

THE WALL STREET JOURNAL

WSJ.com

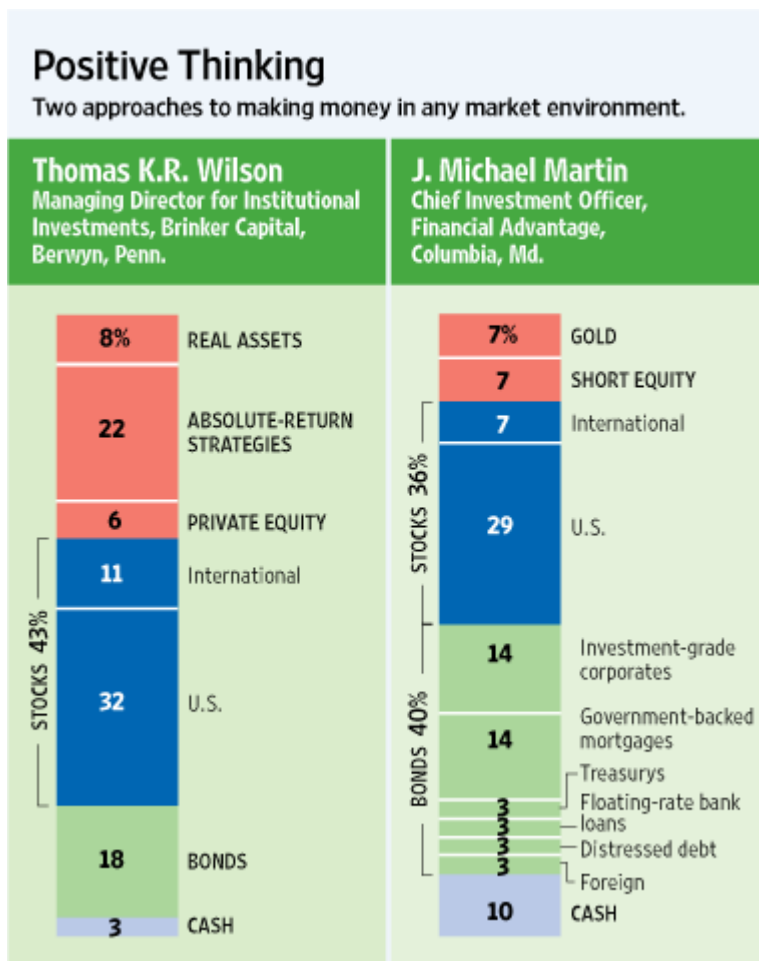
WEALTH MANAGER | JULY 10, 2010

A Strategy for All Seasons

By BEN LEVISOHN

Investors frustrated with stocks are jumping en masse into the safety of bonds. The yields on Treasuries have plunged to lows last seen during the worst of the financial crisis.

But what if Treasuries themselves are headed for a bear market? For the past 10 years, while stocks have basically gone nowhere, bonds have rallied: Total returns on U.S. government debt have soared 82% since the end of 2000.



The recent uncertainty has breathed new life into an investing strategy designed to split the difference between stock-market and bond-market risk by delivering "absolute return" in any environment. These highly diversified and somewhat complex portfolios won't get you the returns you once dreamed of from stocks—but if executed smartly, they should produce positive returns and reduce overall risk.

"There is more discussion today about adapting absolute returns," says Thomas K.R. Wilson, managing director of institutional investments at Berwyn, Pa.-based Brinker Capital, which recently launched an absolute-return portfolio to meet demand for

the strategy. "Midsingle-digit returns are attractive given stock market volatility and where interest rates are."

Investors who don't want to build their own portfolios can consider absolute-return mutual funds, which seek to provide the same diversification and return in one easy vehicle. But while the funds are surging in popularity, they don't always live up to their billing (see story, right).

So what do absolute-return portfolios look like? Most strikingly, they don't hold a lot of stocks. Many strategists recommend an equity allocation well below the standard 60% that financial planners suggest. Among those holdings should be a healthy slug of emerging-markets, which are expected to keep growing despite the troubles in the developed world. On July 8, the International Monetary Fund forecast that emerging economies would grow by 6.4% in 2011, well above the pace of the developed world. "When our equity allocation rises, it will go to emerging markets," says J. Michael Martin, chief investment officer at Financial Advantage in Columbia, Md.

Bonds should also occupy a large slice of an absolute return portfolio—but just how much and which types depend on one's view of the bond market. Sam Katzman, the investment officer at Constellation Wealth Advisors in New York, aims for balance. He has created a "barbell" portfolio of U.S. government debt, with around 70% laddered into one- to five-year Treasuries and high-quality municipal bonds, and the other 30% in debt that is seven to eight years out.

"We want to avail ourselves of higher long-term yields but leave ourselves a way out if the government is able to reinflate the economy," Mr. Katzman says.

Absolute-return portfolios typically include a healthy dollop of alternative investments—everything from private equity to hedge funds and hedge-fund-like strategies. Among them: "long/short" funds, which bet that stocks will rise or fall, and "merger arbitrage" funds that wager that the price of an acquiring company and a purchased company will converge.

For additional diversification, advisers say investors should consider hard assets, including real estate and commodities. Despite an uncertain housing market, some investors see opportunities for income and capital appreciation by investing in real-estate investment trusts or through limited partnerships.

Although commodities plunged in tandem with the stock market during the financial crisis and then rallied sharply in 2009, the two asset classes aren't always highly correlated. During the 1970s, commodities surged as stocks stalled, while during the 1980s and 1990s commodities fell as stocks rose.

Of course, not everyone is convinced that absolute return is the way to go. If global markets flatten out in sync, as some predict, then it would be difficult to generate decent results.

Still, with market sentiment so divided these days, "It's unlikely the coin will land on its edge," says Aaron Gurwitz, chief investment officer at Barclays Wealth in New York. "It makes sense that to look for other ways to take risk and generate returns."