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The
High Income Factor

Unlocking Powerful Strategies to Achieve Superior Returns

Tom Hutchinson, Editor

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The Best 'Bond Substitute' on the Market: This High-Yield Play Delivers

My all-time favorite baseball manager is the late Billy Martin. He was controversial, to say the least. But I love the way he managed.

Martin led many teams over the course of his career, but I know him best from his five stints with the New York Yankees. He was known for turning losing teams into winners — leading four teams to division championships — and, of course, for his volatile personality both on the field and off.

What made him so much fun to watch was that he would do almost anything to win.

He was hell-bent on winning, and one way or another he would find a way to get the job done. If that meant defying convention, so be it. If the pursuit of a victory meant angering everybody he knew, he didn't care.

For example, he once benched the Yankees Hall of Fame slugger Reggie Jackson in a pivotal American League championship series game. Martin's rationale was that Jackson had a terrible batting average against the opposing team's lefty starter.

The benching may seem somewhat reasonable in that context, but you have to understand the crazy circumstances at the time to appreciate the audacity of such a move.

This was the "Bronx Zoo" Yankees that featured constant feuds among Jackson, Martin, and owner George Steinbrenner, who usually sided with Jackson. To Steinbrenner, and the New York media, the idea of benching the team's perfectly healthy multimillion-dollar marquee superstar for the nationally televised biggest game of the year so far was unimaginable. Martin knew this move would provoke an unholy firestorm if the Yankees lost. But he did it anyway. And the team won.

To Martin it was simple. He believed the team had a better chance of winning if someone else batted in Jackson's place. In the dogged pursuit of winning, he defied any penchant to cover his own behind. No other manager would have dared.

> "The safety of bonds seems more important than ever — but that option is no longer viable."

I sometimes think about Billy Martin in certain other contexts, especially in today's investment environment.

Of course, I don't pretend to employ the same courage or take on the level of risk that Billy did. I just want to invoke Billy's boundless drive for success and his practice of looking beyond convention for answers, because the standard methods aren't cutting it.

Time to Bench the Bonds

Income investors generally need a counterbalance to stock market risk. The crucial risk equalizer has always been bonds.

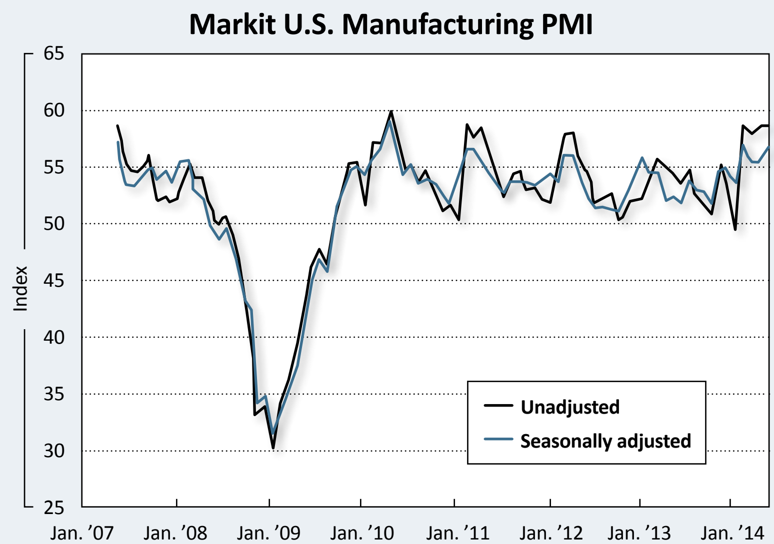
During times of falling stock prices and a faltering economy, bonds tend to perform well, thus tempering the price volatility of the overall portfolio.

But bonds no longer fulfill that role. The crucial diversification and safety function has been lost.

Thanks to the Federal Reserve's actions, not only are bonds not paying an adequate income but they also have become very risky investments. When interest rates rise, existing bond prices will be crushed.

Amid the faltering bond market, many have increased exposure to income-paying stocks. But the stock market is getting very pricey. In addition, it has been an unusually long period of time since stock prices have experienced a significant fall. Many income investors feel overexposed and wonder if the Fed has set us up for slaughter.

Chart 1



The Purchasing Managers Index (PMI), which measures manufacturing activity, came in at 57.3 for June — anything above 50 means expansion. That represents the largest single-month spike since May 2010; the second quarter of 2014 was the best quarter for manufacturing expansion in four years.

SOURCE: Markit

The safety of bonds seems more important than ever — but that option is no longer viable. So it's time to summon the spirit of Billy Martin and figure out some other way to get the job done.

Fortunately, I have identified one of the most stellar defensive income-paying securities on the market that, in today's world, can occupy the risk-equalizing role vacated by bonds.

But first let's take a look at the current situation.

The High-Flying Market

To be clear, I still believe in this current market. Specifically, in my opinion, dividend- or income-paying stocks are the best place to be both for the long and short terms. But even in that space, there is still a need to control for risk.

As I mentioned in past newsletters (see June 2014), the economy will have to pick up strongly for the rest of the year in order to justify current stock prices. After a terrible weather-related performance in the first quarter — an adjusted 2.9 percent GDP decline — the economy by just about all accounts has since picked up strongly.

The June jobs report came in at a better-than-expected 288,000 positions added. That makes an average of 231,000 created per month in the first half of this year and the seventh consecutive month of job growth in excess of 200,000. That hasn't happened since the 1990s.

