Total Return vs. Income Investing

First Ascent Asset Management

There are two approaches to building a portfolio for retirement.

Income Investing. An individual builds a portfolio so that interest and dividend income are sufficient to fund withdrawals. The idea is to avoid “dipping into principal” or sell securities to fund distributions.

Total Return Investing. The idea is to produce a greater and steadier stream of distributions regardless of whether those distributions are funded by interest, dividends, or capital gains.

Why Total Return Investing Makes Sense Today

Both total return and income investors recognize the psychological benefits of not dipping into principal. However, there are some practical reasons to consider total return investing in today’s environment.

- **Yields Are Lower.** For decades, the income approach was a perfectly workable way to build retirement portfolios. Although they have drifted up a bit lately, interest rates have declined significantly in recent years. This makes it difficult to generate enough interest income.

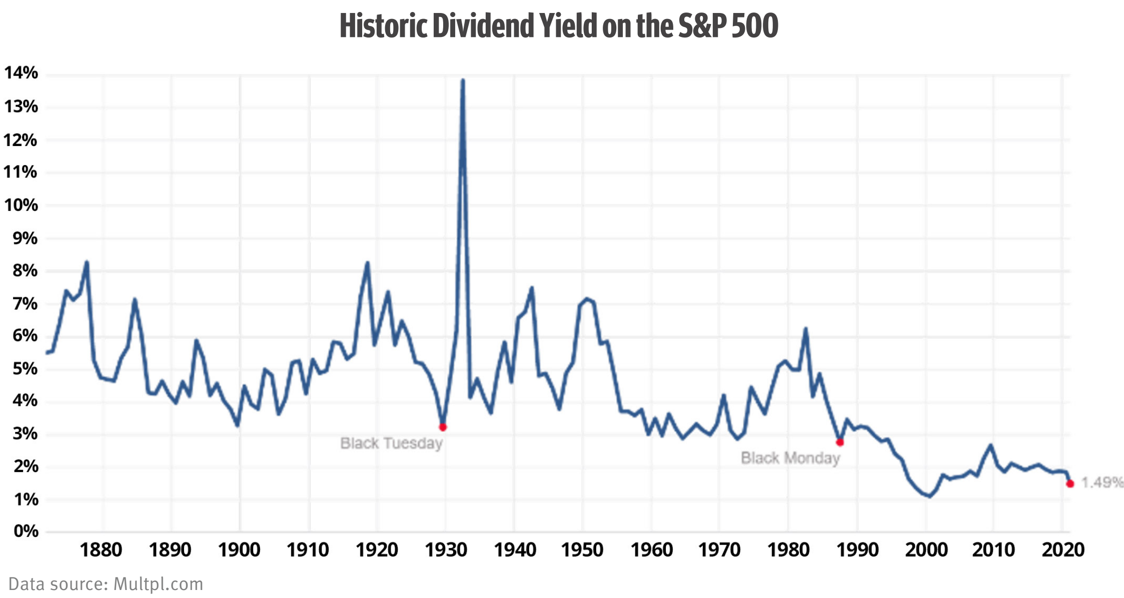
10-Year Treasury Bond Interest Rates

1962- 2020

Source: Macrotrends

- **Reaching for Yield.** It is possible to add securities to a portfolio that pay higher interest rates. But these securities pay higher interest rates for a reason—they can come with much higher risk and more volatility. Some of these securities—high yield bonds, for example—also perform more like stocks than bonds. So, they do not provide the same diversification benefits as bonds and thus disrupt the portfolio’s asset allocation strategy.

- **Dividend Payments Are Lower.** Like interest rates, dividend payments have also declined.



- **There's Simply Not Enough.** The declines in interest rates and dividend payments have made it extremely hard to fund retirement solely from these sources.
- **Steadiness of Distributions.** Because of the historic variability in interest rates and dividend payments, income investors have less control of the steadiness of their distributions.
- **Economic Equivalents.** It may feel better to take distributions from dividends than to sell a stock to fund a distribution, but both are roughly equivalent from an economic perspective. A dollar is a dollar no matter what its source. Don't disrupt your long-term asset allocation strategy or take extra risk solely for the psychological benefit of not dipping into principal.