Ibbotson Target Risk Report 2Q 2014

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In the second quarter, many equity markets achieved all-time high levels, rate sensitive assets benefited from slight reductions in yields, and volatility continued along at very low levels. This "goldilocks" environment resulted in positive returns for all of the target risk funds in our report this quarter. The Chicago Board Options Exchange's Market Volatility Index (VIX), a popular measure of expected market volatility, dipped below 10.3 this month, a level that we have not seen since early 2007 when it briefly dropped below 10. Highlights from this quarter's report include:

- We currently track 314 open-end funds and 274 insurance product funds from 84 firms with aggregate AUM of $746.0 billion.
- Since last quarter's report, three new target risk funds were added from Frost Funds. Four Met Life Insurance Product funds were merged into other products. Two Pioneer VCT Insurance Product funds were closed (Met Life clients were the primary investors and assets were merged into other Met Life funds).
- Target risk funds gained 3.3% on average for the second quarter and 15.1% over the past 12 months.
- Target risk funds saw aggregate flows return to positive territory as $1.8 billion in assets entered the category during the quarter.
- Target risk funds continue to see total assets climb to all-time highs. As of the end of Q2, total assets in target risk funds were over $746 billion, a 15% increase from a year ago.

In our report, we review performance results for target risk funds for the second quarter of 2014 and for the last 12 months. We investigate the drivers of performance and provide an update to industry assets under management (AUM) and flows for the past quarter and year. See the Disclosures section at the end of this report for a additional descriptions of our criteria for inclusion into our report.

Target Risk Performance Summary

On average, target risk funds posted positive returns in the second quarter—the average target risk fund gained 3.3%. For the 12-month period ending June 30, 2014, the average target risk fund posted even stronger performance, generating a return of 15.1%. During the quarter, returns were boosted by REITs, emerging market equities, domestic large-cap equities and TIPs. Over the last year, many equity asset classes have underperformed the S&P 500 (U.S. small-cap equities, international and emerging market equities, for example). This typically diminished the value of diversification in target risk portfolios.

Table 1: Target Risk Performance Summary

	Q2 Return	12-Month Return
Average Target Risk Fund*	3.3%	15.1%
Morningstar Aggressive Target Risk Index	4.7%	22.8%
Morningstar Moderately Aggressive Target Risk Index	4.2%	19.7%
Morningstar Moderate Target Risk Index	3.7%	15.6%
Morningstar Moderately Conservative Target Risk Index	3.0%	11.5%
Morningstar Conservative Target Risk Index	2.3%	7.4%
S&P 500 Index	5.2%	24.6%
MSCI EAFE GR USD	4.3%	24.1%
Barclays U.S. Aggregate Bond Index	2.0%	4.4%

Source: Ibbotson Associates and Morningstar Direct[SM] (see end for important disclosures)
*Average of all Open-end and Insurance Product target risk funds that are tracked by Morningstar
Indexes shown are not available for direct investment. Past Performance is not a guarantee of future performance.

