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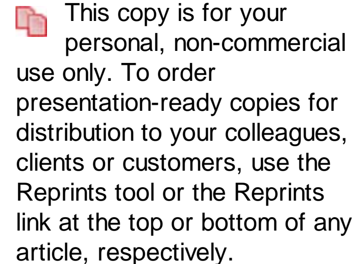

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10 investments to help your clients retire (full story)

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INVESTMENTS

to help your clients retire on time

Getting rich quickly usually depends on luck, but building up enough money to allow your clients to retire comfortably when they want to takes time, discipline and a strategy, as well as a keen eye for opportunities. The following are some of the many options available for those with the will and wherewithal to move beyond basic cookie-cutter asset allocation models. Some are more obvious than others, and none is beyond the abilities of a good financial adviser.

As with almost everything else in life, there is no one-size-fits-all answer for retirement investing, which is why each strategy should be considered in the context of each investor's situation. From there, of course, all that needs to be done is to keep paying attention, because opportunities are changing all the time.

1 Gold Gold prices are trading near record levels, and there are all kinds of reasons to think they will stay there, if not continue climbing. Although it is perfectly sensible to tap into the precious metal's ascent by either buying bullion or through an exchange-traded fund, such as SPDR Gold Shares (GLD), there is an easy gold leverage play in the form of the mining and production companies.

The price of gold, currently at about $1,200 an ounce, has been rising at an average rate of about $100 per ounce per year over the past few years. Some analysts expect the price to climb beyond $1,400 by 2011.

That is good for owners of gold, but it is even better for gold mining and production companies because their operating costs are generally fixed. This means that it costs a mining company between $500 and $700 to produce an ounce of gold, regardless of what the market is willing to pay.

Some examples of solid mining and production companies are Barrick Gold Corp. (ABX), Newmont Mining Corp. (NEM) and Oshkosh Corp. (OSK).

One thing to keep in mind is the benefits of those fixed production costs in a gold rally will lead

to smaller profit margins if the price of gold goes down.

There are also a number of mutual funds that will do the stock picking for you, including the Dynamic Gold & Precious Metals Fund (DWGOX) and the Midas Fund (MIDSX).

2 IPOs The credit crunch that came about as part of the financial crisis put a serious damper on IPO activity, virtually shutting it down from the second half of 2008 through the first half of last year.

But even though the current number of initial public offerings is well below historical levels, the market has become vibrant enough to once again represent investment opportunities.

There were 51 IPOs in the United States this year through the end of May, compared with 14 during the first five months last year and 35 during the first five months of 2008.

As an investment, IPOs need to be analyzed in the context of a life cycle, according to Josef Schuster, manager of the Direxion Long/Short Global IPO Fund (DXIIX), which Direxion Funds launched March 4.

Although most IPOs get attention and are usually well-supported by underwriters, only about 20% of all IPOs actually end up outperforming the overall market.

During the initial launch phase, strong performance is almost a given, according to Mr. Schuster.

During the second phase, which lasts about 12 months, companies tend to build momentum thanks to factors such as index inclusion, institutional-investor support and short-selling restrictions.

But it is during the third phase, between two and four years after the IPO, that most companies fall back down to reality and deserve to be sold short.

3 Water As natural resources go, there is nothing quite like water, which is the only resource that we can't live without and for which there is no substitute or replacement.

Add to that simple premise the increased demands of a swelling global population, and you have a strong argument for identifying new ways to invest across the expansive global water infrastructure.

Although not quite an official investment category yet, the so-called hydrocommerce industry is rapidly taking shape with new mutual funds and new momentum coming from the environmentalist ranks.

The Calvert Global Water Fund (CFWAX) is a recent example of how the investment community is starting to put increased pressure on corporations to be more responsible consumers of water.

Pressure from environmentalists and various socially conscious investment groups will drive innovation and development in areas such as infrastructure, sanitation and desalination, all aimed at bringing potable water to where people live.

Translated to hard numbers, consider that the global population is expected to grow by 1.2 billion to 8 billion people over the next 15 years. In the 20th century, global water usage increased sixfold, which was twice the rate of population growth.

