



403(b) Plan Menu Investment Options

Presented by:

Scott Dauenhauer, CFP(r), MSFP, AIF(r)
Barbara Healy, CFP(r), TGPC, CSF, ChMC, AAMS
Bill Tugaw, President & CEO

SST Benefits Consulting, Inc.

Types of Participants



Delegators

90%



Fine Tuners

9%



Customizers

1%

Delegators: What the studies say

79% believed a target-date would be a good solution*
92% did not know what constitutes a money market

fund**

80% who chose own portfolio judged it to be inferior***

58% spend less than an hour on all retirement decisions



25%



30%



90%

T. Rowe Price study comparing time allocation to
retirement

Challenges for Delegators: What the numbers say:

Efficient menus still lead to inefficient participant portfolios

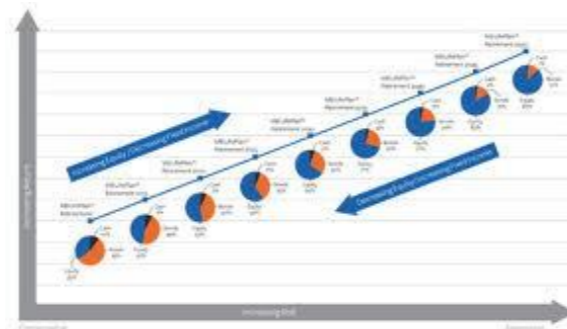
This can lead to a 20% reduction in retirement wealth*
One-third who manage their own account are
diversified**

Plan participants freedom of choice leads to poorer
outcomes***

Delegators' Solutions

“...most employees would be best served by being automatically placed in a one-stop, professionally managed investment vehicle, such as a target-date fund or a managed account.”

Shlomo Benartzi, UCLA Author of Save More Tomorrow



ibbotson.

a Morningstar company



BeManaged

Fine Tuner's Profile

Moderate degree of choice over what goes into their portfolio

Relatively financially literate, but far from experts

Likely to suffer from 1/N syndrome

Large number of choices can be overwhelming

Find speciality funds intimidating

Fine Tuner's Solutions: Miller's Law: The Magical Number 7*

The Magical Number Seven, Plus or Minus Two

7 Wonders of the World

Lucky Number 7

7 Deadly Sins

7 Ages of Man

7 Notes of a Musical Scale

7 Days of a Week, 7 Primary Colors, 7 Levels of Hell...etc

*"The Magical Number Seven, Plus or Minus Two: Some Limits on Our Capacity for Processing Information"[2] is one of the most highly cited papers in psychology.[3][4][5] It was published in 1956 by the [cognitive psychologist George A. Miller](#) of [Princeton University's Department of Psychology in Psychological Review](#). It is [often interpreted to argue](#) that the number of objects [an average human can](#) hold in [working memory](#) is 7 ± 2 . This is frequently referred to as *Miller's Law*. - From Wikipedia

Fine Tuner's Solutions

Plan menu offers 7 options, plus or minus 2

“People find it easier to make decisions when faced with a small menu of options than with many options”

Shlomo Benartzi, Save More Tomorrow (pg. 180)

Offering too many funds leads to “Choice Overload”

Not offering enough funds may be viewed as non-competitive in the marketplace

More funds does not mean more diversification, but if done right can be meaningful

Your potential participants are already faced with a large menu of 403(b) Products

