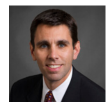
How We Design a Blend Solution for Target Date Investors

Mixing active and passive investments in a target date solution.

October 2023

KEY INSIGHTS

- We are committed to delivering successful retirement outcomes through a range of target date solutions for our clients to help meet their needs and objectives.
- Our blend target date strategy is designed with a goal of delivering a lower fee profile and reduced tracking error with the benefits of our approach to active management.
- We believe the pursuit of lower costs must be balanced with the need for broad diversification and the potential for excess returns.



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Given our leadership in the target date marketplace, we have a strong commitment to research and innovation to help meet investors' evolving needs. Our target date suite is built on the principle that investor preferences should drive design. For that reason, we manage an array of solutions to meet the range of needs we know exist in the market.

A number of plan sponsors have sought out target date strategies that offer lower fees and reduced tracking error.[1] Importantly, they are seeking solutions from providers that can restrain costs but offer a full opportunity set of asset classes that can potentially generate excess returns and greater portfolio growth.

In addition to delivering a strategy that combines the value of active management with the lower costs of passive management, we believe our approach to a blend target date strategy offers investors:

- A thoughtful glide path design tailored to help support investors' objectives, which seeks to balance risk and return potential in line with our research on participant preferences and behavior.
- Enhanced diversification in asset categories that can only be adequately achieved through active management.
- A suite of strong underlying building blocks.
- A robust tactical allocation decision-making process that rigorously assesses market risks and opportunities.
- An experienced team that has managed target date strategies through multiple market cycles.

[1] Tracking error is a measure of how closely portfolios track their benchmarks.

> ...we explored the trade-offs between our active and passive strategies in terms of their potential impact on a range of outcomes, such as cost, excess return potential, and diversification, among other factors.

Solving for Client Needs

Plan sponsors often have unique needs and specific objectives in their selection of target date offerings. Lower cost solutions that couple the benefits of active and passive management are among them. We recognize that some passive investments can provide efficient capital market exposure in select sectors while also delivering significant cost reduction. Importantly, however, we believe our actively managed portfolios can generate excess returns and diversification through exposure to market segments in which passive management cannot drive desired outcomes.

The primary goal of our blended approach is consistent with that of our existing suite of target date solutions: to balance providing support for lifetime income with reducing volatility near retirement through a risk-aware design. We firmly believe that a fully active approach presents the greatest opportunity to generate excess returns, but we also recognize that, for some, this goal must be balanced alongside other considerations. To that end, we sought to design a solution to meet plan sponsors' needs without sacrificing participants' outcomes.

Building a Blend Solution

We sought to design a target date strategy that blends T. Rowe Price's passive and actively managed investments that aim to deliver a lower fee profile and reduced tracking error while maintaining many of the benefits of active management. Through an iterative evaluation process, we explored the trade-offs between our active and passive strategies in terms of their potential impact on a range of outcomes, such as cost, excess return potential, and diversification, among other factors.

Fixed income and equity portfolios have divergent characteristics and are impacted by different factors, particularly when considering the implementations of a blended approach between active and passive investments. For that reason, we considered our approach to the broad asset classes separately.

Fixed Income—Improved Diversification

We believe in broad diversification within fixed income and, therefore, have implemented allocations across both core and diversifying fixed income sectors. As part of our design process, we evaluated the trade-offs of active

Complexities—Index Replication and Tracking Error

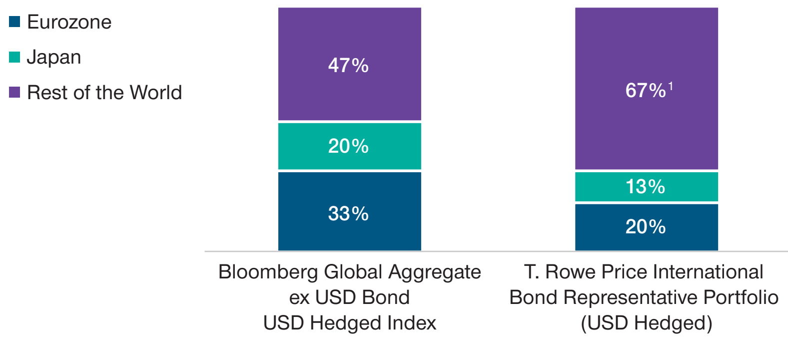
The goal of a manager of a passive strategy is to replicate the performance of a benchmark or index the strategy is intended to track. The ease of replicating an index varies meaningfully across asset classes. Tracking error is a useful measure of how closely portfolios track their benchmark. In certain market segments, like U.S. large-cap equities, tracking error of passive investments tends to be lower, as it is relatively easier for passive managers to purchase the securities that compose the index in the proportions needed to replicate index returns. However, in other areas, particularly in fixed income, tracking error tends to be a more notable challenge.

