



## Lesson From Dubai: Start Cutting Risk In Your Portfolio

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Dubai's debt crisis could be a sign of more trouble ahead for the global economy, though investors don't need to panic, market professionals say.

As stock markets around the world continue to feel the aftershocks of Dubai's debt problems, portfolio managers say it's a reminder that investors should limit the amount of risk they're willing to shoulder.

Some are advocating moves to large-cap market bellwethers—a group that has lagged this year's stock rally—as a way to mitigate damage should Dubai's inability to make good on its debt payments be the first domino in a line of worldwide credit issues.

"We always have to pay attention to these canaries in the coal mine," said Quincy Krosby, general market strategist at Prudential Financial. "We still need to take on risk in the portfolio, but not the unbridled risk that pushed the markets up over 60 percent. It's a reminder that under the surface, issues remain."

What happens in Dubai is less significant for the amount of money involved than on what it portends for the future of emerging markets around the globe.

Investors worried that the US growth will remain tepid in the coming years have been taking increasingly large stakes on economies such as Dubai's in hopes that overseas markets will provide better returns.

Those hopes would be dashed if developing nations are unable to pay on the debt that has helped finance their expansions.

"What this is a reminder of in many ways is a sovereign version of our housing crisis," Krosby said. "If you look at it it's almost a barbell, a sovereign version of what happened with subprime mortgages in Arizona and Nevada. When the music stops you're left with debt, and debt you can't finance."

Stock market investors responded to the Dubai crisis by sending US markets down more than 1.5 percent Friday and by [more modest levels Monday](#), when investors began coming back to Wall Street following the Thanksgiving break.

Even amid the drop in stocks, there were still plenty of voices to trumpet foreign-market investment.

"The Middle East, despite what happened in Dubai, is really rebounding very smartly," Paul Homsy, principal at Crescent Partners, said in a CNBC interview during which he spoke of an emerging markets fund his company is opening. "The region's awash in liquidity. Economies are growing."

Investors echoed fairly bullish sentiments on emerging markets; the **iShares MSCI Emerging Markets Index** exchange-traded fund traded slightly higher for the day even as the broader market slipped. The iShares fund is the most heavily traded ETF in the group, but most other emerging market funds trended higher as well.

Indeed, the buying seemed to reflect a general sentiment that investors should sit tight for the time being until there are clearer signs of what Dubai means.

"Right now it's just something that needs to be watched," said Tracey Ryniec, an analyst with Zack's Equity Research. "Where there's smoke there's fire so right now there's a lot of smoke coming out of Dubai. Where else could there be smoke? What other countries are going to be having some of these issues?"

Ryniec said the situation does evoke memories of Bear Stearns in the summer of 2007 when the Wall Street stalwart warned that it was experiencing trouble with some of its hedge funds. The warnings were generally disregarded until the investment bank experienced a severe liquidity crisis the following March and had to be rescued by **JPMorgan Chase**.

"It's another reminder that while there has been a lot done with the stability of the financial markets and credit system there still is a lot more that will need to be done," she said. "It's a wake-up call to investors that there definitely is risk in investing in some of these emerging market areas that you won't have here."

And to be sure, there were some who believed that the Dubai situation could be the harbinger of bad days to come.

Market pros are closely watching a variety of metrics, particularly credit default swaps where prices are trending higher in some places globally even as world stock markets rise. Swaps are the cost to pay for insuring bonds and normally would move lower in good economic times as risk of default decreases.

John Lekas, portfolio manager at the **Leader Short Term Bond Fund**, said the problems probably won't show up immediately but are looming.

"Where there's one cockroach there's more," said Lekas, who believes the problems in global markets and continued weakness in the US dollar eventually will pressure US stocks—sending the Dow to as low as 4,100 by 2011. "Any subsidizing of Dubai has to come through the United Arab Emirates. If Abu Dhabi can't pay it's going to cause the UAE to write all those assets, along with the debt, down."

Should anything close to nightmare scenarios come true, investors who choose to cut back on risk now will benefit even though they could miss some upside in the near term.

"We've been telling clients that the easy money's been made," Prudential's Krosby said. "Be careful and reduce risk in the portfolio. Look towards quality in the portfolio, even though it does mean the returns are going to be more modest."

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