MAULDIN ECONOMICS | YIELD SHARK

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Twist and Chop
Central Bankers Unite to Push Global Yields Lower

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If cheap money is good, then free money must be even better!

Real yields (after inflation) are already negative. The yield on the 10-year Treasury bond is below 1.5%, and three-month rates are 0%.

The yield on five-year TIPS is a *negative* 1.05%! How much lower can it go?

Heaven knows, but the Fed is determined to push rates lower, because that seems to be the first, middle, and last page of the Central Banker Training Manual.

The Federal Open Market Committee (FOMC) of the Federal Reserve decided to extend Operation Twist through the end of this year and committed an additional $267 billion.

In Operation Twist, the Fed uses cash from the sale of short-dated Treasuries to buy longer-dated securities, in an effort to bring down long-term rates. The hope is that this will reduce the cost of mortgages and auto and business loans.

By the way, as much as I'd like to blame Ben Bernanke for dreaming up Operation Twist, the truth is that a different economic genius came up with it. The original Operation Twist was a program executed jointly by the Federal Reserve and the Kennedy Administration in the early 1960s, to keep short-term rates unchanged and lower long-term rates, thus "twisting" the yield curve. As with today's version, the notion behind Operation Twist 1 was that lowering long-term rates would encourage housing and business investment.

If Operation Twist phase two doesn't work (phase one didn't), the Fed is prepared to do even more.

"The Committee is prepared to take further action as appropriate to promote a stronger economic recovery and sustained improvement in labor market conditions in a context of price stability."

The further action would likely be a third round of quantitative easing –QE3. Given the failing health of our economy, it is only a matter of months before the Fed re-cranks up its printing press.

Even the Fed is concerned about the slowing US economy – go figure!

What hasn't gotten a lot of media attention lately is that, in addition to extending the Twist, the Fed also quietly revised its forecasts for the economy at the latest FOMC meeting.

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At the April FOMC meeting, the Fed forecasted that the US economy would grow by 2.4% to 2.9% in 2012.

Now the Fed expects the US to grow by only 1.9% to 2.4% this year.

Expectations for 2013 were also revised lower. The Fed also reduced its GDP forecast from **a range of 2.7% to 3.1% down to a range of 2.2% to 2.8%**.

Keeping Up with the Bernankes

Ben Bernanke isn't the only central banker that thinks cheap and/or free money is the solution to all the world's economic woes.

In July, the European Central Bank, the People's Bank of China, the Bank of Korea, and the Central Bank of Brazil all cut their key interest rates.

- The ECB cut its key lending rate by a quarter of a percentage point to 0.75%, taking it below 1% for the first time in that central bank's history, and cut the deposit rate it pays on overnight funds from 0.25% to *zero*.
- The PBoC chopped its one-year deposit rate by 25 basis points to 3% and its one-year lending rate by 0.31% to 6%.
- Brazil's central bank first reduced its 2012 GDP growth forecast from 3.5% to 2.5% and then lowered its key lending rate from 8.5% to 8.0%, the lowest rate in Brazil's history.
- The Bank of Korea did the opposite of Brazil. First it cut its rates for the first time in three years, by a quarter of a percent, and then it lowered its growth forecast from 3.5% to 3%.

Not wanting to feel left out from the global print-a-thon, the Bank of England increased the size of its quantitative-easing program by 50 billion pounds ($78.1 billion), bringing the total commitment to £375 billion.

Don't Be a Yield Minnow, Be a Yield Shark!

Clearly, the world's central bankers are determined to push yields lower and keep them low until the global economy turns around.

But recovery will take a few years, perhaps even longer. And living under the new global monetary rules, you must invest differently if you want to prosper.

What these central bankers are doing is defrauding a generation of hard-working savers.

The challenge is that low rates punish savers and leave them with less income, especially retirees living off their investments.

This chart, courtesy of my friend Dan Greenhaus at BTIG, shows that interest income has dropped like a rock as the Fed has lowered, lowered, lowered interest rates.

My forecast is that you will see 2% yields on 30-year Treasuries and less than 1% on ten-year bonds within the next two or three years.

Better yields can be had with some serious research and homework, but that isn't obvious or easy.

My research team and I believe that a carefully selected basket of high-dividend stocks in the right sectors is the right way to navigate the new minefield of income options.

The combination of dividends PLUS capital appreciation is the only way you can beat the central bankers at their *screw-the-savers* game.

