

Alternative Investments

If **diversification** is a fundamental investment strategy, shouldn't one's portfolio include securities that are **not** correlated with the stock and bond markets?

The short answer is a decisive *Maybe*. It depends on the size of your investment portfolio, your financial situation, goals and tolerance for risk—matters to be explored with your financial advisor. But in case your answer is *Yes*, here are a few categories of “non-market-correlated” investments for consideration.

International bonds. Your portfolio may already include an allocation to international stocks, less likely to international bonds. An international bond mutual fund typically holds a wide variety of bonds, perhaps including foreign-government obligations—with all the risks, rewards

and diversification that suggests. The value of the fund's shares is independent from the U.S. bond market, and the investment can provide a hedge against a weakening of the dollar—as well as stock market declines.

Hedging with alternative investments may provide comfort as well as protection in a market downturn.

TIPS (Treasury Inflation-Protected Securities). These are also bonds, U.S. government bonds at that. But the ultimate yield of these U.S. Treasury debt securities is determined by the level of inflation; interest is paid only upon maturity. The higher the level of inflation, the greater the principal amount that is returned at maturity. So the value of these bonds has some independence from the rest of the Treasury-bond market.

Real Estate. We're not talking about your home here, or that tract in the Caribbean. Real Investment Trusts, or REITs, are financial securities representing investments in commercial or residential real estate properties and/or real-estate or hotel companies—domestic and/or foreign. While many but not all of these trade on the stock market, they enjoy a measure of independence from it because they are based on real estate assets. Some REITs have been flying high in the last few years, and given the credit crunch radiating from the mortgage market, you can be sure they won't out-perform the stock market forever.

Commodities. From precious metals to pork bellies, commodities are perhaps the most obvious, “non-correlated” alternative to the stock and bond markets. Like real estate until recently, commodities have been in an extended bull market for several years, and the prices of individual commodities, such as gold and silver, are notoriously volatile. But commodity-related mutual funds, which may include investments in mining, drilling, processing and other commodity-industry companies rather than ownership of the commodities themselves, provide a way to invest with a measure of diversification.

Limited Partnerships. These non-tradable, illiquid investments represent a passive ownership stake in an enterprise—such as a company developing commercial real estate, an equipment-leasing fund, or an oil or gas drilling operation—that is organized as a partnership rather than



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continued

a corporation. Limited partnerships usually require an investment of at least \$25,000, often \$50,000. Returns, which come in the form of dividends and gains from appreciation, as well as return of capital, can be very attractive, but the risks are correspondingly high, particularly for single-focus ventures.

Long-Short funds and Bear-Market funds. These are mutual funds designed for some degree of *inverse* correlation with the stock market, some with particular market indices, such as the S&P 500 Index. That is, they are designed to cushion market declines, or even rise in value when the rest of the market falls. Long-short funds hedge downturns to varying extents and in varying ways. True bear market funds go further, actually betting market prices will decline; many hold large short positions (which pay off when prices fall), as well as positions in gold bullion and

other precious metals. Of course, when stock prices rise, the value of these funds may fall.

But alternative investments have their own risks, and may retard portfolio performance in a bull market.

Which, if any, of these alternative, “non-correlated” investments makes sense for you? Maybe several; maybe none. Alternative investments may represent desirable diversification, even provide rich rewards. They may add

to comfort and provide a measure of protection when markets sour. But alternative investments have their own risks, and a portfolio hedged with investments not correlated with stock or bond markets may also *retard* performance in a strong bull market.

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