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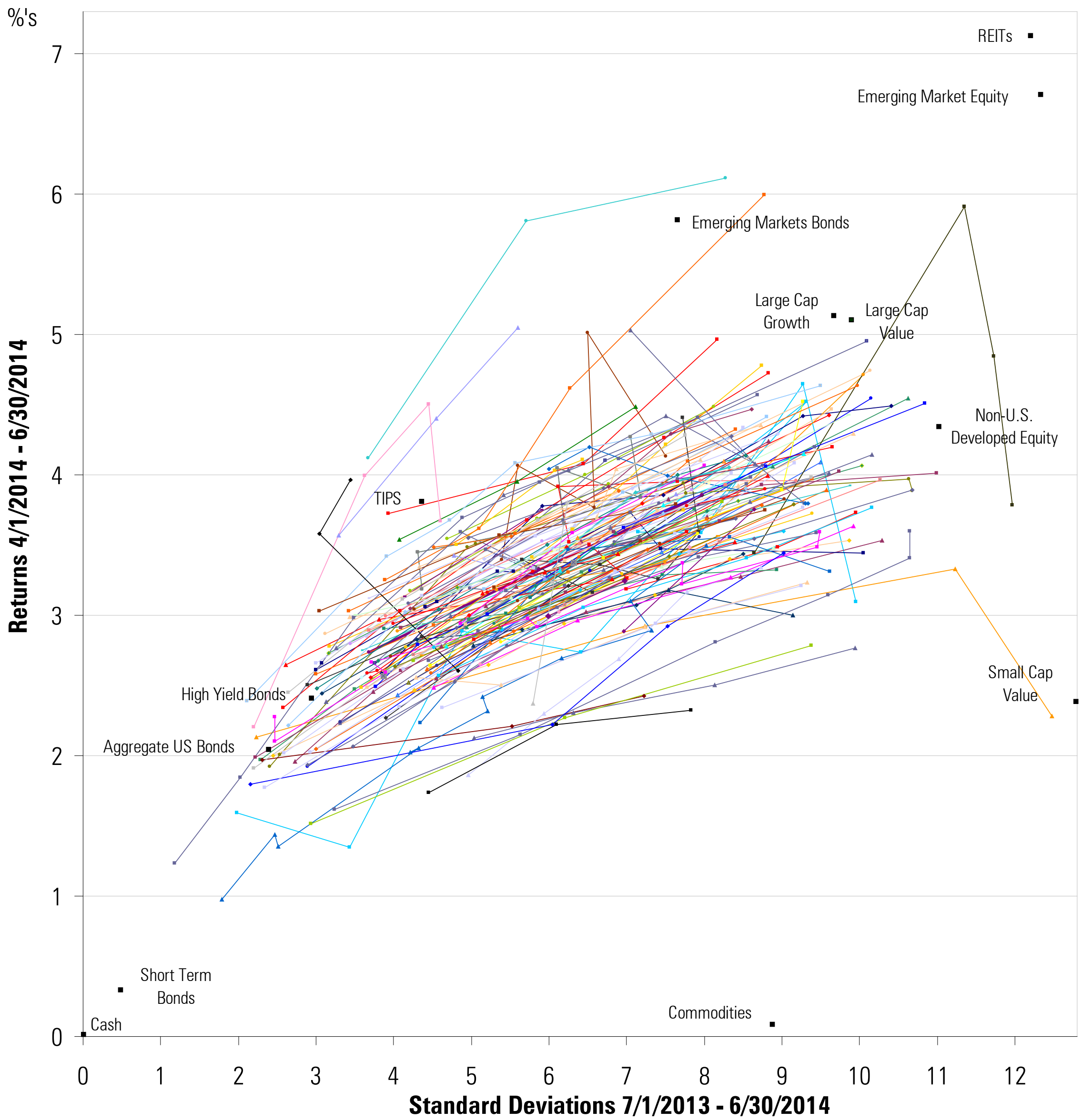
Fund Family Performance

The performance of target risk fund lineups during the quarter is summarized in Figure 1. We are now tracking 562 unique target risk funds with at least a one-year track record that are managed by 83 fund companies. The lines in the graph connect funds from the same fund lineup. Second-quarter net returns are plotted on the vertical axis and 12-month standard deviations are on the horizontal axis. All of the target risk funds we track had positive returns this quarter. The funds show a traditional upward sloping pattern as funds that took on greater levels of risk were generally rewarded with higher returns.

Funds with large REIT, emerging markets equity, and emerging markets bonds allocations have higher lines on our chart this quarter, as those asset classes posted higher returns than other asset classes. Small-cap equities, commodities, and shorter-term bonds contributed to underperformance of many lineups.

Figure 1: Target Risk Fund Lineup Performance – Q2 Return and One-Year Risk Ending 6/30/2014



Source: Ibbotson Associates and Morningstar Direct[SM] (see end for important disclosures)

