MARKET RECAP

The domestic equity markets experienced a bumpy ride during the first quarter of 2014, as investors responded to mixed economic news from around the world. After gaining over 32% during calendar year 2013, the S&P 500 Index returned a modest 1.81% during the first quarter of 2014. For the one year, the domestic stocks, as measured by the S&P 500 Index, still posted strong gains of 21.86%.

Smaller domestic companies, as measured by the Russell 2000 Index, gained 1.12% during the first quarter, and posted a 24.90% return for the one-year period. With slight turbulence in the markets during the quarter, investors favored Value stocks over Growth stocks. In the global context, U.S. stocks outperformed foreign stocks, with the MSCI EAFE Index returning 0.66% over the first quarter and falling behind the S&P 500 Index by 1.15%. The news that affected the U.S. stock market during the first quarter also brought volatility to the international markets, but global markets posted positive returns overall due to the promise of continued economic recovery in the U.S. and Europe.

After a disappointing year for the bond market, the first three months of 2014 turned out to be a strong quarter for fixed income. The Barclays U.S. Aggregate Bond Index returned 1.84% for the quarter, beating the majority of equity indices. As volatility returned to the equity markets, investors sought the safety of bonds. The increased demand drove up bond prices and the 10-year Treasury fell accordingly.

The chart below shows the major index and style category returns for the quarter, year-to-date, one-year, three-year, and five-year time periods ended March 31, 2014:

<table>
<thead>
<tr>
<th>Index/Category</th>
<th>1Q14</th>
<th>YTD</th>
<th>1YR</th>
<th>3YR</th>
<th>5YR</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 Index</td>
<td>1.81</td>
<td>1.81</td>
<td>21.86</td>
<td>14.66</td>
<td>21.16</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>1.12</td>
<td>1.12</td>
<td>24.90</td>
<td>13.18</td>
<td>24.31</td>
</tr>
<tr>
<td>MSCI EAFE Index</td>
<td>0.66</td>
<td>0.66</td>
<td>17.56</td>
<td>7.21</td>
<td>16.02</td>
</tr>
<tr>
<td>Barclays US Aggregate Bond</td>
<td>1.84</td>
<td>1.84</td>
<td>-0.10</td>
<td>3.75</td>
<td>4.80</td>
</tr>
<tr>
<td>Morningstar Large Cap Value</td>
<td>2.30</td>
<td>2.30</td>
<td>20.76</td>
<td>13.10</td>
<td>19.62</td>
</tr>
<tr>
<td>Morningstar Large Cap Growth</td>
<td>0.48</td>
<td>0.48</td>
<td>23.60</td>
<td>12.97</td>
<td>20.22</td>
</tr>
<tr>
<td>Morningstar Small Cap Value</td>
<td>1.70</td>
<td>1.70</td>
<td>23.38</td>
<td>12.38</td>
<td>24.75</td>
</tr>
<tr>
<td>Morningstar Small Cap Growth</td>
<td>0.32</td>
<td>0.32</td>
<td>26.05</td>
<td>12.59</td>
<td>24.46</td>
</tr>
</tbody>
</table>

Source: Morningstar Direct
Past performance does not guarantee future returns.

BALANCED FUNDS AND TARGET DATE FUNDS

As you scan your eyes across the list of funds available in your 401(k) or 403(b) investment lineup, you may encounter names like “balanced fund,” “moderate fund,” or “target date fund.” These funds are different from the traditional stock or bond funds, which are straightforward and more familiar to us. An equity fund, such as “Large Cap Index,” invests the majority of assets in large company stocks, and a fixed income fund, such as “Core Bond Fund,” contains safer bonds as most of its holdings. However, balanced and target date funds are not so clear cut, and it is important to know how these funds are meant to be used before investing in them. In this quarter’s Retirement Matters™ Newsletter, we will highlight funds that are hybrid in nature and more complex in construction.

In this Update:

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Balanced Funds

As the name suggests, balanced funds generally contain different proportions of stocks, bonds, cash, and cash equivalents. These funds are often labeled by the level of market risk tolerance: conservative, moderate, and aggressive balanced funds. The three different risk levels contain different mix of stocks and bonds: conservative funds contain more fixed income and fewer stocks, while aggressive funds contain more stocks and less fixed income. Moderate funds are somewhere in between. For example, Vanguard’s most conservative balanced option, the LifeStrategy Income Fund, has a 20/80 split between stocks and bonds. The moderate balanced option, Vanguard LifeStrategy Moderate Growth Fund, has a 60/40 equity/fixed income ratio. Finally, the most aggressive fund in the Vanguard LifeStrategy family has a portfolio composition of 80% stocks and 20% bonds. These investments are geared toward participants who are looking to invest based on their risk profiles. If you know how much you like or dislike market risk, and also know that you do not want the pressure of building your own portfolio, then these funds may be a good option for you.