The Purchasing Managers Index (PMI for short), which measures manufacturing activity, came in at 57.3 (above 50 indicates expansion). The number for June was the largest single-month spike since May 2010. The second quarter of 2014 was the best quarter for manufacturing expansion in four years. (See Chart 1.)

The Conference Board's Consumer Confidence Index also posted the best number since before the financial crisis, and its index of leading economic indicators has continued to forge impressively higher for the past three months.

It appears that a 3 percent to 3.5 percent GDP growth rate for the rest of the year may well be materializing. But it had better — stocks are priced for this level of growth and anything less could spell trouble.

As of now, the forward price/earnings ratio for the S&P 500 is about 16. That's not all that expensive. Heck, it's actually reasonable considering interest rates are near rock bottom and money doesn't have any place else to go.

But that P/E number assumes double-digit corporate earnings growth from here. While I think there is a good chance that could happen, it is admittedly a high bar. It's been three years since the S&P 500 grew earnings at that strong a clip.

Look How Far We've Come

The S&P 500, as of this writing, is once again at fresh new all-time highs. The market has soared a whopping 193 percent since the low in 2009. That return bests any bull market in the past 50 years except those of the 1980s and '90s.

If the bull market continues for another month or two it will also be the second-longest-lasting bull market in the past 50 years.

It has already been the third-longest market rally in history without a correction of 20 percent or more. The only other markets to enjoy such a run were the bull markets of the 1920s and 1990s — unfortunately, neither of those bull markets ended well.

Aside from the economy turning south, there are two major risks to the market at this point: interest rates and geopolitics.

1. Interest rates. The Federal Reserve's hyperactive stimulus policies since the financial crisis have been unprecedented (see the July 2013 issue). Through its bond-buying programs it has injected the economy with trillions of dollars in liquidity and held interest rates down near historic lows. But the Fed is now withdrawing that stimulus.

The $85 billion bond-buying program known as QE3 is unwinding, or "tapering." It has already been reduced to $35 billion per month, and the Fed has made it clear that it intends to end it completely before the end of this year. In addition, the central bank has also suggested that next year it may begin raising the discount rate (the rate that banks charge other banks for borrowing money, which is considered a benchmark for short-term interest rates in the economy).

Rising interest rates can create a problem for stocks. First of all, the stock market has been so good because money has no place else to go. If you don't like the market, what are you going to do? Earn 1 percent in a three-year certificate of deposit? When interest rates rise, stock market alternatives become more desirable. Secondly, higher rates increase the cost of financing and doing business for corporations. So the bottom line is negatively impacted.

The main risk here is inflation. So far, inflation has been subdued and the Fed has had no reason to worry about controlling it, but if that changes the Fed could be forced to raise interest rates higher and faster.

Ironically, if the economy becomes too strong, inflation could kick in and the Fed would be forced to raise rates more aggressively, which would be negative for the market. The economy needs to be good . . . but not *too* good.

2. Geopolitics: Events around the world always pose a wild-card threat to economic stability and the market. But now that risk seems somewhat elevated. The chaotic situation in Iraq could escalate into a wider conflict and the United States could become further embroiled in the region. Trouble in the Middle East could send oil prices much higher, also putting a damper on the recovery.

Recent events like the Arab Spring, the war in Syria, and the tensions in Ukraine have faded from the headlines as stocks prices went higher. But eventually one of these issues will escalate into a problem that the market can't ignore.

Why Bonds Mattered

Many investors I speak with lately ask me, "Who needs bonds anymore?"

▶ About Tom Hutchinson

I've worked in finance my entire career, from the back office of a Wall Street firm to the floor of the New York Mercantile Exchange learning how markets work. Eventually, I became a financial adviser where I met with thousands of investors and managed the portfolios of hundreds over the course of about 15 years. I left my career as a financial adviser, writing for The Motley Fool as well as StreetAuthority LLC, researching companies, industries, and markets. In The High Income Factor, I can bring you the full benefit of my years of investing experience.

After all, the stock market has outperformed bonds during most years and over the long term. As I mentioned in last month's newsletter, buying quality dividend stocks with strong business niches and growing earnings, and reinvesting the dividends, has a very high probability of success over time.

Plus, even if the market gets spooked and drops 20 percent, there is a good chance it will bounce back. So maybe bonds just slow us down anyway.

Let's remind ourselves why we would invest in bonds in the first place:

1. Income

Bonds have historically paid a higher level of income than stocks. Since 1958, the yield on the safe-haven 10-year Treasury bond was greater than the average dividend stock on the S&P 500. The situation, however, reversed after the 2008 financial crisis.

The higher level of income is no small thing for those who depend on it in order to live. Bonds typically make interest payments twice a year that are the same every time, which created a reliable stream for retirees.

2. Principal protection

Unlike stocks, bonds guarantee return of principal upon maturity. This is comforting to many investors. For many, the principal guarantee enables them to invest and still sleep at night, especially older investors who are no longer working.

The level of safety varies, of course, from the "risk free" U.S. government bonds to high-risk, high-yielding "junk" bonds and everything in between. However, those rated investment grade or above ("Baa" by Moody's and "BBB" from Standard & Poor's) have an excellent historical track record of returning principal.

3. Diversification

Typically, bonds hold up very well in years of down stock markets and vice versa. From 1980 to 2013, the Barclays Capital Aggregate Bond Index (an index of investment-grade U.S. bonds) was up during each of the six years in that period when the S&P 500 was down. The index was down only three times in that period, and in every case the stock market finished higher for the year.

