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Bonds, gold and other alternative investments

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AS the world's banking system teeters and commodities are rejected like baby food, equity investing as a concept seems more than a trifle old hat.

Gone are the gains notched up between the Asian economic crisis of 1997-98 and the onset of the credit crisis in 2007.

Even the Sage of Omaha, Warren Buffett, has burnt his fingers, ignoring his own advice on the folly of greed and borrowing: "When you combine ignorance and borrowed money the consequences can get interesting."

This most admired of investors admitted last week to having lost billions of dollars. "I did dumb some things," he said, when admitting to buying big stakes in two Irish banks and blowing \$US3 billion on an oil company.

The seemingly remorseless retreat in market values -- which has seriously hit super funds -- not surprisingly prompts the question: if Warren Buffett blows it, what else is there for us mere mortals?

It could be a range of alternative investments, and it could be bond funds, according to a research report from Macquarie Securities and the Investor Report. Government bonds are always appealing for their inherent backing and a chance to collect interest -- a coupon -- and in time a return of capital. Last month's \$1.2 billion federal government bond sale proves the point.

Unlike share dividends, which are paid at a company's discretion, the coupon on bonds is paid regularly unless the company goes broke.

Broadly speaking, bond prices rise when interest rates fall.

Research company Morningstar found that last year as rates fell steadily, the top 10 diversified bond funds all returned more than 14 per cent in 2008. The returns may not be as attractive this year, as interest rates are unlikely to fall by the same extent as they did last year.

Gold is another asset class worth looking at, in its various forms. The price has jumped more than 45 per cent to \$US950 an ounce since October, partly because the metal could be a hedge against a resurgence of inflation or an outbreak of recession-fed deflation.

In this climate, protected cash funds are proving popular, according to wealth managers Perennial and IOOF. The two have introduced a range of products to gain access to a government guarantee, under a so-called Perennial Protected Cash Trust, which invests in short-term interest-bearing securities that are explicitly guaranteed by the Australian Government.

IOOF head of marketing Nick Everingham says: "In times like these, most investors are looking for something that will help them sleep better at night, and the Perennial Protected Cash Trust is just that kind of investment."

In overseas markets, retail investors have rushed into bullion coins to such an extent that it has created shortages, as mints have struggled to meet demand. Premiums paid for coins can be as much as 5 per cent above the spot gold price, a level reached briefly after the collapse of Lehman Brothers last September.

Exposure to alternative asset classes, including infrastructure, private equity and direct property, has been heralded as the saving grace for the returns of those superannuation funds -- mostly industry funds -- that were early adopters of unlisted assets.

According to research group Chant West, industry funds on average performed 6 per cent better than retail funds in 2008 due to their greater exposure to unlisted assets, in particular unlisted property. Since one can never be sure what will move, diversification between and within asset classes has proved to be the best defence against volatility and the best way to benefit from the performance of different assets at different times in the investment cycle.

Research by Macquarie Securities and Investment Trends shows an overwhelming majority of planners expect to invest new client money into at least one alternative investment, with the top five products being: long/short funds; capital guaranteed funds with a fixed duration; infrastructure funds; index equity funds; and commodities and resources funds.

"Market volatility means planners are looking for investment solutions that allow them to weather the storm in these turbulent times," says Macquarie Securities Group division director Kurt Jeston.

"They want to offer their clients exposure to investments offering higher growth potential. But they have also highlighted their shift in appetite towards more transparent and simple structures," Jeston says.

"Investors will look at contracts for difference, exchange traded funds, exchange traded options and instalment warrants -- products that help manage their risks through the diversification and capital protection on offer.

"Capital protection is more highly valued than ever before as it allows investors to get back into the market with confidence."

Such thoughts are echoed by Mark Johnston of Investment Trends: "Some of the top planners prefer alternatives designed to reduce risk in a portfolio.

"These can be structured products with capital protection guarantees; infrastructure that has a steady long-term income stream, with lower correlation to traditional assets; and index funds.

"And commodities and resources cannot be ignored, at least by those who think China will continue to outgrow other economies."

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