The Credit Suisse High Yield Index, for example, consists of over 1,200 distinct securities from multiple sectors.[2] Many of these bonds are issued in relatively limited quantities and may trade infrequently, or not at all, in the secondary market. Further, new issuance, maturities, credit rating changes, and redemptions can continuously alter the makeup of a bond index, thereby increasing the difficulty of fully replicating the index and potential for tracking error.

[2] As of September 30, 2023.

Our Active Approach Offers Favorable Diversification

(Fig. 1) Regional diversification comparison



For illustrative purposes only.
As of September 30, 2023.
Figures may not total to 100% due to rounding. The representative portfolio is an account we believe most closely reflects the current portfolio management style for the strategy. Performance is not a consideration in the selection of the representative portfolio. The characteristics of the representative portfolio shown may differ from those of other accounts in the strategy. Information regarding the representative portfolio and the other accounts in the strategy is available upon request.
Source: T. Rowe Price. Source for Bloomberg Index data: Bloomberg Finance L.P.
[1] Reserves are included in this figure, which represented 10.33% of total net assets of the representative portfolio as of September 30, 2023.

"Beyond simple inefficiency and high tracking error, we found that accurate index exposure in certain sectors may produce unfavorable outcomes.

and passive investments across each fixed income sector in which we invest. For each sector, we evaluated a passive investment's ability to achieve efficient exposure with low tracking error as well as the attractiveness of gaining that exposure passively.

While passive investment strategies within certain fixed income market segments face significant challenges gaining efficient exposure, our research indicates that passive can be appropriate in other market segments due to the relative ease of benchmark replication and reasonably well-contained tracking error within those sectors. For example, based on our analysis, we believe passive investments within the U.S. investment-grade and U.S. Treasury sleeves can be employed. Additionally, we believe passive exposure to these sectors is more prudent given their high credit quality. This allocation to passive fixed income investments could also enable us to maintain an allocation to active equity while maintaining a similar mix of active and passive exposures across our portfolios.

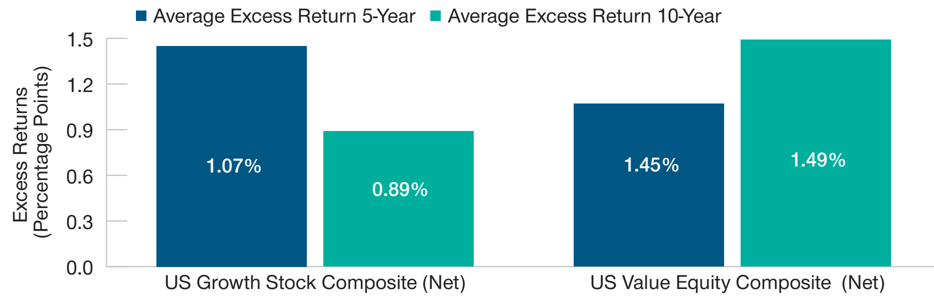
In more specialized fixed income sectors, our analysis suggests that an active management approach can be preferable, as index returns can be more challenging to replicate through passive portfolios. In these sectors—such as high yield and emerging markets debt—passive managers may not be able to purchase and hold some benchmark securities at appropriate weights, and there can be heightened liquidity risks. As a result, tracking error for a passive strategy in these sectors comparably can be as high as an active strategy, and performance may fail to appropriately track the stated benchmark.

Beyond simple inefficiency and high tracking error, we found that accurate index exposure in certain sectors may produce unfavorable outcomes. In some cases, the securities that dominate particular indexes may have potentially unattractive qualities:

- Within high yield debt, index representation skews toward the most highly leveraged issuers. This can expose investors to greater default risk and can also create sector concentrations.

