Registered Investment Advisor Firm

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An Inconvenient Truth – Not the "Documentary"

No, I'm not going to talk about a former Vice President and the thesis of "climate change" – or whatever the politically correct terminology is today.

What I'm referring to is the hunt for yield by the "baby boomers" in their retirement years.

By now you've probably heard that the baby boomer generation consists of those born between 1945 and 1964. You may have also heard that about 10,000 new baby boomers retire each day, and according to the Pew Research Institute, that number should remain above 10,000 per day at least through 2019.

The inconvenient truth is as they (we) settle in to enjoy life in retirement, they're met with the obvious irony that at the time they want attractive interest rates to produce retirement income from their portfolios – there is little yield to be found.

Fortunately you need not worry too much because there are alternatives to fixed income.

In fact, the low interest environment may actually help investors achieve a higher total return - income plus growth as investors are encouraged to keep a greater portion of their portfolios in equities for a longer period of time.

I'm not generally one who accepts that the widely-held belief that investors **should** gradually shift their portfolios to fixed income as they age.

There was a time when this might have made sense, like when interest rates were high in the 1980's and 1990's but it makes little sense in today's historically low interest rate environment.

In fact, it may do more harm than good to switch into fixed income simply because of age. This insures that the growth that investors often need gets left behind.

I'll talk about achieving yield through

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equity investing, but first, a note on global interest rates and where I think we'll see them heading from here (my crystal ball is still in the shop for a tune-up – so keep that in mind).

Global interest rates are about as low as they have been at any point in history and Central Banks around the globe are instituting their own massive Quantitative Easing (QE) programs at accelerating rates.

For many small businesses, corporations and highly qualified borrowers that could be a great thing.

The economic benefit that accrues from low borrowing costs is huge, but only to the extent that banks are actually willing to lend. As a side note, Dodd-Frank and post-crisis regulation hasn't made that an easy undertaking.

Unfortunately for investors this means that the low rate environment leaves very few places where you can earn a decent yield with little risk.

When we look at some of the traditionally "safer" bonds available in the market, like the government bonds of stable economies, you find that the yields are grinding along the bottom, and are hardly paying more than the long-term inflation rate.

In order to try to spur corporate borrowing and lending QE programs in the U.S., and now in Europe and Japan, are designed to keep downward pressure on longer-term interest rates.

The inconvenient truth and collateral damage to investors is that yields are low – frequently too low to rely on for fixed income needs.

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If you would like investment advice, contact Bob Davis or myself and we'd be happy to assist you.

The municipal bond market isn't much brighter than the Treasury market. Normally, you could achieve a higher yield as municipals are slightly riskier than Treasuries, and you get a favorable tax treatment with municipals.

It's no secret that the Fed is poised to raise interest rates later this year – or so they are telegraphing. Even if they do decide raise rates, I expect the rate hike cycle will be gradual over an extended period of time.

This means I wouldn't count on interest rates shooting up in the next couple of years to levels that will pacify investors seeking interest income.

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Therefore, depending on your goals and risk tolerance, it could make sense to pursue alternatives.

One alternative might be dividend paying stocks. These types of investments have tended to historically reduce downside volatility in the near-term, achieve equity-like growth over the long-term, while generating a significant portion of total returns in the form of cash.

While historically more volatile than fixed income, equities can give investors a higher probability of seeing their portfolio grow over time.

While equities have been historically more volatile than fixed income, as an investor the duration of your fixed income can become extremely volatile in a rising rate environment. For example – if you own a fixed income security with a 15 year duration – for every 1% rise in rates you should expect a 15% decline in that security's value.

As a financial professional, I know that periods like the 2008 financial crisis and bear markets tend to make retirees more reluctant to hold a high percentage of their portfolio in equities. This is completely understandable.

However, for an investor entering retirement with income needs that might span 20 to 30 years, the reality is that you probably need more growth than you think. This is where equities and dividends can make a big difference.

Don't expect the interest rate environment to turn around any time soon.

Japan and Europe are in the early stages of their easing program, as are China and Australia. The U.S. has walked up to the water's edge, but hasn't stuck their toe in the water yet when it comes to tightening.

So if you're an investor in search of yield, and have an appropriate time horizon, it might make more sense to look to dividend-paying stocks, and perhaps some corporate bonds, to generate income you seek.

Doing so could also help you achieve better long-term growth rates in your retirement years.

Answer Forum

No questions this month, so class dismissed!

Davis Investment Group

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If you have questions or would like further information on this month's topics or any other financial or

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investment related subjects, including Social Security claiming strategies, please contact me directly at (925) 360-6819 or through my email address at: Bud@DavisInvestmentGroup.biz

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