Private Banking Focus

Stocks, bonds and ... gold bars?

As the stock and bond markets turn more unpredictable, wealthy folks turn to alternative – and, they hope, more dependable – investments

By Audrey Hoffer

Turmoil in financial markets and an increased frequency of black swan events – deviations from the norm – are driving an intensified search for alternative investment classes, from art collections to vintage wines.

Washington-area institutional and individual investors are exploring alternative assets to diversify their portfolios, striving for higher and safer returns.

"In the old days, a financial adviser would build a 60-40 portfolio," said Peter Tanous, president of Lepercq Lynx Investment Advisory in the District. "Sixty percent would be invested in stocks and 40 percent in bonds to provide stability, reduce volatility and provide income."

Today, portfolios cannot be constructed that way because of the increasing likelihood of an inflationary environment in which long-term bonds will go down in value, while current bond yields provide little income.

"No one today should own long-term bonds," Tanous said, "so managing this market volatility demands diversifying assets."

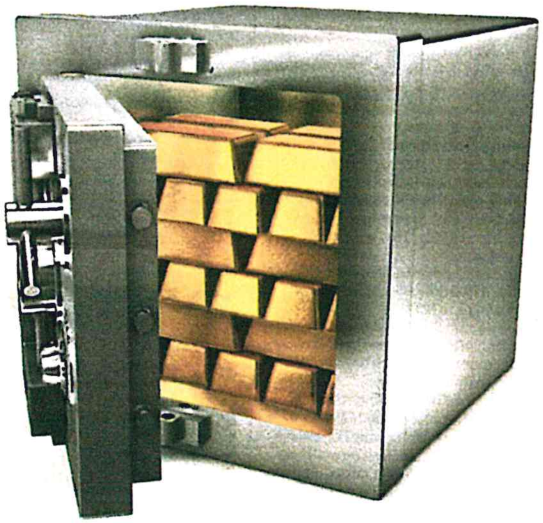
His recommendation? Real assets – gold, oil, timber, water – characterized by little or no substitution and by rising demand and diminishing supply, which means their value is less likely to be eroded by inflation.

"Inflation is coming because it's the only solution for Europe and the U.S. to get out of a huge mountain of debt," Tanous said. "A dedicated allocation to inflation protection is essential."

Stacy Schaus, executive vice president and D.C. practice leader of Pacific Investment Management Co. LLC, agreed on the need for real assets.

"D.C. plans are embracing assets such as Treasury Inflation-Protected Securities (TIPS), commodities and real estate, both to add diversification and as a hedge against inflation," Schaus said.

So what should the modern portfolio look like? The parameters of a portfolio have expanded to include alternative investments comprising tangible assets – art, wine, antiques, stamps, coins and real estate – and financial assets, such as private equity in a business or two.



"In general, alternative investments are designed to provide lower volatility exposure because they have different return streams and lower correlated asset types," said Bob Boyda, senior managing director of the portfolio solutions group at Manulife Asset Management LLC. "However, alternatives can be difficult to analyze and dangerous for investors to use without the guidance of an investment professional."

In this region, said Gerald Hanweck Sr., a professor of finance at George Mason University's School of Management, "tangible assets don't have wide acceptance among the investment community because it can be a daunting task to understand how the return will be generated, and most people don't have the knowledge or time to research."

For people who do pursue those investments, "what it comes down to is more of an abiding interest in the thing than even the money, whether it's gold, antique cars or antique fire engines," Hanweck said.

One risk of alternatives is that you may not be able to sell them as quickly as you can traditional assets, such as stocks, which adds uncertainty to the value of your investment.

Take gold, for example. How much should you expect to earn? Generally, three times the value in two years, Hanweck said.

"People who've invested in gold, like many who collect family jewelry, are waiting for the price to go over $1,600 an ounce," he said. "Now it's about $1,590, down from $1,800 last year when all hoped it'd go to $2,000. That's the risk, and to accept it requires understanding."

Art is evolving as another alternative asset.

