Summary

- Employees who prefer not to think about retirement investing should consider switching their SCU retirement funds to a newly available Fidelity Freedom Index Fund. Switching has big advantages in terms of cost, maintenance, and the nature of the funds’ investments.

- Employees who want to be more hands-on about their SCU retirement plans may wish to consider some of the 19 extremely low-cost Vanguard index funds that are newly available on the Fidelity platform.

Changes to Fidelity Retirement Plans

There are two big changes to the Fidelity 401(a) and 403(b) retirement plans:

1. **Fidelity Freedom Index Funds** will be added to the choices. You use the specific fund nearest to the year you intend to retire, as explained on page 3. For future employees, these funds will be the *default* funds, which are the funds used if no others are specified. However, *current employees will need to switch* to these funds if they want them. These Freedom Index Funds are simple, cost-effective, one-stop shopping for retirement accounts. If you would rather not think about retirement funds, you should consider switching to these and then you can leave them alone until you retire.\(^1\) The advantages of these funds, including why they don’t need to be periodically monitored and adjusted, are explained below.

Switching to these new funds takes about 15–20 minutes, whether you

\(^1\)Ideally, for any major financial decision, you should get help from a non-biased professional financial planner. Remember that SCU gives you free access to Joe Crowley, who is an excellent resource in this regard. To schedule an appointment with Joe, call Yolanda Galindo at ×5397.
are currently with Fidelity or TIAA-CREF. You don’t need to gather any personal financial information or prepare anything to switch. The instructions for switching are on page 10.

2. 19 Ultra-low cost Vanguard Index Funds will be added to the choices. These Vanguard funds will provide access to a large menu of inexpensive, passively managed stock and bond index funds. (The term “passively managed” and its advantages are explained on page 5.) Using these funds gives you more control over the proportions and types of stock and bond classes than the Fidelity Freedom Index Funds provide, while still maintaining ultra-low expense ratios. The expense ratio, further explained on page 4, is the fraction of your retirement money that the financial company (Fidelity, Vanguard, or TIAA-CREF) takes from you each year. Numerous academic studies have shown that the only statistically significant predictor of superior performance among funds within any specific class of investments is a lower expense ratio. The expense ratios of these Vanguard funds are typically between 25% to 80% lower (yes, you read that right) than the corresponding Fidelity or TIAA-CREF funds previously available in the same class of investments.

1 Fidelity Freedom Index Funds

What’s the difference between the previous default fund, “Fidelity Asset Manager 50%,” and the new default Fidelity Freedom Index Funds? Why might an employee want to switch from the Asset Manager 50% or from any of the other Fidelity or TIAA-CREF funds previously available? Three big reasons:

1. **Automatically Transitions from Stocks to Bonds as you get Closer to Retirement.**

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2 To find information about your current retirement funds, you can contact Fidelity by calling 1-800-343-0860. Put in your social security number and, if you know it, your PIN when prompted. If you don’t know your PIN, just press “0” and wait until you reach a human. You can contact TIAA-CREF by calling 1-800-842-2776, and pressing “0”.

3 These new Fidelity Freedom Index Funds are very different from the currently available Fidelity Freedom Funds, despite the ridiculously similar names.
The old Fidelity Asset Manager 50% fund essentially has 50% stocks and 50% bonds and cash. These percentages are unaffected by your age.

In contrast, early in your career, the Freedom Index Funds start you off primarily in stocks with some bonds for balance and then as you head towards retirement, the fund automatically reduces your stock exposure and increases your cash and bond allocations. This gives a bigger chance for growth early in your career (or the time to recover should the market be bad), but also later safeguards from having to postpone retirement should a stock drop occur just as you want to retire.

You simply choose the Fidelity Freedom Index Fund from the following list that is closest to the year in which you intend to retire. The twelfth fund listed, which is the Index Income Fund, is useful if you retired before 2000:

Fidelity Freedom Index 2050 Fund - Class W - FIPFX
Fidelity Freedom Index 2045 Fund - Class W - FIOFX
Fidelity Freedom Index 2040 Fund - Class W - FBIFX
Fidelity Freedom Index 2035 Fund - Class W - FIHFX
Fidelity Freedom Index 2030 Fund - Class W - FXIFX
Fidelity Freedom Index 2025 Fund - Class W - FQIFX
Fidelity Freedom Index 2020 Fund - Class W - FPIFX
Fidelity Freedom Index 2015 Fund - Class W - FLIFX
Fidelity Freedom Index 2010 Fund - Class W - FKIFX
Fidelity Freedom Index 2005 Fund - Class W - FJIFX
Fidelity Freedom Index 2000 Fund - Class W - FGIFX
Fidelity Freedom Index Income Fund - Class W - FIKFX.