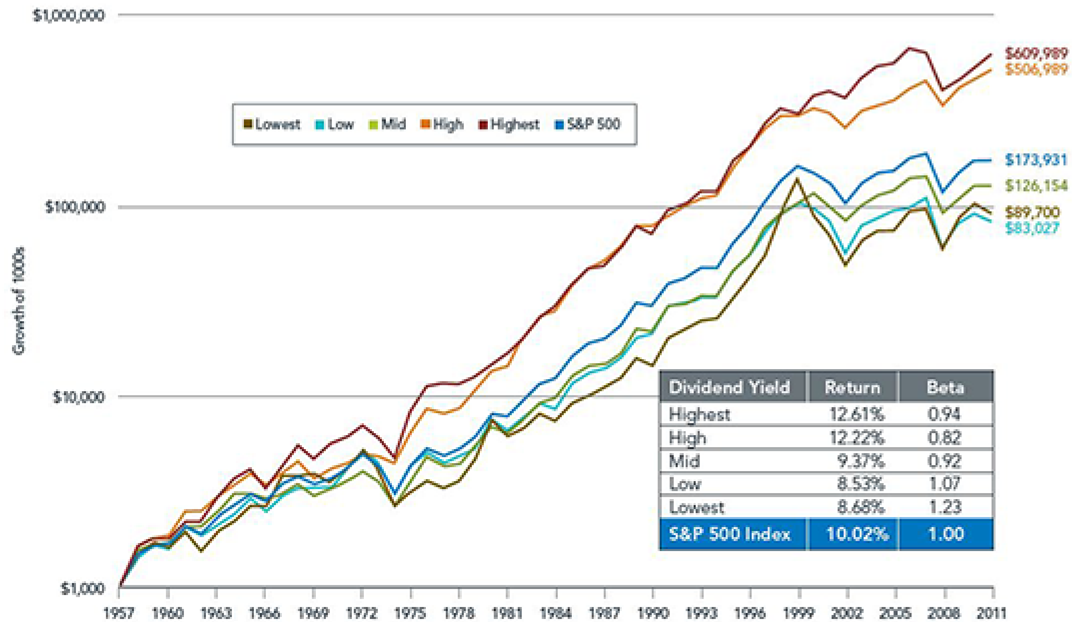
My friends Barry Ritholtz and Jeremy Schwartz recently completed a study that showed that the highest quintile of dividend-payers in the S&P 500 outperformed the overall S&P 500 by more than 2.5% a year.

Over a long period of time, that 2.5% adds up to some serious money.

And those dividend superstars did so with less risk, as measured by lower beta.

FIGURE 1: DIVIDEND YIELD AND RELATIVE PERFORMANCE

[Quintile Charts from Jeremy Siegel's Research]



Dividend Yield	Return	Beta
Highest	12.61%	0.94
High	12.22%	0.82
Mid	9.37%	0.92
Low	8.53%	1.07
Lowest	8.68%	1.23
S&P 500 Index	10.02%	1.00

Heck, even the 2nd quintile beat the S&P by more than 2% a year.

Now, I'm not suggesting that you can buy a basket of dividend stocks, forget about them, and put your portfolio on cruise control.

You need to monitor, analyze, nurture, and actively manage your holdings for maximum safety as well as maximum income. That's good asset management, and it's exactly what we strive to deliver to you each and every month.

This month, my research team has selected one of the most compelling energy stocks you will ever find. Not only does it pay a very attractive 7-1/2% yield, it is expected to do so with great reliability and safety.

High yield... reliability... safety – that's a trio of characteristics that every income investor can love. Here are the details from my Yield Shark Team.

High-Income Opportunity

8% Yield PLUS Growth AND a Big, Soft Safety Net

Oil prices have plummeted this year over fears about shrinking demand due to the global economic slowdown. Oil traded for just a hair below $110 in late February but is now in the mid-$80s.

Most oil and other energy stocks have seen their share prices drop along with the price of oil.

The question is, will the next major move take oil prices to $150 or $50? If you knew the answer to that question, you could make a mountain of money.

However, we've uncovered a little-known energy gem that will make money no matter which way oil prices move.

That's right; whether oil prices go up or down, this stock is going to profit, as well as throw off a nearly 8% dividend to you. That makes it the very best energy stock you can own today.

