



Income Builder Weekly

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Snippets

Bonds, anyone?

We recently bought two bond funds - Alliance Bernstein Global High Income Fund and the Morgan Stanley Domestic Emerging Markets Debt Fund. We bought both at significant discounts to the total value of the securities they held. Now their prices have tumbled some 15% from where we bought them, but their Net Asset Values have barely budged. The former is selling at a 20% discount (instead of the 10% where we bought) and the latter is at a watusi 33% discount (instead of the 23% where we bought). Apparently investors are fleeing in droves, panicked by the global meltdown or, possibly, the discounts herald that the NAV's will drop in the future. Neither fund is very much - leveraged (uses borrowed money to enhance returns) so the risk of an uncomfortable deleveraging is not present. While it gets sorted out, let's enjoy the nice double digit dividends.

Do you know our strategy?

In a nutshell, we want to find high income alternatives for you, each of which fits well into the overall mix from a diversification point of view, each of which is cheap relative to its potential and each of which emits a steady and secure stream of income. Our only concern for price lies at purchase (which determines the number of shares we get) and afterward insofar as price continues to represent good value. In research terms, we are using income as the dependent variable and the security price as the independent variable. It is NOT possible to control for both, except to pick strong companies. This latter point about strong companies cannot be underestimated, for they will tend to be far more resilient at an upturn than will weaker companies. And so it is that in a downturn virtually all stock prices suffer but the strong survive and continue to pay dividends - the others surely fail to do one, the other or both.

Dumb Things Department

No more dumb things this week, thank heavens. Jim 1, Dumb 0. But another really dumb thing is shaping up at the FHA, one which could potentially cost billions. The Federal Housing Administration was set up to insure mortgages against default in 1934. It became almost irrelevant during the mortgage finance boom but now scammers have turned to exploiting the FHA's relatively generous financing and re-financing policies. The Bush Administration's Housing Secretary may have not been paying much attention last year, when scammers really began ratcheting up operations through direct mails and through attempts to get people to refinance repeatedly. The number of mortgages written that will last no longer than the first payment is also rising - alarmingly so (according to an article in today's Washington Post). Fortunately, the new guard is on watch and may well curb abuses in a handy fashion while at the same time assisting in the effort to "keep people in their homes." Unfortunately, this very act of governmental grace can create moral hazards where they did not exist before - like letting one's payments go to enter the program. Ugh. Still - one has to live with one's

conscience and perhaps far afterward.

What causes me to sell?

Anyone investing should have a sell discipline. For income investors the task is not so simple as to set a limit below where we will not let a stock price fall. One of our friends, a Morningstar newsletter writer, is sitting on paper losses of large proportions in his banks and some other holdings like GE - he bought GE about \$28, it's \$6 now; he bought BB&T Bank at about \$28 on average, it's \$13; he bought U.S. Bank about \$30, it's \$10; and so forth. He has sold stocks, but he does not sell them until it's apparent to him that the income flow is unsafe. We will not endure such paper losses IF we think that a stock price is seriously out of whack with income potential. Still, we are aware that a 75% loss requires a 400% gain - if one actually sells. If one does not sell a security with a 75% paper loss and the company continues to pay dividends, the stock price will eventually recover and life will continue to be rosy. Still, one is put in a very uncomfortable position. If one has one of those 75% losses on paper, then one may have to jettison the security at a very unfavorable price if the market is right and earnings will be impaired. What do we do?

We set a maximum 50% line in the sand. A security which is down 50% must be sold from the portfolio unless there is compelling evidence that its income power is not impaired. We have a 60% paper loss in one of our closed end funds - NGPC. The fund invests in energy companies, offering loans and technical assistance. If we're right, the security is just experiencing a drop along with the cyclical drop of oil and gas prices. When those prices recover, the stock should bounce back. The alternative of selling at a steep loss - or any selling at a loss for that matter - forces one to find another security and start the process all over again. One could end up with two losses, not just one. And so it is that we sell only when we feel that income may be impaired, but we have a lower threshold than does our friend. Our interest is simple - we want your income to be stable and to grow, period. It is to this task that we are focused.

Thank you for investing with us.

Jim Pursley

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