



HIGHLIGHTS

Asset Allocation

Your Most Important Investment Decision

Your investment mix — or **asset allocation** — is the most important factor affecting the performance of your TSP account. But what allocation will give you the highest possible rate of return for the amount of risk you are willing to take? Here are some things to consider in choosing the asset allocation that works best for you.

A basic principle of investing is **diversification** — that is, not putting all your eggs in one basket. When you invest in several different securities, you reduce your exposure to risk from any single security. This *security-specific risk* is virtually eliminated in the TSP's F, C, S, and I Funds, because each of these funds is invested in a large number of securities from a variety of issuers, industries, and regions. However, TSP investors remain exposed to *market risk* which results from basic economic forces (for example, the risk of a decline in the overall U.S. stock market). You can manage your exposure to market risk by including different asset classes

— such as Government securities, domestic bonds, and domestic and foreign stocks — in your TSP account. This is why your asset allocation decision is important.

As a TSP participant, you can allocate your account among five funds (see box) that represent different asset classes. Each TSP fund has its own unique market risk. When you invest in several funds, the different market risks will offset each other to some degree. This

TSP Funds

G Fund — invested in short-term, risk-free U.S. Treasury securities that are specially issued to the TSP

F Fund — invested in a bond index fund that tracks the Lehman Brothers U.S. Aggregate (LBA) bond index

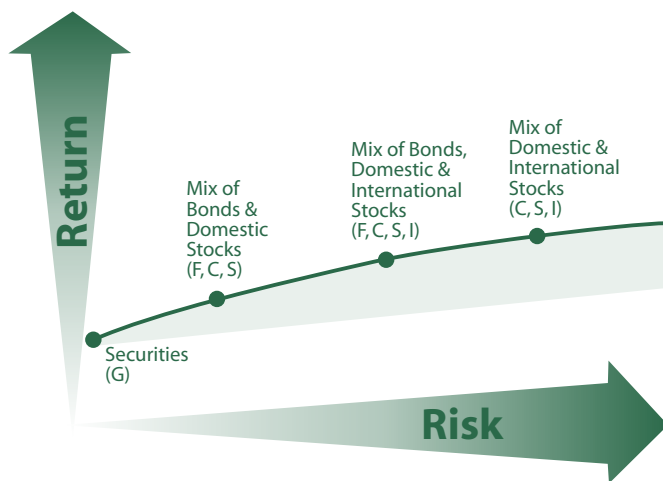
C Fund — invested in a stock index fund that tracks the Standard & Poor's (S&P) 500 stock index (which comprises large companies)

S Fund — invested in a stock index fund that tracks the Dow Jones Wilshire 4500 Completion stock index (which comprises medium and small companies)

I Fund — invested in a stock index fund that tracks the Morgan Stanley Capital International EAFE (Europe, Australasia, Far East) stock index (which comprises stocks in 21 countries)

means that including a higher-risk fund in your account may increase your expected return, yet add little to your overall risk.

In the graph below, the shaded area shows the risk and return associated with different combinations of TSP funds. The G Fund-only allocation falls on the far left point of the curve; it has the lowest risk and the lowest return over time. Risk and return both increase as we move from left to right along the curve. An investor aiming for a higher rate of return must also assume a higher level of risk by investing in more volatile assets, such as small capitalization and international stocks.



The curve at the top of the shaded area represents the group of optimal asset allocations (that is, the combinations of funds with the lowest risk for a given level of expected return, or the highest expected return for a given level of risk). Any asset allocation that does not fall along this curve is less than optimal, because there is an allocation along the curve that has more return for the same level of risk, and another that has less risk for the same amount of return. (Keep in mind that the combinations of funds shown on the graph are based on assumptions about the future performance of the various asset classes. Actual performance may vary from those assumptions.)

How should you select an asset allocation that is appropriate for you? The biggest consideration is your


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time horizon (when you plan to begin withdrawing your account). This may be later than your expected retirement date. An allocation on the right side of the graph is more appropriate for a participant with a time horizon of 10 years or longer than it is for a participant who will need to use the money in his or her account sooner. As time passes and your time horizon shortens, your portfolio mix should move toward the left side of the graph. You should review your asset allocation at least annually and make adjustments as needed.

Would you prefer to have investment experts handle the asset allocation for you? The TSP will be offering professionally managed **lifecycle funds** that combine the five existing TSP funds into various asset allocations. Allocations will be tailored to different groups of participants according to their time horizons. As the target time horizon approaches, the investment mix becomes more conservative. That means you won't need to periodically reallocate the account; the lifecycle fund will do that for you. Our next *TSP Highlights* will provide more information about these funds and when they will be available.

In the meantime, review your account balance and your current investment allocation and decide whether your TSP money is working for you as you intended. You may find it helpful to review the TSP Fund Information sheets, which are available on the TSP Web site or from the TSP Service Office.

Keep in mind that few investors are successful when they make large or multiple changes to their asset allocations in response to events in the market. Over the long term, a consistent approach to asset allocation should outperform a market-timing strategy. 

Do these apply to you?

Deadline for requesting a refund of excess contributions is March 1, 2005 — if you contributed to more than one tax-deferred plan and you exceeded the 2004 IRS annual limit of \$13,000 (\$16,000 if you also made catch-up contributions).

Deadline for completing a withdrawal is April 1, 2005 — if you were 70½ and separated from Federal service in 2004.

IRS Form 1099-R — If you received a withdrawal or other taxable distribution in 2004, make sure the TSP has your correct address so you receive your 1099-R in the mail.

Catch-up Contributions — You must make a new election each calendar year. The limit for 2005 is \$4,000.

For more information, visit the TSP Web site, check with your agency or service, or call the TSP Service Office.

Rates of Return

	G Fund	F Fund	LBA Bond Index	C Fund	S&P 500 Index	S Fund	Wilshire 4500 Index	I Fund	EAFE Index
January – November 2004									
	3.9%	3.3%	3.4%	7.2%	7.2%	13.3%	13.3%	15.0	15.2%
Annual 1994 – 2003									
1994	7.2%	-3.0%	-2.9%	1.3%	1.3%	-	-2.7%	-	7.8%
1995	7.0	18.3	18.5	37.4	37.6	-	33.5	-	11.3
1996	6.8	3.7	3.6	22.8	23.0	-	17.2	-	6.1
1997	6.8	9.6	9.7	33.2	33.4	-	25.7	-	1.5
1998	5.7	8.7	8.7	28.4	28.6	-	8.6	-	20.1
1999	6.0	-0.8	-0.8	21.0	21.0	-	35.5	-	26.7
2000	6.4	11.7	11.6	-9.1	-9.1	-	-15.8	-	-14.2
2001	5.4	8.6	8.4	-11.9	-11.9	-2.2*	-9.3	-15.4*	-21.4
2002	5.0	10.3	10.3	-22.0	-22.1	-18.1	-17.8	-16.0	-15.9
2003	4.1	4.1	4.1	28.5	28.7	42.9	43.8	37.9	38.6
Compound Annual 1994 – 2003									
	6.0	6.9	6.9	11.0	11.1	-	9.8	-	4.4

The returns for the TSP funds represent net earnings after deduction of accrued administrative expenses and, in the cases of the F, C, S, and I Funds, after deduction of trading costs and accrued investment management fees. The returns for the four indexes shown do not include any deduction for administrative expenses, trading costs, or investment management fees.

* The S and I Funds were implemented in May 2001; therefore, there are no returns for these funds for earlier periods. Returns shown for 2001 are for May through December.