



Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit www.djreprints.com

• See a sample reprint in PDF format.

• Order a reprint of this article now

THE WALL STREET JOURNAL

WSJ.com

SEPTEMBER 2, 2009

PORTFOLIO STRATEGY

On Second Thought...

Many financial advisers have tweaked their investment policies after big losses last year. Investors should be sure they're comfortable with the changes.

By KAREN HUBE

After turning in a horrific performance in 2008, many financial-planning firms are heading back to the drafting table—and rethinking how they protect their mutual-fund portfolios.

Last year, the traditional safety-net strategy—diversification—failed as a broad range of investments crashed and burned. Now many planners are going further. They're giving themselves more flexibility to move assets around based on market conditions. Others have sworn off certain asset classes or added some they hadn't dabbled in before.

For instance, Steven Enright, owner of Enright Financial Advisors in River Vale, N.J., is using some mutual funds whose managers can shift assets to react to changes in the market. "We've always been proponents of modern portfolio theory—the idea that everything derives from asset allocation," he says. "But 2008 is the first time this really didn't work to hold up portfolios. So while we haven't been torn away from modern portfolio theory, 2008 has made us think we should modify the way we do things a bit."

Why didn't advisers make these changes earlier to potentially spare clients from losses? Deena Katz, a professor of personal finance at Texas Tech University in Lubbock, Texas, explains that most advisers are limited by the guidelines they spell out in investment-policy statements. Any change in policy typically must be hashed out by committee and then agreed to by clients—all of which can take time.

What's more, many advisers have been "limited by training," says Brian Kazanchy, chairman of the investment committee at RegentAtlantic Capital LLC in Morristown, N.J. "Most advisers adhere to the idea that none of us are smart enough to time the market," he says. "But we've realized that making tactical changes to the asset allocation—overweighting here or underweighting there—can add a lot of value, and it's not like jumping in and out of stocks to capture short-term gains. It's based on research on valuations and long-term trends."

It remains to be seen if the latest changes in advisers' strategies will result in smaller losses in future downturns or better returns over long stretches of time.

Whatever the change, make sure you understand your planner's new methods and are comfortable with them, says Dr. Katz, who is also a financial planner. "While it's been difficult to bear the movement in the market, be cautious if a planner jumps to things that he or she never looked at before," she says.

Here's a look at changes some established financial-planning firms have made recently.

Adding Flexibility

Stewart Welch III, a financial planner in Birmingham, Ala., says his firm traditionally structured clients' stock portfolios with 75% as the long-term core portion. These investments would be held through varying economic and market climates and sold only if their fundamentals changed. Mr. Welch could invest the remaining 25% tactically—in stocks or other assets, including cash—depending on where he judged the market was heading.

That strategy worked for years, as the tactical portion allowed Mr. Welch to make up for short-term losses or flat performance in the core portfolio. But it wasn't enough to shore up portfolios during last year's market rout. So, he says, "we increased our tactical equity allocation to 35% to 40%."

The core portion is now made up primarily of portfolios holding large value stocks, which appear cheap based on measures such as price/earnings ratios, while the satellite portion currently holds emerging-market and other foreign stocks, high-yield bonds, commodities and small U.S. stocks.

Mr. Welch says he uses exchange-traded funds, rather than mutual funds, in the satellite portfolio because they allow him to do intraday trades and their expense ratios are generally lower. What's more, he says, some mutual funds charge a redemption fee of between 0.25% and 1% if an investor sells after holding them for less than a specified period—typically between 90 days and one year—whereas ETFs do not.

Among the ETFs in Mr. Welch's portfolios are [iShares MSCI EAFE Index](#), which tracks an international stock benchmark; [iShares MSCI Emerging Markets Index](#); [Vanguard Extended Market Index ETF](#), an index fund of small and midsize U.S. stocks; ; and [PowerShares DB Commodity Index Tracking Fund](#).

Similarly, RegentAtlantic has decided to take more leeway in making changes to client stock exposure as needed. The firm runs a probability analysis every two years or so for each client, or more frequently when circumstances change dramatically, to determine how much should be held in stocks to give the best chance of meeting retirement goals with the least risk.

