A Total-Return Approach to Retirement Income

On the Need for Capital Gains and the Perils of Chasing Yield

As dividend yields and interest rates around the globe hover near all-time lows, you may be tempted to purchase riskier investments in a search for income. We in PWM Research strongly advise against this and propose an alternative.

PWM Equity & Fixed Income Research

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WHY A TOTAL-RETURN STRATEGY MIGHT MAKE SENSE

- This approach to retirement income combines growth and income to fund retirement goals
- Chasing high yielding securities can skew your portfolio, producing risky bets in stocks and/or bonds
- Investing for growth helps stave off inflation risk and reduces your chances of outliving your money

With global interest rates near historic lows and the S&P 500 yielding less than 2%, counting on dividend and interest income in retirement may feel uneasy. In this environment, your natural inclination may be to reach for higher-yielding securities – after all, this is where a retirement "paycheck" comes from. **But there can be devastating downsides to reaching too far for yield, both in stocks and bonds.**

For one, chasing yield may cause your portfolio to become overly concentrated in certain sectors and investment styles. This unintentional skew can add significant risk. Further, the high-yielding universe is full of "yield traps," stocks whose dividends look attractive simply because their price has gone down (often for good reason). In fixed income, reaching for yield generally means adding interest rate risk or default risk. Both have severe ramifications for portfolio safety and stability. And therein lies the dilemma: additional yield isn't free, and it often comes with outsized risks.

Thus, we propose exploring a total-return approach. This focuses on building diversified portfolios with long-term investment growth in mind, using a combination of income and capital gains to fund retirement goals. **The growth portion is critical**. Not only will it help stave off inflation risk (rising prices), but it reduces the chances you'll outlive your money. Still, this approach can be nerve-wracking. When dividends and interest are not enough, it will mean selling principal. But it may be unavoidable, as retirees today face decades of spending to fund: while the average US worker still retires around 62, he/she now lives to be 85 years of age. By this math, investment growth is critical to retirement success.

Further, should you decide to reach for yield using riskier investments, you jeopardize the very principle you hope to keep safe. Though counterintuitive, a strategy that involves taking capital gains from a high-quality, balanced portfolio can be far safer than relying purely on income from riskier high yielders. It is also worth noting that dividends are not contractual obligations – they can get cut in times of stress, particularly amongst higher-yielding companies with lots of debt. Though dividends are traditionally less volatile than stock prices, they are still vulnerable to market downturns.

As yields come down across the globe, your retirement strategy must adapt, and we firmly believe that taking a total-return approach to retirement income will set you up for success. Creating a well-diversified, balanced portfolio with a focus on dividend growth and high-quality companies is a time-tested strategy that can provide you with both the growth and income needed to enjoy a lengthy and comfortable retirement.

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