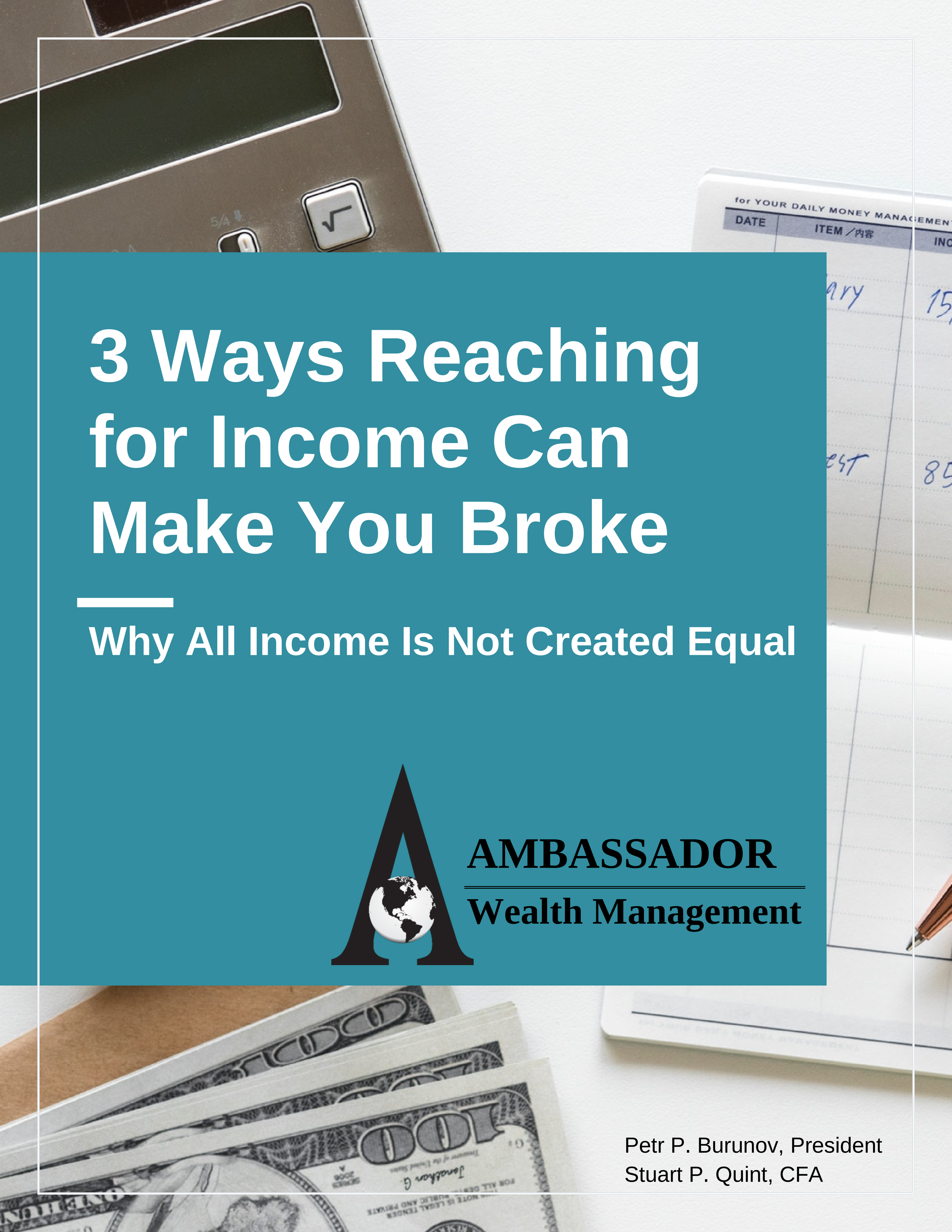

3 Ways Reaching for Income Can Make You Broke

Why All Income Is Not Created Equal

AMBASSADOR

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INTRODUCTION

Many people need additional sources of income. This need becomes acute as people enter retirement.

Precisely where people have the greatest need is also when they are most vulnerable to misunderstanding. **Making mistakes with income risks lowering your future standard of living.**

We continuously run into clients who seek income, but who have misunderstood what they will actually receive.

- Oftentimes, we find people who mistake yield for total return (and forget that they need to earn at least their principal back with some positive return).
- In other situations, investors fail to consider taxes into their overall equation.
- Sometimes, people lock up their money in hopes of a greater coupon. Yet, they leave a lot of money on the table because they fail to understand the intricacies of illiquid investments.
- **One of the greatest pitfalls** we see is people who buy into the **promise of a durable, high income payment**. Because they forget about risk, the investment might not live up to its promise. Thus, investors suffer losses, including reduced income.

Many investors forget **one of the most important rules in searching for income**:

All income is not created equal.

We want you to give you 3 critical perspectives on this critical subject – and how we incorporate these perspectives to help clients like you. Our goal is to build a diversified toolbox for generating meaningful and sustainable sources of income.

1. **Taxes** – one of the two sure things in life! Taxes can either help or hurt your level of income. Fortunately, there are ways to manage them astutely.
2. **Liquidity** – some would have you invest in illiquid alternative income sources. Do these investments really pay more income? Do you necessarily have to surrender transparency and access to earn meaningful income? Let us investigate further.
3. **Risk** – "All that glitters is not gold." To generate any sort of income, you must take some form of risk. That is out of your control. However, what you can control is the amount and type of risk you take to earn a certain level of income. We will explore different types of risk.

