MARKET MONITOR
NOVEMBER 16, 2009

BRETT HAMMOND
CHIEF INVESTMENT STRATEGIST

RECHECK YOUR ASSET ALLOCATION SEAT BELT

Those familiar with air travel know that the pilot will often use the public address system to advise passengers to check that their seat belts are firmly fastened—particularly in these days. The warning often turns out to be unnecessary; the air ahead is smooth or there are a few bumps, but they are nothing to worry about. Recalling the small number of well-publicized occasions on which unbelted passengers were tossed about, the pilot still makes the announcement as a preventative measure, to ensure that the trip is as comfortable as possible and that the passengers arrive at their destination in good shape.

TIME ONCE AGAIN TO CONSIDER YOUR ASSET ALLOCATION MIX

In air travel, no one objects to this sensible, simple constraint. In investing, it is equally good advice to check your asset allocation seat belt as a precaution against the appearance of uncertain, bumpy times. Before you check your asset allocation mix, consider the following:

- After falling about 56% from October 2007 to early March 2009, the U.S. equity market has climbed by nearly 60% since then.[1] After falling more than 3% in 2008, a broad index of corporate bonds has risen more than 15% this year.[2]
- Due to these market gyrations, portfolios containing equities and bonds have significantly altered their asset mixes.
- We would urge individual investors to check their asset allocation seat belts using some simple observations to see whether their portfolio allocations are consistent with their long-term financial goals.

Investors who have allocated a portion of their retirement savings to an equity or bond fund, are likely to have benefited from the rise in market indexes this

[1] S&P 500 total return through October 30, 2009.
[2] Barclays Capital U.S. Corporate Credit Index through October 30, 2009.

year—more than 17% for domestic equities, 27% for foreign equities, and more than 6% for U.S. bonds.[3] Of course, this year follows 2008, when domestic equity markets fell nearly 40%.

No one knows what the markets hold in store, but having enjoyed this period of good results, now is an excellent time for individual investors to review and adjust their contributions and portfolio asset allocations to reflect long-term investment objectives in light of the current situation. Yet, most people find it difficult to objectively assess their portfolio, especially when things are going to extremes, as they have done over the past year.

CHECK THE SAFETY OF YOUR ASSET ALLOCATION SEAT BELT

We encourage investors who wish to get into the right frame of mind, to consider the following nine observations:

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 to returns. After a long period of low market volatility in the late 1980s and much of the 1990s, stock and real estate markets have been highly volatile in recent years. It is hard to predict whether the markets will settle down or continue to gyrate.

2. **Just a dip, or a bursting bubble?** Because of recent history, some people may believe that market retreats are likely to be temporary dips followed by rallies. Others may be convinced that we have been experiencing extreme asset bubbles (and subsequent disruptive bursting) that could continue to plague investors. But in the midst of any market movement, no one will really be sure what will happen next. It is only in retrospect that a market movement can be safely described as a temporary dip or more extreme meltdown.

3. **Don't count on a single asset class to outperform.** Over long periods of time, equities have historically provided superior returns. And alternatives have performed well at times. But along with returns comes risk. Over significant spans of years, bonds, for example, have outperformed stocks and alternatives. Creating the right mix of assets that can be used to balance potential risk with potential return is a better idea than trying to find that one asset class that will beat all the others.

4. **Your asset allocation mix will almost surely have drifted.** Investors with diversified portfolios will discover that their asset mix is surely now more heavily weighted toward stocks and bonds than it had been earlier this year. Without lifting a finger or thinking about it, the asset allocation mix is likely to have changed.

5. **It's hard to overcome inertia.** Circumstances change—in an investor's portfolio, in the markets, and in one's life situation. An investor should ask: Besides my retirement assets, how have my other holdings changed in recent years? How have my spending patterns evolved? What sorts of new financial obligations have I adopted, such as commitments to children, parents, other relatives, or to charitable organizations? What sorts of retirement plans have I made recently that I need to fold into my financial planning? An investor can—and should—adjust his or her allocation as circumstances change.

6. **It's 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." In fact, investors have "earned" these returns by taking a long-term view and accepting the greater risk inherent in equities. Even so, investors should consider their entire portfolio as "fresh" cash no matter where it came from. In fact, it may help to imagine all of it as an inheritance from a favorite uncle. Starting fresh, how should this new found legacy be invested? The answer would be a clearer reflection of an investor's real appetite for risk—as opposed to being emotionally bound by the pathway that led to the 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

[3] S&P 500, MSCI EAFE, and Barclays Capital Aggregate indexes, respectively, through October, 2009.

future. But also similar to housing, rapid increases in investment portfolio value can pause or reverse.

8. **Be realistic about risk tolerance during rough times.** In an untroubled environment, news tends to get a positive spin, with a focus on the benefits of whatever asset class is "hot" at the moment. On the other hand, protracted periods of underperformance, as we have seen, can be tougher to endure than many people anticipate, and can cause some to run away from the previously hot asset at just the wrong time. 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 consider their own views about protecting gains.

9. **Don't let the "crowd" dictate important investment choices.** Almost everywhere we look, we can read or hear stories about how everyone is putting their money in corporate bonds, certain types of equities, or even more exotic alternative investments. 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—these days it is an individual matter, absolutely. 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 asset allocation choices be based on individual circumstances, risk tolerance, and anticipated needs.

MAKE SURE ANY CHANGES SUIT YOUR PERSONAL CIRCUMSTANCES

In sum, the best way for an investor to check on his or her asset allocation seat belt is to first, make sure there are no illusions about your money—imagine it all to be fresh cash; second, figure out how the asset allocation mix may have changed; third, examine whether 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 the investor's responsibility to choose the right balance of funds, because that is the only way to tailor the allocation to personal circumstances. However, TIAA-CREF is well equipped to assist individual investors with these decisions through its network of individual consultants, wealth management advisers, and web tools that use truly independent asset allocation advice. But each investor should know that he or she is in charge of the initial seat belt check. This may sound like work, but it's worth it, if the result is an easier financial flight into the future.

Brett Hammond is available to comment on economic data. If you wish to speak with him, please contact Chad Peterson, Media Relations, 212 916-4808 or e-mail cpeterson@tiaa-cref.org

C46282 (15840)