

## Alternative investments to stocks, bonds may be best now for a 401(k)

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Over the past 20 years, 401(k) investors have invested almost entirely in U.S. stocks and bonds, but a growing number of experts suggest that this may not be the best strategy for the next 20 years.

Warnings about the possible overvaluation of U.S. equities and the potential for rising interest rates could mean it's time to consider alternatives to what have traditionally been the 401(k) investments of choice.

It's not surprising that 401(k) investors are currently so heavily invested in U.S. stocks and bonds, given that 401(k) plans came on the scene in 1981 - the very beginning of the strongest bull market in history and an extended period of falling interest rates.

In fact, according to the Employee Benefit Research Institute, the average 401(k) account balance, approximately \$58,000, is invested 62% in U.S. stocks and nearly 30% in U.S. bonds and guaranteed vehicles.

Past successes do not make this strategy right for the future, especially given the increased chance that U.S. stocks and bonds could underperform for an extended period.

Think it can't happen?

In January 1966, the U.S. stock market, as measured by the Dow Jones Industrial Average, peaked at 1001 and didn't move significantly higher until December 1982. During this 16-year period, an index fund would have gained no ground and would have lost significant value when adjusted for inflation. During this same period, interest rates rose from 5% to 14%, as measured by 10-year Treasury yields, making bonds an even worse option.

As an investor, your challenge is to stop fixating on past performance and start considering the best place to be in the future. The question then becomes, where are the best places to put your money?

Pension industry experts have begun talking of a fledgling "revolution" in pension investing as meaningful pools of money have begun flowing out of U.S. stocks and bonds into "alternative" asset classes. Alternatives include:

**Foreign stocks and bonds**, particularly those from "emerging" countries that are generally less developed economically and therefore less closely tied to the growth rate of the U.S. economy.

### **Inflation-sensitive investments.**

For equity investors, natural resources such as precious and non-precious metals, energy (oil, gas, coal), timber and raw land all hold the potential for appreciation in an inflationary environment. For fixed-income investors, the U.S. government has begun issuing securities that lock in an income stream and adjust the income and principal invested upward based on the rate of inflation.

**Publicly traded real estate**, also known as real estate investment trusts, or REITs, offer investors participation in the income stream generated by commercial real estate such as office buildings, apartments and shopping centers, as well as a limited amount of appreciation potential, particularly if interest rates fall.

**Absolute return funds.** These are most commonly known as hedge funds and were previously available only to the wealthiest individuals and large institutions. These funds are increasingly available through registered funds to a broader audience. Most are structured as partnerships and utilize various arbitrage strategies designed to generate positive returns in both up and down markets.

**Private equity investments.** These privately negotiated transactions generally involve a substantial investment in a non-public company. They require a significant commitment of legal and due diligence resources and are therefore appropriate

only for sophisticated investors with large pools of capital.

While many of the above-mentioned "alternative" investments are not currently available in 401(k) plans because of concerns regarding excessive volatility, lack of liquidity or high costs, they represent the fastest-growing segments of the institutional asset management world.

As Wall Street figures out how to mitigate these risks, you could see some of them appear as investment options for your plan. Alternatively, you could consider them for investments outside your retirement plan.

The rising popularity of these alternative investments will continue to attract attention in part because of their ability to generate positive results while U.S. stocks and bonds are performing poorly, as we saw during the recent three-year bear market for U.S. stocks.

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*Alternative investments are not appropriate for all investors and can involve significant risk. Be sure to consult a qualified investment professional before investing. Michael J. Francis of the Francis 401(k) Advisory Group at Smith Barney is senior vice president of Citigroup Global Markets Inc., a member of SIPC, in Pewaukee. Francis can be reached at [michael.j.francis@smithbarney.com](mailto:michael.j.francis@smithbarney.com). The information contained here is provided for informational purposes. The preceding summary has been obtained from sources Smith Barney believes to be reliable, but Smith Barney cannot guarantee its accuracy or completeness. Neither the information nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. Past performance does not guarantee future results. Smith Barney does not offer personal tax or legal advice. Smith Barney and Consulting Group are divisions of Citigroup Global Markets Inc., a member of SIPC.*