A Comprehensive Approach to Target Date Funds

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September 28, 2015 marks the three-year anniversary of the PNC Target Date Funds. In this Q&A, Jake Moloznik, member of the portfolio management team discuss the advantages of a comprehensive approach and process.

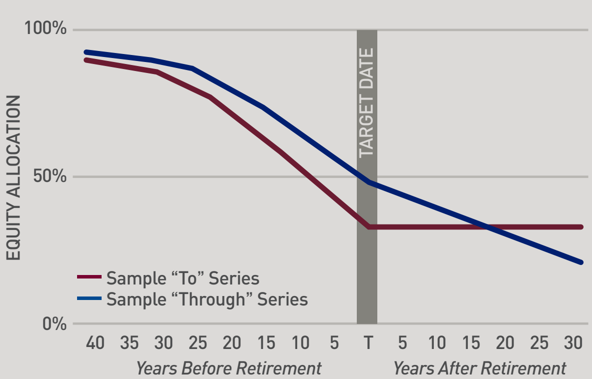
WHAT ARE TARGET DATE FUNDS AND WHY MIGHT THEY BE AN ATTRACTIVE OPTION FOR THOSE INVESTING FOR RETIREMENT?

While most mutual funds invest directly in stocks, bonds, and other securities, a target date fund invests in multiple mutual funds and other investment products. An investor may choose the target date fund that is best aligned with their expected retirement date. The asset allocation mix of the fund automatically shifts as the target date approaches. This allows target date fund investors to gain broad asset class diversification and professional portfolio management in a single investment.

ARE ALL TARGET DATE FUNDS ALIKE?

Each series of target date funds is unique in its own way. One common difference involves the glide path that is used. The individual fund's glide path approach may impact that fund's performance if certain market events occur at or near a fund's target date.

SAMPLE GLIDE PATH "TO" VERSUS "THROUGH"



Note: Sample glide paths compiled based on data reported to Morningstar by managers of various target date series (2014).

For illustrative purposes only. Does not necessarily reflect the glide path for any particular target date fund or target date fund series.

The glide path of a target date series is a concise visual of how each fund will de-risk over time as it approaches the specific target date. There are two distinct philosophies on what should occur once a fund or participant reaches the target date. The two resultant variations are commonly referred to as "to" versus "through."

- A "to" style target date series manages the assets to the target date, at which point the glide path reaches a static allocation. Once the target date is reached, the assets of the fund may be automatically rolled into a retirement income fund.
- A "through" style series, on the other hand, manages the assets through the target date, and the asset allocation de-risking continues in the years following the target date as the assets remain in the fund.

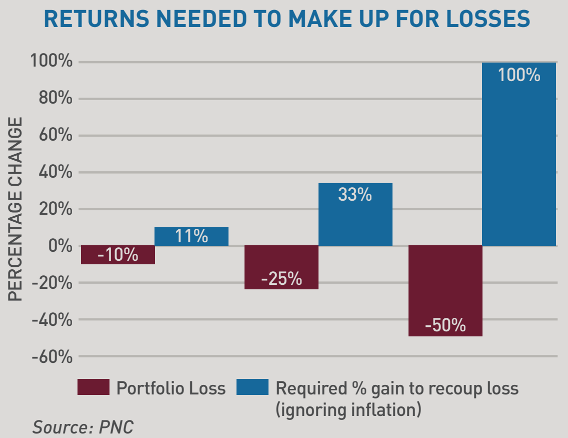
HOW ARE PNC TARGET DATE FUNDS CONSTRUCTED AND WHY IS THIS IMPORTANT TO TODAY'S RETIREMENT INVESTOR?

The recession had a profound and lasting effect on the psychology of those investing for retirement. One of the biggest distinctions involved the investments returns some retirement investors in Target 2010 funds experienced during the recession. The recession period highlighted how different returns of "to" versus "through" strategies could be. "Through" style target date funds suffered much larger losses than "to" styles.

We wanted to be very clear in the level of equity a retirement investor was exposed to at, and during retirement. For this reason, we choose a "to" retirement glide path approach over a "through" approach. Since a retirement investor is likely to have reached a peak in terms of cumulative retirement contributions, minimizing the shortfall risk for the investors retirement balance is critical to us.

Both psychologically and mathematically, large investment losses have impacts on investors. Psychologically, an investor may be more familiar with the level of their investment balance, say $1,000,000 for easy math. If an investor loses 25% of a $1,000,000 balance, assets fall to $750,000. Investors may react after the fact, sell their investments at the wrong time and risk missing out on a possible recovery.

Mathematically, to recoup the 25% loss, which brought the investment balance down to $750,000, an investor would need to see a recovery of 33% = ($250,000/$750,000) to bring the investment balance back to $1,000,000.



