



The Financial and Estate Planning Council of Metropolitan Detroit, Inc.

April 2012

30600 Northwestern Hwy., Suite 208, Farmington Hills, MI 48334 • (248) 538-7654 • FAX: (248) 538-7656

President's Message

You might find this hard to believe...as president of this organization or any other organization; you are at the center of any critique, both positive and negative, especially as it relates to meetings. I have to tell you though, after our last meeting which was Spouses' Night held at the Holocaust Memorial Center we received nothing but positive feedback. The evening started with docent led tours of the museum and ended with a most captivating talk presented by Holocaust survivor, Paula Marks Bolton. A special thank you goes out to all the spouses and significant others who attended the event sponsored by the Dykema law firm.

Our next meeting is the Annual Charity Golf Outing. It's hard to believe this is our 6th annual outing. We really would like to continue growing the event, so please consider sponsoring a foursome and a hole. Every year we try to make it bigger and better. Volunteer opportunities are available; and even if you don't golf, you can still attend the meeting and dinner. The details were mailed out the middle of April and are available on the FEPCMD web site. This year's charity is The Michigan Humane Society, and our special guest speaker is none other than Detroit News lead sports writer, Lynn Henning. Lynn's topic is Detroit's Big Four, the State's Big Two – Sizing up Michigan's Sports Scene.

I wanted to give you a heads up...the Board of Directors has passed a motion to revamp the sponsorship format for the FEPCMD meetings. I can't tell you how important meeting sponsorships are to the financial strength of our Council. It is also very difficult to find sponsors from time to time, so we are looking for a minimum of 12 firms to sponsor all events for an annual fee of \$1,500. More information will follow, but I wanted you to be on the lookout to participate in this opportunity.

Looking into the future we have excellent meetings planned for September 18, 2012 and November 8, 2012, so mark your calendar.

I hope to see all of you on the links May 21.

Brad M Kreiner CFP®, AEP® ✦

The Quest for Yield - The Roles of Dividend and Interest Income

Laura Thurow, CFA

Summary

Investment income has always been an important part of the total return for investments: Total Return = Price Change + Investment Income. Income can come in various forms, including the dividends associated with stocks and the interest associated with bonds. For the sake of consistency, we will refer to investment income as yield. Yield is simply the income received stated as a percentage of the security price. Traditionally, investors have sought price appreciation from stocks and income from bond investments, though these delineations are starting to blur.

Yield has become increasingly important to investors. Following the extreme market volatility over the past few years, many investors have allocated away from stocks and other risk assets, either to position themselves more defensively in the face of uncertainty or to correct an over-allocation to risky assets. However, while investors are taking on less risk, it appears they have not ratcheted down their return objectives, increasing the need for yield. Additionally, most would agree that the outlook for the stock market over the decade to come is more muted than the recent past. Whatever the driver, it is clear that yield is top-of-mind for many investors.

As investors search for new and often less-traditional sources of income, we remind our clients to put their decisions into context by answering three important questions. What is the yield or income that is required on a regular basis? What is the total return necessary to achieve my objectives? What risks and volatility am I willing to tolerate to meet the yield and return objectives? Investing involves many trade-offs, some of which we will discuss later in this paper.

Key Considerations in the Quest for Yield

There are two key considerations to keep in mind when evaluating different yield instruments: 1) how the current market environment impacts the level of yield that can be expected, and 2) the trade-offs necessary to earn higher yields.

Market Environment. The challenge facing yield-seeking investors today is that the rates to which they have grown accustomed in the past are no longer attainable using the same investment vehicles. As a result of monetary policy actions taken by the Federal Reserve, coupled with a period of weak economic growth and low inflation, the yields available on different asset classes have been compressed across the board.

The yields available on traditional income oriented investments now stand at or near historic lows. The bellwether 10-year U.S. Treasury Bond, which has averaged a 5.2% yield over the past 20 years, today stands at a yield under 3.2%. Riskier high-yield bonds, which have historically averaged a yield of over 10%, today offer less than 7%.

Investors commonly assess yield based on expectations they have formed from past experience. However, investors must recognize that the current environment is different from what they have experienced in the past, and that their yield expectations may need to be adjusted accordingly. Achieving the yields investors have obtained in the past might require utilizing different asset classes, which will likely entail increased risks, as discussed in the remainder of this paper.

