Junks bonds are the wrong way to higher income

today's investor

Thomas E. O'Hara

of the National Association of Investors Corp.

Q. I have had a great need for more income. I decided to get it by buying a number of bonds that pay a high rate of interest. Recently, I have met a new broker, and he tells me that I am in a very risky position. He says the bonds that I have bought are commonly referred to as junk bonds, and there is not much in the way of assets behind them. I thought I had done a good job by spreading my money over 10 different issuers, but he says all of them are of the junk classification. What is your opinion of junk bonds? Should I sell them now?

A. I guess I have learned there is a lot of truth in the old adage: "The higher the interest, the greater the risk." Your new broker sounds like a person with good judgment who has your interest at heart.

The reason the so-called junk bonds pay such a right rate of interest is that they were issued in transactions where values were stretched to the limit and the assets in back of them were greatly reduced from normal standards. In cases where the remaining business has been highly leveraged with debt, there is not much room for mistakes in running the business.

The record of junk bonds is not very good. In a recent article, Charles Allmon reported that professor Paul Asquith of Harvard University made a study of junk bonds that were sold in 1977 and 1978. He found that 34 percent had defaulted by 1988. In another study, professor Edward Altman of New York University found that the junk bond default rate from 1976 to 1987 was 36 percent.

IF YOU have a chance of losing 34-36 percent of your capital, it would not seem that you are making a sensible investment putting your money in such items. You may be lucky and put your money in junk bonds that work out, but I would prefer to skip that kind of investment completely.

There are some mutual funds that invest in junk bonds, and if you are determined to put your money in them, that might be the safest way to go. But with the high percentage of defaults, it seems likely that even the best fund would be caught with a loss on one or two junk bond issues.

In looking at junk bonds, remember that companies that are in very cyclical businesses may be the most likely to run into trouble if they are highly leveraged. High leverage suggests that in a business slowdown, they might find their income drying up.

R.J.R. Nabisco is one of the highly publicized cases where junk bonds were issued in the buyout. Because of its stable business, I would think it would be most able to resist a downturn and continue to pay interest.

Thomas O'Hara of Bloomfield Hills welcomes your questions and comments but will answer them only through this column. Readers who send in questions on a general investment subject or on a corporation with broad investor interest and whose questions are used will receive a free one-year subscription to the investment magazine "Better Investing." For a sample copy of "Better Investing" or information about investment clubs, write Today's Investor, P.O. Box 220, Royal Oak, Mich. 48068.

datebook

● CREDIT COLLECTION
Thursday, Oct. 12 — "The Check is In the Mail" offered 1-4 p.m. in Rochester. Fee: $45. Information: 370-3120. Sponsor: Oakland Unversity.

● VENTURE GROUP
Friday, Oct. 13 — Southeastern Michigan Venture Group meets at Walsh College in Troy. Information: Scott Eisenberg, 446-0100.

● CPAs
Tuesday, Oct. 17 — Education requirements discusses at fall accounting conference of Michigan Association of Certified Public Accountants 8 a.m. to 5 p.m. at Roma's in Bloomfield Hills. Continuing Professional Education credit. Fee: $90. Information: 855-2288.

● PERFORMANCE APPRAISALS
Tuesday, Oct. 17 — "Conducting Effective Performance Appraisals" offered 9 a.m. to 4:30 p.m. in Southfield. Non-member fee: $205. Information: 353-4500. Sponsor: American Society of Employers.

● BOOKKEEPING COURSE
Tuesday, Oct. 17 — "Basic Bookkeeping" offered 8:30 a.m. to 4:30 p.m. in Rochester. Fee: $95. Information: 370-3120. Sponsor: Oakland University.

● APARTMENT ASSOCIATION
Tuesday, Oct. 17 — Apartment Association of Michigan meets in Bloomfield Hills. Non-member fee: $20. Information: 737-4477.

● CREDIT COLLECTION
Tuesday, Oct. 17 — Credit and Collections course offered 1-4 p.m. in Rochester. Fee: $45. Information: 370-3120. Sponsor: Oakland Unversity.

