

## How to Get Safe Annual Payouts of 7%

By Karen Hube

Not so long ago, you could build a reliable portfolio of income-producing investments with just a few simple steps: Buy some Treasuries, some corporate bonds and some munis, and then watch the money roll in. That kind of investing is a long-lost luxury. Yields on core bond holdings have been slim for three years in a row. And while 10-year Treasury yields, at 2%, are higher than they were a year ago, you aren't going to do much better any time soon. The Federal Reserve says it is going to hold rates low until mid-2013. Bottom line: Traditional fixed-income portfolios don't work anymore, and "if retirement investors don't start thinking differently, they're going to run out of money," says Erin Botsford, CEO of the Botsford Group, a Frisco, Texas-based financial advisory firm.

Thinking differently, however, raises new challenges for retirement. Yields of 5% and 7% are attainable, but you have to look globally and across asset classes that may seem unfamiliar, such as emerging-market bonds, global infrastructure stocks, master limited partnerships and mortgage real-estate investment trusts.

The hunt for higher yields requires vigilance. Some risks are obvious: Greek sovereign debt, now yielding over 100%, clearly is no way to finance a leisurely retirement. But more often risk is difficult to spot.

Take the Pimco High Income closed-end fund (ticker: PHK). The fund not only has a highly regarded brand name and widely respected manager, Bill Gross, but also an enticing 11.7% yield.

"But if you look at funds not to buy, this is the poster child," says Maury Fertig, chief investment officer at Relative Value Partners in Northbrook, Ill., who

points out that the fund trades at a 67% premium to its net asset value. Investors who buy into the fund are paying far too much for a yield that isn't guaranteed, he says.

Then there's the risk of inaction. If you stick with the traditional income investments, you will be losing money in inflation-adjusted terms.

The 10-year Treasury, with its 2% yield, is a clear loser with today's 3%-plus inflation. Ditto for certificates of deposit and money-market funds.

"You may be preserving your principal, but you aren't going to keep up with inflation," says Malcolm Makin, an advisor at Professional Planning Group in Westerly, R.I. For example, you have to lock your money up in a CD for five years just to get an average 1.5% pretax return. "That isn't going to seem so safe in retrospect at age 70 or 75, when your money has dried up," Makin says.

To increase yield and balance the risks, income portfolios must be cobbled together with a number of investments, ranging from Treasuries to junk bonds. Some—those with the highest credit risk or illiquidity, for example—should make up 2% or less of a portfolio. But even at those levels they can add income and help diversify your holdings.

Here are 11 choices with attractive yields. If you haven't looked at these kinds of investments before, now is an excellent time to start.

### Closed-End Corporate-Bond Funds

Regular corporate-bond mutual funds can give you an edge over Treasuries, with yields around 3%, but you can get much more from closed-end bond funds, which trade like stocks.

"There are funds available at substantial discounts to net asset value, and the fact that these funds employ leverage, and their cost of borrowing is very low, can provide additional yield," says Relative Value's Fertig, who recommends these as a piece of a diversified income portfolio.

Fertig likes AllianceBernstein Income fund (ACG), which specializes in investment-grade corporates, Treasuries and agency bonds-debt issued by the likes of Fannie Mae and Freddie Mac. The yield: 6%. "It's trading at a 10.7% discount to its net asset value," he points out.

BlackRock Credit Allocation Income Trust fund (BTZ) is another good prospect, trading at a 13% discount and with a yield of 7.7%. But it is a little more risky, with many AA-rated and BBB-rated bonds—still investment grade, but just barely.

### Municipal Bonds

Municipal bonds offer a rare opportunity for investors because they yield more than their taxable-bond counterparts and provide tax breaks to boot. For individuals, leveraged closed-end muni funds are great choices. They are riskier because of their leverage, but that's limited by the Fed's pledge to keep rates low. With tax-free yields above 6%—and many muni funds selling at a discount to NAV—that's equivalent to a taxable yield over 9% for somebody in the 35% tax bracket. Two that look good are BlackRock Municipal Income Quality Trust (BAF), with a 6.3% yield, and Neuberger Berman Intermediate Municipal (NBH), yielding 5.6%. Those yields equate to 9.7% and 8.6%, respectively, for taxpayers in the top bracket.

Less risky, because it uses no leverage,

*(over please)*

# 11 Ways to Earn Juicy Yields

It pays to look well beyond Treasuries and CDs when hunting for income these days. Some of the best choices: high-yield bonds, dividend stocks, master limited partnerships and REITs that buy government-backed mortgage securities. Would you believe yields of 15%?

