Stop the Glide!

Morningstar's recent changes to its global allocation categories may help fiduciaries re-evaluate the asset allocation funds within their investment menus and provide solutions to participants who do not wish to follow the predetermined glidepath of target date funds (TDFs). Now may be the time to consider adding global allocation funds to 401(k) menus.

As Zig Ziglar stated in *Secrets of Closing the Sale*, buyers will rarely change their minds but will make "a new decision based on new information." In that vein, we believe substantive new information is now available to retirement plan fiduciaries to help address an issue faced by retirement plan participants, particularly those closer to retirement with near-term TDF vintages. The critical issue is what to offer plan participants that do not wish to or do not believe it is appropriate for them to automatically let their retirement portfolio allocations follow the predetermined TDF glide path.

What's New?

Morningstar has been assigning category classifications to funds since 1996 to help investors make meaningful comparisons between them. On April 30, 2025, Morningstar revised the definitions of the US allocation fund categories and retired the legacy global allocation fund category. This was replaced with five new allocation categories. The new categories provide guidelines for fund objectives and set expectations for forward-looking equity volatility, as well as a threshold for domestic and foreign securities. We believe these new categories, along with revised language for US allocation categories and global stock categories, provide much needed clarity for retirement plan fiduciaries and plan consultants.

The five new categories are delineated by investment objective and expected volatility similar to a strategic allocation to equity securities in a multi-asset portfolio. The expected volatility thresholds match the existing US allocation categories. The previous category did not define the percentage of US versus foreign securities that would determine if a fund will be categorized as global or US. Under the new guidelines, global allocation categories may have up to a 75% composition in US securities. Funds with more than 75% exposure to the US will be placed in the US allocation categories. Below is a list of the new categories and their expected equity exposure:

- Global Aggressive Allocation: Greater than 85% equity exposure
- Global Moderately Aggressive Allocation: Between 70% and 85% equity exposure
- Global Moderate Allocation: Between 50% and 70% equity exposure
- Global Moderately Conservative Allocation: Between 30% and 50% equity exposure
- Global Conservative Allocation: Between 15% and 30% equity exposure

We believe these new categories have significant implications for how plan sponsors and plan consultants build retirement plan menus, including how they select Qualified Default Investment Alternative (QDIA). In our view, plan sponsors and consultants should consider taking two possible actions in response to these recent category changes.

Action #1: Re-Evaluate Your Core Menu for Allocation Funds

If the goal is to provide menu options that have broader diversification, then selecting a fund with a global allocation will by definition provide more geographic diversification relative to domestic-only funds. We believe broader global diversification may provide more opportunity, particularly as markets go through cycles.

Over the past 10 years, US and growth-oriented investments have dominated markets, which reflects historical performance statistics that show that US allocation funds provided higher returns with slightly more risk than global funds:

But will style factors be the same over the next 10 years, or will the next 10 years favor global securities? The relative performance of US and non-US stocks over longer periods and multiple market cycles may simply be part of the natural ebb and flow of markets around the long-term mean. Should the next 10 years favor global securities, we believe that plan lineups may consider replacing a domestic-only allocation fund in a core menu with a global diversified fund to expand market exposure beyond US borders. This may provide participants the opportunity to be "where the puck is going to be, not where it has been," as hockey Hall of Famer Wayne Gretzky said. Please see "Non-US Equities: An Exception to American Exceptionalism?" for a detailed discussion on why non-US equity markets and the broad appeal of global diversification may be mounting a comeback.

We believe that adding a global allocation choice may also act as a diversifying option to core menus that typically offer three to four more domestic fund choices. Additionally, funds in the new global allocation categories may provide international diversification that have historically lower volatility than US equity-only investments.

We believe it may be helpful for fiduciaries to review the historical risk metrics delivered by allocation funds for both domestic and global funds relative to other allocation categories. Morningstar defines risk based on expected volatility. In reviewing the new categories and the risk metrics of funds, we found examples of funds that exhibit higher-than-expected volatility based on their allocation to equities versus fixed income without offering equivalently higher expectations for investment returns. For example, we identified a fund categorized in the new Global Moderate Allocation category that had historical standard deviation and beta metrics similar to funds in the more aggressive Global Moderately Aggressive Allocation category. In other words, while this fund is categorized as a moderate expected risk, its historical risk metrics were more in-line with funds in the more aggressive moderately aggressive allocation.