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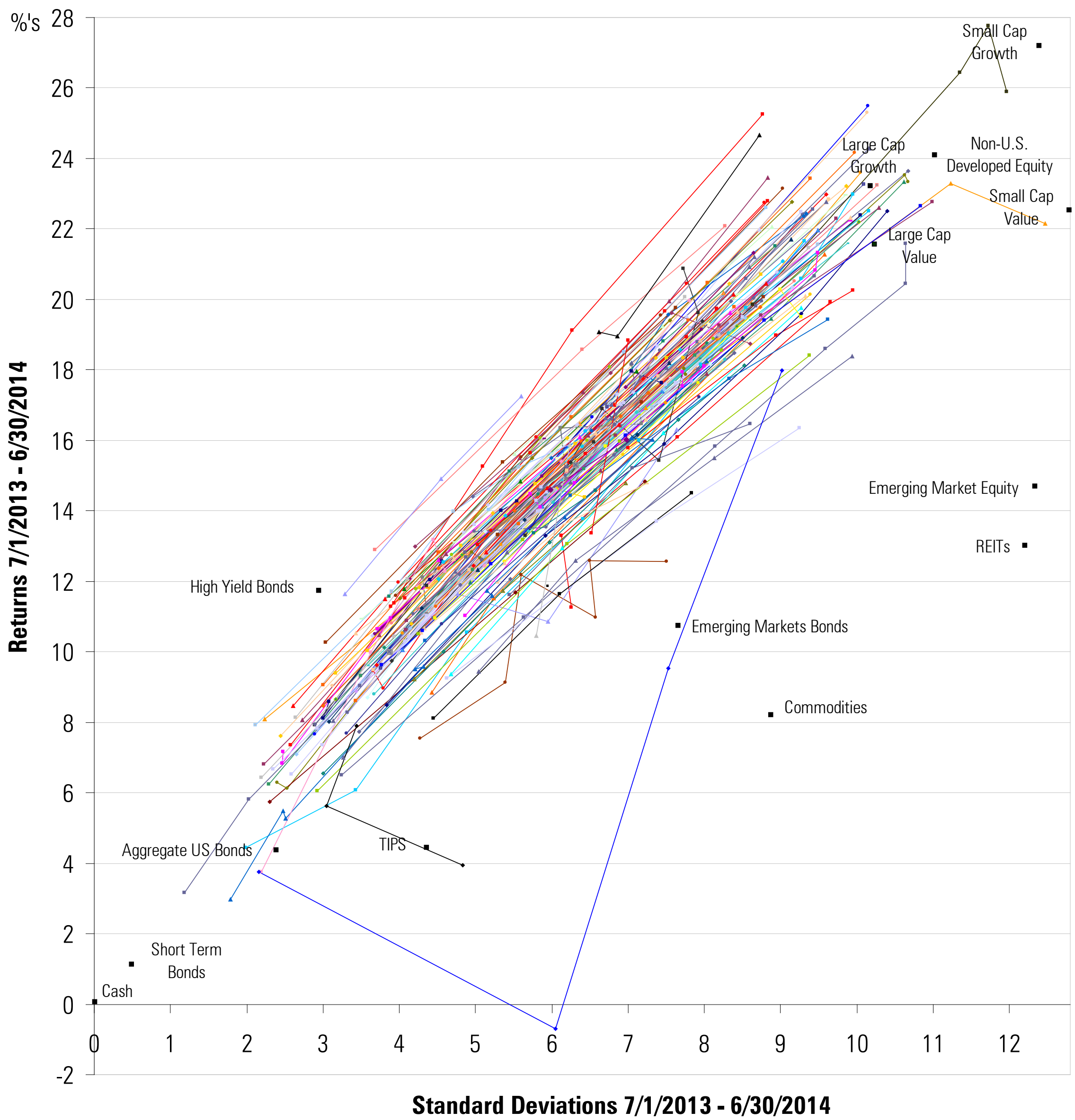
The same risk/return information over the past 12 months is displayed in Figure 2. Here we see a steeply upward-sloping trend, as results have been strongly influenced by returns of over 20% for many U.S. equity asset classes. Overall volatility has been quite low relative to historical results, as standard deviations around 10% for aggressive models are roughly half what we have seen in the long run. In our view, Sterling Capital's Strategic Allocation series (light blue triangles) and Manning & Napier's Pro Blend series (red squares) had good performance and risk results that landed their lines in the upper left side of the cluster. Sterling Capital's funds are relatively concentrated, with only four underlying funds in each fund-of-funds. Their low exposure to REIT securities helped boost relative performance. Manning & Napier is one of the few families that hold individual stock and bond securities (over 400 in each fund) instead of funds. Their higher than average allocation to utility stocks and their overall growth bias helped boost relative performance. At the bottom right are Stadion's funds (dark blue diamonds) and Forward's series of funds (light brown circles). Stadion's funds include tactical and managed risk strategies that did not perform well over the last year. Forward has relatively large allocations to commodities and non-U.S. equities that hurt relative performance. The five Morningstar Target Risk Indexes are difficult to pick out, but plot in the center of the cluster in a red line.