● SUPERVISION I
Tuesdays, Oct. 17-31 — "Principles and Practices of Supervision I" offered 9 a.m. to 4 p.m. in Southfield. Non-member fee: $350. Information: 353-4500. Sponsor: American Society of Employers.

● STAFF COMMUNICATIONS
Wednesday, Oct. 18 — "Effective Office Communication for Clerical and Administrative Staff" offered 9 a.m. to 4 p.m. in Southfield. Non-member fee: $190. Information: 353-4500. Sponsor: American Society of Employers.

● U.S.-JAPAN
Wednesday, Oct. 18 — "The U.S./Japan Interface" seminar begins at 7:30 p.m. in Bloomfield Hills. Information: 645-3635. Sponsor: Cranbrook Schools.

● OFFICE COMMUNICATION
Wednesday, Oct. 18 — "Effective Office Communication for Clerical and Administrative Staff" offered 9 a.m. to 4 p.m. in Southfield. Non-member fee: $190. Information: 353-4500. Sponsor: American Society of Employers.

● BUILDERS AND LAW
Wednesday, Oct. 18 — Builders Association of Southeastern Michigan meet in Bloomfield Hills. Non-member fee: $15. Information: 737-4477.

● WOMEN OWNERS
Wednesday, Oct. 18 — National Association of Women Business Owners meets in Troy. Information: 851-8270.

● DP MANAGERS
Wednesday, Oct. 18 — Data Processing Management Association meets in Southfield. Information: Joy Carroll, 358-2300.

● GROUP FACILITATORS
Thursday, Oct. 19 — "Developing Group Facilitator Skills" offered 9 a.m. to 4:30 p.m. in Southfield. Non-member fee: $205. Information: 353-4500. Sponsor: American Society of Employers.

● *PURCHASING MANAGERS*
Thursday, Oct. 19 — Purchasing Management Association of Detroit meets in Farmington Hills. Information: 474-4800.

● BUILDING OWNERS
Thursday, Oct. 19 — Building Owners and Managers Association meets in Southfield. Information: 984-4000.

● SMALL BUSINESS SEMINAR
Thursday-Friday, Oct. 19-20 — "Emerging Businesses: Practical Financial Tools for Successful Business Planning" in Detroit. Fee: $95. Information: 225-2123. Sponsors: National Bank of Detroit, Michigan Consolidated Gas Co., New Detroit, Wayne State University, Minority Technology Council of Michigan.

● LOTUS 1-2-3
Saturdays, Oct. 21 through Nov. 11 — Course on Lotus 1-2-3 on the IBM PC offered 9 a.m. to 12:30 p.m. in Rochester. Fee: $150. Information: 370-3120. Sponsor: Oakland University.

● LIEN LAW SEMINAR
Monday, Oct. 23 — Seminar on the *Michigan Lien Act offered 8:30 a.m.* to noon in Troy. Non-member fee: $35. Information: 737-4477. Sponsor: Builders Association of Southeastern Michigan.

● INTERMEDIATE LOTUS1-2-3
Mondays, Oct. 23 through Nov. 13 — Intermediate Lotus 1-2-3 on the IBM PC offered 7-9 p.m. in Bloomfield Hills. Information: 645-3635. Sponsor: Cranbrook Schools

● ENGINEERING REVIEW
Tuesday, Oct. 24 — Engineering fundamentals review course offered in Detroit. Information: Anthony Corte, 271-1500, Ext. 515. Sponsor: Society of Manufacturing Engineers.

● EMPLOYMENT LAW
Tuesday, Oct. 24 — "Employment Law: A Legal Update" offered 9 a.m. to 4:30 p.m. in Southfield. Non-member fee: $205. Information: 353-4500. Sponsor: American Society of Employers.

● PERSONAL LAW
Tuesday, Oct. 24 — Personal law update seminar offered at the Kingsley Inn, Bloomfield Hills. Non-member fee: $45. Sponsor: Oakland County Chamber of Commerce. Information: 644-1229.

● WILLS AND TRUSTS
Tuesday, Oct. 24 — Free seminar on wills, trusts and property ownership begins at 7 p.m. in Southfield. Information: 557-7840. Sponsor: Empire of America.