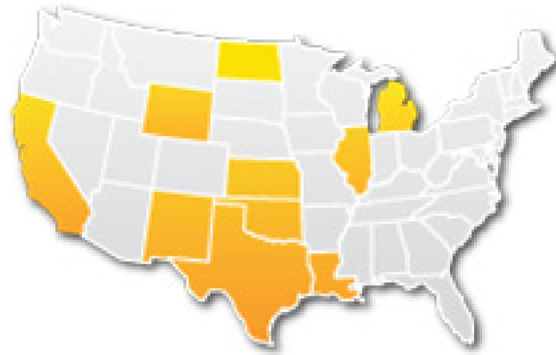
That company is Linn Energy (LINE).

Most investors haven't heard of Linn Energy, but it is the 11th-largest independent oil and natural gas company in the US, with over 15,000 very productive oil and natural gas wells.

Plus, Linn Energy has 4.3 *trillion* cubic feet equivalent of proven natural gas reserves, which is like money in the bank. At its current rate of production, Linn Energy has 21 years' worth of proven reserves.

Today, Linn Energy has approximately 1,000 employees, spread across more than two dozen locations in the United States.

The company's wells are located in the Midwest, the Southwest, Michigan, California, and North Dakota.



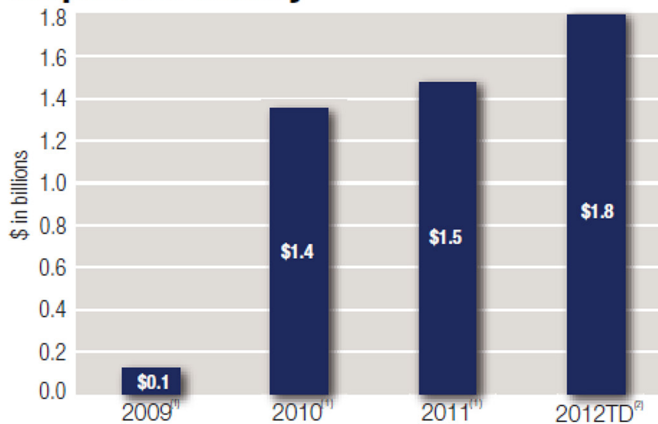
In 2006, Linn Energy became the first publicly traded, independent oil and natural gas limited-liability company in the US, and is now **structured as a master limited partnership, or MLP.**

Since its IPO in 2006, Houston-based Linn has grown through a series of accretive acquisitions – deals that immediately increase cash flow per partnership unit, the ultimate goal.

Linn Energy isn't a speculative wildcatter that drills holes in the ground, praying to find oil. What Linn does is buy established oil and natural gas properties and use its expertise and economies of scale to maximize the profits from those existing wells.

Linn's business model is really quite simple: it acquires mature oil and gas-producing assets and hedges the majority of its production for five years into the future to lock in gains.

Starting with a $12-million deal in its first year, Linn Energy has made 52 transactions worth $8 billion, with a focus on acquiring producing wells and increasing their output.



Fifty-two deals may sound like a lot, but Linn Energy is extremely selective. In just the first six months of 2012, Linn Energy looked at 80 potential acquisitions, bid on only six of them, and actually closed on three of them, for a total of $1.8 billion.

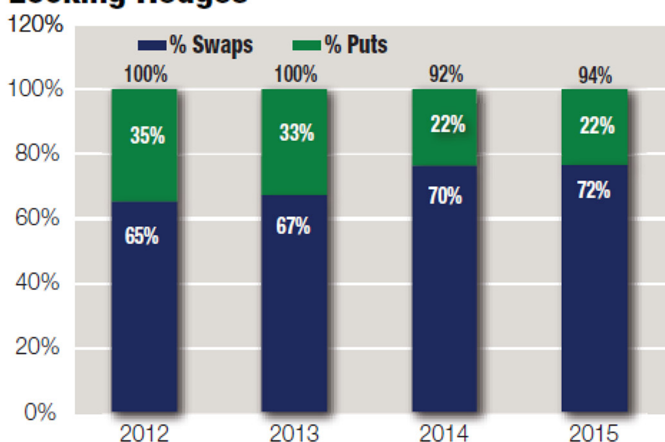
Despite its track record of successful acquisitions, the company's organic growth hasn't taken a back seat. Production grew 40% in 2011, and the management team expects growth this year to exceed 20%.