"People buy art to feed their souls, but there are other reasons as well, including as an investment, for prestige and the cultural advantage of their children," said Royce Burton, a dealer with Burton Marinkovich Fine Art, a gallery in D.C.'s Dupont Circle

"The safest bet for a good return is to buy the best piece by the most successful artist in the style and period you like and put it away to ripen," he said. "Good art always keeps its value relative to the market and is less risky than most speculative investments in today's economy."

In 1989, Burton helped a client buy an Andy Warhol screen-print for $1,600. It recently sold for $16,000.

"In my field, contemporary art on paper, works by Richard Diebenkorn, Helen Frankenthaler, Robert Motherwell and Ken Noland are doing well now," he said.

Works on paper by those artists range from $5,000 to $100,000 with a top end around $250,000.

Old maps are another possibility. An early city plan of D.C. published in 1792 and prepared by Andrew Ellicott, a city planner who worked with Pierre Charles L'Enfant, is an example. The Old Print Gallery in Georgetown is selling this 9-by-11-inch plate engraving for $18,500, said staffer Caroline Bonardi. "It's in excellent condition and rare."

"People ask us where this or that item will be in market value in 10 years, and we say most will go up," she said. "We're seeing people who aren't hesitating to buy big-ticket art and antiques as investments."

There are also people who see the long-term market value of high-end wines, said Tim O'Rourke, general manager of Weygandt Wines in D.C.'s Cleveland Park neighborhood, who manages a portfolio of top boutique French wines. "They travel, know producers and taste out of a barrel. They know exactly what they're after."

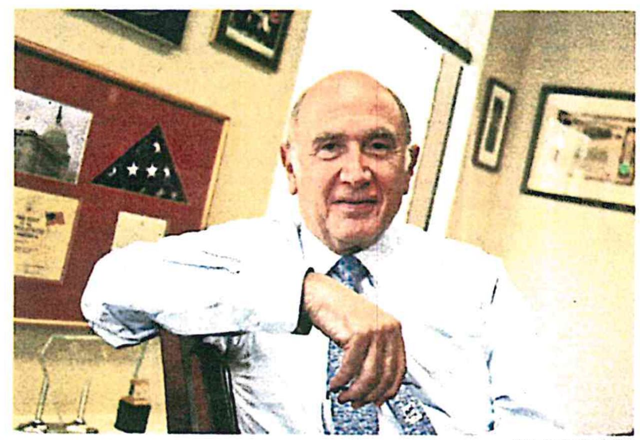
He sold a bottle of 2002 Bernard Dugat-Py Chambertin for $1,000 about 2½ years ago. Today, it can be found on auction for more than $2,000. The creme de la creme of wines, Domaine de la Romanée-Conti Romanée-Conti, sells for more than $15,000 per bottle.

"Burgundy lovers drink these wines, but when they know the provenance they often buy as an investment and keep in their cellars two to 35 years," O'Rourke said.

Certain vintages of Burgundy, such as 2007, may offer only a 5 percent uptick in value after a couple of years, but other vintages can garner as much as 200 percent in gains over five years.

"As interest in alternative investments grows, there's a move away from purely stock and bond portfolios in favor of a more widely diversified asset allocation," Tanous said. "Asset managers can design profitable strategies with the goal of increasing portfolio returns while hedging against inflation and market risk."

Audrey Hoffer is a freelance writer based in D.C.



JOANNE S. LAWTON / STAFF

To counter the troubled times for stocks and bonds, investment adviser Peter Tanous recommends a portfolio that includes tangible assets like gold and oil.

Private Banking Focus

Wealth of advice

Wealthy individuals face no shortage of places to put their dollars, especially if they're eyeing something other than the traditional slate of stocks and bonds. Four local wealth management experts tell us what their best advice is when it comes to branching off into alternative investments.

Mitchel Schlesinger
Managing director
FBB Capital Partners, Bethesda

Our best advice for alternative assets is to understand the risks involved – some of them are not so obvious.

First and foremost is liquidity. Like the old Paul Masson slogan, "We will sell no wine before its time," investors may not be able to sell their alternative assets when cash is needed. The money is tied up until the investment has fully ripened. In some sectors, like land, the investment time horizon may be measured in decades rather than years. And many alternative assets are "unique" and not fungible. One can't simply substitute a 1949 Ferrari Barchetta for another vehicle, unlike with say barrels of crude oil or shares of stock in a public company.

