Income Strategies in a Low Yield Environment

Income investing is a staple of a diversified portfolio, regardless of investment goals. In an interest rate environment defined by historically low yields, investors may wish to change their approach to generating monthly cash.

Visit cioninvestments.com for more information.

Diversified investment portfolios, particularly those focused on retirement, have followed a similar script for decades: Comprised of a mix of equity and debt, initially with a majority in equity followed a gradual shift towards a debt focus and as retirement approaches. The rationale behind this tried and true wisdom is simple. Investors generally seek to grow their nest eggs with higher-upside, higher-risk equity assets while they are still in the work force and then replace their bi-monthly paychecks with income from their debt allocation. While this strategy was highly effective in the days of double digit U.S. treasury yields, it warrants a re-evaluation in today's suppressed yield marketplace.

INVESTING FOR MONTHLY INCOME

Income generation should be a key consideration for all investors assembling their portfolios, whether they be specifically for retirement or not. The income produced by an investment portfolio represents one of two components of the total return equation, the other being price appreciation. As investors age the importance of these income-generating investments becomes increasingly vital to provide the monthly cash flows that retirees require to fund things like groceries, medical bills, and living the lifestyles they planned for their entire careers. The natural inclination of an investor looking to maximize income in retirement would be to maximize the amount of stable, income producing investments in their portfolio in lieu of asset appreciation.

This strategy exists for a reason – should equity or debt markets suffer price depreciation; most income investments will continue to produce income in the form of stock dividends or other interest distributions. In today's interest rate environment however, investors are left wanting more from the cash flows that traditional dividend stocks, bonds, and U.S. treasuries can provide. Yield pressures in the last ten years especially have forced many managers to take on additional credit risk with lower rated bonds or longer-term maturities. Managers looking to avoid stretching for yield have instead turned to total return strategies.

TOTAL RETURN APPROACH

A total return approach is focused on generating returns full stop, instead of emphasizing just one component of total return – generating monthly cash flow. An investor making use of a total return strategy for income does not care whether their monthly bills are paid by interest payments, price appreciation, or a combination of the two. Cash can be generated for current income by re-balancing the asset mix in the portfolio and selling the corresponding amount of assets needed to cover monthly expenses. The idea of selling assets to generate current cash flow may give some investors pause but the hesitation to do so is misguided. When a stock pays a dividend, its price generally is reduced by the same amount, effectively drawing from the principal in a different capacity.

Although diversification does not provide profit assurance or guarantee loss prevention, one notable element of the total return strategy is the ability to diversify a portfolio across more asset classes than an income-only portfolio. Given the importance of principal preservation to retirees, avoiding over concentration in any one industry or asset class is an advantage in the effort to mitigate downside risk in a portfolio. A total return approach can also reinvest dividends or interest payments rather than taking the cash to fund monthly expenses – over 90% of long-term wealth creation in stock and bond markets alike is the result of the compounding effect of the growth and reinvestment of income payments.

TYPICAL INCOME INVESTMENTS

Income seeking investors utilize various strategies to facilitate the income portion of their portfolio's total return. These strategies, like any investment strategy, are not guaranteed to meet their objectives. The two most common are bonds and dividend stocks.

Bonds

A bond is a fixed income investment in which an investor loans money to a corporation or government agency which borrows funds for a defined period in exchange for periodic cash payments at a variable or fixed interest rate. Bonds are used by companies, municipalities, states and sovereign governments to raise money and finance a variety of projects and activities. Bonds investors must be cognizant of the possibility that a borrower may not be able to fulfill their payment obligations which should be taken into consideration.

Dividend Stocks

When corporations declare their earnings, they may choose to reinvest profits into the company in an effort to raise the stock price or they can choose to pass them on to their shareholders in the form of a dividend payment. Dividends may be in the form of cash payments or additional units of stock. There is no assurance that companies will not reduce or even eliminate their dividend payments. Therefore, the financial health of a company should always be considered.

Naturally, there are other options outside of stocks and bonds, e.g., alternative investments. You may wonder, what are alternative investments? To find out, read our article on alternative investments.

To learn more, please contact your financial professional.

The information contained herein is intended to be used for educational purposes only and does not constitute an offer to sell or a solicitation to purchase securities. Such offers or solicitations can only be made by means of a prospectus. Prior to making any investment decision, you should read the applicable prospectus carefully and consider the risks, charges, expenses and other important information described therein.

CION Securities, LLC, Member FINRA/SIPC.