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FOR THE GREATER GOOD®**

Do You Have a Plan?

We all have financial goals we want to realize. A good way to reach them is by developing as sensible a plan as possible. But do you understand how your emotions affect the process?

Your emotions can have a lot to say about how you manage your money, so it's important to understand how they can affect your decisions. Consider this: If you were to burn a \$50 dollar bill, would it cry or complain? Obviously it wouldn't, because money doesn't have feelings. However, if you talk to people about money, you get a range of reactions, including embarrassment, awe, fear, envy, shame or just plain denial. Why is this? The answer is money equals the power to have the things we want, and that makes us emotional about it.

If you're already a successful saver, congratulations, keep doing what you're doing. But if you know you need to improve your money management skills, take heart: You can improve them if you become more disciplined. Here are a few things to work on to become more financially fit.

1. Change Your Spending Behavior

Changing your mindset from a spender to a saver is the first step. You can begin to make this change by maintaining a written journal, which can show you what and how you're thinking financially, a key to changing your behavior. A journal can help you crystallize your real wants and needs and may also help reveal personal disappointments or doubts that might be interfering with your financial discipline. As your writing unearths these influences, you'll steadily gain more control over the unhealthy spending urges they create, and you'll become more determined about your goals.

2. Set Goals

Begin by clearly defining your financial goals. Rather than using abstract definitions, try to specify your goals in clear, personal words. You might say, for example, "I want to retire in 12 years" or "I want a house for the winter months" or "I want to be able to send my daughter to an Ivy League school."

If sorting out your goals becomes difficult, try to distinguish your wants from your needs. It may be useful to differentiate your goals by time horizon — a designation of when you'll need the money — and by how long you'll need the money to last. For example, you can place your goals in three broad time horizons: short term (one to three years), intermediate term (three to 10 years), or long term (10-plus years). Later, you'll

probably shift your priorities, because goals and their importance vary with circumstances.

3. Create a Budget

Once you identify your goals, look ahead, set a deadline for making them real and put them on a calendar. “Making them real” is where budgeting comes in.

You’ll need to find a way of allocating your limited dollars among several competing goals. To get started, track your earnings and expenses by doing a cash flow analysis using the worksheets in our online brochure, “Your Financial Organizer,” available from the “Planning Tools” section of our website, at www.tiaa-cref.org.

If you notice that too much of your budget goes to eating out, entertainment, clothing, traveling or electronic toys, cut back on these.

If you find it hard to cut some of this “unnecessary” spending, you’ll probably need to probe deeper to find out what’s behind your habit. Do you spend because you’re bored, because you’re sometimes unfulfilled and need a pick-me-up or because you’re rebelling against too much discipline from your youth or from a problematic recent or past relationship? You’ll need to identify the root cause and come to terms with it. Otherwise, you’re likely to repeat the same fruitless behavior and never give your worthwhile goals an honest chance.

Once you’ve developed a strategy for increasing your savings, you’ll want to invest as much as you can for retirement and other goals. That may mean “maxing out” your contributions to supplemental retirement plans, IRAs and other savings products, or contributing as much as you possibly can if you can’t contribute the maximum right now.

Next, Focus On Asset Allocation

As you save money, it’s important that your asset allocation — the percentage of money you place in stocks, bonds, real estate, money market and guaranteed investment options — is appropriate for your *risk tolerance*, or the extent to which you can handle volatility in your portfolio. Your asset allocation plays a very important role in determining the risk and returns of your portfolio. *(Of course, asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns.)*

But, as with spending and saving, emotions can also affect how you allocate your assets. An example may help illustrate this. Say your risk profile indicates you’re a moderately conservative investor. If the stock market starts heading higher and all you hear from colleagues at work, and family and friends is how much money they’re making, you’ll probably find it hard to maintain your moderate allocation strategy. As a result, you may change your allocation, moving money to the currently “hot” fund or

stock. The problem is that this change is really an emotional reaction rather than a rational asset allocation adjustment.

There are three common forms of disruptive allocation behaviors you should guard against: overconfidence, loss aversion and present-biased preferences. Since we all may exhibit these tendencies at some point to some degree, the goal is to avoid engaging in any of them excessively.

Overcoming Overconfidence

Frequent trading, or switching between investment accounts, to increase returns, may be a good indicator of overconfidence. It often results in a tendency to sell “losers” at low prices and buy “winners” at high prices, which actually makes it more difficult to get the desired higher returns, and, therefore, puts you further away from achieving your goals.

