

## Try broadening focus beyond the usual U.S. stocks, bonds

While most 401(k) investors have learned the importance of diversification, few have thought about what might happen if their retirement portfolios containing U.S. stock, bond and money market funds were not diverse enough.

Diversifying one's retirement savings broadly across these traditional fund categories has been a successful strategy for the past 20 years. Looking ahead to the next 20 years, however, this approach to diversification could prove less effective.

Industry experts predict that the future performance of most traditional U.S. stock and bond funds will disappoint investors who have come to expect the double-digit returns of the 1980s and '90s. And in your 401(k) account, disappointing investment performance could require you to save more, work longer or enjoy a less comfortable retirement.

### Time for a review

Given the potential severity of the consequences, now is a good time to ask yourself whether your retirement portfolio is diversified enough to meet your investment objectives if interest rates rise and the U.S. stock market stagnates.

Many 401(k) investors need to adjust their long-term U.S. stock and bond fund performance expectations, as well as improve their investment diversification. Some of the brightest minds in the investment business are acting on these same concerns with their long-term investment assets.

Yale University is a good case in point. The Yale Endowment Fund, an \$11 billion portfolio, has a target allocation to U.S. stocks and bonds of only 22.5%, according to its annual report. So where is the other 77.5% invested?

It has been diversified to capture ownership returns from alternative assets. Specifically, a meaningful percentage of Yale's long-term assets are invested in foreign securities, as well as "real assets," such as oil and gas, commodities, real estate and timberland.

These investments are not only expected to generate solid long-term returns, but also act as powerful portfolio diversifiers because they can do well when U.S. stocks and bonds are lagging.

### The global connection

What could drive U.S. markets down and these alternative equity markets up?

Economists believe that, as new technologies connect developing countries with modern economies and bring nearly half the world's population into the global work force, global capital markets will be affected.

This explosion of cheap labor, armed with the newest technologies, is driving profits up for the developed world, while simultaneously transferring jobs to and speeding up the economic growth of emerging nations.

The resulting lower labor costs will alter the complexion of worldwide consumption and market share as these emerging countries grow at a rate two to three times faster than the U.S. This could drive the dollar lower as these rapidly growing countries grab a larger share of the world's resources.

The last time the world was fighting for scarce resources on this scale was the mid-1970s, after the OPEC oil embargo forced world energy prices to skyrocket. This was not a great time to be "diversified" into only U.S. stocks and bonds.

### Looking at the record

Many years of investment data demonstrate that different types of equity investments come into and go out of favor.

During the '70s and early '80s, most financial equity instruments lagged the returns from real estate, precious metals, and oil and gas investments. In recent years we've seen the reverse, which is all the more reason to think twice before placing all your retirement savings into U.S. stocks and bonds today.

That's not to say you should make a major move away from U.S. stocks and

bonds. These investments are important components of a well-diversified portfolio. Stock funds will always be attractive as long-term investments, while bonds provide a degree of stability and safety.

What we are advising is that 401(k) investors broaden their horizons beyond stock, bonds and cash. In short, build a better portfolio by adding alternative asset classes.

Good examples include foreign, especially emerging market, funds as well as funds tied to real assets. A broader investment strategy should help lessen the risk of your retirement savings stagnating for a lengthy period of time, or worse, dropping precipitously in a sell-off like the one we saw in 1973-'74.

If you're not comfortable with alternative asset classes or not sure how to incorporate them into your portfolio, seek help. It is important that these categories are used properly within a portfolio and not overdone. Many employers now make advisory services available through their savings plans, so if yours does, take full advantage.

Bottom line, the concept of 401(k) diversification is evolving, and you should consider expanding your retirement portfolio to include new investment categories that will better prepare you for the years ahead.

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