You will learn **what** the issues are, **why** you should care, and **how** we might help you manage through the issues.

Please contact us to discuss your need for income.

"WEALTH IS NOT HIS THAT HAS IT, BUT HIS THAT ENJOYS IT."

- *Benjamin Franklin, American statesman and inventor*

I. All Income Is Not Created Equal Because of Taxes.

What are the issues?

Income comes in many forms. Wages and bonuses, you earn, sales or income from hard assets, Social Security, and sudden wealth are examples.

For many people, especially those in or approaching retirement, income from their investments is a major way to fund their lifestyles.

People might be tempted to lump income into one big category. For those of us who pay taxes (hint: most people pay taxes!), this would be a mistake. The IRS and state tax authorities view income under several categories.

The table below illustrates the different categories of income from a tax perspective and typical sources of such income:

Introducing Different Tax Categories of Income

Income Type	Examples of Investment Sources
Ordinary Income	- REIT's - BDC's - Immediate Annuities - Fixed Income
Qualified Dividends	- US Stocks - Foreign Stocks (sometimes with additional foreign withholding tax)
K-1 Pass-through Income	- MLP's (public and private) - Hedge Funds (LP's) - Business Interests (LP's) - Private Equity (LP's)

The table below sheds light on how tax laws might apply for each category of income. This includes both taxable and qualified accounts (typically IRA's or other retirement accounts).

Different Tax Treatment for Sources of Income in Taxable and Qualified Accounts

Income Type	Tax Treatment for Taxable Accounts	Tax Treatment for Qualified Accounts
Ordinary Income	- Taxed at marginal income tax rate - Added to Adjusted Gross Income (AGI) - Itemized deductions might offset	- Not taxed specifically in current year
Qualified Dividends	- Taxed at long-term capital gains rate (varies based on AGI) - Only capital losses might offset	- Not taxed specifically in current year
K-1 Pass-through Income	- Return of Capital – taxed at long-term capital gains only when partnership unit is sold - UBTI – potential taxes owed to IRS - Possible additional state tax filings and payments needed - Certain deductions might offset	- If UBTI exceed $1,000 for an IRA, federal tax is due (special filing Form 990-T)

1. Ordinary income

a. Taxable accounts
   - Income other than long-term capital gains. Wages, salaries, and dividends are examples.
   - Ordinary income is taxed under your marginal tax bracket as defined by the IRS.
   - A range of itemized deductions might be able to offset a portion of ordinary income.

b. Taxes on ordinary income are **not relevant when held in retirement accounts**.

2. Qualified dividends

a. Taxable accounts
   - Taxed at the long-term capital gains tax rate (used for gains on sale of investments held for greater than 1 year).
   - No cost basis, but also favorable tax treatment due to (typically) lower long-term capital gains tax rate.
   - Only offset on income tax returns is capital losses (selling assets below purchase price and writing off all or a portion of the difference).

b. Taxes on qualified dividends are **not relevant when held in retirement accounts**.

3. K-1 income Pass-through Income

a. Tax considerations for taxable accounts
   - Partnerships such as LP's and Master Limited Partnerships (MLP's), both public and private, pay income that the IRS treats differently from ordinary income.
   - Investors at the end of each year receive a form K-1. A good portion of the income should be tax-deferred. However, there are complexities:
     - Most income qualifies as "return of capital", which is recorded for tax purposes not as income, but rather as a reduction of the cost basis of the shares the investor purchased.
     - If and when the investor sells the shares of the partnership, the investor will pay capital gains tax on the difference between the share price and the cost basis. Hence, return of capital is considered "tax deferred" into the future, not "tax free".
     - Unrelated business taxable income (UBTI) is "income regularly generated by a tax-exempt entity by means of taxable activities." Not only is this income taxed, but it also has the potential to bump up the investor's marginal tax bracket if it causes the investor's total income to exceed certain thresholds.
     - Taxable income from MLP's might offer potential offset in the form of depreciation and other deductions. These items would be listed on the K-1.

b. You might have to file income tax forms in states where you do not live but where the MLP might do business.
    - According to the MLP Association: "Because of the pass-through structure of MLPs, unitholders in multistate MLPs may owe tax in each state in which the MLP earns income. The K-1 package provided to you by the MLP each year will include information on how much income has been allocated to you in each state."
    - Apart from a couple of states, most states have low thresholds as to how much income triggers a state income tax filing.
    - You might want to discuss with your professional the need for additional state income tax filings, payments, and whether you want to put up with the burden going forward.

c. **Taxes could still be quite relevant even if held in retirement accounts (such as IRA's).**
    - Retirement accounts (IRA's) – if total UBTI on all your investments in an IRA exceeds $1,000 in a year, you must file a special form and pay tax on it.
    - In addition, you will need to file a special form with your 1040 (Form 990-T).

One additional consideration specific to income generated from investments with a foreign domicile is withholding tax.

Some countries have tax treaties with the US and do not withhold additional tax from dividends. However, others do not. The situation varies by country.

The UK poses an interesting example for foreign investors. Sometimes, certain structures (such as UK corporations) are exempt from dividend withholding tax. Yet, other structures in the same country (such as UK REITs) are subject to dividend withholding tax.

Why should you care?

