How to Collect GMIO Payments

(Government Mandated Income Opportunities)

IMPORTANT NOTE: This special report is for information and educational purposes only, based on data as of 2019. Do not buy or sell any investments until you done adequate research on your own.

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Introduction

Dear Reader,

Let me come right out and say this… GMIOs are not in **any way** related to GMOs (genetically modified organisms) that you might hear about when shopping in the supermarket.

GMIO is my term for Government Mandated Income Opportunities, or opportunities that investors can take advantage of to profit from rules that are made by the federal government itself.

Sounds interesting, huh?

Let's get into it then.

Sincerely,

Bryan Perry

Editor, *Cash Machine*

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To find an alternative source of financing during difficult lending environments, mid-sized private businesses are increasingly turning to business development companies (BDCs).

BDCs are specialty financial companies that have been introduced on a widespread basis during the past 10-20 years. They are not as well-known as the big banks, but they are a viable way for retail investors to jump headlong into the private equity market as they engage in pure plays on the financing of small- to medium-sized businesses in a growing economy.

The last decade or so has been a catch-22 for many banks. After getting shell-shocked by the recession and the real estate bubble, banks were awash in cash and began tightening lending standards on small-business loans.

This conundrum drove, and continues to drive, certain businesses to borrow from BDCs at rates of 10-15%.

The end result is a fat dividend payment for investors.

Let's break the process down a bit.

When small- or mid-size private companies apply to banks for loans and get turned down or receive risky financing deals, they turn to BDCs for help.

BDCs can then turn around their profits and pay high yields because they have chosen to be taxed as "regulated investment companies," or RICs, as opposed being placed under the more typical "C corporation" status. Thus, RICs avoid corporate taxes on the income and capital gains they distribute to shareholders.

However, the catch is that such companies <u>must distribute at least 90% of their income to shareholders</u> (who are then taxed). This approach avoids double taxation.

BDCs are focused on second-tier (also called mezzanine) financing and issue debt instruments. Thus, they may have features similar to convertible bonds and convertible preferred stocks and allow big gains to be realized through each investment's exit strategy.

BDCs also have similar features to real estate investment trusts (REITs), as they offer their shareholders a way to participate in these private financing arrangements. BDCs are made up of some of the smartest people in all of finance. They are also attracting top talent and new capital at a robust pace as the economy continues to improve.

Keep reading below for more about BDCs, including one of my favorite such companies, and unique features that make them such a great high-yield investment opportunity.

What Are BDCs?

Although tax-friendly BDCs are becoming more widely known, the federal law that created them actually was a product of the dismal economic climate of 1980.

With all the inflation, oil shocks and general malaise that was going on at the time, private equity and venture capital firms simply couldn't provide financing to small growing businesses.

Because of tight regulations, small business were left with really only one option: getting funding from banks.

Just like today though, traditional banks were playing defense and were extremely hesitant to make these kinds of loans.

In response, Congress passed the Small Business Investment Incentive Act of 1980, which essentially created business development companies -- a new kind of publicly traded corporation that could sell stock on the major exchanges.

The 1980 law is still in effect today, and it provides the following for BDCs:

- Required to **invest <u>at least</u> 70% of their assets** in the small companies in their portfolio.
- Must make available "**significant management assistance**" to those same portfolio companies.
- Must **follow all the rules** of publicly traded companies, including filing quarterly reports and having their books audited.
- **Can use leverage** in their own operations. For example, if one of these investment companies has $50 million in equity, it can borrow another $50 million to have a total of $100 million in investable funds.
- **May avoid taxes** at the corporate level. As long as a BDC distributes at least 90% of investment income to shareholders annually, these companies can qualify for "pass through" tax treatment of the income and capital gains that are distributed to shareholders.

For me, the second bullet point above about providing management assistance is one of the biggest reasons why BDCs make for a more trustworthy investment than traditional banks.

Because BDCs are *required* to play a role in supporting the management of their small-business clients, they are devoted not only to picking the right companies to invest in -- but in helping them succeed after writing them the loan.

While the big banks were hanging everyone out to dry during the 2008 financial crisis, these BDCs were quietly helping their clients work through challenges by often attending board meetings or even serving as board members.

By virtue of their status as specialized investment vehicles, and because the companies they're invested in aren't public, "insider" rules are irrelevant for BDCs. They are given the freedom to offer their full expertise on operations, financing, expansion or any number of areas that a small, but growing, business might not have experience in on its own.

