

Target Date Funds

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An industry overview of glide paths and asset allocations

Target Date Funds (TDFs) have been utilized since the Pension Protection Act (PPA) of 2006 in a Qualified Default Investment Alternative (QDIA) setting as a means of providing retirement savers with a one-stop solution suited to their age and, in some cases, risk tolerance level. Among the allowed QDIA options which consist of managed accounts, balanced funds and TDFs, the target date option is the most utilized by far. The framework utilized with TDFs is meant to provide a comprehensive, generalized asset mix solution that is deemed appropriate for most retirement investors.

The associated asset mix glide path typically decreases in portfolio risk level over a person's lifecycle. The academic foundation of this lifecycle approach is, in large part, Human Capital Theory, which was first posited by Jacob Mincer and Nobel economist Gary Becker in the late 1950s and early 1960s.^{1,2} Some later extensions of this work, including by Ravi Jagannathan and Narayana Kocherlakota,³ more oriented toward lifetime savings strategies, posited that as the relative weight of the current financial value of the portfolio increases relative to the present value of future human capital, the ability to weather volatility shocks declines. In practice, TDF glide paths conform to the prescriptive advice of practitioners that model volatility in conjunction with time horizon.

Empirical work by behavioral economists had demonstrated that, in practice, savers' investment allocation choices in the absence of QDIA options tended to follow more haphazard construction approaches, such as equally allocating among investment options, otherwise known as the 1/n heuristic.⁴ The systemic response to problems identified by behavioral economists resulted in a system comprised of stimulants and stabilizers designed to address historical behavioral shortcomings in investor retirement savings behavior, including automatic enrollment, automatic contribution rate escalation and the use of QDIAs.

As the most utilized QDIA option, it is worthwhile to explore what lifecycle glide paths typically look like: How steep is the typical glide path? How great is the general variation among providers? How does the allocation to different asset classes vary? Where is there general agreement or disagreement? This paper provides an overview of industry average and variation in asset class allocations for the TDF lifecycle glide paths, as well as widely utilized TDF benchmark series. In aggregate, we find general similarities evident at the aggregate equity and fixed income level across time horizon, but interesting variations in allocations to international equity, emerging markets and smaller capitalization domestic equity.

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Target Date Funds (TDFs) have been utilized since the Pension Protection Act (PPA) of 2006 in a Qualified Default Investment Alternative (QDIA) setting as a means of providing retirement assets with a one-stop solution subject to their age and in some cases, risk tolerance level. Among the various QDIA options, the most common are managed accounts, balanced funds and TDFs. The target date option is the most utilized by the framework utilized with TDFs. It is meant to provide a comprehensive, generalized asset mix solution that is deemed appropriate for most retirement investors.

The evolution of the glide path formula, however, is difficult to deal with in a general sense. The academic literature of this formula approach is, in large part, Human Capital Theory which was first applied to such "labor and human capital" by Becker in the late 1960s and early 1970s. Some key extensions of this work, including the fact that human and "human" characteristics, were related toward future savings strategies, posited that as the number years of the career decrease, the value of the portfolio increases, related to the present value of human capital, the ability to weather volatility, credit facilities, in practice, TDF glide paths continue to be prescriptive rather than prescriptive, that model ability to respond to the future.

Despite the work by behavioral economists, had demonstrated that, in practice, asset allocation decisions in the absence of QDIA options tended to follow more behavioral investment approaches, such as equity weighting among investment options, often based on the "in-the-moment." The systemic response to problems identified by behavioral economists resulted in a system comprised of objectives and solutions designed to address "ticks" or behavioral shortcomings in investor retirement savings behavior, including automatic investments, automatic contribution rate escalation and the use of QDIA.

In the most common QDIA option, it is common to require an investor glide path formula, look like the typical glide path "mix" model is the general career saving strategy, "how does the allocation to different asset classes vary" often a three general response in development. This paper provides an overview of history, savings and investment in asset class allocations for the TDF glide path, as well as a review of the TDF investment rules in aggregate, on the general investment context of the aggregate equity and fixed income that exist over "horizon" but increasing volatility in allocations to international equity, emerging markets and other capitalization domains, equity

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Contents

- 1. Glide paths and how they work in allocations to equity 2
- 2. Allocation with equity 3
- 3. How equity investment works among asset classes 3
- 4. Differences in international equities among asset classes 4
- 5. Quantitative rules within asset classes 5
- 6. Conclusion 5

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