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ALLOCATION: West L.A. financial planner Joel Framson says his clients' portfolios have more of an international flavor these days. ANNE CUSACK Los Angeles Times

Low-Return Market Calls for Discipline

Planners stress portfolio diversification as well as looking for value in nontraditional funds.

By JOSH FRIEDMAN
Times Staff Writer

For American investors, 2005 has been uninspiring. The most popular domestic stock funds are posting gains of about 3% to 5%, and bond funds are earning even less.

That beats the losses of the 2000-02 bear market, but it's a far cry from the 1990s — when double-digit annual returns were almost a given.

For professional financial advisors who get paid to guide other peoples' portfolios, the climate of low returns on bread-and-butter U.S. funds poses the challenge of how to meet clients' goals without taking undue risk.

Many financial planners say they're stressing several of their long-standing favorite themes, such as broad-based portfolio diversification, while also looking for value in nontraditional mutual funds — including some sectors that have been on hot streaks in recent years.

Joel Framson, a financial planner at Silver Oak Wealth Advisors in West Los Angeles, said his clients' portfolios had more of an international flavor and more

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commodity-focused funds these days. International stock funds gained an average of 11.8% in the first three quarters, and some commodity-fund categories fared even better, including natural resources, which rocketed 40.6% as energy prices escalated.

"Ten years ago I was much more comfortable using tradi-

tional stock-index funds and asset-allocation models, but the market and the investment environment have changed, especially since 2000," Framson said, pointing to the bursting of the technology stock bubble.

Where the traditional basic portfolio consisted of 60% stocks or stock mutual funds (primarily from the U.S.) and 40% fixed income such as bonds or cash, Framson said his typical client today had only 40% to 50% in stocks, with "a good portion" of that in non-U.S. shares.

Framson also likes funds that invest in commodities, both those that focus on the energy sector and those that are more

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QUARTERLY MUTUAL FUND REPORT

Squeezing Out Extra Returns

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diversified. His clients in the Pimco Commodity Real Return Strategy fund (which uses so-called derivative securities to invest in a range of commodities from aluminum to zinc, as well as inflation-indexed government bonds) benefited from a gain of about 25% in the first three quarters.

Framson is among those who believe Wall Street could be in for a low-return market that lasts five to 10 more years, echoing the 1966-82 period, when blue-chip stocks went nowhere. That could continue to drive money into alternative investments, creating or sustaining bull markets elsewhere.

"Some people would say I'm 'market timing,' but I see it more like identifying macro trends and being responsive," he said. "Our role is kind of like the Old West scouts: You get the lay of the land, and you change the wagon trail depending on how high the mountain range is."

Even if single-digit returns end up being the rule on Wall Street for years to come, financial planners say a disciplined approach to deploying their clients' assets among different investment categories can squeeze out extra returns.

The process "is counterintuitive, but works," said planner Cynthia L. Conger in Little Rock, Ark.

One client of hers, with a 5% allocation to the natural resources industry sector via the Vanguard Energy fund, recently saw that holding shoot up to nearly 7% of his portfolio in less than a week thanks to the oil boom. Conger sold enough shares of the fund to get the weighting back to 5%.

"It's a disciplined method for harvesting gains," said Conger, who noted that the fund zoomed 49.7% in the first three quarters.

"Most people want to hold on to things that have done well," she said, "but this way you're forced to sell high and buy low, and in the long run that's how you can outperform the expectations."

Advisors whose clients need current income say they're giving extra consideration to steady investments such as mutual funds that focus on dividend-paying stocks, and immediate annuities, which offer a lifetime

What investors are buying

Here are the mutual fund categories that have attracted the largest net cash inflows this year. The list is dominated by relatively conservative funds (portfolios that mix stocks and bonds) and by foreign stock funds.

Fund category	2005 net cash inflow (through August, in billions)
Moderate allocation (stock and bond mix)	\$34.9
Intermediate-term bond	23.3
World allocation (stock and bond mix)	19.3
Foreign large-cap blend (growth and value stock mix)	19.0
Mid-cap value stock	14.8
Conservative allocation (stock and bond mix)	14.2
Foreign large-cap value stock	11.6
Natural resources	11.3
World stock	11.2
Foreign large-cap growth stock	8.8

Source: Financial Research Corp.

Los Angeles Times

stream of payouts similar to an old-fashioned pension.

Conger said bond portfolios that historically had generated 6% to 7% returns were now producing 4% to 5%. For income-oriented clients, she is shifting some money from bonds into dividend-paying stocks, and "judiciously" capturing capital gains by selling appreciated investments.

Funds that own a mix of stocks and bonds also have been popular this year as investors seek out income as well as growth potential.

Advisors whose clients are retired and either have no traditional pension or insufficient Social Security income to cover their necessities are looking hard at immediate annuities, said Sheryl Garrett, head of Garrett Planning Network Inc. in Shawnee Mission, Kan., an advisory service that caters to ordinary investors.

"The industry has recognized that the most important factor to retirees is the concept of security — not how much stuff you can buy," said Garrett, whose nationwide network of 250 planners charges by the hour with no minimum asset requirements,

unlike many independent wealth managers.

Garrett said planners affiliated with her network increasingly are viewing immediate annuities as a viable option for their clients, "almost like another asset class."

Although deferred annuities have been criticized over the years for high fees and contract restrictions that limit investor access to the money, immediate annuities have been far less controversial.

An immediate annuity offers a payout stream like a traditional company pension upon retirement. The investor puts up a lump sum in exchange for regular monthly payments guaranteed for life.

Because those payments are based on interest rates at the time of purchase, Garrett said she would consider waiting a year before making at least part of an immediate annuity purchase. Garrett said interest rates could be higher a year from now, meaning an investor might be able to lock in a better payout rate.

Searching for extra returns, some planners say they are using hedge fund strategies, which are

aimed at succeeding whether Wall Street sees bull or bear markets.

"I call it shopping for solutions in a low-return environment," said planner David Diesslin of Diesslin & Associates in Fort Worth.

Diesslin is using funds of hedge funds to replace part of the bond portfolios for his wealthy clients. Hedge funds "hedge" their bets with various complex strategies, and are restricted to rich investors because they presumably can afford the risk.

Diesslin said he also used mutual funds that had adapted some hedge fund strategies, such as the Gateway fund. Gateway, which invests in stocks but also uses options to try to limit the risk of market downswings, gained 4.2% in the first three quarters and has averaged 7% annual gains in the last 10 years with less volatility than most pure stock funds.

Options, commonly used as a hedging tool, allow investors to bet on the direction of an index such as the Standard & Poor's 500.

Diesslin said one strategy he had cautioned investors against was loading up on real estate. He said he had warned several clients that buying investment properties at appreciated levels could prove risky, including a California couple in their 50s who wanted to buy a second home in a resort area.

Diesslin cautioned them that rental properties typically produce negative cash flow for their owners, and that housing values could fall 20% to 30% if the market cools.

"I asked them, 'How would you like it if the house makes it so you have to postpone retirement?' It was a risk they weren't willing to take," he said.

For their part, investors say strategies such as classic portfolio diversification have kept them from fretting too much about the fortunes of the stock market.

"If your investments are spread out, among different types, whenever the stock market is down something else is probably doing OK," said Ken Molina, 46, a real estate agent in Silver Lake whose portfolio includes investment properties, stock funds, annuities and cash.