Risk/Return Trade-Off. As investors pursue yield opportunities, it is paramount to factor in the risk/ return trade-offs associated with various investments. Whether the search for increased yield is driven by a desire to offset lower expected price appreciation or by unrealistic expectations, investors must be aware that higher-yielding investments are often characterized by higher volatility and risk of loss. Though investors may be hesitant to accept lower returns, we caution them not to chase higher-yield opportunities without full consideration of the risk/return trade-offs, as they may be taking on more risk than they are aware.

Traditional bonds (government, corporate, and high-yield) have historically provided average to above-average yields, lower volatility and moderate total return. Less traditional yield options (REITs, MLPs, preferreds) generally have above-average yields and total return potential, but they also have higher volatility and are susceptible to periods of pronounced negative performance.

Yield Opportunities

There are several investment vehicles that offer the potential for income instead of, or in addition to, the potential for price appreciation. These include more traditional investment vehicles such as bonds and dividend-paying stocks, as well as less traditional vehicles such as preferred stocks, real estate investment trusts (REITs) and master limited partnerships (MLPs).

Each of these vehicles has a unique structure and a unique risk/return trade-off, described below. As such, investors can benefit from having a diversified portfolio of yield-focused investments across several of these categories.

Bonds. Bonds are among the most common way that investors can add yield to a portfolio. This yield comes in the form of income that bonds are required to pay on a periodic basis. Generally, these income payments constitute a large percentage of an investor's total return from bonds because price appreciation is not a main driver. The stability of income payments makes bonds less volatile than other yield-oriented options that have higher potential for price appreciation.

It is important to note that all bonds are not created equal. A bond offering higher yields is a sign that investors expect to be compensated for taking on additional risk. That risk may stem from concerns about the financial health of the issuer or from the structure of the bond itself. For example, bonds with longer maturities are more susceptible to changes in interest rates and have greater uncertainty that all future interest payments can be made. Thus, these bonds will often have a higher yield.

The bond market is very diverse and offers bonds with many different types of characteristics. Common classes of bonds include government bonds, corporate bonds and high-yield (or junk) bonds, among others.

Dividend-paying Stocks. Companies have choices on how to best utilize earnings: paying down debt, reinvesting in the company, buying back shares and returning earnings to shareholders through dividend payments are all available options. More mature companies that produce cash earnings in excess of growth needs often choose to pay cash dividends. An attractive feature of investing in dividend-paying stocks is that investors are able to share in a portion of the earnings and are not reliant solely on price appreciation for returns.

Historically, dividends have made a meaningful contribution to the total return of the stock market, at least in the United States. Since 1970, dividend income has provided approximately one-third of the total stock return. In periods where stock market performance is negative to moderately positive, like the 1970s and 2000s, dividends provide a valuable source of return.

Hybrids: Preferred Stocks and Convertible Bonds. Preferred stocks and convertible bonds are hybrid securities that have characteristics of both bonds and stocks. Similar to a bond, a preferred stock is issued with a fixed value, and payments are made based on a percentage of that value. Preferred shareholders have priority claim over stockholders

FINANCIAL AND ESTATE PLANNING COUNCIL OF METROPOLITAN DETROIT

6th ANNUAL CHARITY GOLF OUTING

NET PROCEEDS AND ADDITIONAL CONTRIBUTIONS TO BENEFIT
THE MICHIGAN HUMANE SOCIETY



MAY 21, 2012

WABEEK COUNTRY CLUB

4000 Clubgate Drive, Bloomfield Hills, MI 48302

<http://www.wabeekcc.org/>



11:15 AM REGISTRATION /11:45 AM: BOX LUNCH/
SHOTGUN START 12:00 PM

\$150 PER GOLFER
(SINGLE GOLFERS ARE WELCOME)

18 HOLES OF GOLF WITH A CART/DRIVING RANGE
WARM-UP/UNLIMITED COURSE BEVERAGES

\$600 PER FOURSOME

4-PERSON SCRAMBLE

\$700 FOR A FOURSOME AND A HOLE SPONSOR

5:30 PM COCKTAILS

\$150 HOLE SPONSOR ONLY

6:30 PM ANNUAL MEETING & GUEST SPEAKER

ADDITIONAL HUMANE SOCIETY DONATIONS:

7:30 PM DINNER

(\$60.00 COCKTAILS & DINNER ONLY)

\$25.00 \$50.00 \$100.00



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YES I WANT TO SPONSOR A HOLE: _____

