THE CASE FOR FIXED INCOME

How to Help Avoid the Most Common Mistakes That Could Derail Your Retirement

Find out why:

How to create steady streams of income you can count on well into retirement

Why now is still a good time to buy and hold bonds and bond-like instruments

What if I invest today and rates go up tomorrow?

Why most financial advisors aren't equipped to manage fixed income investments the right way

The Case for Fixed Income

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Renewable Resource — A natural resource that can replenish itself naturally over time.

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 — 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 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 lump sum dollars. Often, the easier approach might be to maximize the amount of interest and dividends that lump sum can generate.

Know, with Greater Certainty, What Your Financial Future Holds

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 well into retirement, while helping to preserve the value of their original investment. The reason it's called fixed income is because the income is fixed, whereas stocks and mutual funds can actually cut the dividends they pay.

The universe of bonds and bond-like instruments is much larger than the stock market and much more diverse than bank deposits or U.S. Treasury bonds. In fact, building a portfolio with securities yielding approximately 5% puts you well ahead of today's inflation rate and close to what the stock market actually averaged from 2000-2020, without the stress and aggravation that can come with the ups and downs of the stock market.

Investing in income-generating securities can be similar to lending your money to the largest U.S. companies that pay you regularly scheduled interest. In the case of 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 common stock and stock mutual funds, can't offer as much certainty.

Investors who use bonds and bond-like instruments find that the consistent income helps bring a sense of relief, because it is a renewable resource. With this, many find that they actually get more enjoyment from their retirement because they are more comfortable 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—both guarantees are assuming there have been no defaults.

The market value of individual bonds will fluctuate, but bond holders can take solace in knowing their income won't change, and they'll still receive their par value back at maturity, as long as the issuer is doesn't default. 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 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 other fixed income securities.

If you are interested in learning more about the dangers of investing in mutual funds in general, you may want to read our report: Why Investing in Mutual Funds Could Jeopardize Your Plans for Retirement.

As we mentioned earlier, the universe of fixed income investing is much larger than that of stock market investments. 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 that allow you to enjoy the benefits of investing by contract include: preferred stock, bank CDs, annuities, government bonds, municipal bonds, and corporate bonds.

Although Real Estate Investment Trusts (REITS) and Business Development Companies (BDCs) do not have a par value, when you invest in them you own common stock of a company that owns contracts within their portfolio. Although REITs and BDCs can be a riskier approach than investing by contract, they can offer an opportunity for investors to earn even higher yields.

Start Using The Same Methods Institutional Investors Use to Help Ensure Steady Streams of Income

Institutions that specialize in bonds and bond-like instruments typically invest heavily in technology, as well as the knowledge that often includes a team of chartered financial analysts (CFAs) to basically do the five things below:

Things That Define True Income Specialists

I. Invest in Individual Bonds and Bond-Like Instruments Instead of Bond Mutual Funds

Most financial advisors today got into the business during the 1980s and 90s, in what was the fastest growing stock market in U.S. history, so their area of knowledge became the stock market, not the bond market. Frankly when they do fixed income, it's merely an afterthought. Most will simply use bond mutual funds.

As we mentioned earlier, the problem is that 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 client money in individual bonds and bond-like instruments and avoid bond funds.

II. Look 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 they look beyond the Moody's and Standard & Poor's rating 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 Specialists knows that they need to look beyond these ratings and research the actual financials and management of the issuers themselves.

III. Don't Just Buy Bonds and Bond-Like Instruments at Regular Market Prices

Let's say an advisor passes the first two tests; they don't use bond funds and they look 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 be sure their clients don't overpay.

IV. Fixed Income Specialists Go 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% 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.

V. Active Management

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 — seeking to try to maximize income first and provide opportunities for 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 it is held until maturity, the client can earn more. Something else a true Income Specialist can do is to swap bonds and bond-like instruments defensively to get a more secure bond with a higher rating, or a shorter-term bond.

So, What If I Invest Today and Rates Go Up Tomorrow?

When it comes to fixed-income investing, most people understand that as interest rates go up, bonds and bond-like instruments tend go down. So, if rates go up after they build a fixed-income portfolio, many believe they've made a mistake, but this is not necessarily the case.

