Strategies That Could Add to Volatility

INVESTING
LANDON THOMAS JR.

On Wall Street, investment strategies that promise to insulate investors from risk are being seen as actually having contributed to the market's recent wild swings.

That seemingly upside-down outcome follows an explosion in investments aimed at avoiding pratfalls in the market, as opposed to making direct bets on a company, asset class or theme. Their popularity boomed after global central banks pumped trillions of dollars into asset markets in a bid to spur economic growth.

Now some experts warn that the sums that have flowed into so-called risk-parity funds and exchange-traded funds, or E.T.F.s, over the last five years have become so large that the end result has been a more volatile market.

Analysts estimate that there is currently around $4 trillion tied up in these investment strategies. The fear is that as their returns continue to suffer, a wave of investor selling will start a wider market rout as managers struggle to unload high-yield, high-return bonds and equities alike. "The professional investment community is very worried about this," said Julian Brigden of Macro Intelligence 2 Partners, an independent research firm based in Vail, Colo.

Mr. Brigden contends that these sophisticated investment vehicles have created a false impression of robust investment returns with minimal downside risks.

Risk-parity funds, for example, have used leverage to reduce the exposure that portfolios have to stocks by loading up on emerging-market and high-yield bonds. The idea is to give investors equitylike returns without the volatility and concentration risk that comes from a big bet on stocks.

Then there are exchange-traded funds, investment vehicles that track an index linked to an investment style (stocks, bonds or commodities to name a few), but trade on exchanges and promise the investor instant liquidity and transparency. Trading in E.T.F.s accounts for close to 20 percent of total volume for stocks in the United States. While many investors in some of the larger funds, like the $169 billion SPDR fund, which tracks the Standard Poor's 500-stock index, are in it for the long term, there is a lot of short-term buying and selling that goes on within the fund.

Risk-parity and exchange-traded funds are questioned.

At a time when global liquidity has been ample, piling into an E.T.F investing in leveraged loans or into the $80 billion risk-parity hedge fund run by Raymond Dalio of Bridgewater Associates has paid dividends for investors.

But China's recent decision to let its currency weaken has set off a new wave of market turmoil. Bonds that were supposed to provide stability to investor portfolios have declined in value along with stocks. Central banks in China and other Asian countries, which for years have been large buyers of Treasury securities, have started to sell out of these positions to defend their weakening currencies. With many of these bonds being core holdings in E.T.F. and risk-parity portfolios, the downward pressure on markets has been amplified.

Last month, Mr. Dalio's All Weather hedge fund was down 4 percent. Of course, Mr. Dalio's risk-parity strategy has had a long record of success, returning 8 percent since its inception in 1996. Defenders of risk-parity investing say that these investment styles are not set in stone and that portfolios can be recalibrated quickly to make them less vulnerable.

As for E.T.F.s, practitioners say that the funds to date have held their own despite some concerns over how portfolios were being valued during the sharp market sell-off late last month.

What remains unclear, however, is how an investing community that has become accustomed to churning out safe and steady returns in a low-interest-rate, low -volatility environment adapts to wild market swings.

People might as well get used to them, says Nicolas Just of Natixis Asset Management, which oversees $904 billion in assets. "These types of sudden market swings will become more and more frequent," he said.

Mr. Brigden thinks that the shakeout will continue as investors come to realize that the days of low volatility investing are over.

"We have had this long backdrop of suppressed volatility with equities doing well and an utter lack of bond risk," he said. "With central banks no longer buying bonds, that virtuous circle is becoming vicious."

A Time To Take No Action

SKETCH GUY
CARL RICHARDS

When the markets get scary, there's a temptation to do something with our portfolios. But we all know that selling during a dip is a bad idea, and the data confirms that successfully timing the market is highly unlikely. Yet it feels crazy to just sit in front of what feels like an oncoming train.

Knowing how strong that feeling is, I want to give you something to do during any scary market.

Pull out a piece of paper. You're going to remind yourself why you're doing what you're doing and why you've invested the way you are. I'm not talking about why you own specific investments, but why you are investing in the first place. The foundation of this whole process is the question, "Why is money important to you?"

For me, that answer is: time spent with my family, mainly outside, and serving my community. Your answer will probably be different, but once you know it, you can answer the next question, "What do I want?" Think of this as a way of stating your goals.

For instance, let's say you want $5,000 to hit your bank account every month after you've retired so you have enough money to live on. The money may come from investments, Social Security or even a pension. You probably also want to give yourself a little raise every year to keep up with the cost of living. Be specific. With your "why" and "what" in mind, it's time to look at "how" you'll do it.

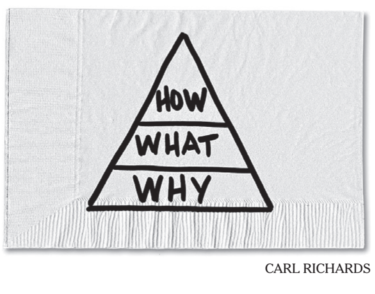
So, does how you are investing create the greatest chance of meeting the goals that express your values? Obviously, you don't want your investments to be based on advice you heard watching the financial network. That's a perfect recipe for building a smorgasbord of investments, making you a collector and not an investor.

Still, if you can't connect how you're investing to your values and goals, it's time to hit the pause button and review. Do you need to realign your "how" to better match your values and goals?

If you decide changes are needed, sit down in front of a video camera and capture your commitment to make these adjustments when the markets are more stable. The video is important because I want you to see the fear in your eyes so you remember how you felt at the moment you realized that there was a disconnect. It will increase the odds you'll follow through when things settle down and it's time to make changes to your investments to match what you've learned.

