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GLOBAL SOCIAL AND COMMUNITY INVESTING

SOCIALLY RESPONSIBLE INVESTING: EVOLVING STRATEGIES, GROWING DEMAND

Once relegated to peripheral status or perceived strictly as a niche strategy, socially responsible investing (SRI) has proved its staying power, representing a visible and growing trend in global asset management. Building on its historical roots in values-driven investing, SRI has expanded to include an increasing emphasis on risk management and enhanced return potential over the long term.

This evolution reflects the emergence of new perspectives, diverse approaches and a host of critical environmental, social and governance (ESG) issues that have captured the attention of investors around the globe. Recent trends in investor demand, collaboration among stakeholders, and the development of enhanced SRI research and metrics are among the factors contributing to continued growth in this important area of investing.

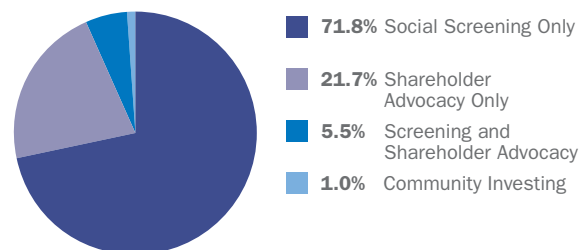
SRI ASSETS SURGE IN THE UNITED STATES

Aggregate SRI assets under management in the United States have grown steadily in recent years. According to the Social Investment Forum (SIF), at the end of 2007, \$2.7 trillion in assets were invested by individuals, institutions, investment companies or money managers that use one or more of the three strategies that commonly define SRI: social screening, shareholder advocacy and community investing.¹ That \$2.7 trillion represents approximately 11% of all U.S. assets under professional management — nearly one out of every nine dollars.

¹ Social Investment Forum, www.socialinvest.org/news/releases/pressrelease.cfm?id=108



Figure 1
Socially Responsible Investing in the United States
\$2.7 trillion in 2007



Source: Social Investment Forum Foundation

Of the three primary SRI strategies, social screening is the most widely practiced, as shown in Figure 1. Separately managed accounts represented the largest share of socially screened assets in 2007 — more than \$1.9 trillion, based on SIF data. Assets under management in socially screened mutual funds, variable annuities and other pooled accounts available to individual investors totaled \$201.8 billion, as shown in Figure 2.

Figure 2
Types and Assets of Socially Screened Funds
2001–2007

(Assets in Billions)	2001	2003	2005	2007
	Funds / Assets	Funds / Assets	Funds / Assets	Funds / Assets
Mutual Funds (Ex-annuities)	154 / \$111	178 / \$127	151 / \$148	154 / \$159.2
Variable Annuities	13 / \$7	11 / \$2	22 / \$11	19 / \$12.5
ETFs	N/A	N/A	N/A	8 / \$2.2
Closed-End Funds	N/A	N/A	N/A	3 / \$0.9
Alternatives	N/A	N/A	N/A	46 / \$5.3
Other Pooled Products	14 / \$18	11 / \$22	28 / \$19	30 / \$21.7
TOTAL	181 / \$136	200 / \$151	201 / \$179	260 / \$201.8

Source: Social Investment Forum Foundation

Note: Prior to 2007, Closed-End Funds and Alternative Investment Vehicles were not separately tracked, but rather included within “Other Pooled Products.” There were no socially screened ETFs available prior to the 2007 SIF report. Due to the effects of rounding, totals and calculated values may not always agree. In order to avoid any possible double counting, the screened fund categories of Alternative Investments and Other Pooled Products are not aggregated into the total \$2.7 trillion in SRI assets identified in Figure 1.