You then put all your money in the fund you selected and do nothing more until you need the money in retirement.

The columns in the table below show the percentages of the six component indexes that make up each of these 12 Freedom Index funds. (So each column adds to 100%.). To determine how your portfolio will

\[^4\] Please see [http://math.scu.edu/~dostrov/StockData.pdf](http://math.scu.edu/~dostrov/StockData.pdf) for a comparison of the risks and rewards of stocks vs. bonds.

\[^5\] 1. The U.S. Stock Index tracks the entire U.S. Stock Market. 2. The U.S. Commodities index follows commodities like oil, gold, wheat, and cotton, which can smooth out some of the volatility of stock movement and can also help to protect your portfolio against
change as time progresses, you move a column to the right (*not* the left) for each 5-year interval that elapses.

<table>
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<tr>
<th>Years until retirement</th>
<th>Fund name</th>
<th>2020</th>
<th>2025</th>
<th>2030</th>
<th>2035</th>
<th>2040</th>
<th>2045</th>
<th>2050</th>
<th>2055</th>
<th>2060</th>
<th>2065</th>
<th>2070</th>
<th>2075</th>
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</thead>
<tbody>
<tr>
<td>+40</td>
<td>1. U.S. Stock</td>
<td>96</td>
<td>55</td>
<td>52</td>
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<td>47</td>
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<td>39</td>
<td>35</td>
<td>32</td>
<td>27</td>
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<td>+35</td>
<td>2. U.S. Commodities</td>
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<td>10</td>
<td>10</td>
<td>9</td>
<td>9</td>
<td>8</td>
<td>7</td>
<td>6</td>
<td>5</td>
<td>5</td>
<td>2</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>+30</td>
<td>3. International Stock</td>
<td>24</td>
<td>23</td>
<td>23</td>
<td>22</td>
<td>20</td>
<td>19</td>
<td>16</td>
<td>14</td>
<td>13</td>
<td>12</td>
<td>6</td>
<td>6</td>
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</tr>
<tr>
<td>+20</td>
<td>5. Inflation Prot. Bonds</td>
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<td>0</td>
<td>0</td>
<td>1</td>
<td>4</td>
<td>7</td>
<td>9</td>
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<td>10</td>
<td>11</td>
<td>12</td>
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<tr>
<td>+15</td>
<td>6. Money Market</td>
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<td>0</td>
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</table>

2. Better Expense Ratios.

The expense ratio of each Freedom Index Fund is .19; the expense ratio of Fidelity Asset Manager 50% is .73.

*What does that mean? What is an expense ratio?*

The expense ratio is the annual management fee deducted from your fund’s worth by the fund manager. Here, this means Fidelity collects 19 cents every year for every one hundred dollars you have in their Freedom Index Fund, while every year they collect 73 cents for every one hundred dollars you have in their Asset Manager Fund.

Is this difference of 54 cents that big? **Yes. Over time it’s huge.** Let’s say that the two funds start with the same amount of money and do equally well (see reason 3 below for more on that), except for this 54 cent difference in the expense ratio.

After 10 years, the cheaper fund is worth 5.5% more than the expensive fund.

After 20 years, the cheaper fund is worth 11.4% more.

After 30 years, the cheaper fund is worth 17.6% more.

After 40 years, the cheaper fund is worth 24.1% more.

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inflation. 3. The International Stock Index follows all non-U.S. stocks. 4. The U.S. Bond Index follows all U.S. government treasuries, corporate bonds, and mortgage backed securities. 5. Inflation Protected Bonds, commonly called “TIPS,” are government bonds that increase in worth with inflation, which gives some balance to bonds and money markets, which are vulnerable to inflation. 6. Finally, a money market is like a bank account with slightly better returns but a little less government protection in the event of a panic.
Now let’s apply this specifically to SCU retirement plans. Consider an employee who has worked at SCU for 10 years. Let’s say she has accumulated $90,000 in her SCU retirement plans. She currently has an annual salary of $55,000. Assume a 3% annual salary raise over the next 30 years until she retires, and assume that SCU continues to contribute 10% of her salary to retirement, as is currently the case. At the end of these 30 years,

the SCU employee will have $209,898 more money at retirement

if she has a 7.54% rate of return rather than a lower rate of 7.00% due to the bigger expense ratio caused by the extra 54 cents. Without the switch in funds, Fidelity collects this $209,898 difference, instead of the employee. (And if the employee stays with these funds after retirement, which could easily entail another 20 or 30 years, this difference gets much, much larger.)