When considering balanced funds (also called lifestyle, risk-based, or target-risk funds), there are a few items to keep in mind. These funds are static and are designed to maintain a certain level of risk. This means that a conservative fund will stay conservative, and an aggressive fund will always strive to be aggressive. Therefore, if your risk preference changes for any reason, you should make sure to address your stake in these balanced funds. From the perspective of time horizon, aggressive balanced funds in a 401(k) or 403(b) lineup are generally targeted to investors in their twenties and thirties, while conservative balanced funds are meant to attract employees nearing retirement. You should make sure that you are investing in the appropriate risk level for your age. For example, for participants in their twenties, it is generally recommended that the retirement portfolio be aggressive. If you pick a conservative balanced fund in your twenties, you may lose out on the higher gains in the stock market over a long period of time, which will not help you obtain your retirement goals. On the other hand, if you invest in an aggressive fund due to a long investing time horizon (during your twenties or thirties), then you must make sure to move from an aggressive fund to a moderate or conservative balanced fund as you age and your investing time frame shortens. It is not desirable to neglect your position in an aggressive balanced fund, only to find yourself decades later, invested in a risky investment vehicle. If the market falls, you will have little time to recoup your losses. Of course, 401(k)/403(b) savings is highly individual in nature, and your unique circumstances (like Social Security, pension plan, spousal retirement savings, and other sources of future income) may provide a reason for you to invest in a more aggressive portfolio, even with a shorter time horizon.
**Target Date Funds**

If you would prefer not to build your own portfolio and are also not inclined to rebalance or make adjustments over time, then target date funds may be the right option for you. Target Date Funds (also called lifecycle funds) are like balanced funds in that they contain a mixture of bonds and stocks. Even though you see just one fund on your statement, target date funds are “funds of funds,” meaning that each target date fund consists of a number of stock and bond funds. These underlying funds may own hundreds of securities, making them very diversified. In addition, they have the added feature of changing asset allocation automatically over time to accommodate the changes in the risk levels as participants get closer to retirement. The industry term for this automatic adjustment of asset allocation through time is “glidepath.”

Let us take two hypothetical investors to help illustrate how target date funds work. The first employee is young and is hoping to retire in the year 2049. He would choose a target date fund that represents that approximate year of potential retirement, Target Date Fund 2050. The other, who is older and is planning on retiring in the year 2021, would choose Target Date Fund 2020. The difference is that Target Date Fund 2050 is aggressive and heavy toward stocks, poised to take advantage of the power of compounding during its long time horizon for the young investor. Target Date Fund 2020 would hold relatively more bonds and cash equivalents and less stock exposure; it would experience less volatility and would more likely retain the assets earned in preparation for withdrawals during retirement years. The thing to remember is that neither of our hypothetical investors would need to rebalance or manually change from the aggressive to conservative portfolios as their time horizon shortens. The glidepath of the 2050 fund allows the first investor to stay invested in this one target date fund, and the portfolio would adjust the risk as his time horizon contracts. The glidepath of the 2020 fund already took the second investor from an aggressive allocation to a more conservative stance over time. As the second investor is preparing for retirement, the portfolio is positioned to better retain the gains of the last several decades.

**Remember…**

Balanced and target date funds certainly take the pressure of choosing a mix of investments away from the investor and put allocation decisions in the hands of professionals. There are, however, a few things to keep in mind. As mentioned before, balanced funds (or lifestyle, risk-based, target-risk funds) do not change over time (does not have a glidepath like target date funds do), so it is the responsibility of the participant to make sure that the balanced fund of your choice continues to reflect your comfort level on market risk. Again, the industry recommendation is that the younger participants invest in more aggressive portfolios, while participants nearing retirement taper into more conservative funds.

**Investing in balanced funds still requires periodic maintenance, but target date funds do not because they offer a glidepath through time. While the low maintenance aspect of target date funds is attractive, this hands-free approach to investing is not for everyone. If you are invested in a target date fund, you are accepting a portfolio manager’s allocation at any given time. It may be the case that you are more comfortable with risk in your fifties or less comfortable with risk in your twenties. If you have strong preferences when it comes to exposure to market risk, then the automatic nature of target date funds will not be attractive to you. In this case, you may want to pick a balanced fund to suit your risk level, or construct a portfolio with other funds in the 401(k) or 403(b) lineup. If you need help, you can always reach out to CBIZ Retirement Plan Services. Our toll-free number is printed in the bottom left corner of the first page of this newsletter and is an important resource for our participants.

Lastly, it is important to remember that both balanced funds and target date funds are designed to be one-fund portfolios. This means that the asset allocation within these funds provides sufficient diversification for healthy retirement investing. Any extra fund you choose outside of these hybrid funds will alter your risk level. Let us use an example. An investor is planning to retire in 2016 and is invested in the 2015 target date fund. The allocation in this fund is already designed to accommodate someone who is about to retire and is conservative. If this investor has additional funds in her retirement portfolio, such as a Large Cap Index fund or an International Stock fund, she has unintentionally increased the overall risk in her retirement savings. This may not be a desirable scenario for someone who is about to leave the work force in two years.

In this quarter’s newsletter, we wanted to demystify the nature of hybrid funds that may be in your 401(k) or 403(b) lineup. We hope that this letter has shed light on this subject, and as always, you can reach out to CBIZ Retirement Plan Services with any question regarding the fund lineup or your retirement portfolio construction.

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