

The Hidden Risks of Target Date Funds: Why Your Retirement Savings Could Be at Risk

Admin User · February 14, 2026

Target date funds often underperform compared to broader market indexes and balanced portfolios. This article examines the reasons behind this, including asset allocation and fund management.

By David Marra

Since their creation in the mid-1990s, target date funds (TDFs) have become a retirement investing staple. These gained popularity in 2006 after the passage of the Pension Protection Act, which allowed employers to automatically enroll employees in 401(k) accounts or similar pension plans, resulting in most participants placed in target date funds.

The basic idea is simple enough: pick a target date fund, technically a fund composed of an evolving allocation to other funds, or “fund of funds,” set to mature close to your intended retirement date. Then, sit back and relax as fund managers ensure an “age-appropriate” mix of stock and bond holdings by rebalancing the underlying funds for you over time.

In the early stages, most TDFs are made up of roughly 54% U.S. stocks, 36% international stocks and 10% U.S. and international bonds. Around age 40, these funds gradually begin to reduce their stock exposure. By age 60, they usually sit at 60% stocks and 40% bonds. By age 65, considered the typical retirement target age, the fund reaches a 50/50 split. As retirement progresses, the portfolio continues to become more conservative, eventually consisting of 30% stocks and 70% bonds and cash equivalents.

Sounds like the perfect, hands-off way to invest for retirement, right? Think again. Here’s what you need to know about these so-called “hassle-free” solutions:

1. Target date funds consistently post mediocre returns.

While the logic behind TDFs isn't necessarily flawed, the execution has been nothing short of subpar. Over the last 28 years or so, [2040 target-date funds returned a total of 750%](#), underperforming the 1,494% logged by the S&P 500 and even the 866% logged by a balanced 60% stock, 40% bond allocation.

Most investors assume that the underperformance stems from TDFs holding comparatively fewer stocks. After all, stocks have outpaced bonds in nearly every 15-year period in recent history, including 2008–2022, when U.S. stock market indexes delivered an annualized return of about 9%, while bond indexes managed closer to just 3%.

However, many target-date funds actually held more equities on average than balanced funds through those 15 years. The Vanguard Balanced Index fund (VBINX), for example, [was matched or beaten out in terms of equity percentage by a number of shorter-date TDFs](#). Despite heavier equity allocations, TDFs still failed to outperform.

Why? It largely comes down to poor fund management, including poor underlying asset allocation and fund selection. TDFs underperform balanced funds largely due to their heavy reliance on international equities. [Vanguard's 2060, 2050 and 2040 target-date funds devote at least 30% of their holdings to international investments](#), an area of the market that has underperformed U.S. equities for almost a decade and a half. Ironically, this strategy stems from institutional mandates for diversification, as TDFs are sold almost exclusively through 401(k) plans. Diversification is great when done right, but non-strategic diversification just for the sake of it can weigh heavily on performance.

2. TDFs are nothing special when it comes to risk management.

Not only have TDFs historically lagged the index, [they've also done so without the added benefit of significantly less volatility](#) — 13.6% for 2040 target funds compared with a close 14.9% for the S&P 500 since March 1994.

Given this, TDFs have a long history of failing to provide adequate downside protection in volatile periods. During the 2008 financial crisis, [most 2010 TDFs lost 30–40% of their value](#), despite being marketed as low-risk options for folks just two years away from retirement. In 2022's bear market, 2020 TDFs, for those already living in retirement and relying on that income, [were down over 11%](#).

TDF's reliance on outdated assumptions about bonds being universally effective equity hedges is to blame. While stock and bond prices typically move in opposite directions, "typically" is not always the case, as was true in 2022 where rising interest rates clobbered both.

Retirement investors need a far more proactive approach to risk management than what

TDFs currently provide, which, in essence, is throwing in some bonds and calling it a day. To effectively protect their nest egg, they require solutions that are continuously adjusted to reflect evolving economic conditions. Think hedging with strategies like options or strategic concentration avoidance, minimizing large losses while still maintaining sufficient growth.

