



Carla Pasternak's

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How Do These Assets Keep Raising Their Payouts? Read the Fine Print -- and Cash In!

-- By Carla Pasternak

Today we'll take a look at special securities that were designed for one sole purpose -- to provide investors with a steady stream of rising income. We're not talking about some made-up Madoff scam. We're talking about a little-known and often misunderstood group of securities called "general partners."

Only a few years ago, you couldn't invest in these money-making machines. They were the exclusive purview of private-equity firms and other big-money insiders. But in the past three years, some GPs have started trading publicly. And although the doors are now open to the public, many investors aren't yet aware of the tremendous income potential of these distribution-growth dynamos. (See *Below*)

Also in Today's Issue...

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How Do These Assets Keep Raising Their Payouts? Read the Fine Print -- and Cash In!

Many income investors are familiar with [master limited partnerships](#), a group of about 100 securities, mostly pipeline companies, that boast double-digit yields and double-digit dividend growth. But you may not be familiar with the groups behind these MLPs, the people that really run the show -- the general partner (or more accurately, the company that owns the general partner).

I'll tell you more about them in a moment, but you should know that until recently, general partners (GPs) offered dividend yields of only about 4% to 5%.

Income Notes

A number of major indices have dividend yields that exceed the 10-year Treasury (2.68%) by 100 basis points or more. They include the DJ Industrials (3.86%), Amex Composite (3.98%), Nasdaq Financials (4.08%), DJ Utilities (4.34%) and Nasdaq Bank (4.46%).

-- Andy Obermueller

Big oil, already in a slump because of lower prices, could get even more tempting as the companies report earnings, issue subdued guidance and reduce the value of reserves to reflect the lower prices. The U.S. Energy Information Administration expects oil to average \$43 a barrel in 2009; some bulls consider \$60 more likely. Either way, the trend is upward.

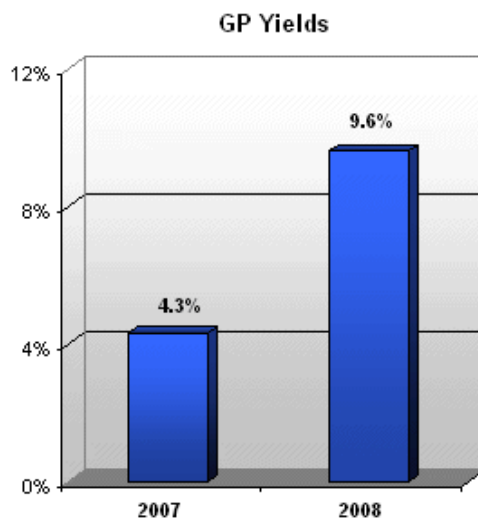
Royal Dutch Shell's A shares, which underlie its most active American depository receipts, carry the lowest multiple among the big oil stocks. It's a solid long-term, total-return play, with a nearly 7% dividend yield.

-- Barron's

That has changed.

Now the average yield of the nine strongest and highest-yielding GPs we've identified is a solid 9.6%. The yield for this group has risen +123% between 2007 and today.

As you know, yields rise as prices fall. But lower share prices are not the sole reason for these higher yields. Even as dividend stalwarts like Bank of America (NYSE: BAC) have slashed payouts, the GPs we've selected have increased their dividends -- called "distributions" in trust lingo -- an average of +14.0% during 2008.



How GPs Make Money

What's behind this growth? After all, the U.S. is smack dab in the middle of one of the worst downturns in its history, and it hasn't been good for dividends. Well, the secret is something called "incentive distribution rights." Don't let this legal jargon make you think these rights are just a bunch of mumbo jumbo. They're not. In fact, they're the money-making catalyst for the general partners and the investors who own a stake in them.

Here's how the system works: General partners manage the day-to-day business of master limited partnerships. Think of an MLP as the silent partner. It gets a check from the net income of a pipeline, but it isn't involved in actually running the business.

Instead, that's the job of a company like Magellan Midstream Holdings (NYSE: MGG), which owns and controls Magellan GP. This entity identifies potential acquisitions, arranges financing, oversees operations and even sets dividend policy. GPs also may help fund growth by providing capital, loans or other financing.