When you revisit these questions in the future, you may find that your values or goals have changed. But only then will you need to worry about updating your investments.

So turn the noise off and walk through these questions, preferably during a conversation with someone else so you have to talk it through out loud. It's the perfect antidote for what supposedly passes as financial advice in a scary market.



CARL RICHARDS

MICHAEL APPLETON FOR THE NEW YORK TIMES

COLLEGE-BANK PARTNERSHIPS **A Chase bank in Manhattan. Colleges and universities have increasingly partnered with banks to market special debit cards and checking accounts to students.**

Bank Muddle for College Students

YOUR MONEY
ANN CARRNS

Students heading to college are often barraged with offers to open special accounts to manage their money. But they should be aware that not all the accounts are alike.

In recent years, colleges and universities have increasingly partnered with banks and other financial services companies to market special debit cards and checking accounts to students.

Many schools contract with outside companies to handle the distribution of financial aid "refunds," or money left over for educational costs after deducting tuition and fees. Students are often steered to accounts or debit cards offered by the school's contractor; sometimes, students receive debit cards that double as student identification cards.

Forty percent of college students attend schools with such marketing agreements, according to a report from the federal Government Accountability Office.

And while the accounts may benefit a small proportion of students who don't qualify for traditional bank accounts, students shouldn't assume that these accounts are their best option, consumer advocates say.

Campus-affiliated accounts may come with fees that can add up if students don't use the accounts carefully. Some campus debit cards, for instance, charge fees when students make purchases using their PINs, rather than with a signature — a fee not typically seen with traditional checking accounts.

And some may charge hefty overdraft fees for debit transactions — that is, fees charged for overdrawing the account, according to a study this year by the Center for Responsible Lending.

That means it is important for students to clearly understand the terms of any account they are offered and to make sure they are using it in a way that minimizes fees, said Meredith Turner, chief governmental officer with the California State Student Association. "Read the fine print," she said.

While becoming acclimated to campus can be overwhelming at first, students should set aside a few minutes to familiarize themselves with the rules of their bank accounts.

"Take the time to ensure you're setting yourself up for financial success while you're in school," she said.

Q & A

¶ How can I avoid an account with excessive fees?
Look for an account with no monthly fee, no overdraft fees and a widely available network of automatic teller machines. If there is only one A.T.M. that is convenient, you will probably pay out-of-network fees to get your money. Maura Dundon, senior policy counsel with the Center for Responsible Lending, suggests looking at credit unions near campus, or even online-only bank accounts, since they may offer lower fee structures.

The Consumer Financial Protection Bureau offers a guide to choosing a student account on its website (consumerfinance.gov).

¶ If I receive a debit card from my college, do I have to use it?
No, even if the card has your college logo on it. "Just because it appears to be affiliated with the school doesn't mean you have to use it," said Suzanne Martindale, a lawyer with Consumers Union.

¶ Are new regulations for campus accounts in the works?
The Department of Education is expected to complete rules this fall governing college-bank partnerships. The rules would rein in unreasonable fees on accounts used to distribute student aid. They won't take effect until the academic year that starts in the fall of 2016.

Fannie Mae Opens Up To the Extended Family

BORROWING
LISA PREVOST

Fannie Mae is overhauling its mortgage program for low- to moderate-income households to better accommodate today's financial and familial realities.

Renamed HomeReady (from MyCommunityMortgage) and set to start in December, the program has revised guidelines to acknowledge that many borrowers share homes — and finances — with extended family. That's the situation for about 19 percent of African-American households and 24 percent of Hispanic households, according to Jonathan Lawless of Fannie Mae.

Lenders will be able to qualify borrowers by including income generated by non-borrowers living in the household. Data generated by the Census Bureau's American Community Survey and American Housing Survey shows that this income tends to be stable over time, Mr. Lawless said. "So it's not only common to have multiple generations or more than one family living in the same house," he said, "but it's something that actually helps support the household."

Borrowers may also be able to include income from non-occupant co-borrowers such as parents. The down payment requirement is as little as 3 percent. Fees and mortgage insurance requirements will be lower than on standard loans.

The program will no longer be limited to first-time home buyers. By expanding eligibility to repeat buyers, Fannie Mae hopes to help homeowners who lost wealth when property values plummeted.

There are no income guidelines for borrowers buying within designated low-income census tracts. Those buying in high-minority census tracts must have no more than 100 percent of area median income. And those buying in all other census tracts must be at or below 80 percent of area median income.

Borrowers must complete a homeownership education course. The online course takes four to six hours, Mr. Lawless said. Borrowers will be provided with information about housing counselors should they ever struggle to make mortgage payments.

While it's not clear how many lenders will offer the program, HomeReady could offer an opportunity for some households burdened by high rents to get into homeownership. A recent report from Zillow found that the average renter spends 30.2 percent of his or her monthly income on rent, compared with an average of 15.1 percent for homeowners with a mortgage. In metro areas, the rental burden rises to as high as 40 percent.

Wells Fargo is preparing to offer the HomeReady program, said Brad Blackwell, an executive vice president. The program will be part of the bank's effort to better serve low- and moderate-income communities by increasing the company's presence in those areas.

"Since the recession, these communities have been slower to regain their footing, especially when it comes to achieving homeownership," Mr. Blackwell said.

Some neighborhoods were hit hard by the housing market collapse, primarily because of loose lending practices that targeted low-income areas. But today, Mr. Blackwell said, "we are very diligent in our assessment of borrowers' ability to repay. We don't feel that the programs out today or the HomeReady program are anywhere close to tipping the scales to credit that's too loose."

KEVIN LAMARQUE/REUTERS

LOOSER LENDING **Fannie Mae's new program will allow the use of family members' income to increase eligibility for mortgages.**