That combination of acquisitions and organic growth has translated into very impressive revenue and profit growth. Over the last five years, Linn has grown revenues and profits by an average of 43% and 52%, respectively.

Locking In Profits and Hedging Away Risk

Oil and natural gas stocks are prone to big swings, up and down. Linn Energy has an extremely effective hedging strategy that ensures a steady stream of high dividends and provides a big, soft cushion of safety against wide swings in energy prices. These hedges provide stability for the company and investors.

One investment banker called this strategy the "secret sauce" that makes Linn Energy so profitable.

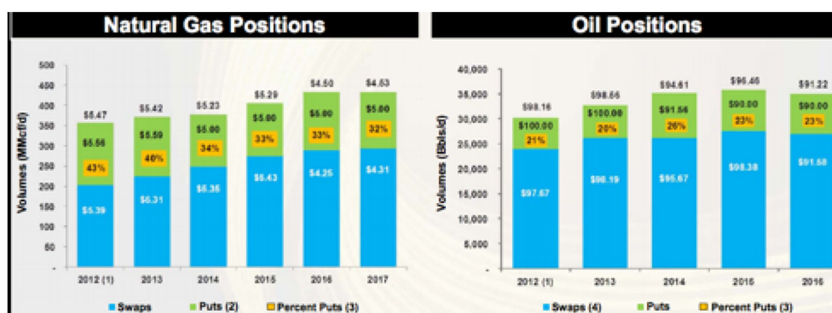


Linn uses a combination of swaps and puts, with the puts allowing participation in price upside for an up-front cost.

What Linn Energy does is employ a combination of swaps and puts that protects it from falling oil prices but still preserves a reasonable amount of upside.

Linn Energy has hedged 100% of its natural gas production through 2017, and its oil is 100% hedged through 2015 and 94% through 2016.

That's right; no matter how far oil and natural gas prices fall, Linn Energy is protected.



More importantly for income investors, this strategy secures a guaranteed stream of future cash flow that will enable Linn to continue to pay its dividend while investing for growth.

Today, the value of that cash-flow hedge stands at approximately $5.50 per Mcf for natural gas through 2015, and approximately $100 per barrel of oil.

Of course, hedging can work against you, too. In Linn Energy's case, if the price of oil shot back up to $150 a barrel, it would still only receive $100 a barrel.

The end result is that Linn Energy isn't a stock that is going to skyrocket if oil prices take off, but neither will it get clobbered by falling oil prices.

Meanwhile, you are going to get paid very well.

Love That Juicy Dividend

Linn Energy has paid out 24 consecutive quarters of dividends without fail, since its inception in 2006. And it hasn't cut its dividend, despite falling energy prices that have caused many other energy trusts and master limited partnerships to rein in their payouts.

Linn Energy currently pays out $2.90 a year in dividends, which works out to just a hair below 8%.

Eight percent is a heck of a income, but we think it will increase over time. Linn Energy has increased its dividend by an average of 4% a year since its inception.

May 4, 2011	0.66 Dividend
Feb 3, 2011	0.66 Dividend
Nov 2, 2010	0.66 Dividend
Aug 4, 2010	0.63 Dividend
May 5, 2010	0.63 Dividend
Feb 3, 2010	0.63 Dividend
Nov 4, 2009	0.63 Dividend
Aug 5, 2009	0.63 Dividend
May 4, 2009	0.63 Dividend
Feb 4, 2009	0.63 Dividend
Nov 5, 2008	0.63 Dividend
Aug 5, 2008	0.63 Dividend
May 2, 2008	0.63 Dividend
Feb 6, 2008	0.63 Dividend
Oct 31, 2007	0.57 Dividend
Jul 31, 2007	0.57 Dividend
May 1, 2007	0.52 Dividend
Jan 25, 2007	0.52 Dividend
Oct 18, 2006	0.43 Dividend
Aug 2, 2006	0.40 Dividend
May 3, 2006	0.32 Dividend

Between dividends and stock appreciation, Linn Energy investors have been well rewarded. Since its 2006 inception, Linn Energy has returned an average of 17% a year.

The most recent dividend was paid out in early May, so the next dividend will be in the first week of August.

Buy Your Straw Hats in January

Linn Energy is on sale. It fell in price since its recent high of $41 and is now in the high $30s. We consider this drop an excellent buying opportunity.