Another feature of BDCs that makes them appealing – which is also is causing the sector to go gangbusters in the larger market -- is that they can charge 10-14% on their small-business loans.

With federal budget cuts always a threat, I don't see the government stepping up to make small-business lending programs better. Even if a small business manages to secure a loan from a bank, BDCs offer a lot of extra "perks" which have made them quite popular over the last few years.

With that said, here's my favorite BDC that also pays a nice monthly dividend…

Ares Capital (ARCC)

For those who don't know, I run a dividend-oriented newsletter and weekly trading service called *Cash Machine.* In that service, one of my favorite moves is to leverage the service's portfolio to the economy, often with the goal of searching for "high-yield diamonds in the rough" at the same time.

That said, if a business development company can generate an 8% current yield from a portfolio of floating-rate loans and pay a monthly dividend, I'm very interested in getting involved.

Given those criteria, I believe **Ares Capital (ARCC)** should be an excellent place to ride the rise in interest rates on the short end of the yield curve.

As stated on the company's website, ARCC's goal is "to create long-term value for our shareholders through an attractive dividend and solid investment performance across economic cycles."

Under normal market conditions, ARCC's management will pursue risk-adjusted returns by leveraging its "disciplined investment philosophy, multi-asset class expertise and creative structuring capability".

ARCC generally expects that first-lien senior secured loans will represent at least 44% of the overall portfolio. The company also generally invests a portion (currently 56%) of the overall portfolio in other types of investments, including second-lien, senior subordinated loans, collateralized loan obligations, preferred equity securities and senior direct lending programs.

As a result of the company's primary focus on minimizing downside risk, protecting invested principal and generating an appropriate risk-adjusted return, the portfolio is constructed to withstand market and economic volatility. You can see ARCC's recovery after a recent decline in the one-year chart below:

Source: Stockcharts.com -- January 29, 2019

Currently, ARCC pays out a quarterly $0.39 dividend , which amounts to a solid 9%+ annual yield.

Boost the Economy with BDCs

A few years ago, people thought that despite the recession's depth, it would be just another vanilla recovery. They thought that we'd come out of it fine, a stimulus package would produce results and the economy would lift.

Those efforts failed to meet expectations for years in what has honestly been the most bizarre economic recovery I've ever seen. European and Asian economies are still on uncertain ground, and while the U.S. economy is finally seeing some substantial growth, it sure took a while to get here.

A while back, I read that consumer debt has risen since 2013 as Americans have stepped up borrowing to buy cars and attend school, among other reasons. The last time I checked, the tab for America's outstanding unsecured credit line was at least $3.5 trillion, the highest level on record.

Despite some measure of recovery, I still believe we need to boost the economy with small-business creation. Since someone has to believe in, and finance, the small- to medium-sized businesses that will create more jobs, BDCs are in the sweet spot for private financing, especially with the possibility of further tax hikes on both the consumer and corporate side.

Not only can you feel good about boosting the economy with BDCs, but you're also boosting your own income and growth, since the RIC tax status of BDCs makes them some of the highest-yielding assets out there.

I hope this special report has helped to learn more about a rather opaque and often confusing sector of the market. Of course, I encourage you to do additional research on BDCs to determine if they would be a good match for your portfolio.

Happy Investing!

Biography

For over a decade, Bryan Perry has brought his expertise on high-yielding investments to his *Cash Machine* subscribers. Before launching the *Cash Machine* advisory service, Bryan spent more than 20 years working as a financial adviser for major Wall Street firms, including Bear Stearns, Paine Webber and Lehman Brothers.

Bryan co-hosted weekly financial news shows on the Bloomberg affiliate radio network from 1997 to 1999, and he's frequently quoted by *Forbes*, *Business Week* and CBS' *MarketWatch*. He often participates as a guest speaker on numerous investment forums and regional money shows around the nation. With over three decades of experience inside Wall Street, Bryan has proved himself to be an asset to subscribers who are looking to receive a juicy check in the mail each month, quarter or year.

Bryan's experience has given him a unique approach to high-yield investing: He combines his insights into dividend-paying investments with in-depth fundamental research in order to pick stocks with high dividend yields and potential capital appreciation.

In addition to *Cash Machine*, Bryan provides a supplemental service called *Premium Income*, which gives subscribers a unique way to generate additional income on the *Cash Machine* stocks. He also offers several other trading services designed to maximize income generation while playing a variety of market trends: *Quick Income Trader, Instant Income Trader,* and *Hi-Tech Trader*.

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