Customizer's Profile

Financially sophisticated

Appetite for expanded menu and specialty funds

Sufficient skill to take care of themselves

Customizer's Solutions

An expanded menu that includes speciality options

Self-Directed Brokerage Option

An expanded menu is an issue with most record keeper platforms

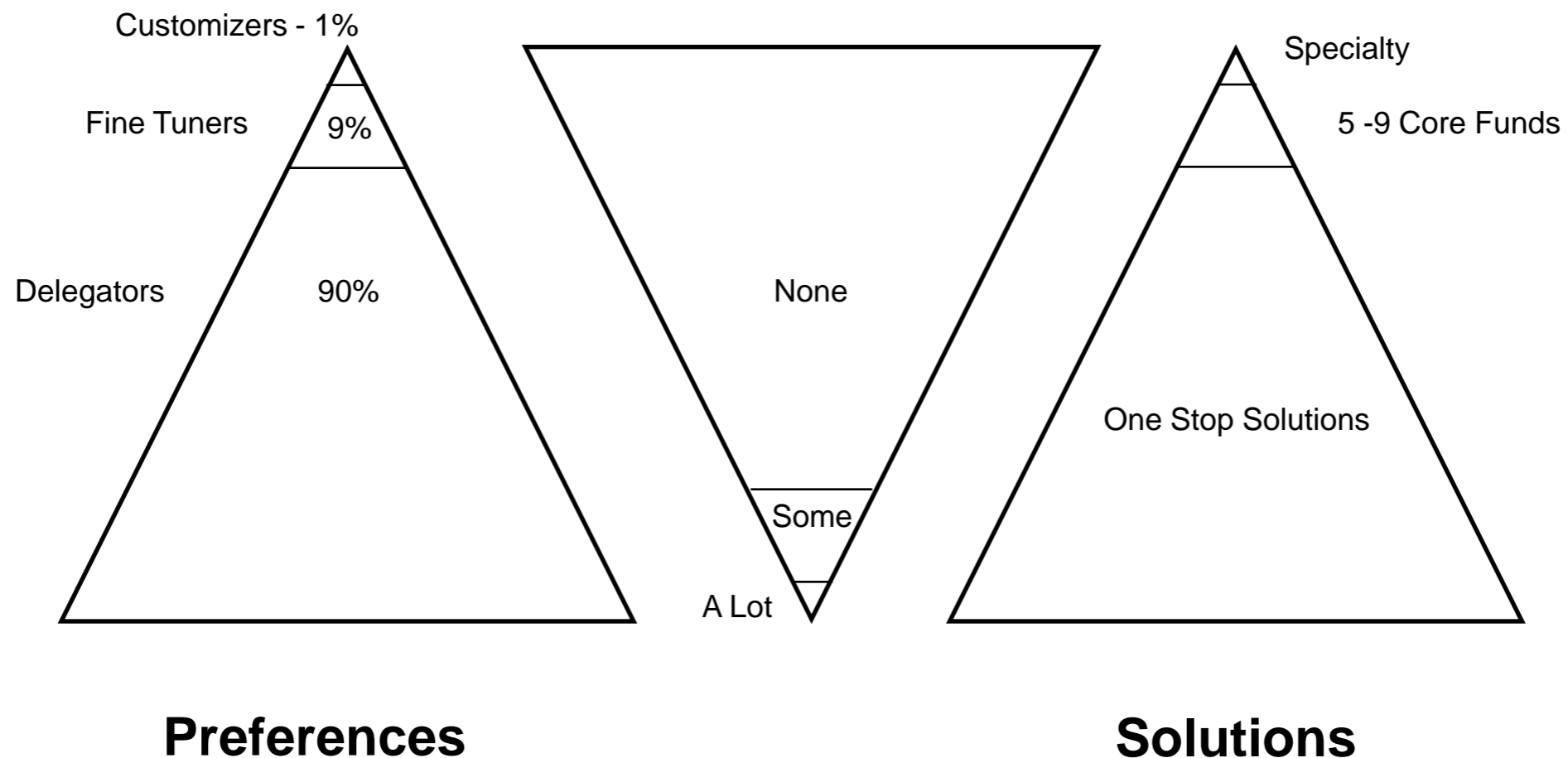
Most record keepers don't have the ability to offer tiered menus

Most record keepers don't have the ability to re-order investment options

Paper enrollment is one solution, but can also be a step backward

Save More Tomorrow Pyramids

Appetite / Action



Plan Menu Size

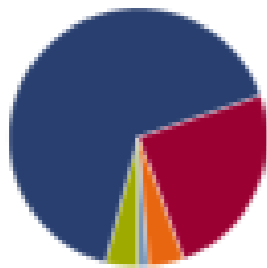
<u>Decade</u>	<u># of Options</u>
80's & 90's	2 or 3
2000's	11
2010's	18

Building A Diversified Portfolio

Can a “Goalmaker” type program work with a small plan menu?

