The OXFORD INCOME Letter

CREATING INCOME FOR TODAY, WEALTH FOR TOMORROW | ISSUE 11, FEBRUARY 2014

# Triple Your Money on the Dividend King of the Dow

by Marc Lichtenfeld, Senior Editor, *The Oxford Income Letter*

MARC LICHTENFELD

I became an investor at an incredibly early age – three days old. My grandfather bought me five shares of **AT&T** (NYSE: T).

Throughout my childhood, I would get a dividend check for a few bucks every quarter.

Unfortunately, no one told me about the power of reinvesting dividends back then (if only someone had given me a copy of *Get Rich with Dividends*).

The dividend money probably went towards baseball cards that my mother ultimately threw away when I was older.

In my early twenties, living in Manhattan on $500 a week but with a girlfriend who had expensive tastes, I had an epiphany.

I've got those shares of AT&T I could sell for a few hundred bucks. That would help pay a month's rent or, what it was likely used for, keeping the girlfriend happy for the weekend.

If I had held onto those shares and reinvested the dividend, I'd be sitting pretty today.

AT&T is one of the highest-yielding non-REIT or MLP stocks in the market, currently sporting a fat 5.5% yield.

In fact, it is the biggest dividend payer in the Dow Jones Industrial Average.

Fortunately, you understand how reinvesting dividends can make you wealthy. Even today, AT&T is a perfect stock for this strategy.

Over the next few minutes, I'm going to show you how you could more than triple your money on the stock. All you'll need is a little bit of time.

But first, let's talk about AT&T.

## IN THIS Issue

## It's Really Not Complicated

In addition to its 5.5% yield, AT&T has raised its dividend every year for 30 years.

That was the same year "Terms of Endearment" won the Oscar for best picture, Culture Club's "Karma Chameleon" hit No. 1 on the Billboard charts and when the Bell System broke up and AT&T divested itself from local phone companies.

That was a long time ago. And it has raised the dividend every year of its current existence.

The company provides service to 30 million landline customers, 16 million internet customers and 5 million television customers.

It is also the largest wireless provider in the world with an incredible 109.5 million subscribers. That compares to No. 2 provider **Verizon**'s (NYSE: VZ) 101.2 million.

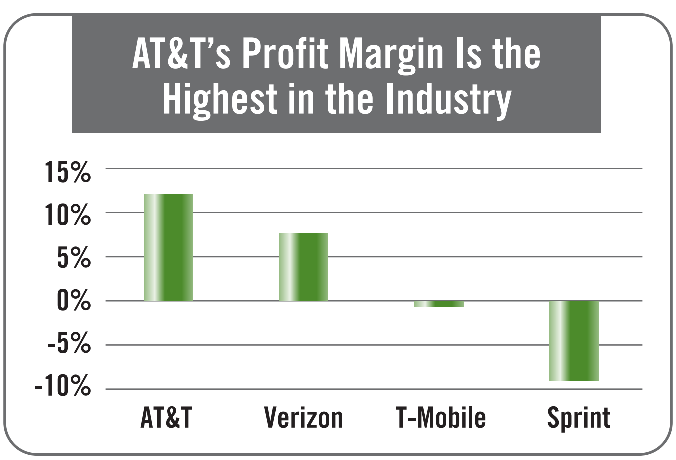
AT&T and Verizon dominate the wireless market. And when it comes to business services, AT&T's scale makes it a formidable foe.

Additionally, it operates the fastest and most reliable 4G LTE network with voice coverage in 225 countries and data roaming in 210 countries.

Despite its enormity, AT&T is still in growth mode. Wireless revenue was up 5.1% in the third quarter of 2013 and the company has experienced 19 consecutive quarters of Average Revenue Per User growth.

It also has the best profit margin in the business – by far.

