Dow Jones NewsPlus: North American Equities

July 27, 2011 12:54 p.m. EDT

WEALTH ADVISER: How Advisers are Facing the Debt Crisis

DOW JONES NEWSWIRES

--Advisers in uncharted territory

--Morgan Stanley Smith Barney: Timing fallout would be "exceedingly difficult"

--Janney: Avoiding downgrade might not be best scenario

By Ian Salisbury
A DOW JONES NEWSWIRES COLUMN

NEW YORK (Dow Jones)--If financial advisers could do just one thing for clients, it might well be to prepare them for unanticipated financial calamities. The looming U.S. debt crisis is one of those moments when anxious and confused investors are most in need of hand holding. Except that unlike with other investing perils, such as rising inflation or interest rates, no one really knows how a U.S. downgrade or default might affect investors' portfolios. We've polled some advisers over the phone and by reviewing their communications with clients to see what they recommend.

- Morgan Stanley Smith Barney's chief investment officer Jeff Applegate says he's "telling folks to stick with your current strategy." His reasoning: The chance of a default is "very, very, very low." If it did come to pass, he believes markets would react the way they did when Congress failed to approve the bank bailout in 2008 -- with sharp drops in stocks and other types investments, while a few holdings, like gold and the Swiss Franc could benefit. Just as before, he predicts the carnage would quickly prompt Congress to change course. While such an event would be gut-wrenching, small investors would be foolish to try jump in and out of the market in response.

"It would be exceedingly difficult to trade around it," he says.

- For Linthicum, Md.-based John Bacci, the debt crisis "is the first time I've ever witnessed people being nervous when the market is doing well."

In some ways, he adds, that's a benefit. Usually investors call him wanting to sell only after their stock portfolios have taken a big hit. Even in normal markets, Bacci recommends mutual funds that incorporate bearish bets, like Hussman Strategic Growth, to hedge clients' stock exposure. Recently he's allowed some worried investors to boost holdings in such funds slightly to about 15% of their portfolios, while keeping another 15% in cash. But he's reluctant to do more.

"You don't want to neuter your portfolio," he says.

- Sallie Krawcheck, president of Global Wealth and Investment Management for Bank of America (BAC) and for Merrill Lynch, has been communicating with firm's clients and advisers through forums like teleconference calls and Web casts. Addressing the debt crisis on one recent recording, Krawcheck said Merrill is bullish on large-company U.S. stocks as well as overseas stocks and bonds, especially in emerging markets. Krawcheck added investors should consider "rebalancing away from U.S. Treasurys which are likely to be impacted by rising interest rates and inflation."

- Lansing, Mich., adviser Ted Feight sold his clients' short-term bond holdings last year amid worries about Washington spending, inflation and gridlock. Instead, he holds a Charles Schwab Corp. (SCHW) money-market fund. Feight says uncertainty, first surrounding the Japanese tsunami and now the debt standoff, has kept him on the sidelines. While he'd like to put some of that money back to work soon, he prefers dividend-paying stocks to bonds. He thinks a default could lead to a quick 10% correction in stock prices, but he'd be surprised if the drop hit 25%. A smaller move might be a buying opportunity.

"We're getting ready to go into the market," he says.

- Guy LeBas, chief fixed-income strategist at Philadelphia-based Janney Montgomery Scott LLC says a U.S. default isn't the only bad outcome for stocks. Narrowly avoiding a default with a deal that sharply cuts spending could also send prices tumbling, just not overnight.

"It will slow economic output," he says, with declines "driven by economic risks rather than investors' risk aversion."

While such cuts might or might not spur growth in the very long run, for now, a better outcome for investors could be a solution that slowly trims spending, even if that threatens the U.S. credit rating, says LeBas.

- While Salt Lake City-based Paul Winter thinks a U.S. default would likely trigger a "flight to quality," with investors snapping up Treasurys while dumping riskier assets like commodities and emerging markets stocks.

But he sent a letter to clients Monday explaining he doesn't intend to re-make their portfolios. "We investors always face uncertainty, and are rewarded over time for enduring it," it said.

(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.)

Copyright (c) 2011 Dow Jones & Company, Inc.

URL for this article:
http://www.djtopstories.com/article/0,,DN-CO-20110727-015923,00.html