

Putnam Investments
Managing Director Jeffrey Knight
Testimony on Target-date Fund Issues
Joint DOL/SEC Hearing
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Good morning...

I am Jeff Knight, Managing Director and head of Global Asset Allocation for Putnam Investments of Boston, Massachusetts. In this role, I helped to design our lifecycle offerings beginning in 2003, and am presently the lead manager on our “Retirement Ready” and “Retirement Advantage” lifecycle strategies.

I want to commend the Department of Labor and the Securities and Exchange Commission for convening today’s hearing on target-date funds, arguably the single most useful investment innovation of the past generation – with particular value in workplace savings such as 401(k) plans, 403(b)s and 457s.

Congress, in our view, took a major step forward with the Pension Protection Act of 2006 to recognizing the emerging role of workplace savings as the primary source of future retirees’ lifelong incomes.

The PPA’s explicit recognition of lifecycle or target-date funds as qualified default alternatives was especially valuable in calling attention to an investment strategy that helps investors solve a complex lifelong investment challenge with

a single strategy that provides diversification, risk-adjustment and re-balancing over a lifetime. Since many participants in workplace savings program rarely, if ever, change their investment selections, mutual funds that adjust over time are especially valuable.

It makes sense, after all, for young investors to commit the bulk of their savings to higher-risk, high-returning stocks since they have little to lose and many years to make up for any downturns. Over time, as their wealth grows, it equally makes sense for middle-aged investors to hedge their bets by shifting steadily – as lifecycle strategies do – to lower-returning, but less volatile assets like bonds. The closer one approaches retirement and the larger one's assets grow, the stronger grows the case for yet more conservative allocation since there is more money at risk, less toleration for volatility and less time to make up for any losses.

Within the overall lifecycle pattern there are many different approaches – or glide-paths – for managing the shift from higher-to-lower risk asset allocations. All lifecycle fund managers must balance the objectives of growing investor's wealth and protecting investor's wealth, in the face of both market risk and longevity risk. At Putnam, we have prioritized wealth conservation in our glidepath design, as evidenced by our low allocation of 25% to equities at our funds' designated target date. Our research concludes that such conservatism minimizes the risk of asset depletion or severe financial stress in late old age.

Last year, the stress across financial markets was unusual and severe. Stocks, as measured by the S&P 500, fell by 37%, its third worst year since 1900. Many categories of fixed income securities, including corporate bonds and mortgage backed bonds, fell in price as dramatically as equities did, as forced selling into frozen credit markets drove unprecedented pricing volatility in those areas. Diversification across asset classes, or across geographies, provided weak defense against these market losses.

Not every investor in lifecycle funds was hurt by these events. Younger investors in lifecycle funds still have plenty of time before retirement. They may well recoup all of last year's losses long before they have to draw down their savings. For them, the stock market drop represents a chance to buy low, accumulating long-term equity and bonds at fire-sale prices.

But for investors in or very close to retirement, the timing was awful. Many 2010 lifecycle funds, including ours, fell by 25% to 30% or even more. For those who needed to draw current income from these shrinking portfolios, the impact was severe. Under stress, existing risk dampening strategies fell short last year. In fairness, this episode is not over, and securities prices have recovered substantially in 2009. Our own 2010 fund, for example, has gained 10.27% at Net Asset Value through June 15, 2009.

A calm reckoning of last year's events suggests that we indeed have work to do to improve the resilience of lifecycle strategies.

But to dismiss the lifecycle concept now, in the wake of a market trauma, or to return to stable value funds as qualified default options in our retirement policy planning – would be a gross mistake. A more sensible course is for providers to identify, and repair, the vulnerabilities that were exposed by the market stress of 2008.

The good news is that we can – and should – evolve and improve these funds.

Among the steps that we are taking at Putnam to improve the resiliency of our lifecycle funds is evaluating the role that absolute return strategies can play in the glidepath, as well as evaluating methods to incorporate customized insurance against longevity risk into our product offerings.

And make no mistake: target-date funds face strong market discipline and competitive pressures. There may, at times, be a disconnect between the lifelong investment horizons that lifecycle managers aim for – thirty years or more -- and the far shorter “windows” that some rating agencies use to judge lifecycle funds’ investment “performance” – often three years or less. We would not oppose regulatory guidelines to limit such pressures while fostering strong competition.

On behalf of Putnam Investments, thank you very much for this opportunity to share our views.

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