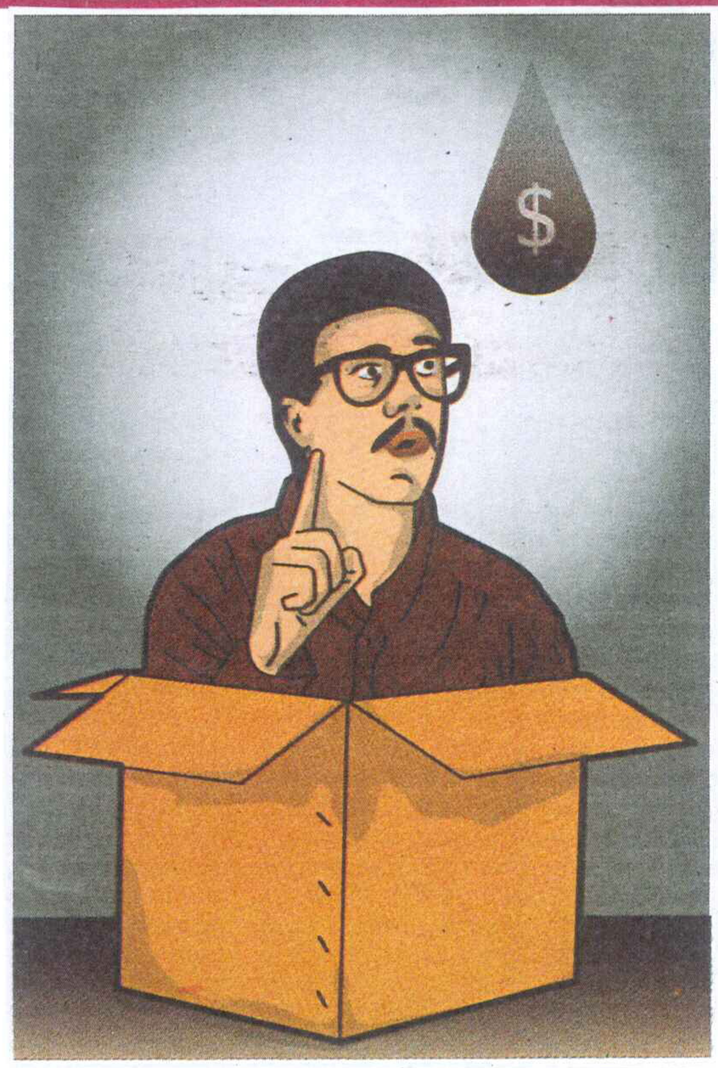
Step Outside Investment Box, but Do It With Caution

Colin Bloodworth explains the pros and cons of some unusual places for your cash



Last week we recalled the fate of the dinosaurs. They perished because they failed to adapt to a changed environment after a catastrophic event.

The investment environment has also changed in recent years and we must adapt to it. This means thinking a little differently and looking outside the box.

But first, what is "inside the box?" Inside you'll find all the asset classes we usually put our money into, such as cash deposits, bonds, stocks and property.

This combination was once sure to help us steadily build wealth, but something has gone wrong, and now the model is barely producing returns for us.

Interest rates on cash deposits are at record lows for most major currencies, bonds are offering returns that are barely sufficient to beat inflation, and the world's major stock markets have made little or no gains since 2000.

Some people have done well in parts of the world with property, including in Indonesia, but in other parts like the United States, thousands have lost their homes through foreclosures and millions owe more than their property is worth. In Spain, thousands of properties remain empty. In that case, should we get right out of the box?

No, that would be a mistake. While cash may not grow in real value, it is fundamental to sound financial planning. You should hold enough cash to see you through the short term and meet unforeseen contingencies. Selling long-term assets to raise cash in an emergency invariably leads to losses.

Government bonds are a fairly safe bet, though you will be lucky if they beat inflation. Corporate bonds are relatively safe if you select solid companies. Owning shares or related mutual funds should ensure growth over the long term, provided you can tolerate short-term losses. Everyone should aim to own property because whatever its value, you can always live in it.

To increase your prospects for higher and more consistent returns, you have to look outside the box — but only when you have a solid asset base within the box.

So what lies outside the box? In short, a massive array of asset classes, products and opportunities.

Gold and precious metals

This should probably be inside the box. Gold is a timeless store of value and an excellent refuge during economic or political turmoil. A 5 percent holding within a balanced portfolio would be reasonable, while other metals add a bit of spice. Some metals, such as platinum, are essential in certain industries while supplies are finite. It is possible to invest in the metal or via mining shares or funds.

Energy

The world cannot turn without energy. Again, this really belongs inside the box, because the demand for energy will continue to increase and therefore so will its value. During recessions, oil and other energy shares and funds can fall, but they are definitely assets for the long term.

Agriculture and forestry

The world population is growing at an alarming rate, and this will put pressure on global food supplies and forest products, creating investment opportunities.

Asset-backed lending

Mark Twain once said: "A banker is a fellow who lends you his umbrella when the sun is shining, but wants it back the minute it begins to rain." Since the credit crunch of 2008, most Western bankers think it's still raining, and while this creates misery for businesses, it has provided opportunities for private investors.

In the past couple years, individuals have been able to invest in funds that provide finance for groups ranging from property developers, student housing providers, farmers, law firms and even garbage recycling companies. Investor returns are generally at least 10 percent per annum and even higher in some cases, such as litigation funding.

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What are the risks? As a basic rule of thumb, the higher the return, the higher the risk. In many of the quoted asset classes, the risk is not so much losing money but giving up access to cash. Investing in many of these products ties up your money for between two and five years, and occasionally longer.

Banks are reluctant to take this kind of risk because a run on deposits could leave them without cash. But for individuals who have ample cash and other holdings "within the box," these funds and products offer opportunities to build wealth.

Even further outside the box, for the well-heeled or bold investor, are opportunities in private equity. Here, a piece of action in an project or a share in a distressed company could produce a profit 10 times greater than the investment. Or investors could lose all their money.

If you're a budding entrepreneur, you may fancy starting your own business. Just keep in mind that for every Bill Gates, there are thousands who have fallen by the wayside.

So, if you have your basic financial planning in place and want higher returns, look outside the box. Just don't step too far.

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