4. Lower volatility

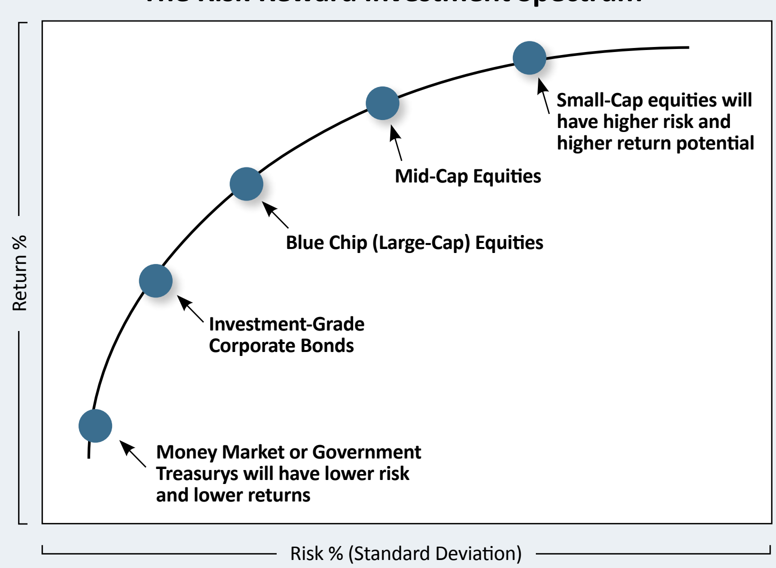
In the 34 years between 1980 and 2013, the worst single-year return for the Barclays Capital Aggregate Bond Index was minus 2.92 percent, whereas the worst year for stocks in that period was minus 37 percent. In 2008, when the stock market experienced its worst year, the bond index returned a solid 5.24 percent.

To be sure, stocks tend to perform better than bonds most years and over long periods as well. From 1970 through 2013, large company stocks have posted an average annual return of 10.41 percent per year compared to 7.94 percent over the same period for the Barclays bond index. And in the 10 years ending in March 2014, the S&P 500 averaged 7.41 percent per year compared to 4.46 percent for the index.

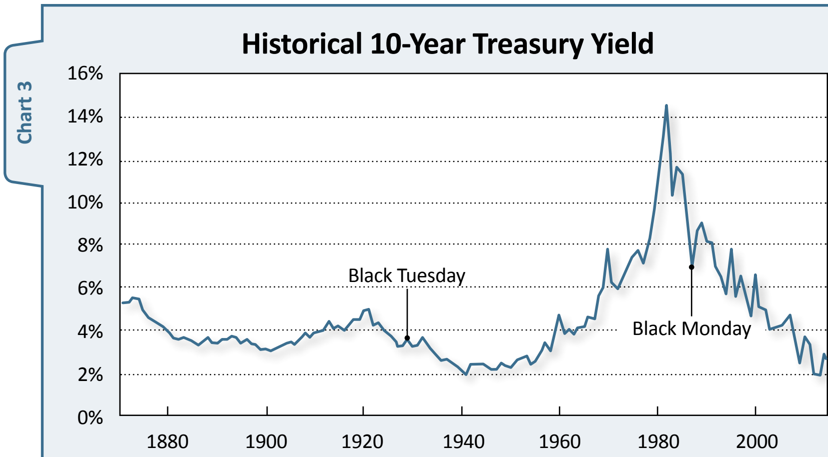
Thus, bonds have performed with a far lower variation of returns year to year. This lower volatility may not sound exciting, but it is important. Adhering to a less erratic investment

Chart 2

The Risk-Reward Investment Spectrum



This simple chart shows the relationship between risk and reward — at the lower end are money market accounts and government Treasurys, offering safety but a small return, while small caps provide the greatest potential return but at the price of high volatility.



The 10-year Treasury yield fell from over 15 percent in 1981, stayed as high as 8 percent as recently as 1990, and dropped to under 2 percent in 2013 before a small rally. In the past, investors enjoyed not only much higher interest rates than currently exist, but also consistent appreciation in the prices of bonds.

SOURCE: multpl.com

portfolio — instead of whipsawing in and out of trades whenever the market winds blow a different way — tends to keep investors invested through the rough patches and positioned to benefit when markets rebound.

The Case for Diversification

Consider the fact that many investors who left the market during the financial crisis did not get back in and have missed the 190 percent rally. In 2008, when the S&P 500 fell 37 percent, the bond index returned 5.74 percent. A theoretical portfolio divided equally between stocks (the S&P 500 index) and bonds (the Barclays index) would have been down less than 16 percent for the year. Investors would be more likely to weather a storm if they were down 16 percent than if they were down more than twice that, at 37 percent.

A rule of thumb for investing in a 401(k) or a pension plan has been to diversify according to age. A person typically held his or her age as a percentage in bonds and the rest in stocks. For example, if you were 30, you had 30 percent in bonds and 70 percent in stocks, and vice versa.

The idea was that as you got older, you would have less ability to endure a downturn in the market. When I was a financial adviser, I worked with retirees. Almost all of them wanted most of their money in bonds. I would usually provide them with a regular income from a portfolio of highly rated bonds or bond funds. You could actually get a decent income from these investments back then.

