INVESTMENT UPDATE NEWSLETTER

ALLEN TRUST COMPANY

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Where's the Beef? Or the Bun?

Many of you will remember an early 1980s TV advertisement from Wendy's Old Fashioned Hamburgers. It featured an oversized bun, an undersized beef patty, and an outraged Clara Peller (at right) hollering "Where's the beef!"

From an income perspective, we have long considered the Treasury interest rate curve to be decidedly bun-like: something to bite through on the way to what really matters – all the *good* stuff for which the bun is just framework – as well as a way to hold on without getting too messy. It is not in itself particularly flavorful or filling.

Stretching the metaphor, let's liken the various toppings to all the other income-generating instruments in the investment universe – a mix of REITs, MLPs, spread sector bonds, and foreign securities serves different investment palates just as cheese, condiments and bacon/avocado/fried egg/you-name-it distinguish one burger from another and keep things interesting.

When you get down to it though, it's equity income that really sticks to your ribs. Stock dividends are the beef. Unlike bonds – carbs whose income boost can't last long, fixed payouts being easily digested by inflation – stocks provide protein, fuel not so quickly broken down.

For the last few years, investors who care about income have been hollering themselves hoarse as Clara Peller. What's more, faced with miniaturized yields *across* asset classes, they don't even have a big bun to tuck into – if anything, the Wendy's spoof (of a competitor's bun oversized to trick customers into thinking they're getting a big sandwich) has now been turned on its ear, such that a ridiculously *small* interest rate "bun" is being used to tout the attraction of a slightly larger yet still diminutive

Photo Source: Wendy's commercial via forbes.com

equity yield "patty." As if to say, "Sure earnings, dividend and distribution yields are tiny by historical standards, but compared to near-zero interest rates, they're huge!"

Our view remains that <u>scant interest rates do not, in and of themselves, justify our paying up for low yields on risky assets</u>. Even so, we think there are some areas with enough income potential to be worth the risks that attend them. Following are some of them.

We still see opportunity in obscure or far-flung corners of the bond world, such as taxable munis, non-agency mortgage-backed securities, and foreign developed and emerging markets bonds. For equity income, we favor US sectors with dividend growth absent overvaluation, namely energy and technology, which interestingly have sat out much of the recent market rally yet have been contributing more and more to market dividend growth, unlike hotter and dubiously safe sectors such as consumer staples, telecom and utilities, whose market-wide dividend contribution has been slipping since 2011. We supplement these with multinational megacaps and dividend-paying emerging markets stocks. Altogether, it is unusual fare for unusual times.