Source: PNC
For illustrative purposes only

We believe the 2008 recession was a catalyst that spurred many existing target date series to reexamine the level of equity in their allocation glide paths and may have contributed to existing target date providers launching a second set of target date funds with glide paths that have lower exposures to equity. It was also the experience that inspired PNC Capital Advisors, LLC, to construct target date funds designed to help manage the impact of severe market volatility. More than ever, managing risk is a goal.

With that in mind, PNC Target Date Funds were built based on the following tenets:

- A carefully constructed asset allocation philosophy – with a "to" retirement glide path
- A multi-manager approach focused on rigorous due diligence in manager selection
- A mix of active and passive styles
- Use of specialty diversifiers for risk

CAN YOU EXPLAIN EACH OF THESE TENETS? LET'S START WITH ASSET ALLOCATION.

Appropriate asset allocation is a key driver in determining investment success. The managers of PNC Target Date Funds begin with a goals-based approach, focusing on what they want the portfolio to accomplish and what roles different asset classes will play. Then we carefully evaluate capital market expectations of asset classes, including both returns and risk. Portfolio allocations are designed and adjusted using a multi-variable model that includes:

- Expected returns
- Expected volatility
- Asset class correlations
- Asset class weighting constraints

In making decisions, the Funds' managers factor in a variety of research, information, and data from both proprietary and external sources to help validate our perspectives, analysis, and conclusions.

The managers' assumptions incorporate a forward-looking view of macro factors, including the overall return and interest rate environment. Correlation estimates are based on historical observations with a weighting toward the most recent past to identify the magnitude and the direction of correlation trends between asset classes.

CAN YOU SHARE MORE ABOUT YOUR DISTINCTIVE MULTI-MANAGER APPROACH?

We believe that a diversified portfolio of proprietary and third-party investment managers provides benefits to investors including a layer of diversification, which can help to reduce the reliance on a single manager and may serve as a risk management tool. As a manager of proprietary strategies, we believe PNC Capital Advisors is well qualified to select other investment managers. We seek to use strategies that have strong historical track records. The process of selecting individual strategies and managers is rigorous and multifaceted as we seek groups that may add value and/or reduce portfolio volatility.

CAN YOU TELL US A LITTLE MORE ABOUT WHAT YOU CONSIDER WHEN SCREENING MANAGERS?

We look for managers and strategies with proven track records over a full market cycle. We carefully screen and select external managers using criteria that include:

- Management fees and expenses
- Investment strategy
- Fund size
- Share classes offered
- Volatility of returns
- Manager tenure
- Adherence to style

We specifically seek expertise in downside risk management and look for strategies that have historically performed better in downturns. We also evaluate how underlying managers and strategies complement one another to help achieve our goal of capital preservation.

THE THIRD TENET INVOLVES USING BOTH ACTIVE AND PASSIVE MANAGEMENT. WHY IS THIS IMPORTANT IN TARGET DATE FUNDS?

Many target date funds utilize all actively managed or all passive strategies when building portfolios. The PNC Target Date Fund managers believe that utilizing a mix of active and passive strategies provides an additional opportunity for prudent diversification.

We rigorously evaluate each asset class in our target date funds to determine if an active or passive strategy is more appropriate.

Utilizing selected passive funds helps manage asset class exposure and control fund fees and expenses. Therefore, in some instances, we may use a lower cost passive fund. For other strategies in less efficient markets, we select actively managed strategies. For example, in fixed income, we believe in active management that seeks to identify securities with the highest risk-adjusted return potential.

ACTIVE MANAGEMENT	PASSIVE MANAGEMENT
▪ Higher fees and operating expenses ▪ Seek to outperform benchmarks over time ▪ Higher turnover, less transparency ▪ May be more or less volatile than the benchmark i.e. tracking error relative to the benchmark ▪ Wide differentials between top performing and bottom performing managers	▪ Lower fees and operating expenses ▪ Seek to replicate the benchmark over time ▪ Lower turnover, greater transparency ▪ Similar to equal volatility of the benchmark ▪ Lower performance differentials between passive managers

Not a complete list of differences

YOU MENTIONED THE USE OF ASSET DIVERSIFIERS. WHAT IS AN ASSET DIVERSIFIER AND WHAT ROLE DOES IT PLAY IN THE PNC TARGET DATE FUNDS?

PNC Target Date Fund managers believe that evaluating and utilizing a relatively broad array of asset classes can further diversify the portfolio. We take a highly selective approach to adding unique asset classes to manage portfolio risk, while avoiding diminishing returns from over-diversification. This is accomplished by adding specialty, nontraditional, diversifying asset classes with varying risk and return features that can play a specific role, help to add value, and/or reduce risk. Examples of these asset classes that we may consider include:

- Dividend income equity
- International small cap
- Emerging markets
- REITs
- TIPS
- Commodities

ARE THERE OTHER WAYS THE TEAM MANAGES DOWNSIDE RISK?