Overconfidence can increase your transaction costs, the potential for higher tax liabilities and the possibility of selling your securities just when the market begins to rise. Generally, investors who overtrade tend to make more mistakes than those who stay the course.

Another sign of overconfidence is *market timing* — the buying and selling of securities in anticipation of changes in market or economic conditions. By and large, market timing over long periods does not provide higher returns than maintaining a buy-and-hold strategy. It may also increase portfolio volatility.

To cure overconfidence: Develop realistic expectations and try to curb skewed performance assumptions by studying historical returns of specific investments and asset classes. Research will reveal that certain investments can potentially offer higher returns because they carry more risk. This may be fine if you understand and accept the higher risk of losing money with such securities, but you need to understand what you’re getting into. This awareness can help you establish an appropriate asset allocation strategy that is realistic for your goals. (*Just remember, as you examine historical returns, that past performance cannot guarantee future results.*)

Loss Aversion

This has to do with how we feel about losing money. Essentially, our disappointment about losing money is stronger than our joy in making it. While it’s perfectly normal to want to avoid losses, excessive fear of loss can hurt investment prospects.

Loss aversion can be especially damaging in combination with market timing. For example, some investors react to immediate stock market losses by pulling money out of their accounts, with the idea of reinvesting it when stocks become less volatile. The problem is that this can result in a systematic “buy high and sell low” strategy that can lead to lower returns and greater risk. Loss aversion can even lead some investors to stop

their pretax contributions to their supplemental 401(k), 403(b) and 457(b) retirement plans during down markets.

While this certainly reduces your potential losses, it may have several negative consequences. By cutting off your pretax contributions, you increase your taxable income, which of course leads to paying higher taxes. You may be left with the unhappy results of guaranteed reduced savings, higher taxes and potentially missed opportunities of buying shares at lower prices.

To cure loss aversion: Make sure your investment decisions are in line with your long-term goals. For example, if you reduce your exposure to stocks because the market goes from bull to bear, make sure your adjustment is part of a thoughtful financial strategy and not just a reaction to the market.

Present-Biased Preferences

“Present-biased preferences” has to do with focusing on short-term financial events at the expense of your long-term needs. For example, if you give people the choice between receiving \$100 today or \$110 next week (that’s a 10% return in just one week!), some will take the \$100 now. But if you offer the same people \$100 in a year or \$110 in a year and a week, they almost all opt for the \$110. This illustrates that we often put too much emphasis on getting something now, even when it’s not always the best choice. You can identify this behavior by a lack of commitment to saving regularly and by acts that interfere with good budgeting. Another behavioral sign is procrastination.

To cure present-biased preferences: Create a savings/investment plan and periodically check to see if you’re saving enough for your goals. To strengthen your commitment, use “forced savings” tactics. For example, you can enroll in an employer-sponsored supplemental 401(k), 403(b) or 457(b) retirement plan; in which a specified percentage of your salary is contributed each month. For IRA, after-tax annuity and mutual fund contributions, set up an automatic investment plan where a fixed amount is withdrawn from your checking or savings account and deposited into your product account on a specified date.

As you commit to your financial plan, you’ll start to realize that achieving and maintaining financial success is a process. You will learn, change and become more focused, and you’ll realize that planning is not a one-time exercise. You might even adopt the philosophical view that since it took time to develop these unhealthy habits, it will also take some time to acquire the healthier ones. But, more than anything, you should realize that making these changes can pay off financially.

How to Invigorate Your Financial Plan

First, Improve Your Savings Habits:

- Describe and classify your goals and put them on a calendar

- Study your expenditures and adjust your spending habits
- Create a new budget with dedicated savings for your goals
- Build an emergency fund for unexpected expenses
- Get insurance to help protect against the financial consequences of a premature death
- Reduce your debt (if you can, pay it all off)

Second, Keep Learning, Keep Growing

- Continue to develop your financial knowledge
- Learn your investment tendencies and emotional “triggers”
- Do an investment risk profile assessment (available through the Asset Allocation Evaluator on our website)
- Review (and refine when appropriate) your investment strategy
- Monitor your asset allocation and account performance
- Call TIAA-CREF for help

To develop an asset allocation strategy, use our online Asset Allocation Evaluator at www.tiaa-cref.org in the “Planning Tools” section.

To learn more about retirement planning and other TIAA-CREF financial services, visit us at www.tiaa-cref.org, [schedule an appointment online](#), or call a consultant at **800 842-2776**.

This article uses “you” in the general sense. Please consider your own situation before investing.

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