Russell LifePoints Target Date Series Target-Date Fund Series Report

Executive Summary

Key Features

- **Asset-Weighted Expense Ratio**: 0.80%
- **Active/Passive Exposure**: 100% Active
- **Open/Closed Architecture**: 33% Closed
- **Total Net Assets ($M)**: 266

**Morningstar Analyst Rating**: Neutral

**Price**: Neutral

A restructuring in 2014 moved several of this series’ retirement share classes to more expensive but generally more comparable peer groups. Although the fees haven’t materially changed, their relative rankings have improved, and they’re now competitively priced compared with their similarly sold peers.

**Performance**: Negative

While the series’ underlying funds have delivered improved performance in recent years, it’s often light position in equities, as well as comparatively substantial allocations to international stocks and commodities, have weighed heavily on the relative returns of the target-date funds. Over the past five- and 10-year periods through the end of 2016, funds in the series ranked, on average, in the bottom third of their respective peer groups.

**People**: Neutral

This series continues to see manager turnover. Most recently, Rob Balkema joined Brian Meath as co-manager of this series in mid-June 2016. He replaced lead manager John Greves, who left Russell to join Schwab’s target-date team. Greves and Meath had only co-managed the series since early 2014. Meanwhile, the series’ construction remains largely the same, even as the managers of its underlying funds and their respective sub-advisors constantly shuffle.

**Parent**: Neutral

Russell built out its fund complex from its consulting background, focusing on multifund-managed products run by third-party sub-advisors. But high manager turnover and low manager investment keep this firm from being best in class. Following a year in limbo, there’s now less uncertainty at the firm: In June 2014, parent company Northwestern Mutual agreed to sell Russell to the London Stock Exchange, with the deal closing in December 2014. In October 2015, LSE agreed to sell most of the business to private equity firm Northwestern Mutual, after an expected sale to TA Associates in 2016.

**Morningstar Analyst Rating**: Neutral

Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

**Analyst Rating Spectrum**:
- **Gold**
- **Silver**
- **Bronze**
- **Neutral**
- **Negative**

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**Morningstar Opinion**

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06-08-2017

On June 7, 2017, Russell announced plans to liquidate the funds within its Russell LifePoints target-date series by Oct. 6, 2017. As of the close of business on June 7, new employee benefit plans will no longer be able to add the LifePoints target-date funds to their investment menus, though existing investors and investors within plans that already use the funds may continue purchasing new shares until Oct. 4.

The mutual funds never gained a meaningful foothold in the target-date space, reaching a high point in assets of roughly $900 million in 2010. The series has been in outflows for the six calendar years since then, with just $286 million in assets at the end of April 2017.

The series’ poor performance during this period likely played a part in these outflows. During the past five years, funds in the series trailed, on average, two thirds of their respective target-date peers. The series’ relatively bond-heavy asset-allocation glide path was a headwind during a time when equity returns have resolutely led those of bonds. The series’ more global orientation was also an anchor compared with peers—most of which have a strong home-country bias—in a market where U.S. equities have performed particularly well.

Also not helping flows were a few years of uncertainty stemming from firm ownership changes: Northwestern Mutual sold Russell to the London Stock Exchange in December 2014, and LSE eventually sold Russell Investments to private equity firm TA Associates in 2016.

Russell also offers target-date collective investment trusts, which are primarily aimed for large market plans. These CITs will remain open for investors.

The remaining text in this report remains unchanged from its March 2, 2017, initial publication.
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The Five (5) Pillars

Morningstar has identified five key areas that we believe are crucial to predicting the future success of funds: People, Parent, Process, Performance, and Price. Each pillar is evaluated when assessing a fund as follows:

- People
- The overall quality of a target-date fund series’ investment team is a significant key to its ability to deliver superior performance relative to its benchmark and/or peers. Evaluating a target-date fund series’ investment team requires that analysts assess several relevant issues including how key decisions are made.

