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Cash in on your Money Smarts Contest

01/27/06

Money Smarts: Planning for the Future

Smart investing can help most people to achieve their monetary goals, but potential investors must discern between good investments and bad ones. Various investment options include bonds, stocks, hedges, and various funds. The crucial mix of investment tools differs in different market conditions and for different objectives. For a steady income, bonds and dividend-paying stocks are attractive. Long-term growth requires a consistent approach and patience. Short-term growth is only concerned with the miniscule ups and downs in the daily market, focusing on earning money quickly and then earning more in a different set of stocks. A balanced approach contains a number of different styles, combining risky investments with safer ones.

Investing can lead to financial security, enable investors to fund hobbies and dream homes, or simply provide for retirement. I would invest to save for the future by setting aside money for a dream home, my retirement, or unforeseen personal troubles. By investing across the board in many areas, I would provide myself with the means to eventually live comfortably and to give to charities. In fact, giving to charities on an ongoing basis is investing in the future, so I would include charities in my investment strategy. My strategy would also include creating my own hedge fund, investing in small-cap stocks, large-cap stocks, funds, hedges against inflation, and bonds. The following table shows my target investment allotments. For the sake of simplicity, brokerage fees have not been taken into account, but they could be minimized by buying through discount brokerages.

Category	Percentage	Dollars
Hedge fund	10%	\$10,000
Small-cap	10%	\$10,000
Large-cap	20%	\$20,000
Equity funds	20%	\$20,000
Hedges against inflation	10%	\$10,000
Bonds	20%	\$20,000
Charity	10%	\$10,000
Totals	100%	\$100,000

First I would make my own hedge fund by piecing together various mutual funds. A hedge fund makes money by buying options for stocks and then selling the stock on a set date for a predetermined price. One of the biggest problems with hedge funds is that they charge too much in fees. A second problem with them is that hedge funds typically have multi-year lock-ups, while other options provide instant liquidity (Braham 98). A third problem with hedge funds is that they are loosely regulated, and some of the biggest names are now under “legal and regulatory probes” (Roane 49). In order to avoid the onerous fees and lack of investor control, I would include in my hedge fund various existing funds that copy one side of the hedging strategy, either buying long or selling short. Many funds exist that are devoted to one side of the issue. If an investor invests equally in short and long funds, he/she has “hedged the bet.” Instead of just hedging the bet in one sector, I would pair opposing funds from many sectors to create a private fund of many home-made hedge funds. I would invest \$4000 in each of two

pairs, \$2000 in each component, for a total 8 percent of the \$100,000. One bet would be that blue-chip stocks would beat small-cap stocks, so I would pair Brandywine Blue (BLUEX) with Profunds Short Small-Cap (SHPIX). Assuming that cheap stocks will appreciate and that expensive ones will lose value, I would go short on expensive stocks and long on cheap stocks. To that end, I would pair Fairholme (FAIRX) for the long with Prudent Bear (BEARX) for the short (Braham 99).

Continuing on to small-cap stocks, Genesee & Wyoming (GWR) offers opportunities. Genesee & Wyoming, a short line railroad company, owns 47 short line and port railroads in five countries, the USA, Canada, Bolivia, Mexico, and Australia. Last year Genesee & Wyoming acquired 14 new railroads, which should add \$22 million to its profit for a total of \$50 million. Although the short line railroad industry “is susceptible to slowdowns in the manufacturing industry, Genesee and Wyoming’s geographic diversity...mitigates the risk” (Bullock 27). Genesee & Wyoming trades around \$34 a share and I would invest in 300 shares, a little over ten percent of my investment capital.

Moving on to large-cap stocks, the market offers many opportunities for investors seeking undervalued large companies which earn hefty sums. Banking, the biotech industry, energy corporations, healthcare companies, and conglomerates offer compelling reasons to invest (Wang 70 and Pearlman 53-67). I would focus my efforts in the banking industry because dealing with money is profitable.