Get this: Linn Energy has compounded its profits by an average of 40% a year over the past five years, but it has a P/E of only 17.

Finally, we believe the dividend is extremely safe, because of Linn Energy's hedging strategy as well as a super-conservative payout ratio of 56%.

Simply put, we believe that Linn Energy is the very best energy stock an income-seeking investor can own. Here's what to do:

> **Assuming a $100,000 portfolio, BUY 100 shares of Linn Energy, symbol LINE, at the market. Place a protective stop to sell ALL your shares at $31.50.**

Portfolio Review

Aberdeen Asia-Pacific Income Fund (FAX): The fund pays out its monthly dividend at the tail end of each month. On June 27, a 3-1/2 cent per-share dividend was paid out.

That dividend was on top of what was a very good month, with the share price rising from $7.31 to $7.64, a 4-1/2% appreciation on top of the 6% dividend yield.

Recommended action: HOLD

New subscribers: BUY 600 shares of Aberdeen Asia-Pacific Income Fund, symbol FAX, at the market. Place a protective stop loss at $6.85.

Annaly Capital Management (NLY): Can Annaly keep paying that juicy double-digit dividend? If history and management are any guide, absolutely!

Annaly has generated positive free cash flows in every year of its existence since 1997, and that includes the very difficult years of 2008 and 2009.

Your account should have been credited with a 55 cent per-share dividend on June 27.

Recommended action: HOLD

New subscribers: BUY 400 shares of Annaly Mortgage, symbol NLY, at the market. Place a protective stop to sell ALL your shares at $12.80.

Philip Morris International (PM): PM is the third security in our portfolio that paid out a dividend in June: 77 cents on June 25.

Jun 25, 2012	0.77 Dividend
Mar 27, 2012	0.77 Dividend
Dec 20, 2011	0.77 Dividend
Sep 23, 2011	0.77 Dividend
Jun 21, 2011	0.64 Dividend
Mar 22, 2011	0.64 Dividend
Dec 21, 2010	0.64 Dividend
Sep 22, 2010	0.64 Dividend
Jun 22, 2010	0.58 Dividend
Mar 23, 2010	0.58 Dividend
Dec 23, 2009	0.58 Dividend
Sep 24, 2009	0.58 Dividend
Jun 22, 2009	0.54 Dividend
Mar 23, 2009	0.54 Dividend
Dec 23, 2008	0.54 Dividend
Sep 11, 2008	0.54 Dividend
Jun 26, 2008	0.46 Dividend

Since it was spun off from Altria in mid-2008, PM has paid out a total of $10.58 in dividends, a handsome income stream that we expect to keep growing.

Recommended action: HOLD

New subscribers: BUY 50 shares of Philip Morris International, symbol PM, at the market. Place a protective stop to sell ALL your shares at $67.

Plum Creek Timber (PCL): Plum Creek is in the lumber business, so it is easy to overlook the valuable real estate on which all that timber is grown.

Plum Creek has a market cap of $6.2 billion and owns 6.6 million acres of land, which works out to $940 per acre. Some of that land is in remote, uninhabited areas, but some of it is prime development property in the most beautiful settings anywhere in America.

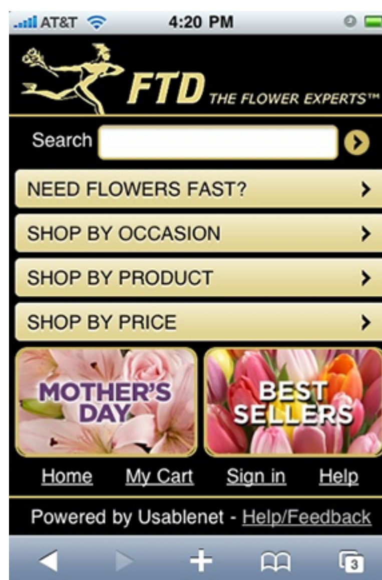
What you have is a profitable lumber business that made $1.14 a share in profits over the last 12 months, has billions of dollars worth of standing timber, owns 6.6 million acres valued at ONLY $940 an acre, and pays a 4.4% dividend.

Recommended action: HOLD

New subscribers: BUY 50 shares of Plum Creek Timber, symbol PCL, at the market. Place a protective stop at $35.

United Online (UNTD): Don't let the 10% yield on this gem trick you into thinking this is a risky stock.

