



**FINANCIAL SERVICES
FOR THE GREATER GOOD®**

Your Retirement Income: Help Maintain Its Value

Inflation and poor investment performance are the chief enemies of steady, reliable retirement income. Can the way you manage your investments help combat these foes? Let's look at them one at a time.

Inflation: When inflation rises, goods and services cost more and your money buys less. Fortunately, Social Security benefits rise each year with the cost of living, helping offset inflation's effect. But what about the rest of your income?

Poor investment performance: When one area of the market sinks — stocks, for example — your income could drop. What can you do to help prevent losses?

Strategies That Can Help

To stay ahead of inflation: Avoid relying too heavily on conservative investments — for example, TIAA Traditional and Money Market. Take some risk; consider adding stocks to your mix.

To help avoid sharp drops in income: Diversify your investments. You can spread your investments among asset classes (types of investments) that perform differently under varying economic circumstances. Think pistons: When one goes down, another goes up. This technique is called “asset allocation.”

(Keep in mind that proper diversification and asset allocation can't prevent losses or guarantee that your goal or objectives will be met.)

How Does Asset Allocation Help?

By including several asset classes in your income portfolio, you are better able to avoid extreme lows — and highs — and help smooth your income stream.

Asset classes that can help offset the effects of inflation. The following asset classes have historically outpaced inflation over the long-term. Typically, they have little correlation to one another, meaning that they react differently to changing economic conditions. Incorporated into a retirement income portfolio, gains in one type of investment might help offset losses in another. Each of these asset classes has its pros and cons.

Asset Classes

Stocks, the most volatile asset class, have historically beaten inflation over the long term.

And within equities, there are subcategories that don't closely correlate with each other. For example, during 2006, large-cap domestic stocks lagged behind mid-sized and international stocks. Stocks have trailed inflation during certain years, however — for example, 1973 – 74, 1981, 1990 and 2000 — although their performance from 1993 to 1999 was generally stellar.

Real estate can serve as an inflation hedge, since the cost of commercial real estate and rents rises with overall business expansion and prices. But because real estate is illiquid, it may be slow to respond to rapid rises in inflation. Ultimately, real estate prices reflect the general economy and prevailing interest rates.

Money market account interest rates rise quickly in response to inflation, but they exceed it by only a small margin. When rates are very low, account management fees may negate any gain.

Longer-term bonds tend to provide higher returns than money market instruments, but they are vulnerable to changes in current interest rates. When interest rates rise, returns on a bond mutual fund portfolio will fall.

U.S. Treasury inflation-protected securities (TIPS) are designed to track inflation. If inflation and interest rates rise, returns of inflation-linked bonds will rise with them. And if inflation is low or flat, returns generally will be modest.

Let's take a close look at TIPS, since they are a relatively new product.

U.S. Treasury Inflation-Protected Securities (TIPS)

TIPS are designed to provide a “real” rate of return that is higher than the inflation rate. (If inflation is 3%, for instance, a 7% rate of return provides a 4% real rate of return over inflation.) They do this through a formula that changes the value of the TIPS principle each month based on a rise or fall in the Consumer Price Index for Urban Consumers (CPI-U), a measure of the changing prices of goods and services. The “real” fixed interest rate is applied to the changing (usually increasing) principle so that the payout changes with inflation.

So if you bought a \$1,000 TIPS at a real coupon rate of 2% in 2006, and the CPI-U rose 3% over 2004's rate, the principal on your bond would be worth \$1,030 in 2007. And you would earn 2% interest on the \$1,030, so the interest you actually earn rises even though the real coupon rate remains the same. In addition, if you keep the bond to maturity, you will get back a principle amount that has also increased with inflation over the life of the bond.

If inflation heats up, interest rates tend to rise, which will depress the price of existing regular bonds, may dampen stock prices, and possibly hurt real estate sales and new construction. But returns on TIPS are designed to climb right along with higher interest rates that are caused by inflation.

After several years of spectacular returns well in excess of the coupon plus inflation, TIPS returned less than inflation during 2006. That's because real rates were rising and investors weren't particularly worried about future inflation increases, thus making the bonds relatively less desirable. Over the long run, however, an inflation-bond fund should more than keep up with inflation.

Note that unlike other Treasury securities and corporate bonds, TIPS provide for growth in principal; such growth is taxed as current income even though you don't receive the increase as cash. (The exception to this is Series I U.S. Government Savings Bonds.) The best use of TIPS may, therefore, be to hold them in a tax-deferred account or fund.

Individual TIPS Versus a TIPS Account or Fund

Individual TIPS and a TIPS annuity account or mutual fund don't behave the same way. That's because the account/fund invests in a pool of bonds, which is actively traded. The account follows market prices and won't always track inflation as directly as individual bonds. An individual TIPS that you bought and held to maturity wouldn't be affected by market prices. Note that owners of a fund owe management fees; owners of individual bonds incur transaction fees.

The chief advantage of a TIPS account/fund is that you don't have to manage your own TIPS portfolio. Professional managers can do this for you to minimize the risks associated with selling and buying bonds or rolling them over into new issues.

TIAA-CREF offers TIPS products, including TIAA-CREF mutual funds' Inflation-Linked Bond Fund and the TIAA-CREF Inflation-Linked Account variable annuity. For information on TIPS and help with adjusting your income portfolio to hedge inflation risk, call **800 927-3059** and speak with one of our consultants. Or visit www.tiaa-cref.org for specific TIPS product information. Read the prospectus carefully before investing.

Inflation During Your Retirement Years

If you retire at 65 and die at 90, you must weather 25 years of inflation. Even if inflation remains modest — averaging only 3% per year — after 25 years, one dollar of income you receive will be worth only 47 cents.

That's why we advise people who can tolerate some fluctuation in their retirement income to draw a portion of it from stocks, bonds and real estate — not just from a fixed-interest or guaranteed annuity product. Although performance can fluctuate, these types of investments can help counter inflation's effects in the long run, and each one performs a little differently in helping preserve your buying power.

For a Portfolio Check-Up . . .

Our consultants can help you evaluate the appropriateness of your income portfolio and select the right investments for your goals and risk tolerance. For your retirement savings, call **800 927-3059**. For TIAA-CREF Mutual Funds, call **800 223-1200**. If you're interested in individual bonds and the 6,500-plus mutual funds available through TIAA-CREF Brokerage Services, call **800 927-3059**, or visit us on the Web, www.tiaa-cref.org.

TIAA-CREF Individual & Institutional Services, LLC, and Teachers Personal Investors Services, Inc., Members, NASD, distribute securities products. **Consider the investment objectives, risks, charges and expenses carefully before investing. Call 877 518-9161, or go to www.tiaa-cref.org for a current prospectus that contains this and other information. Please read the prospectus carefully before investing.** TIAA (Teachers Insurance and Annuity Association), New York, N.Y., issues annuities. TIAA-CREF Brokerage Services is a division of TIAA-CREF Individual & Institutional Services, LLC, member NASD and SIPC.

© 2007 Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF), New York, N.Y. 10017

C39139