**T-Mobile** (NYSE: TMUS) and **Sprint** (NYSE: S) aren't even profitable.

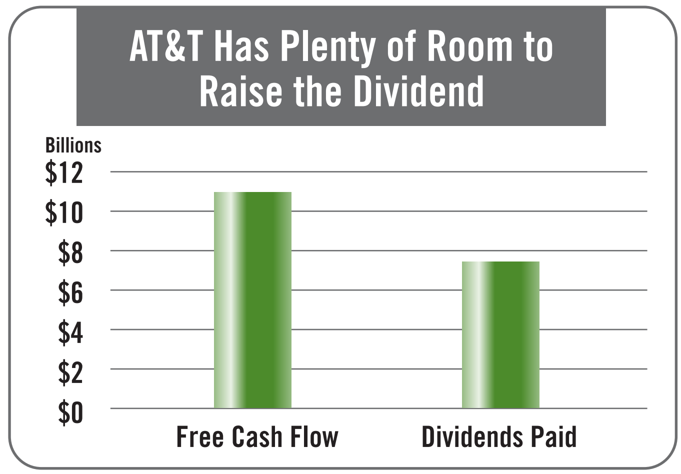



Verizon's net margin was 7.4% in the third quarter, versus AT&T's at 11.9% (which was higher than the 11.6% it recorded a year ago).

## Collect, Reinvest, Repeat

As you can probably imagine when you pay your wireless bill every month, AT&T generates tons of cash. In the first nine months of 2013, free cash flow (cash flow from operations minus capital expenditures) totaled $11.1 billion.

During that period, it paid out $7.3 billion in dividends for a payout ratio of 66%.




And the growth should continue, as well.

AT&T is expected to generate over $17 billion in free cash flow in 2014 and 2015.

Earnings per share are projected to grow to $2.66 in 2014 from $2.48 in 2013, giving the stock a forward P/E of just 12.7. That compares with 13.7 for Verizon.

You won't get huge dividend growth out of AT&T but, with a starting yield of 5.5%, you don't need to in order for the stock to qualify for the 10-11-12 System.

Assuming the same average 2.3% annual dividend increase of the past three years and that the stock trades in line with the market average, over the next 10 years, AT&T investors should see an average annual return of over 12.2% (with dividends reinvested).

That will more than triple your money in 10 years in a safe, high-yielding stock. Now if only I started reinvesting that dividend 40 years ago.

**Action to Take:** *Buy **AT&T** (NYSE: T) at the market for the Compound Income Portfolio.*

## "Superfy" Your Dividends

AT&T's 5.5% yield is strong in today's market. But some investors are looking for even more.

Fortunately, there's a way to capture an even higher yield. And no, you don't have to go investing in a different stock.

It's a different mindset than the Compound Income Portfolio strategy where we're buying the stock with a plan to hold it for years... decades even.

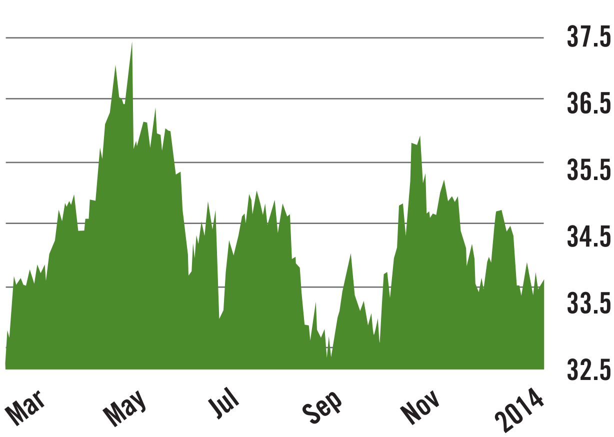
In this other strategy, we're going to "rent" the stocks instead of buying them – meaning we'll be fine if we have to sell it as we're simply using the stocks to capture extra income.

Here's how it works:

1. Buy a stock with an upcoming ex-dividend date.
2. Sell a covered call slightly out of the money that expires right after the ex-dividend date.

Let's use AT&T as our example.

**AT&T: One-Year Performance**




Source: StockCharts.com

As I write this, the stock is trading at $33.70. So we buy 100 shares at $33.70.

The company's most recent ex-dividend date was January 8.

It hasn't announced the next one, but it will likely be in early April.

So we'll sell the AT&T April $34 call for $0.80.

That means the investor will collect $80 (options are priced in 100 share contracts).

By selling the call, he is selling the right for the buyer to purchase his stock for $34 by the third Friday in April (options expire on the third Friday of the month), no matter where the stock is trading.

By selling the call, the investor collects the $0.80 per share option premium plus the $0.46 per share dividend.

Because the ex-dividend date will probably be before options expiration, the shareholder will likely still own the shares and be entitled to the dividend.

If, at expiration, the stock is not above $34, the investor keeps his stock and has collected $1.26 or $126 for every 100 shares, or 3.73%.

Remember, that's 3.73% in just three months.

That's the equivalent of the full-year yields for many quality stocks.

