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GETTING PERSONAL: Advisers Look For New Inflation Hedges

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By Ian Salisbury
A DOW JONES NEWSWIRES COLUMN

NEW YORK (Dow Jones)--Many financial advisers are looking beyond traditional hedges against inflation, considering everything from commodity-sensitive stocks and real-estate investment trusts to doing nothing at all.

With the Federal Reserve expected to pump more money into the financial system in a bid to spur the economy, investors have responded. On Monday, investors bid so aggressively at a \$10-billion auction of Treasury Inflation-Protected Securities that yields were driven down into negative territory, a first for TIPS auction. Others have sent prices for gold, long seen as a store of value, to record highs, while driving the U.S. dollar down about 15% vs. the euro since June.

"The government is trying to promote inflation as a way to recover the economy," says Merritt Island, Fla.-financial adviser Steve Podnos. Still, Podnos worries TIPS's negative yields suggest some investors may be overpaying. He also dislikes the complexity of investment vehicles that target commodity futures markets. The solution: he's put about one-fourth of clients' stock holdings into ETFs that own natural resource stocks, such as PowerShares Water Resources ETF (PHO) and the Market Vectors Agribusiness ETF (MOO).

Another strategy has been to pare back holdings of long and intermediate-term bonds, since inflation typically drives up interest rates, hurting bond prices. Chicago-based Harris Private Bank has rejiggered its investors' portfolios, creating a new "diversified income" strategy, which is meant to mimic a bond portfolio but with more inflation-friendly assets including real estate investment trusts; international bonds, whose prices should hold up if the dollar weakens; and preferred shares. While rising interest rates would hurt preferred shares' trading values all other things being equal, Harris believes the losses would be offset by increased revenue, another side-effect of inflation that would benefit the issuers' balance sheets.

Chief Investment Officer Jack Ablin says Harris uses ETFs such as PowerShares Preferred Portfolio (PGX) and iShares iShares S&P US Preferred Stock ETF (PFF) rather than individual securities. The ETFs tend to be cheaper to trade, making it easier for Harris to make small tweaks to portfolios as market conditions change.

Despite inflation worries, some advisers are holding the course. Wells Fargo Advisors, which projects inflation of about 2.5% over the next 10 years, is counting on already broad diversification among clients' stock and bond holdings to offset the risks, says Chief Macro Strategist Gary Thayer.

For long-term stock holders, inflation is less of a worry because profits, and ultimately dividends, should climb alongside prices. Meanwhile, both international stocks and international bonds offer an additional layer of protection because they stand to appreciate if the dollar weakens. And economies in many developing companies are heavily tied to natural resources, providing another potential hedge, much like the natural resources ETFs do.

For moderately aggressive investors seeking growth and income, Wells Fargo recommends about 13% of stock holdings and 3% of bond holdings be international, Thayer adds.

(Ian Salisbury is a Getting Personal columnist who writes about personal finance; he covers topics including exchange-traded funds and separately managed accounts. He can be reached at 212-416-2241 or by email at ian.salisbury@dowjones.com.)

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