Taxes are a major, if not the largest, expense for many people. They can take a bite out of any income you generate.

Yields, the amount of pretax income generated per dollar of a given investment, are often presented as independent of taxes. Yet, yield in and of itself does not really tell you how much money you will receive.

Taxes are a real expense for your wallet. The true income you earn comes after the tax man takes his "fair share", not before.

The good news is that awareness and prudent management around the different tax categories of income can help you. You can have significant influence over maximizing income after tax.

How we can help you deal with the issues

Let us examine a case study.

Hypothetical Martha and Fred are a family who seek additional income. The family pays meaningful taxes even without investment income. They own both taxable and qualified accounts.

They might want to house sources of ordinary income in their tax deferred/qualified accounts. The ordinary income generated would not count against their other taxable income. Additionally, they would not pay tax on income generated for that year. (However, a tax deferred account would mean they eventually pay tax once they being to take Required Minimum Distributions. Alternatively, if they were to take money out before age 70.5, they would also owe tax.)

Fred and Martha could place investments that generate qualified dividends in their taxable accounts. Such income in a taxable account would not count against their AGI. Additionally, they would pay a lower tax rate under long term capital gains rate rather than ordinary income tax.

While we currently do not utilize investments with K-1 Pass-through income, if we did, we would lean toward housing them in taxable accounts to maximize tax deductions for investments held for the long-term.

We are cautious about using investments that generate K-1 Pass-through income. Most of our clients do not wish to stomach the filing headaches that might arise from such income. Additionally, we believe there exist other investments with competitive and sustainable yield but with far less tax complications.

However, some clients might still benefit from pass-through income. For instance, you might have a long-term need for meaningful amounts of income. You would need to have a lot of confidence in the investment’s ability to pay income for the long term. You are willing to hold such an investment for a long time. Furthermore, your accountant and you have the stamina to deal with complicated tax filings. This sort of client might benefit from sourcing income from K-1 pass-through sources.

Tax is an important issue to consider, but it is one of many. Depending on your situation, we might recommend a diversified bucket of sources for income with different types of tax treatment.

II. All Income Is Not Created Equal Because of Liquidity.

What are the issues?

Pay attention to the liquidity of your investments.

We have seen many people ignore one critical factor in their investments.

Liquidity measures how quickly without excessive cost you could withdraw money from your investment. NASDAQ also considers the relative ease transacting in an investment under its definition.

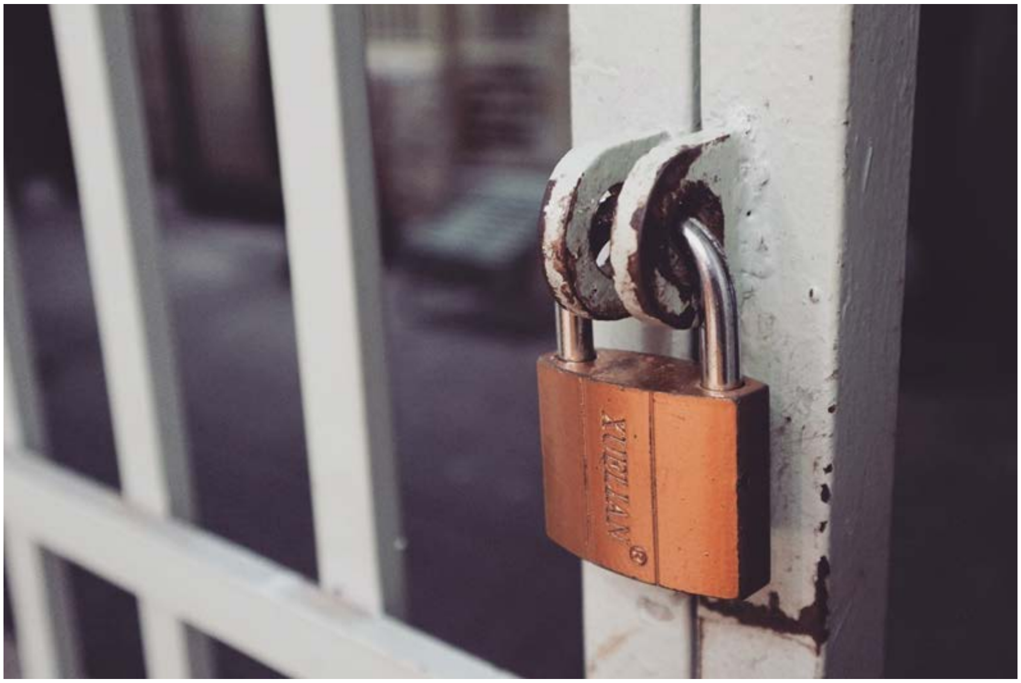
Here are some examples of liquid and illiquid investment vehicles:

Liquid	**Illiquid**
Exchange Traded Products (ETF's, ETN's)	Partnerships (private general and limited)
Stocks	Private REIT's
Mutual Funds	Hedge Fund LP's
MLP's (exchange listed)	Annuities

In other words, ***can you get your money out when you need it?***

Let's take a deeper dive into 2 of the more popular vehicles within illiquid investments.

- Annuities
- Non-Traded REITs



Annuities

Annuities are a contract between an investor and an insurance company. The insurance company charges fees to the investor for assuming certain risk. In exchange for investing money with the insurance company, the investor expects to receive a payout in the future tied to a specific goal.