When I was young in the business I would sometimes suggest to them that they might be better off over time allocating a little bit more money into quality stocks. They would usually scoff at the idea. "If I lose money I can't make it back," they would say, or "We use that income to eat." They simply didn't want to take on any unnecessary risk at that point in life. In short, the low-risk, low-volatility space that bonds had represented was invaluable to investors who depended on income.

The New Bond Reality

For the past several decades, bonds have been rock-solid performers, paying a high level of income and lowering the volatility of returns. But here's the problem. Bonds have been in a secular bull market for the last 30 years or so, which looks like it has come to an end.

Bond prices move inversely with interest rates. As rates rise, bond prices decrease to the point where the yield will be in line with the new market rates. Falling rates, of course, have the opposite effect of increasing bond prices. And the longer the maturity of a bond, the more volatile the price is to a given change in interest rates. Since interest rates have little room to move lower and lots of room to move higher, the prognosis for bond returns going forward looks poor.

In Chart 3, we see that investors used to enjoy much higher interest rates than currently exist. The situation can only get worse going forward. Even if interest rates stay near where they are, or approach zero percent as happened in Japan, it would be impossible for investors to generate anything approaching the returns they enjoyed over the past several decades.

Here's a look at some of the rates on traditional investment-grade rated bonds available.

Traditional Investment-Grade Rated Bonds	Percent Gain
iShares iBoxx $ Investment Grade Corp Bond Fund (LQD)	3.57%
10-Year Treasury	2.64%
20-Year AA-Rated National Municipal Bond	3.45%
3-Year CD	1.50%

For the subpar level of income that these investments generate, it seems hardly worth the risk that rising rates would pose. The LQD ETF and the 20-year municipal bond are investments that go fairly far out in maturity and will be quite sensitive to changes in interest rates.

Bonds these days pay little income and put your principal at great risk. Of course, you can get back the original principal if you hold the bond until maturity, but in order to do that, you would earn subpar income the whole time and, thanks to inflation, be repaid in dollars worth far less than they were when the bond was purchased. That's not a great deal.

A Bond Substitute

So, with bonds no longer able to act as a risk equalizer in a portfolio, we must look to an alternative.

The good news is that certain sectors of the stock market represent industries that have similarities to the traditional bond market. Defensive-oriented industries that pay high dividends and typically don't offer much growth potential somewhat mimic that market.

Perhaps most notable of these industries is utilities.

A utility is a company that generates, transmits, or distributes electricity, water, or gas from facilities that it owns and operates. These are companies that provide essential services to the population. Because things like electricity and water are so fundamental to life, the demand for them is far less tied to the economic cycle than most other businesses.

In other words, people still turn on the lights and drink water regardless of the state of the economy.

Utilities usually operate monopolies in their area and are often regulated by government bodies or agencies. Being the only provider of crucial services enables these companies to earn regular and predictable revenue in just about any environment. Being regulated by the government prevents the utilities from raising prices too much so their earnings growth potential is typically somewhat limited.

Highly predictable cash flows lend themselves naturally to paying strong dividends. Utilities are typically among the highest dividend-paying sectors on the market.

This high level of income, combined with the limited growth of these companies, makes the stocks similar to bonds.

But, to be clear, utility stocks *are not bonds*. Bonds offer a guarantee of principal upon maturity and, in the event of bankruptcy, the payment of principal and interest must be made before stockholders receive anything. Utility stocks, on the other hand, offer no such assurances. They just have certain properties that are similar to bonds.

Utilities also offer similar weaknesses to be aware of before you invest, the most notable being the relationship to interest rates. Utility stocks, like bonds, hate rising interest rates and historically perform poorly in such an environment. As with bonds, rising interest rates diminish the relative value of the payouts as yields on alternative investments rise.

But interest rates are also a double whammy for utilities. Delivering electricity and water to millions of people requires extensive investment in infrastructure. Consequently, utilities usually hold relatively high levels of debt. Rising interest rates increase the cost of indebtedness and thus raise the cost of doing business, thereby lowering profit margins.

Utilities are so similar to bonds in their strengths and weaknesses that historically the behavior of the utility sector has been more correlated with the bond market than with the stock market.

But the similarities raise an important question. If the current environment is perilous for bonds, why would I want to jump into utility stocks?

That aforementioned diversification, for one. The risk of an overall portfolio is lowered by having various investments that thrive in different environments.

It is more risky to have a portfolio loaded with all the same kinds of things. It is prudent for conservative income investors to perhaps sacrifice upside performance for an insurance policy against a down market.

Also, while it's true that utilities will likely behave poorly during periods of rising interest rates, they also offer some key advantages over bonds that make them very attractive for us right now.

One advantage is income. You could perhaps temper the risk of an overall portfolio by holding short-term bonds. But if you need income, that won't help much. Utilities are now paying historically high income compared to bonds. This higher level of income helps offset rising rates.

Moreover, certain utilities, unlike bonds, offer earnings growth and dividend growth over time. A rising dividend can also offset the risk of inflation and rising rates.

But there's something else to consider. A strong economy with rising interest rates is only one possible scenario going forward, and probably not the most likely one.

Most see a stronger economy on horizon, but nothing to write home about. The economy is still a far cry from what it was in the '80s and '90s. There is still lingering long-term unemployment and Main Street is still hurting.

Rates will likely rise somewhat from here. But with the still-tepid recovery, combined with the effect of the more accommodative policy being signaled by new Fed Chair Janet Yellen, it is unlikely that interest rates will move conspicuously higher in the near term.

