What do we do for Income in Today’s Environment?
Andrew Schultz
April 2017

It used to be very easy to create income producing portfolios that had a high level of safety and yield. I used to easily buy high quality tax free bonds with 5% coupons at or below par and/or investment grade corporate bonds or preferred securities with 7% coupons at or below par. Additionally, I would layer in short duration government agency bonds with approximately 5% coupons and sometimes buy high yielding CD’s. The bond portfolios tended to produce all the income that was needed and the balance of a portfolio could then be invested into quality growth investments that would not be touched and could potentially compound upwards over time.

For the most part, since the 2008 credit debacle, the pure bond strategy for income has been over. Many banks that issued investment grade preferreds have now had their ratings moved to “junk,” (non-investment grade). Currently, it is difficult to find quality investment grade corporate bonds yielding over 4%. It is now a battle to find investment grade municipal tax free bonds yielding at 4% (forget 5%). We are in fact very lucky if we get small windows to buy 4% coupons at par. It is hard to find government agency paper with 3% coupons at or below par with short durations. It is therefore now almost impossible in a strictly bond portfolio to get even a 4% after tax yield safely.

There might be a solution. There are other types of investment vehicles that have the potential to provide greater than 4% after tax yields. But caution. These opportunities can typically have more volatility than bonds and/or less liquidity. The key is to diversify across many different income producing strategies in order to reduce the volatility and not over concentrate in any one style. In 2015 many income producing investors were far too overweight in energy investments because they yielded so well and were perceived to be safe. When the price of oil dropped below $30 a barrel many of these investments nosedived in value, some up to and over 50% down. The latter can be stomached (with only a small belly ache) if it is 5-10% of a portfolio. It was far too painful for many that had more than 10% of their portfolio allocated to the energy asset class.

The good news is there are multiple types of asset categories besides energy investments that generate income. If a portfolio only has a small allocation to each category, in aggregate, collectively it may be enough to juice up the yield of the portfolio but not enough in any one category to blow up the portfolio.

The key is to work with a financial advisor that is skilled in all aspects of income producing investing that has the access and ability to build a well-diversified, income producing portfolio, with different complimentary strategies along with quality bonds based on a client’s needs and desires.

The views expressed herein are those of the author and do not necessarily reflect the views of Morgan Stanley Wealth Management or its affiliates. All opinions are subject to change without notice. Neither the information provided nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. Past performance is no guarantee of future results. Morgan Stanley Smith Barney LLC. member SIPC.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond’s maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.