Annualized, that comes out to 14.9%.

If the stock is trading above $34, the stock will be called away and the investor sells his shares at $34, capturing an additional $0.30 capital gain.

In that case, the $0.30 is added to the $1.26 and the investor has earned 4.6% in just three months or 18.5% annualized.

Let me emphasize that to use this strategy, the investor has to be OK with selling his stock.

It is simply a vehicle for earning extra income, not a long-term investment – although an investor can easily reinvest his dividends and the option premium into the stock to increase the share count to generate even more dividends and option premiums.

Yields of 14.9% or 18.5% probably sound pretty good.

But using this strategy, I'm targeting 20% annualized yields at a minimum.

If this sounds interesting to you, check out my new service *Dividend Multiplier*. Give it a try and let me know what you think.

(Please note: The above covered call example using AT&T is not a recommended trade, it's just an example. The recommendation to add AT&T to the Compound Income Portfolio is official, however.) ■

# The Sweet Spot for Bonds

## How to Find Safety and Profits as Interest Rates Rise

by Steve McDonald, Bond Strategist, *The Oxford Income Letter*

Anyone with experience in the markets knows nobody can accurately and consistently predict what any market – stocks or bonds – will do.

Still, the money press is on fire again with all kinds of calls about the death of bonds. These pundits don't bother to specify which bonds are in trouble or under what circumstances – they just blast bonds in general.

Yes, when the Fed finally raises interest rates, which many believe could still be several years away, there has to be a sell-off in the bond market. The mechanical nature of bonds requires it. As interest rates go up, bond prices have to go down.

But just as in a stock market sell-off...

- Some bonds will be crucified.
- Some will take a moderate hit.
- Some will be relatively untouched.

The same mechanical nature of bonds that allows us to know a drop in prices has to happen also gives us the ability to know which bonds will be hit the hardest and which will be hit the least.

That's an edge no other investment offers.

### Keep the Focus

Obviously, as an income investor, you want to be in the bonds that pay enough to make them worth owning and you want bonds that will not be affected by rate changes.

Ideally, we want to own those that will still pay above-average returns even if they take a small hit.

So, rather than guessing about when and how much rates will go up, what we need to focus on is:

- What we know will happen in the bond market.
- When the inevitable increase in rates happens.
- How to capitalize on it.

Here's what to expect.


STEVE MCDONALD

### Quality Time

When rates finally move up, bonds, all bonds – yes, Treasurys too – will fluctuate in value. How much a bond's price fluctuates is a function of its credit quality and maturity.

In other words, the higher the credit quality and the shorter maturity, the less a bond will fluctuate.

The chart below illustrates this point. It shows the approximate price drops for Treasurys for a one-, two- and three-point increase in interest rates.

**Treasurys vs. Interest Rates**

| | 1% | 2% | 3% |
|---|---|---|---|
| 30-Year | 84.55 | **72.32** | 62.58 |
| 10-Year | 91.82 | 84.41 | 77.68 |
| 2-Year | 98.05 | **96.15** | 94.29 |

A Treasury bond with a 30-year maturity will drop from a price of $1,000 to about $723.20 with just a 2% increase in rates. That's a decline of 38%. And when rates do finally get moving we will see at least a two-percentage-point increase.

But the shorter maturity two-year Treasury bill will only drop to $961.50 with the same increase in rates. That's only a 4% decrease.

This fluctuation in market value is cast in stone and 99% predictable.

Granted, Treasurys are guaranteed, so they will generally have smaller percentage drops in value than non-guaranteed municipals and corporate bonds.

But this principle applies to all bonds… The shorter the maturity of a bond, the less it will drop in value.

And the truth is, a five-year maturity BB- or BBB-rated bond will have a fraction of the price volatility of a 10- to 30-year bond of the same credit rating.

"AngloGold has been one of my favorite opportunities of the past several months."

## As Sweet as It Gets

There is a sweet spot for bonds as interest rates inevitably climb higher.

First, the bond has to have less than seven years to maturity. Second, it has to be rated between CCC+ and BBB.

Bonds that fall in these two categories are the perfect compromise for rising interest rates and lower bond prices. That said, here's a bond that falls in my sweet spot for corporate bonds.

**AngloGold Ashanti Ltd.** has a BB+ rated bond (CUSIP: 03512tad3), with an 8.5% coupon that matures July 31, 2020. It is priced at about 105.4, or $1,054 per bond, and will yield about 7.28% annually to maturity.