A few of the ETFs that offer exposure to the growing water industry are Claymore S&P Global

Water (CGW), First Trust ISE Water Index (FIW) and PowerShares Water Resources (PHO).

Two individual companies that offer exposure to the growing water industry are American Water Works Co. Inc. (AWK) and Aqua America Inc. (WTR).

4 Health care It likely will take years for the full picture of health care reform to come into focus, but the case can already be made for more exposure to certain subsectors.

Biotechnology, pharmaceuticals, medical-device companies and hospital operators all represent strong investment opportunities as reform takes hold.

For hospitals, it comes down to simple math. On average, about 20% of all hospital bills currently go unpaid. But once everyone is insured, non-payment becomes a non-issue, which will directly affect the bottom line of companies such as Health Management Associates Inc. (HMA), MedCath Corp. (MDTH), Tenet Healthcare Corp. (THC) and Universal Health Services Inc. (UHS). Picking the winners might be easy and even obvious, but the real opportunities in this area could come through short selling within some of the health care sector's subcategories.

Take the area of health insurance, for example. Medicaid providers that serve the lower-income market are likely to benefit because they will be insuring a lot more people. But two types of insurers could be harmed: Medicare insurers for people over 65, which will struggle unless they can build market share in the Medicaid market, and commercial insurers providing corporate plans to employees.

The latter will come under new rules that will force companies to narrow their profit margins. Companies likely to be affected include Aetna Inc. (AET), Cigna Corp. (CI) and WellPoint Inc. (WLP).

5 Options Because staying in the market is a critical part of investment performance — particularly during choppy periods like the present when cash equivalents offer returns of next to nothing — the use of options offers a perfect tool for hedging.

Buying a put option on an underlying security can limit downside risk, and the cost of that put can be financed through the sale of a call option on the same security.

Keep in mind that just as the put will limit losses by means of a preset strike price, a call comes with a strike price that caps the returns of the underlying security.

The trade-off is usually worth it, according to a study comparing collared and non-collared versions of the PowerShares QQQ, an ETF that tracks the Nasdaq Composite Index.

Between April 1999 and May 2009, the ETF (QQQQ) generated an annualized loss of 3.6%, with a maximum decline during the period of 81.1% and a Sharpe ratio of -0.22, meaning that a riskless asset such as a Treasury bond would have performed better than the ETF.

By applying a basic collar over the same period, the ETF generated an annualized return of 9.3%, with a maximum decline of 17.9% and a Sharpe Ratio of 0.56, illustrating superior risk-adjusted performance.

6 Dividends As a long-term investment strategy, dividends are difficult to beat. During the past nine decades dividends have represented between 20% and 40% of the total return of the S&P 500.

Yet during the past decade, for reasons that likely are related to an increased appetite for

performance, investors have ignored dividends. They have done so at their own peril.

Dividends are one of the few things a company can't fake or finagle, and when dividends are reinvested, investors are forced into dollar cost averaging, regardless of market conditions.

In April 2009, for example, when the stock market was at its most recent low point, investors set up for dividend reinvestment were buying more shares at bargain prices.

In practice, it works as follows: $10,000 invested in the S&P 500 in 1930 and held through last year would have grown to $490,000 through stock appreciation alone. But if all dividends had been reinvested over the 79-year period, the original investment would have grown to $12.6 million.

The number of dividend payers in the S&P 500 has declined in recent years, but that trend is reversing.

As of the end of April, 368 of the companies in the index were paying a dividend, up from 363 a year earlier but down from 390 in 2007.

Between 1980 and 1999, there were never fewer than 400 companies in the index paying dividends, which suggests that more dividends are on the horizon.

7 Emerging markets When it comes to international equities, you have to favor emerging markets over the developed foreign alternatives.

Even with the run-up over the past few years, emerging markets are still sitting pretty because they don't face the same sovereign-debt issues looming for several members of the European Union.

One popular strategy at this point is a barbell approach that balances U.S. equities with emerging-markets equities, avoiding too much exposure to Europe.