Active Management Maximizes the Potential for Excess Returns

(Fig. 2) Average annualized excess returns (net of fees)



As of September 30, 2023.

Past performance is not a reliable indicator of future performance

Sources: T. Rowe Price, FTSE/Russell (see Additional Disclosures).

For illustrative purposes only. Not representative of the performance (past or future) of any target date strategy. Net-of-fees performance reflects the deduction of the highest applicable management fee that would be charged based on the fee schedule contained within this material, without the benefit of breakpoints. Net performance returns reflect the reinvestment of dividends and are net of all non-reclaimable withholding taxes on dividends, interest income, and capital gains. Data are calculated on a monthly basis over a 25-year period and are based on returns over rolling 5- and 10-year periods. The benchmark used for the excess return calculation for the US Growth Stock Composite is the Russell 1000 Growth Index. The benchmark used for the US Value Equity Composite is the Russell 1000 Value Index. **Please see Performance Appendix for the Composites' total returns as of most recent quarter end.**

- In emerging markets debt, benchmark representation is typically limited to sovereign issues, which reduces the opportunity set available to investors.
- In international developed debt markets, indexes tend to skew toward a high concentration of issuers in a limited number of countries, which increases idiosyncratic risk.

We believe target date strategies should have strategic exposure to these sectors, which provide important, long-term diversification benefits. In our view, exposure to these sectors can be best achieved through an active management approach.

Equities—Potential for Excess Returns

Among equities, we found that the appropriateness of passive and active vehicles similarly varied across market segments and styles. In core allocations to U.S. and international developed markets equities, we determined that passive allocations could achieve efficient market exposure while restraining cost. However, we found that—given the magnitude of potential excess returns—desirable outcomes were most supported by combining these passive allocations with our active allocations to narrower, style-based segments. We believe our active capabilities in growth- and value-focused segments in the U.S. and international developed markets provide opportunities to maximize potential excess cost-adjusted returns that may deliver value for plan participants.

For instance, passive investments in U.S. equities present opportunities to gain efficient market exposure at lower cost and minimal tracking error. We believe that a purely passive approach to the segment may limit the ability to generate excess returns. In particular, we have maintained a sizable allocation to U.S. large-cap equities throughout the glide path, and we believe the magnitude of potential value added from our active strategies within U.S. large-cap equities outweighs the lower cost of a passive alternative.[3] Given our sizable allocation and track record of generating

[3] The allocation is largest furthest from retirement age and decreases over time.

> Our emphasis is on participant outcomes, and we have a high conviction on maintaining active allocations where we believe we can add significant value.

excess returns net of fees within U.S. large-cap equities,[4] we believe it was prudent to utilize a degree of active management within the space. Our emphasis is on participant outcomes, and we have a high conviction on maintaining active allocations where we believe we can add significant value.

While efficient passive market exposure is available in certain market segments, we determined that investment opportunities in a number of sectors could also be enhanced though our active management approach. Passive options in emerging markets equities are less desirable, as they are generally viewed as largely inefficient markets and because indexes may skew heavily toward concentration in a few countries. Our suite of target date solutions also maintains an allocation to real assets equities, which can enhance diversification and provide a potential hedge against inflation. In our view, the universe of passive investments does not offer an adequate alternative for this allocation.

Conclusion

By including a blend strategy to our suite of target date solutions, we believe we can provide plan sponsors a unique alternative that stands out from the existing universe of investment options. The integration of active and passive strategies in our blended solution may offer investors the potential for lower costs and the opportunity to benefit from excess returns driven by fundamental research.

Performance Appendix

The 1-, 5-, and 10-year annualized net of fees total returns as of September 30, 2023 were **27.57%, 7.59%** and, **11.86%** for the U.S. Growth Stock Composite. The **1-, 5-,** and **10-year** annualized net of fees total returns as of September 30, 2023 were **13.70%, 8.26% and, 9.52%** for the U.S. Value Equity Composite.

Past performance is not a reliable indicator of future performance.
Net of fees performance reflects the deduction of the highest applicable management fee that would be charged based on the fee schedule contained within this material, without the benefit of breakpoints. Net of fees performance returns reflect the reinvestment of dividends and are net of all non-reclaimable withholding taxes on dividends, interest income, and capital gains.

