Rebecca Katz: Hi, I’m Rebecca Katz. Vanguard recently announced changes to the fixed income portion of our Target Retirement portfolios. So today I’m here with John Ameriks, head of Vanguard’s Investment Counseling & Research group, and he’ll help us talk through the changes and explain the rationale behind them. John, thanks so much for being here.

John Ameriks: It’s a pleasure, thank you Rebecca.

Rebecca Katz: Why are we making changes to the Target Retirement portfolios?

John Ameriks: It’s all about diversification really. Our attempt here is to further diversify the fixed income portion of the portfolios. You know, changes to the Target Retirement Funds are something that we take very seriously. We don’t do this a lot but when we think there’s some value to be added in terms of improving the diversification of the portfolios, we do take the steps to do that, and that’s what we’ve done here.

Rebecca Katz: So, how exactly are the funds changing?

John Ameriks: Well there are really three important changes to talk about. The first of these is that we will be changing the sub-asset allocation of the fixed income portfolio so that 20% now of the fixed income portfolio will be in non-U.S. bonds via our total international bond portfolio. Second change is that we are shifting the allocation in our TIPS index fund into our short-term TIPS fund. And the third change is that we’re eliminating the very small exposure to money market that exists in the Target Retirement portfolios.

Rebecca Katz: So, what is the rationale for adding international bonds to the portfolios?

John Ameriks: Well again, international bonds are there for diversification purposes. So what we are trying to do is give people exposure to a broader base of fixed income securities and risks. That should help to lower the volatility of the portfolios, especially for retirees and pre-retirees where fixed income is a large portion of the portfolios.

Rebecca Katz: But aren’t international bonds more volatile themselves? So, how does Vanguard mitigate that risk?

John Ameriks: Well it’s actually not the bonds themselves necessarily that are a lot more volatile than what you would see in the U.S. market. A lot of the volatility that comes from international bonds comes from the currency aspect of that. We’re adding a hedged exposure to the portfolio so we’ll be taking steps to attempt to eliminate or reduce the currency risk in the portfolios.

Rebecca Katz: So, how will the addition of these international bonds impact the glide path for the Target Retirement portfolios?

John Ameriks: Well again, this is a shift to the sub-asset class allocation within fixed income. So the overall stock bond mix in the Target Retirement portfolio isn’t changing. This is just a change to what happens with the bond piece. What we’re doing here is we’re going to be allocating 20% of that bond allocation to
non-U.S. bonds. So that’s the important point. When you look at the actual glide path, if you look at the point of retirement, that’s about 10% of the portfolio that would be moved into international bonds. If you looked at someone that’s, say, 25 years away from retirement, it’s a lot less than that, more like 2% of the total portfolio that would be shifted over.

Rebecca Katz: So, why 20%?
John Ameriks: Well, we’re trading off a lot of factors there. While we believe that the addition of international bonds to the portfolio increases diversification, it also can increase cost and we’re trying to balance those two things off when we select an allocation.

The other thing that’s a very important consideration is home bias. We know that there are a lot of investors who have a strong preference for domestic assets. Some of that is rational, some of it may not be. But regardless, if we look broadly at the universe of U.S. investors, look at their fixed income portfolios, only about 13% on average of those fixed income portfolios is invested outside the U.S. We’re targeting 20% [percent], so we’re pushing that up a little bit. We’re comfortable that that gives people good diversification, manages those costs, and is something they would be comfortable holding from a home bias perspective.

Rebecca Katz: So let’s talk about the TIPS exposure. Why the shift there?
John Ameriks: Well for TIPS, that market has matured a lot since the late ’90s, when it first came into existence. We’ve seen a lot of growth on the shorter-term side of that. And our research shows that there’s a higher correlation between inflation and return when you look at the shorter end of the maturity in the TIPS world. And so that’s really the rationale for this. TIPS have always been in the portfolio to provide inflation protection. We think you get a little bit more of that with the shorter exposure. You know here we also think the cost in terms of slightly lower return is worthwhile.

Rebecca Katz: So, you’ve mentioned costs twice already. How does this impact the overall costs of the portfolios?

John Ameriks: So, in terms of the expense ratios, we’re not expecting any change to those expense ratios at this time.

Rebecca Katz: Are we considering any other changes to the Target Retirement portfolios’ glide path?
John Ameriks: Well not at this time, but again, you know this change is evidence that over time we look at these portfolios. We are constantly doing research to try to improve them. And when the research adds up and the cost can be controlled in a way such that we see an improvement is possible, we are going to take steps to implement that. But there’s nothing further planned at this time.

Rebecca Katz: John, thanks so much for helping us understand how the Target Retirement portfolios are changing.
John Ameriks: Happy to be here. Thank you.
Rebecca Katz: For more about the Target Retirement portfolio changes, go to our website at institutional.vanguard.com.

Important information

A registration statement relating to Vanguard Total International Bond Index Fund has been filed with the Securities and Exchange Commission but has not yet become effective. This security may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This communication shall not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of, this security in any state in which such offer, solicitation, or sale would be unlawful prior to registration or qualification under the securities laws of any such state.

For more information about Vanguard funds, visit institutional.vanguard.com or call 800-523-1036 to obtain a prospectus. Investment objectives, risks, charges, expenses, and other important information about a fund are contained in the prospectus; read and consider it carefully before investing. Copies of the final prospectus can be obtained from Vanguard. Please note that a preliminary prospectus is subject to change.
An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of your investment at $1 per share, it is possible to lose money by investing in such a fund.

All investing is subject to risk, including the possible loss of the money you invest. While U.S. Treasury or government agency securities provide substantial protection against credit risk, they do not protect investors against price changes due to changing interest rates.

Investments in Target Retirement Funds are subject to the risks of their underlying funds. The year in the fund name refers to the approximate year (the target-date) when an investor in the fund would retire and leave the workforce. The fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in the Target Retirement Fund is not guaranteed at any time, including on or after the target date.

Bond funds are subject to interest rate risk, which is the chance bond prices overall will decline because of rising interest rates, and credit risk, which is the chance a bond issuer will fail to pay interest and principal in a timely manner or that negative perceptions of the issuer’s ability to make such payments will cause the price of that bond to decline.

Investments in stocks or bonds issued by non-U.S. companies are subject to risks, including country/regional risk and currency risk.

Diversification does not ensure a profit or protect against a loss in a declining market.

Total International Bond Index Fund will be subject to currency risk, which is the chance that currency hedging transactions may not perfectly offset the fund’s foreign currency exposures and may eliminate any chance for a fund to benefit from favorable fluctuations in those currencies. The fund will incur expenses to hedge its currency exposures.