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CORRESPONDENCE / MEMORANDUM

DATE: February 26, 2015
TO: Deferred Compensation Board
FROM: Shelly Schueller
Deferred Compensation Director
SUBJECT: Vanguard Target Date Fund News
1) Institutional share class option available
2) Global allocation change

Staff recommends the Board consider changing the Vanguard Target Date Fund offerings from retail share classes to the soon-to-be-available and lower-cost institutional share class options.

No action is required regarding the change in global allocations. This information is for information only.

Vanguard Opening Institutional Share Class Option for Target Date Funds

The Target Date Retirement Funds are very popular with Wisconsin Deferred Compensation Program (WDC) participants. As of January 31, 2015, approximately 20,000 participants held more than \$350,228,000 in the Target Date Retirement Funds. This is more than 10% of the WDC's overall assets.

As part of the Board's ongoing review of investment fees, the Investment Committee met with Vanguard on February 10, 2015 to discuss collective trusts and pros and cons associated with moving the Target Date Retirement Funds from the current mutual fund versions to lower-cost collective trusts. The trade-offs with collective trusts discussed included a positive in potentially lower expenses of 8.25 bps and negatives in reduced transparency and regulatory oversight. (See Item 6)

On February 26, 2015 Vanguard announced that new, lower-cost institutional share classes of the Target Date Funds will be available to qualified institutional investors such as the WDC by the end of June 2015. The new institutional share class option would preserve the transparency and oversight offered by mutual funds at a lower cost to WDC participants than the retail share classes now offered. The Vanguard Target

Reviewed and approved by Matt Stohr, Administrator,
Division of Retirement Services

Electronically Signed 2/26/15

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Retirement Date Funds offered now through the WDC have expense ratios ranging from 16 to 18 bps (basis points). If the WDC's Target Retirement Date funds were converted to institutional share classes, the expense ratios would drop to an estimated expense ratio of 10 bps. This would be a significant savings for WDC participants utilizing the Target Date Funds. Staff recommends the Board pursue moving to the institutional share class options as soon as practicable.

Global Diversification

Vanguard also announced on February 26, 2015, that the firm intends to increase the international equity and fixed income allocations in the Target Retirement Funds and decrease U.S. equity and fixed income allocation throughout the remainder of 2015. This is a strategic decision on Vanguard's part intended to provide further diversification and reduce volatility. International equities and fixed income will both increase by 10% and U.S. Equity and fixed income will decrease 10%. The target for international equities is 40% and international fixed income is 30%.

Staff from Vanguard and the Department will be at the Board meeting to discuss the contents of this memo.

Attachment: February 26, 2015 Vanguard Announcement "[Expanded target-date lineup, more diversification](#)"



Expanded target-date lineup, more diversification

February 26, 2015

Vanguard plans to expand its low-cost target-date lineup with an array of new mutual funds and trusts for institutional investors by the end of the second quarter. The company also will increase the exposure to international equity and fixed income in several all-in-one funds, including the Target Retirement Funds.

The Vanguard Institutional Target Retirement Funds, announced in a registration statement filed today with the Securities and Exchange Commission, are expected to be priced 30% lower than the lowest-cost target-date mutual fund option in the industry.¹ The funds will include 12 new target-date funds, with an estimated expense ratio of 0.10% and a minimum initial investment of \$100 million.²

"Single-fund options have revolutionized the retirement savings landscape," said Vanguard CEO Bill McNabb. "Professionally managed, diversified investment options such as Target Retirement Funds have helped enhance the future financial security of investors by providing a sophisticated asset allocation and a disciplined, long-term strategy in an all-in-one fund offering."

Along with the new mutual funds, Vanguard will also introduce Target Retirement Trust Select by the end of the second quarter. The Target Retirement Trusts are collective investment trusts that, like the Target Retirement Funds, invest in several Vanguard mutual funds to create a broadly diversified mix of equities and fixed income. Target Retirement Funds and Trusts have identical investment approaches, glide paths, and target allocations.

Enhancing global diversification

Vanguard also announced today that it will increase the international equity and fixed income weightings in the Target Retirement Funds and other all-in-one funds to further enhance global diversification and reduce country-specific investment risk.

International allocations within the two asset classes will increase by 10 percentage points in each portfolio of the Target Retirement Funds and the four LifeStrategy® Funds. The new allocations are shown in the table below:

Asset class	New allocation	Former allocation
Equities	60% U.S./40% international	70% U.S./30% international
Fixed income	70% U.S./30% international	80% U.S./20% international

¹ Source: Vanguard and Morningstar, as of November 2014.

² Investment minimums are at the plan sponsor level. Participants are not subject to a minimum investment requirement.

"International holdings are a valuable diversifier in a balanced portfolio, giving shareholders exposure to return streams that don't move in lockstep with the U.S. markets," Vanguard Chief Investment Officer Tim Buckley said. "It has become easier to capture these diversification benefits as the costs of international investing have decreased."

In recent years, the cost differences between U.S. and international markets have shrunk by approximately 30%, and international transaction costs have declined as well. Therefore, the shift to higher international equity and fixed income weightings can be achieved without increasing costs.

The overall strategic asset allocation of the Target Retirement and LifeStrategy Funds won't change, and the new allocation won't alter the overall glide path of the Target Retirement Funds. The investment allocation changes to the higher weightings in international equities and fixed income are expected to be completed by year-end 2015.

Holistic approach to allocation decisions

Since introducing the Target Retirement Funds in 2003, Vanguard has made only a few allocation changes. Increased global diversification has been a consistent theme, with the addition of emerging market exposure to "near-dated" funds in 2006, increased exposure to international equities in 2010, and the addition of international fixed income in 2013.

Such changes grow out of an approach that embraces a wide range of expert perspectives including internal and external research, plan design optimization, input from consultants and plan sponsors, and analysis of investor behavior.

"We carefully debate the merits of proposed changes to our Target Retirement Funds and other funds of funds, and make them when deemed to be in the best, long-term interests of our clients," Mr. Buckley said.