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“Have you considered the often-overlooked MLP for your portfolio?”

By Timothy E. Flatley

Creating income still continues to be the Holy Grail for investors. The Federal Reserve's policies have resulted in interest rate levels of approximately 1.85 percent on the 10-year Treasury note. Tying up your money for ten years at that rate, however, is quite undesirable, not to mention the fact that you risk loss of principal should interest rates rise. As a result, investors are moving to a number of other yield-oriented investments, including dividend-paying stocks and high-yield bonds. Yet another often overlooked investment that merits attention is the master limited partnership (MLP).

These securities are frequently based in the oil and gas industry, particularly pipeline transportation and energy storage. An investment in an MLP provides the investor with current yields in the 5 percent to 6 percent range and a chance to participate in the energy boom that some say will make the United States energy independent by 2025.

Just as with any other investment, there are risks. MLPs are capital intensive, so rising interest rates can make their yields less attractive. MLPs have a strong history of raising their distributions, though, which helps to offset the negative effects of rising rates. There is also the potential for price volatility, based upon the fluctuation of different energy commodities. **While many MLPs earn large portions of their income through transportation fees, some are actually engaged in the exploration and production of energy products.** Investors should be able to identify the main sources of their MLPs' income as a way of properly diversifying the risks in their portfolio.

There are over 100 traded MLPs on the market today, and all operate differently from stocks. By definition, you the investor are buying into a partnership, and partnerships issue a K-1 for tax reporting purposes. This makes filing your tax return more complicated. Distributions are partially taxed as income and partly deferred, meaning they are treated as a return of capital, which reduces your cost basis. K-1s are often issued well after the typical investment account's 1099, leaving the tax filer to play the waiting game. Also, the unrelated business income of MLPs can create taxable events in IRAs under certain circumstances. To simplify matters, several firms have begun offering mutual funds and exchange traded funds. These investments issue the traditional 1099 for tax return purposes and provide the added benefit of diversification.

Today's investment market certainly is challenging for the income investor. MLPs currently offer average yields on par with high-yield bonds and greater than those of the more traditional dividend-paying stocks, while still providing the potential for capital appreciation. **We always advise that the best approach is to have a diversified portfolio.** This includes looking outside the traditional stock/bond spectrum, where MLPs may create a unique investment opportunity.

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