



Struggling for Income?

Steps to Consider

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If you are retired, your investment portfolio probably plays a major role in providing some of your income, along with Social Security and perhaps a pension. As your current fixed-income investments come due or your bonds are called, you may be faced with a dilemma – replacing the income you were receiving from higher-yielding investments in what is now a low interest rate environment. The question then becomes – how?

Higher Rates = Higher Risk

In an effort to maintain the same income level, some investors are too focused on finding higher rates. But in low-rate environments, trying to get the same income you received from maturing investments likely means taking on additional risk in your portfolio. Some common missteps include:

- **Reaching for higher yields** – High-yield investments are likely to be lower quality, which carry higher potential risks, as shown below.
- **Allocating too much to long-term fixed income to generate more interest income** – Long-term bonds carry additional risk because their prices decline more than short-term bonds when interest rates rise. We recommend that long-term bonds account for 15%-25% of your overall fixed-income portfolio.
- **Shifting too much of your portfolio to dividend-paying stocks** – Dividend-paying stocks are an important part of a retirement portfolio, but they have different risks and aren't a substitute for your fixed-income allocation.

Rates and Risks Today versus Yesterday

Bond	Yield	Credit Rating	Maturity	Asset Class	Investment Category
Typical bond today	4.4%	A	20-year	U.S. Investment Grade Bonds	Income
Typical bond beginning of 2008	6.3%	A	20-year	U.S. Investment Grade Bonds	Income
Typical bond today to approximate yield of 2008	6.3%	B	20-year	High Yield Bonds	Aggressive Income

Source: Bloomberg; 7/31/2018.

In 2008, you could find a 6.3%, 20-year investment-grade bond. But to get a similar yield today, you'd have to buy a lower-quality bond. That may be too risky, depending on your risk tolerance and financial goals. Instead, you may need a different income strategy, which may include systematic sales from your portfolio, adding intermediate-term bonds and reducing long-term bond holdings, or reviewing your spending.

Where to Invest Today?

Every time a bond gets called or matures, you should take a step back and look at your overall portfolio. Don't assume that just because a bond was called, the money should simply be reinvested into another bond.

It's tempting to reach for higher income, but it's always more important to make sure your portfolio contains the right balance of stocks and bonds. Your portfolio's mix should be based on your overall risk tolerance, investment goals and time horizon.

With your portfolio mix in mind, we believe there are attractive investment opportunities in today's market:

Stocks

Stocks continue to trade near new highs, but values are not as compelling as in recent years. While we still find stocks attractive, we believe you should expect lower returns from stocks going forward. Make sure your portfolio is not overweight in stocks – and if you are underweight, consider adding to:

- **Developed International Large-cap Stocks** – The synchronized rebound in global growth seems to be intact. Additionally, developed-market equity investments currently have higher dividend yields, better valuations and higher expected long-term earnings growth than U.S. large-cap stocks.
- **Companies growing their dividends** – Higher-quality companies that grow their dividends over time can provide a rising stream of current income that helps offset inflation. Historically, these stocks have delivered a higher total return than the broader market.*

Fixed Income

Bonds have performed well in recent years, but not as well as stocks. Based on this, you may now be underweight in fixed income within your portfolio. While rising rates could push down bond prices and in turn negatively affect fixed-income investment returns, these investments can provide diversification and act as a complement to stocks. We recommend:

- **Reducing overweight positions in long-term bonds** – Allocate no more than 25% of your fixed-income portfolio to long-term bonds and bond funds.
- **Adding short- and intermediate-term bonds** – We believe short- and intermediate-term bonds offer an attractive combination of current yields, less sensitivity to rising rates and good diversification.

Positioning Your Portfolio for Income

In previous generations, retirees often lived on their dividend and interest income because alternate sources of income – such as pensions and Social Security – provided the majority of their income needs.

Today, pensions are being replaced by 401(k)s and other retirement accounts, such as Individual Retirement Accounts (IRAs). As a result, most investors will need to sell some of their investments over time to supplement their dividend and interest income.

After factoring in outside sources of income, including Social Security, pensions and annuities, you can then determine the role your portfolio must play in supplementing your retirement income.

1. Determine how much you need from your portfolio to cover your expenses for 12 months. This amount should be held in cash. Dividends, interest and systematic sales can “refill” your cash allocation as you use it.
2. An additional three to five years of your income needs should be held in a short-term, fixed-income investment ladder, which can be used as these investments mature.
3. If you need to make systematic sales from your portfolio to supplement your income, focus on reducing overweight positions and taking long-term capital gains.

During a down market – If equity investments are underperforming, maturing CDs from your short-term ladder can provide for your current income needs. This can help you avoid selling longer-term investments when they are down in value.

During a strong market – When equities are performing well, you can cover some of your current expenses through portfolio growth, taking money from equity investments that have performed well. Additionally, you can take some of this growth to “restock” your cash and short-term ladder.

* Ned Davis Research. Based on the constituents of the S&P 500 Index. Past performance is not a guarantee of how the market will perform in the future.

Built for Balance

Today, interest rates are low and generating income may be a challenge – but we believe regardless of the interest-rate environment, your income strategy should be built for balance. The balances of your withdrawals, spending, income sources and investment mix are important considerations for any interest-rate environment.

Balance Your Withdrawals

Cash flow from your portfolio can come from:

- Dividends
- Interest
- Proceeds from investment sales

You may be most familiar with receiving income from dividends and interest. But selling a portion of your investments, particularly those that have grown in value or make up too much of your portfolio, can help supplement your retirement income.

Our withdrawal rate guidance – approximately 4% for a 65-year-old retiree – assumes that withdrawals include interest, dividends *and* some investment sales. Your portfolio's return is made up of growth of principal as well as dividends and interest, so your retirement income should include those components, too.

But remember – if you're trying to get the entire 4% from dividends and interest alone, you're likely taking too much risk.

Balance Your Spending

It's always a good idea to review your spending habits, especially in light of today's low interest rates.

If your portfolio withdrawals are modest, you still may be able to spend the same amount. But if you are withdrawing too much, you may need to spend less and budget to ensure your money lasts as long as you need it.

Balance Your Income Sources

It's just as important to diversify your income as it is your investments. Income in retirement can come from several sources:

- Social Security, pensions and annuities provide lifetime income that is unaffected by market fluctuations. Social Security has a cost-of-living adjustment, but payments from pensions and some annuities are typically fixed.
- Your investment portfolio can supplement your current income, but it also should have growth potential to provide for your future income needs and fight inflation.

Balance Your Investment Mix

When you diversify, each investment serves a purpose for your current and future income:

- Cash is available for your current income needs and helps provide stability to your portfolio.
- Fixed-income investments give you a stream of income to add to Social Security or your pension and provide income over the intermediate term.
- Stocks provide growth potential to help your income keep pace with inflation and supplement your long-term income needs. They also may provide dividends for current income.

Actions for Investors

Ultimately, if you're trying to generate all of your retirement income from interest and dividends alone, you are probably taking on too much risk. Instead, we recommend a balanced and diversified approach. Review your portfolio and income options with your Edward Jones financial advisor.

Investing in equities involves risks. The value of your shares will fluctuate, and you may lose principal. Investments that are concentrated in a specific sector or industry may be subject to a higher degree of market risk than investments that are more diversified. Special risks are inherent in international investing, including those related to currency fluctuations and foreign political and economic events. An investment in bonds involves risk, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity.