Don Martin, CFP®
940 Stewart Dr., Ste. 319
Sunnyvale, CA 94085
phone: **(650) 949-0775**
www.mayflowercapital.com
don@mayflowercapital.com

Getting Decent Yields In This Market

Examples of high yield, high risk investments:

- **Domestic junk bonds**
- **Distressed Debt funds**
- **Emerging Market Bonds**
- **Mortgage REIT's**
- **European Rental Property**
- **Master Limited Partnerships**
- **Oil and gas Royalty Partnerships**
- **Closed End Mutual Funds using leverage**
- **Long-Short Hedge-fund like investments**
- **High yielding high risk junk quality stocks**
- **Foreign Utility Stocks**
- **Business Development Companies**
- **Private ("B" paper) Mortgage Investments**
- **Writing Naked Put and Call Options**
- **Writing Covered Call Options**
- **Bank Loan Funds**

The challenge created by these risky investments is that they have significant risk of sudden, permanent loss of principal. Some assets such as Closed-end funds may actually pay out a return of the shareholder's original capital where they sell off assets each month and send a check to the shareholder. This is not income, it is a liquidation of assets. If the shareholder is careless he won't notice that this type of "yield" is not really yield, instead it is a return of principal and his remaining asset at the fund may be shrinking.

Assuming the reader seeks yield because he is retired and wants to live off of yield without reducing principal then he should be aware that high yield investments, for example, junk bonds, typically incur a risk of loss of principal. In economic theory the higher coupon should be saved and used to compensate for the risk of loss of principal. Thus high yield assets are not really offering all of the distribution as yield. Instead the total payout by the fund company should be broken down into several parts: 1. Compensation for future risk of loss of principal primarily from borrower's defaults, but it could be from bad stock options writing, a drop in commodity prices, a worsening economy that triggered the "Value trap" for high yielding stocks, a worsening economy that resulted in confiscatory taxation (primarily relevant to foreign utility stocks), risk of drop in bond values due to duration risk. This is referred to as a "risk premium". 2. Compensation for the serious risk of using leverage. This is especially true with Closed-end funds, mortgage REIT's, Long-Short hedge-fund like investments where margin calls during a Flash Crash could result in a dramatic loss. 3. Part of the yield (often a very small part) is a reflection of the low yielding investment grade yield. The sum of these three parts is what produces the total yield.

To reduce risk down to manageable levels one should rank mutual funds by risk levels, standard deviation, Sharpe ratios and stick to ones in or near the lowest quartile of risk metrics.

Avoid owning leveraged assets such as closed-end funds, mortgage REIT's. Diversify. If not enough diversification is available in risk assets then avoid owning a significant amount of risky "B" grade credit quality assets, even if it means an overconcentration in cash.

Use experienced investment managers whose documents describe their standards of seeking to manage their firm with a risk adverse, risk aware culture. This type of manager may have the lowest rate of return when the economy is not going through a crash since they are seeking the lowest areas of risk. However, when a crash comes then the slow, risk adverse turtle will beat the hare.

I wrote some articles "Boosting retirement income avoid traps" and "Beware of high yield mutual funds".

These investments may be hard to understand and hard to buy. The providers of those investments may underplay their hidden risk. Please seek out independent advisors who are fee-only for assistance to evaluate these high risk assets.

Please contact Don Martin, CFP® at Mayflower Capital if you would like assistance at (650) 949-0775. Email Don@MayflowerCapital.com.
Follow Don on Twitter @DonMartinCFP
Subscribe to our blog at www.mayflowercapital.com/blog