**BOND: AngloGold Ashanti Ltd.**

CUSIP: **03512tad3**

Maturity: **July 31, 2020**

S&P Rating: **BB+**

A global gold mining company with 21 operations spanning four continents. Headquartered in Johannesburg, South Africa.

AngloGold has been one of my favorite opportunities of the past several months.

In fact, I wrote about another AngloGold bond in September that was also rated BB+. It was trading at $850 per bond and had a maturity date set for April 15, 2020.

In December, I was happy to inform readers it was on pace to return 9% in annual income plus capital gains.

So you won't make as much money as you would have if you purchased the bond from September. But if a 7.28% yield doesn't seem like much – especially after the year stocks just had – remember that is 7.28% every year until maturity in 2020.

That's enough to turn every $1,000 into $1,508.50 with capital gains at maturity. Who can complain about that?

Plus, since this bond is right in the sweet spot – less than a seven-year maturity and the BB+ rating – we can expect minimal price fluctuation from it.

There will be some price volatility when the Fed finally raises rates, but it should be negligible compared to longer maturities.

How much is negligible?

When the yield on the 10-year Treasury ran up 87% last summer (1.6% to 3%), the BB bonds in our portfolio with maturities of less than seven years showed almost no change in price. In fact, most of our bonds have run up in value despite the big increase in rates.

And if that's not enough, the same predictable nature of the bond market also allows you to know, before you invest one cent, exactly what your minimum return will be and exactly when you will receive it, to the penny. I call it the Minimum Expected Annual Return.

Bonds like those listed above can provide a stable and predictable income in all market conditions. They can also give investors the security of knowing how much and when they will be paid. And that's enough to get you to and through retirement, and let you sleep at night, too.

Take a look at corporate bonds in the sweet spot. They have a lot to offer the income investor. ■

# *The* OXFORD INCOME MAILBAG

*We've received a tremendous response from subscribers. We always believe it's good to share these questions and clarifications of dividend-investment strategies with all our subscribers.*

*As always, feel free to send us emails at mailbag@oxfordincomeletter.com.*

**Q:** I just finished your book and need a little direction. I want to start a portfolio using this plan. Is there any dividend-paying stock that meets your qualifying requirements, is contrarian and could be in a 401(k) or a Roth? This would seem to even boost value even more.

Also I am having a hard time deciding on which brokerage service to use.

– Tim R.

**Marc responds:**

Any of the stocks in the Instant Income or Compound Income portfolios meet the criteria for my 10-11-12 System that was detailed in my book, *Get Rich with Dividends*.

However, MLPs **Brookfield Infrastructure Partners** (NYSE: BIP), **Buckeye Partners** (NYSE: BPL) and **Williams Partners** (NYSE: WPZ) are generally better off in your taxable accounts.

That's because MLP distributions are already mostly tax deferred and if you earn too much unrelated business taxable income (UBTI) from MLPs that are in a 401(k) or IRA, you may be penalized by the IRS. So it's almost always better to hold them in non-retirement accounts.

You're right, keeping the other stocks in a retirement account would boost the value of the dividends even more because the investments would continue to grow (and compound) tax deferred.

As far as brokers, any of the big online brokers are fine. They tend to be very inexpensive and have similar tools and features. You can see The Oxford Club's description of some of the top online brokers, as well as Pillar One Advisors, who can give you personal advice by going to www.OxfordClub.com and looking in the "Member Resources" tab.

**Q:** I'm seeking guidance for those of us lacking income sources, such as sales of holdings in trading portfolios, for making new investments. What are the pros and cons of accessing funds by selling a part of a holding that has a capital gain?

– Carol H.

**Marc responds:**

You should sell an existing investment when you believe you have a better opportunity elsewhere. For example, if you own a stock that you believe will return 8% per year and you're looking at a stock in one of *The Oxford Income Letter*'s portfolios that you expect to return 12% per year, then it might be suitable for you to sell the eight-percenter to invest in the one that you expect to achieve greater returns.

You should also consider taxes. I generally don't make "Buy" and "Sell" decisions based on taxes, but if you are going to sell an investment for a gain and it's held in a taxable account, you'll need to be sure you can pay the taxes on it the following April.

As far as new sources of income, get creative. Try to pick up a few hours at a part-time job, turn a hobby into a paycheck, sell stuff on eBay. Anything you can do to get a few dollars that can be invested in Perpetual Dividend Raisers will pay off big in the long run.