- Lifetime income after a certain age
- Nursing home/long term care
- Legacy planning (tax deferral strategy)

Many people express interest in annuities because they fear of running out of income due to living too long. They believe that locking up their money with an insurance company will also lock in a certain level of income based on the size of their contract.

However, **annuities in their current form have drawbacks**.

Problems with Today's Annuities

Drawback	Explanation
High expenses	- High cost to enter - High ongoing expense to stay - High charge to exit
Lack of transparency	- Investors do not understand costs - Numbers on statements hard to read - Use of derivatives difficult to comprehend
Highly illiquid (tough to exit annuity)	Investors are stuck for a long time
Risk of dying early	If investor lives even to average life expectancy, contract might not earn the investor much

1. **Annuities can be <u>expensive</u> to own**.

   a) **<u>It often costs a hefty sum to enter</u>** into an annuity contract.
      - A broker or insurance agent typically charges a commission of roughly 3.5-7% on the initial contract.
        - There might be cases where the commission is higher or lower.
        - However, the broker or agent might also charge an additional annual fee to reduce the high up-front cost of an annuity. (This might be akin to a bank charging a higher interest rate or taking an up-front fee on a mortgage.)
        - Typically, annuities mature within 5-7 years, so clients might be on the hook once again to pay commission.
      - Commission product might not be in a client's best interest.
        - Entering an annuity incurs a steep transaction cost in the first year.
        - One potential risk exists that the broker or advisor might have less incentive to check in with you later to see how you are doing (and how the annuity is doing).

   b) **<u>It frequently costs a lot to stay</u>** in an annuity.
      - Management fees: annual expense ratios from underlying mutual funds
        - Fixed annuities charge 1% a year plus the interest expense charged by the insurance company to generate income.
        - Variable annuities incur typical annual charges can be 2-4%.
      - Insurance charges, also known as "Mortality and Expense (M&E) Fees", along with other administrative fees can add up to 1% or more.
      - Fees associated with riders, optional features purchased by investors, cost incremental fees of at least 0.5% each year.

   c) **<u>It usually costs a bit of money to exit</u>** an annuity contract.
      - Surrender charges are assessed by the insurance company if you want to withdrawal part or all of your money early.
      - Investors might forfeit 7% of their annuity investment out of pocket if they withdraw in year 3, down to 0% only over in year 10
      - Specific cases as high as 13% surrender to start exist on some annuities.

2. Annuities suffer for lack of transparency.

a) Many investors often do not comprehend the costs of their annuity.
b) Some investors at times are confused as to which numbers on their statements are most relevant to their investment.
c) Numerous investors forget that insurance companies heavily use derivatives, often known as options, used to hedge their annuity.
   - Warren Buffett, the famous institutional investor, fears investments with derivatives.
   - He repeated his concern in April of this year: "In my view, derivatives are **financial weapons of mass destruction**, carrying dangers that, while now latent, are potentially lethal."
   - Insurance companies rely heavily on derivatives to hedge their books against market volatility.

3. Annuities are highly Illiquid for much of the life of the contract.

a) You are stuck in the annuity for a long time.
b) If circumstances change and you need to take out part (or all) of your investment, it might cost you a lot.

4. Annuity income is not true income unless you live beyond a certain age.

a) When a client turns "on" annuitized income, that "income" in reality is paid out of that client's investment principal until it is exhausted!
b) Only if the client outlives the life expectancy assumptions of the insurance company can the client ultimately stand to make money on the contract.
c) Great risk exists that the heirs receive a reduced inheritance from the money in the annuity contract, because it is eaten up by:
   - Ongoing annual fees
   - Commissions
   - "Income" payouts (in reality, they are more like returning investment principal to the annuity holder, unless the holder lives longer than expected.)

Is there anyone who might benefit from annuities?

While we think there is a lot of confusion on illiquid investments such as annuities, we believe selective clients might potentially benefit from having one. However, they still need to consider the costs and other considerations we mentioned earlier.

Here are some possible situations of clients that might benefit:

- Clients unable to access life insurance and want it can get a death benefit rider (which in many cases is inferior to regular life insurance)
- Someone betting on permanent low interest rates AND believes they will live well past age 90
- A client with poor health and seeking to enter a nursing home might consider an annuity with a nursing home rider.
- A client who would lose their spouse's pension income upon death might benefit from an annuity (if the client were to live for a long time).

We would like to see products without commission, more transparency, and lower fees.

Non-Traded Private REITs:

On the surface, real estate might appear an attractive investment alternative for generating income. However, just as not all income is created equal, neither is all real estate developed equal. Whether you go with a liquid publicly-traded REIT or an illiquid non-traded REIT can make a big difference.

Not only have investors in illiquid REITs not earned additional return for giving up liquidity on their investments. They also have forfeited nearly 4% a year in returns over 25 years!

Brad Case of NAREIT.com used data from Cambridge Associates to compare returns between liquid publicly-traded REITs with Non-Traded REITs from 1992 to 2017. The results are shocking:

"To put that into perspective, imagine you had a million dollars 25 years ago and you were deciding whether to invest it in the private equity funds that make up the C|A benchmark or in the stocks that make up the FTSE NAREIT All Equity REIT Index. If you had put it into private equity funds (and reinvested the net total returns) it would have grown to $5.6 million today, but if you had put it into listed equity REITs instead it would have grown to $13.8 million—***nearly 2½ times as much!***"

Why do people invest in Non-Traded REITs?