There is a very good chance that we'll see a continuation (basically) of the slow-growth/low interest-rate environment for the foreseeable future. Such an environment would be good for utilities.

Duke Energy (DUK) is a utility giant. In fact it is the largest electric power company in America. This Charlotte, North Carolina-based regulated utility supplies energy to more than 7 million customers. It supplies electricity to North Carolina, South Carolina, Indiana, and Florida, and natural gas to Ohio and Kentucky.

The company also operates diverse power-generation assets in North America and Latin America, including a portfolio of renewable energy assets.

A Monopoly With the Right Stuff for Long-Term Income Investors

The important thing to note about Duke is that it is more than anything else a regulated utility. In 2013, 86.8 percent of the company's adjusted income was generated from these operations. Utilities are natural monopolies because the tremendous expense to build and maintain sufficient infrastructure cannot be easily duplicated by newcomers.

Utilities that aren't run by the government, such as Duke, are allowed monopoly status but are regulated by government bodies. These regulators dictate the prices that a utility can charge customers for services rendered.

That means that in Duke's operational

PICK AT A GLANCE

DUKE ENERGY (DUK)

SECURITY TYPE: Common stock

INDUSTRY: Electric Utilities

PRICE: $72.32 (as of July 8, 2014)

52-WEEK RANGE: $64.16–$75.13

YIELD: 4.30%

PROFILE: Duke Energy is the largest regulated utility and the largest electric power company in the United States with operations in the Southeast and Midwest.

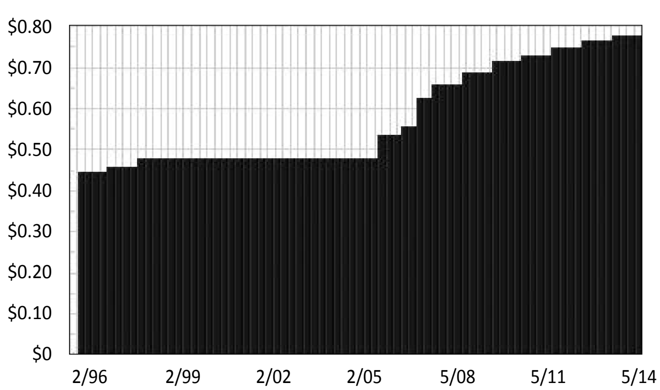
POSITIVES

- A recent merger has created synergies that should power earnings in the future.
- Duke operates in a typically accommodative regulatory environment.
- The strong yield and defensive nature of the business make the stock an excellent hedge against a falling stock market.

RISKS

- Rising interest rates will likely be a headwind for the stock from a capital appreciation perspective.
- Regulations regarding energy and power generation are becoming increasingly unpredictable amid the partisan battles that drive climate change politics.

DUKE ENERGY DIVIDEND PAYMENTS



area, anyone who uses electricity has to get it from Duke. There are minor exceptions such as companies with their own power-generation facilities or residential customers with rooftop solar systems. But these exceptions are not significant.

Such a monopoly on something so universally needed as electric power generates regular and predictable revenues.

While steady and reliable cash flows are common among regulated utilities, there are two main points of differentiation when sizing up a utility investment: the regulatory environment and the growth of the customer base. Duke scores high on both counts and that is the core reason I like it.

Some regulators are friendly and some not so friendly from the point of view of a utility. Friendly regulators enable utilities to recoup the cost of infrastructure investments by passing costs on to consumers. In that vein, Duke's regulators have historically been accommodative.

Duke got a rate increase approved in 2013 and has no major rate decisions pending in the next couple of years.

The current rate-based earnings growth for Duke is a solid 4 percent. However, the company plans to accelerate its capital expenditures, starting in the year 2015, on improvements and additions, and aims to increase its earnings growth from its regulated customer base to 6 percent in the years ahead.

A Powerful Merger Strengthens Duke

The most significant recent event was Duke's merger with Progress Energy in 2012.

Progress was the other major player in the Carolinas and also had significant operations in Florida. The $32 billion merger made Duke the largest regulated utility in the country.

The combination enables greater efficiencies of scale, and regulators approved it because some cost savings are likely to be passed on to customers. There is significant overlap between the two companies and Duke is targeting roughly 9 percent per year savings from merger synergies.

The combined company actually increased Duke's percentage of revenues from regulated business, mostly in the regulator-friendly Carolinas. As well, the fuel source mix is now more diversified.

As of the end of 2013, the sources of electricity generated were the following:

Electric Source	%
Coal	35.6%
Nuclear	28.6%
Oil & gas	21.6%
Hydro & solar	1.5%
Purchased power	12.7%

Prior to the merger, Duke used coal for more than 50 percent of its electricity generation. Coal is the biggest polluting source and this could be somewhat problematic in the face of the Obama administration's new proposed limits on carbon dioxide emissions from power plants. The proposed rule would require that carbon dioxide emissions from power companies be reduced 30 percent between 2005 and 2030.

However, that rule won't be final until next year, and in the meantime faces huge legal and political challenges. Even if it does eventually go through, almost half of the proposed goal has already been met by power companies, and there is time for Duke to adjust.

Another significant recent development is Duke's divestiture of its unregulated assets in the Midwestern U.S. and increased focus on its core regulated business. The company expects to receive more than $2 billion from the sale by the end of the year.

