

MarketWatch

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WEEKEND INVESTOR

5 investments to gird against a weak market

ETF, bond and gold investments that can diversify your portfolio

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July 22, 2011

SAN FRANCISCO (MarketWatch) -- An earnings shortfall at a major bank triggers a drop in drug stocks. Fuzzy accounting in tech, and investors flee the energy sector. CEO quits a major retailer? Better sell airlines.

Of course, nobody really complains when everything in the market is in rally mode. But when faced with the kind of volatility investors have seen in recent months, conventional diversification strategies are proving to be less effective.

"A dropping tide lowers all boats, and it doesn't matter if one of the boats doesn't deserve to be lowered," said United Capital Chief Executive Joe Duran, who manages more than \$5 billion in assets.

He blames this condition on the proliferation of exchange-traded funds. Now, when one stock takes and hit, the rest of the group follows simply because this "interlinkedness" has never been so prevalent.

Nicholas Colas, chief market strategist for ConvergeX, backs that point by noting that shares of apparently unrelated industries moved in virtual lock-step together during June.

"How can you take seriously a rally that doesn't differentiate between industrials, technology and consumer discretionary stocks?" Colas said. "Modern portfolio theory says that the more non-correlated assets you can put into a portfolio, the better off your risk/return profile will be. Financial assets can only take you so far in this

quest."?

From gold and silver to real estate and currency, there are plenty of ways to avoid getting run over by the herd. Up until recently, getting access to these strategies just wasn't realistic for mom-and-pop investors.

Fortunately, that has changed. If you want to break from the pack and spreading out risk is a priority for you, here are five investing plays to consider.

Managing your future

An increasingly popular means of bucking market trends is through managed-future ETFs. Like their more exclusive hedge-fund cousins, these ETFs trade actively across many asset classes.

In 2000, managed-future funds tallied a relatively paltry \$38 billion under management, according to BarclayHedge, a performance tracking firm in Fairfield, Iowa. A decade later, that swelled to almost \$270 billion as investors sought, and continue to seek, gains in a mostly dreary stock market.

These funds may go long or short in futures contracts involving everything from soybeans and wheat to market indexes and cocoa.

Altegris Advisors, which runs the Altegris Managed Futures Strategy Fund (MFTAX, US) lays out a compelling case for the approach.

During the tech wreck from September 2000 to September 2002, managed futures roared 43% higher while the S&P 500 (SPX, US) dropped 45%, according to Altegris, which tracks the 40 leading managed futures programs.

Similar divergence hasn't always played out in favor of these investments. During a five-year

running of the bulls from 2002 to 2007, when U.S. stocks doubled, managed futures gained only 35%.

U.S. stocks have had the upper hand since early 2009, returning 88% vs. a 2% gain in managed futures.

History suggests that buying these funds during a bull market for stocks is tantamount to buying insurance against the next bear market.

Indeed, during the market freefall in 2008, when U.S. stocks lost more than one-third of their value, managed futures churned out a 16% rally.

Another fund mentioned by Duran that could be worth checking out is the ASG Managed Futures Strategy Fund (AMFAX, US).

Two ETFs that have performed relatively well recently are the WisdomTree Manage Futures Strategy Fund (WDTI, US) and the Elements S&P Commodity Trends Indicator (LSC, US).

The shiny stuff: Gold, silver

There's nothing particularly new about using precious metals as a hedge. Gold has long provided a safety net in the face of a teetering market, and that hasn't changed. Bullion has made new highs while stocks can't seem to keep their footing.

And now, there are more ways than ever to gain exposure to not only gold, but silver and copper, as well.

Bob Fitzwilson, chief investment officer of Portola Group, manages about half a billion dollars in assets and has easily beaten broader market benchmarks in the past decade.

The private-wealth manager, based in Menlo Park, Calif., has accomplished that with more than half of his assets devoted to gold, silver and related companies.

"In the '70s, it was all about investment management, then it morphed into wealth management, and now it's all about wealth preservation," Fitzwilson said.

If investors had put \$1 million into the fund from 1998 through the first quarter of this year, they would have seen that top \$2.5 million, he says. If that money had been bet on the S&P 500, it would have turned into \$1.7 million, or \$1.9 million on the Nasdaq.

Fitzwilson recommends looking at Sprott Physical Silver Trust (PSLV, US) and Sprott Physical Gold Trust (PHYS, US), both of which essentially give shareholders direct exposure to both metals by holding actual bars at the Royal Canadian Mint in Ottawa.

iShares Silver Trust (SLV, US) and SPDR Gold Trust

(GLD, US) are two others that fit the same needs. For broader exposure to the metals group, ETFS Physical Precious Metal Basket Shares (GLTR, US) and ETFS White Metals Basket Trust (WITE, US) are also worth a look.

"Wealth preservation used to be cash, CDs or fixed income," Fitzwilson said. Nowadays, however, cash is shaky, as currencies like the U.S. dollar risk long bouts of depreciation.

Currency plays

Still, some currencies have a good track record as thriving when other assets tank. Along with his hefty exposure to gold and silver, Fitzwilson leans on the Swiss franc to round out his holdings. A strong economy coupled with low levels of inflation and unemployment have helped the currency easily outperform its counterparts in recent years.

The CurrencyShares Swiss Franc Trust (FXF, US) is a straightforward play on Switzerland's stable currency (USDCHF, US).

Plus, there are exchange-traded products based on the carry trade, in which the manager sells a low-interest rate currency to buy a different currency with higher yields.

For instance, the Optimized Currency Carry ETN (ICI, US), which tracks the Barclays Capital Intelligent Carry Index, and the PowerShares DB G10 Currency Harvest Fund (DBV, US) aim to capitalize on growing interest rate differentials between developed countries.

REIT preferreds

Buying equities that pay out a nice yield is a popular way to diversify a stock-heavy portfolio. An unpopular choice in the category, however, has been real estate investment trust preferred shares.

That should and could be changing, according to Simon Wadsworth, former chief financial officer of Mid American Apartment Communities (MAA, US)

When two investments always move together, they're considered to have a correlation of 1. REIT preferreds have a correlation of 0.03 with large-cap stocks, according to Callan Associates. So aside from having an inverse relationship, that's about as divergent as investments can get. Ashford Hospitality Trust (AHT.PE, US), Apartment Investment & Management Co. (AIV.PU, US), Glimcher Realty Trust (GRT.PG, US), and Kite Realty Group Trust (KRG.PA, US) are all REIT preferreds that Wadsworth owns and recommends.

"Prices have proven to be very resilient, not just

over the last couple of years, but over the last few months as well,"? Wadsworth said. "With dividend yields in the 6% to 9% range, and some with spreads at 500-plus basis points above the 10-year Treasury, they continue to be an attractive harbor for yield-hungry investors."?

Global bonds

Fixed income has traditionally played the counterpart to equities in the balanced portfolio. But investors focusing solely on U.S. debt are missing out on a valuable tool for diversification.

In fact, over the past quarter-century, portfolios with up to half of their fixed-income allocation in foreign bonds have realized higher returns than those with just U.S. bonds, with little to no added risk, according to a Standard & Poor's study.

In the past 20 years, correlation of foreign government bonds to the U.S. stock market has been just 0.11 while their correlation to the U.S. bond market stood at 0.47, according to Morningstar data.

The following mutual funds in this category are worth considering for the well-rounded portfolio: the Templeton Global Bond Fund (TPINX, US), the Dreyfus International Bond Fund (DIBAX, US) and the Loomis Sayles Global Bond Fund (LSGBX, US).