

The Colorado Springs BUSINESS JOURNAL

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WE MEAN BUSINESS

May 1, 2009

DARE TO BE DULL

Three bad alternatives to the market

Despite the stock market showing some signs of life during the past month (the fastest bull market since 1938), investors are exploring new ways to build wealth.

Interest in stocks and real estate has cooled to say the least, while high-yield bonds, gold and annuities are on fire. Let's look at each.



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R O T H

High-yield bonds

With Treasuries paying well under 1 percent annual interest, I'm frequently asked about these bonds. Some high-yield bonds are paying more than 10 percent annual interest, and owning a bond in a company is more secure than owning stock in that same company.

But before you jump in, remember that these high-yield bonds are also known as "junk bonds," such as those issued by General Motors.

Anyone believe these are secure?

I'm a believer that the role of bonds is to act as the portfolio's shock absorber. Last year, the U.S. stock market lost 37 percent, yet a high-quality bond fund like the Vanguard Total Bond Fund (VBMFX) earned a bit more than 5 percent. It served that role well and cushioned the fall of stocks.

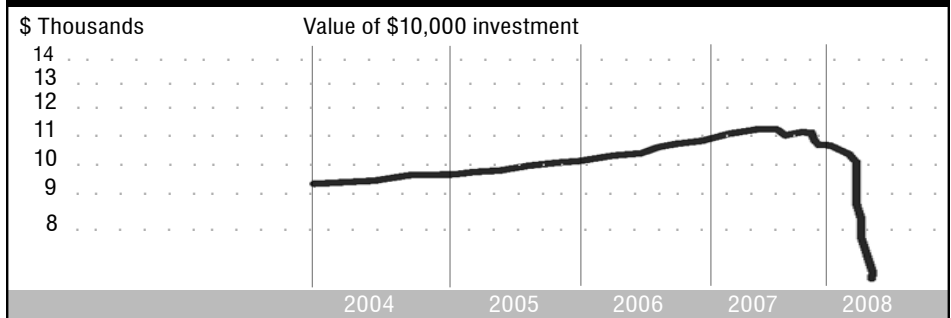
But many people come to me with portfolios that were decimated last year. In the pursuit of a little extra yield, they bought funds like this Schwab YieldPlus ultra-short fund (SWYPX) that lost more than 35 percent of its value last year, nearly as much as the stock market.

And for those thinking it will bounce back this year, it's down more than 15 percent as of the time of this writing.

There is a long list of safe-sounding bond funds that got creamed last year, such as the Oppenheimer Core Bond fund (OPIGX) that lost nearly 36 percent. Ironically, they were billed as the safe part of a portfolio.

Although I'm not completely averse to junk bond funds, I do tell my clients to limit such

The Schwab YieldPlus fund was billed as a safe alternative to money market funds.



investments and consider it part of their risky portfolio.

Gold

Other than high-quality bonds, about the only investment that did well was gold. With our government, and others, printing money as fast as they can, there's talk that gold is going to continue to skyrocket. While this is possible, I wouldn't go overboard.

Let me confess that back in 1980 I bought gold at \$664 per ounce with the college graduation gift I received from my parents. Since oil was skyrocketing, inflation was running rampant and the economy was diving, I was sure that gold was about to be worth a few thousand dollars an ounce.

Didn't happen.

In actuality, my investment has badly lagged inflation, but I still consider this the best investment I ever made. Why? Because it taught me I wasn't nearly as smart as I thought I was.

I am a believer in precious metals, although I lean more toward stocks of precious metals and mining companies, as well as limiting the investment to no more than 5 percent of any portfolio.

Annuities

While junk bonds and gold can have a small place in a portfolio, annuities are another matter.

In this market, there's nothing I'd like more than to put my money into a tax deferred vehicle, like the one I heard about on the radio,

that would guarantee me a minimum of 7 percent annually.

So, let me make an offer to any insurance producer: If there really is such a thing, bring it on. I'll not only buy it, I'll write a column about it every month for the rest of this decade! Any takers?

If there actually were such a product out there earning a risk-free 7 percent, do you really think institutions would be buying U.S. Treasuries paying less than 1 percent? The people selling these annuities are merely taking advantage of the anxiety that we are all feeling about the market by offering faux guarantees.

My advice

Keep your safe money safe, and make sure your fixed income is mostly backed by the U.S. government via CDs and bonds. Don't get greedy and chase an extra 0.5 percent annual yield only to lose a third of your total investment.

And if someone promises you a 7 percent annual guaranteed yield, just ask them if that payment is in cash. If they say yes, please have them contact me.

Like any investor, I want the upside of the market without the downside risk.

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