Is now the time for baby boomers to put their retirement assets at risk?

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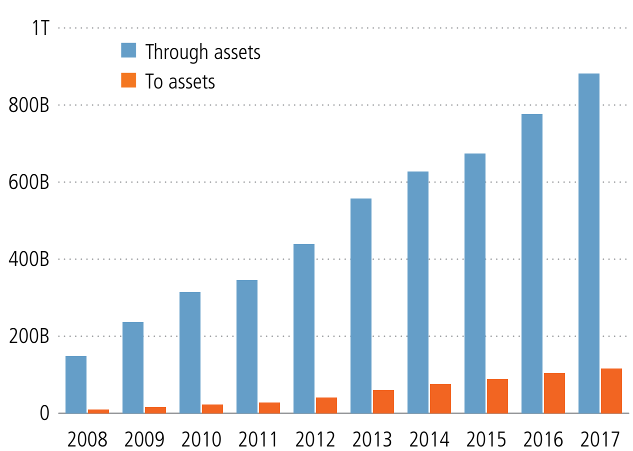
"Throughout history, investors have suffered for being lulled into complacency, particularly those on the cusp of retirement in 1987, 2000, and 2008."

At the top of every equity market cycle, some prognosticator invariably claims "this time it's different," helping foster pro-risk behavior and a false sense of security at precisely the wrong time. Throughout history, investors have suffered for being lulled into complacency, particularly those on the cusp of retirement in 1987, 2000, and 2008. Only with the benefit of hindsight will we know when this market cycle will end. Regardless, with unusual political developments at home and abroad, with many assets trading near all-time highs, and with prospective returns likely to be exceptionally low, it seems that—for certain investors—the risk of capital losses could be far more harmful than the risk of missing out on future gains. A measure of caution may be in order for many market participants.

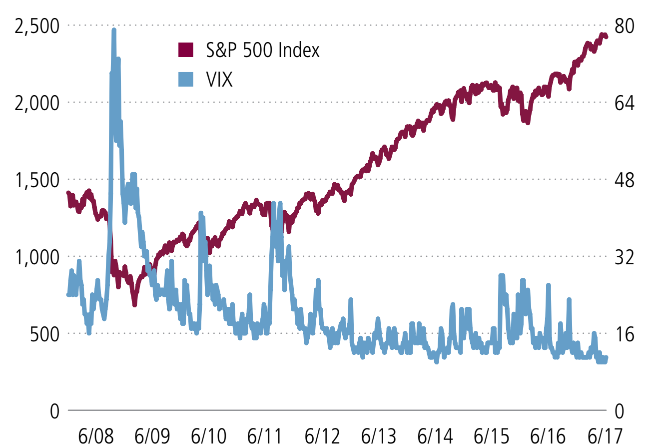
This is especially the case for baby boomers in the retirement readiness zone—those recently retired or expecting to retire within the next few years. With $1 trillion in assets today,[1] target-date funds have become one of the most popular ways for working Americans of all ages to save for retirement. But most of these target-date assets sit in funds that hold relatively heavy allocations to stocks, even as the investor's retirement draws closer. A more preservation-oriented glide path option emphasizing bonds may better suit 401(k) plan participants who don't have the willingness—or the ability—to expose their retirement assets to so much stock market risk.

Equity-oriented target-date funds have grown sixfold since the current market cycle began

Through and *to* target-date fund glide path assets ($)



The S&P 500 Index (left axis) and CBOE VIX (right axis)



Source: Morningstar (left), Federal Reserve Bank of St. Louis (right), as of 6/30/17. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. The Chicago Board of Options Exchange Volatility Index (CBOE VIX) shows the market's expectation of 30-day volatility and is constructed using the implied volatilities of a wide range of S&P 500 Index options. It is not possible to invest directly in an index. Past performance does not guarantee future results.

Riskier target-date fund assets dwarf those in more conservative offerings

Retirement target-date funds follow a glide path that trims stock exposure over time. Asset growth has been impressive in recent years, buoyed by the Pension Protection Act of 2006, which made target-date funds a qualified default investment alternative, or QDIA, for defined contribution plans. Depending on the type of target-date fund, the dynamic derisking process can either continue *through* the retirement years or continue *to* the start of retirement, when the most conservative allocation is permanently reached.

