SmartMoney

The New Safe Havens (Without the Crowds)

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Treasurys and gold are too popular. Here are some roads less travelled.

By JACK HOUGH

For investors, there's anything but safety in numbers. When safe-haven assets are crowded by the fearful, the result is often meager returns, increased risk or both.

Consider two worry-driven investments: Treasurys and gold. A Friday downgrade of the U.S. by Standard & Poor's spooked investors Monday into -- what else? -- Treasurys, pushing the 10-year yield below 2.4%. (See S&P, Moody's Downgrade Irrelevant). That's less than half its historic average. Invest a million dollars, and the reward for your faith is a dishwasher's salary. No thanks.

Gold soared, too, topping $1,700 for the first time. It's up six-fold in a decade but is still well short of its 1980 all-time high of nearly $2,400, adjusted for inflation. It could easily get there before long, but only because of feverish speculation, not because of a fundamental justification. Gold produces no income for its owners and has few industrial uses. That makes it the most exciting musical-chairs trade going, but not a refuge.

The investments that follow range from awkward to off-putting, but they have a couple of attributes that ought to appeal to investors who don't mind straying from the herd. They're not nearly as easy to get into as stocks and bonds, and perhaps for that reason, they offer handsome cash returns. They also offer sweet relief from the daily price swings of investment markets.

Rental Houses

In April 2007 I argued here that house prices had gotten so bloated that renting was a better deal than homeownership. Prices are down 31% nationwide since then, or close to 40% if adjusted for inflation. Some markets look plenty cheap, and although my position was overwhelmingly unpopular at the time, it's gaining followers: The homeownership rate recently hit a 13-year low. That suggests that in plenty of pockets home-buying is now a good move, even for investors.

Not every market has cheap houses or healthy rents. Judging by the latest rent-versus-buy data from Trulia, these six cities hold particular promise for landlords: Las Vegas, Phoenix, Arlington (Texas), Fresno (Calif.), Miami and Mesa (Ariz.). Bargain hunters should be able to find properties that can bring in rent yields of more than 10% before expenses and 7% to 8% after expenses. That's double what many of the real estate investment trusts that trade on stock exchanges pay. Forget about these six cities for house-hunting: New York, Fort Worth (Texas), Kansas City, Los Angeles, Memphis and Seattle. Trulia's numbers suggest they still favor renters.

Private Mortgages

"Sub-prime borrowers" and "safe haven" might seem like phrases that don't belong in the same sentence. Low-quality mortgages, after all, played a starring role three years ago in the global financial crisis. But that was because lenders made two big mistakes. First, they issued mortgages that were far too large in relation to house prices, which left many borrowers owing more than their houses were worth after prices fell. Second, from the perspective of a so-called hard money lender, they didn't charge enough.

Hard money lenders deal with poor-credit borrowers and buyers of distressed properties, two groups banks are reluctant to touch. They begin by determining a quick-sale value for the property. That's not the price it might fetch under ideal conditions. It's the price it could be unloaded at in a hurry, even in a lousy market. Then they offer loans of 50% to 60% of this value -- nowhere near the 80% cutoff that banks commonly use. Interest rates often top 10%. Loans are for as little as a few months or for as long as a few years, often with a balloon payment at the end.

Hard-money lending isn't for dabblers. One of the biggest challenges is finding worthy borrowers; for that, take a cue from mortgage brokers and find realtors to work with. Also, those who make collateralized loans should be willing to take possession of the collateral if there are no other options. Foreclosing on homeowners isn't for everyone. Then again, so long as private lenders stay within state interest restrictions, they can be as flexible with borrowers as they please.

Main Street Businesses

If private lending is akin to making your own bonds, buying cash businesses -- coin laundries, pizzerias, beauty salons -- is like making your own stocks. Both bypass capital markets and create a direct relationship between the investor and the cash flow. With businesses, of course, there's an investment of time as well as money. "No one wants to work," says Brenda Bernhard, a Los Angeles business broker. "When I list businesses for absentee owners the phone rings like crazy. But the most successful businesses I see are ones where the owner gets involved." That needn't mean a 40-hour work week, of course. Bernard's clients include "serial buyers" who hold diversified portfolios of businesses and spend time at all of them.

Buyers should look for businesses that sell for one to three times yearly net income, says Bernard. That can compare favorably with the stock market's historic price of 15 times yearly income, even after subtracting for the time commitment. And sellers often offer financing with rates in the 6% to 8% range, says Bernard.