Asset Allocation

ING Solution 2045 Port I (ISRX)



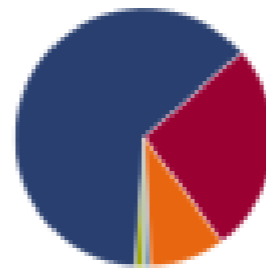
Cash	4.18
US Stock	65.51
Non US Stock	24.65
Bond	4.47
Other	1.19

T. Rowe Price Retirement 2040 (TRR0X)



Cash	3.03
US Stock	61.28
Non US Stock	27.52
Bond	6.71
Other	1.45

Vanguard Target Retirement 2040 Inv (VFT0RX)



Cash	1.17
US Stock	62.43
Non US Stock	26.18
Bond	9.49
Other	0.73

Detailed Breakdowns

Equity World Regions

Americas %	Greater Europe %	Greater Asia %
76.04	14.64	9.13
73.26	14.92	11.62
74.56	14.17	11.27

Equity Sectors

Cyclical Econ	Sensitive Econ	Defensive Econ
37.56	42.23	20.19
38.23	43.90	17.87
33.26	42.44	24.30

ING Solution 2045 Port I (ISRX)
T. Rowe Price Retirement 2040 (TRR0X)
Vanguard Target Retirement 2040 Inv (VFT0RX)

Equity Statistics

Price/Earn TTM	Price/Book TTM	Price/Sales TTM	Price/Cash Flow TTM	Geometric Market Cap	Return on Equity %	Return on Assets %	Debt to Capital %	Net Margin %
15.19	2.07	1.24	9.34	24,045.06	19.63	8.62	33.58	13.70
15.67	2.07	1.26	9.04	24,609.25	19.24	8.53	33.02	13.66
14.16	1.91	1.11	8.40	26,788.95	19.92	8.05	34.67	13.28

ING Solution 2045 Port I (ISRX)
T. Rowe Price Retirement 2040 (TRR0X)
Vanguard Target Retirement 2040 Inv (VFT0RX)

The above mentioned funds are for example only, this is not an endorsement or recommendation

Building A Diversified Portfolio

Sample of Asset Allocation options (Target Date fund) and the number of funds versus returns

# of Funds in Portfolio	U.S. Equity	International	U.S. Fixed	Intl. Fixed
ING (22 funds)	15	5	2	0
Price (18 funds)	8	4	4	2
Vanguard (3 funds)	1	1	1	0

Returns:

Trailing Performance

% Ret 1 Mo	% Ret 3 Mo	% Ret 12 Mo	% Ret 3 Yr	% Ret 5 Yr	% Ret 10 Yr	Since Inception	Inception Date	
3.31	-4.79	-2.79	12.96	-1.72	—	3.47	4/29/2005	ING Solution 2045 Port I (ISRO)
3.65	-4.54	-1.12	14.45	0.29	—	8.55	9/30/2002	T. Rowe Price Retirement 2040 (TRRD)
4.03	-3.81	-0.91	13.40	0.17	—	3.45	6/7/2006	Vanguard Target Retirement 2040 Inv (VFTD)
4.31	-4.59	-3.11	14.02	-0.02	7.88	5.76	12/31/1999	Idc Morningstar Lifetime Aggressive 2040

Adding more funds does not always increase return

3 Funds will do the job, but 5 - 9 seems more optimal

Current Investment Structure

Sands Capital



Neuberger
Berman



Wellington



1/3rd of each combine to
make:



North Carolina Large Cap Growth Fund



- Not a mutual fund
- Funded with separate accounts
- Structure not allowed in 403(b)
- Cannot combine multiple Large Growth Mutual Funds into a Single Option
- Large asset base allows for low costs in 401(k)/457(b)
- All-in fees are .632%
- The managers do have mutual fund equivalents
- But they are very expensive at .83% before any admin fees