A separate 2007 survey, commissioned by SIF and conducted by Mercer Investment Consulting, found additional evidence of strong demand for SRI, specifically within U.S. defined contribution (DC) plans. According to that survey, one in five U.S. plans already offers an SRI option to investors; two in five plans do not currently offer an SRI option but expect to do so within three years — combined, this would translate into a 60% market penetration for SRI in DC plans by the year 2010.²

GLOBAL DEMAND FOR SRI IS ALSO STRONG

Similar studies conducted in non-U.S. markets, including Canada, U.K. and the European Union, also show an upward trend in SRI activity.³ In addition, a survey of 98 global asset managers, conducted by *Investment & Pensions Europe* and *Responsible Investor* magazine and published in June 2008, found that SRI assets represented more than 10%, or \$2.2 trillion, of total assets at the world’s largest asset management firms, which collectively manage \$19.4 trillion. These firms predict that by 2010 this figure will reach over \$2.9 trillion — a gain of \$700 billion, or 35%.

This predicted rise in SRI assets is expected to be sharper among those managers who do not currently manage 100% of their assets on an SRI basis — suggesting that SRI is increasingly being recognized as a mainstream approach, according to *Responsible Investor*.⁴

2 www.mercer.com/referencecontent.jhtml?idContent=1267560

3 The most recent Canadian study, published by the Social Investment Organization in March 2007, is available at www.socialinvestment.ca/documents/SRIReview.pdf. Eurosif, the European Social Investment Forum, will publish new survey results in 2008; the most recent Eurosif study can be obtained at www.eurosif.org/publications/sri_studies.

4 www.responsible-investor.com/home/article/ri_landscape_asset_managers/

KEY DRIVERS OF SRI GROWTH

Rising demand for SRI opportunities is being driven by multiple factors:

- **Sustained importance of values-driven investing.** Investment strategies guided by moral, ethical or religious values remain central to many SRI practitioners and are generally implemented using methods such as social screening, shareholder advocacy and/or divestment. During the 1980s and 1990s, these strategies were widespread among investors opposed to apartheid in South Africa and to specific products like tobacco and alcohol, and have expanded over time to include environmental, supply chain, and human rights issues. One recent example: in response to an international treaty banning the production and use of cluster bombs, many global government-sponsored pension funds have voluntarily divested their holdings in companies that manufacture these weapons⁵ — a clear attempt to align values with investment approaches.

In addition, growing consensus on issues such as climate change has led various constituents of the investment community to converge around the need for global action. Assessing the risks and opportunities posed by climate change has been a catalyst for such action on the part of many investors seeking to address environmental challenges through investment portfolios (see “Global Climate Change: A Point of Convergence,” below). Values-driven investors, particularly those with a faith-based perspective, may be further motivated to action by their specific principles or beliefs.

- **Broadened perspectives and support for “responsible investment” approaches.** In addition to values-based investing, many institutional investors have begun to take ESG issues into account when assessing overall risk management, and some are revisiting their views on how these issues relate to competitive long-term returns. The integration of ESG issues across multiple asset classes, coupled with the rising supply of investment opportunities, has made it increasingly possible for investors — particularly institutional investors — to construct diversified portfolios based on ESG principles.

⁵ www.responsible-investor.com/home/article/cluster2/

New resources, such as the Institute for Responsible Investment’s *Handbook on Responsible Investment Across Asset Classes*, are available to help investors identify and incorporate social and environmental information across their portfolios.⁶ An example of an emerging opportunity in this regard is the concept of “responsible property investing,” founded on a strong business case.⁷

In addition, whereas many values-based practitioners remain committed to the principle of avoiding certain companies or industries in their portfolios, proponents of a broader approach suggest that superior ESG performance offers potential insight into key elements of the investment process, including research and portfolio construction. These approaches are not necessarily incompatible or in opposition to each other — in fact, some investors apply them in a complementary way — and both have been essential to boosting growth in SRI worldwide.