Second are the costs involved. If your assets need to be sold through a specialist broker, a consignment shop or via an auction process, be prepared to give up a significant portion of the proceeds to the dealer. Moreover, you may be paying a big premium to keep those valuables stored and insured. This is especially true with art, rare books, gems and coins.

The third is price. While many investors simply expect their assets to appreciate ad infinitum, the final value they realize is uncertain and subject to the vagaries of a negotiated market. Art auctions are a good example. Once in a while, the final price far exceeds the auctioneer's estimate, but many times they often fall far short. This can be because of changes in general wealth – which is often correlated to the stock market's performance – or because of something as unpredictable as fashion trends. And don't forget, sometimes the wine goes sour.

Hilda Ochoa-Brillembourg
Founding partner, president, CEO
Strategic Investment Group, Arlington

There are many types of alternative investments. Hedge funds and private equities are usually included in that category, but wealthy individuals, collectors or investors may go into art, rare books, coins, stamps and others assets with varying degrees of expertise behind them.

In making any investment, stocks, bonds or alternatives, I believe there are three simple rules to follow: One, make sure you are not buying at or near a market peak, when everyone is touting their success. Two, make sure you truly know what you are getting into and have reasonable expectations of expected return over a long enough horizon and expected volatility and illiquidity – all investments are volatile, and under extreme conditions can be illiquid. And three, make sure you are sufficiently diversified and have intelligent analytical support.

The most serious risk an investor faces is following a crowd over a cliff and not being well-diversified. Investing is never easy. You have to have a long horizon, realistic expectations and a well-diversified portfolio, with sufficient liquidity to meet unexpected cash flow demands. Greed and fear are generally powerful motivators and your worst enemies.

Barry Glassman
President
Glassman Wealth Services LLC, McLean

In order to choose the right alternatives, investors should explore the why, how and what.

First, why are you investing in an alternative? For most alternative strategies, the answer is either lower risk or low correlation. In the case of lower overall risk, managers who have the ability to short, or bet against some stocks in the portfolio, typically do so to lessen the downside in case of a severe downturn in the markets.

Trend-following managed futures strategies may be as volatile as stocks, but most have low correlation to stocks and bonds. In testing why you own a strategy, a good proxy of diversification is its performance during the 2008 financial crisis.

Several years ago, the how was easy, as an illiquid hedge fund was virtually the only choice. Today, many funds have simplified their ownership structure, lowered their fees, expanded the potential for liquidity and dumped the K-1 form for a simplified 1099 when it comes to reporting taxes. In other words, don't get hemmed in by any onerous terms of a hedge fund. Ask your financial adviser for what other alternative options might be out there.

As far as what to own, I suggest deciding on a strategy first. Then decide what to own. Keep in mind that each may have its own advantages and disadvantages, and many financial advisers are limited as to which they may recommend.

Susan Traver
Washington regional president
BNY Mellon Wealth Management, D.C.

It's a tough environment for investors out there: Slow growth and low interest rates offer very little yield. Amid enormous market volatility, investors are seeing little reward and a fair amount of risk.

So it's small wonder that some investors are considering alternative investments to protect their portfolios and achieve some growth at the same time.

We hear of some qualified investors who are considering nontraditional asset classes, such as private investments in art, antiques and collectables.

While we strongly encourage diversifying one's investments, we think diversification is better achieved through vehicles that are both regulated and maintain some level of liquidity – investments that can be sold quickly if an investor needs the cash.

Items such as art, coins and collectibles are not considered as liquid as, say, stocks, and therefore carry more risk.

For that, and other reasons, we don't see our clients turning to these kinds of investments. Instead, we continue to encourage our clients to hold on to stocks, as we believe their long-term growth potential is in a strategically diversified portfolio.

By diversified, we mean broader types of investments to include commodities and real estate, and for some qualified investors, even private investment funds that include global opportunities.

In fact, we consider a global investment strategy an important feature of diversification. For example, emerging market economies are likely to expand faster than the developed world, and that is where we see great potential for growth in the years ahead.