

INVESTMENT INSIGHTS: JUNE PODCAST

WITH BRETT HAMMOND

June 15, 2010

Chief Investment Strategist Brett Hammond discusses his outlook on the European debt crisis and its impact on individual investors.

Hello and welcome to the June edition of TIAA-CREF Investment Insights. Today is Tuesday June 15th. I'm John Wilkens and we're joined by TIAA-CREF's Chief Investment Strategist Brett Hammond.

Lets get down to the proverbial brass tacks. Initially Europe was going to be a problem, then it wasn't. Then it was and now last week the market jumped on news that the risks of widespread problems emanating from Europe may not have been as high as was once thought.

Yes. There were two main components in all of that. The European Central Bank, or ECB, raised its 2010 growth estimates for the region just a little.

I know we talk about growth a great deal from an economic standpoint, and you're fond of saying how economic indicators and the markets don't always move in lockstep, especially in the short run, but they seemed to do here.

In this instance though, there's been a lot of unknowns, a lot of negative headlines, and not a small amount of panic. I think this small piece of positive news just quelled some of the lingering concerns investors had. It's a positive, but still fairly small change in growth estimates for the Euro-zone. And in fact estimates for 2011 came down a bit.

Rather I think it's just a bit of confirmation that a lot of the doomsday scenarios we heard from various pundits were perhaps somewhat overblown.

You talked about the trillion dollars in loan guarantees last month. What about the monetary policy side of the European equation?

Well the ECB is continuing its policy of buying debt from some of the more troubled countries. The intent is similar to what our central bank did with the TARP program. Only there it was troubled assets from the corporate sector and not sovereign debt from countries.

And the ECB will also provide cheap, short term loans to banks for at least the summer. Obviously things in Europe aren't good enough to avoid the need for such programs, but the good news is at least the ECB didn't see the need to expand these types of programs.

Am I safe in saying that like us, the Euro zone is a ways off from inflation concerns?

Europe's inflation estimates actually went up slightly, but are still thankfully low and below their 2% target threshold. Which, again similar to what we're seeing in the United States, helps since it provides plenty of room to hopefully stimulate growth before the ECB has to even start thinking about interest rate hikes and other tightening measures.

One other point to perhaps consider when thinking about all of this is even though we've heard a lot about what led to Greece's problems there are still some less well known considerations. For example they have very young retirement ages in Greece, and seemingly extremely generous pension benefits and so on. I think it's important to remember that even with these less than prudent policies, Greece still has a functioning economy.

Unlike specific companies, Greece itself won't go out of business.

And it's citizens will still pay taxes and even under the worst case scenario, it's logical to think that Greece will still pay off at least part of its debt.

Along with the Europe news Brett, the second component of the rally was China's sizable increase in exports. Why is that good news outside China?

Well it was leaked and later confirmed that China's exports grew 50% in May versus the same period last year. Why this is important is that it shows that China's economy is growing and that problems in Europe weren't severe enough to reduce their demand for Chinese goods.

We've seen in the news though stories of labor strife over there. A first I'd think.

Yes, and something that may have impact down the road. Something else to think about. There's been increasing calls' from G20 leaders for China to revalue its currency, which would make its considerable exports pricier on world markets.

And as I'm wont to ask at this juncture, what does all of this mean for individual investors Brett. The return of market volatility would seem to aptly illustrate the dangers inherent in market timing.

Well let's take a different tack and look at what's happening here from a very high level. I think there's an interesting lesson in all of this. As you said earlier, the headlines coming out of Europe all of a sudden were bad, then not so bad as the loan package seemed likely, then sour again and so on and so forth.

Let's take a look backward. And from 1995 to 1997 large cap US stocks – measured by the performance of the S&P 500 was one of the better performing major asset classes.

Over the same period, the MSCI EAFE Index - that's an index of stocks from developed economies outside the US – Europe, Asia and the Far East. Well the returns from that index were among the lowest for key indices during that same period.

Now let's look ahead to 2005 through 2007 and the situation reversed itself. The EAFE Index returns were markedly higher than those from the US-based S&P.

Let's disclaim appropriately. You can't invest directly in an index. Past performance is never a guarantee of future results and future returns will of course vary.

All absolutely true. And over time aggregate returns wouldn't be as disparate as for the time periods I've chosen. But that's just the point.

What this shows I think and what the rather bipolar news out of Europe also demonstrates - is that different asset classes behave differently at different times and hence, the importance of a well diversified portfolio

And before we close Brett. We should mention that in an attempt to prevent another Flash Crash, the SEC has imposed trading restrictions on all individual stocks that drop by 10% or more within 5 minutes.

Yes and the restriction will apply across all US markets, which is key. Like the economy itself, things may well go wrong on occasion. But whether on their own or with a little regulatory push, thankfully they tend to get fixed.

Thanks Brett. This has been the June edition of Investment Insights. Thank you for listening.

Investment Insights is prepared by TIAA-CREF and represents the views of TIAA-CREF's Investment Strategy and Client Solutions Group. These views may change in response to changing economic and market conditions. Diversification is a technique to help reduce risk. There is no absolute guarantee that diversification will protect against a loss of income.

Past performance is not indicative of future results. The material is for informational purposes only and should not be regarded as a recommendation or an offer to buy or sell any product or service to which this information may relate.

TIAA-CREF is a national financial services organization and the leading provider of retirement services in the academic, research, medical and cultural fields. Further information can be found at tiaa-cref.org.

TIAA-CREF personnel in its investment management area provide investment advice and portfolio management services through the following entities: Teachers Advisors, Inc., TIAA-CREF Investment Management, LLC, and Teachers Insurance and Annuity Association.. TIAA, TIAA-CREF, Teachers Insurance and Annuity Association, TIAA-CREF Asset Management and FINANCIAL SERVICES FOR THE GREATER GOOD are registered trademarks of Teachers Insurance and Annuity Association.

©2010 Teachers Insurance and Annuity Association—College Retirement Equities Fund (TIAA-CREF), New York, NY 10017.

C48167