**Q:** I really enjoy subscribing to *The Oxford Income Letter* and listening to these audio programs (got started by reading your book). I had been reviewing your recommendation in adding **Eaton Vance Tax-Managed Global Diversified Equity Income Fund** (NYSE: EXG) to my new portfolio but could not find expense/management fees listed such as are plainly listed by typical mutual funds and ETFs.

How is the shareholder charged by this Eaton fund – are closed-end funds different on expense methodology? What do I need to consider regarding fund expense?

– Garrick L.

**Marc responds:**

Great question. I'm glad you're paying attention to fees as keeping your costs low is an important part of generating better returns and making more money.

Closed-end fund expenses are similar to those incurred in mutual funds. So you don't feel it like you would with an advisor who takes his fee out of your cash or sells an investment to generate the cash for the fee.

While loads and fees for selling a fund do come directly out of your pocket, management fees come out of the assets of the fund, of which you are a shareholder. If a fund has $1 million in assets and takes a 1% fee, the asset value will be lowered by $10,000 to $990,000. If there are 100,000 shares outstanding, the price will fall from $10 to $9.90.

If investing in a mutual fund, in my opinion, there is rarely a reason to own an actively managed fund that has an expense ratio of more than 0.3% or 0.4%. Most actively managed funds have expense ratios of around 1% or more. And most actively managed funds don't beat the market or their benchmark indices, so I'd always rather go with a cheap index fund that charges about 0.2% and keep the extra money in my pocket.

Some closed-end funds are different, however. In the example of the Eaton Vance Tax-Managed Global Diversified Equity Income Fund, we are engaging in an active strategy in which the manager is writing covered calls. Also, we are buying the assets at a discount.

So it's worth paying a 1% management fee in order to buy assets at an 8% discount, which is the current discount at the time of this writing.

You can find expense ratio information for free at Morningstar.com or at the website of the Closed-End Fund Center, www.cefa.com. Just type in the ticker symbol of the fund you're looking for.

The Eaton Vance Tax-Managed Global Diversified Equity Income Fund has an expense ratio of 1.07%, which is below the category average of 1.16%.

**P.S.** Thanks for so many nice comments on my book. When I wrote the book, one of my goals was to show people in their 20s, 30s and 40s how they can secure their retirements or build real wealth over the years without having to speculate wildly.

At next month's Investment U conference, I'm going to lead a special workshop geared towards those people who still have some years to go until retirement. If this sounds like you or you know someone who could benefit from the information, please be sure to ask for details on the conference at conferences@OxfordClub.com. Hope to see you there.

## The Instant Income Portfolio

Income for today.

Avg. Yield on Rec. Price: **5.0%** Projected Annual Dividend Growth: **10.3% Avg.**

Avg. Yield on Curr. Price: **4.3%** Dividends Raised Annually for an Avg. of **11 Years**

| Company/Ticker | Rec Date | Rec Price | Current Price | Dividends Collected | Current Yield | Rating | Trailing Stop* |
|---|---|---|---|---|---|---|---|
| Buckeye Partners L.P. (NYSE: BPL) ***MLP*** | Apr-2013 | $58.80 | $72.20 | $3.19 | 5.9% | Buy | $54.56 |
| Digital Realty Trust (NYSE: DLR) | Jan-2014 | $49.47 | $52.35 | $0.00 | 6.1% | Buy | $39.77 |
| Intel (Nasdaq: INTC) | Apr-2013 | $21.05 | $24.81 | $0.68 | 3.6% | Buy | $20.00 |
| Lorillard (NYSE: LO) | Jun-2013 | $42.32 | $49.53 | $1.10 | 4.5% | Hold | $39.33 |
| Meredith Corp. (NYSE: MDP) | Apr-2013 | $38.72 | $44.44 | $1.22 | 3.7% | Buy | $40.00 |
| Nippon Telegraph and Telephone Corp. (NYSE: NTT) ***ADR*** | Apr-2013 | $21.59 | $27.43 | $0.39 | 3.0% | Buy for $28 or less | $20.98 |
| Raytheon Co. (NYSE: RTN) | May-2013 | $61.66 | $88.13 | $1.65 | 2.5% | Buy | $69.34 |

## The Compound Income Portfolio

Dividend reinvestment for tomorrow.

