

## Income Investors Try To Cope With Zero Interest Rates

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Bond investors might be looking to take cover amid Europe's debt crisis.

Remember when you just wanted a few million dollars so you could retire and live on the interest? Forget it.

Investors seeking income are facing a new reality, and it isn't pretty. With Treasury yields so low, it's hard to survive.

We all know why rates are so low: The economic rebound is still fragile, and governments worldwide are saddled with a staggering debt load.

But that doesn't make things any easier for yield seekers.

So you can take one of three roads.

- **Road 1:** Live with these low returns. But liquid, risk-free income has shrunk to almost nothing.

One-year T-bills pay just 0.27%. That's \$51.92 per week for a \$1 million nest egg. And these rock-bottom returns would look even worse if inflation returns.

One ticket to prime seating at a Yankee game would eat up 19.3 weeks of interest. Ten years ago, one-year bills returned 6.06%. Yankee tickets were much cheaper.

- **Road 2:** Move further down the quality ladder.

"People should look beyond Treasuries," said John Hakopian, president and chief investment officer of First Foundation Advisors in Irvine, Calif. Even there, he notes, the yields on the highest-quality borrowers aren't that much more than for risk-free government bonds.

To get a big add in income, Hakopian advises looking into BBB-rated bonds.

You should have your guard up, especially if this isn't your risk capital. Proper credit analysis could help you get into a good portfolio of these higher-yielding bonds.

Hakopian says the individual investor is rarely well-enough informed to take those risks, but you could invest in a bond fund that specialized in BBB-rated companies.

Still, there's no getting around the fact that you'd be taking on more risk than if you had stuck with T-bills. This probably would have you thinking about another option.

- **Road 3:** Move further out on the maturity curve.

This path allows you to stay with risk-free government bonds. And the increase in income is dramatic: The five-year T-note yields 1.91%, the 10-year 3.12%, the 30-year 4.08%.

Even better, as long as you're committing to longer-date issues, don't forget to check out agency bonds, like Fannie Mae, Freddie Mac, the Federal Home Loan Bank and Ginnie Mae.

These debts are guaranteed by the Treasury, and they typically pay a few basis points more than T-bonds at any given maturity.

But when you're talking about longer-term debt, the term "risk-free" becomes inaccurate. Sure, the Treasury will pay off its debt (or so we can assume), but holding a long maturity carries a different kind of risk.

Just like stocks, the market can fall. And agency bonds can fall harder than Treasuries when the bond market gets hit. Maybe it wouldn't matter to you. If most of your basic living costs are fixed, you might be happy with a 4% return. What's that bond worth after a year or two? What do you care?

But if the 10-year yield surges to, say, 6%, that 10-year note's price can fall hard. You might care — a lot.

First, you could have gotten 6% instead of 3%. But OK, you paid your money, and you decided you could live on the cash flow generated by that 4% yield.

But if you must sell that bond, you're stuck. That lower price means you'll lose a bundle. And if you're forced to sell that bond, you probably have other problems.

So where does all this leave you? You get what you pay for.

If you want perfect security, with no credit or market risk, you'll get almost no return. If you venture from that low-paying T-bill roost with your retirement nest egg, do so with the utmost caution.