Plan Lineup Choices

Federal Model

Federal Model Expanded

Federal Model Expanded + Strategy

Active+Passive+Strategy

Plan Lineup Possibilities

Federal Model

Domestic	Vanguard Total Stock Market	0.06%
International	Vanguard Total International Stock Market	0.18%
Fixed Income	Vanguard Total Bond Market Index	0.10%

Federal Model Expanded

Domestic Large Cap	Vanguard Index 500	0.05%
Domestic Mid Cap	Vanguard MidCap Index	0.10%
Domestic Small Cap	Vanguard Small Cap Index	0.16%
International Developed	Vanguard Developed Markets Index	0.12%
Intl Developed Small	DFA International Small	0.55%
Intl Emerging Markets	DFA Emerging Markets	0.61%
Fixed Income	Vanguard Short Term Bond Index	0.11%

Federal Model Expanded + Strategy

Domestic Large Cap	Vanguard Index 500	0.05%
Domestic Mid Cap	Vanguard MidCap Index	0.10%
Domestic Small Cap	Vanguard Small Cap Index	0.16%
International Developed	Vanguard Developed Markets Index	0.12%
Intl Developed Small	DFA International Small	0.55%
Intl Emerging Markets	DFA Emerging Markets	0.61%
Alternative (Tactical)	PIMCO All Asset	0.88%
Global Equity	GMO Global Asset Allocation	0.53%
Fixed Income	Vanguard Short Term Bond Index	0.11%

Active+Passive+Strategy

Domestic Large Value	American Mutual	0.32%
Domestic Large Growth	T. Rowe Price Growth	0.70%
Domestic Large Blend	Vanguard Index 500	0.05%
Domestic All Cap	Vanguard Total Stock Market	0.06%
Domestic Mid Cap	Vanguard Mid Cap Index	0.10%
Domestic Mid Growth	T. Rowe Price Mid Cap Growth	0.18%
Domestic Small Value	Allianz NFJ Small Cap Value	0.78%
Domestic Small Cap	Vanguard Small Cap Index	0.16%
Global Stock	GMO Global Asset Allocation	0.53%
Foreign Large Growth	American EuroPacific Growth	0.50%
Foreign Large	Vanguard Developed Markets	0.12%
Foreign SMID	DFA International Small	0.55%
Foreign Emerging Markets	DFA Emerging Markets	0.61%
Domestic Fixed Income	Vanguard Short Term Bond	0.11%
Domestic Fixed Income	Vanguard Inflation-Protected	0.20%
Domestic Fixed Income	PIMCO Total Return	0.46%
Tactical Asset Allocation	PIMCO All Asset	0.88%

Potential Lineup Costs	Avg. Cost	Plan Admin	Total Avg. Cost
Federal	0.11%	0.25%	0.36%
Federal Expanded	0.24%	0.25%	0.49%
Federal Expanded+Strategy	0.35%	0.25%	0.60%
Active+Passive+Strategy	0.37%	0.25%	0.62%

Federal Model

This model menu essentially mirrors the Federal Thrift Savings Plan. It consists only of broad based indexes that are extremely low in cost and diversified, typically as follows:

Vanguard Total Stock Market Index
.06%

Vanguard Total International Stock Market Index
.18%

Vanguard Total Bond Market Index
10%

The beauty of this model is in its simplicity, there is no (very limited) monitoring needed and participants are not overwhelmed by too much choice.

There are some downsides to this model though. While the funds are diversified, one cannot vary exposure to individual stock asset classes other than deciding between domestic and foreign. In addition, every so often market-cap weighted indexes become dominated by certain asset classes (such as the late 90's) and investors become overly invested in the most expensive stocks.

While this model is extremely low in cost it excludes alternative asset classes (such as real estate, TIPS, commodities, etc.) and does not allow for a very active asset allocation process.

Pros

- Very Simple
- Fulfills ERISA
- Similar to Federal Thrift Savings Plan
- Low in cost
- Limited monitoring
- 2nd Largest Target Date provider uses only these funds

Cons

- Might be too Simple
- Limits ability to do asset allocation
- Broad indexes sometimes get too focused in top stocks
- Excludes alternative asset classes that allow for greater diversification

Federal Model Expanded

This model is very similar to the Federal Model but allows for a larger menu of index funds in order to allow the participant or the participant's advisor to target certain asset classes and build more diversified and tactical portfolios.

