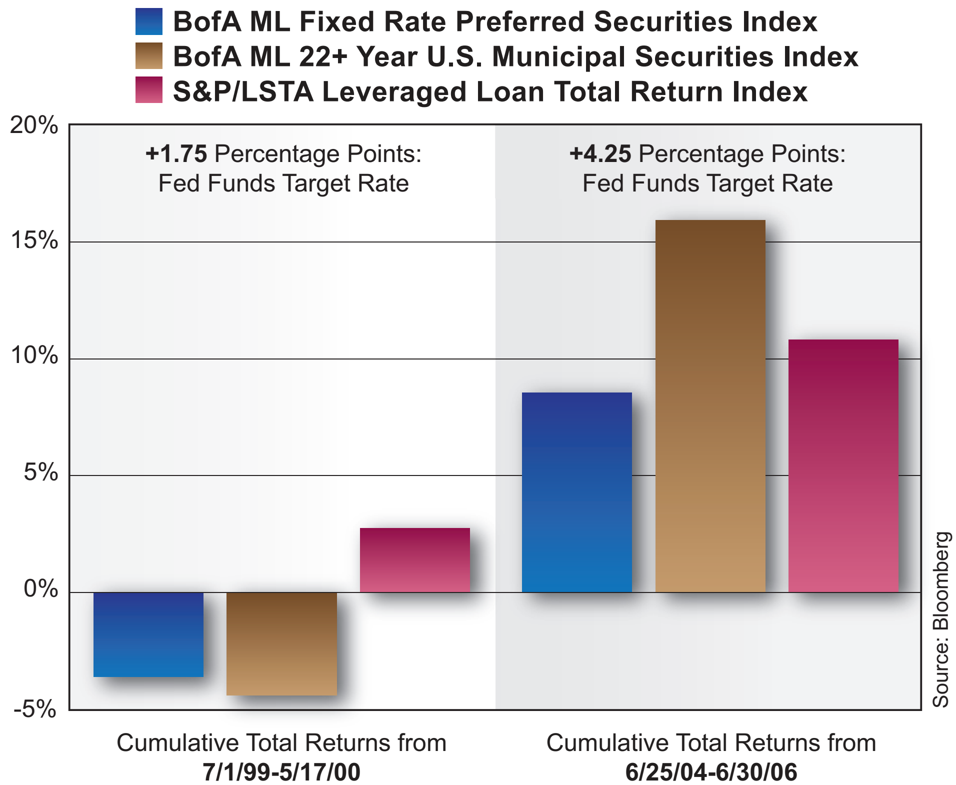
Senior Loans Can Be A Positive Contributor When The Fed Tightens Monetary Policy



View from the Observation Deck

1. Conventional thought says that it is prudent to shorten the duration of one's bond holdings when interest rates are on the rise. While solid advice, there are more ways than one to accomplish this task.
2. One such way is to equally weight short maturity debt securities with longer maturity debt securities. It is called a barbell approach.
3. The goal is to mitigate capital erosion, while seeking to generate a blended yield. Senior loans are a candidate for the short maturity end of the barbell.
4. The income distributed by senior loans fluctuates based on the direction of short-term interest rates. Loans are typically indexed to the 3-month Libor rate, which tends to track the U.S. federal funds rate over time.
5. The chart shows how senior loans, fixed-rate preferred securities and long-term municipal bonds performed during the last two tightening phases. Preferreds and municipals currently offer attractive yields, in our opinion.
6. With respect to how the yield on the 10-Year T-Note fluctuated in the two periods featured in the chart, it rose 66 basis points from 5.84% to 6.50% (7/99-5/00) and 49 basis points from 4.65% to 5.14% (6/04-6/06).
7. While those increases are not very dramatic, keep in mind that the nominal levels back then (4.65% and 5.84%) were well above today's 10-Year T-Note yield of just under 3.00%.
8. The following shows the average yield on the 10-Year T-Note over the past 10-, 20- and 30-year periods (Source: Bloomberg): 3.53% (8/03-8/13); 4.62% (8/93-8/13); and 6.01% (8/83-8/13).
9. For those investors who appreciate patterns, coincidence or otherwise, the Fed raised the federal funds rate in 1994 and 2004. Is 2014 next?

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The BofA Merrill Lynch U.S. Preferred Stock Fixed Rate Index ($25 par) consists of investment grade, fixed and fixed-to-floating rate U.S. dollar denominated preferred securities. The BofA Merrill Lynch 22+ Year US Municipal Securities Index is a subset of The BofA Merrill Lynch U.S. Municipal Securities Index including all securities with a remaining term to final maturity greater than or equal to 22 years. The S&P/LSTA Leveraged Loan Total Return Index tracks the performance of a broad cross section of leveraged loans, including dollar-denominated loans to overseas issuers.