> *"… bull markets don't die of old age. More concerning are the valuations."*

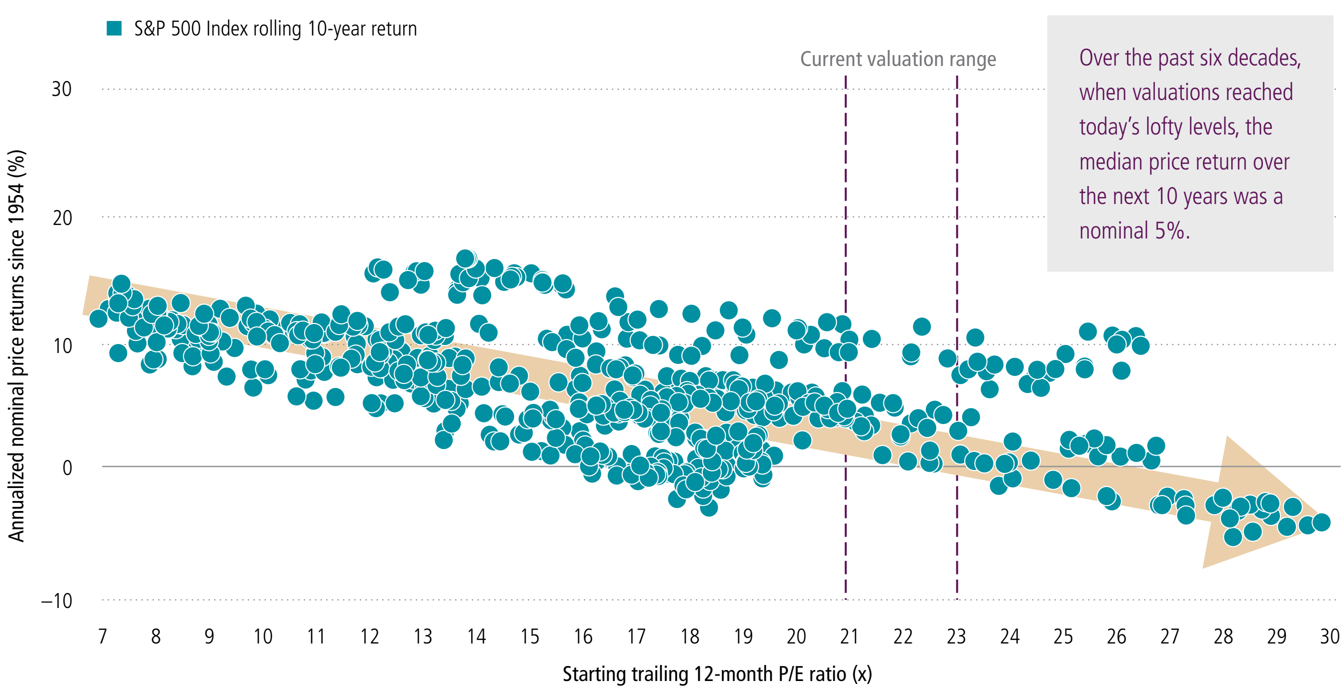
Target-date funds following *through* retirement glide paths are typically more heavily allocated to equity at the target retirement date and are what dominate the marketplace today, with over $880 billion, from less than $150 billion at the end of 2008.[1] This growth is not surprising in light of the market appreciation we've seen over that period, as funds demonstrating stronger performance tend to be rewarded with higher inflows. A few of these target-date fund managers even use leverage, carrying the assumption of greater risk for greater return potential to its logical extreme.

Target-date funds following *to* retirement glide paths that have relatively high allocations to fixed income at retirement have also demonstrated asset growth, but their assets under management stand at less than $120 billion today.[1] The tempered enthusiasm for these less risky offerings is understandable given that they tend to underperform stocks in extended bull markets. But this tamer type of target-date fund may represent a solution that better suits late-career investors, especially given the mature stage of the current equity market cycle.

The market's multiple expansion has left stocks with less room to run

The current market cycle began in March 2009, and it's been an exceptionally generous run so far, but bull markets don't die of old age. More concerning are the valuations. Price-to-earnings, or P/E, multiples, for example, can give us clues as to whether markets are overvalued—a key question for U.S. equity investors right now.

Long-term returns have clearly declined as valuations rise



Source: Standard & Poor's, Bloomberg, as of 6/30/17. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. It is not possible to invest directly in an index. Trailing price-to-earnings (P/E) ratios measure a company's current stock price as a multiple of its trailing 12-month earnings. Past performance does not guarantee future results.

While short-term results are driven by a variety of factors, the trend is clear: Long-term returns have declined as starting valuations have risen. In fact, over the past 60 years, when stock market valuations reached today's lofty levels, the median price return over the next decade was a nominal 5%, an even smaller return when taking inflation into account. It's possible that multiples could continue to expand from here given today's low rates of interest and inflation. However, at some level, valuations will matter, and it seems the risk is on the downside given where we are in the current market cycle.