Instead of using the broad based market indexes, it slices the indexes up into their components. Looking something similar to the chart to the on the right:

This menu maintains simplicity (only four funds added) while allowing greater asset allocation options for investors.

Domestic Large Cap	Vanguard Index 500	0.05%
Domestic Mid Cap	Vanguard MidCap Index	0.10%
Domestic Small Cap	Vanguard Small Cap Index	0.16%
International Developed	Vanguard Developed Markets Index	0.12%
Intl Developed Small	DFA International Small	0.55%
Intl Emerging Markets	DFA Emerging Markets	0.61%
Fixed Income	Vanguard Short Term Bond Index	0.11%

Federal Model Expanded+Strategy

This plan lineup model builds on the Federal Model Expanded by adding a few alternative asset classes and managed strategies.

In this model you can add the individual component alternative asset classes such as real estate, commodities, inflation-protected securities, emerging market bonds, etc.

The one issue with adding the individual alternative asset classes is that participants may not know how or when to utilize and instead of using them in a strategic or tactical manner they will simply choose the one's that had the highest return in the past few years.

One solution is to add “Strategy” managers who have the ability to use alternatives within their asset allocation solutions. Examples are PIMCO’s All Asset fund and GMO’s suite of asset allocation funds.

This lineup adds costs to the menu, but with the added benefit of adding diversification and if used correctly lowering volatility in a participants portfolio. You can keep the lineup to about a dozen funds (before target dates) which is still a relatively simple lineup.

Domestic Large Cap	Vanguard Index 500	0.05%
Domestic Mid Cap	Vanguard MidCap Index	0.10%
Domestic Small Cap	Vanguard Small Cap Index	0.16%
International Developed	Vanguard Developed Markets Index	0.12%
Intl Developed Small	DFA International Small	0.55%
Intl Emerging Markets	DFA Emerging Markets	0.61%
Alternative (Tactical)	PIMCO All Asset	0.88%
Global Equity	GMO Global Asset Allocation	0.53%
Fixed Income	Vanguard Short Term Bond Index	0.11%

Active+Passive+Strategy

This lineup includes both active and passive asset class investment options as well as alternative asset classes and/or strategy funds.

This lineup requires additional monitoring and tends to be more expensive. The advantage is that it could add to participants returns (if the active solutions work) and it could allow for greater diversification.

This is essentially the strategy employed for the current 401(k) and 457(b) programs.

Current 401(k) & 457(b):

GoalMaker
14 Investment Options

8 Active Equity (multi-manager)
1 Active Fixed Income (multi-manager)
3 Equity Indexed Options
1 Fixed Income Index Option
1 Stable Value Fund

Domestic Large Value	American Mutual	0.32%
Domestic Large Growth	T. Rowe Price Growth	0.70%
Domestic Large Blend	Vanguard Index 500	0.05%
Domestic All Cap	Vanguard Total Stock Market	0.06%
Domestic Mid Cap	Vanguard Mid Cap Index	0.10%
Domestic Mid Growth	T. Rowe Price Mid Cap Growth	0.18%
Domestic Small Value	Allianz NFJ Small Cap Value	0.78%
Domestic Small Cap	Vanguard Small Cap Index	0.16%
Global Stock	GMO Global Asset Allocation	0.53%
Foreign Large Growth	American EuroPacific Growth	0.50%
Foreign Large	Vanguard Developed Markets	0.12%
Foreign SMID	DFA International Small	0.55%
Foreign Emerging Markets	DFA Emerging Markets	0.61%
Domestic Fixed Income	Vanguard Short Term Bond	0.11%
Domestic Fixed Income	Vanguard Inflation-Protected	0.20%
Domestic Fixed Income	PIMCO Total Return	0.46%
Tactical Asset Allocation	PIMCO All Asset	0.88%



Questions?