Investment	Avg. Yield	Risk / Rating	What's To Like
<b>Dividend-Paying Stocks</b>	2.5%	Stock-market volatility	Backed by strong earnings; yields on some solid companies are 5% or more.
<b>High-Yield Bonds</b>	8.5%	Rating: BB or lower	Attractive valuations thanks to overly bleak assumption: about default rates.
<b>Closed-End Corporate-Bond Funds</b>	7%	Loss of principal if interest rates rise.	High yields relative to regular bond funds; some solid funds trading at healthy discounts.
<b>Emerging-Market Government Bonds</b>	5.3%	Changes in government and economic policies	Issuers are fiscally sound with low default rates, low debt-to-GDP ratios, strong growth prospects.
<b>Equipment Leasing</b>	6%–8%	Illiquid for 5-to-10 years	Steady performers, low risk of default, leases backed by collateral.
<b>Master Limited Partnerships</b>	6%–7%	Changes in tax-favored status	Minimally impacted by swings in energy prices.
<b>Real-Estate Investment Trusts</b>	4%–15%	Highly sensitive to interest rates	Strength in apartment sector: some mortgage REITs are offering big yields with little credit risk.
<b>Global Infrastructure Stocks</b>	5%	Changes in infrastructure policies and regulation	Stable cash flows and revenues; less downside risk than stocks in general.
<b>Immediate Fixed Annuities</b>	6%–7%	Insurance company fails; illiquidity	Payouts higher than investors could arrange for themselves thanks to mortality credits.
<b>Longevity Insurance</b>	8%	Premature death; illiquidity	Guarantees income late in life; minimizes concerns about longevity risk.
<b>Municipal Bonds</b>	2.5%	State and muni fiscal trouble worsens, causing defaults	Munis trounce Treasuries on an after-tax basis; yields on closed-end muni funds are about 6%.

is the Vanguard High Yield Tax Exempt fund (VWAHX), which yields 4.4%, equivalent to 6.8% for high earners.

## High-Yield Bonds

Bonds that don't qualify as investment-grade-rated BB or lower-clearly come with more risk, "but you can pick up substantial yield if you look at BB ratings primarily," rather than lower-rated bonds, says Michael Persinski, managing director of U.S. Investment for Citi Private Bank. Yields on these issues are around 7.3%.

Investors have been flocking to high-yield, or junk, bonds lately because the difference between their yields and those of Treasuries widened significantly since April. The current spread is 7.2 percentage points. Valuations are still attractive, says Jamie Kramer, head of thematic advisory at J.P. Morgan. The market is pricing in default rates of around 8%, yet the current rate is 2%.

The best strategy for investing in junk bonds is through a fund or ETF, because they are broadly diversified and have low transaction costs. Eaton Vance Income

Fund of Boston (EVIBX) yields 7.9%, and iShares iBoxx \$ High Yield Corporate ETF (HYG) yields 7.5%

## Emerging-Market Government Bonds

Compared with European sovereign debt, emerging-market government bonds look like safe bets. And with an average yield of 6%, they pay three times that of U.S. Treasuries. Once viewed as high risk, these bonds have become much sturdier amid the rapid growth of developing-world economies.

Emerging-market bond funds can minimize currency risk by using hedging strategies; or you can bet on currencies as well as yields. Funds with currency exposure can give added return when the dollar falls.

While emerging-market currencies are expected to strengthen over the long term, that is no steady trend. Lately, those currencies have declined about 20% relative to the dollar, making currency-exposed funds more volatile, says Michael Herbst, associate director of fund analysis at Morningstar. For currency diversi-

fication, he likes Pimco Emerging Local Bond (PELAX), yielding 6.8%. A solid fund that hedges currency risk is Fidelity New Markets Income (FNMIX), with a 5.4% yield.

If you want to leave it up to a manager whether or not to hedge currency risk, consider T. Rowe Price Emerging Markets Bond fund (PREMX), yielding 6.8%.

## Dividend-Paying Stocks

Your grandfather may have scoffed at today's dividend yields, but don't pass them by. The average yield on Standard & Poor's 500 stocks that pay dividends, at 2.5%, is well below the historic average of 5.8%. But the last time the index had a higher yield than 10-year Treasuries was 1958. That means investors have an opportunity to capture capital appreciation as well as Treasury-beating yields. And payouts are likely to get stronger as the economy continues to recover, says Howard Silverblatt, senior index analyst at S&P.

By sector, telecom companies have the highest yields, at 6%, followed by utilities at 4.2% and health care at 3%.

For investors who like these yields but are concerned about the risk of investing in stocks, look for companies that have raised their dividends for the past 10 years and aren't straining to pay them, Silverblatt says.

He suggests making sure that companies' earnings are at least twice their payouts. Among those that make the cut: Chevron (CVX), which yields 3%; Johnson & Johnson (JNJ), 3.5%; and Northeast Utilities (NU), 3.2%.

### Global Infrastructure Stocks

Companies that own and operate infrastructure such as sea ports, toll roads and utility lines not only are good for yield—expect about 5% from a basket of the stocks—but also tend to perform better than the market in downturns.