Avg. Yield on Rec. Price: **5.1%** Projected Annual Dividend Growth: **10.5%**
Avg. Yield on Curr. Price: **4.7%** Dividends Raised Annually for an Avg. of **11.4 Years**

| Company/Ticker | Rec Date | Rec Price | Current Price | Dividends Collected | Current Yield | Rating | Trailing Stop |
|---|---|---|---|---|---|---|---|
| **AT&T (NYSE: T)** | **Feb-2014** | **New** | **New** | **$0.00** | **5.5%** | **Buy** | **None** |
| BCE Inc. (NYSE: BCE) | Nov-2013 | $43.66 | $41.57 | $0.58 | 5.3% | Buy | None |
| Brookfield Infrastructure Partners (NYSE: BIP) ***MLP*** | Apr-2013 | $37.80 | $37.05 | $1.29 | 4.7% | Buy | None |
| Darden Restaurants (NYSE: DRI) | Aug-2013 | $49.05 | $50.10 | $1.10 | 4.4% | Buy for $55 or less | None |
| Digital Realty Trust (NYSE: DLR) | Jan-2014 | $49.47 | $52.35 | $0.00 | 6.1% | Buy | None |
| Lorillard (NYSE: LO) | Jun-2013 | $42.32 | $49.53 | $1.10 | 4.5% | Hold | None |
| Meredith Corp. (NYSE: MDP) | Apr-2013 | $38.72 | $44.44 | $1.22 | 3.7% | Buy | None |
| Omega Healthcare Investors (NYSE: OHI) | Sep-2013 | $27.74 | $32.02 | $0.48 | 6.1% | Buy | None |
| Raytheon Co. (NYSE: RTN) | May-2013 | $61.66 | $88.13 | $1.65 | 2.5% | Buy | None |
| Texas Instruments (Nasdaq: TXN) | Apr-2013 | $34.15 | $42.95 | $0.86 | 2.8% | Buy | None |
| Williams Partners (NYSE: WPZ) ***MLP*** | Apr-2013 | $51.27 | $50.87 | $2.59 | 6.9% | Buy | None |

## The Retirement Catch-Up/High Yield Portfolio

Emphasis on current high yields.

Avg. Yield on Rec. Price: **8.1%** Avg. Yield on Curr. Price: **8.0%**

| Company/Ticker | Rec Date | Rec Price | Current Price | Dividends Collected | Current Yield | Rating | Trailing Stop |
|---|---|---|---|---|---|---|---|
| Buckeye Partners L.P. (NYSE: BPL) ***MLP*** | Apr-2013 | $58.80 | $72.20 | $3.19 | 5.9% | Buy | $54.56 |
| Eaton Vance Tax-Managed Global Diversified Equity Income Fund (NYSE: EXG) | Oct-2013 | $9.56 | $10.05 | $0.33 | 10.0% | Buy | $7.72 |
| GlaxoSmithKline (NYSE: GSK) | Dec-2013 | $52.11 | $53.33 | $0.00 | 4.5% | Buy | $41.21 |
| Goodrich Petroleum Corp. Series C Preferred (NYSE: GDP-C) | May-2013 | $25.40 | $25.42 | $1.70 | 9.8% | Hold | $19.60 |
| PennantPark Investment Corp. (Nasdaq: PNNT) | Jun-2013 | $11.16 | $11.24 | $0.84 | 10.0% | Buy for $12 or less | $8.91 |
| Williams Partners (NYSE: WPZ) ***MLP*** | Apr-2013 | $51.27 | $50.87 | $2.59 | 6.9% | Buy | $39.67 |

Prices as of 1/24/2014. * Use a 25% trailing stop. Trailing stops are adjusted to reflect dividends collected. † Prices adjusted for stock split. ADR – American Depositary Receipt. MLP – Master Limited Partnership. REIT – Real Estate Investment Trust. mREIT – Mortgage Real Estate Investment Trust.



Basic subscriptions costs for *The Oxford Income Letter* are $129. Subscription includes membership to The Oxford Club. The newsletter is published monthly by The Oxford Club, LLC, 105 W. Monument Street, Baltimore, MD 21201. Non-U.S. dues are higher and vary from country to country. Send address changes to *The Oxford Income Letter*, 105 W. Monument Street, Baltimore, MD 21201. For questions regarding the status of your membership call Member Services at 443.353.4056 or fax to 410.246.2297. Our website is: www.oxfordclub.com.