Bayer's Trading in Emerging Markets for Fixed Income in Client Portfolios

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Mike Bayer considers himself a contrarian investor.

In the past few months, as stock markets soared, that sort of go-against-the-grain approach has taken center stage.

The Toronto, Canada-based adviser and president of Strategic Analysis Capital Management says he prefers to buy exchange-traded funds when they're out of favor.

“The problem most investors have is that they tend to trade too frequently and make changes in the wrong direction. They're buying high and selling low,” said Bayer, who works with individual and institutional clients in Canada and the United States.

Since early March, SACM has been taking advantage of the rally in stocks to rebalance client portfolios. Bayer has been trimming positions in the Vanguard Emerging Markets Stock ETF (NYSE: VWO).

“Emerging markets have had a big run-up in the past few months,” he said. “I've been carefully monitoring portfolios to make sure they stay within our asset allocation limits. In cases where VWO has exceeded those bands, we've sold positions and redeployed proceeds into mainly bond funds.”

The proceeds from selling VWO have been mainly going into buying more fixed-income ETFs and funds, says Bayer. Those include the iShares Barclays TIPS Bond ETF (NYSE: TIP) and the iShares Barclays 1-3 Year Credit Bond ETF (NYSE: CSJ).

“Usually, we'll use a band of about 5% to determine when to make changes,” he said. “But that's not a hard-and-fast rule. If someone's in a taxable account, we'll customize our rebalancing strategies so people can take advantage of tax-loss harvesting and reduce their overall tax liabilities.”

Taking A Cue From History

Bayer says he's a big fan of simplicity in investing. He likes to stick with four to seven funds built around the long-term needs of each client. “The portfolios are built around broad diversification, but they don't include commodities,” he added. “That asset class tends to add too much volatility. And over time, it doesn't necessarily add any additional return.”

In a typical portfolio with 60% equities and 40% bonds, Bayer likes to keep around 45% of total stock assets in funds focused on the U.S. and Canada.

With a total stock market approach, he'll use the Vanguard Total Stock Market ETF (NYSE: VTI) or the Vanguard Total World Stock ETF (NYSE: VT). In cases where VTI is implemented, at least 60% will go into that fund.

But with clients who don't mind being a bit more aggressive, Bayer prefers to slice and dice allocations. He'll put an equal percentage of U.S. stock allocations into the four corners of the market: large-cap value, large-cap blend as well as small-cap value and small-cap blend.

In a slice-and-dice portfolio, Bayer uses the iShares Russell 1000 Value Index (NYSE: IWD) and the Vanguard Value ETF (NYSE: VTV). He balances those with the iShares Russell 1000 (NYSE: IWB) or the Vanguard Total Stock Market ETF (NYSE: VTI).

"If you have a long time horizon and can handle the volatility, slicing and dicing the market can really provide some extra benefits," said Bayer. "But a slice-and-dice strategy isn't necessarily the easiest type of portfolio to hold. You need to remain very disciplined to make it work well over time."

Nod To Small-Cap Value

Even with a more total-markets approach, the firm still likes to tilt allocations toward small-caps and value. On the small-cap side, it uses the iShares Russell 2000 Value Index (NYSE: IWN) and the Vanguard Small Cap Value ETF (NYSE: VBR).

Whether slicing and dicing or total markets in design, Bayer says his portfolios avoid small-cap growth. "It just adds a lot of unneeded volatility and lower returns over time," he said. "I'm a value investor. So even when a client is better-suited to a more total markets approach, I still like to tilt towards value."

In those cases, he will add blended ETFs such as the iShares Russell 2000 Index (NYSE: IWM) and the Vanguard Small Cap ETF (NYSE: VB).

"Usually, I'll start by talking to clients about taking a total stock market fund and then adding IWN or VBR to tilt the portfolio a bit," said Bayer. "Taking a total market approach appeals to a lot of people in terms of simplicity and slightly lower costs."

A Global View Of Markets

In a global portfolio, Bayer leans toward about 55% in non-U.S. stocks. "I'm not trying to predict whether foreign markets are doing better than the U.S.," he said. "But a 55% international tilt roughly follows the global market capitalization percentages of VT, which is a good barometer of the total world market."

For international exposure, he'll buy the iShares MSCI EAFE Index (NYSE: EFA) or the Vanguard Europe Pacific ETF (NYSE: VEA). Bayer also uses the Vanguard FTSE All-World ex-US ETF (NYSE: VEU) for some investors. In a standard portfolio, he'll put about 10-15% into emerging markets of the stock portion of his global portfolios.

His bent toward sticking with broad-based asset classes and a disciplined strategic allocation approach to investing has its roots in the tech boom. Bayer was managing accounts for a large technology distributor and watched investors rush into hot sectors and get crushed from 2000-2002.

“I’ve always been an index investor. But back then, there weren’t as many choices with ETFs, especially to gain international exposure. But I was an early adopter,” said Bayer, who began investing for himself as well as family and friends as a teenager.

He decided to work with individual investors in 2002 and joined a small local brokerage. “They were selling traditional high-fee mutual funds,” said Bayer. “My strong preference was to use ETFs and DFA funds, which are lower-costing and provide superior long-term risk-adjusted performance,” he said.

-- This report was submitted by IndexUniverse.com's Murray Coleman.

Original post

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