People seeking income often forget that income is only one part of the investing equation. Total return, defined as income plus the return on your original principal, decides how much (if any) money one truly earns.

Yes, many Non-Traded REITs advertise allegedly fat yields of 7-8% compared with roughly 3.7% on publicly traded REITs.[1]

Yet, illiquid REITs still have not delivered solid returns in spite of the advertised yield and lack of liquidity.

What are the problems with Non-Traded REITs?

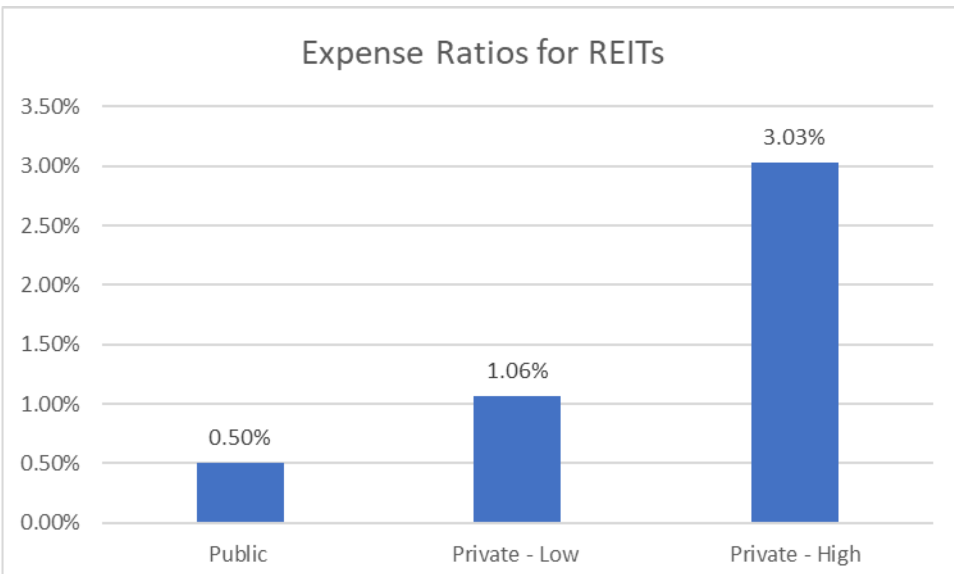
Drawback	**Examples**
Expensive	- Commissions paid to broker - Ongoing annual fees paid to REIT manager
Lack scale, inferior opportunity set	- Minimum expense overhead applies to all REITs - Limited geography and properties to buy
Lack of liquidity	- Ultimate dependence on public markets or other buyers to realize value for investors
Inferior investment returns with greater investment risk	- High debt leverage - Overly dependent on factors outside Non-Traded REIT's control to make money for investors

[1] Yields calculated by taking trailing 12 month dividends versus share price on the iShares DJ US REIT ETF (ticker: IYR) and comparing with anecdotal quotes from anonymous non-traded REIT providers. Source for public data: ycharts.com accessed on July 20, 2018. Past performance is no guarantee of future return. Yield is but one component of a return of a specific investment.

1. **Non-Traded REITs are expensive**.

   a. What you pay to the broker-advisor
      - Until 2017, when the US Department of Labor was about to introduce regulation to limit excessive commissions, brokers could earn as high as 12% on sales of Non-Traded REITs to customers.
      - Just imagine investing $100 and ending up earning interest only on $87.
      - However, some broker-dealers have pre-empted these high commissions and reduced payments to as low as 6%.

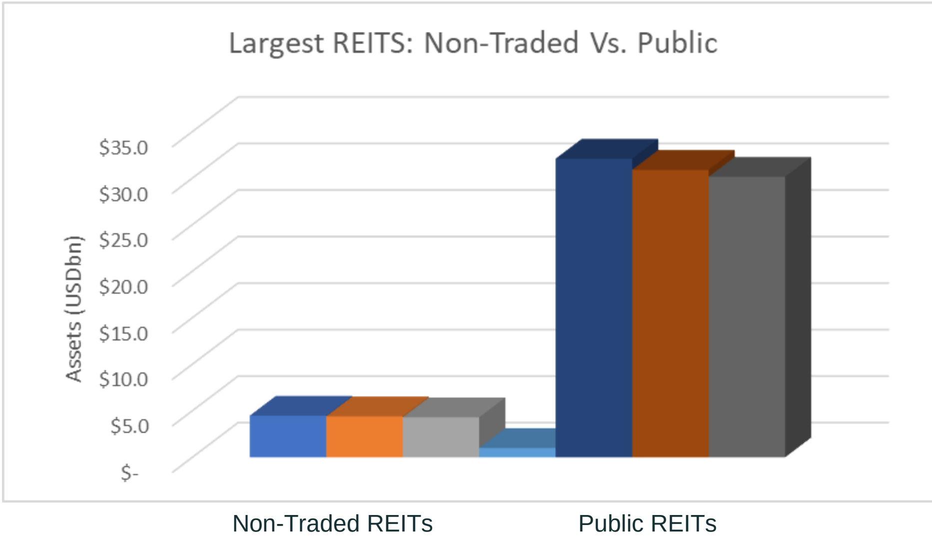
   b. What you pay to the real estate management company in ongoing annual expense ratio
      - According to data gathered from NCREIF, The Townsend Group, and FTSE NAREIT, expense ratios for Non-Traded REITs are higher than for public REITS:



Source: REITS: Real Estate with a Return Premium 2015 on https://www.reit.com/sites/default/files/portals/0/PDF/REITsRealEstateWithAReturnPremium.pdf accessed on July 20, 2018.

