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PRESS CUTTINGS

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Look beyond the obvious to build your wealth

Alternatives

Commodities and property present opportunities to diversify, writes *James Pickford*

An Isa portfolio is generally regarded as a vehicle for safe, long-term investments, not an opportunity for the kind of white-knuckle ride more familiar to City traders going through torrid times.

But there can be sensible reasons for Isa savers to consider venturing beyond the simplest stocks, shares and cash investments into more uncharted territory. Spreading risk is one. Many funds now offer ways not only to diversify one's investments, but also to decouple them from the rising or falling tide of equities or bonds. Another is to find strategies that beat inflation, which corrodes the value of investments, held in Isas or otherwise.

What are the alternatives? Though they carry a volatile and unpredictable reputation, commodities are frequently recommended as an option by fund managers – within limits. As part of a balanced portfolio, managers believe investors can benefit from allocating up to about 10 per cent of their Isa portfolio to these investments. They can invest in individual shares, funds focused on commodity-related companies, or some exchange-traded funds, which offer investments in commodities such as gold, wheat and oil.

Thomas Becket, chief investment officer at Psigma, believes some commodities are a good long-term investment, reasoning that China and India will continue to see economic growth, driving demand for raw materials. Industrial metals such as nickel and zinc are starting to see lows that would suggest an improvement in outlook over the medium term, he says: companies such as BHP Billiton or Rio Tinto stand to benefit, or investors could choose a resource-focused fund such as Investec Enhanced Natural Resources Fund.

Mr Becket also marks out energy as an attractive investment for the long term, because of, rather than in spite of, the falling oil price. Alternative sources of energy will remain unattractive for many while the oil price stays low. Heavy cuts to companies' capital expenditure, he added, could mean the balance of demand and supply could "easily swing in the opposite direction".

"The longer the oil price stays in the doldrums or drops further, the longer-term upside is probably stronger."

Tritax Big Box invests in retail warehouses – Bloomberg

Property is another road less travelled for Isa investors, but opportunities are becoming available. Most are in commercial property. Mick Gilligan, head of research at Killik, recommends Tritax Big Box, a London-listed real estate investment trust (Reit) which invests in distribution warehouses that are let to retailers such as Ocado or Marks and Spencer, and yields around 4 to 5 per cent. Rapid growth in internet retailing underpins the fund's model, he says, which avoids development risk by taking on only properties that are already built.

Student accommodation is another area allowing diversification into property without correlation with residential prices. GCP Student Living, another Reit, invests in London and its environs and yields around 4.5 per cent. Mr Gilligan says: "The demand for the higher end student accommodation is driven by primarily by overseas students and London is the main beneficiary of those types of students."

Those more interested in residential investments have seen greater choice in recent years as UK house prices have soared, particularly in London and the Southeast. One newcomer is the so-called Housa launched last year by Castle Trust, which is linked to average UK house prices, measured by the Halifax index.

Investors can choose exposure to UK property or Greater London only. Two-, five- and ten-year terms are offered and Castle Trust charges a 2.5 per cent fee – or 3 per cent for the London Housa – if you cash in early.

Another is the Hearthstone UK Residential Property Fund, which has investments in a portfolio of professionally managed properties across England, Scotland and Wales. Rental surplus is channelled back into the fund.

A big risk with residential property funds is that those people who can afford to invest in them are already likely to own a house – so they are investing in something heavily correlated with what is already their biggest asset.

For those who might otherwise be drawn into Britain's buy-to-let boom, the convenience and relative liquidity of these property-linked vehicles may be attractive.

Darius McDermott, managing director, Chelsea Financial Services, said: "It's useful for people who want diversification but don't want to do buy-to-let. They don't want the hassle of a managing tenants or paying tax on the rent but they still like the asset class."

Another growing area of activity for investors and asset managers – which can also form part of an Isa – is asset-backed securities.

Mr Gilligan of Killik says the income generated by such funds tends to be linked to Libor, so it goes up if interest rates go up.

"It insulates you from the shock to the system that you typically get with a conventional bond fund when you get a rise in rates."

He recommends the Monument bond fund via TwentyFour Asset Management, a regulated fund yielding about 2 per cent. "It's sterling or sterling hedged so there's no currency risk at all."

Other managers point to so-called absolute return funds as a way of achieving extra diversification. These vehicles use hedge-fund-like techniques to pursue a distinct investment strategies at selected grades of risk. They might invest in UK equities, bonds or commodities but aim to avoid correlation with broader asset classes of equities and bonds.

Mr McDermott recommends Henderson UK Absolute Return Fund, which invests in UK companies but goes long on some and short on others. "When the FTSE 100 index was down 30 per cent in 2008, the people running this fund made 28 per cent," he says. "They shorted the banks but they shorted them early."