Action #2: Allow Participants to "Stop the Glide" in Target Date Funds

If we are indeed entering a market cycle where foreign securities may lead performance over US markets, should participants within 10-20 years of retirement consider allocating away from domestic and foreign equities into domestic and foreign fixed income investments?

For millions of 401(k) plan participants holding Target Date Funds (TDFs) with vintages between 2035 and 2045, their TDFs will automatically re-allocate for them, which renders this question moot. For example, the largest TDF by vintage (a 2035 vintage fund) is projected to move $10-20 billion of retirement saver assets from equities to fixed income over the next 10 years.

In 2020, this passive approach to investing in challenging markets occurred, which provided a hard-earned lesson about the longer-terms implications of passive investing. In an investment environment characterized by fixed income securities that have a 10-year duration with a 0.5% yield to maturity, TDFs automatically glided down their portfolios to allocate more to fixed income without considering the fundamentals of the market environment. Was it prudent for TDF investors to accept a return of less than 1% for a 10-year investment? Did the glidepaths of the TDFs consider how much capital would be lost if interest rates were to rise 400 basis points over the next five years?

But what if a participant in a near-term vintage TDF doesn't want that re-allocation to fixed income to happen? Shouldn't participants be able to have the choice to move their assets from a TDF to an allocation fund option or a series of options that are globally diversified? Based our experience, we believe the answer is "yes." An allocation fund or other options may be beneficial for those participants to consider.

We believe that there is a reason many plan investment menus lack these options: because many plan sponsors and retirement plan consultants have historically eschewed funds populating the legacy Morningstar Global Allocation category, the category formerly known as World Allocation. Lack of delineation between funds in the category was a headwind for prudently selecting funds from this category. In our view, this changed in 2025 and we believe plan sponsors now have a much better framework for evaluating the funds that were previously lumped into a single category.

A review of the category changes shows that revisions to each category's criteria may also be applied to TDFs and may enable a broader comparison of TDFs to Allocation Funds. We found that long-dated TDFs — 20 years or more from retirement — generally meet the criteria for inclusion in the Morningstar Global Large Stock categories. In contrast, TDFs between zero years and 20 years until retirement (e.g. 2025-2045) would generally meet the criteria for one of the five new Global Allocation categories. Meanwhile, post-retirement date TDFs (e.g. 2020 and earlier) generally met the criteria for the legacy Morningstar US Allocation category due to the large percentage of US securities.

What Opportunities Does This Change Provide?

Add Value Through Education for Plan Consultants

- While most retirement plan sponsors and participants may understand the basics of changes in asset allocations in TDFs, they may not fully understand that the shift in asset allocation occurs regardless of what is occurring in capital markets or the investment environment. Near-term TDFs, particularly those 10 to 20 years from retirement, will experience the most significant portfolio allocation glide. TDF vintages between 2025 and 2045 will experience significant shifts away from equities to domestic and foreign fixed income securities. This allocation change may not be desired or even appropriate for participants based on their individual situation.

- Improving how sponsors and participants understand the mechanics of a glidepath change may prompt sponsors to provide a globally diversified allocation option in their core investment menus if participants do not wish to glide their allocation as pre-determined by the TDF methodology while ignoring the prevailing market environment.

Add Global Allocation Fund(s) to the Core Menu

- Many plans simply do not offer an investment that currently fits into any of the five new Morningstar Global Allocation categories. If participants wish to stop the glide path and remain in a globally diversified investment, they may have no option to do so.
- Our review generally found that 2035-2045 TDF vintages matched with the Global Moderately Aggressive category as measured by volatility. Likewise, the 2025-2030 TDF vintages generally matched with the Global Moderate Allocation category.
- If plans want to offer participants an alternative to the QDIA TDFs glide path, they may consider adding an option that fits the Global Moderately Aggressive Allocation and another option within the Global Moderate Allocation categories. This would give participants invested in different TDF vintages, who may want to step away from the glide path, two available alternatives to potentially invest their retirement savings while trying to maintain a globally diversified, risk-appropriate investment option.
- It may be prudent to offer plan participants several globally diversified allocation fund options that have different expected risk levels because a participant 20 years from retirement may wish to have a different risk level than a participant within five years of retirement.
- Plan sponsors could also elect to dynamically re-enroll participants in near-term TDF vintages to Global Allocation categories that best fit their goals.