2. **Non-Traded REITs lack scale and might be limited to investing in inferior properties versus other real estate firms**.

   Non-Traded REITs are smaller operations than public REITs.



Sources: http://www.investmentnews.com/section/reit-database/closed accessed on July 20, 2018 and "Largest Listed Real Estate Investment Trusts (REITs) – Top 400 by Assets as of 2017", GFM Asset Management, October 3, 2017 on https://gfmasset.com/2017/10/largest-listed-real-estate-investment-trusts-reits-top-400-assets-2017/ accessed on July 20, 2018.

Top 3 Non-Traded REITs in terms of assets: Corporate Property Associates 17, Hines Global REIT, InvesTrust Properties

Top 3 public REITs in terms of assets (excluding mortgage REITs): American Tower, Simon Property Group, Prologis.

a. Fixed overhead expense (people and infrastructure to acquire and manage properties) is the same minimum scale regardless of how large or small the REIT.
b. Non-Traded REITs suffer concentration risk due to their smaller scale relative to many public REITs.
    - Non-Traded REITs tend to invest in a narrow geographical focus.
    - Typical deals for Non-Traded REITs tend to be isolated properties.

3. Non-Traded REIT investors lack liquidity.

a. In theory, you can withdraw money beyond income after 3 years but with penalties.
b. Practically, you might be stuck with distributions, not principal, as your only liquidity.
c. Often, your only access to principal (and potential gains) occur if auspicious corporate events occur.
    - Your Non-Traded REIT gets sold to another firm.
    - Your Non-Traded REIT does an IPO on a public stock exchange.

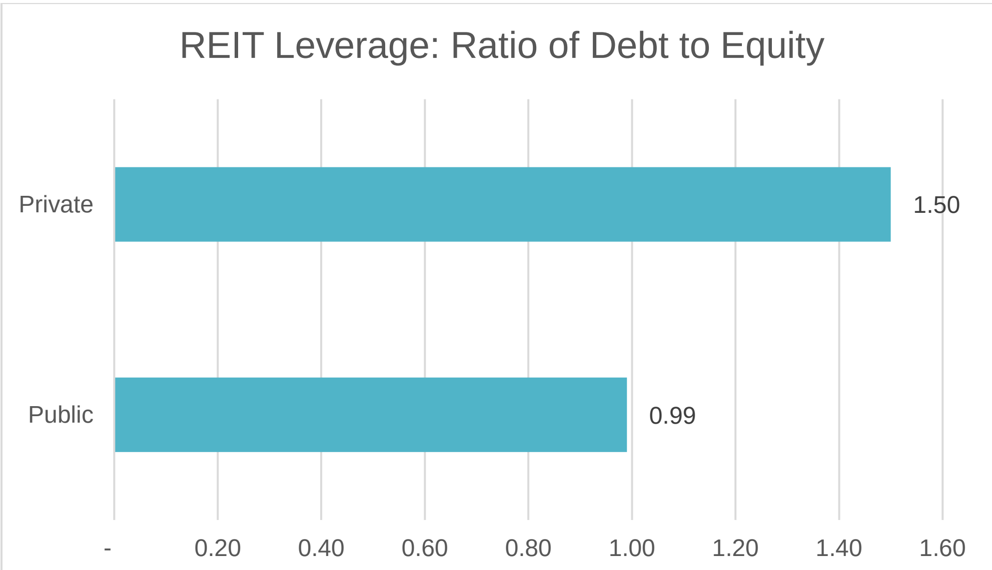
4. Non-Traded REITs pose greater investment risk.

a. Non-Traded REITs require a liquidity event to realize value for investors.
    - IPO on public stock exchange might be necessary to realize value for investors.

- Acquisition of the Non-Traded REIT by another company might be another way for investors to make money on their investment.

b. The median Non-Traded REIT has higher financial leverage than the median public REIT.

- Data gathered from NCREIF, The Townsend Group, and FTSE NAREIT reveals that debt leverage (ratio of debt to shareholders' equity) for Non-Traded REITs well exceeds that for public REITS:



Source: REITS: Real Estate with a Return Premium 2015 on https://www.reit.com/sites/default/files/portals/0/PDF/REITsRealEstateWithAReturnPremium.pdf accessed on July 20, 2018 and Ambassador Wealth Management.

- High debt leverage increases risk, especially if the economy were to go into recession.
- Additionally, debt leverage potentially offers the opportunity to flatter returns using certain calculations. Investors might not necessarily benefit.

Why should you care?

Surprisingly, many investors ignore liquidity to their possible detriment. Why?

One reason is that some investors reason that they do not need to touch the principal on their investment for a very long time. The psychological concept of mental accounting involves taking money and allocating it across different mental "buckets" for different purposes. Short, medium, and long-term investment horizons are attached to different buckets. Some people use that concept as a discipline to organizing their savings and investments.

But what happens when life events might force you to change your allocation? Unexpected high expenses, such as the cost of a serious surgery, might deplete your "rainy day" fund.