[4] Based on rolling 5- and 10-year annualized total returns for our US Growth Stock and US Value Equity Composites compared with the strategy benchmarks.

GIPS® Composite Report

US Growth Stock Composite

Period ended December 31, 2022.
Figures shown in U.S. dollars

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Gross Annual Returns (%)	40.11	9.60	11.60	2.12	34.50	-0.44	31.77	37.68	19.68	-39.41
Net Annual Returns (%)[1]	38.46	8.28	10.25	0.88	32.91	-1.65	30.20	36.05	18.25	-40.18
S&P 500 Index (%)[2]	32.39	13.69	1.38	11.96	21.83	-4.38	31.49	18.40	28.71	-18.11
Russell 1000 Growth Index (%)[2]	33.48	13.05	5.67	7.08	30.21	-1.51	36.39	38.49	27.60	-29.14
Composite 3-Yr St. Dev.	13.94	11.33	11.68	12.68	11.94	13.25	13.73	19.97	18.49	24.53
S&P 500 Index 3-Yr St. Dev.	11.94	8.97	10.47	10.59	9.92	10.80	11.93	18.53	17.17	20.87
Russell 1000 Growth Index 3-Yr St. Dev.	12.18	9.59	10.70	11.15	10.54	12.13	13.07	19.64	18.17	23.47
Composite Dispersion	0.14	0.11	0.06	0.06	0.04	0.10	0.22	0.34	2.02	0.60
Comp. Assets (Millions)	57,968.5	60,474.0	67,413.3	67,584.3	82,561.0	78,496.7	100,283.6	125,875.2	140,528.0	83,853.2
# of Accts. in Comp.	20	19	18	19	22	23	25	26	25	24
Total Firm Assets (Billions)	696.3	749.6	772.4	817.2	1,000.2	972.7	1,218.2	1,482.5	1,653.6	1,237.4[3]

[1] The fee rate used to calculate net returns is 1.22%. This represents the maximum fee rate applicable to all composite members. **Past performance is not a reliable indicator of future performance.**

[2] The primary benchmark is the S&P 500 Index and secondary benchmark is the Russell 1000 Growth Index.

[3] Preliminary—subject to adjustment.

T. Rowe Price (TRP) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. TRP has been independently verified for the 26-year period ended June 30, 2022 by KPMG LLP. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm wide basis. Verification does not ensure the accuracy of any specific composite presentation.

TRP is a U.S. investment management firm with various investment advisers registered with the U.S. Securities and Exchange Commission, the U.K. Financial Conduct Authority, and other regulatory bodies in various countries and holds itself out as such to potential clients for GIPS purposes. TRP further defines itself under GIPS as a discretionary investment manager providing services primarily to institutional clients with regard to various mandates, which include U.S., international, and global strategies but excluding the services of the Private Asset Management group. As of October 1, 2022, there is no minimum asset level for portfolio inclusion into the composite. Prior to October 2022, the minimum asset level for equity portfolios to be included in composites was $5 million and prior to January 2002 the minimum was $1 million. The minimum asset level for fixed income and asset allocation portfolios to be included in composites was $10 million; prior to October 2004 the minimum was $5 million; and prior to January 2002 the minimum was $1 million. Valuations are computed and performance reported in U.S. dollars.

Gross performance returns are presented before management and all other fees, where applicable, but after trading expenses. Net of fees performance reflects the deduction of the maximum fee rate applicable to all composite members as shown above. Gross performance returns reflect the reinvestment of dividends and are net of nonreclaimable withholding taxes on dividends, interest income, and capital gains. Gross performance returns are used to calculate presented risk measures. Effective June 30, 2013, portfolio valuation and assets under management are calculated based on the closing price of the security in its respective market. Previously portfolios holding international securities may have been adjusted for after-market events. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Dispersion is measured by the standard deviation on across asset-weighted portfolio returns represented within a composite for the full year. Dispersion is not calculated for the composites in which there are five or fewer portfolios.

Some portfolios may trade futures, options, and other potentially high-risk derivatives that may create leverage and generally represent in aggregate less than 10% of a portfolio.