As with any significant change, the new categories and revised definitions do present some challenges. For example, the new Global Aggressive Allocation category differs from the equity-focused Global Large Stock categories primarily in the multi-asset fund definition, and the Global Large Stock categories are segmented by value, blend and growth. Additionally, Morningstar uses the term “securities” to set the threshold of US exposure to delineate what considered a global fund. Could a fund with only US equity securities and enough foreign bonds be placed in the new Global categories? Lastly, the category definitions use “expected volatility” of equity exposure to delineate between aggressive, moderately aggressive, etc. Does more equity exposure necessarily mean more volatility? While this terminology provides flexibility, it may create confusion.

We believe the new categories created by Morningstar are a catalyst to add a globally diversified allocation option or funds to meet the needs of participants that wish to have an alternative to the automatic reallocation dictated by the TDFs’ glide path. Retirement plan fiduciaries now have new tools to more confidently approach global investments for their core menu investment options. The five new Global Allocation categories may help more clearly identify a fund’s objective, risk level and set a more appropriate peer group for fiduciary evaluation. Retirement plan fiduciaries should still conduct qualitative due diligence on funds in the new categories to ensure the selected fund meets their objective and needs and goals of their participants.

Sources: Morningstar, Bloomberg, Vanguard.

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All investments involve the risk of loss.

Definitions

Beta is a measure of an investment's price volatility relative to that of the overall market.

A **QDIA** (Qualified Default Investment Alternative) is the investment used when an employee contributes to the plan without having specified how the money should be invested.

Standard deviation is a statistical measure of volatility that captures the degree to which an investment's price has deviated from its average over time.

Target-date funds (TDFs) are age-based retirement investments whose asset allocation automatically adjusts to become more conservative over time as the target date nears.

Morningstar Global Aggressive Allocation Funds in allocation categories seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These aggressive strategies typically prioritize capital appreciation over preservation. They typically expect volatility similar to a strategic equity exposure of more than 85%. Funds in this global category are generally expected to have no more than 75% of their assets in US securities.

Morningstar Global Conservative Allocation Funds in allocation categories seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These conservative strategies prioritize preservation of capital over appreciation. They typically expect volatility similar to a strategic equity exposure between 15% and 30%. Funds in this global category are generally expected to have no more than 75% of their assets in US securities.

Morningstar Global Large-Stock Portfolios invest in a variety of international stocks and typically skew toward large caps that are fairly representative of the global stock market in size, growth rates, and price.

Morningstar Global Moderate Allocation Funds in allocation categories seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These moderate strategies seek to balance preservation of capital with appreciation. They typically expect volatility similar to a strategic equity exposure between 50% and 70%. Funds in this global category are generally expected to have no more than 75% of their assets in US securities.

Morningstar Global Moderately Aggressive Allocation Funds in allocation categories seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These moderately aggressive strategies prioritize capital appreciation over preservation. They typically expect volatility similar to a strategic equity exposure between 70% and 85%. Funds in this global category are generally expected to have no more than 75% of their assets in US securities.

Morningstar Global Moderately Conservative Allocation Funds in allocation categories seek to provide both income and capital appreciation by primarily investing in multiple asset classes, including stocks, bonds, and cash. These moderately conservative strategies prioritize the preservation of capital over appreciation. They typically expect volatility similar to a strategic equity exposure between 30% and 50%. Funds in this global category are generally expected to have no more than 75% of their assets in US securities.

Morningstar US Equity Portfolios are fairly representative of the overall US stock market and categories vary based on general size, growth, rates, and price of equities within the portfolios.

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