You might have to raise funds from your other buckets to replenish your “rainy day” fund for the next emergency.

Yet another reason people ignore liquidity in their investments is the promise of high, sustainable income. They believe the allure of certain investments that claim to generate income well superior to market rates. Some people are attracted to the idea of receiving a periodic check without having to worry about how their investment is doing. Or so they think.

We get concerned when we hear these stories. Not only might investors fail to consider the benefits of being able to see what their money is doing, but they might be missing out on other big issues.

- They should not automatically assume that illiquid assets generate higher income than liquid assets.
- Neither should they assume an illiquid asset structure is less risky than a liquid asset.
- Whether a structure is liquid or illiquid does not tell you much about risk in and of itself.
- Illiquid structures might appear to fluctuate less in value than liquid investments with transparent market pricing. However, public market volatility makes illiquid assets extremely difficult to value. Look at the headaches of 2008.

How we can help you deal with the issues

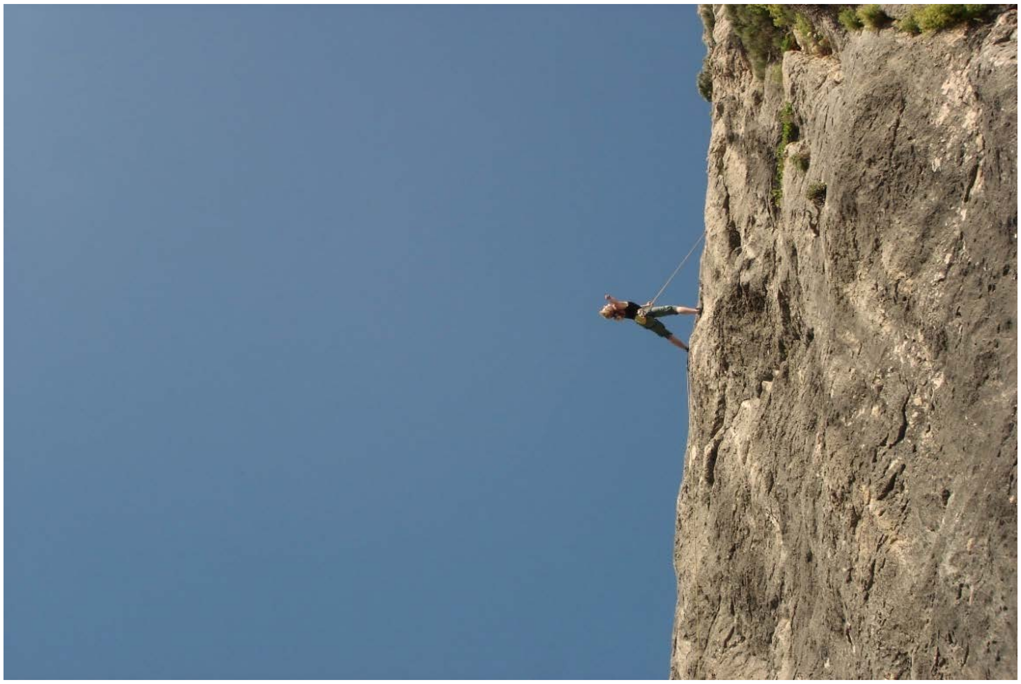
Currently, we see little to no excess total return in many illiquid structures and do not encourage people to invest in them. High expenses are also a key factor as to why we shy away from illiquid investment vehicles.

But what might you do if you have already invested in an illiquid vehicle?

With regard to annuities, the answer is “it depends”. We mentioned a few examples of situations where someone might benefit from holding onto an annuity. Some situations we tell people to stay in the annuity. Other situations we might advise you to take out the money even with incurring the surrender charge. However, there are other times when we might recommend to take a moderate approach. We would be happy to discuss your specific situation and explore alternatives.

With regard to Non-Traded REITs, currently your best bet is to watch and hope to collect your distributions and perhaps get a liquidity event that will bail you out of it. Take it as a painful lesson and look for other vehicles that generate income more cheaply while also giving you a return on your principal. Stop following the crowd that bought these vehicles because their neighbors did.

III. All Income Is Not Created Equal Because of Risk.



"All that glitters is not gold."

Income is like a promise. People trust another party to perform their end of the deal.

Your investment is similar to a promise. The exception is that money transacts in order to get the other party to reciprocate and honor their part of the agreement.

But what happens if they do not honor their promise?

More importantly, are there ways to mitigate risk of such unpleasant situations?

We believe there are ways to figure out when to trust and when to steer clear of certain "promises" in the world of income.

Your understanding of the risk that someone (or an investment) will fail to honor the promise they advertise is critical. Not only do you want to receive the income the investment "promises", but you also want to do everything possible to ensure that you get a positive return on your principal.

A lot of people forget about that detail. Yet, it is key to generating meaningful, sustainable income.