Big banks’ stock prices hovered then fell during 2005 as earnings grew 14 percent. The reason? Investors worried about rising interest rates, which reduce profits. Interest rates would have to spike upwards to significantly damage earnings, “but that’s an unlikely scenario” (Pearlman 55). As a result, Bank of America’s (BAC) stock price fell as earnings grew. Trading

around \$45, just ten times the 2006 expected price-to-earnings ratio, Bank of America has encouraged Thornburg Core Growth Fund to buy BAC shares. Last year, Bank of America bought MBNA, the nation's largest credit card issuer. I would buy 200 shares of Bank of America stock and 100 shares in United Bank of Switzerland (UBS). UBS is also an attractive bank because it has \$2.1 trillion entrusted to it in asset-management, making it the world's largest management firm. UBS' P/E ratio is less than 13, and analysts expect UBS to earn \$7.06 a share in 2006. My total investment in banking would equal 18 percent of the \$100,000 investment capital (Pearlman 55-56).

Equity mutual funds offer another place that investors can earn money. These funds appeal to investors because funds invest in many different stocks simultaneously, so the probability of a certain fund failing is smaller than that of any one component company. According to *Business Week (BW)*, mutual funds provide a way to spread the risks among many investments without having to invest millions. Equity mutual funds have performed well in 2005 and their prospects look favorable for the future. Growth funds outperformed value funds last year. Consequently, I would invest \$8000 in the Fidelity Contrafund, which grew 17 percent last year; \$6000 in the Growth Fund of America, which grew 14 percent last year; and \$6000 in Dodge & Cox Stock, which grew 8 percent last year, for a total equity fund investment of \$20,000 and 20 percent of the whole (Young 106).

I think it wise to invest 10 percent in hedges against inflation, since inflation is unpredictable and surpassed analysts' expectations last year. I would invest \$5000 in the Goldman Sachs Commodities Index, which owns stock in hard assets like copper and steel. It hedges against inflation by owning stock in markets that sell raw goods. The prices of these goods cannot fall below a certain point, and last year, developing countries demanded these

commodities, raising prices faster than inflation. I would also invest \$5000 in gold, another traditional hedge against inflation. Gold's price rides the inflation curve well. An ounce of gold buys the same amount of a product in a variety of economic situations. Thus, if the value of the dollar drops, gold will retain its purchasing power (Weber 123).

Another place I would invest is in the bond market, specifically \$20,000, or 20 percent of the total, in the Vanguard Long-Term Treasury Fund (VUSTX). According to *Money*'s Michael Sivy, the best justification for owning bonds or stocks in bond funds is that bonds smooth out ups and downs in the market. When the market recedes, bonds perform better, easing the strain on portfolios. The bonds that most successfully accomplish this objective are U.S. Treasury bonds, because they are tied to interest rate changes. I would include the Vanguard Long-Term Treasury Fund because it is a fund of long-term government bonds. "Bonds may falter in a boom, when investors fear (interest) rates will rise. But when your stocks are tanking, they can ease your pain." (Sivy 68).

Another way to invest in the global economy is to invest in certain charities. Some charities feed starving humans, while others help the impoverished to improve their lives. I would focus on improving the lives of the poor, rather than feeding them for a day, for their longer-term benefit. Therefore, I would give ten percent of my \$100,000 to Food For The Poor. Food For The Poor distributes food in impoverished countries in Latin America and the Caribbean, but at the same time builds homes, teaches fishermen better methods, and provides job training. My contribution would include: one \$6500 tilapia fish pond for a rural village, one \$3,135 dinking well, 9 pigs for \$300, 40 baby chickens for \$50 dollars, and a contribution of \$15 for an even \$10,000. By our helping these people to improve their situation, developing nations will experience a decrease in poverty and an increase in prosperity. When lives can be devoted

to tasks other than those of survival, new markets can spring up yielding future investment opportunities (<http://foodforthepoorgift catalog.org/giftcatalog/>).

In summary, I would invest just over 10 percent in Genesee & Wyoming, a small-cap company; just over 18 percent between Bank of America and United Bank of Switzerland; 20 percent among three equity funds; 10 percent in two hedges against inflation; 20 percent in the bond market; 8 percent in home-made hedge funds; and 10 percent in Food for the Poor, an investment in the future. The difference between the sum and 100 percent is \$3736 and would be invested in a Bank of America Money Manager Account to retain liquidity for emerging investment opportunities. This investment strategy has paired risky investments, hedge funds, with safe investments, bonds. There is also a fair amount of “middle ground” material that offers potential long-term growth. The market offers many possibilities for growth in 2006, but a balanced approach is necessary for success in the long-term, because nothing is certain. With the right mix of bonds, stocks, and hedges, this portfolio can ride out a bear market or capitalize on a bull market, providing a level of financial security.

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