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# What should investors in search of yield-and income-producing investments consider?

BY TIMOTHY E. FLATLEY
AND MATT CROLEY

Clockwise, from top left: *Sean M. Flatley, Michelle Smaltz, Timothy E. Flatley, Lisa Curcio*

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ILLUSTRATION BY KEVIN SPROULS

**Income-investing was once a very straightforward exercise: In 2008, you could purchase a 10-year U.S. Treasury bond yielding 5.0 percent. This created significant income with essentially no credit risk, given the backing of the U.S. government.**

Then came the financial crisis. The Federal Reserve reacted by reducing short-term rates to zero, in an effort to stimulate the economy. Longer-term rates followed, causing the 10-year Treasury bond to reach a low of 1.37 percent, in 2016. As of this writing, the 10-year bond is yielding 2.3 percent.

The message? Before you plunge into the bond market, there are a number of risks you need to consider. Interest-rate risk is a primary concern. Even though the 10-year Treasury is yielding 2.3 percent, it was only at 2.1 percent as recently as two weeks before this writing.

While that difference may not seem like much, it is actually a substantial increase in a very short time. This can create an enormous problem, with just a 1 percent increase in interest rates.

If the 10-year Treasury yield climbs 1 percent, for instance, the increase could result in an approximate 7 percent loss in value of the bond. That is equivalent to almost three years' worth of income from that bond. It is therefore quite unappealing to make an investment for ten years and earn a low yield while losing purchasing power to inflation by the time the bond matures.

The credit quality of the bond represents another meaningful risk. The U.S. Treasury bond is backed by the full faith and credit of the federal government. However, there are now available a proliferation of alternative, usually higher-yielding bonds, including those backed by mortgages, corporations and international governments.

Generally, the higher the bond yield, the lesser the credit quality. These "high-yield" bonds may have rates at 5 percent, with some even reaching into double-digit territory. In theory, an investor is purchasing bonds to diversify and lessen risk in his or her investment portfolio. But, studies have shown that many high-yield bonds are nearly as volatile as a standard stock portfolio.

Duration risk poses another potential problem for investors. The longer the duration to a bond's maturity, the longer the period of time before you will be paid back your principal, and the greater the bond's sensitivity to interest-rate movements. Staggering these maturities so that you have bonds maturing on a regular basis, also known as a bond ladder, ensures that proceeds are always available to be used for consumption purposes or reinvestment in a more favorable manner.

**WHAT, THEN, IS AN INCOME INVESTOR TO DO?**

One of our primary income preferences is stocks which are paying at least a 3 percent dividend and have also increased their dividends' dollar amounts every year for over 25 consecutive years. Johnson & Johnson is an example of one of the many companies that qualify. Of course, a thorough evaluation of any company's many other components is a must, as well.

"The days of earning an attractive income strictly within the safety of U.S. Treasury bonds have passed in terms of the foreseeable future."

Assuming that an investor is concentrating on his or her bond portfolio, we suggest blending a variety of strategies, each designed to perform in a unique manner. This includes, but is not limited to, short-duration bonds, corporate bonds, floating-rate bonds, preferred stocks and international bonds.

We caution against simply turning to an index for your bond portfolio, as indexes often have a hefty concentration of bonds which would be adversely affected by interest-rate movements. For less experienced investors, bond mutual funds offer professional expertise at a reasonable cost.

What's more, there are many free-fund research tools that allow you to learn these funds' composition, to review their past performance in disparate markets and to measure performance on a regular basis.

When managing the bond portion of your portfolio, it is imperative that you understand the risks and continually monitor the wide range of options. The days of earning an attractive income strictly within the safety of U.S. Treasury bonds. have passed, in terms of the foreseeable future. To attain your income goals, you should be willing to broaden your fixed income portfolio. ●

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