Figure 2: Target Risk Fund Lineup Performance – 12-Month Return and One-Year Risk Ending 6/30/2014



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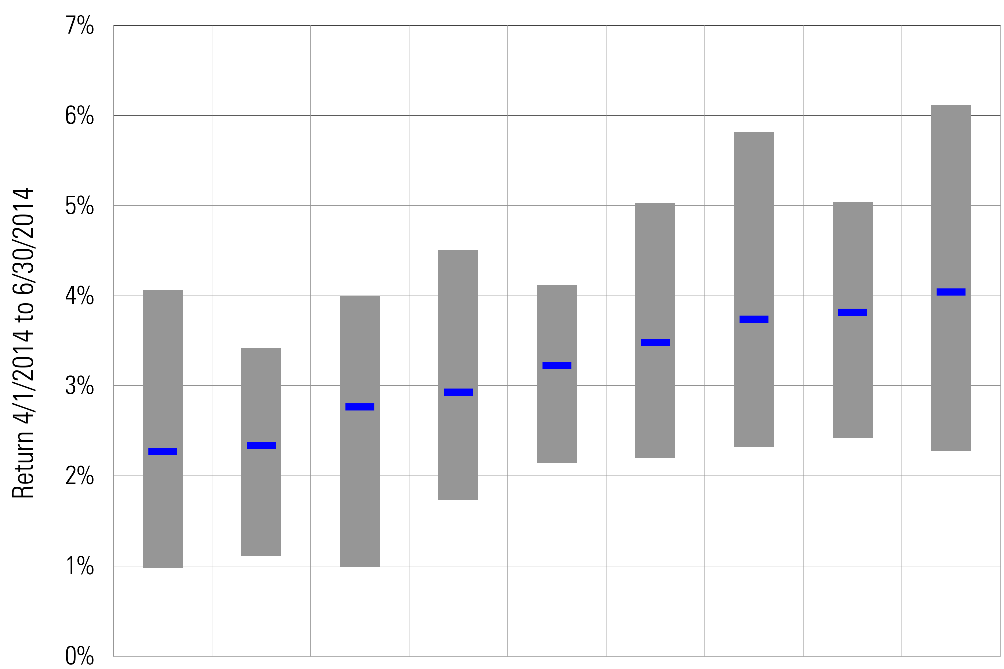
Target Risk Fund Performance

Most of the target risk funds covered in this report are assigned to one of four Morningstar Categories:

- U.S. Conservative Allocation - 10 to 50% equity
- U.S. Moderate Allocation - 50 to 70% equity
- U.S. Aggressive Allocation - 70 to 90% equity
- U.S. Large Blend - 90 to 100% equity

For the purpose of this report, we are subdividing these broad categories into more granular, 10 percent range groups (i.e. 15 to 24.9% equity). We used average recent historical equity exposure information from Morningstar Direct[SM] to make these assignments (for funds with high "Other" exposure and for very young funds, we used a multi-factor daily return regression analysis). This will allow us to make more specific statements about each peer group. Figure 3 offers performance data relative to each fund's equity group. The floating gray bars within the chart show the range of quarterly returns for our nine peer groups. The blue line within each bar identifies the average fund performance for that group. Meaningful differences can be observed between the best-performing funds ("Max" row within the table below) and the worst-performing funds ("Min" row within the table below) in each group, reflecting "intra-category" differences in equity levels, granular asset class differences, and underlying security and/or fund exposures.

Figure 3: Target Risk Peer Group Performance Q2 2014



Category	Under 15 Equity %	15 to 24.9 Equity %	25 to 34.9 Equity %	35 to 44.9 Equity %	45 to 54.9 Equity %	55 to 64.9 Equity %	65 to 74.9 Equity %	75 to 84.9 Equity %	85 to 100 Equity %
Max	4.1%	3.4%	4.0%	4.5%	4.1%	5.0%	5.8%	5.0%	6.1%
Average	2.3%	2.3%	2.8%	2.9%	3.2%	3.5%	3.7%	3.8%	4.0%
Min	1.0%	1.1%	1.0%	1.7%	2.2%	2.2%	2.3%	2.4%	2.3%
# of Funds (vs Group Avg)									
Outperformers	8	23	33	37	38	45	43	31	30
Underperformers	10	19	26	36	39	51	36	42	38
Total	18	42	59	73	77	96	79	73	68

Source: Ibbotson Associates and Morningstar, Inc. (see end for important disclosures)

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Asset Class Performance

Quarterly performance for some of the most common asset classes that comprise target risk funds are displayed in Table 2. This data allows us to determine which asset classes were the primary drivers and detractors from performance during the second quarter of 2014.

