primarily because of high bond returns.[2] However, if stock returns continue to surpass bond returns, the advantage of the life-cycle fund relative to the S&P 500 may change.

While the life-cycle fund moderated both extreme negative and positive market performance over the selected time period, as always, there is no guarantee that an investor will experience similar results.

Price Path of a Dollar Invested in a Life-Cycle Fund Relative to the S&P 500



SOURCE: Author's calculations based on a representative life-cycle fund and the S&P 500.

NOTES: All content is simplified for presentation. Please see source material for full details and caveats.

The findings and conclusions presented in this summary are those of the authors and do not necessarily represent the views of the agency.

Background

- Life-cycle funds are a popular option for defined contribution pension allocations.[3]
- Life-cycle funds are marketed as a one-stop, total diversification option for long-term investors that can reduce the risk of large, negative returns at older ages.
- The extent to which life-cycle funds achieve this goal can have important implications for retirement security.[4]

Key Terms

- *Life-cycle fund* refers to a single fund that invests in several different funds, with the typical asset allocation heavily invested in stocks early in the fund's life and adjusting toward bonds as the fund's target retirement date approaches.
- The *S&P 500* represents the 500 largest publicly traded companies in the United States, held in proportion to their size.

[1] A representative life-cycle fund for a 50-year-old starts out with 50 percent invested in the C fund of the Thrift Savings Plan, 30 percent in the F fund and 20 percent in the I fund with decreasing allocations to the stock funds each month and offsetting increases in the F fund.

[2] Shiller, Robert J. 2005. "The Life-Cycle Personal Accounts Proposal for Social Security: A Review." NBER Working Paper No. 11300.

[3] Investment Company Institute. 2011. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2010." ICI Research Perspective, Vol. 17, No. 10.

[4] Kintzel, Dale. "Portfolio Theory, Life-Cycle Investing, and Retirement Income." Social Security Administration Policy Brief No. 2007-02, October 2007.