SEARCHING FOR YIELD IN 2015

Back in the early 1980's the yield on my money market fund was around 18% - yes, that is not a typo. At that time, you could buy a non-callable, 30-year maturity U.S. Treasury Bond that provided you a guaranteed 15% annual yield. Of course, inflation was also sky-high and there were many other economic challenges, but we tend to forget those pesky details and just remember how great the yield was.

Since those heady days, yields and inflation have steadily declined. A year ago the 10-year Treasury yielded 2.7% and the 30-year about 3.5%. Despite expectations of rising interest rates, both of these have actually declined with the 10-year now around 1.9% and the 30-year about 2.6%.

Over the past year it was widely anticipated that interest rates would begin climbing. The economy was improving and the Federal Reserve talked about winding down its low-interest rate policy. But the anticipated rise in rates never happened due to lingering concerns about slow global growth, stubbornly high unemployment and pockets of weakness in the U.S. economy. Even now, despite the Fed hinting of mild rate increases, many doubt the timing and magnitude of any ratcheting up of rates.

So, income-seeking investors are in about the same position they have been in for the past several years. If they sit in cash they feel safe, but it comes at the cost of earning almost nothing. If they want to obtain an acceptable yield, they find it necessary to move beyond the comfort zone of "guaranteed" or "FDIC insured" investments. With money market funds paying nothing and rates on CDs below 1%, what is an investor to do?

Diversify Your Strategies

First of all, just as you think of diversifying a stock portfolio, you should also diversify your income strategies. You want multiple streams of income, each with its own unique risks and rewards.

Bonds

Fixed-income investments, such as bonds or bond mutual funds have always been the solid base for income investors. Despite today's yield challenges, bonds are still the foundation asset for income investors. However, you must think carefully about quality and maturity.

Interest rates will eventually go up and at some point you will want to own bonds of longer maturity, but today I would stick with short to intermediate maturity bonds. And while I would mostly want to own the higher-quality "investment grade" bonds, I would allocate a small portion of my bond portfolio to bonds of lower quality and even emerging-market debt where I could obtain more attractive yields.

Tax-exempt bonds are another place for yield-starved investors to consider. Even if interest rates do begin moving up this year, the impact on intermediate-to-longer term tax-exempt bonds is expected to be modest. Plus, rising interest rates and an improving economy should help the finances of municipalities – higher-income taxpayers know this is one of the few places to escape the grasp of the tax collector.

Yield-oriented investors should also consider a bond fund that has a flexible strategy, allowing the fund to alter its approach and investments in response to the economy and market yields.

Stocks

In recent years, investors have rediscovered dividend-paying stocks which continue to offer an attractive alternative for yield-hungry investors. The yield on the stocks in the Dow Jones Industrial Average is about 2.2% and the S&P 500 sports a yield around 2.0%. However, yields of 3% - 4%+ *are*achievable from a number of stocks in the consumer, healthcare, financial and utility sectors. At the same time, keep in mind that dividend-paying stocks are still stocks – they will rise and fall along with the overall stock market.

There are some special corners of the stock market that income investors may find especially interesting such as "master limited partnerships" (MLPs) and "real estate investment trusts" (REITs).

MLPs are typically energy-related companies who collect fees for transporting oil and gas. However, the steep drop in oil prices this past year has also impacted the prices of energy MLPs (a reminder that while dividends may help cushion a stock's price, you are still invested in a risk asset).

Investors in REITs should spread their money across different types of REITs, since some focus on apartments or office buildings, while others may own shopping centers, industrial parks, health care facilities or timber.

Income investors tend to be older and more conservative in their investment goals. Because of this, they should avoid over-emphasizing any particular income strategy and above all, do not overreach in their search for yield. You don't want to squeeze out $1 in additional income, only to find you have lost $2 in principal.

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