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GETTING GOING

By JONATHAN CLEMENTS

Seven Places to Get Decent Yields

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There just isn't much interest.

Yield-hungry investors were supposed to get a little relief this year. But it sure hasn't worked out that way.

True, the Federal Reserve has nudged up short-term interest rates, so that money-market funds today yield more than 1%, up from 0.5% at year-end 2003. But the yield on the benchmark 10-year Treasury note, now around 4%, is actually lower than it was at the beginning of the year.

What to do? If you are a conservative investor looking for moderate returns, consider these seven options.

1. Mortgaging Your Future

When interest rates tumble, mortgage-backed bonds aren't especially appealing. The problem: As rates fall, homeowners rush to refinance, which means high-yielding mortgage-backed bonds get paid off early. That's bad news for the bondholders involved, because they then have to reinvest the money at lower yields.

But with the long decline in interest rates apparently over, bondholders don't have to worry so much about "prepayments." For mortgage-backed bonds, "their best environment is a stable rate environment, and that's what we seem to have," says Richard Schroeder, a financial planner in Amherst, N.Y. He recommends Vanguard GNMA Fund, which yields 4.45%.

2. Beating Inflation

Mr. Schroeder also likes inflation-indexed Treasury bonds. If a

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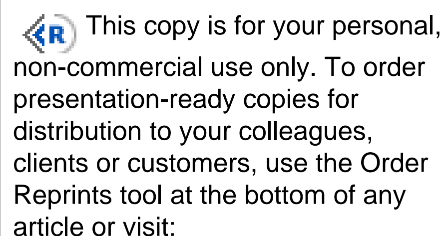
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rebounding economy, rising oil prices and today's massive federal-government budget deficit spur a sharp rise in consumer prices, inflation-indexed bonds "will have a much better chance of keeping up than any other fixed-income investment," he says.

To tap into inflation bonds, Mr. Schroeder favors Vanguard Inflation-Protected Securities Fund. Over the long haul, the fund should keep pace with inflation, while also paying shareholders a small "real" yield, currently 1.44%.

3. Looking Abroad

Feeling adventurous? Consider Loomis Sayles Global Bond Fund, says Rich Chambers, a financial planner in Menlo Park, Calif.

"If the dollar stays the same, we'll get about the same yield as we would with dollar-denominated bonds," Mr. Chambers reckons. "And if the dollar declines, which we think is likely, we'll get a better total return." As the dollar falls, that boosts the value of foreign bonds when figured in U.S. dollars.

Minneapolis financial planner Ross Levin also believes that foreign bonds are less likely to get hammered by rising interest rates. Bond prices and interest rates move in opposite directions. That means bondholders can suffer nasty short-term losses if interest rates spike higher.

"I think there's a lower risk that interest rates will rise abroad than that they'll rise here," Mr. Levin says.

4. Getting With the Plan

To find healthy yields, you may need to look no further than the office. "One place where yields are still decent is stable-value funds in 401(k) plans," says Michael Maloon, a financial planner in San Ramon, Calif. "Those can be a sweetheart deal right now, because yields tend to lag when interest rates drop."

Like money-market funds, stable-value funds don't fluctuate in share price. But the yields on stable-value funds are far higher. Indeed, they currently average 4.2%, according to Hueler Cos. in Minneapolis.

If your 401(k) plan includes a stable-value fund with a mouthwatering yield, you may want to load up on the fund, even if it means underweighting stocks in your 401(k). To compensate, you can always overweight stocks in your individual retirement account or your taxable account, Mr. Maloon says.

5. Saving Yourself

Like a stable-value fund, EE savings bonds will let you clock decent yields while protecting principal. The interest rate on EEs, currently 2.84%, is reset every six months at 90% of the average yield on five-year Treasury notes. But unlike five-year Treasurys, your savings bonds won't suffer a short-term loss if interest rates climb.

In fact, you will benefit, because the rise in five-year Treasury yields will drive up EE bond yields. "That's the whole beauty of them," says Mr. Levin, the Minneapolis financial planner.

One warning: If you buy savings bonds, you have to wait a year before selling. Moreover, if you sell in the first five years, you will lose your last three months of interest. Even with that penalty, however, "you'll still earn more than a money-market fund," Mr. Levin says.

6. Stocking Up

Yields on conservative investments are so low that investors often can bolster their income by swapping part of their portfolio into high-dividend stocks. As an added bonus, those dividends will usually be taxed at a maximum 15%, while bond and money-market interest is dunned at income-tax rates, which can mean losing as much as 35% to Uncle Sam.

With that in mind, Mr. Levin recommends Vanguard Dividend Growth Fund, which yields 1.85%. He also likes two stock-exchange-traded index funds with decent yields, **iShares Dow Jones U.S. Utilities Sector Index Fund** and **Merrill Lynch Pharmaceutical HOLDRs Trust**. Full disclosure: Dow Jones & Co., publisher of The Wall Street Journal Sunday, receives a licensing fee from the iShares fund.

"What you're getting is a nice income stream, plus you get a call on the stock market," Mr. Levin says. "People may have survived the bear market by staying in bonds. But their income has dropped considerably, because yields have fallen. If you buy some stocks, hopefully the growth in your portfolio will compensate for the fall in yield."

7. Paying Down

Don't just hunt for high interest rates. Also look to avoid them. "The best yield now would be paying off credit-card debt," says Mr. Maloon, the San Ramon, Calif., financial planner. After all, if your credit-card balance is costing you 12% or 13%, that is what you effectively earn by paying down that debt.

Also consider making extra principal payments on your mortgage. "If you have a 7% or 8% mortgage that's too small to refinance, you should pay that off as fast as you can," Mr. Maloon says. "To get that sort of yield in the bond market, you'd have to go into low-quality bonds."

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