# ALTERNATIVES IN A LOW RATE ENVIRONMENT-THE MONEY MARATHON

## FEBRUARY 2012

Last week the Chairman of the Federal Reserve, Ben Bernanke, announced that the Federal Reserve plans to leave rates at their historic lows through 2014. With money markets and savings at near zero, a 5 year treasury bond at a rate of approximately 6/10$^{th}$ of 1% (.60%) and most Certificates of Deposit at 1% or less, it is difficult for an investor to know what to do. As an aside from this, I think the Federal Reserve has gone too far in keeping rates near zero. The effect is to penalize savers at the expense of borrowers. By keeping rates this low, a saver is effectively losing 2% to 3% per year to inflation, whereas, normally a saver would earn a rate of return up to 2% greater than inflation. This policy also lowers the value of the dollar and raises prices for commodities, foreign currencies and gold. The difficult part of this low rate environment is that the amount of money required to replace an income of $50,000 at a 1% return without dipping into the principal is $5,000,0000 (not an easy bogey unless you're a Warren Buffet type).

Here are a few alternatives that can be considered as a way to increase return. (It should be noted that none of these are without some risk. Additionally, investments should be considered as part of an overall portfolio strategy. Be sure and visit with a financial consultant about what is appropriate for you.)

1) Energy Master Limited Partnerships (MLPs): Many pipeline stocks pay approximately a 6% dividend. Although these are stocks, they are considered less volatile or less risky than normal stocks because they are basically a toll road for oil and gas. Big Oil companies pay these pipeline companies to transport energy and the price they pay is based on volume not the price of the commodity. There are also funds that own a number of these that also trade as a stock. There are some special tax consequences for taxpayers who purchase individual MLP stocks, so you should check with your accountant before investing, but the funds generally produce the same 1099's as individual non MLP stocks.
2) Investment Grade Corporate Bonds: There are funds that own a diversified pool of the debt of investment grade companies (which means reasonably financial strong companies). Yields currently are slightly over 3%. This is debt which is generally safer than stock but there is credit risk, again more than insured deposits or treasury bills.
3) High Quality Dividend Paying Large Stocks: There are a number of the biggest and safest stocks in our country that pay 3% or more, some even up to nearly 6%. Excluding financial stocks, (many of the financial stocks eliminated their dividends in the financial crisis of 07 and 08), dividends of the biggest and safest stocks are reasonably stable. Over the last 50 years, dividends of the largest 500 companies, excluding financials, have only lowered their overall dividends 5 times in the last

50 years and never by very much. In fact, excluding financials, the stocks in the S&P 500 are paying a higher dividend currently than at their peak before the financial crisis. Also, it should be noted than these big companies in some respects are safer than our government, in that they have a much lower per cent of debt than our own government, and they are only paying out, on average about 30% of their earnings. This means even in recession or slowdown in which their earnings drop, the dividend payment should be secure.

4) High Yield Bonds: These are bonds that are issued by companies which are rated below investment grade, hence the name high yield, or junk bonds. Various high yield funds pay over 5%. There is more risk here and these bonds have volatility more like stocks.
5) Municipal Bonds: Many long term maturing bonds of 25 to 30 years pay nearly 5% and are tax free of federal income tax for individual investors. Long bonds do have significant price risk if rates rise in the future which they most certainly will sometime, probably past 2014.
6) Closed-End Stock and Bond Funds: Closed-End bond and stock funds do not grow their assets once they are established. They are not open to new funds from investors and hence are called closed-end. However, even though they are closed to new money into the fund, they can be purchased by new investors, like a stock. These funds buy a pool of bonds or stocks and many times borrow up to 50% of the fund to buy more stocks or bonds. In this interest rate environment, this can increase the yield of the fund, because these large funds can borrow at .25% and invest at 4% to 5% to increase the overall fund yield. As an example, a stock utility fund that invests in utilities yielding 4% to 5% is able to increase the yield of the fund by the leverage of its borrowed funds, increasing the overall yield of the utility fund to possibly even 6%. Leverage creates more risk, but in today's environment it is a reasonable alternative.

These are just a few ways to consider increasing the yield of a portfolio. Each has a certain degree of risk, but the alternative of taking no risk, is nearly no return. The tradeoffs between risk and return have to be balanced with each individual specific circumstance. Feel free to call me if you would like additional information on this subject.

Ed Douglas is a Certified Financial Planner/Consultant, Chairman Emeritus of Citizens Bancshares and author of three books, "Making a Million With Only $2000-Every Young Person Can Do It", "The Money Marathon: 7 Simple Steps to Financial Freedom" and " 25 Truths: Winning Wisdom for a Better Life", available at www.eddouglas.com. Ed can be contacted for financial planning services or seminars based on his books at ed@eddouglas.com or 660-646-2066 or at his office at 601 Locust.

25 TRUTHS: WINNING WISDOM FOR A BETTER LIFE - TRUTH NUMBER 13: *Make Every Day Your Best Day.* Ed's books are available at eddouglas.com, Hy-Vee, Amazon, or Boji Stone.