Government Executive

Risk and Retirement: Managing Your TSP Investment

By Tammy Flanagan

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A new law requires the Thrift Savings Plan to invest the automatic contributions of recently hired federal employees into an age-appropriate lifecycle fund. Eric Katz outlined this change to the TSP under the Smart Savings Act, which President Obama signed into law in December 2014. The G Fund previously was the default option for the TSP. Besides new employees, the switch also will affect new survivor annuitants and re-hired federal employees who have a zero balance in their TSP account.

How is a participant's default L Fund determined?

According to TSP Bulletin 15-2, the L Fund selection for each participant will be based on a projected retirement age of 62. For example, the age-appropriate default investment fund for someone born between 1973 and 1982 would be L2040, since they would be expected to begin drawing on their TSP funds between 2035 and 2044.

In last week's column on 12 practical tips for a successful retirement, I urged readers to consider their tolerance for risk. Participants subject to the new default investment rules will receive a letter from the TSP that includes such risk information as required by the Smart Savings Act.

The TSP spells out the investment risks as follows:

- **Credit risk:** A borrower will default on a scheduled payment of principal and/or interest—present in the F Fund.
- **Currency risk:** The value of a currency will rise or fall relative to the value of other currencies—present in the I Fund.
- **Inflation risk:** Your investments will not grow enough to offset the effects of inflation—present in all five funds.
- **Market risk:** Your investments could decline in value with a decline in the market value of stocks or bonds—present in the F, C, S and I Funds.
- **Prepayment risk:** During periods of declining interest rates, homeowners may refinance their high-rate mortgages and prepay the principal. The F Fund must reinvest the cash from these prepayments in current bonds with lower interest rates, which lowers the return of the fund.

A few years ago, when the TSP began the automatic enrollment of new hires, TSP Director Greg Long was interviewed on Federal News Radio where he made the following comment: "I think the big takeaway of what we saw (with automatic enrollment of new hires) is that the number of people that are the youngest that are invested heavily in the G Fund—the super-safe, never-has-a-bad-day G Fund—is higher than we expected." Long added, "That might not be appropriate for a 28-year-old who's got 30 or 40 years ahead to work for the federal government."

Considering that 35 percent of the entire Thrift Savings Plan is invested in the G Fund (as of June 30), this change to move the TSP default option from the G Fund to lifecycle funds can go a long way towards helping TSP participants become more diversified across a broad range of investments. The G Fund has remained popular among investors because of its safety. According to the TSP, if you choose to invest in the G Fund, you are placing a higher priority on stability than long-term growth.

Risk has a bad connotation for many folks. It means there is no guarantee of safety. But investment always requires some degree of risk. To manage that risk, the Financial Industry Regulatory Authority recommends understanding and employing two basic investment strategies: asset allocation and diversification.

Diversification and Asset Allocation

By including different asset classes in your portfolio (for example stocks, bonds, real estate and cash), you increase the probability that some of your investments will provide satisfactory returns even if others are flat or losing value. How does this apply to the TSP and the Lifecycle Funds? You are using different asset classes within the lifecycle funds because you are buying stocks in the C, S, and I Funds and you are buying bonds and Government securities in the G and F Funds. The lifecycle funds' asset allocations are described in this summary.

When you diversify, you divide the money you've allocated to a particular asset class, such as stocks, among various categories of investments that belong to that asset class. Diversification, with its emphasis on variety, allows you to spread you assets around. In short, you don't put all your investment eggs in one basket. How does this apply to the TSP? The five individual TSP funds offer a broad range of investment options, including Government securities, bonds, and domestic and foreign stocks. For example, the C Fund offers the opportunity to earn a potentially high investment return over the long term from a broadly diversified portfolio of stocks of large and medium-sized U.S. companies. The objective of the C Fund is to match the performance of the Standard & Poor's 500 Index. You can learn more about the diversification of the five individual TSP Funds here.

The bottom line is all investments carry some degree of risk. By better understanding the nature of the risks and taking steps to manage them, you put yourself in a better position to meet your financial goals.

I am happy to announce that I will be partnering with Micah Shilanski, CFP, again next month for a new webinar series, titled "Secrets to a Successful Retirement" which includes separate sessions on the topics of wealth building, insurance and estate planning. The series will air live on October 15th, 22nd and 29th. The Plan Your Federal Retirement webinar library includes:

- Three Irreversible Mistakes (FERS)
- Maximizing Your Social Security Benefits
- Phased Retirement
- Smart Choices for Open Season
- The Missing Key to the TSP

Micah and I will discuss these topics in three one-hour segments and take audience questions. With our annual pass, you will have access to over 18 hours of training along with all new webinars over the next 12 months. You can register for our upcoming webinar series or enroll for the annual pass here.

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