"These companies are rich on physical assets, and a lot of them have monopolies. For example, if a company builds a toll road, someone isn't going to build a toll road right next to it," says Mike Finnegan, chief investment officer of Principal Funds and manager of the Principal Global Diversified Income fund.

Among his funds' holdings are PPL (PPL), a utility with operations in the U.S. and Britain, and BCE (BCE), a Quebec-based telecom provider.

### Master Limited Partnerships

Advisors like energy-related master limited partnerships not only for their solid dividend yields—often 6% or more—but because they are relatively stable investments and good for diversification.

MLPs are publicly traded limited partnerships. Because of their organizational structure, they don't pay corporate taxes and can pass much of their profits on to their investors. The safest bet is to stick with energy MLPs that own and operate oil and natural-gas pipelines, such as Kinder Morgan Energy Partners (KMP), yielding 6%, and Mark West Energy Partners (MWE), yielding 5.3%. These partnerships aren't closely correlated to stocks and aren't affected by the rise and fall in energy prices, because they collect fees for transporting oil and gas, no matter what happens to the prices.

### REITs

Real-estate investment trusts have had strong returns in recent years, and right now they are paying respectable yields.

The apartment sector has been particularly strong, the result of millions of cash-strapped families deciding to rent instead of buy. David Campbell, a principal at Bingham Osborn & Scarborough in San Francisco, recommends two apartment REITs: Camden Properties Trust (CPT), yielding 3.3%, and AvalonBay Communities (AVB), yielding 2.9%.

Fidelity Real Estate Income fund (FRIFX), with a yield of 5.1%, and Vanguard REIT ETF (VNQ), 3.4%, each will give you a diversified basket of REITs.

But when it comes to income, mortgage REITs that invest in mortgage-backed securities issued by Fannie Mae and Freddie Mac may be your best bet. Since their portfolios are guaranteed by the federal government, there's very little credit risk. So the main risk is that the Fed raises interest rates, and it has told us that won't happen before 2013. Annaly Capital Management (NLY) is the biggest in the bunch, with \$113 billion in assets and a whopping yield of 14.8%.

### Equipment Leasing

When a company leases a piece of heavy equipment, such as an oil tanker or a railroad car, income investors stand to benefit.

Here's how: Independent firms buy up large quantities of leases with investors' pooled assets, "and then investors pick up the income stream from these leases," she says. Current yields are 7% to 8%.

Investors take on the risk of the leases, but Botsford thinks this risk is small.

"We're talking about low-tech equipment that doesn't get obsolete, and 20-year lease cycles," Botsford says. Companies leasing the equipment typically have long track records of making their lease payments. The default rate is minimal, and typically there are about 50 leases in an investment pool.

To participate you have to work through brokers or asset managers, whose firms often have access to specific pools, such as those managed by Icon Investments and Cyprus Financial.

The caveat: These lock up investors' money for five to seven years, so Botsford recommends keeping the allocation to about 2% of your portfolio.

### Immediate Fixed Annuities

Major stock-market declines and wild volatility have increased the appeal of

low-cost annuities. One of the most widely recommended types by advisors is the simplest kind: an immediate fixed annuity. You fund this annuity with a lump sum, and it immediately starts paying out a guaranteed income for life—or a term you specify.

Investors get a higher monthly payment than they could if they tried to create their own income stream from their investments. That's because of annuities' so-called "mortality credit," which is the benefit resulting from pooled assets of many investors. "Some investors are going to die early, and since the insurance company isn't going to have to make their payments, they use them to benefit those still living," says Steve Horan, head of private wealth at the CFA Institute.

With yields of 6% to 7%, a 65-year-old man in good health can turn a \$200,000 annuity into monthly payments of \$1,100 for life.

### Longevity Insurance

If you knew you were going to live until, say, age 85, planning an income stream would be a lot easier. But what worries many retirees is their longevity risk—the chance that they will live a lot longer than they expect.

That's why insurers have recently come out with a new kind of annuity called longevity insurance. This is a kind of deferred annuity that you buy early on to secure an annuity stream five to 20 years down the line. At age 65, you can buy one to begin paying at age 85. "This fixes the time—horizon problem and makes planning a lot easier," Horan says. "These are cost efficient, and they transfer the longevity risk to the insurer," says Horan.

Solid longevity-insurance providers include New York Life Insurance and Metropolitan Life. Fees are embedded in the annuity calculation, but as with immediate fixed annuities, they are reasonable. Through NY Life, a 60-year-old healthy man who buys a \$100,000 longevity insurance contract today can secure a \$2,916-per-month annuity that begins at age 80 and pays out for life.

In all, our 11 investments offer solid income at a time when any income is hard to come by. In other words, yes, you can still retire comfortably. ■