OPPORTUNITY COST— THE TRUE COST OF WAITING

The Random House Dictionary defines the term opportunity cost as the money or other benefits lost when pursuing a particular course of action instead of a mutually exclusive alternative. When it comes to fixed-income investing, for every day you wait for interest rates to go up, rates must rise much more to make it worth the wait. Take a look at the example below. Here, the market is paying investors 5% for a five-year security. The question most investors ask is:

What if The Rates Rise Next Year?

Imagine that you are holding a 5% security and a year later, your neighbor invests in the same security and gets 6%. Is your neighbor better off? Not necessarily.

What matters here is how much each of you earns. In this scenario, after you factor in the interest payments you have already collected during the first year, you would be the one who makes more money because you invested sooner. Your neighbor would actually have to earn 6.25% to make up for lost time.

A hypothetical example assuming 0% return in a bank account **5 Years at 5% ($100,000)**		**1st Year at 0% - the rate needed is then 6.25% ($100,000)**	
Year 1	$5,000	Year 1	$6,250
Year 2	$5,000	Year 2	$6,250
Year 3	$5,000	Year 3	$6,250
Year 4	$5,000	Year 4	$6,250
Year 5	$5,000	Year 5	$6,250
	$25,000		$25,000

In the example above, investment grade securities yield 5% with a five year maturity. If an income investor decided to wait a year because they were guessing rates would rise, they would need a new higher rate to make up for the first year when they weren't earning. The math is very clear. If they sit earning nothing in a bank account, a year from now, rates for a four-year investment will have to be 6.25% in order to earn the same $25,000 after the fifth year.

They are gambling that rates in the next year will go from 5% for a security due in five years to 6.25% for a security due in four years. Do you think rates will move this high in a year?

What Happens If The Rates Go Up And I Need My Money Early?

When rates go up, bond prices go down. So, if you buy a five-year security and rates go up, and you wind up selling early because of an unforeseen emergency, will you be worse off? If you already held your investment for a year or longer, rates would have to go up much faster than usual for you to lose money.

In the example below, you can see that although the market will pay you less than you had originally paid, the interest that has been paid to you more than makes up for the price erosion to your original fixed-income security.

Using the previous example, let's say rates go up to 6.25% from 5% in one year. Because of an unforeseen circumstance, you need your money 2 years after you invested. Are you worse off? It might feel that way, but the math helps you understand the actual decision you're making.

Two more hypothetical examples assuming 0% return in a bank account:

5 Years at 5% ($100,000)		1st Year = 0%, the rate needed is then 6.25% ($100,000)	
Year 1	$5,000	Year 1	$0
Year 2	$5,000	Year 2	$6,250
Year 3 SOLD	$0	Year 3 SOLD	$0
Year 4	$0	Year 4	$0
Year 5	$0	Year 5	$0
Sales price	+$96,250	Sales price	+$100,000
	=$106,250		=$106,250

In both examples, interest rates were 5% at the beginning of year one and jumped to 6.25% at the beginning of year 2. Unforeseen circumstances occurred where you needed to sell the bond after 2 years. In the example on the left, you bought the 5% bond immediately and therefore had to sell it at a loss because interest rates rose. You would have earned $10,000 in interest for the first two years, plus the market will pay you $96,250 for a total of $106,250, or 3.125% per year — better than the 0% you would have earned by waiting. In the example on the right, you waited one year to buy the bond and therefore you locked in a higher interest rate of 6.25%, meaning that when you sold the bond a year later, you got the full par value of $100,000. You earned one year's interest payment of $6,250 plus $100,000 when you sold the bond, for a total of $106,250, or 3.125% per year.

The math reveals that what's best isn't always intuitive. Even if rates go up and prices go down, it often doesn't make sense to wait. How much you earn in income is what's most important.

Financial Advisors Who Specialize in Investing for Income Can Help to Ensure Their Clients' Smooth Transition into Retirement

The Retirement Income Store works with a wide range of clients nationwide and specializes in helping those who are in or near retirement. Our Income Specialists are experienced in investing with methods that can help to maximize opportunities for income and growth, while helping to minimize risk.

If you were born in 1970 or earlier, our Income Specialists can help to get you started on the path to a more reliable retirement outcome than most traditional stock market-based plans can offer.

When you have your call with an Income Specialist in your area, they can help you determine the extent to which investing for income can work for you. If you have any questions while reading the material in your Retirement Income Kit, please write them down, so you can remember to ask your Income Specialist about them during your complimentary call.

For additional information, feel free to call us on our main line at (888) 888-4176, or visit our website: TheRetirementIncomeStore.com.