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Check Your Asset Allocation Seatbelt, Again

The markets have performed well in recent years, but no one knows how they'll do in the future.

If you've allocated some of your retirement savings to an equity (stock) or real estate fund, there's a good chance you've benefited from their rise in value the past few years. But it is impossible to predict future performance, and we know that past performance is no guarantee of what's to come. For this reason, now might be a good time to review your asset allocation to make sure it is still in line with your long-term investment objectives.

The following observations may be helpful in nudging your thinking, since most people find it difficult to objectively assess their portfolio, especially when things are going well.

1. The future may really be different.

Investors are often advised to avoid extrapolating from the past. This applies to risk levels as well as returns. Stock and real estate market volatility has been relatively low in recent years but could increase again as it has in the past.

2. We never know when a dip is just a dip.

Because of recent history, some people may believe that market retreats are likely to be temporary dips followed by rallies. But in the midst of any market decline, no one will really be sure what will happen next. It is only in retrospect that a downward market move can be safely described as a "dip." It's better to be proactive and make adjustments before experiencing not a dip but a sizable drop.

3. Equities and alternatives don't always beat other assets.

Over long periods of time, equities have historically provided superior returns. Also, investment alternatives like real estate have also performed well. But along with returns comes risk, which is why it's important to remember that over significant time periods, bonds, for example, have sometimes outperformed stocks and other investment alternatives.

4. Your asset allocation mix has probably drifted.

Given the run-up of recent years, investors with diversified portfolios will discover that their asset mix is now probably more heavily weighted toward stocks and real estate. Without lifting a finger or thinking about it, the asset allocation changed.

5. It is hard to overcome inertia.

Circumstances change in an investor's portfolio, in the markets, and in one's life. As an investor, you should, therefore, ask yourself: Besides my retirement assets, how have my other

investments changed in recent years? How have my spending patterns evolved? What sorts of new financial obligations have I assumed (such as commitments to children, parents, other relatives, or to charitable organizations)? What additional retirement goals have I made in recent years that I need to fold into my financial planning? The point is, as life and circumstance change, so too may your need to modify your allocation.

6. It is all “real” money.

Gamblers sometimes keep their original stake in one pocket and any winnings, which they call “house money,” in the other pocket. Retirement investment returns aren’t “house money.” The fact is that these accumulations have been “earned” by taking a long-term view and accepting the greater risk inherent in equities. So, it’s probably wiser to approach your entire portfolio as “fresh” cash. Imagine it as an inheritance from a favorite uncle. Then, starting afresh, think carefully how you should invest this newfound legacy. The answer would be a clearer reflection of your real appetite for risk — as opposed to being emotionally bound by the pathway that led to your portfolio’s current value.

7. Be aware of the “wealth effect.”

The most recent — and spectacular — example of the wealth effect is the residential housing market price rise, which enabled many homeowners to tap rising home equity for consumption and investment. Similar to housing, as an investment nest egg grows, it is perfectly natural to consider new purchases now, or the opportunity to be more generous with loved ones and other legacies in the future. But, you should be cautious, because just as appreciating housing values can pause or reverse, so too can your portfolio’s investment value decline.

8. Be realistic about risk tolerance during rough times.

When the investment markets are going well, news tends to get a positive spin, with a focus on the benefits of globalization, emerging markets, and alternative investments. On the other hand, protracted periods of underperformance, if they occur, can be tougher to endure than many people think. For one thing, research on people’s financial behavior tells us that most people care much more about the prospect of a loss than the prospect of a gain. In plain language, most people find that they strongly dislike losing money and should, therefore, think seriously about how to protect their gains.

9. Don’t let the “crowd” dictate important investment choices.

Again, when the markets are performing well, stories about how everyone is putting their money in certain areas of the equity markets, or into alternative investments, abound. Of course, there is a certain emotional insurance in being in the same boat with friends and peers. But financial security is not a relative matter. It is an individual process driven by personal goals and concerns. With any serious financial setback, it will be cold comfort to know that you’re part of a larger crowd. It is fine to listen to friends and associates, but investors should recall that in the final analysis they and their families will bear the consequences. So, it is important that you base your asset allocation choices on your individual goals, risk tolerance, and anticipated needs.

In summary, then, the best way for you to check your asset allocation seatbelt is to first, make sure that you have no illusions about your money — imagine it all to be fresh cash. Second, determine how your asset allocation mix may have changed since the last time you looked. (The

Asset Allocation Evaluator, at www.tiaa-cref.org in the “Planning Tools” section, is designed for this.) Third, examine whether your retirement and other needs may have changed. And fourth, consider whether there is a need to modify the asset allocation mix in light of any changing circumstances or plans.

It is your responsibility as an investor to choose the right balance of funds, because no one knows your financial personality and needs better than you do. Of course, through our network of individual consultants, wealth management advisors, and Web tools, we can help you get through the clutter and make sensible decisions.

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

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