Table 2: Asset Class Performance – Q2 2014

Asset Class	Q2 2014 Return	12-Month Standard Deviation
U.S. Large Growth Equity	5.1%	9.7%
U.S. Large Value Equity	5.1%	9.9%
U.S. Small Growth Equity	1.7%	14.3%
U.S. Small Value Equity	2.4%	12.8%
Non-U.S. Developed Equity	4.3%	11.0%
Emerging Market Equity	6.7%	12.3%
Real Estate	7.1%	12.2%
Commodities (Futures)	0.1%	8.9%
High Yield Bonds	2.4%	2.9%
U.S. Aggregate Bonds	2.0%	2.4%
U.S. Short-Term Bonds	0.3%	0.5%
TIPS	3.8%	4.4%
Cash	0.0%	0.0%

Source: Ibbotson Associates and Morningstar Direct[SM]
Indexes shown are not available for direct investment. Past Performance is not a guarantee of future performance.

Equity markets posted gains during the quarter, buoyed by increasingly positive trends in domestic economic data. GDP forecasts point to over 3% growth during the quarter, while the unemployment rate fell to 6.1% over the period. The S&P 500 Index delivered a 5.2% gain in the second quarter; outsized on an annual basis compared to historical returns. While large-cap stocks posted strong relative performance, the Russell 2000 index of smaller companies returned 3.0% less than its larger counterpart. International developed stocks underperformed their domestic counterparts; however, emerging markets had a bit of a resurgence, beating the S&P 500 by 1.6% during the period. Considering the difficult political circumstances involving Ukraine and Russia, it is encouraging that there was no negative contagion to the broader emerging market economies. Real estate securities followed a strong first quarter by posting the highest second quarter return among commonly used asset classes in target risk programs.

Bond investors were rewarded during the quarter as falling yields led to positive total returns. Even with the sustained reduction in bond purchases by the Federal Reserve, over the past three months, the 10-year Treasury yield fell from 2.73% to 2.53%. TIPs, high yield and aggregate bonds all returned over 2.0% for the quarter, while long-term bonds delivered even higher gains. While many market prognosticators have remained concerned about yields given the expected future rise in the Federal Funds rate, the fixed income market has not been negatively impacted at this juncture.

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Similar to Table 2, asset class returns and standard deviations for the past 12 months are displayed in Table 3.

Table 3: Asset Class Performance – 6/30/2014 Trailing 12 Months

Asset Class	12-Month Return	12-Month Standard Deviation
U.S. Large Growth Equity	26.9%	9.7%
U.S. Large Value Equity	23.8%	9.9%
U.S. Small Growth Equity	24.7%	14.3%
U.S. Small Value Equity	22.5%	12.8%
Non-U.S. Developed Equity	24.1%	11.0%
Emerging Market Equity	14.7%	12.3%
Real Estate	13.0%	12.2%
Commodities (Futures)	8.2%	8.9%
High Yield Bonds	11.7%	2.9%
U.S. Aggregate Bonds	4.4%	2.4%
U.S. Short-Term Bonds	1.1%	0.5%
TIPS	4.4%	4.4%
Cash	0.1%	0.0%

Source: Ibbotson Associates and Morningstar Direct[SM]
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Trailing 12-month returns through the second quarter of 2014 continue to look impressive for most equity markets. U.S. large-cap growth stocks returned a leading 26.9% over the period and U.S. growth stocks continued to edge out U.S. value stocks. International equities, including emerging markets, underperformed U.S. equities thereby detracting from the overall returns for target risk funds that incorporate a stronger global tilt relative to their peers. As mentioned earlier, emerging markets have closed the performance gap slightly with a strong start to 2014, but growth concerns have weighed on the asset class over the past 12 months. REITs and commodities, while positive on an absolute basis, hurt performance relative to a basic equity benchmark. Target risk funds have had a difficult time adding value through diversification over the near-term due to the outsized relative performance of the S&P 500.

As we mentioned in prior reports, it is worth noting that risk across most asset classes has been significantly below historical averages during the past year. Since 1926, the S&P 500 has an annual standard deviation of 21%. All of the asset classes shown in Table 3 have a standard deviation below this figure, with some domestic equities at less than half of this historical risk measure.

Investment-grade fixed income returns moved into positive territory for the trailing 12 month period. High-yield bonds continued to lead fixed income securities during this period with a return of 11.7%. Flat yields and tight credit spreads have contributed to the strong returns. Rates on 10-year government bonds fluctuated over the past 12 months, but ended nearly exactly where they began last July. This allowed investors to collect yield while generally experiencing little difference in their principal investment.

