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# Global Allocation Funds Can Go Anywhere

by Sheyna Steiner Published November 08, 2011 Bankrate.com



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An increasingly popular type of mutual fund investment has shed some of the constraints that hem in traditional funds. Colloquially called "go-anywhere funds" and more formally known as "global allocation funds," these investments can turn on a dime and zig and zag through asset classes as the management team sees fit.

With that kind of flexibility, global allocation funds should be able to protect you from market downturns and amplify returns in good times by finding great deals all over the globe. But do they shake out that way?

Investment research company [Morningstar](#) classifies these funds under the world allocation category. The three-year annualized total return for the category through Oct. 31, 2011, is 10.9%, compared to the Standard & Poor's 500 index return of 11.4%. But with 125 funds competing, it's a big field spanning wildly varied strategies and investments. Fund performance reflects this. For example, for the 10 years through October 2011, annualized returns run the gamut from 13.27% for First Eagle Global I to 1.77% for Oppenheimer Global Allocation B.

## What are Go-Anywhere Funds?

Global allocation funds can invest anywhere, across asset classes and regions. Some funds may take that mandate to an extreme whereas others may behave more like a traditional balanced fund.

"Funds in the world allocation category typically invest in a mix of stocks and bonds. Also a fair number of them invest in things like commodities and things along those lines," says Michael Herbst, associate director of fund analysis at Morningstar Inc.

Some of these funds give you exposure to alternative asset classes such as real estate investment trusts, or REITs, futures contracts

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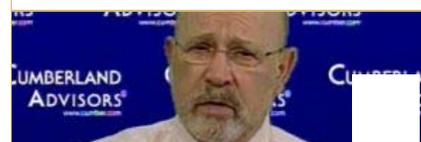
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and swap agreements in addition to stocks and bonds. Global allocation funds can also use alternative trading strategies -- for instance, using long and short positions.

### What to Look For

Before selecting mutual funds in this category, investors should be aware of what they want from the fund and the spot -- or spots -- they're looking to fill. Morningstar breaks down the category into funds suitable as a portfolio anchor, and more tactical funds that work better as supplementary holdings.

The characteristics of a portfolio anchor will differ from the more tactical fund. For instance, the former type often provides protection from volatility.

"World allocation funds that are designed to be a portfolio anchor are likely to try to strike some balance between capital appreciation and downside protection. Those trying to build some protection into the portfolio usually do so through exposure to fixed income, or other protective strategies such as holding gold or cash, or maintaining some kind of tail-risk hedging program," says Herbst.

"Tail risk" is a statistical term referring to the likelihood a portfolio move will exceed three standard deviations from the mean.

Think of investment returns as a bell curve. Normally returns will fall into the middle of the bell, but tail risk refers to the chance they fall under the "tails" of the curve -- either much higher than expected or much lower.

Hedging that risk involves mitigating a portfolio's potentially huge downside moves.

Conversely, funds that move more tactically may not necessarily build in those cushions against downturns. Instead, managers determine what investments look attractive and can load up on them -- so much, in fact, they may become extremely narrowly focused on only one asset class.

At first glance it can be difficult to ascertain what kind of global allocation fund you're looking at; just reading the fund's objective and investment strategy within the prospectus may not give you the entire picture.

If you think it sounds tricky, you're right.

In order to really get a feeling for how the fund moves over time, investors need to look at its historical patterns to see how the fund is actually managed.

Managers who run go-anywhere funds have flexibility, but they

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may lack deep knowledge and expertise.

"In the credit crisis, what we saw was that some of the folks overseeing the fixed-income parts of these funds really got stung by some things that were going on. These might be funds that look appealing, but if you dig a little bit deeper, you might find that their fixed-income capabilities aren't as strong as their equity capabilities," says Herbst.

While all actively managed funds are dependent on the skill and expertise of the manager or management team, the risks are heightened in a fund that can stray anywhere.

"The biggest thing I would look for is first how long the manager has been running the particular fund and similar go-anywhere funds, so you're looking at manager tenure," says Chad Nehring, CFP, vice president of Conceptual Financial Planning in Appleton, Wis.

Manager tenure for these funds spans from less than a year to nearly 20 years, with the average tenure at 3.6 years. Information about the fund's management team can be found in the fund's prospectus.

There are a few other caveats to be aware of when considering world allocation funds.

### **Taxes**

The average turnover ratio for funds in the world allocation category is 125%, according to Morningstar. That compares to an average 34% for index funds and 89% for actively managed funds.

The turnover ratio is a measure of how much trading goes on within the fund, and the ratio represents the percentage of the portfolio that has shifted within the past year. An average turnover ratio of 100%, for example, means all the holdings in a portfolio change over the course of a year. Mutual funds that engage in a lot of trading can incur taxes for shareholders.

"If tax efficiency is important, consider using ( global allocation funds) in sheltered accounts because they may have a greater level of taxable distributions," says Evan Shorten, CFP, president of Paragon Financial Partners in Los Angeles. "Over the last year or so, the funds may have been able to manage those distributions based on other losses. But if part of the strategy is to be trading fair amounts, they very well may have a higher level of turnover, which may create greater distributions" on an ongoing basis.

### **They Can Move Fast**

All mutual funds must send shareholders updated financial information twice a year. This gives shareholders two opportunities

to review the holdings in their funds. Mutual funds must also file form N-Q with the [Securities and Exchange Commission](#) at the end of the first and third quarters. Form N-Q is not sent to shareholders, but it also discloses portfolio holdings and is available on the SEC's EDGAR database.

In between those reports, a go-anywhere fund's holdings could change substantially.

"They may be holding something completely different than what is currently published, and it may not fit within a client's overall portfolio allocation and goals," Shorten says.

### Some Funds May Become Very Concentrated

Global allocation funds may have the ability to narrow their focus to one sector or asset class.

"Prospectuses of some of the tactical funds may say the fund can invest up to 100% of assets in a single asset class. Unfortunately, we can't draw hard and fast conclusions from the prospectus language, since many funds may detail that much flexibility in the prospectus but in practice maintain more diversified, fairly steady asset allocations," Herbst says.

Global allocation funds can be a bit more sophisticated than traditional mutual funds, so paying close attention to details is important. Also, keep the impact of fees in mind. According to Morningstar, the average expense ratio for the category is 1.23%, on par with other funds. Also, many global allocation funds do come with a sales charge. The average front load, according to Morningstar, is 5.35%. For funds that carry a deferred sales charge, the average is 2.13%.

The right global allocation fund may add diversity and some downside protection to your portfolio. At the same time, adding one or more of these mutual fund investments to your lineup could introduce new risks.

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