To see how big this difference is for your situation, you can download the Excel spreadsheet at http://math.scu.edu/~dostrov/Retirement_Calculator.xls and replace the numbers just used above with your own data.

3. Passively managed instead of actively managed.

Why are these new funds so much cheaper? Because they are passively, as opposed to actively, managed. An actively managed fund hires a manager to try to buy and sell stocks or bonds to beat a given market index, like the Dow Jones average or the S&P 500. That costs money and resources. A passively managed fund just buys and holds the stocks or bonds in the index, which requires almost no resources.

But don’t the active managers do much better than the passive managers who do nothing? Interestingly, in study after study, the answer is no. Let’s consider just a couple of these studies:

A study by Lipper and Vanguard compares the (passive) index for the entire U.S. stock market to the average of actively managed stock funds over the period of 20 years from 1990 to 2010. It finds that the passive index averaged .89% better per year than the average actively managed
passive fund. That corresponds to an index return that is 19.5% larger than the average actively managed fund return over these 20 years.

Passive funds decisively beat the average of active funds over other time periods as well. In fact, the longer the time period, the better the passive funds perform. Passive funds also decisively beat the average of active funds in different indexes, such as medium-sized and small-sized U.S. companies, international stocks, emerging market stocks, bonds, etc. Further, the most successful active funds over a previous decade have, on average, done worse in the next decade than the active fund average of that decade, which is worse than the passive index. In other words, when an active fund prospectus says “past performance is no guarantee of future results,” they mean it. If anything, it’s the opposite. To see the data from these and other studies more carefully, please go to http://math.scu.edu/~dostrov/StockData.pdf.

You may also want to check out http://www.nytimes.com/2011/05/14/your-money/401ks-and-similar-plans/14money.html, a recent New York Times article by their weekly *Your Money* columnist Ron Lieber. He goes so far as to suggest it should be illegal for a retirement fund *not* to offer index funds, because these funds are so much in the best interests of employees.

2 19 Ultra-low cost passively managed Vanguard Index Funds

Employees who want more control and flexibility over their stock and bond choices than the Fidelity Freedom Index Funds provide can now choose from a wide variety of Vanguard passive index funds through Fidelity if they desire. (Employees can also set up automatic rebalancing\(^6\) for their 401(a) and

\(^6\)Automatic rebalancing resets your portfolio on an annual basis to the original percentages you chose. For example, let’s say you set up 40% of your account to be in the total bond market index and 60% to be in the total US stock market index. At the end of the year, you might have 48% in bonds and 52% in stocks because it was a bad year for stocks. Your account would then automatically sell some of the bonds and buy some of the (now cheaper) stocks so that you were at 40% bonds and 60% stocks again. Automatically rebalancing allows an employee to “sell high and buy low” in an automatic way. See http://math.scu.edu/~dostrov/StockData.pdf for some data on how advantageous this rebalancing can be.

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403(b). Further, employees can choose a Roth option\(^7\) for their 403(b) if they wish.)

The expense ratios of these passive index funds range from .06 to .29. Compare that to the expense ratios of Fidelity and TIAA-CREF’s active funds, which are almost all between .38 and 1.20. You can find the expense ratio of any of your Fidelity funds at http://math.scu.edu/~dostrov/Fid_Exp_Ratio.pdf under the “expense ratio” column. You can find the expense ratio of any of your CREF funds at http://math.scu.edu/~dostrov/TI_CR_Exp_Ratio.pdf under the “estimated annual expenses” column.

Fidelity will continue to offer 7 less expensive passive index funds, called Fidelity Spartan Index Funds. With the exception of the still superior Spartan Extended Market index fund, current investors in Fidelity’s Spartan funds should almost certainly switch to the cheaper, but otherwise essentially equivalent, Vanguard funds now offered.\(^8\)

TIAA-CREF offers only one passive index fund, which is for the entire U.S. stock market. The expense ratio for this TIAA-CREF index fund is .39. The expense ratio for Vanguard’s almost identical Total U.S. Stock Market Index is .07. In other words, TIAA-CREF charges you more than five times more money than Vanguard for essentially the same fund.

If you like TIAA-CREF’s Social Choice Fund, which has an expense ratio of .41, you might prefer the new Vanguard FTSE Social Index fund, whose expense ratio is .29.

\(^7\)In a normal (non-Roth) 403(b) you pay no income tax on your contribution, but you then owe income tax on every withdrawal in retirement. With a Roth, it’s the opposite: you pay normal income tax on your contribution, but then you owe no taxes on any withdrawal in retirement. There are real advantages in having some retirement money be non-Roth and some be Roth. So, for example, because your 401(a) (the 10% contribution SCU automatically gives you) is required to be non-Roth, you might consider having your 403(b) (any money you decide to put in over SCU’s contribution) be Roth. Again, see http://math.scu.edu/~dostrov/StockData.pdf for a more full explanation of the advantages of doing this.

