The Case for High Yield Investing

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August 19, 2009

Many of today's investors have grown up accustomed to markets of the 80's and 90's, where growth of capital dominated income. We believe that the landscape has changed – for at least another generation. This paper examines some of the dynamics involved in the switch.

Growth investing got a huge boost with the growing popularity of mutual funds and 401(k) plans in the 80's, fueled by very high (17%) interest rates at the beginning of the 80's. The final boost came with the income-less dot coms, which promised the moon but delivered a pair of scissors to one's balance sheet. If the drop in the financial markets in 2000-2003 wasn't enough, the death knell to pure growth investing (speculating) came with the cresting of the huge credit bubble which began – well, in the early 80's. It is now time to think of a new investment paradigm if one wants to do well over the coming 10-15 years or so.

Growth comes from a number of sources, but primarily it comes from higher prices relative to company earnings and sales or higher earnings themselves. The 90's had the former, the 00's the latter. The late 00's and the 10's will have little of either, we think. Is this a reason to be pessimistic? Not at all.

Even in the 30's, about 50% of companies maintained their dividends. Thus, it was possible to remain invested in stocks and to still pull through an arguably very, very bad period. The period we are in is not unlike that of the 30's – declining personal spending and huge government outlays. But our government of today is not as fiscally strong as it was in the 30's, believe it or not. Not only is the current debt burden high and growing, but future obligations from social programs are forecast to rise dramatically in coming years. There is, however, a very bright spot – emerging countries.

We need to think of the world as a whole, though we occupy a small part of it. The inertia gained by economic growth in China, India, Brazil and other emerging countries will not likely be broken by a retrenching U.S. consumer. If we are right, we will see a sustainable growth cycle as the U.S. had in the 50's and 60's, this time in emerging countries. But great care must be taken, for the "great moderation" of the 80's and 90's is no longer with us. Profits need to be taken fairly quickly… buy and hold will probably not work well for the next few years.

The world economy was given a huge shot in the arm by governments in their stimulation efforts of late last year and early this year. Those programs are having an effect, but their cost is a greatly increased debt burden in developed countries and very questionable sustainability of growth in countries like China, which are not entirely open to free markets. The piper will have to be paid through higher taxes, we believe, and lower economic growth. But we'll see spurts at times and drops at other times. The "great moderation" has turned into the "great reflation" with all of its attendant potential problems.

We invest in income producing securities in order to capitalize on the best source of profits in the coming years - cash in the pocket from economic activity by companies all around the world. A yield (interest) of 10% goes a long way toward account growth when compounded over several years (both income and account values increase tremendously over seven years at the 10% rate).

Income investing can serve the growth-oriented person through compounding -reinvesting. Income investing can serve the person who needs income from investments, such as retirees, by providing a solid stream of cash to spend throughout life. We believe that the coming epoch will reward thrift and it will reward income investors through high yields (dividends) and higher security prices as more and more people come to see our point of view.

We look forward to this exciting time.

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