Benchmarks are taken from published sources and may have different calculation methodologies, pricing times, and foreign exchange sources from the composite.

Composite policy requires the temporary removal of any portfolio incurring a client initiated significant cash inflow or outflow greater than or equal to 25% of portfolio assets. The temporary removal of such an account occurs at the beginning of the measurement period in which the significant cash flow occurs and the account re-enters the composite on the last day of the current month after the cash flow. Additional information regarding the treatment of significant cash flows is available upon request.

The firm's list of composite descriptions, a list of limited distribution pooled fund descriptions, and a list of broad distribution pooled funds are available upon request.

A portfolio management change occurred effective October 1, 2007 and January 16, 2014. There were no changes to the investment program or strategy related to this composite.

GIPS® Composite Report

US Value Equity Composite

Period ended December 31, 2022.
Figures shown in U.S. dollars.

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Gross Annual Returns (%)	38.41	14.28	-0.96	11.84	19.84	-8.75	27.16	11.29	30.78	-10.77
Net Annual Returns (%)[1]	36.97	13.07	-2.01	10.66	18.58	-9.73	25.83	10.11	29.41	-11.73
Benchmark (%)[2]	32.39	13.69	1.38	11.96	21.83	-5.56	26.54	2.80	25.16	-7.54
Russell 1000 Value Index (%)[2]	32.53	13.45	-3.83	17.34	13.66	-8.27	26.54	2.80	25.16	-7.54
Composite 3-Yr St. Dev.	13.82	9.73	11.01	10.75	10.27	10.31	10.86	18.41	18.14	20.39
Benchmark 3-Yr St. Dev.	11.94	8.97	10.47	10.59	9.92	10.51	11.79	19.66	19.06	21.25
Russell 1000 Value Index 3-Yr St. Dev.	12.70	9.20	10.68	10.77	10.20	10.82	11.85	19.62	19.06	21.25
Composite Dispersion	N/A	N/A	N/A	0.02	0.05	0.03	0.02	0.07	0.11	0.03
Comp. Assets (Millions)	22,284.7	28,963.5	30,683.4	33,420.5	40,234.1	35,587.6	45,921.8	58,333.9	76,762.8	58,242.0
# of Accts. in Comp.	4	5	6	7	7	7	8	8	9	10
Total Firm Assets (Billions)	696.3	749.6	772.4	817.2	1,000.2	972.7	1,218.2	1,482.5	1,653.6	1,237.4[3]

[1] The fee rate used to calculate net returns is 1.07%. This represents the maximum fee rate applicable to all composite members. **Past performance is not a reliable indicator of future performance.**

[2] Effective March 1, 2018, the benchmark for the composite changed to Russell 1000 Value Index. Prior to this change, the primary benchmark for the composite was the S&P 500 Index and secondary benchmark was Russell1000 Value Index. The changes were made because the firm viewed the new benchmark to be a better representation of the investment strategy of the composite. Historical benchmark representations have not been restated.

[3] Preliminary—subject to adjustment.

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The firm's list of composite descriptions, a list of limited distribution pooled fund descriptions, and a list of broad distribution pooled funds are available upon request.

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A portfolio management change occurred effective January 1, 2010. There were no changes to the investment program or strategy related to this composite.

Fee Schedules

Period ended December 31, 2022

US Growth Stock Composite

The US Growth Stock Composite seeks long-term capital appreciation primarily through investment in large-cap growth companies. (Created June 2006, incepted December 31, 1995.)

First 50 million (USD)	50 basis points
Next 50 million (USD)	45 basis points
Above 100 million (USD)	40 basis points on all assets[1]
Above 200 million (USD)	33 basis points on all assets[1]

US Value Equity Composite

The US Value Equity Composite seeks long-term capital appreciation by investing primarily in common stocks believed to be undervalued. Income is a secondary objective. (Created June 2006, incepted December 31, 1995.)

First 50 million (USD)	47.5 basis points
Next 50 million (USD)	42.5 basis points
Above 100 million (USD)	37.5 basis points on all assets[1]
Above 200 million (USD)	32.5 basis points on all assets[1]

[1] A transitional credit is applied to the fee schedule as assets approach or fall below the break point. Minimum separate account size 50 million USD.

INVEST WITH CONFIDENCE℠

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

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