\(^8\)For the total U.S. market index and the S&P 500 index, the Vanguard expense ratio is .07 and .06, respectively, compared to the Spartan’s .10. For the short, the intermediate, and the long-term treasury/government bond indexes, the Vanguard expense ratio is .15 compared to the Spartan’s .20. For international stocks, the Spartan fund, which has an expense ratio of .20, only covers big companies in Europe and the Pacific rim. The Vanguard funds for big companies in Europe and for big companies in the Pacific rim each have an expense ratio of .14. Better, there’s a Vanguard fund that includes all international countries (including emerging markets) and small companies with an expense ratio of .20.
The asset class and expense ratio of the 19 new Vanguard funds are listed below:

1. Stocks:

   (a) Domestic:

   i. Total Market Index. Exp. Ratio: .07
   ii. By Company Size (“Large Cap” = Large companies, etc.):
       A. Large Cap: S&P 500 Index. Exp. Ratio: .06
       B. Mid Cap: No Vanguard fund because the current Spartan Extended Market Index fund, with an expense ratio of .10, is less expensive.
       C. Small Cap Index. Exp. Ratio: .17
   iii. FTSE Social Index Fund. (This is a Large and Mid Cap fund that screens for certain social, human rights, and environmental criteria.) Exp. Ratio: .29
   iv. REIT (Real Estate) Index Fund. Exp. Ratio: .12

   (b) International:

   i. Total International Stock Index. (Includes International Small Caps and Emerging Markets) Exp. Ratio: .20
   ii. By region:
       A. European Stock Index. Exp. Ratio: .14
       B. Pacific Stock Index. Exp. Ratio: .14
   iii. We are unable to include Vanguard’s Emerging Markets Index fund and Vanguard’s International REIT Index fund on the Fidelity platform at the moment, however, they may become available in the future.

2. Bonds:

   (a) Total Bond Market Index. Exp. Ratio: .11
   (b) By duration:

   i. Short-Term Bond Index. Exp. Ratio: .11
   ii. Intermediate-Term Bond Index. Exp. Ratio: .11
   iii. Long-Term Bond Index. Exp. Ratio: .22
(c) By type and duration:
   i. Short-Term Government Bond Index. Exp. Ratio: .15
   ii. Intermediate-Term Government Bond Index. Exp. Ratio: .15
   iii. Long-Term Government Bond Index. Exp. Ratio: .15
   iv. Mortgage-Backed Securities Index, Intermediate-Term. Exp. Ratio: .15
   vi. We are unable to include the Vanguard Corporate Bond Index funds (Short-term, Intermediate-term, and Long-term) on the Fidelity platform at the moment, however, they may become available in the future.

(d) Inflation-Protected Securities Fund. Exp. Ratio: .22

3. Balanced between 60% Stocks and 40% Bonds:

   (a) Balanced Index. Exp. Ratio: .12
3 How to Change your Current Funds to these New Funds in about 15–20 Minutes.

If you don’t know whether your retirement funds are currently through Fidelity or TIAA-CREF, call or email Anne Mota (x1934, amota@scu.edu) or Caroline Zelaya (x5750, czelaya@scu.edu) at HR to find out.

If you are currently a TIAA-CREF customer:

Call or email Anne or Caroline at the above contact info to schedule an appointment. Your appointment can either be at HR or, if you prefer, at your office. They will go over the few necessary forms with you.

If you are currently a Fidelity customer:

1. Call 1-800-343-0860. When prompted for your user name or social security number, enter your social security number, followed by the # sign.

2. When prompted, enter your password, if you know it, followed by the # sign. If you don’t know your password, just press “0” once and wait. Either way you’ll be transferred to a representative.

3. Tell the representative who answers the phone that you are an employee at SCU. Answer any security questions they ask.

4. Tell them to “please direct all of my future contributions and my current long-term shares, but not my short-term shares, to a Fidelity Freedom Index Fund.” If you redirect your short-term shares now, there will be a fee.

If you want Vanguard funds, obviously you replace “Fidelity Freedom Index Fund” in the sentence above with the Vanguard funds you want.

5. To avoid the fee for trading short-term shares, wait 91 or more days. Then repeat steps 1-3 and tell them to “please put all my remaining funds into the Fidelity Freedom Index Fund.” (By this time, your previous short-term shares will no longer be short-term, so you can transfer them without a fee.)

If you are using the Vanguard funds, you might also want to set up automatic rebalancing at this time. (See footnote 6 on page 6.)