



October 24, 2007

Guest Column: DOL Ruling on Qualified Defaults Opens Doors

by Charles W. Kadlec

Charles W. Kadlec is the managing director of J. & W. Seligman & Co. Incorporated and president of Seligman Advisors and Seligman Services. He is also portfolio manager for the Seligman Time Horizon Funds and the Seligman Harvester Fund as well as co-portfolio manager for the Seligman Target Horizon ETF Portfolios.

The adage “When opportunity knocks, open the door” is especially appropriate now that the Department of Labor has issued the final regulations under the Pension Protection Act of 2006 (PPA) with regard to 401(k) plan default funds, or qualified default investment alternatives (QDIAs).

The safe harbor provided by these regulations offers the financial services industry - and every plan sponsor - a once-in-a-generation opportunity to contribute to the financial health of the American people. The reason: These new regulations directly challenge the traditional one-dimensional measure of investment risk, short-term volatility.

There are few myths that are as powerful - and as destructive - as this view of risk when investing for retirement or other distant goals. It ignores three principles of managing risk over time when investing for periods of five, 10 or more years: the power of compounding, the insight that the relative risk of asset classes changes over time, and the importance of executing a research-based and disciplined investment process.

Even worse, it creates the illusion that risk can be avoided, when, in fact, pursuit of a “safe” investment strategy by plan participants in their 20s, 30s and even their 40s can mean a dramatic increase in the risk of not having enough money at retirement.

The PPA’s regulations allow more powerful default investment solutions that may help individuals manage risk over time. Consider the potential gains from the power of compounding. Assuming a hypothetical 4% average annual return, an investment in a traditional default option, such as a money market fund or stable value fund, would double in value in 18 years.

By contrast, from 1950 through 2006, the S&P 500 produced an average annual return of 11.8% a year. Such an investment would double nearly three times in 18 years. Put another way, an initial \$10,000 investment in the S&P 500 would grow to \$74,500 - \$54,000 more than in the hypothetical “safe” investment.

The second key to managing risk over time is to understand that the relative risk of stocks, bonds and cash changes as investment time horizons change. For example, in 16 of the past 57 calendar years through 2006, small-cap stocks produced negative returns, including a 30.9% decline in 1973. For investors needing cash within a year, such an investment would be quite risky, and a cash account would be more prudent.

However, on a rolling 10-year basis, the risk of loss is reduced significantly. In fact, from 1950 through 2006, small-caps’ worst 10-calendar-year return - the period ending 1974 - was a positive 3.2% average annual return. Even more striking, in their worst 20-calendar-year period since 1950, small-caps produced a positive 8.2% average annual return, which is better than the best 20-calendar-year average annual return for Treasury bills of 7.7%, which occurred over the high-interest-rate period ending 1991.

The third critical step to managing risk is providing an investment process that includes prudent exposure to equity

markets - especially when investment time horizons are long - and that is strong enough to keep most individuals invested during volatile markets.

An oft-quoted study by Dalbar reports that the average investor in U.S. equity mutual funds got only a 4.3% return for the 20-year period ending 2006; that's 750 basis points per year less than the S&P 500. An investment process that helps individuals close that gap - a result we call "Investor Alpha" - is one of the single greatest opportunities to increase returns to plan participants.

Our experience at Seligman shows that individuals are willing and able to take advantage of such a process. Our process, called Seligman Time Horizon Matrix, enables individuals to seek the benefits of compound returns by investing in asset classes that have historically provided higher expected returns and greater short-term volatility when their investment time frames are long. In addition, it includes a risk-management process that adjusts those allocations to less volatile asset classes as their investment time frames shorten and short-term volatility grows in importance.

More recently, we introduced the Seligman TargETFunds, a series of target-date mutual funds that implements the same investment process by investing in exchange-traded funds (ETFs).

More than 70% of 401(k) participants actively choose the Time Horizon strategy in the plans where it is offered as an option. Equally important, this strategy kept the vast majority of participants invested through the bear market of 2000–2002, much to their benefit in subsequent years when markets rebounded.

The PPA's creation of a safe harbor for QDIAs, such as target-date investment processes and funds, gives every defined contribution plan sponsor the opportunity to enhance the default options being offered to its plan participants. Financial advisors and investment management firms should do all that we can to help them deliver this potential lifestyle-changing benefit to the millions of American workers who will look mainly to the assets in their defined contribution plan for sustenance in retirement.

Copyright 2007, Money-Media Inc. All rights reserved. Redistributed with permission. Unauthorized copying or redistribution prohibited by law.

To learn more about Seligman's Time Horizon asset allocation strategy, please contact Seligman Advisors, Inc. at 888-597-1553.

The S&P 500 is an unmanaged index representing the performance of large-cap US stocks. Investors cannot invest directly in an unmanaged index.

While they offer greater potential for capital appreciation, equity investments carry greater investment risk and may be less liquid as compared to stable value funds and money market funds. Stable value funds typically invest in high-quality bonds and interest-bearing contracts and guarantee to maintain the value of principal and accumulated interest, and money market funds typically seek to maintain a consistent net asset value of \$1.00 per share by investing in short term high-quality debt securities. In addition, money market funds and stable value funds generally carry lower fees and expenses than an equity fund.

Description of Asset Classes: *US Small-Company Stocks: 1979 – 2006: Russell 2000; 1950 – 1978: Ibbotson Small Stock Index. US Large -Company Stocks: Standard & Poor's 500 Composite Stock Index (S&P 500). Investment Grade Fixed Income: 1973 – 2006: Lehman Brothers Government/Credit Bond Index; 1969 – 1972: Estimated as the Citi group High Grade Corporate Index; 1950 – 1968: Ibbotson Long-Term Corporate Bonds estimate. US Government Bonds: 1973 – 2006: Lehman Brothers Government Bond Index; 1950 – 1972: Ibbotson Long-Term Government Bond Index. Treasury Bills: Ibbotson One Bill Portfolio.*

Important Risk Information: *Stock prices fluctuate and you could lose money. The stocks of small- and mid-cap companies may be subject to above-average price fluctuations. Bonds are subject to interest-rate risk, credit risk, prepayment risk, and market risk.*

Past performance of asset classes is no guarantee of future results. The return and principal value of an investment will fluctuate with market conditions. Returns do not represent the performance of any Seligman mutual fund, and do not reflect the effect of any management fees or trading costs. If such charges had been included, performance would have been lower.

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

The views and opinions expressed are provided for general information only, and do not constitute specific tax, legal, or investment advice to, or recommendations for any person. Opinions, estimates, and forecasts may be changed without notice.

This material is authorized for use only in the case of a concurrent or prior delivery of the offering prospectus of Seligman TargetHorizon ETF Portfolios. You should consider the investment objectives, risks, charges, and expenses of a fund carefully before investing. A prospectus contains more complete information about a fund (including its investment objectives, risks, charges, expenses, and other information about a fund). Please read it carefully before investing or sending money.

The Seligman Group of Funds is distributed by Seligman Advisors, Inc.

Distributed by Seligman Advisors,

Inc. 800-221-2783

Ignites- 1007