The divestiture will lower Duke's risk profile by eliminating much of its commodity price exposure and will also generate a lot of cash to repurchase shares and/or pay down debt. In all, the divestiture should lower uncertainty and increase stock performance.

What's In It for Us: The Payout

Duke just raised the quarterly dividend to $0.795 per share (payable in September), which translates to a strong 4.3 percent yield at the current price.

It's also worth noting that the dividends qualify for the 15 percent maximum tax threshold. That's not a bad return these days. If the company can maintain and grow the payout, the stock should be a solid defense-oriented hold.

The dividend history is rock solid, consistently paying dividends for 88 straight years, going back to 1926. A key element to the dividend story is growth, because earnings and dividend growth will defend against the negative effects of rising interest rates and inflation.

Duke has raised the dividend every year for the past 10 years. While the compound annual growth rate (CAGR) for the payout was just 2 percent over the past five years, there is good reason to believe that growth will accelerate going forward.

The utility is targeting paying dividends at 65 percent to 75 percent of adjusted earnings per share in the years ahead. Earnings are targeted to grow 4 to 6 percent per year (even factoring in the cost of complying with the new environmental regulations). The accelerated earnings growth should translate directly to the dividend and possibly more than double the growth rate of the previous five years.

Duke is a good investment in these times. But one problem is that a lot of investors seem to already know it. The stock is near its 52-week high as of this writing and is currently selling at a rather lofty 27 times earnings.

That may sound high — and for many stocks, that would be enough to give us pause — but we shouldn't be scared off in this instance. Despite the current price, Duke is selling at a relatively cheap 14.2 times forward earnings, as recent rate hikes and merger synergies are expected to raise earnings in the next year.

In addition, the company has a solid balance sheet with a debt/equity ratio of just 102, compared to the industry average of 134. Duke also has investment-grade-rated debt. The company's defensive properties in falling markets cannot be underestimated. The company has a microscopic beta (a measure of a stock's volatility) of just .05, meaning it doesn't tend to move with the overall market.

Recommendation: Duke Energy (trading symbol DUK) is the epitome of a high-yielding defensive stock. Its solid growth prospects should enable the stock to weather possible rising interest rates and inflation over the longer term while providing an excellent hedge against a falling stock market and a faltering economy.

Look to buy it at or under $69 per share for the Income Strategies Portfolio.

Best Buys of the Month

"Best buys" comprise what I think are especially good values among all the holdings in our portfolio as we go to press. The picks are not necessarily those with the cheapest price compared to their recommended "buy in" level. What they are, however, is a good guideline, especially for those new to the High Income Factor newsletter. They're the answer to the question, "If I were just starting to invest in the High Income Factor Portfolio, which securities would I buy first?"

AUGUST BEST BUYS

Security	Price*	52-Week Range	Yield
Northern Tier Energy (NTI)	$26.81	$17.83–$29.60	6.12%
Williams Partners (WPZ)	$53.08	$47.59–$57.29	6.82%
Brookfield Infrastructure Partners (BIP)	$40.80	$34.09–$42.09	4.22%

* As of July 8, 2014

Northern Tier Energy (NTI)

Shares of this Midwest oil refiner took a hit over the past month along with the rest of the U.S. oil refiners. The issue was an Obama administration announcement giving permission to two companies, Pioneer Natural Resources (PXD) and Enterprise Products Partners (EPN), to export American crude oil.

The news sent refining stocks reeling as it stoked fear that the move could pave the way for the Commerce Department to lift the four-decade ban on exporting crude oil. The exportation of U.S. crude oil would likely raise the price as U.S.

refiners would have to compete with foreign buyers. High U.S. crude prices could eliminate the huge advantage of cheaper feedstock that U.S. refiners have enjoyed.

The market overreacted. It remains unlikely that the administration would allow the mass export of U.S. crude oil. It has publicly denied any intention of doing so. But even if this happened and prices for U.S. crude reached parity with international prices, NTI would still have access to cheaper oil.

NTI is located near the Bakken shale (a significant oil-producing area that covers areas of Montana, North Dakota, Saskatchewan and Manitoba) — being in this vicinity and near Canada, where huge crude oil supplies are usually priced well below benchmark WTI prices, is a competitive advantage. Thus, Northern Tier is armed with a leg up price-wise above and beyond the WTI/Brent spread that most American refiners rely on.

The market's overreaction simply created a buying opportunity for NTI, which should enjoy a favorable operating environment for years to come. The stock should continue to pay a strong dividend too. **With that in mind, I've raised the "buy at or under" price for Northern Tier Energy (NTI) from $26 to $28.**

Williams Partners (WPZ)

Williams is one of the largest natural-gas infrastructure companies in the United States and is at the forefront of the energy boom. There was important news in late June that improved the future of the stock.

General partner Williams Companies (WMB) announced a $6 billion acquisition of Access Midstream Partners (ACMP) and the merger of WPZ with Access Midstream.

ACMP is the largest natural gas gatherer and processor in the country, and its assets also happen to be located at the epicenter of the shale energy boom in locations such as Eagle Ford, Permian, Marcellus, and Utica. The company also has rapidly growing revenues.

WPZ was a limited partnership with a great long-term story and a somewhat dicey short-term story. The merger fortifies the short-term prospects and makes the long-term prospects even better. Williams Partners estimates that, as a result of the merger, the dividend will increase 24 percent this year and 10 to 15 percent through 2017.

