

Capstone Comments

A forum for communicating information about the management of assets

Q:
A:

How are financially established investors creating “Life-Style Sustaining” dividend income in a low interest rate environment?

In past decades, retirees have used bonds to meet current and future cash flow needs. Cash from bonds can substitute a regular paycheck. However, using bonds for the sole purpose of income can add unanticipated risk.

Getting enough cash out of bonds through interest income to pay bills may mean extending maturities, going lower in credit rating or both. The present income from a basket of bonds may in adversely add risk that is especially rough on retirees. Long term bonds are a poor hedge against inflation which makes the stream of future income highly sensitive to inflation.

Nobel Laureate, Merton Miller said “Cash is cash. Should a retiree care whether they draw income from bond interest, dividends or capital growth?” His research argues there is no reason to prefer one source of cash above the other. For example, a business will have different sources of income; consulting fees, sales of product and investment income. All sources contribute to the business cash flow.

Bonds are an important part of a well-diversified portfolio. In any given year income for the retiree may be distributed from a combination of the portfolios capital appreciation in bonds or stocks, dividend or interest. This inflation hedged income is known as a “synthetic dividend” generated from the portfolios growth from many sources through the years of retirement.

We look forward to visiting with you in more detail of how we employ this academic approach in our client’s portfolios to distribute the “synthetic dividend”.

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If you have questions that you think would be interesting for our readers, please call Kerrie at 406-325-1500 or email your questions to kkern@capstoneretire.com.