



Carla Pasternak's

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## The Shunned Income Investment That's Beat Stocks 3-to-1

-- By Carla Pasternak

Don't look now, but a batch of securities everyone knows about -- and seemingly shuns -- has been one of the highest-return investments in 2009.

And the party isn't over yet. There's still time for you to lock in double-digit yields... if you can handle the unfortunate name of this investment. (*Full Story Below*)

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### The Shunned Income Investment That's Beat Stocks 3-to-1

Stocks have been on a tear the past few months, no doubt about it.

With a +54% gain since bottoming March 6th and a +13.4% gain year-to-date, investors would have done pretty well to simply buy into the S&P at the start of the year.

Of course, that's only if they didn't mind missing out on triple that return *and* historically high yields.

It's true. The typically "shunned" securities I've found have walloped stocks this year -- returning +38.6% on average from the start of the year through mid-August -- and their yields peaked at a record 21.8% just a few months ago.

Meanwhile, in at least one key way these assets are safer than any stock. If you own them and the issuing company goes into bankruptcy or liquidation, you are higher on the payment pecking order than any common or preferred shareholder.

### Income Notes

Spreads on high-yield bonds roughly doubled in the six months before the recession that started in December 2007. As the credit crisis came to a head a year ago, spreads on many junk bonds and even some investment-grade bonds widened to "distressed" levels of more than 10 percentage points over Treasuries, prefiguring mega-defaults by Lehman Brothers, Washington Mutual, Tribune Co. and others.

About 31% of high-yield bonds are still trading at distressed levels, down from a peak of about 87.5% in November, but still high by historical standards.

-- Reuters

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But despite their strong rise this year... despite their potential safety compared to stocks... and despite their sky-high yields... most investors still avoid this asset class like the plague.

You see, too many people are tripped up by the name "junk bonds." The name makes the bonds sound like something you put in the blue recycling bin. But you shouldn't be scared away, especially if you're looking for double-digit yields in today's market.

#### The Most Lucrative Time to Invest

Simply put, junk bonds are any bonds rated "BB+" and lower by S&P or "Ba1" and lower by Moody's. These bonds generally rise and fall with the fortunes of the economy, since that's the biggest factor as to whether the parent company can cover the bond obligation.

Investors tend to dump junk bonds during economic downturns since they're less likely to be paid back. The result is depressed prices and high yields. During economic recoveries the bonds tend to rise as the risk of default lessens and investors move to lock in the high yields.

It's the period after an economic downturn and before the recovery that is usually the most lucrative time to invest in junk bonds.

*We seem to be in that period right now.*

The credit crisis pushed default rates on U.S. junk bonds to a six-year high of 11.5% in July, up from a mere 2.7% in July 2008, according to Moody's. The rating agency predicts the U.S. speculative-grade default rates will peak in the fourth quarter this year at 12.7%.

The rapid rise in defaults led investors to dump the bonds with abandon. Junk bonds bottomed in mid-December as fears of rising defaults sent yields to a record 21.8%.

But fears about the severity of the Great Recession have abated, and yields have declined as prices have risen. Between October 2008 and April 2009, yields held stubbornly above 15% as judged by the Merrill Lynch High-Yield Master II Index. They're now moving lower again, but the sector still yields an average of 11.7% as of late August.

Despite the improvement in the outlook for junk bonds, they still have room to run. The spread between junk bonds and Treasuries is still historically high. For the last few years, investors were satisfied with spreads of between 2% and 4%. As of two weeks ago that spread was about 9%. And with junk bonds still selling at roughly 80% instead of the historic 90% of par value, prices can rise as well.

Commodity traders the world over are paying nearly \$70 for a barrel of crude, but there's a much smarter way to go about it. Here's an easy way to buy oil today for just a fraction of its market price.

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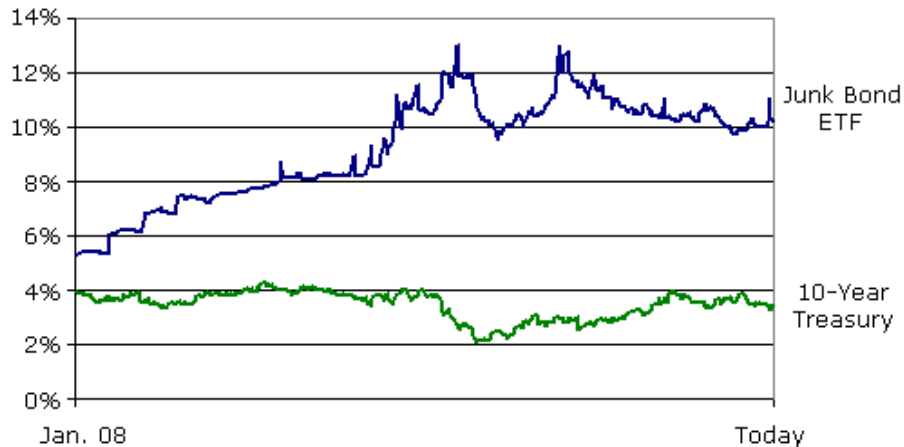
[Buy These 'Boring' Stocks -- And Then Forget About 'Em](#)

Warren Buffett once said his preferred holding period is "forever." Some say that philosophy is dead. They couldn't be more wrong. Here are two high-quality stocks you can sleep easy owning.

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### The spread between yields on junk bonds and Treasuries is still wide...



There's always the risk we could slide back into recession, which would hurt the bonds, but it's likely the worst has passed. Many pundits, including Alan Greenspan and Ben Bernanke, share this outlook, although the potential for a strong recovery isn't clear. This lack of clarity is why the opportunity in junk bonds still exists today, even though Moody's expects default rates in the U.S. to retreat to 3.8% by this time next year.

If you can avoid being scared off by the name, I think junk bonds offer one of the most attractive opportunities around for income investors.

One thing to note: With junk bonds, diversification across companies and industries is crucial, and it's best achieved with ETFs, CEFs or mutual funds. They may not throw off yields as high as some individual bonds, but being able to purchase a stake in dozens of bonds at once is a necessity, especially until there's a clearer sense of a strong economic rebound.

Good Investing!

*Carla Pasternak's Dividend Opportunities*

P.S. -- I can't stress enough how important it is to invest in junk bonds via a fund. If you hold one bond and it defaults, your investment will be in trouble. With a fund, you have instant diversification. I brought my [High-Yield Investing](#) readers nine junk bond funds in my September issue. My favorite yields a solid 12.8%. To join now and get the names of these funds, please [visit this link](#).

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