The new combined master limited partnership will be on a par with the largest midstream natural gas companies in the United States — and brilliantly poised to reap the benefits of the energy boom.

The stock currently yields 6.8 percent before any dividend growth. Both Jefferies and Credit Suisse have raised their price targets on Williams Partners to $65, which would be great for all of you who got in under my recommended price of $58 per share.

Brookfield Infrastructure Partners (BIP)

Brookfield owns and operates infrastructure assets all over the world. The company particularly focuses on high-quality, long-life properties that generate stable cash flows, have low maintenance expenses, and are virtual monopolies with high barriers to entry.

Here are a few examples of the properties in BIP's current portfolio:

- The sole railroad network in Southwest Australia
- Chilean utilities that generate 98 percent of the country's electricity
- Toll roads that are crucial arteries in Brazil and Chile covering over 3,200 km
- Ports throughout Europe and in China
- Natural-gas storage terminals in Canada

The company benefits from the continuing enormous need for infrastructure, both new and improved, across the globe. This company, more than any other I know, offers investors a combination of defense and growth. Given the nature of its assets, the revenue generated is not cyclical, and the increasing demand for infrastructure creates growth.

The strong and growing nature of the business, along with the stellar track record and high dividend, make this one a keeper.

I am raising the "buy at or under" target price for BIP to $42. ■

The High Income Factor Portfolio

THE HIGH INCOME PORTFOLIO

Recommendation	Ticker	Entry Date	Entry Price	Recent Price	Buy at or Under	Current Yield	Effective Yield	Dividend Pay Date	Total Return
Navios Maritime Partners	NMM	01-Mar-12	$16.37	$19.39	$17.50	9.13%	10.81%	8/13/14	49.39%
SeaDrill	SDRL	01-Feb-12	$35.24	$37.53	$36.00	10.66%	11.35%	9/22/14	30.41%
Terra Nitrogen	TNH	01-Apr-12	$249.75	$141.67	HOLD	10.13%	5.75%	9/3/14	-25.55%
FLY Leasing Limited	FLY	27-Nov-12	$11.97	$14.16	$16.00	6.21%	7.35%	8/20/14	28.34%
Teekay LNG Partners LP	TGP	20-Dec-12	$38.30	$45.68	$42.00	5.91%	7.05%	8/12/14	31.40%
Prospect Capital	PSEC	26-Feb-13	$11.06	$10.61	$11.50	12.54%	12.03%	7/23/14	10.58%
Main Street Capital	MAIN	21-Aug-13	$29.21	$31.95	$32.00	6.20%	6.78%	7/15/14	17.24%

THE WEALTH BUILDER PORTFOLIO

Recommendation	Ticker	Entry Date	Entry Price	Recent Price	Buy at or Under	Current Yield	Effective Yield	Dividend Pay Date	Total Return
PepsiCo	PEP	01-Apr-12	$66.74	$89.73	$72.00	2.52%	3.39%	7/30/14	42.55%
Eli Lilly	LLY	01-Apr-12	$40.48	$62.46	$52.00	3.14%	4.84%	9/9/14	70.06%
Williams Partners	WPZ	01-May-12	$57.30	$53.08	$58.00	6.82%	6.32%	8/12/14	16.72%
Vodafone	VOD	27-Sep-12	$28.72	$32.57	$34.00	4.95%	5.61%	9/22/14	14.98%
Intel	INTC	27-Nov-12	$19.98	$30.79	$29.00	2.92%	4.50%	9/3/14	62.01%
Philip Morris	PM	04-Feb-13	$87.00	$86.29	$87.00	4.36%	4.32%	7/14/14	4.44%
Riocan REIT	REI-UN.TO	20-Mar-13	$26.97	$25.05	$29.00	5.60%	5.21%	7/14/14	9.08%
General Mills	GIS	19-Apr-13	$49.94	$53.10	$50.00	2.86%	3.04%	9/3/14	9.73%
Kinder Morgan Energy Ptnrs	KMP	22-May-13	$88.50	$80.73	$88.50	6.69%	6.10%	8/14/14	-3.89%
Brookfield Infrastructure Ptnrs	BIP	03-Jun-13	$36.00	$40.80	$42.00	4.22%	4.78%	7/28/14	17.49%
Health Care REIT	HCN	15-Aug-13	$60.00	$62.50	$60.00	5.09%	5.30%	8/20/14	8.32%
BP plc	BP	22-Nov-13	$47.65	$52.38	HOLD	4.47%	4.91%	9/22/14	12.49%
Realty Income	O	18-Dec-13	$39.14	$44.74	$40.00	4.88%	5.58%	7/21/14	17.34%
HSBC Holdings	HSBC	27-Jan-14	$52.98	$50.97	$60.00	3.92%	3.78%	8/19/14	-0.99%
Verizon	VZ	21-Feb-14	$47.27	$48.76	HOLD	4.35%	4.48%	8/5/14	4.25%
Northern Tier Energy	NTI	26-Mar-14	$26.00	$26.81	$28.00	6.12%	6.31%	8/28/14	6.05%
Ventas, Inc.	VTR	23-Apr-14	$64.42	$64.23	$65.00	4.52%	4.50%	8/29/14	0.82%
Magellan Midstream Ptnrs#	MMP	—	—	$81.74	$65.00	3.00%	—	—	—
Deere & Company#	DE	—	—	$90.12	$80.00	2.60%	—	—	—