- **Development of mainstream investor networks and coalitions.** Several global initiatives have harnessed the energy and commitment of long-time SRI practitioners while fueling greater interest in ESG topics among mainstream investors. Some of these initiatives are broad in scope; others focus on specific ESG issues such as climate change. Of the broad initiatives, UNPRI (United Nations Principles for Responsible Investment) has generated a great deal of attention and involvement. As of May 1, 2008, UNPRI had approximately 360 signatories, representing \$14 trillion in assets under management. European investors led the pack in both number of signatories (148) and assets under management (\$9.7 trillion). A UNPRI progress report is available at www.unpri.org/files/2008PRI_Report_on_Progress.pdf.

⁶ See www.bccccc.net/responsibleinvestment for more information on this handbook.

⁷ www.unepfi.org/fileadmin/documents/building_responsible_property_portfolios.pdf

- **Enhanced disclosure of environmental, social and governance factors.** The assessment of “extra-financial” factors is central to the approaches used by the SRI community. A growing number of investors and other stakeholders are increasingly seeking more and better ESG-related information from companies. However, unlike financial reporting, most ESG-related disclosure is voluntary and not yet standardized.

The goal of standardized ESG-related reporting, often referred to as “sustainability reporting,” is to enable investors and other stakeholders to better assess the impact of ESG factors that represent potential market, operational, regulatory, legal and reputational risks or opportunities.

In response to this demand, the Global Reporting Initiative (GRI), a worldwide nongovernmental organization, was independently established in 2002 to develop and disseminate guidelines for voluntary sustainability reporting. The GRI’s vision is a future in which reporting on economic, environmental and social performance is as routine and standardized as financial reporting is today.⁸ This goal is shared and supported by multiple stakeholders, including the investment community.

8 www.globalreporting.org

- **Availability of more robust ESG research and analysis.** Building on improved available data, an increasing number of institutional investors are expressing interest in asset management approaches that explicitly include ESG criteria or metrics in cases where these factors may become relevant to investment performance. The United Nations Environment Programme Finance Initiative (UNEP FI), a global partnership between UNEP and the financial sector, works across numerous channels to better understand the materiality of environmental and social considerations on financial performance.⁹

In a related vein, a group of institutional investors, including asset managers and pension funds, established the Enhanced Analytics Initiative (EAI) in October 2004, on the premise that investment firms and their clients are best served by a more rounded assessment of corporate performance than that offered by traditional sell-side research.¹⁰

Currently representing \$2.4 trillion in total assets under management, EAI encourages the development of improved research that takes into account the impact of ESG factors on long-term investment. Specifically, EAI encourages research providers to compile better and more detailed analysis of material, extra-financial issues within mainstream research.

9 www.unepfi.org/index.html

10 www.enhancedanalytics.com

GLOBAL CLIMATE CHANGE: A POINT OF CONVERGENCE

For many within the broader responsible investment community, global climate change may be the most pressing issue of our time. Widespread interest in this topic has led to the development of several convening organizations that bring together institutional investors, asset management firms and individual companies, all of which have a stake in the outcome of efforts to reduce global warming. The following are among the leading groups dedicated to this issue:

- *The Carbon Disclosure Project (CDP)* is an independent global organization that coordinates a climate change disclosure initiative on behalf of institutional investors with more than \$57 trillion in combined assets under management. The CDP seeks standardized information on the business risks and opportunities presented by climate change, including greenhouse gas emissions data from the world’s 3,000 largest companies — enabling investors to better evaluate the companies’ climate change actions.
- *The Investor Network on Climate Risk (INCR)*, representing more than 60 U.S.-based institutional investors and \$5 trillion in assets under management, leverages the collective influence of its members to promote improved disclosure and corporate governance practices related to climate change.

THE FUTURE OF SRI: A COMPELLING LONG-TERM OUTLOOK

SRI now occupies a prominent position in the investment marketplace, supported by steady growth in assets, continually evolving strategies, and a global environment that inspires engagement on a variety of issues. Amid growing recognition that there is no one-size-fits-all approach to SRI — and that diverse perspectives may well be a catalyst for future growth and innovation — the long-term prospects for a healthy, vibrant SRI industry seem bright.

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