

Default Investment Options in Defined Contribution Plans: A Simple Comparison

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The DOL proposed three types of "qualified default investment alternatives." At this moment, we have compared the investment performance of two of them - a balanced fund and a lifecycle fund - using average asset allocations observed on the market. They are evaluated as well against the near-risk-free Treasury Inflation-Protected Securities (TIPS). According to the simulations, the balanced fund is slightly more likely to outperform the lifecycle fund, but its more aggressive approach also leaves plan participants more vulnerable to losses when they are least likely to be able to afford them - as retirement approaches. The lifecycle fund is better at safeguarding wealth in a downward market, while still doing a reasonable job of building wealth. Because it shifts assets to cash at retirement, the market average lifecycle fund, however, forgoes hedging opportunities for the purchase of immediate life annuities.