Overall, target risk funds that had higher exposure to domestic equities and bonds with lower credit quality were rewarded over the last year. Diversification into non-U.S. equities and alternative asset classes generated significant headwinds for many target risk funds.

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Fund Flows

During the second quarter, inflows were positive overall with $1.8 billion entering target risk funds. As we have seen in recent periods, the extreme portfolios (very conservative/very aggressive) have seen outflows, while portfolios with equity levels between 30-85% capture a majority of the inflows. John Hancock, Pacific Life and Columbia were the firms with the largest outflows, all exceeding $900 million for the quarter. Lincoln, Transamerica, and Fidelity had the largest inflows.

As of the end of Q2, total assets in target risk funds were up over 15% from a year ago and 34% over the past three years. Variable annuity ("VA") programs account for a slight majority of registered target risk assets, representing 61% of the overall AUM in the target risk products we are tracking. For the quarter, open-end products saw inflows of $1.3 billion, outpacing VA program flows of $541 million. Outflows aside, John Hancock continues to be the largest target risk fund family in terms of total AUM, accounting for approximately 10% of total assets ($77 billion); however, Columbia, Advanced Series Trust, Pacific Life, and Met Life all have over $40 billion in assets.

Table 4: Target Risk Fund Flows Q2 2014

	Asset Under Management ($Mil)		**Estimated Net Flow ($Mil)**	
Peer Group Equity Range	End Q1 2014	End Q2 2014	Q1 2014	Q2 2014
< 15%	8,548	8,805	40	27
15%-24.9%	29,879	32,586	-1,220	-509
25%-34.9%	41,102	42,468	76	286
35%-44.9%	63,103	67,902	-1,468	697
45%-54.9%	155,374	155,380	802	239
55%-64.9%	178,938	184,667	115	564
65%-74.9%	122,372	126,853	-126	381
75%-84.9%	82,328	85,231	-200	229
85%-100%	40,564	42,122	364	-68
Total	**722,210**	**746,016**	**-1,617**	**1,845**

Source: Morningstar Direct[SM]

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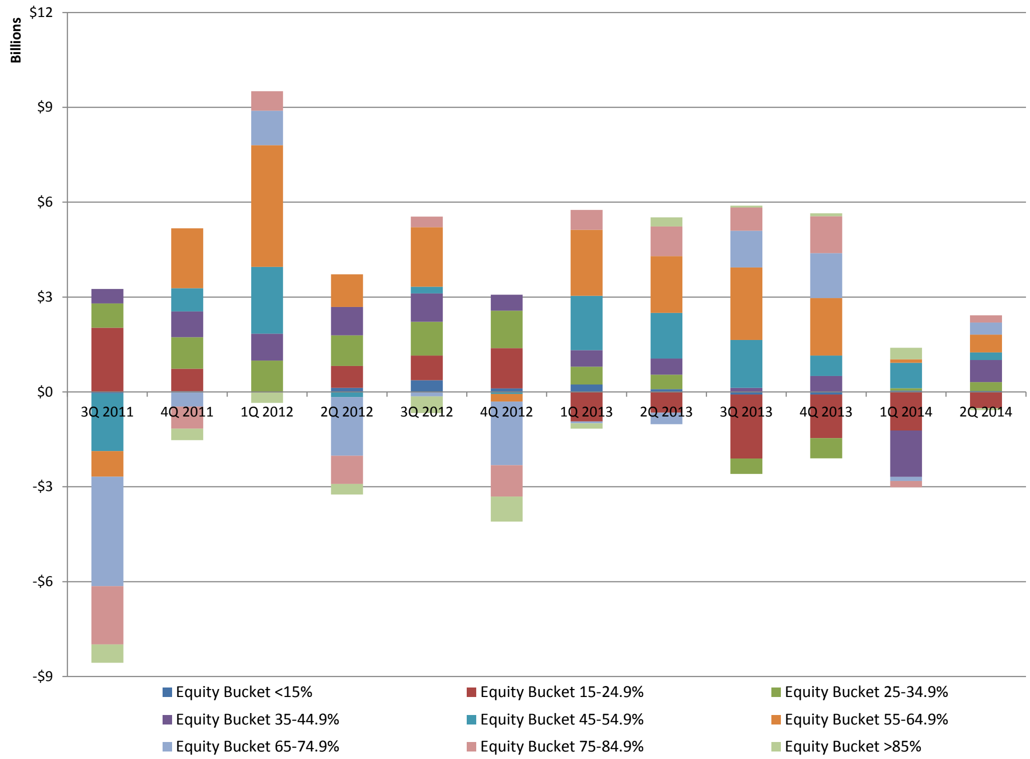
Figure 4: Quarterly Estimated Net Flows by Peer Group as of 6/30/14



Source: Morningstar Direct[SM]

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Funds Included In This Report

The table below contains a list of the firms that offer the target risk funds that were included in this report. We list the fund count and the most recent AUM reported by Morningstar Direct^{SM}.