GPs are amply rewarded for their efforts. They typically own a 2% equity stake in the MLP, but that's not all. They also receive a special management fee in the form of incentive distribution rights. These additional distributions are legally binding. They're paid according to a formula that's written into the prospectus when the partnership is formed.

Exponential Distribution Growth

MLPs are legally bound to pay almost all their available cash each quarter to their investors (known as partners), including the general partner. Most general partners are also organized as partnerships or limited liability companies, so they must also distribute the bulk of *their* cash flow to their unitholders.

The GP typically receives an initial 2% of the MLP's distributable cash flow to reflect its 2% equity interest, while MLP unitholders get the remaining 98%. As the limited partner's distributions increase, however, the percentage take of the GP also increases, often to a maximum of 50%.

MGG's distribution rights, together with the 2% equity interest, look like this:

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By Carla Pasternak
January 14, 2009

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By Andy Obermueller
January 7, 2009

The U.S. is in recession, but there are plenty of places where things are booming. Not only did these countries fare well in 2008, they're going to post strong

| Quarterly Distribution/Unit | MLP | GP |
|-----------------------------|-----|-----|
| Up to \$0.29 | 98% | 2% |
| From \$0.29 to \$0.33 | 85% | 15% |
| From \$0.33 to \$0.39 | 75% | 25% |
| Above \$0.39 | 50% | 50% |

Here's how it works: The latest quarterly distribution for MMP totaled \$1.05 per unit before MGG took its cut. Of that, MGG investors received 2% on the first \$0.29, 15% on the next \$0.04, 25% on the next \$0.06, and 50% on the remaining \$0.66, giving unitholders a total quarterly distribution of slightly more than \$0.35 per unit. Though this seems complicated, this progressive system is the same way your income taxes are figured.

You can see from this real life example that as the distribution grows for the MLP, the general partner receives a bigger piece of the pie, as it gets half of any amount over \$0.39 per unit.

In fact, MGG's distribution has grown more than +70% since the first distribution in May 2006. The MLP's distributions have grown less than half of that amount over the same period. Would you rather own shares whose payout grew modestly, or shares whose payout positively exploded?

Just to be clear, we are not saying GPs make better investments than MLPs. While GP distributions grow faster, MLP distributions are larger since they receive a bigger share of the base distribution. MLPs also offer steady distribution growth, but GPs may be just the ticket for income investors willing to forgo some current income in return for faster distribution growth, which in turn could fuel greater share price appreciation.

An Average Yield of 9.6%

As with any investment, there are risks to holding a GP. However, given that they are trading with historically high yields powered by growing distributions, GPs offer ample compensation for these risks.

| General Partners | Price | Yield | 2008 Distribution Growth |
|--------------------------------|---------|-------------|--------------------------|
| GP No. 1 | \$17.83 | 7.4% | +35.4% |
| GP No. 2 | \$15.89 | 7.7% | +12.3% |
| GP No. 3 | \$20.94 | 8.3% | +11.0% |
| GP No. 4 | \$18.20 | 10.7% | -12.7% |
| GP No. 5 | \$44.70 | 10.2% | +10.9% |
| Magellan Midstream (NYSE: MGG) | \$14.63 | 9.7% | +15.3% |
| GP No. 7 | \$19.11 | 13.6% | +16.1% |
| GP No. 8 | \$19.60 | 8.8% | +19.4% |
| GP No. 9 | \$12.15 | 12.5% | +18.8% |
| Average | | 9.6% | +14.0% |

Subscribers to my [High-Yield Investing](#) newsletters recently read about these nine GPs with an average yield of 9.6% and average 2008 distribution growth of +14.0%. As a subscriber, you'll have access to learn the names of these exciting securities. To read more about my favorite GP, and to learn about the high-quality investment ideas we provide each and every month at *High-Yield Investing* -- many with 10%, 12%, and even 15% yields -- [click here](#).

growth in 2009 and through 2010. Plus, stocks in these countries are cheap, and, best of all, each of these countries sports a higher-than-average dividend.

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[An Exclusive Interview With Carla Pasternak](#)

January 20, 2009

Carla Pasternak has worked in the investment industry for more than two decades. Now, as the editor of StreetAuthority's *High-Yield Investing*, she uses this insider's perspective to bring her subscribers the best research into high-yield securities.

We recently sat down with her to learn what she's keeping an eye on as the new year begins to unfold.

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-- Carla Pasternak

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