Target date funds that are designed for stability may go beyond investing in long-only strategies to try to achieve capital preservation goals. PNC Target Date Funds may, from time to time, hedge positions. This may include investing in asset classes that have typically low or negative correlations to traditional asset classes, such as market-neutral strategies, short sales, long/short strategies, and derivatives. While we do not anticipate the frequent use of these tools, they provide the ability to add an additional layer of risk management in the funds. This can be particularly helpful in times of greater uncertainty and volatility.

DOES THE TEAM REGULARLY MONITOR THE PERFORMANCE OF THE PNC TARGET DATE FUNDS TO SEE IF THEY ARE PERFORMING AS DESIGNED?

Yes, regular evaluation of performance can help to increase the potential for a target date fund to reach its goals and to avoid negative surprises. Our frequent and regular review of target date fund performance includes a multidimensional approach to assessing returns.

- We measure overall portfolio performance versus the benchmark
- We determine the value added through the portfolio's asset allocation versus the benchmark
- We analyze the portion of performance attributable to the selection of individual strategies within the portfolio

For actively managed strategies, we determine whether a fund is outperforming its benchmark over time with low volatility. For passive strategies, we look at how closely the strategy follows the benchmark and how low the tracking error is.

If a particular underlying strategy is not adequately filling its role within the Fund's overall portfolio or as an individual strategy, we will determine if a replacement is appropriate.

SO IT SOUNDS LIKE ALL TARGET DATE FUNDS ARE NOT CREATED EQUAL.

That's right. We believe that experience leads to a more thoughtful approach to building target date funds. Also that such an approach should pay special attention to managing downside risk through prudent allocation, manager selection, and broad asset class diversification utilizing passive and active strategies, alternatives, and targeted hedging.

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An investment in the PNC Target Date Funds (the "Funds", and each a "Fund") may not provide a complete investment program and does not guarantee any level of return or income. You may experience losses, including near, at or after the target date, by investing in a Fund. The suitability of an investment in a Fund should be considered based on the investment objective, strategies, and risks described in the Fund's prospectus and in light of all other relevant factors, including other investments in your portfolio, financial needs, savings rate, risk tolerance, and financial goals. There can be no assurance that investing in a Fund will provide a sufficient source of income at or through retirement, or that the Fund's returns will keep pace with the rate of inflation. An investment in the Funds is not guaranteed.

As noted in the Funds' prospectus, the Funds are subject to a myriad of risks, any of which could cause an investor to lose money. A Fund gradually shifts its emphasis from more aggressive investments to more conservative ones as its target date approaches. The Funds may change their target allocations to equities, fixed income, diversifiers, and cash without notice to shareholders. In addition to the risks inherent in the asset classes of the underlying investments, the Funds are also subject to asset allocation risk, which is the chance that the selection of underlying investments and the allocation of fund assets will cause the Funds to underperform other funds with a similar investment objective.

Diversification and asset allocation cannot guarantee a profit or prevent a loss. An investment in the Funds is subject to interest rate risk, which is the possibility that a Fund's yield will decline due to falling interest rates and the potential for bond prices to fall as interest rates rise. High yield bond investing includes special risks. Investments in lower rated and unrated debt securities are subject to a greater loss of principal and interest than investments in higher rated securities. The values of mortgage-backed securities depend on the credit quality and adequacy of the underlying assets or collateral and may be highly volatile. International investments are subject to special risks not ordinarily associated with domestic investments, including currency fluctuations, economic and political change, and differing accounting standards that may adversely affect portfolio securities. These risks may be heightened in emerging markets. The Funds' use of leveraging may cause the Fund to liquidate portfolio positions to satisfy its obligations at disadvantageous times or prices and could theoretically be subject to unlimited losses. The Fund's investments in commodities or commodity-linked instruments may expose the Fund to greater volatility than investments in traditional securities. The Fund's investments in securities that are or become illiquid may reduce the returns of the Fund because it may be unable to sell the illiquid securities at an advantageous time or price. Each Fund may invest a portion of its assets in derivatives. Derivative instruments include options, futures, and options on futures. A small investment in derivatives could have a potentially large impact on a Fund's performance. The Funds may be unable to terminate or sell a derivatives position. Derivative counterparties may suffer financial difficulties and may not fulfill their contractual obligations.

For a complete listing of all risks and further details on the principal risks highlighted above, please refer to the Funds' prospectus.

You should consider the investment objectives, risks, charges, and expenses of PNC Funds carefully before investing. A prospectus or summary prospectus with this and other information may be obtained at 800-622-FUND (3863) or pncfunds.com. The prospectus should be read carefully before investing.

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