Consider Alternatives to Stocks and Bonds

By Andrew Menachem

If you've invested in a stock market index fund, you are probably feeling good about that decision.   In the past year, the S&P 500 Index of leading U.S. companies has climbed about 14 percent, reaching 2,425 on June 12.

But there is no guarantee that stocks will continue to rise in the second half of the year with all the political and economic uncertainties around the world. After all, the S&P index has fallen by approximately 50 percent twice in the past 17 years, after the dot-com crash in 2000 and the global financial crisis of 2007-08.

That risk of a sudden loss is one reason many investors dedicate a large portion of their portfolios to bonds, whose values usually fluctuate much less than stocks. However, bonds typically deliver a much lower rate of return, making them less attractive, particularly during times of inflation.

Bonds can also be pummeled by global events affecting other financial markets. In 2008, for instance both the stock and bond markets fell in tandem, and many investors who felt they had diversified their holdings suffered an unpleasant surprise .

In the years since the "great recession" and slow economic recovery, many investors have recognized the potential benefits of adding alternative types of assets to a traditional portfolio consisting of stocks, bonds and cash-like securities.

South Florida investors have a wide range of alternative assets to consider, beginning with precious metals like gold and silver and real estate investment trusts (REITs) that hold commercial properties like offices, shopping centers, hotels, apartment buildings and self-service facilities.

For investors, gold is often considered as a hedge against runaway inflation or an unexpected shock to the global financial system. It can offer that kind of downside protection, but generates no interest, dividends or other income.

On the other hand, real estate, whether owned directly or through a REIT, can provide an ongoing cash flow, along with some protection against inflation through rent increases. If you own an income-producing property, such as a vacation condominium or apartment building, you may be able to receive significant tax benefits, as well. However, liquidating real estate, can take a long time and you may lose substantial.

Infrastructure funds can also deliver steady flows of income, from fees and tolls on highways, airports, bridges, pipelines, utility plants and other physical assets. Today, there is a growing need for infrastructure improvements in the U.S. and around the world, and many projects will be financed by the private sector as well as government. Discuss dangers like not backed by a municipality,

Other types of alternatives are more complex and appeal to sophisticated investors who understand both the risks, lack of liquidity, bankruptcy, and potential rewards of these strategies. For example, private equity and credit funds (what are credit funds? Qualified investors?) provide financing to business ventures seeking to grow their sales or maintain their position in the marketplace.

These private funds may be able to provide investors with higher returns than assets traded on the public markets like stocks and bonds. However, they also carry a higher level of risk, including…. and are not as liquid as shares of stock. These assets are usually meant to be held for several years, and can't be sold immediately if an investor suddenly needs the cash.

Managed futures are another type of alternative that can help diversify an investment portfolio. Historically, they have often performed well when stocks and fixed-income bonds have fallen, reducing the volatility of the overall portfolio.

Qualified investors might also consider hedge funds, which offer a wide range of strategies aimed at improving returns or reducing risk under different market conditions. Expand on "qualified"

If you are seeking to add a little more zip to your investment returns or are concerned about the risks, it's a good idea to talk with your financial advisor. Based on your goals and current situation, it may make sense to consider adding one or more types of alternative assets to your portfolio. In any case, understanding the range of alternatives now available in the market can help you make better decisions for your own financial future.

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In addition to the general risks associated with real estate investments, REIT investing entails other risks such as credit and interest rate risk. Real estate investment risks can include fluctuations in the value of underlying properties; defaults by borrowers or tenants; market saturation; changes in general and local economic conditions; decreases in market rates for rents; increases in competition, property taxes, capital expenditures, or operating expenses; and other economic, political or regulatory occurrences affecting the real estate industry.

Risks of private real estate include: illiquidity; a long-term investment horizon with a limited or nonexistent secondary market; lack of transparency; volatility (risk of loss); and leverage.