TRENDS & IDEAS

CIOS SEE GOLD, U.S. EQUITIES SHINING

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TAKEAWAY: CIOs like gold and domestic equities, but are avoiding European stocks.

POSITIVE IMPLICATIONS:

Rydex S&P Equal Weight ETF	Marketweight	[RSP]
SPDR Gold Shares	NA	[GLD]
SPDR S&P 500 ETF Trust	Overweight	[SPY]

NEGATIVE IMPLICATIONS:

First Trust DJ STOXX European Select Dividend 30 Index Fund	Marketweight	[FDD]
iShares FTSE EPRA/NAREIT Developed Europe Index Fund	Marketweight	[IFEU]
iShares S&P Europe 350 Index Fund	Marketweight	[IEV]
SPDR S&P World ex-US ETF	Marketweight	[GWL]

In light of the euro's decline and uncertainty over major economies' currencies and debt issues, the buy side continues to recommend some defensive positions, and by-and-large are avoiding European stocks.

Chief investment officers (CIOs) are telling their clients to allocate a portion of their portfolios to precious metals and focus their stock picks on domestic mega caps with clean balance sheets, lots of cash and geographically diverse operations.

"Gold is the only AAA-rated currency," notes Ian MacCallum, CIO at Bedlam Asset Management, which manages about $700 million. "Gold has the best supply dynamics. For the first time in decades, this is the perfect storm for precious metals." MacCallum is referring to how gold continues to be one of the beneficiaries of the global credit and currency-market turmoil.

The euro remains in a downtrend and appears to be testing its late-2008, early-2009 lows in the $1.24 to $1.26 zone, according to S&P's technical analysis. A lower euro makes U.S. company products less competitive in the eurozone. Internationally, Europe and the United Kingdom represent 44% of overseas equity market cap.

On May 5, the S&P Investment Policy Committee reduced its U.S. and foreign-equity exposures to its benchmark allocations of 45% and 15%, respectively, and raised its cash allocation to 15% because it sees heightened sovereign-debt concerns possibly triggering a 10% to 15% decline in the S&P 500.

But the U.S. economy continues to show signs of a stronger-than-expected recovery, and CIOs argue that investors need exposure in that area. However, they also believe like S&P Economics, that the expansion in the United States is likely to be more sluggish than the typical rebound in a recession.

One place to turn in the meantime remains precious metals, according to the CIOs.

"We're finally reaching the point where the psychological barrier about gold is waning... It's gone from the barbaric relic towards a monetary asset," notes James Dailey, CFA, CIO and lead portfolio manager for TEAM Asset Strategy Fund (TEAMX 10 NR), which launched in late 2009 with a top-down investment strategy.

"The issues with sovereign debt are so explosive potentially. Gold could go to unbelievable heights. That's why more people are flocking to it. They see the risks building because of what all major economies are doing with their currencies. A marginal pickup in demand can make the price go way up," he says.

As Dailey explains, demand may likely come from China, Brazil, and India, which have about 5% of their currency reserves in gold, while developed markets such as France, Germany, and the United States are well over 30%. He says there's room for these emerging markets to buy more gold.

But one CIO is worried that gold's price could remain volatile in the foreseeable future. "Many of our clients were playing the SPDR Gold Shares (GLD 117 NR), but now the downside protection is what we're most interested in," says Randy Bateman, CIO and president of Huntington Asset Advisors.

The Gold Shares "were a great deal for our clients but we don't want a replay of 2008 and want ways to protect our customers," Bateman says. In that year, the precious metal's rise of 5.6% paled in comparison to a sharp climb of 31% in 2007.

In 2009, the price of an ounce of gold climbed more than 23% and has risen more than 8% through May 6. Bateman's now concerned that the precious metal could be volatile over the next few years. As a result, his company co-developed a three-year structured note based upon the price of gold that would limit the volatility he expects, whether gold's price climbs further or drops down to $850, which would be about 25% lower than current levels.

But Bateman's concern over gold's price does not mean he would lower his allocation to gold right now. He thinks the dollar is at risk and he is "looking at asset substitutions, which are using cash substitutions, options and the gold strategies."

Huntington recently reduced its international exposure within its asset allocation model by five percentage points. "This deployment of cash was reinvested in domestic large, mid and small-cap equities. We continue to look favorably toward sectors of the international arena that are demonstrating fiscal responsibility and diversified opportunities," according to Bateman's market update for May.

In terms of allocation, Dailey at TEAM is similarly positioned, noting that "global and international is going to be more dangerous than the U.S. over the next several months." In addition to precious metal (20% in gold stocks) or mining stocks, he likes energy stocks, and companies involved in agricultural, such as fertilizer companies.

"There is still inherent value to stocks, if they are not overleveraged," says Dailey. TEAM is underweight in sectors exposed to consumer debt and overspending, namely consumer discretionary, financials, and select technology stocks.

Bedlam's MacCullum, who is also the co-portfolio manager of the Touchstone Global Equity fund (TGEAX 10 **), is also bearish on financials and select technology, and is underweight in energy. His gold allocation stands at 13%.

However, Christian Wagner, CEO and CIO of Longview Capital Management, has a slightly different perspective on equities in the short term. Although he too believes that the United States will outperform other markets in the near term, he advises equal-weighting mega caps instead of investing in a market-cap weighted index fund.

"We think equal weighting the mega caps is a defensive play," says Wagner, who likes the Rydex S&P Equal Weight ETF.

"Any revenue decline is going to force large domestic companies to acquire the growth. We could be looking at a unique opportunity of smaller companies to get acquired, and we think the best way to play that is to remain allocated but in an equal-weighted basis from the same index," according to Wagner.

"We have a lot of confidence in the U.S. economy. We're using the volatility in stocks to add to positions," he adds.

ISABELLE SENDER, S&P Editorial