There are always risks associated with emerging markets, but so far, the risks aren't the same as the government debt problems still being ironed out in Greece, Ireland, Italy, Portugal and Spain.

The primary difference to consider is that better fiscal health leads to more flexibility by governments when it comes to policymaking decisions, which is usually better for the markets and the economy.

For many market watchers, the case for emerging markets boils down to something akin to a negative beauty contest.

In Europe, there is the looming threat of sovereign-debt problems, and in the United States, virtually every other risk rears its head: high unemployment, regulatory uncertainty, higher taxes and swelling government debt levels.

As one market strategist put it, emerging-markets economies contract because of concerns about inflation, but in the United States, the economy contracts because of concerns about debt.

8 Bond ladders There is nothing quite like the idea of a guaranteed retirement income stream when it comes to investor satisfaction, and that is why a basic bond-laddering strategy should have a place in just about any asset allocation strategy.

A model followed almost religiously by the Alliance of Cambridge Advisors Inc., a niche association of fee-only financial advisers, uses long-term zero-coupon Treasury bonds to lock in a predictable retirement income stream.

The idea is to buy Treasury bonds that are set to mature during the first 10 or 15 year's of a client's retirement, thus building a ladder of predictable income.

Critics of the strategy cite the low yield, but laddering is more about security.

Once the income stream is guaranteed for the first several years of retirement, an adviser has more flexibility to allocate the remainder of a client's assets to equities for growth.

Depending on how the equity portion is performing as each rung of the ladder matures, an investor might sell stocks for income and use the income from the bond to purchase another Treasury bond on the long end of the ladder.

If the stock market is declining, the investor derives income from the bond.

And when the market is flat, the investor can pull equal amounts of income from the bond and equities.

9 Interest rates Interest rates continue to hover near historic lows, but when they do start rising, the best place to be invested will be the technology and health care sectors.

An analysis of the 13 rising-rate environments during the past 64 years found that the technology sector of the S&P 500 gained an average of 20% during the 12-month period following the first rate hike of each cycle.

The health care sector was the second-best performer, with a 13% average gain.

The worst-performing sectors were financials at 4% and materials at 3%.

The S&P 500, during the same 13 rising-rate cycles, had an average gain of 6.2%.

The key is to remain nimble because the markets are forward-looking, which means paying attention to factors that lead to rising rates such as inflation.

In examining each of the Federal Reserve's monetary-tightening policies between January 1946 and the most recent rate hike, in July 2006, Todd Rosenbluth, equity analyst with Standard & Poor's Financial Services LLC, identified three examples of mutual funds that should benefit in a rising-rate environment.

The Calvert Social Investment Equity Fund (CSIEX), Laudus Growth Investors U.S. Large Cap Growth Fund (LGILX) and Sit Large Cap Growth Fund (SNIGX) each have significant exposure to a combination of technology and health care stocks.

10 Closed-end funds Although closed-end funds stand out as one of the worst investments to buy at the IPO, they present plenty of opportunities once they trade in the secondary market.

The appeal of closed-end funds trading in the open market is that their shares, unlike those of an open-end mutual fund, trade independently from the underlying net asset value. As a result, many closed-end funds trade at a significant discount to NAV.

Identifying good funds that are trading at a discount is a legitimate strategy for a lot of institutional money managers, but retail investors rarely participate.

The $305 million RiverNorth Core Opportunity Fund (RNCOX) is one of the few mutual funds dedicated almost exclusively to investing in closed-end funds based on the widening and narrowing of the discounts to NAV.

Generally speaking, discounts tend to widen along with stock market declines. But the key to trading closed-end funds goes beyond just finding the most attractive discounts, which technically represent value.

The ultimate goal of this strategy is to evaluate the discount and then, just like a stock investment strategy, look for some kind of catalyst that might force the discount to narrow.

One of the more powerful catalysts is the presence of shareholder activism, often in the form of a hedge fund investor, which seeks to force the fund to work to narrow the discount.

One basic method for evaluating the discounts is to compare the current discounts with the 52-week moving-average discount.

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