Table 5: Target Risk Firms, Fund Count and AUM by Channel

Firm Name	Total AUM ($ Mil)	Ins Prod Count	Ins Prod AUM	Open End Count	Open End AUM
John Hancock	77,821	10	33,883	10	43,938
Columbia	56,868	8	51,022	5	5,846
Advanced Series Trust	51,462	8	51,462		
MetLife	45,629	7	45,629		
Pacific Life	45,321	8	41,186	5	4,135
AXA Equitable	39,270	21	39,270		
Fidelity Investments	39,215	8	17,269	7	21,946
Transamerica	35,348	20	25,324	17	10,024
Vanguard	32,314	2	298	4	32,016
Jackson National	31,456	14	31,456		
Nationwide	25,168	23	25,168		
Thrivent	22,402	4	17,225	4	5,176
Lincoln National	20,187	12	20,187		
Principal Funds	19,624	10	5,782	5	13,841
T. Rowe Price	15,984			5	15,984
MFS	15,983			4	15,983
JPMorgan	14,789			4	14,789
Allianz Life	11,049	12	11,049		
ING	11,006	8	10,691	5	315
Russell	9,335	4	696	5	8,639
American Century	7,690			8	7,690
Dimensional Fund Adv	6,616			3	6,616
MainStay	6,415	4	4,394	4	2,021
Manning & Napier	6,378			4	6,378
MassMutual	6,150	5	5,020	4	1,130
Franklin Templeton	6,089			3	6,089
Vantagepoint Funds	5,690			4	5,690
Oppenheimer Funds	5,579			4	5,579
Lord Abbett	5,529			4	5,529
GuideStone Funds	4,521			8	4,521
USAA	4,156			6	4,156
Putnam	3,971			3	3,971
Wells Fargo Adv	3,831			8	3,831
Sun Life of Canada	3,740	3	3,740		
AllianceBernstein	3,535			5	3,535
Great-West Funds	3,329	5	563	5	2,766
TOPS	2,997	5	19	4	2,978
Goldman Sachs	2,913			4	2,913
Curian Series Trust	2,805	18	2,805		
Ivy VIP Funds	2,723	8	2,723		
Invesco	2,544			3	2,544
Schwab Funds	2,361	3	232	4	2,129

Firm Name	Total AUM ($ Mil)	Ins Prod Count	Ins Prod AUM	Open End Count	Open End AUM
Legg Mason	2,067	3	306	4	1,761
Hartford Mutual Funds	1,979			3	1,979
AdvisorOne Funds	1,914			9	1,914
American Gen Life	1,889	8	1,889		
GuidePath	1,784			7	1,784
SEI	1,639	6	14	12	1,625
VALIC	1,597	3	1,597		
Janus	921			3	921
ALPS	917	5	671	4	246
Penn	859	5	859		
Nuveen	826			7	826
Ultra	751	3	751		
Prudential Investments	690			4	690
Pioneer Investments	678			4	678
Mutual of America	662	3	662		
Delaware Investments	593			3	593
Calvert Investments	574	3	147	3	427
Fund X	556			4	556
Stadion Funds	541			4	541
Touchstone	467	3	87	4	380
Flex-funds	430			4	430
Waddell & Reed	403			3	403
New Covenant	392			2	392
BlackRock	369			4	369
TIAA-CREF	327			5	327
Madison Funds	288			3	288
RidgeWorth	287			4	287
Allianz Funds	257			3	257
Compass EMP	225			3	225
New Century Portfolios	191			2	191
Timothy Plan	176	2	67	2	109
Dreyfus	144			3	144
Wilmington Funds	140			3	140
HSBC	133			4	133
Forward Funds	129			6	129
MMA Praxis	124			3	124
Sterling Capital Funds	85			3	85
Pathway Advisors	69			3	69
Strategic Inc Mgmt	54			2	54
Huntington	41			3	41
Pax World	40			3	40
Frost Funds	21			3	21
Totals	746,016	274	454,142	314	291,873

