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RETIREMENT WATCH

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Seeking income in a low-rate world

Dividend-paying stocks, bank loans, short-term Treasuries also can provide an inflation hedge

ixty is the new 40. At least that's how some investors at or near retirement would like to think of their portfolio's asset allocation model and its potential returns.

As baby boomers migrate out of the traditional 60/40 allocation model — 60% stocks and 40% bonds — and into a more conservative 40/60, the quest for equitylike returns and the need for alternative income sources have intensified.

By cutting their equity position,

investors and advisers have reduced the growth and capital gains components of their portfolios, which they

typically rely on for returns. That, coupled with quantitative easing, has investors wondering how they should deal with interest rate exposure and inflation potential.

InvestmentNewsWebcast

Recently, yields on Treasuries and some other fixed-income products have risen from near multiyear lows, providing an attractive entry

point for investors. New issuance of shorter-duration paper has come to market, offering liquidity and less

> downside if rates rise unexpectedly.

Even if the Fed reduces its quantitative-easing program, shorter maturities shouldn't be affected sig-

nificantly. In addition, the credit spread on shorter corporate debt would tighten in an improving economy. Shorter-term Treasuries could offer some protection with limited

upside if the market becomes defensive. Investors, however, would be placing an expensive hedge by holding Treasuries when considering the opportunity cost associated with such a low-yield product.

ATTRACTIVE RETURNS

Dividend equity funds and bank loans are two other alternative income solutions that can give attractive returns while mitigating the effects of rising interest rates and inflation.

Dividend equity funds typically invest in the shares of high-quality companies across multiple sectors that regularly pay dividend income.

Dividends historically have been a large part of equity market total returns. Dividend-paying securities offer the potential for both capital growth and income. They have lower variability of returns than non-dividend-paying companies and have helped buffer portfolio losses when equity prices decline. In a low-interest-rate environment, some investors have used dividend equity funds to augment their fixedincome allocation, making them a plausible source of alternative income.

Last year, falling rates were a large part of total returns in fixedincome portfolios. But the massive gains in fixed-income products are unsustainable as rates hover near historic lows. Thus there is a strong argument for positioning fixedincome-credit portfolios to capture the value and opportunity the bank loan asset class offers.

Many investors believe that they should allocate to bank loans because they're a floating-rate instrument. While that is true, the primary reason to consider bank debt is because it will enhance the yield of a portfolio without adding substantial risk. In fact, the asset could reduce risk if the investor is rotating out of high-yield bonds. The outlook for bank debt appears healthy, in the 5% to 6% range.

Bank loans also are secured

against the issuers' underlying

assets, and their low default rates

and high recovery rates translate

into reduced risk of credit loss. Con-

trarily, high-yield bonds are lower in

their capital structure, and most are

have had only one negative-return

year (2008), while high-yield bonds,

investment-grade bonds and Trea-

suries have had three negative years.

potential related to interest rates has

been priced into the bond market

and that the downside risks are sig-

nificant. We also think that credit

migration is inevitable in the coming

years and that rotating out of high

yield - which is going to be more credit-sensitive and could have

higher defaults and lower recoveries

- is something to consider. High

yield isn't going to experience the

interest rate move it has in the past,

and it lacks the senior structure that

diversity without wishing to

increase the risk profile of their

portfolio greatly should consider the

income opportunities offered within

dividend equity funds and bank

loans. Those seeking simply to protect and preserve capital should look

Sixty may be the new 40, but that

at shorter-term Treasuries.

Investors searching for yield and

bank loans provide.

We believe that all the upside

Over the past 20 years, bank loans

LOW DEFAULT RATES

fixed-rate.

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Finding Risks and Opportunities in Fixed Income

Tuesday, March 12, 2013 4:00 p.m. - 5:00 p.m. ET

With interest rates at historic lows, how much risk is lurking in fixed income, and how can advisers position their clients for a rising rate environment?

This webcast will look at fixed-income investing from a variety of perspectives, including individual bonds, ETFs and mutual funds. Our panelists will offer outlooks for the bond market as well as investing strategies.

Specifically, our experts will discuss:

- Identifying risks inside bond portfolios
- Finding yield if rates stay flat, and the associated risks
- Pros and cons of laddered bond portfolios
- · How bond ETFs will handle rising rates
- The inflation outlook
- The Fed's next move

Attendees may submit questions before and during this live event.

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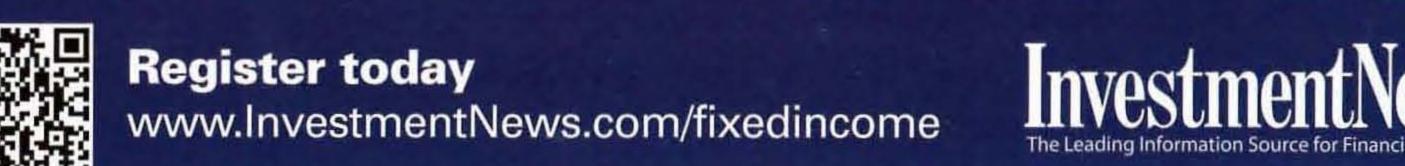


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rifice return and diversity in their

doesn't mean investors have to sac-

Mark Okada is the co-founder and chief investment officer of Highland Capital Management LP.