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Six Rules for Retirement Investors

When you're investing for retirement, here are six rules to follow when pursuing your savings goals.

1. Take advantage of tax-deferred products. When saving for retirement, use tax-deferred products such as employer-sponsored supplemental retirement plans and IRAs to reap tax advantages as you build assets for the future. If you're eligible to invest in a supplemental retirement plan, contribute at least the minimum amount required for you to receive the maximum matching contribution from your employer. Any matching contribution you get is a good deal, because it's essentially "free money" — funds you otherwise wouldn't have available to use toward building your nest egg.

When you invest in a supplemental plan, your contributions are deducted from your paycheck, before taxes are taken out. This means you report a lower salary to the IRS, and thus pay less in income tax than you would if you didn't contribute to the plan. Also, earnings in a supplemental retirement plan are tax deferred, which means you don't pay taxes until you withdraw the money in retirement. (Note that withdrawals from supplemental retirement plans prior to age 59½ are generally subject to a 10% IRS penalty tax, plus ordinary income tax.)

Starting in 2006, many employers began offering a new kind of supplemental retirement plan known as the Roth 401(k) or Roth 403(b). Unlike pretax supplemental retirement plans, contributions to a Roth 401(k)/403(b) plan are made on an after-tax basis, which means you don't get a payroll tax reduction on your contributions. However, Roth 401(k)/403(b) earnings become available completely tax free when you're age 59½ or older, and if you hold the account for five or more years, or if you satisfy other retirement criteria.

2. Don't Forget IRAs. Whether or not you're eligible for a supplemental retirement plan, you *can* invest in an IRA, provided your contributions come from earned income. As with supplemental plans, earnings in an IRA grow tax deferred until you withdraw the money in retirement. (Note that

not everyone can deduct the amount they contribute to an IRA from their income taxes.) For the 2007 tax year, you can contribute a maximum of \$4,000 per year to an IRA, or up to \$5,000 annually if you're age 50 or older.

The two major types of IRAs are Traditional IRAs and Roth IRAs. With Traditional IRAs, contributions may be tax deductible, depending on the taxpayer's adjusted gross income, tax filing status and whether he/she is covered by an employer-sponsored retirement plan. Investing in a Roth IRA can be advantageous, because Roth IRA owners can withdraw their contributions free from taxes and penalties at any time, and can withdraw earnings free from federal taxes and penalties provided they've had the IRA for five years and satisfy one of the following conditions: reach age 59½, use the funds for a qualified first-time home purchase (up to a \$10,000 lifetime maximum), become disabled or die.

3. Create a diversified investment portfolio. When deciding how to invest your money, diversify your portfolio among a broad range of asset classes such as stock, bond, real estate, money market and guaranteed accounts or funds. Investing in a variety of different asset classes will balance your portfolio's performance, which means that as economic and market conditions change, the upward movement of one asset class may help offset the downward movement of another.

As a result, diversifying your holdings among different asset classes can give you a portfolio with lower overall volatility than a portfolio that consists of holdings in only one or two asset classes. (Note, however, that diversification does not guarantee against loss.) A consultant can help you develop a diversification strategy that's appropriate for your needs.

4. Realize you're saving for the long term. If you're a young investor, you have many years to go before you retire. However, if you're older — say age 55 or above — you may be surprised to learn that retirement is a long-term goal for you, too. Generally, no matter where you are in life, retirement savings requires a long-term outlook, because your investment period includes both your working years (when you're accumulating funds) and your retirement years (which may last 20 or 30 years or even longer).

Because you're investing for the long term, consider allocating more of your assets to investments with higher growth potential, such as stocks. Speak with a consultant for help with creating an asset allocation strategy for your retirement savings. (There are inherent risks in investing in securities. Past performance is no guarantee of future results.)

5. Don't try to "time" the market. *Market timing* involves making investment decisions by judging market price movements. One example of market timing is when an investor purchases a stock after a big market decline, when he thinks the market has bottomed out, and then tries to sell the stock when he thinks a rebound has occurred. For market timing to work successfully, the investor must predict market directions correctly, and then make the right investment decisions based on these predictions. However, making such predictions correctly on a regular basis is extremely difficult.

Instead of trying to time the market, maintain a diversified allocation strategy, as described in point three above. If you become concerned about market volatility, or you experience a major change in your life or you are within 10 years of retirement, you should revisit your allocation strategy to see if it's still appropriate for your investment goals.

6. Pay attention to expenses. As we've mentioned, you can't predict how a given financial market will perform from one year to the next. But you *can* control the impact that expenses have on your investments. All things being equal, expense charges — such as commissions and management fees — can make a substantial difference in your investment returns. Higher fees do not necessarily translate into higher returns, but they can definitely take away from your investment's performance. (However, lower expenses do not mean higher returns.)

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