THE CASE FOR FIXED INCOME

Retirement Income Source®

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We hear the term "renewable resource" used often when referring to energy — solar, wind, and even tidal energy. Most agree that the practical use of renewable energy is essential for our future well-being. The same can be said for money, investing, and retirement. By planning ahead, Americans born in or before 1970 — a.k.a. The Income Generation — can help to ensure they do not run out of money in their golden years.

Only decades ago, people were expected to retire and only live for a few years, during which time they could simply spend down their savings. However, as life expectancies continue to increase, many people can expect to enjoy 30 years or more in retirement. That's why it's become imperative for anyone over the age of 50 to establish their own renewable streams of income to cover the cost of enjoying more time in retirement.

You might think this means you need a bigger lump sum of money to retire, but at the end of the day, it can take a long time to accumulate more lumpsum dollars. In my experience, the more sensible approach is to try to maximize the amount of interest and dividends that a lump sum can generate.

A More Certain Future

By placing a significant part of their portfolio in fixed-income securities, or what I refer to as the universe of bonds and bond-like instruments, members of The Income Generation can establish a renewable source of income they can count on throughout retirement, while also helping to preserve the value of their original investment.

Investing in income-generating instruments can be like lending your money to the largest U.S. companies that pay you regularly scheduled interest. In the case of individual bonds, at the end of the loan term, they send you the last interest payment along with the return of your original principal. This is, of course, assuming there are no defaults.

By owning predominantly bonds and bond-like instruments, retirees can know with a greater degree of certainty what their financial future holds. Other investments, such as growth stocks and mutual funds, can't offer as much certainty.

Investors who use bonds and bond-like instruments and, for those with higher risk tolerance, stock dividend strategies, find that more consistent income helps bring a sense of peace because it is a renewable resource. With this, many find that they get more enjoyment from their retirement because they are more comfortable doing things like making large purchases, helping their kids financially, and going on vacations.

Investing by Contract

When you invest in an individual bond, you have a contract with the borrower. Naturally, that contract is only as good as the solvency of the borrower, but it gives you two important guarantees:

1. You are guaranteed to get a fixed amount of interest on a regular basis for the life of the bond.
2. When the bond matures, you are guaranteed that the borrower will repay the par value.

And, again, both guarantees are assuming there have been no defaults.

The market value of individual bonds will fluctuate, but bondholders can take solace in knowing their income won't change, and they'll still receive their par value back at maturity. Stocks and stock mutual funds can't provide these assurances, and neither can bond mutual funds.

When you buy a bond mutual fund, neither of the two guarantees that you get with individual bonds exist. Many are surprised to find that the definition of a bond mutual fund is the stock of a company that owns bonds. Plus, most people don't realize bond mutual funds also have fees and tax implications that can be reduced by investing in a portfolio of individual bonds and bond-like instruments.

When it comes to investing by contract, it's not just bonds that provide you with the opportunity to enjoy the benefits of doing so. Other types of fixed-income instruments also allow you to enjoy the benefits of investing by contract, including preferred stock, bank CDs, and annuities.

Although Real Estate Investment Trusts (REITs) and Business Development Companies (BDCs) do not have a par value and aren't contractual investments per se, when you invest in them you own common stock of a company that owns contracts within their portfolio. Although REITs and BDCs can be riskier approaches, they can also offer an opportunity for investors to earn even higher yields.

It Takes a Professional

Perhaps the most important thing to understand about investing in fixed income is that it's not generally a strategy for do-it-yourselfers. Even most financial advisors don't really have the right qualifications for it, which is why most have business models geared toward growth-based strategies, which are simpler. All of this is especially true in today's market environment, where ongoing active management is an important part of successful fixed-income investing. The reality is, income investing takes a true Income Specialist, meaning someone who understands and adheres to these qualifications:

1) He invests in individual bonds, not bond mutual funds

Many financial advisors today got into the business in the 1980s and 90s, amid the fastest growing stock market in U.S. history. Thus, their area of knowledge became the stock market, not the bond market. Frankly, when they do fixed income, it's merely an afterthought, and most will simply use bond mutual funds. As I noted earlier, bond mutual funds carry risks, fees, and tax implications that can be reduced by investing in a portfolio of individual bonds and bond-like instruments. That's why a true Income Specialist will invest their clients' money in individual bonds and bond-like instruments and avoid bond funds.

2) He looks beyond the ratings

If an advisor is smart enough to invest in individual bonds and bond-like instruments instead of bond mutual funds, the next question is whether he looks beyond Moody's and Standard & Poor's ratings of the bond. We learned during the Financial Crisis of 2007-2009 that many of those AAA-rated Mortgage Bonds that were about to default had ratings attached to them that were far too generous. A true Income Specialist knows that they need to look beyond these ratings and research the actual financials and management of the issuers themselves.

3) He doesn't simply buy at regular market prices

Let's say an advisor passes the first two tests; he (or she) doesn't use bond funds and he looks beyond the ratings. The next question becomes whether the advisor is following a stockbroker mentality and simply buying these securities at current market prices, without the use of limit orders.

Most advisors will purchase bonds and bond-like instruments at current market prices, which means if the market happens to be up, their clients are probably overpaying. That's why a true Income Specialist uses limit orders when buying bonds and bond-like instruments on their clients' behalf. That way if the prices of those securities happen to be up that day, an Income Specialist can help ensure their clients don't overpay.

4) He goes direct

To buy individual bonds and bond-like instruments, every broker or investment advisor must have a clearing house such as Charles Schwab, TD Ameritrade, or Fidelity. When you're buying stocks and stock mutual funds, the commissions and/or trading fees are required to be 100 percent transparent. The underlying issue with bonds and bond-like instruments is that the clearing houses don't have to disclose to the client, broker, or investment advisor how much extra they're tacking on to the price of the bond or bond-like instrument they own.

True Income Specialists know this and invest in the technology and research to find out who is buying and selling various bonds or bond-like instruments at any given time. This knowledge gives true Income Specialists the ability to go directly to the buyers or sellers and negotiate the best price, almost on a wholesale basis, for their clients.

5) They actively manage accounts

In the rare case that an advisor passes the first four tests, it's almost inevitable they will fail the final test, which is whether they are actively managing these bonds and bond-like instruments. Active management of individual bonds and bond-like instruments allows true Income Specialists to continually identify and act upon opportunities to try to maximize returns for their clients, to increase income first, and provide opportunities for portfolio growth second.

To do this, a true Income Specialist uses a variety of strategies. These include proactively swapping bonds and bond-like instruments to get a higher current yield today or swapping bonds and bond-like instruments to get a higher yield in the future by getting a better purchase price today. This way, if the bond or bond-like instrument is held until maturity, the client can earn more. Something else a true Income Specialist can do is swap bonds and bond-like instruments defensively to get a more secure bond with a higher rating, or a shorter-term bond.

Take Action!

So, how can you get started making your retirement income a renewable resource? Simple: Contact a qualified financial advisor who specializes in the universe of income-based financial strategies designed to help protect your principal and generate more reliable income through interest and dividends. This is income you can spend or, if you don't need it, reinvest to grow your portfolio organically, or "the old-fashioned way"!

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