Your 401(k) Is Probably Underperforming

Avery Hayes

Most people set up their workplace retirement account once and never look again. If you landed in a target-date fund by default, you may be paying more than necessary, growing more slowly than you should, and taking far less control than you realize you can.

Roughly 80% of 401(k) assets held by first-time participants end up in target-date funds, according to Vanguard's *How America Saves* report.[1] For many plans, enrollment in a target-date fund is the automatic default. You do nothing, and the plan does it for you.

That convenience sounds like thoughtful design. But the more you understand what a target-date fund actually does, and what it assumes about your life, the more questions it raises.

What a Target-Date Fund Actually Is

A target-date fund (TDF) is a "fund of funds." It holds a mix of stock and bond funds, and that mix automatically shifts toward bonds as you approach the year in the fund's name. A 2045 fund holds mostly equities today and drifts more conservatively over the next 20 years.

For someone who would otherwise leave their account untouched, a TDF is meaningfully better than nothing. But "better than nothing" and "right for your situation" are two very different things.

> **THE CORE ASSUMPTION**
> Target-date funds are built around one premise: that you retire on a specific date and begin drawing down your assets shortly after. For most people today, that assumption misses the full picture. The consequences compound quietly for decades.

The Longevity Problem Nobody Talks About

The average 65-year-old American today can expect to live well into their mid-to-late 80s, with many reaching 90 or beyond.[2] A retirement that begins at 65 may last 25 to 30 years, longer than most people's working career before age 40.

30	3x	40-50%
Avg. years in retirement	Purchasing power lost to inflation over 30 yrs at 3%	Typical TDF bond allocation at target date

A portfolio that is 40 to 50% bonds at retirement may look prudent on paper. In practice, it has a much harder time keeping pace with inflation over a multi-decade withdrawal period. You may run out of money not because the market crashed, but because your portfolio simply did not grow enough to sustain 30 years of spending.

The glide path built into a TDF was designed for a retirement model that assumed people lived to roughly 80. It was not designed for the retirement most people are actually facing today.

Bonds Are Not as Safe as They Used to Be

There is a second problem with the shift toward bonds that gets far less attention: bonds have not behaved like a safe harbor in recent years.

In 2022, the Bloomberg U.S. Aggregate Bond Index, the benchmark most TDFs use for their bond allocation, fell by over 13%, its worst year in modern history.[3] That same year, many target-date funds with 2025 or 2030 target dates lost 15 to 20% of their value, nearly as much as equity-heavy portfolios.[4] For someone five years from retirement, that was a significant blow at exactly the wrong time.

> *"Moving into bonds as you near retirement used to mean reducing risk. In a rising-rate environment, it can mean trading one kind of risk for another."*

The traditional logic of stocks for growth and bonds for safety holds up over long time horizons. But when interest rates rise sharply, bond prices fall. A retiree who shifted heavily into bonds, expecting stability, got neither stability nor growth. This is a structural limitation of the TDF model that the target date on the label does nothing to address.

The Fee Question Worth Asking

Target-date funds carry what is called a layered expense structure. The TDF charges its own management fee on top of the fees of every underlying fund it holds. This can make them more expensive than building a similar allocation yourself using your plan’s individual index fund options.

FUND TYPE	TYPICAL EXPENSE RATIO
Low-cost index fund (e.g., S&P 500)	0.03% to 0.05%
Institutional TDF (large employer plan)	0.10% to 0.15%
Retail TDF (smaller employer plan)	0.40% to 0.75%

Source: Morningstar 2023 Target-Date Landscape report.[5]

The key question is not just what you are paying, but what you are getting for it. A higher-cost TDF in a smaller plan that still does not address your tax situation, Social Security timing, healthcare costs, or estate wishes may leave a lot on the table.

What a TDF Cannot Do

A target-date fund cannot know your tax situation, your Social Security strategy, your spouse's income, your pension, or how much guaranteed income you will have in retirement. It knows your projected retirement year and nothing else.

Two 50-year-olds in the same 2040 fund could have completely different financial pictures. One might have a pension and a spouse's income providing a strong base, so she may actually benefit from more growth-oriented exposure, not less. The other might have limited savings and no other retirement assets, so he also needs more growth, just for entirely different reasons. The fund treats them identically.

This is where working with a retirement planning specialist makes a material difference. Someone who integrates investment management with tax planning, income planning, Social Security strategy, healthcare and Medicare planning, and estate planning sees the whole picture. The investment allocation is one piece. A coordinated retirement plan accounts for all of them.

A Few Steps Worth Taking Now

QUESTIONS TO ASK ABOUT YOUR 401(K)

1. **Find your expense ratio.** Log into your 401(k) portal, locate your current fund, and look up its expense ratio. If you are in a retail TDF above 0.40%, your plan likely has lower-cost individual index fund options worth exploring.
2. **Revisit your equity allocation.** If you are in your 40s or 50s and have a 25 to 30 year retirement ahead, consider whether your current allocation actually reflects that time horizon, or whether the fund's glide path is pulling you more conservative than your situation warrants.
3. **Think about your full retirement picture.** Will you have Social Security? A pension? A spouse's income? The more guaranteed income you will have, the more risk your portfolio may be able to tolerate. Your allocation should reflect that, not just your age.

4. **Get a second set of eyes.** A retirement planning specialist can review whether your 401(k) fits into your broader plan, including taxes, income sequencing, healthcare costs, and legacy goals.

Your 401(k) is likely your largest financial asset. It deserves more than a default enrollment choice made at onboarding. Whether you are 35 or 60, a few hours of attention to what's inside your account can meaningfully change what retirement actually looks like for you.

This article is for educational purposes only and does not constitute personalized investment advice. All figures and examples are illustrative. Please consult with a qualified retirement planning specialist before making changes to your retirement accounts.

SOURCES

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AVERY HAYES

Financial Strategist, Investment Advisor Representative

Avery Hayes is a dedicated Financial Strategist at Hayes Advisory Group with a focus on strategic planning and education. With a passion for helping clients navigate the complexities of financial management, Avery specializes in creating and implementing comprehensive plans that encompass investment management, financial planning, and tax planning. Avery's approach is rooted in a deep understanding of the financial landscape and a commitment to educating clients, empowering them to make informed decisions about their financial future. Avery also helps with educational courses taught through employer classes, classes taught for Federal employees, and The Prepare Institute, a 501©3 non-profit educational institution.

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