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The Alternative Wave Theory-Catching Up With Stephen Todd Walker

Managing Director, Oppenheimer & Co.

Stephen Todd Walker, Managing Director, Oppenheimer &Co.

Record volatility in recent weeks means more clients are looking for downside protection, and non-correlated assets are a major way to go. But too many alternative asset classes failed to perform as expected in the market implosion in 2008, leaving investors frustrated and skeptical. What's to be done? Stephen Todd Walker, formerly with Deutsche Bank Alex.Brown and now managing director at Oppenheimer & Co., was named to Barron's list of top 1,000 advisors due in part to his strategic (and successful) use of alternatives. His new book, "Wave Theory for Alternative Investments," takes on three asset classes in particular: venture capital, commodities and hedge funds.

He sat down with *Investment Advisor* to talk about the wave theory: what it is and how members might benefit from understanding its ebb and flow.

What's the elevator pitch for the wave theory?

Years ago, I was with Deutsche Bank Alex.Brown, which is a firm that is very involved with alternatives. I noticed if I added alternatives it decreased risk and increased return. I also noticed, over and over again, the same patterns seem to revert to the mean. For example, if I was to say I know someone who bought a house, flipped it and bought two more houses with the proceeds and then overextended and went bankrupt, you'd say, "Sure, that was, like, three years ago." Actually, I was referring to 1922, when there were 30,000 realtors in the Miami-area alone. Similar patterns have happened in real estate between then and now. So that's an example of what the wave is: patterns, cycles and trends that occur in different alternative asset classes.

About the only asset class that performed to expectations as truly non-correlated were managed futures. Given that generally poor performance, does the term "alternative investments" turn the public off?

Depends on the time period you're talking about. Many didn't perform to expectations. But managed futures were up 14.09% during the worst of the last market downturn, and hedge funds were down significantly less than the equity markets as the equity market got creamed. And those were abnormal times.

But isn't that what alternative investments are for, to protect against abnormal markets?

Hedge funds, for instance, go short by their very nature, yet the government banned the shorting of 1,000 companies. And hedge funds borrow from banks. Suddenly, banks and firms like Lehman Brothers got into trouble and said, "Give me my money back." That will affect performance.

Money manager Peter Schiff recently said that the Swiss franc and the Japanese yen are no longer currency havens for investors and gold is the only alternative left. Do you agree?

We had a situation in the 1970s that was not dissimilar to what we're experiencing now. In 1973, gold was at $106.48. In 1979, it rose to $459 and in 1980 it was at $594.90. Just one year later, in 1981, it fell to $271.04 and it stayed there until 2001. Is there more to eke out in the current run-up? Possibly, but the standard deviation has doubled in volatility from as recently as March 2009 and gold is at a 10-year high.

Is there a case for alternative investments in the distribution phase, or do they carry too much risk?

It depends on the individual investor. But if we're talking simply about risk, there was quite a bit of risk experienced with traditional securities, including money market funds recently. I am a big fan of bonds, but even investors in low-risk bond funds lost 50% in the last downturn. I think a case can be made for alternatives in retirement portfolios, but it will depend on which ones, because there's plenty of garbage out there.

Is the book for advisors as well as investors or is it more of an introduction to alternative investments and what they offer?

Both. My experience is that there are a lot of advisors who don't have a good grasp of alternatives. There are 500 pages in the book, so there's plenty of information for everyone. There are two chapters specifically on gold, which makes it very topical. The book really expands on hedge funds, venture capital investments and commodities. It provides the history, performance and risk of each, as well as the vehicles that can be used to gain access to them. Lastly, it lays out each alternative's advantages and disadvantages, and discusses the "wave theory," or the concept that all securities move in patterns, cycles and trends. Investors should be cognizant of these waves to possibly lower risk and maximize returns when adding alternatives to their portfolios.