ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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Vanguard Puts Two Funds to Rest
With little fanfare, Vanguard completed the planned elimination of two funds earlier this week. Target Retirement 2005 was merged into Target Retirement Income while Asset Allocation ended its 23-year run by merging into Balanced Index. While the end results were the same, the reasons behind the two mergers were different.

Target Retirement 2005's Retirement
When Vanguard introduced its first six Target Retirement funds in 2003, the stated goal of five of them was to have their allocations gradually come to match Target Retirement Income's, at which point their assets would be merged into that fund. Seven years after its target date, Target Retirement 2005 did just that--the first of the series to do so--completing the progression Vanguard had designed for the fund and setting the pattern for the rest of the lineup. (Investors in Target Retirement 2010, for example, can expect that fund to match the more conservative Target Retirement Income's allocation in 2017 and be merged into it that year.)

We continually question whether target date funds like Vanguard's Target Retirement series' one-size-fits-all approach is really appropriate for a majority of investors, believing that folks can do better in a portfolio custom tailored for their needs and risk tolerance. That said, investors in Target Retirement 2005 shouldn't be concerned by the merger, as the transition to Target Retirement Income did not involve any significant reallocation among the funds in the portfolio.

Asset Allocation Reallocated, Permanently
While the Target Retirement fund's merger was planned long in advance, Asset Allocation was likely merged out of existence due to disappointing performance.

For most of its run, original manager Mellon Capital used computer models to tactically allocate assets between stocks, bonds and cash (from month to month, the fund could have between 70% and 100% in stocks, with the remainder in bonds and/or cash). The fund got off to a promising start, but over the last decade, it couldn't keep up with Vanguard's most comparable balanced offering, the Wellington fund.

Asset Allocation's underperformance didn't affect just its own investors--the fund was also a significant holding of Vanguard's four LifeStrategy funds-of-funds (about 20% of each in 2011). In fact, the LifeStrategy funds accounted for about half of Asset Allocation's assets last fall.

Last September, Vanguard decided to cut its losses, fired Mellon Capital (which had run the fund since its 1988 inception), removed Asset Allocation from the LifeStrategy funds' portfolios, and assigned a team of in-house managers to reallocate the fund's portfolio to match Balanced Index's 60%/40% stock/bond mix to prepare it for a proposed merger. Asset Allocation's investors approved the move earlier this year, and Friday, February 10th was the fund’s final trading day.

Investors in the affected funds don't have to take any action--assets were automatically transferred and converted to shares in the new funds. The changes should be reflected in account statements going forward.

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