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MEMBER MEETING PRECEDED BY THE 6th ANNUAL GOLF OUTING
(Please refer to the additional Golf Outing Notice)

GUEST SPEAKER: LYNN HENNING
Detroit News Lead Sportswriter

Detroit's Big Four, the State's Big Two - Sizing Up Michigan's Sports Scene

MONDAY, MAY 21, 2012

Wabeek Country Club
4000 Clubgate Drive, Bloomfield Hills, MI 48302
Office: 248-855-0700

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FOR SOUTHEAST MICHIGAN

Lynn joined The *Detroit News* sports staff in 1979 after 3½ years as a sports writer and columnist for the *Lansing State Journal*. A lifelong Michigan native (St. Johns) and a 1974 journalism graduate from Michigan State, Henning has specialized through the years in covering baseball, as well as Michigan and Michigan State, Lions and Red Wings, and in writing about the outdoors. Henning spent seven years during the 1990s as editor of *PGA Magazine* and as a writer for the national weekly, *Golfweek*.

AGENDA:

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|-----------|-------------------------|
| 5:30 p.m. | Complimentary Cocktails |
| 6:30 p.m. | Presentation |
| 7:30 p.m. | Dinner |

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**NEW FEATURE: Log onto our website by May 14, 2012 to make your reservation and pay with VISA or Master Card.**

[www.metrodetroitfepc.org](http://www.metrodetroitfepc.org)

**RESERVATIONS RECEIVED AFTER MAY 14 WILL COST \$85.00 PER PERSON.**

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MEMBER NAME: \_\_\_\_\_ GUEST NAME: \_\_\_\_\_

TOTAL ENCLOSED: \_\_\_\_\_

on a company's earnings. In this sense, a preferred stock's income stream is more dependable than a dividend payment. Although the yield premium for preferred stocks over Treasury bonds has fallen from the peak, the asset class still provides an above average yield relative to Treasuries.

On the downside, preferred shareholders give up voting rights and generally have less of an opportunity for price appreciation. Additionally, issuing preferred stock is a less common form of financing, and not all companies will have that option.

Convertible bonds are unique in that they can be converted to a fixed amount of equity. Whether or not a bond will be converted is at the discretion of the issuer. Issuers are most likely to force a conversion if interest rates decline significantly; note that forced conversions are generally detrimental to the holders of the security. Given the conversion potential, these bonds present greater upside potential than most bonds, which can be important for those seeking higher total return.

However, in order to gain this upside potential, convertible bonds typically offer a lower yield than traditional bonds, albeit generally still higher than dividend-paying stocks.

**REITs and MLPs.** What makes REITs and MLPs attractive to investors seeking income is the legal structure of these securities. REITs and MLPs are required to pay out 90% of their taxable income to investors. As such, above-average yields can be earned. Additionally, both can add the benefits of diversification to a portfolio, as they are often less correlated with the stock market.

REITs provide investors with access to a pool of real estate assets. These pools may be specialized (commercial property, apartments, health care facilities, etc.) or diversified. MLPs are commonly associated with the natural gas and oil industries, though other non-energy industries are slowly beginning to adopt the MLP structure. The goal is to assemble a portfolio of assets and revenue sources that provide a steady income stream that can be paid to investors.

Along with the unique benefits of REITs and MLPs, some unique considerations also exist. These securities have stock-like volatility and are often concentrated in narrow industry segments that may be subject to periodic shocks. Also, any income derived is subject to ordinary tax rates. Due to these complexities, we recommend to our clients that they consult with their Financial Advisor before making an investment in these areas.

### **Tax Considerations**

As always, the level of income earned after taxes is the most relevant figure to most clients. There are too many nuances

to the tax code to list here, so we recommend evaluating the merits of each option with your tax advisor.

### **Conclusion**

Yield has historically accounted for a meaningful portion of total return, especially in lower-return environments. As such, adding different instruments to access yield opportunities may enhance a portfolio. The differences in yield between investments are a result of the risks that are associated with an investment. Balancing the risk and return trade-offs is an important step in constructing a suitable portfolio. ■

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*Article written by Laura Thurow, CFA, Co-Director of Private Wealth Management Research, and provided by Robert W. Baird & Co. for Skip Massengill, Senior Vice President, Senior Investment Consultant at the Philadelphia office of Robert W. Baird & Co., member SIPC. He can be reached at 215/553-7828 or [SMassengill@rwbaird.com](mailto:SMassengill@rwbaird.com).*

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