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Beacon Wealth Management

Mark S. Germain, CFP®, MBA, Founder and CEO

“Can junk bonds be turned into treasure?”

By Mark S. Germain

Where does an investor go today when experts predict low and slow economic growth? After 30 years of utilizing high-yield bonds in stressful times, they have once again risen as a wise investment. First, let us use the market name for high-yield bonds: junk bonds. Junk, by its very name, implies it is of no value, ergo rubbish. To that, I say rubbish!

Junk bonds function like regular bonds. They are debt investment vehicles in which an individual loans money to a corporation or government for a definitive period of time at a fixed interest rate. Bonds are used by companies, municipalities, states and the federal and foreign governments to finance projects and activities. The rating agencies define “junk” as below-investment grade with a credit rating below BBB. Therefore, a BB bond is one notch below BBB (investment grade). My contention is if one notch were that significant, why was the default risk of government bonds unaffected when S&P lowered the government rating from AAA to AA?

It is interesting to note that since the credit debacle of 2008, many junk bond funds and managers have experienced a decline in actual risk. In its monthly default report, Moody's reported that the 2011 third quarter speculative-grade default rate fell to 1.8 percent. Compare that to 4 percent—the default rate in the 2010 period. Ask yourself why. The simple

answer is companies are more fiscally responsible and bond issuance is tougher for them, hence better credits.

Historically, the spread or the difference in yield between government and high-yield (junk) is 400 basis points or 4 percent. With the spread approaching 700 basis points and high-yield bonds priced at a discount to par value, it appears to be a no-brainer. However, there is also no lunch that is free. High-yield bonds will have swings in price based on fear in the marketplace. This fear will lower the price and cause you to feel like you have lost money. And you can lose money if you sell. However, bonds increase in yield when prices go down, thereby creating another buying opportunity.

From Beacon's perspective, buying bonds should be executed with a manager who has a proven track record of success and analysis and who purchases in large enough quantities to benefit from economies of scale. You, as an individual investor, can buy ETFs such as HYG (iShares iBoxx High Yield Corp Bond) and JNK (SPDR Lehman High Yield Bond), or mutual funds such as Alliance Bernstein High Income (AGDAX), IVY High Income I (IVHIX), and Mainstay High Yield Corporate Bond (MHYIX).

Therefore, in this market of declining stock prices and tiny yields, junk is my treasure. ☺

HIGH-YIELD BONDS

A high-yield bond is one that is rated below investment grade—BB or lower—at the time of purchase.

BENEFITS

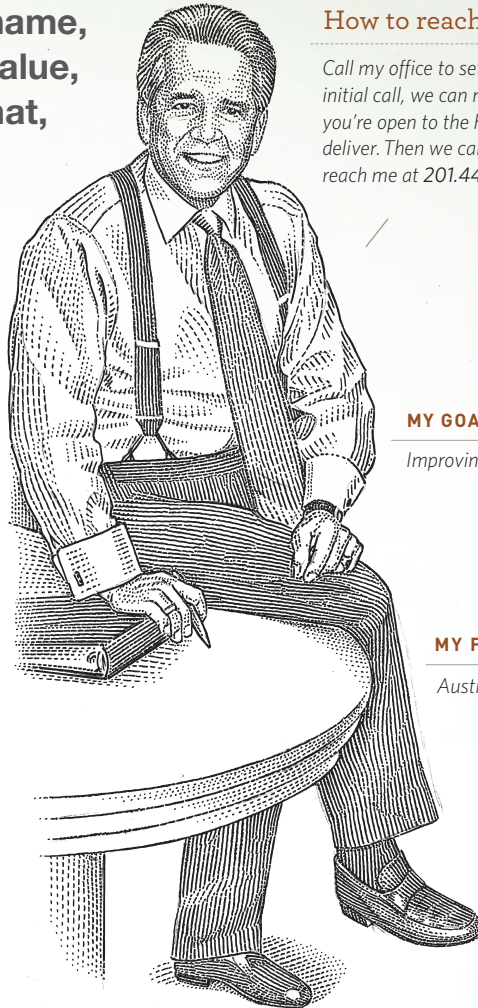
- Higher yields
- Capital appreciation potential
- Security
- Portfolio risk diversification
- Less interest rate volatility risk compared with long-term U.S. Treasury bond prices

RISKS

- Higher risk
- Rising interest rates can worsen yields

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– Mark S. Germain



How to reach Mark S. Germain

Call my office to set up a phone consultation. In an initial call, we can make sure our values align and that you're open to the high level of customer service we deliver. Then we can determine next steps. You can reach me at 201.447.9500.

MY FAVORITE RESTAURANT...

The Central Park Boathouse

MY GOALS FOR THIS YEAR INCLUDE...

Improving my golf handicap to single digits

MY FAVORITE CAR...

Austin Healey 3000

About Mark S. Germain

Mark S. Germain is the founder of Beacon Wealth Management. A relentless tactician, Mr. Germain has managed his clients' financial lives with passion and precision for more than 26 years. In addition to his work building wealth management strategies for professionals, Mr. Germain educates professionals on all facets of asset protection, investment growth, tax reduction and financial planning. After completing his BS degree in economics and accounting, Mr. Germain earned his MBA degree in finance and taught accounting at Northeastern University. He is currently an adjunct professor at Fairleigh Dickinson University where he teaches CFP candidates the financial planning process.

Assets Under Management
\$268 million (as of 12/30/11)

Minimum Fee for Initial Meeting
None required

Minimum Net Worth Requirement
\$1 million

Largest Client Net Worth
\$50 million

Financial Services Experience
26 years

Compensation Method
Asset-based, fixed and hourly fees

Primary Custodian for Investor Assets
TD Ameritrade

Professional Services Provided
Planning, investment advisory and money management services

Association Memberships
CFP, FPA, IMCA

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