It used to be that once the stock allocation was set, "we never moved it up or down—if it was 60% equities it would stay that way," says RegentAtlantic adviser Christopher Cordaro. "In hindsight, that was too rigid. We have increased flexibility, so if we reach a point where we think stocks are overvalued, we could reduce exposure to them."

The firm, under its new policy, can now move a stock allocation up or down within about a 20% range, Mr. Kazanchy says. "More conservative portfolios have a tighter band. And the more aggressive ones have more latitude," he says.

Wide-Ranging Funds

Flexibility has also been the buzzword at Mr. Enright's firm, which traditionally invested exclusively in mutual funds that pick investments according to a specific style within certain asset classes—for example, a stock fund that holds only value stocks or a bond fund that focuses on long-term corporate bonds.

"Now we've moved away from that for 10% of our assets, and we're inviting in different funds with flexibility" in the securities they hold, Mr. Enright says. He adds that these types of funds may lag behind stock indexes in good times, but in market declines the manager may stem losses by pulling out of losing asset classes and moving into more stable ones without any limits.

Mr. Enright says he uses two funds from Allianz SE's Pacific Investment Management Co. that can roam across asset classes and also short securities. One, [Pimco All Asset All Authority](#), largely invests domestically. Over the five years through August, the fund's institutional shares returned an average 6.8% a year, while the Standard & Poor's 500-stock index gained an average 0.5%. The second, [Pimco Global Multi-Asset](#), is similar in strategy but has no geographical limitations. It was launched in November 2008 and is up 13.2% so far in 2009.

Mr. Enright also likes [Caldwell & Orkin Market Opportunity](#) and [Hussman Strategic Growth](#). These funds roam across stocks, bonds and cash and short securities to keep a low correlation to both stock and bond indexes—and to each other.

Over the past five years, the Caldwell & Orkin fund has returned an average 5.7% a year, and the Hussman fund has returned 3% a year.

Adding And Subtracting

In an effort to reduce liquidity risk in the second half of 2008, San Francisco firm Bingham, Osborn & Scarborough LLC cleared its client portfolios of all high-yield bonds. In the credit crunch, these below-investment-grade bonds suddenly became quite hard to sell.

The shift meant missing out on the 32% return in high-yield-bond mutual funds so far this year, but the firm is sticking with its decision. "High yield had always been a part of our portfolio," says David Campbell, a principal at the firm. "But we don't want to have exposure to investments that can suddenly become illiquid. They may not ever be part of our portfolios again."

Carl Amos Johnson, an adviser at Ames Financial Planning in Peterborough, N.H., says his firm has traditionally used sector mutual funds to invest in health care, technology, natural resources and other industries.

But the firm now views such targeted bets as too risky, he says, and "we got rid of those and are investing in broad, indexed ETFs instead." The ETFs are tied to world-market indexes, and the firm's exposure now approximates the world-market capitalization of 50% in U.S. stocks and 50% in foreign.

Darlene Murphy, a financial planner and accountant at Sudbury Wealth Management in Sudbury, Mass., has added precious metals as a permanent fixture in her portfolios. She caught most of the runup in gold at the end of 2008 and this year, and plans to keep as much as 5% of her clients' assets in gold and other metals for the long term.

"Gold hasn't had the best long-term track record if you look at the past 25 to 30 years. But I'm looking for safety and a hedge against inflation," Ms. Murphy says. She gets the exposure through [Permanent Portfolio](#), a mutual fund that targets a 20% allocation to gold and 5% to silver and which has been ranked in the top 1% of Morningstar Inc.'s conservative-allocation category for the past three, five and 10 years.

Of course, many of these strategies are at odds with each other: Some advisers are dumping targeted investments and choosing broad index funds, and others stepping up their tactical bets. That echoes the perennial debate over whether to take a passive or active approach to investing, says Deanna L. Sharpe, associate professor of personal financial planning at the University of Missouri in Columbia.

"I'm afraid this is a debate that will probably never be resolved," Dr. Sharpe says. But investors shouldn't preoccupy themselves with which approach—passive or active—their financial planner takes. Instead, they should make sure their planner's changes suit their long-term goals and appetite for risk.

More important than classifying a planner as an active or passive investor, Dr. Sharpe says, is "actively managing your relationship with those managing your money."

--Ms. Hube is a writer in Westport, Conn. She can be reached at reports@wsj.com.

Copyright 2009 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com