



PORTFOLIO STRATEGY: Rob Carrick's ideas for managing your investments

Preparing your portfolio for a rebound

Four themes for a stock market rebound: Bonds are not as safe as you might think. Energy, mining and bank stocks beat pipeline and grocery stocks. Prepare for inflation ahead. Emerging markets are worth the risk.

There's little consensus today about whether the stock markets have turned around for good, but a new bull market will begin at some point. Now is the time to prepare.

Start by considering the government bonds and bond funds that sustained your portfolio through the stock market plunge. You love them, right? Now, it's time to reassess.

"If you were fortunate enough or smart enough to be overweight in bonds through this whole mess, you've done well and you've protected capital," said Andrew Pyle, a wealth adviser with ScotiaMcLeod. "But that doesn't mean the capital you've protected will be safe looking forward."

Here's the problem with bonds. As the global economy stabilizes and stock markets take off, bonds are going to be a lot less attractive. Prices will fall, which means bonds and bond funds will lose value. They'll continue to pay interest, but otherwise they'll be a drag on returns.

Mr. Pyle says long-term bonds - those with 10 years or more until maturity - will be hit hardest, though all government bonds will likely fall. That's why he's arranging client bond holdings so that they have an average of two or three years until they mature.

An easy way to accomplish this is to build a ladder of bonds or guaranteed investment certificates. That's where you evenly divide the money you want to invest into maturities of one through five years. As bonds or GICs come due every year, you'll take the money and reinvest it in a new five-year term.

This is important in the years ahead because, as interest rates rise amid an economic rebound, there will be higher returns available for new money invested in bonds and GICs.

The stock markets have been a



wasteland over the past year, but some comparatively decent returns were generated in sectors like consumer staples - grocery and drugstores mainly - as well as utilities and pipelines. Their time is over once the markets revive, said Avery Shenfeld, chief economist at CIBC World Markets.

"You'll want to be in the things that got beaten up in the recession - metals, energy, industrials and financials," he said. "Everything you'd put in the head-in-the-sand portfolio, you would judge as being likely to underperform."

Mr. Shenfeld said in a report this week that the stock markets could stumble once again as a result of disappointing corporate earnings and bad economic news. But we've already had a taste of what happens to conservative sectors in a market rally.

As the S&P/TSX composite index gained 11.4 per cent in the 30 days to April 16, the shares of George Weston Ltd. and Metro Inc. fell 4.3 and 2.5 per cent, respectively. Metro and Weston were bear market stars. While the S&P/TSX composite lost 33.7 per cent in the previous 12 months, Metro surged 52.7 per cent and Weston gained 16.2 per cent.

Note that the business outlook for these stocks doesn't worsen in an economic recovery. It's just that investors will see more potential to make money as

economic growth raises demand for commodities and as a healing financial system makes banks a safer bet.

For now, though, we're in recession. How big a concern could inflation possibly be?

"Huge, massive," says Tyler Mordy, director of research at the portfolio management firm Hahn Investment Stewards. He believes that the inflation rate could be quite low for the rest of the year, possibly even going into negative territory. Eventually, though, all the economic stimulus that governments around the world are working on will take hold and start driving inflation higher.

Mr. Mordy says his firm protects client portfolios against inflation through holdings in gold, widely regarded as a hedge against a rising cost of living, and real-return bonds, where interest payments ratchet higher if the cost of living increases, and so does the amount that investors get when the bond matures.

For real-return bonds, Mr. Mordy suggests a 5-per-cent weighting for balanced investors who have roughly half of their assets in stocks and half in bonds. For gold, he suggests a 5- to 10-per-cent portfolio weighting divided between investments that offer exposure to gold bullion and gold mining stocks. He said gold stocks are attractive right now because falling mining costs should

improve profits in the sector.

Part of positioning a portfolio for a market turnaround is about reducing risk. That's where real-return bonds and gold come in. But it can also make sense to add risk in order to boost returns. This brings us to emerging markets, where the benchmark MSCI Emerging Markets Index fell 48 per cent in the year to March 31 as measured in U.S. dollars.

Mr. Mordy's argument in favour of emerging markets is that they are untainted by the twin problems facing the developed world: heavily indebted consumers and a damaged banking system. This suggests emerging markets

will bounce back faster from the recession. Stocks from emerging countries are also cheaper than their developed market counterparts, and they have better growth prospects looking forward.

The trendy emerging market investment of the last bull market was the BRIC fund, which invested in companies from Brazil, Russia, India and China. To Mr. Mordy, this is a sales gimmick. He's a lot less interested in Russia, for example, than he is in China and India.

The MSCI Emerging Markets Index surged 14 per cent in March, but Mr. Mordy believes there's more upside ahead

for investors who are willing to stay put for a long period of time. "If you hold on to emerging markets for the next seven years, you're going to be very happy with the returns."

Prepare for Takeoff

There's no agreement at all on whether the stock markets have begun a sustainable recovery from the past year's losses, but a rebound will come eventually. Here are some ways to get ready, and some exchange-traded funds that may be of interest in your planning.

Theme	How to follow through	ETFs of interest
Mind the risks in the bond market.	Focus on short-term bonds, or those that mature in one to five years, and reduce exposure to long-term bonds	Claymore 1-5 Yr Laddered Gov. Bond ETF (CLF-TSX); Claymore 1-5 Yr Laddered Corporate Bond ETF (CBO); iShares CDN Short Bond Index Fund (XSB); iShares CDN Corporate Bond Index Fund (XCB)
Prepare for safe havens in the stock market to falter, and for hard-hit sectors to rebound	Make sure you own mutual funds, ETFs or individual stocks with exposure to energy, metals, banks and industrials (note: anything tracking the broad Canadian market will work).	iShares CDN LargeCap 60 Index Fund (XIU); Claymore Canadian Fundamental Index ETF (CRQ)
Watch out for inflation	Include gold and real-return bonds in your portfolio	iShares CDN Real Return Bond Index Fund (XRB); iShares CDN Gold Sector Index Fund (XGD); iShares Comex Gold ETF (IGT)
Consider emerging markets	ETFs and mutual funds in this sector	Claymore Broad Emerging Markets ETF (CWO); SPDR S&P Emerging Asia Pacific ETF (GMF)

Note: All ETFs are listed on the TSX except GMF, which is NYSE-listed