



## **TIAA-CREF's Dual Investment Management Strategy**

### ***"Dual Investment Management Strategy" Defined***

In the early 1980s, CREF Investments pioneered using two established methods of managing equity funds—active and quantitative management—within a single equity fund. We call this proprietary technique the Dual Investment Management Strategy<sup>SM</sup> (or Dual Strategy<sup>SM</sup>). We use it to manage the vast majority of TIAA-CREF's domestic and international equity holdings across four product groups: 1) variable annuity pension accounts, 2) retail mutual funds, 3) institutional mutual funds and 4) personal annuities. The Dual Strategy rests on a simple basic premise: Coordinating active and quantitative techniques can heighten the effectiveness of both approaches, thereby offering substantial benefits to investors.

### ***The "Active" Component***

In active management, portfolio managers choose individual stocks based on company, industry and economic fundamentals. Managers who rely mainly on this technique find it challenging to beat their benchmarks consistently over extended periods. Two factors make it difficult for traditional active management strategies to outperform the market consistently.

First, cash flow problems can dictate investment decisions that are counterproductive to the underlying investment criteria established by the fund manager. If a fund is under performing, the only option for many active fund managers may be to change the level of stock holdings, which effectively exposes investors to market-timing risk. For example, investors withdrawing cash from a fund may force the manager to sell at an inopportune time. On the other hand, when large amounts of cash flow into an account, a manager may need to buy a particular security in order to balance the portfolio.

The other hurdle for active managers is that equity markets can sometimes be highly efficient, pricing securities quickly and rationally. During these periods, analysts may find no individual stocks that they believe will outperform the pack. In this case, managers may need to choose among unattractive alternatives, or simply hold more of the accounts' assets as cash, which can expose the portfolio to market-timing risk.

### ***The “Quantitative” Component***

Quantitative management, or “enhanced indexing”, tries to replicate the risk-and-reward profiles of market benchmarks, such as the Russell 3000 or the S&P 500. While indexing offers a viable alternative to active management, it too has some limitations. Foremost is that index strategies, by their very nature, cannot outperform the benchmarks they are designed to track. In certain cases, indexing’s sub-benchmark returns may be an attractive alternative to the risks of active management. However, this method often frustrates investors, since indexing frequently cannot at least meet benchmark returns,

### ***Combining Active and Quantitative Management***

By combining the strengths of both active management and quantitative enhanced indexing, the Dual Investment Management Strategy captures the benefits of each approach while mitigating their disadvantages. Dual Strategy-managed funds seek to outperform their benchmarks while maintaining low risk relative to their peers.

### ***How the Dual Strategy Works***

We divide each fund into two sub-portfolios, with their own portfolio management teams. One employs stock selection (active) and the other uses TIAA-CREF’s enhanced approach to indexing (quantitative). The teams meet frequently to discuss the best combination of stock-picking techniques for the sub-portfolios. The active side can function as a driver, adding value to the portfolio, while the quantitative side can act as a shock absorber to offset risk.

The relative size of the two sub-portfolios varies, depending on where the management teams see significant opportunities. Within a portfolio, a 60%-to-40% or 40%-to-60% ratio (of actively versus quantitatively chosen securities) is typical. However, managers can alter the mix daily to take advantage of new opportunities, or to make significant changes over a longer time horizon.

### ***The Dual Investment Management Strategy is Unique***

Few institutional investors have the specialized skills and necessary support systems to make the Dual Strategy work. In addition, developing expertise in two distinct disciplines is generally too costly or cumbersome to manage under one roof. The success of the Dual Strategy depends on a number of CREF’s strengths: 1) an in-house pool of skilled active and quantitative analysts; 2) a team approach to managing funds; and 3) a strong benchmark orientation to control and monitor risk-and-reward profiles of the funds. Because our

approach has been to combine active and quantitative management, we have developed an organizational structure that can effectively accommodate both. This approach also enables us to stay fully invested, which in turn, keeps investors' money working fully for them in the stock market. For investors who take a long-term view of relative performance and relative risk, TIAA-CREF's Dual Investment Management Strategy offers a compelling alternative to conventional fund management.