3. These funds treat all retirees the same.

From a broader perspective, one of the main issues with TDFs is their one-size-fits-all approach to retirement investing. By sticking to a rigid structure and timeline, they don't account for the wide range of financial situations, risk tolerances and goals of retirees. Some may have ample savings, a longer life expectancy and a higher risk tolerance, meaning they can afford to take on more growth-oriented investments. Others may need income right away or face higher health care costs and therefore require a more cautious approach. TDFs don't adjust for these differences, leaving retirees with a blanket solution that doesn't truly match their personal needs or long-term objectives. A more tailored strategy is essential to address each investor's unique circumstances.

Why TDFs could fail you in 2025

As we look ahead, retirement investors, particularly those relying on TDFs, face mounting risk of periods of loss posed by increased volatility. Predictions of a large fiscal deficit, trade policy volatility, worker deportations and stricter immigration laws present potential threats to equity and debt markets both at home and abroad, given the global implications of a more uncertain U.S. economic and trade policy.

The new administration in Washington hasn't been shy about plans to enact tax cuts in 2025. While the outcome of such plans is not certain, such a move could deepen the fiscal deficit, drive inflation and send treasury yields soaring as the government attempts to attract more bond investors to finance the debt. The 10-year yield, which affects everything from corporate debt to mortgages, [may very well climb to 6%](#) for the first time in more than two decades, putting downward pressure on both bond and stock markets.

In terms of trade, the new administration is moving on threats to raise tariffs on foreign goods. This has sparked further fears of either re-igniting inflation or reducing U.S. growth (or perhaps both simultaneously). In the case of the former, U.S. enterprises could be forced to pass increased costs onto consumers, thus detrimental to fixed income and bond investors, and in the case of the latter, detrimental to equity investors.

On the immigration front, calls for mass deportation and stricter immigration laws are also

fueling concerns about inflation. Large scale deportations in particular would significantly disrupt industries such as food production, landscaping and restaurants, all of which depend heavily on immigrant labor. The resulting shortage of workers would drive up wages, thereby increasing the prices seen by the consumer and prompting the Fed to raise rates to combat inflation.

Another important factor of the risk picture to consider is the current state of a fully valued equity market. Following the election, there has been a strong sense of bullishness amongst Americans, with price-to-earnings ratios at a record high. While this paints a seemingly favorable picture, full equity valuations also heighten the risk of sharper declines when increased inflation and rates raise the cost of doing business, leading to lower equity growth and returns. In this environment, a downward correction of as much as 20% wouldn't be out of the question.

On the other hand, even if the U.S. avoids an inflation spike and the Fed instead remains in cutting mode to prevent potential economic stagnation — [indicated by factors like rising unemployment and a slowdown in residential construction](#) — that would still imply risk for equity and bond markets, albeit via a different path. That said, the Fed's hawkish tone in December called the likelihood of this scenario into question.

Any way you look at it, there are negative implications for TDF investors owing to the funds' historical inability to navigate return opportunities and risks in a thoughtful and profitable manner. As we enter a period of rising risk and uncertainty, a fund that a) already underperforms in bull markets and b) lacks the expected risk cushion of a lower-return fund would not appear to be a wise choice for your retirement dollars.

Don't settle for less

Luckily, these funds are far from your only option. Like all things in investing, you have a lot of options and the key is to find smart investments for you and your family. A good adviser can help you find smarter, better managed funds that balance growth with protection and fit with your risk preferences, income needs and investment philosophy.

While it's crucial to remain exposed to U.S. equities due to their unique growth potential, it's equally important to hedge against the rising potential for large losses, and not just through bonds. Funds that employ techniques like strategic diversification, hedging and active management can help do so. Don't settle for less. Position your retirement portfolio for safe, long-term growth and steady income with the support of expert guidance to find the funds that align with your unique need.

About the author: David Marra

[David Marra](#) is the co-founder and chief investment officer at [Markin Asset Management](#). He specializes in building and managing investment strategies and funds for individuals in the retirement, near-retirement and accumulation phases of their lives. David works with advisers, employers, families and individuals across the United States to align their investment strategies with their goals, helping them increase their income and the value of their assets.
