

# PERSONAL JOURNAL

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**GETTING GOING** | By Jonathan Burton

## What Your Portfolio Really Needs

**F**eeling whipsawed by this market? It's times like these when a diversified portfolio is supposed to pay off. But with so many exotic choices out there, it's hard to know what diversification really means.

These days, what happens on Wall Street doesn't stay there. Gyrating U.S. stocks affect Europe, Asia and elsewhere, as has been painfully evident recently to investors seeking shelter from the markets' torrential storms.

So why diversify? Two words: risk control. Diversification keeps several pots simmering at once. It's a curious fact that adding riskier assets to a portfolio actually makes it safer. The key is how much of each ingredient you use. Ultimately that depends on your taste, but if Julia Child had been an investment adviser, she would have told you that a little spice goes a long way. Putting 5% of a portfolio in emerging-market stocks and 5% in real estate, for example, has been shown to boost returns and lower volatility.

It turns out that when viewed over many years, markets aren't so intertwined after all. Stocks in the U.S. and other developed countries take independent paths, and emerging economies are in another orbit. Stocks have even looser ties to bonds, real estate, commodities and other alternative investments.

Your options, however, seem endless. Some tap vital markets; others are just clever marketing. Confused? Here's what you really need to diversify, what's nice to have and what you can do without.

■ **Need to have.** Stocks: Fundamentals apply. Own shares of large and small companies—only now when you buy locally, think glo-

bally. The big companies in the Standard & Poor's 500 Index, for example, generate almost half of their sales outside of the U.S.

With a conservative allocation of 60% stocks, for example, give brand-name S&P 500 stocks 35% of the portfolio and small caps 5%. Then earmark 15% to an international index fund that holds companies of all sizes, plus another 5% to a geographically dispersed emerging-markets fund.

**Bonds:** The subprime mortgage mess is tainting bonds. Avoid trouble by investing in U.S. government bonds and other top-quality issues. Bonds provide regular income, so they're a terrific diversifier, and over time show decent returns. Long-term Treasuries, for example, have delivered three-fourths of the S&P 500's 11.7% annualized gain since 1989 with about 60% of stocks' volatility, says Ibbotson Associates.

Bond prices fall when interest rates rise, and vice versa. Longer-dated bonds are susceptible to rate changes, while short-term issues are insulated. Cover yourself with a "laddered" strategy of one-, three-, five- and 10-year debt. Consider Treasury Inflation Protected Securities, or TIPS, which unlike most bonds will hold their value as the cost of living climbs.

"Have the core of your portfolio in stock index funds and bond index funds," says John Bogle, founder of mutual-fund giant **Vanguard Group**. "That's the way you will capture the largest percentage of returns that a business earns."

■ **Nice to have.** Real estate: Home ownership

is probably enough real estate for most of us. But property does act differently from other investments. A 5% stake in a mutual fund or exchange-traded fund that owns real-estate stocks or real-estate investment trusts should do the job. Again, think globally—the world is getting wealthier, and as the saying goes, they're not making any more land.

■ **Don't really need.** Sector funds: Buying a surging sector is tempting, but such bets can turn against you quickly. "Be involved in profitable businesses around the world regardless of what's hot and what's not," says Kacy Gott, a financial adviser in San Francisco. "Don't chase sectors. That's not for investors; that's for traders."

**Gold:** It insures against financial catastrophe and marches to

its own drum. But as an investment, short-term risk is high and long-term reward is marginal. If you want gold, buy jewelry.

**Other commodities:** This is a controversial call, for good reason. The price of so-called hard assets is soaring. China, India and other fast-growing countries need oil, natural gas, metals and materials to fuel development. Demand for agricultural products is also high.

You can play this trend with funds or ETFs that own a basket of commodities, and yes, you'll get diversification. But in truth, you'll do fine without direct exposure.

"Commodities are way overhyped as an asset class," says Jeremy Siegel, a Wharton School finance professor. Instead, he'd buy stock in oil producers, mining companies and other businesses that stand to profit from this global boom.

*Jonathan Clements is on vacation.*

### How to Diversify

■ **Need to have:** U.S. stocks, overseas developed- and emerging-market stocks, U.S. government bonds.

■ **Nice to have:** U.S. and international real estate investment trusts and other real estate securities.

■ **Don't really need:** Sector stock funds, gold and other commodities.