Even at a 10% dividend yield, the payout ratio for United Online is less than 80%, which not only means that the dividend is secure but that UNTD has enough free cash flow to use for growth and/or acquisitions.



The next quarterly dividend of 10 cents is scheduled to be paid out in early August.

Recommended action: HOLD

New subscribers: BUY 500 shares of United Online, symbol UNTD, at the market. Place a protective stop at $3.20.

Yara International (YARIY): The board of directors of Yara think their stock is a pretty darn good value. At the recent annual meeting, the board authorized the purchase of up to 5%, or 14.2 million, of Yara's outstanding shares before the end of 2013.

Yara isn't wasting any time. Since the buyback announcement, the company has already purchased 1.9 million shares on the open market.

We love stock buybacks because subsequent profits are divided over a smaller number of shares and provide an instant boost to earnings per share.

Recommended action: HOLD

New subscribers: BUY 50 shares of Yara International, symbol YARIY, at the market. Place a protective stop to sell ALL your shares at $29.

YIELD SHARK PORTFOLIO[1]

INVESTMENT	Ref. Date[2]	Symbol	Current Rec	Price at Issue	Latest Closing Price	Price Target	Gain / (Loss) %[3]	Dividend Paid	Yield	Total Return
HIGH CURRENT INCOME										
Annaly Capital Management	7/4/2012	NLY	Buy	$16.91	$16.91		0%		12.99%	
INTERNATIONAL INCOME										
Aberdeen Asia-Pacific Income Fund	7/4/2012	FAX	Buy	$7.74	$7.74		0%		5.43%	
Yara International ASA	6/29/2012	YARIY	Buy	$41.53	$43.23		4%		2.70%	
BEST OF BOTH WORLDS										
Plum Creek Timber	7/4/2012	PCL	Buy	$39.51	$39.51		0%		4.22%	
Philip Morris International	6/29/2012	PM	Buy	$86.91	$88.19		1%		3.46%	

[1] This sheet represents our current portfolio recommendations and is not a comprehensive track record.

[2] Reference date is the release date of the publication when the recommendation was originally made in Yield Shark.

[3] Includes dividends

You Ask, We Answer

Question: The Aberdeen Assets fact sheet shows that 35% of fund assets are held in US dollar-denominated bonds! That doesn't seem compatible with your "investing in non-dollar-denominated" statements. Is there perhaps another fund that does not hold so much in USD-denominated bonds? – Lance M.

Answer: Aberdeen's Asia-Pacific Income Fund has increased its stake in US dollar-denominated bonds. These are primarily bonds of non-US countries that choose to price them in US dollars instead of their home currencies. This keeps the fund true to its charter to keep 80% of its assets in Asian bonds.

That move was a good one because of the recent strength of the US dollar, but we expect it to be temporary and for the fund to increase its exposure to Asian-currency bonds.

Question: How do you set the stop-loss price? Once we have a portfolio established, will you monitor these investments and supply sell signals if the fundamentals change? – Robert T.

Answer: Great question. There are two answers: (1) the general answer is that we will suggest selling roughly 15% to 20% above the price where we recommended a security, but (2) every situation is unique, so we look at recent lows, trading volume, and support/resistance levels.

With regard to monitoring our recommendations, don't worry, we will give you an update on each stock in every issue; and if something important – good or bad – comes up between issues, we won't hesitate to send out a Flash Alert with specific buy/sell instructions.

Comment: I have followed you for many years and am convinced you are one amazing guy. Outside of buying your books and trying *Over My Shoulder* briefly, I have not found a venue for reimbursing you for your great insight and information – until now. I am very happy with *Yield Shark! – Charles S.*

Answer: Thank you!

Have a question? We truly appreciate the confidence you have placed in us and welcome the opportunity to answer your questions. We have already received hundreds of letters in response to the first edition of YS, and regret that due to time issues it is impossible for us to reply to them all (although we do of course read them all). Please send your questions to subscribers@mauldineconomics.com.

Unfortunately, regulatory concerns make it impossible for us to provide you with investment advice, or to discuss specific securities recommendations, outside of what's included in our publications and posted on our website. And, of course, we don't know the details of your financial circumstances – information a good advisor would want to weigh before providing you with guidance about specific securities.

To get individualized advice, we suggest that you contact a broker who is knowledgeable and experienced and who is familiar with the kinds of stocks we write about in *Yield Shark*.

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