Source: Ibbotson Associates and Morningstar, Inc. (see end for important disclosures)

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Important Disclosures
This report includes U.S. domiciled diversified funds that firms present to investors as "all-in" models, or models that could be appropriate for an investor's entire nest egg (based on our interpretation of each fund's prospectus and marketing). We exclude single, stand-alone offerings (many firms offer one diversified "Balanced" fund option that is not part of a traditional series of target risk funds) and sector specific "satellite" or "completion" portfolios. The majority of these products are funds-of-funds, but a few invest directly in individual stocks and bonds. Most target an equity level or range, but a few newer funds are targeting a stated volatility level or range. We report results for the oldest registered share class for each fund.

Unless specifically noted, the performance data shown are net of administrative, management, and other on-going fees, but do not account for sales or transaction charges. Results for the oldest share class were presented for each fund. Returns may be substantially less from the returns shown. The performance data shown represents past performance. Past performance does not guarantee future results. The above commentary is for informational purposes only and should not be viewed as an offer to buy or sell a particular security. The data and/or information noted are from what we believe to be reliable sources, however Ibbotson has no control over the means or methods used to collect the data/information and therefore cannot guarantee their accuracy or completeness. The opinions and estimates noted herein are accurate as of a certain date and are subject to change. The indices referenced are unmanaged and cannot be invested in directly. Ibbotson Associates subadvises and consults on a number of the funds that are included in this report.

This commentary may contain forward-looking statements, which reflect our current expectations or forecasts of future events. Forward-looking statements are inherently subject to, among other things, risks, uncertainties and assumptions which could cause actual events, results, performance or prospects to differ materiality from those expressed in, or implied by, these forward-looking statements. The forward-looking information contained in this commentary is as of the date of this report and subject to change. There should not be an expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.

Appendix: Index Definition
Morningstar Target Risk Indexes are a family of multi-asset class target risk indices. There are five risk levels ranging from 20% Equity to 95% Equity. The risk levels and strategic asset allocations of the indices are based on Ibbotson's Lifetime Asset Allocation methodology. Security selection for each sub-asset class in the index family is provided by a matching Morningstar market index.

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Standard & Poor's 500 Index: Market-capitalization-weighted index of 500 widely held stocks. Member companies are chosen based on market size, liquidity, and industry group representation. Included are the stocks of industrial, financial, utility, and transportation companies.

Barclays Capital U.S. Aggregate Bond Index – Broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS.

BofA Merrill Lynch U.S. 3-Month Treasury Bill - Comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month that issue is sold and rolled into a newly selected issue. The issue selected at each month-end rebalancing is the outstanding Treasury Bill that matures closest to, but not beyond, three months from the rebalancing date. To qualify for selection, an issue must have settled on or before the month-end rebalancing date. While the index will often hold the Treasury Bill issued at the most recent 3-month auction, it is also possible for a seasoned 6-month Bill to be selected.

Barclays Capital Global Inflation Linked U.S. TIPS Index – Includes securities which offer the potential for protection against inflation as their cash flows are linked to an underlying inflation index. The index represents a standalone multi-currency index exposed to the real yield curve for each relevant currency.

Barclays Capital U.S. 1-3 Year Government/Credit Bond Index – An unmanaged market value weighted performance benchmark for government and corporate fixed-rate debt issues with maturities between one and three years.

Barclays Capital U.S. Corporate High Yield Index – Covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

DJ-UBS Commodity Index – A broadly diversified index composed of futures contracts on physical commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME).

FTSE NAREIT Equity REITs Index – Spans the commercial real estate space across the U.S. economy. The index series provides investors with exposure to all investment and property sectors.

MSCI EAFE Index – Measures international performance and comprises 21 MSCI country indices, representing the developed markets outside of North America: Europe, Australia and the Far East.

MSCI Emerging Markets Index – A market capitalization weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin.

Russell 1000 Growth Index – Measures the performance of the 1,000 largest companies in the Russell 3000 Index, with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index – Measures the performance of the 1,000 largest companies in the Russell 3000 Index with lower price-to-book ratios and lower forecasted growth values.

Russell 2000 Growth Index – Measures the performance of the 2,000 smallest companies in the Russell 3000 Index with higher price-to-book ratios and higher forecasted growth values.

Russell 2000 Value Index – Measures the performance of the 2,000 smallest companies in the Russell 3000 Index with lower price-to-book ratios and lower forecasted growth values.

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