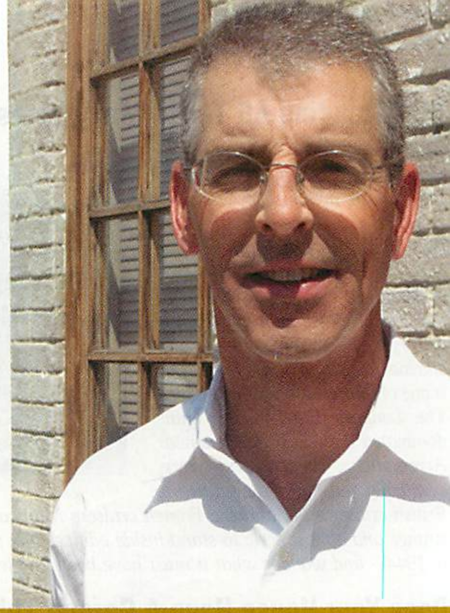
Chaussee's insight



Growth without the restless nights

by Stuart Chaussee

In the summer of 2004 I wrote a series of articles for TheSteet.com, a financial Web site co-founded by CNBC's Jim Cramer. One was titled "Protection Against A Housing Collapse," and another "Nowhere to Turn in this Rate-Hike Cycle."

I had grown increasingly worried about the poor lending practices at the time and the fact that everyone was bragging about his or her home's price appreciation As beautiful as it is in the South Bay, there should be limits to what one pays for a home. The enthusiasm reminded me of the technology/Internet bubble of the early 2000s.

My articles for TheStreet.com warned about the coming housing collapse and the devastation it would cause to stocks, real estate and other asset classes. I basically wrote "there was no place to hide."

While I stressed protecting wealth before the coming decline in stocks and real estate, I was wrong in stating "there was no place to hide." Other than CDs or cash, there was a great place to "hide" – in short-term corporate bonds. Short-term bonds, which mature in from one to five years, are simply loans you make to corporations. In turn, the corporations agree to pay you an income stream (certain percentage coupon), typically twice yearly. At maturity, assuming no default by the issuer, you will have received all your income payments and repayment of your principal. The yield-to-maturity at the time of purchase tells you the exact percentage return you can expect if held to maturity.

During the recent bear market in stocks, real estate and other asset classes, short-term, investment-grade corporate bonds have provided fairly steady returns without the volatility and risks associated with other asset classes. The Vanguard Group has several short-term bond funds that performed admirably during this period. I've chosen Vanguard's offerings for comparison purposes because they are the best-known provider of low-cost funds. Vanguard's Short-Term Bond Index Fund (symbol VBISX) returned 3.7 %on average over the past five years and 5.7% on average over the past three years. Since inception in 1994, it has returned 5.3%, averaged annually. Vanguard's Short-Term Investment-Grade Fund (VFSTX) also held up well during this period, earning 2.1% on average the past five years and 2.4% during the past three years. Its average annual return since inception in 1982 has been 6.8%.

While Vanguard's low-cost offerings are an attractive alternative for many investors, my preference is for investors to build their own portfolio of individual bonds. Corporate bonds are available for purchase at all major brokerage firms and are typically offered in tranches of 10 bonds (approximately $10,000 in most cases). But some dealers have minimums that are even lower (one to five bonds).

These portfolios are appropriate for clients who have moderate-risk profiles, but want potential returns in excess of money markets and

CDs. Building a bond ladder, where maturities are staggered each year, is an excellent way to achieve a decent income stream without assuming a lot of risk. As the shortest maturity bonds come due, the investor simply extends the ladder back out to five years with other bond purchases. It's not an automatic-pilot investment plan, but it does provide for a fairly passive, cost-effective way to invest for income.

Of course, owning short-term bonds means you give up the potentially high returns from stocks or real estate investments going forward. But you certainly sleep better at night and should do a much better job of preserving your wealth. Furthermore, I'm not sure many investors are aware that bonds beat stock returns over many years in certain cases. *Barron's* recently ran an article that showed that for the past two hundred years (that's not a typo...1802 to 2008); stocks beat bonds by an average of 2.5% annually. During the most recent 41-year period (February 1969 through February, 2009), the *Barron's* article shows, bonds have actually outperformed stocks, and without the crazy volatility associated with stock ownership. Bonds also beat stocks from 1803 to 1871 and again from 1929 to 1949. My point is there are periods of multiple decades when owning stocks is simply not worth the risk of loss and bonds are a better alternative.

Certainly, from present depressed levels, stocks may well outperform bonds going forward and a strong case can be made that present valuations would suggest this to be the case. We just don't know for sure.

Here is an example of a Short-Term Investment-Grade Corporate Bond Ladder:

Issuer	Rating	Maturity	Coupon	Yield-to-Maturity
Cox Communications	BBB-	1/2010	4.6%	4.7%
Timken	BBB-	2/2010	5.7	5.8
Simon Property Group	A-	6/2010	4.6	7.7
Ameren Energy	BBB-	11/2010	8.3	5.7
Fortune Brands	BBB-	1/2011	5.1	5.2
AOL Time Warner	BBB	4/2011	6.7	5.4
Exelon Generation	BBB	6/2011	6.9	5.1
FirstEnergy	BBB-	11/2011	6.4	5.3
Consolidated Energy	BBB	3/2012	7.8	6.5
Kinder Morgan Energy	BBB	3/2012	7.1	5.4
Weyerhaeuser	BBB-	3/2012	6.7	7.4
Verizon NY	A	4/2012	6.8	5.3
UST	BBB	7/2012	6.6	5.6
Indiana/Mich. Power	BBB	11/2012	6.3	5.5
Sempra Energy	BBB+	2/2013	6.0	5.3
Autozone	BBB	6/2013	4.4	5.6
Reynolds American	BBB	6/2013	7.2	7.4
Buckeye Partners	BBB	7/2013	4.6	5.9
Altria Group	BBB	11/2013	8.5	6.1
Average coupon and yield-to-maturity:			6.3%	5.8%

Short-term corporate bonds are an excellent vehicle to help investors meet their income needs and maintain their lifestyle during retirement — or even for younger investors who can't stomach the risks associated with stock ownership.

Stuart Chaussee is a Palos Verdes-based fee-only Registered Investment Advisor. He is the author of three financial books, including the award-winning, Advanced Portfolio Management; Strategies for the Affluent. *He is also a former contributing writer for TheStreet.com. Stuart welcomes your feedback and can be reached through* www.preservingwealth.com *or e-mail him directly at* stuartchaussee@msn.com

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