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More income for your retirement years

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Question: What type of income-producing investments do you recommend for retirement?

Podnos: It is common for families I work with to inquire about changing their portfolio to produce more income as they enter the retirement years. They might inquire about buying more bonds and dividend-paying stocks in order to make enough return for their intended distributions.

This strategy may have worked a few decades ago when fixed income produced solid positive returns with relative safety, but no longer. With ultra-low interest rates, just getting the return desired through interest is nearly impossible, and carries significant investment and inflation risk.

Over the past five decades, cash investments just equal inflation at best (and after tax usually lose some purchasing power annually). Fixed income of all kinds (bonds, CDs, etc.) over that time makes a "real return" (return after inflation) of perhaps 1-2 percent. But this happens when intermediate term interest rates are market determined and not suppressed by the Federal Reserve.

Currently, 10-year U.S. treasury bonds are paying under two percent, so their "real return" is probably negative. Increasing your allocation in retirement to bonds may be a losing strategy, especially when interest rates start to move up (this will drop the price of your bonds). Perhaps we'll return to the days of reasonable interest rates on intermediate term fixed income (remember 5-6 percent on one-year bank CDs in 2006?), but we don't know when.

In the meantime, your best bet for a portfolio that can supply a real return is one that holds a significant percentage of global stocks, and is both low cost and diversified. It needs to be a long-term portfolio and you need the discipline not to sell due to market drops. We will call this a "total return" portfolio. You just take your annual tolerable distributions each year from the mix of dividends, interest and capital gains regardless of the exact makeup of the portfolio. This way, portfolio design is driven by the maximal expected total return rather than just interest and dividends.

As a somewhat extreme example, in mid-2009, interest rates were already very low and bound to stay there for many years. However, stocks were really inexpensive. The smartest "total return" portfolio had a high percentage of stock investments.

So, think about your total return in a retirement portfolio. Get some help in its design if you don't have the interest to do so yourself.

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