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Your target-date fund may have too much risk right now if you plan to retire soon

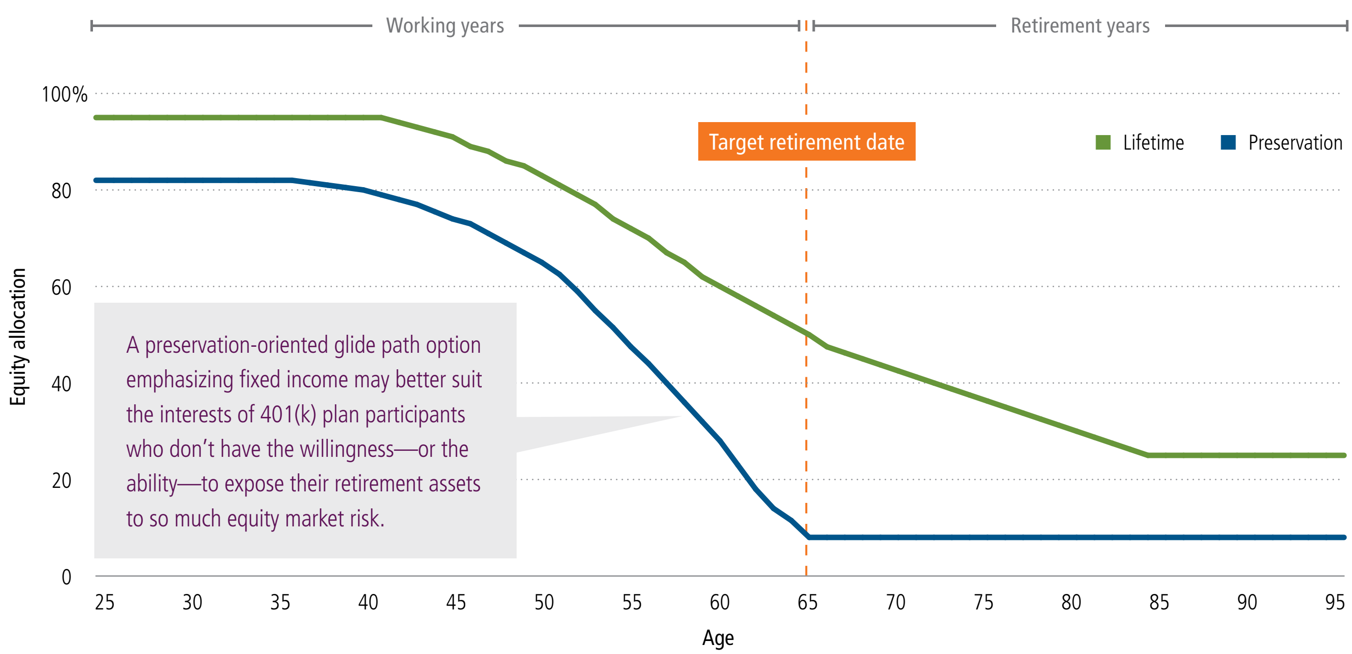
All things considered, is now the right time to be putting retirement assets at risk? For millennials, Generation Xers, and other investors in their prime accumulation years, the answer is probably yes. Despite today's high valuations, stocks still have the best long-term wealth-building potential of all the major asset classes.

However, the answer may be different for baby boomers, or anyone else who will soon require an income-producing investment portfolio—instead of a paycheck—to cover basic living expenses. One of the greatest challenges for investors and their advisors resides in trying to assess the potential rewards relative to the risks at any given point in time. The relationship between risk and reward isn't static, and it isn't necessarily symmetrical either. As we've shown, the potential rewards in U.S. stocks look low right now, but these low prospective returns don't mean that market volatility is likely to be low. On July 26, 2017, the CBOE VIX slipped to 8.84,[2] the lowest level ever in intraday trading, capping off an extended period of subdued readings. However, market volatility only stays low until it doesn't: Historically, some of the largest VIX spikes have immediately followed calm periods.

How and when will the story of this current bull market cycle end? No one knows. But that shouldn't stop retirement savers from being prepared.

Plans without preservation target-date fund options may be hurting their participants

Two different target-date fund glide paths, each designed to address a different investor need



Source: John Hancock Asset Management, 2017.

1 Morningstar, 6/30/17.

2 "Wall Street's 'fear index,' the VIX, falls to record low as traders maneuver after Fed statement," cnbc.com, 7/26/17.

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Price to earnings (P/E) is a valuation measure comparing the ratio of a stock's price with its earnings per share.

Diversification does not guarantee a profit or eliminate the risk of a loss.

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