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Column for Miami Herald

The Running of the Bulls

By Andrew Menachem

Back in April, I warned about the danger of being too bullish about Wall Street. At that time, many investors were convinced that the stock market would continue to move upward indefinitely, providing strong returns on their portfolios.

Now, the pendulum has swung in the other direction and many investors are once again feeling skittish about equities. You might say it's the running of the bulls.

After the S&P downgrade of U.S. long-term debt, fear is the dominant emotion on Main Street, as well as Wall Street. Will there be a double-dip recession? What will happen to oil prices? Can our economy create more jobs?

These are very real concerns for our nation, and for investors. But the issues need to be examined clearly in an objective way – not through the emotional prisms of fear and greed.

First of all, despite the political gridlock in Washington, the U.S. economy continues to recover. While growth will continue to be slow, I believe there will not be a double-dip recession. For investors, that means there may still be attractive opportunities to invest in U.S. equities – particularly the strong, blue-chip companies with global operations. Small-cap companies in sectors like alternative energy or information technology also have the potential to generate strong returns, although they are more likely to run into some market bumps along the way.

It's likely that the market turbulence of the past few months will continue into 2012, as investment sentiment swings back and forth. That's why it's important to sit back and take a few deep breaths when the Dow Jones Industrial Average soars or plummets in the day's trading.

It's also another reminder of the importance of building a diversified portfolio that includes assets like emerging market equities, corporate bonds, real estate, managed futures and municipal bonds – all topics of recent columns.

In July, for instance, I wrote that municipal bonds might be one of the summer's more successful investments, despite the plethora of negative headline news they had been receiving. Since then, "munis" have generally gone up in value, unlike the stock market. In fact, carefully chosen munis remain attractive today, since many states and local governments have cut their spending and strengthened their budgets.

Looking ahead at the coming months, I expect the global economic recovery will continue into 2012. The emerging nations like China, Brazil and India are likely to show the strongest growth, while the European community deals with its debtor nations and Japan recovers from the March 10 earthquake and tsunami.

For investors, that means now is a good time to review your assets and consider increasing your allocations to U.S. and emerging market equities. It's best to undertake this process gradually in small increments, rather than to make wholesale changes.

In general, the best time to buy equities is when prices are down and the future looks uncertain. That's because most investors follow the herd and wait until stock prices have already gone up significantly. Everyone knows the old saying, "buy low and sell high," but it's surprising how difficult it is to follow that advice in the eye of the storm.

While international investing may not be suitable for everyone and is subject to additional risk, another type of asset to consider is emerging market debt. In general, the ratings agencies have steadily upgraded their assessments of emerging markets to a BBB level (investment grade) in the past decade. In our hemisphere, for instance, Brazil, Colombia, Panama and Uruguay were recently moved up to the investment-grade category. That's not as strong as AA rating that S&P gave the U.S. or the AAA rating from Fitch, but clearly these Latin American countries, like others around the world, are managing their fiscal affairs more responsibly than in the past.

Since emerging market sovereign and corporate bonds generally offer significantly higher returns than U.S. Treasuries, which are guaranteed by the U.S. government if held to maturity, investors should consider whether it makes sense to add emerging market debt, as well as emerging market equities to their holdings.

In such a turbulent market environment, having a well-balanced portfolio with many types of assets can reduce your overall investment risk, deliver stronger returns over the long-term and help you sleep better at night.

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