ALLEN TRUST
COMPANY

Monthly Newsletter

May 15, 2005

William A. Harris, CFA
Portfolio Manager

Risk ≠ Return: High-Yield Bonds May Yet Prove "Junk"

Picture this: A lion paces before ten doors, behind one of which is a stack of crisp $100 bills. You manage to pick the right door and get through it without being eaten. Which is nifty. But should you thank the lion? And the next time you encounter a lion, will it be logical to conclude that there's money nearby?

A popular notion is that you profit by taking risk, as if the latter causes the former. On the contrary, you do not make money *because* of risk, you only make money *in spite of it.* In our ridiculous example, the lion may have kept someone else from walking off with the cash. But he didn't put the money there or help you to it.

Over the last few years, Allen Trust has taken some judicious, well-diversified positions in high yield bonds (aka "junk" because of a history where investors sometimes *didn't* use them judiciously). For accounts where it was appropriate, and in limited allocations, we've found high cash flows in a low interest rate environment, and even earned some capital gains to boot.

But whereas in 2002 the JP Morgan High Yield Index yielded as much as 10% more than Treasuries, lately it's yielded less than 4% more. Also, speculative bonds (CCC+ or lower) have increased as a proportion of total high yield issuance, and recent downgrades of GM and Ford constitute a huge supply influx to the better-rated reaches of high yield. Hints of inflation and hitches in economic growth likewise raise the sector's risk.

Accordingly we have been pulling back from high yield bonds, whose old moniker "junk" may again prove apt. It looks like there are three lions now, and if there's still any cash behind the doors, it's denominated in $5 bills — paltry reward for taking a chance at being cat food.

Bill Harris

Sharon Heth, JD
Vice President

Charitable Solutions for These Taxing Times

As tax season draws to an end, now is a good time to plan tax saving strategies for this year and the future. One such strategy is charitable gifting, which can reduce both income and estate taxes. Charitable gifts can help not just the charity itself, but also your loved ones, while minimizing how much of your wealth winds up going to an *unintended* beneficiary, Uncle Sam.

Current gifts provide valuable income tax deductions while supporting the important charitable causes you care about. Gifts of appreciated property such as stock or real estate can provide an additional benefit. Sales of such assets generate taxable capital gain. However, if you give an appreciated asset to charity, the gain is avoided and the gift produces a charitable deduction for the fair market value of the asset.

Gifts through your estate plan will ensure that your favorite charities continue their mission after you are gone. Additionally, gifts through your will or trust can provide estate tax savings and even income tax savings.

A life income gift plan such as a charitable remainder trust affords tax savings and an income stream during life. A charitable remainder trust "CRT" is tax exempt and thus does not have to pay capital gains tax when it sells appreciated assets. Appreciated real estate or stocks are particularly good for setting up a charitable trust. Moreover, CRTs enjoy tax-free growth on their investments. These two benefits provide donors with excellent opportunities to diversify and invest for the future in a tax efficient manner.

For more information on how you can benefit your favorite charity, your loved ones and yourself, please contact Sharon Heth V.P. Charitable Services.

Sharon Heth