INCOME STRATEGIES PORTFOLIO

Recommendation	Ticker	Entry Date	Entry Price	Recent Price	Buy at or Under	Current Yield	Effective Yield	Dividend Pay Date	Total Return
Blackrock Enhanced Cap Fund	CII	01-Jan-12	$12.50	$14.98	$13.00	8.01%	9.60%	9/30/14	44.58%
Barclays 7.75 Preferred	BCS-PC	27-Sep-12	$25.52	$25.85	Hold	7.89%	7.99%	7/16/14	15.92%
PowerShares Preferred	PGX	24-Oct-12	$14.84	$14.60	Hold	6.08%	5.98%	8/7/14	7.03%
Osterweis Strategic Income	OSTIX	25-Sep-13	$11.80	$12.00	$12.00	4.98%	5.07%	9/18/14	2.79%
PowerShares Sr Loan Portfolio	BKLN	25-Sep-13	$24.77	$24.86	$25.00	4.01%	4.02%	8/7/14	3.03%
SPDR Barclays ST HY Bond	SJNK	25-Feb-14	$31.03	$30.83	$32.00	4.94%	4.91%	7/14/14	1.07%
BUY Duke Energy	DUK	—	—	$72.32	$69.00	4.30%	—	9/16/14	—

Notes on all portfolios: In order to receive the dividend payment, you will need to own the stock several weeks before the pay date. The "Total Return" column includes all reinvested dividends at concurrent recommended buy prices. Returns calculated based on a purchase of $1,000 of the security on the listed entry date and price. The "Effective Yield" column reflects the yield investors receive assuming they bought at the entry price and followed all subsequent recommendations. #Denotes recommendation not yet purchased. To see the chart of previous "sold" positions, subscribers can log onto www.highincomefactor.com (under the "Portfolio" tab). All chart data is as of close July 8, 2014.

Closing Thoughts →

The
High Income Factor

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Closing Thoughts

The market is ever evolving, but some things don't change. The need for a "risk equalizer" to the stock market in order to lower your overall portfolio risk and volatility remains the same, for one. (By risk equalizer, I mean something that is more defensive in nature, with lower upside potential but which brings dependability and regular income to the table.)

Yes indeed, the need is the same, but nature of the investment that occupies that crucial space has changed.

In the past, it was bonds that people turned to for safety and income. But no more — because of politics, the Federal Reserve, and the inevitable end of a three-decade-long bull run, among other factors, bonds no longer offer the lower-volatility/high-income benefits they used to. Nor do they offset the stock market, serving as a counterbalance to equity moves.

Instead, today's low-paying and treacherous bond market leaves vacant a crucial space in an investment portfolio. But there is a suitable alternative — utility stocks can pinch-hit for bonds by offering a higher level of income and downside protection if the economy falters.

One of the very best utility stocks on the market in my analysis is **Duke Energy.** The company offers stable and growing profits that will likely fuel a rock-solid and growing payout in the quarter and years ahead. In this issue, I lay out the comprehensive case for adding this stock to our High Income Factor lineup.

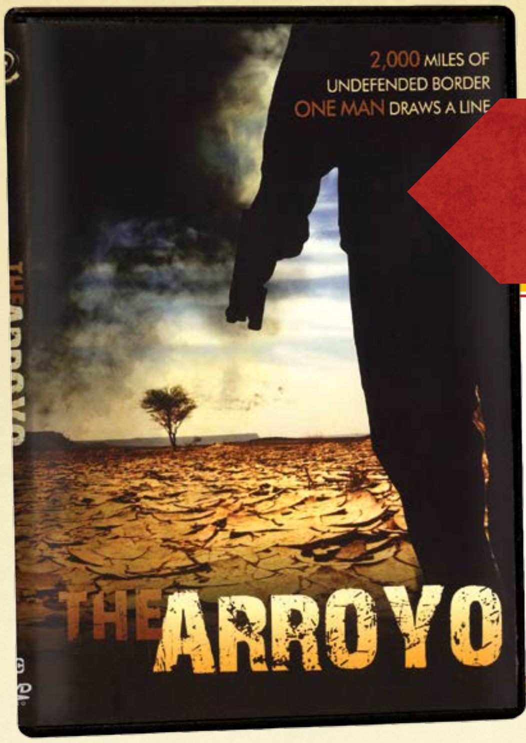
Actions to Take Now

Action No. 1: Look for an opportunity to buy **Duke Energy** (**DUK**) at or under $69 per share for the Income Strategies Portfolio.

Action No. 2: Note my new "buy at or under" prices for two of our current holdings: **Northern Tier Energy** (**NTI**) from $26 to $28, and **Brookfield Infrastructure Partners** (**BIP**) from $40 to $42.

Sincerely,

Tom Hutchinson



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THE ARROYO is fictional, but these issues are dangerously real. **NEWSMAX** magazine spent two months on the border in Texas, New Mexico, and Arizona. We found Mexico's drug cartels have penetrated deep into our nation, striking fear in ordinary Americans.

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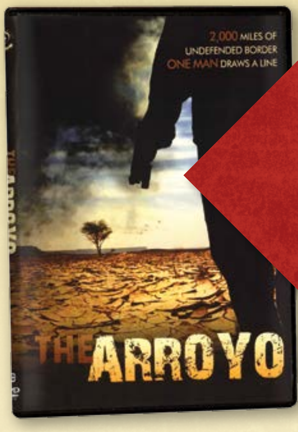

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(Continued from other side)

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