- Parent
- We believe the parent organization is of utmost importance in evaluating a target-date fund series. The target-date fund series’ management set the tone for key elements of our evaluation, including capacity management, risk management, recruitment and retention of talent, and incentive pay. Beyond these operational areas, we prefer firms that have a culture of stewardship and put investors first to those that are too heavily weighted to salesmanship.

- Process
- We look for target-date fund series with a performance objective and investment process (for both security selection and portfolio construction) that is sensible, clearly defined, and repeatable. In addition, the portfolio should be constructed in a manner that is consistent with the investment process and performance ob-jectives.

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**Performance**
We do not believe past performance is necessarily predictive of future results, and this factor accordingly receives a relatively small weighting in our evaluation process. In particular, we strive not to anchor on short-term performance. However, we do believe that the evaluation of long-term return and risk patterns is vital to determining if a target-date fund series is delivering to our expectations.

**Price**
To reflect actual investor experience, price is evaluated within the context of the relevant market or cross-border region—for example, the United States, Australia, Canada, or Europe. In recognition of differences in scale and distribution costs in various markets, the level at which a target-date fund series is penalized for high fees or rewarded for low fees can vary with region. In Europe, for example, target-date fund series are penalized if they land in the most expensive quintile of their Morningstar category and are rewarded if they land in the cheapest quintile. The assessment is made using prospectus expense ratios, but in the case of target-date fund series with performance fees, expenses are evaluated excluding any performance fees and then the structure of the performance fee is evaluated separately.

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Morningstar Analyst Ratings are assigned on a five-tier scale running from Gold to Negative. The top three ratings, Gold, Silver, and Bronze, all indicate that our analysts think highly of a target-date fund series; the difference between them corresponds to differences in the level of analyst conviction in a target-date fund series’ ability to outperform its benchmark and peers through time, within the context of the level of risk taken.

**Gold**
Represents target-date fund series that our analysts have the highest conviction in for that given investment mandate. By giving a target-date fund series a Gold rating, we are expressing an expectation that it will outperform its relevant performance benchmark and/or peer group within the context of the level of risk taken over the long term (defined as a full market cycle or at least five years). To earn a Gold rating, a target-date fund series must distinguish itself across the five pillars that are the basis for our analysis.

**Silver**
Represents target-date fund series our analysts have high conviction in, but not in all of the five pillars. With those fundamental strengths, we expect these target-date fund series will outperform their relevant performance benchmark and/or peer group within the context of the level of risk taken over the long term (defined as a full market cycle or at least five years).

**Bronze**
Represents target-date fund series that have advantages that clearly outweigh any disadvantages across the pillars, giving analyst the conviction to award them a positive rating. We expect these target-date fund series to beat their relevant performance benchmark and/or peer group within the context of the level of risk taken over the long term (defined as a full market cycle or at least five years).

**Neutral**
Represents target-date fund series in which our analysts don’t have a strong positive or negative conviction. In our judgment, these target-date fund series are not likely to deliver standout returns, but they aren’t likely to seriously underperform their relevant performance benchmark and/or peer group either.

**Negative**
Represents target-date fund series that possess at least one flaw that our analysts believe is likely to significantly hamper future performance, such as high fees or an unstable management team. Because of these faults, we believe these target-date fund series are inferior to most competitors and will likely underperform their relevant performance benchmark and/or peer group, within the context of the level of risk taken, over a full market cycle.

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This designation means that a change that occurred with the target-date fund series or at the target-date fund series company requires further review to determine the impact on the rating.

**Not Ratable**
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**Equity-Related Data Points**

The Report lists the top ten holdings in the target-date fund series as of the dated noted. For each underlying holding, a series of data points is provided including, where applicable, that security’s Economic Moat rating as of the date noted.

**Economic Moat**

The concept of an economic moat plays a vital role in our equity analyst’s qualitative assessment of a firm’s long-term investment potential, but also in the actual calculation of its fair value estimate. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm’s cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm’s cost of capital more quickly than companies with moats.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm’s cost of capital more quickly than companies with moats.

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