Example of Total Return:
Cumulative Return on Principal from Hypothetical Non-Traded REIT

Non-Traded REIT Example							
	Year						
	1	2	3	4	5	6	7
Initial Investment	$ 100.00						
Less: Commission@6%	-6.00%						
Real New Investment	$ 94.00						
Investment Principal	$ 94.00	$ 90.04	$ 86.25	$ 82.62	$ 79.14	$ 75.81	$ 72.62
Income Promise (Annual Coupon as % Total Investment)	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
Annual Income if Promise Honored	$ 6.58	$ 6.30	$ 6.04	$ 5.78	$ 5.54	$ 5.31	$ 5.08
Price Appreciation	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Less: Management Fee (Average of Non-Traded REITs)	-2.00%	-2.00%	-2.00%	-2.00%	-2.00%	-2.00%	-2.00%
Net Price Appreciation	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
End Investment Balance	$ 90.04	$ 86.25	$ 82.62	$ 79.14	$ 75.81	$ 72.62	$ 69.56
Income Generation	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
Net Gain in Investment Principal	2.79%	2.79%	2.79%	2.79%	2.79%	2.79%	2.79%
Total Return after Fee	9.79%	9.79%	9.79%	9.79%	9.79%	9.79%	9.79%
	-9.96%	-13.75%	-17.38%	-20.86%	-24.19%	-27.38%	-30.44%
	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
Total Cumulative Return	**-2.96%**	**-6.75%**	**-10.38%**	**-13.86%**	**-17.19%**	**-20.38%**	**-23.44%**

Source: Ambassador Wealth estimates.

Assume average commission rate (Investmentnews.com) on Non-Traded REIT sales and average annual expense ratio on REITs (REIT.com) for core and opportunity funds. Price appreciation is estimated at nominal GDP plus inflation. Yield is taken from anecdotal quotes of Non-Traded REITs. All returns hypothetical and not indicative of any actual past or future performance.

In the example above, a hypothetical Non-Traded REIT faces some challenges just to recoup investors their principal.

Using market assumptions for yield, commission, expense, and a moderate economic scenario for annual price return, this Non-Traded REIT would have lost investors money from year 1.

WHY?

In spite of the healthy 7% coupon, the Non-Traded REIT lost money because of high expenses and the lack of a roaring bull market in asset values to offset expenses and payout. Expenses include annual management fees and the one-time but steep commission charged to enter the Non-Traded REIT.

Consequently, the investment in 6 years would have lost 1 out of 5 dollars in value even including income!

This analysis does not factor in a bear market, which might produce negative price returns. Neither does it presume any risk of a dividend cut.

Both of these risks reared their ugly heads in 2008-9. Several Non-Traded REITs were forced to cut dividends, take writedowns on property values and thus investment principal, and even closed their doors for investor distributions and withdrawals.

Even in a good economy, Non-Traded REITs still can cut dividends. (See http://rationalrealist.blogspot.com/2018/01/merger-misfire.html https://thediwire.com/ar-globals-healthcare-trust-lowers-monthly-distribution-rate/

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NEWS

AR Global's Healthcare Trust Lowers Monthly Distribution Rate Again

The board of Healthcare Trust Inc., a publicly registered non-traded real estate investment trust sponsored by AR Global, has decreased its monthly distribution rate effective March 1, 2018.

February 27, 2018

Income matters, but total return matters even more.

Here is a sample of other potential risks that come with sources of income:

Type of Risk	Example
Credit	- Customers/tenants unable to pay obligations - Excessive leverage - Double leverage (example: LP takes on leverage and invests in properties or companies with debt)
Interest rate	Mismatch of funding of assets with liabilities leaves investment vulnerable to rising interest rates
Operational	- Bad execution of business strategy
Economic	- Economic downturn hurts revenues, investment unable to offset with costs - Fallout from local economy - Vulnerability to weak global economy
Counterparty	- Fraud on part of business partner - Default of key business partner
Sector	- Overconcentration in a weak sector for doing business - Competition (technological change – Amazon, new entrants) - Regulatory risk (changes in tax law make investment less advantaged, more legal scrutiny, litigation) - Environmental risk

Why should you care?

- Pursuing income is a noble pursuit. It is not sufficient in and of itself.
- Seeking to preserve and grow principal is just as important, if not more so.
- Putting money in an investment to generate income is akin to buying into a promise. The investment promises to honor its commitment to paying you a dividend.
- Investments do not always honor their promises to continue paying the same rate of distributions. Investors suffer when the truth comes out.
- One should seek to understand the risks they take in seeking income from a given source. Either the investor should choose to accept risks with which they feel comfortable, or else they should seek to diversify into a number of different sources. The goal is to mitigate risks in the event one or more investments has problems in fulfilling its promises to pay income.

How we can help you deal with the issues

We strongly believe in “not putting all your eggs in one basket”. Diversification across industry sectors and types of investments is critical to building an income strategy. Investors should not merely chase yield. As well, they should consider risk and how to plan for “rainy days”.

Meaningful yield does not mean chasing the highest advertised numbers. In fact, there might even be more risk solely in high yield. In many cases, the market might be signaling justified worries to the sustainability of such yields in the future. Investors ought not to get caught in such situations. Investments that cut dividends can also suffer drastic reduction in valuation (investment principal).

While we advocate “playing defense” when it comes to income, we also believe select opportunities exist in finding income. One should not simply panic by hiding in cash or bank deposits (which currently pay little to no yield).

Some examples of areas we find attractive include certain domestic equities where dividends have room to grow, other stocks where the market underestimates the investment’s ability to pay income and perhaps grow it, short duration corporate bonds and floating rate Treasury, and preferred

We would be happy to assist you in finding sources of meaningful and sustainable income that can help you live life with purpose.

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Life is complicated, let's simplify it.
Building relationships to help you navigate life with purpose.

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