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How To Maximize Your Retirement Income With Assets You Already Have

Dan Eggertsen: Hi I'd like to welcome everyone to the call. This is Dan Eggertsen. I'm here with my dad, Karl Eggertsen. Hi there Dad. How you doing today?

Karl Eggertsen: Hey Dan. How are you doing?

Dan Eggertsen: Hey I'm great. So we've been getting a lot of questions specifically regarding income investing and I wanted to take a few minutes with you, dad to answer the top three questions we keep getting asked over and over again. The first one of those questions is, "What is income investing exactly? Can you define it for everybody?"

Karl Eggertsen: Sure. Income investing it consists of placing your investment nest egg into income producing assets such as bonds and CDs and then just living off the income.

Dan Eggertsen: Okay.

Karl Eggertsen: This is in fact, going a little further with this, traditionally this has been what retirees were supposed to do over the years. In the past, from my dad's time and people a generation or two older than me that was kind of what was considered the best way to do things. Don't spend the principle but just live off the interest. But there're a couple of key things there. One is, hopefully you have enough money invested away that you only have to draw the interest, that you don't need to draw principle to have enough income.

Dan Eggertsen: Right.

Karl Eggertsen: The other thing is there's really very little growth element in doing that. As a result many people had problems running out of money, not having enough to just live off the interest, had to keep working longer, maybe longer than they wanted to or physically able to. Today influential academic researchers and financial advisors are encouraging more and more retirees to look at total return in a portfolio that's not just income investments like bonds but includes stocks, assets that will also grow.

All your taken income, also having parts of your portfolio that will maintain the value if not grow it even more. So the total return is more and more being recommended by financial advisors to retirees. Studies have shown that a mix of stocks and bonds, growth assets and income assets provide a much better balance of growth and income with greater stability.

Studies have shown that, and this is very factual that a growth and income mix in a retirement portfolio will have about a 98% success rate over a 30 year retirement period. Whereas if you have a pure bond portfolio for example, just pure income assets, you're only going to have about a 27% chance of survival rate over a 30 year retirement period which could be disastrous. The things that can kill you are inflation and interest rate is going to vary. It can be high like today interest rates are much higher than they are normally or they can be a lot lower.

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So getting back to the income investing question, income investing has been just living off the interest from a portfolio of bonds for example. Whereas today income investing has evolved more and more into a portfolio that's a mixture of growth assets like stocks and income assets like bonds.

Dan Eggertsen: Right. Okay. Excellent answer so everyone has a better idea of what income investing actually is and how it's changed over the years. The second question we keep getting Dad, is, "I want to invest my money in things that give me enough returns to pay some of my bills. Is that possible and recommended?" What types of income investments do you have or would you recommend for this type of thing?

Karl Eggertsen: So for the first part of the question. There's no one best answer. It depends on the situation for an individual. But I'll address a few cases that I think will help answer this question. One is, for somebody who's unable to work. Maybe they're out of work, maybe they've got health issues, maybe there's something else in their lives that's preventing them from working, the thing that's important is you're going to have to have some money to invest in something that's going to - you know income assets like bonds or even real estate investments for us that provide a pretty good interest rate.

You're going to have to have some money to invest to begin with. If somebody's out of work, hopefully they have some money that they can invest in income assets to provide income to help them pay their bills while they're not working or while they're unable to work. But you're going to have to have the money to invest to begin with. Interest rates for example, if somebody had \$100,000 they could invest in an index bond fund that will provide around 5% return, about \$5000 a year, about \$420 a month.

If they had \$200,000 they'd get twice that. Now if they invest in like high yield bonds, they're referred to as junk bonds too. Right now they're getting like 9%. Real estate investment trusts are getting like 9% interest so you'd get \$1000, \$2000 depending on how much money you had. \$100,000, \$200,000 or whatever; this is just an example.

Somebody who's financially dependent of course and they're unable to work or they don't want to work for whatever reason, they don't have other income sources or don't have enough to pay all their bills, they can certainly tap interest from these type of investments.

Now if somebody's working, is able to work and is less than 60 years old - less than 55, 60 years old - it's not recommended to be taking interest income from your portfolio. You want it to grow. While you're able to work, time is your greatest asset when you're a young person and the ability to work and pay your bills and save 5%, 10%, 15% at least and put it away for the future, for your retirement years.

Dan Eggertsen: Right.

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Karl Eggertsen: So this is really not recommended. In fact, if you're drawing interest and income from your portfolio that is otherwise going to be growing and compounding over time, a lot of the blue chip stocks, half of their total return is dividends. So if you're taking dividends from stocks along with interest from bonds, you're really cutting way back on your potential value of your retirement portfolio when you're ready to retire.

Dan Eggertsen: Right.

Karl Eggertsen: So it's best not to do that. Do as little as possible. If you've got an emergency, you're out of work for a while or something. There're situations like that but it's not a recommended thing to do until you enter retirement.

Dan Eggertsen: Right. Okay, okay. When you enter retirement you can think about just going, well you know shifting most of your portfolio over to income so you can just pull the interest out to live on.

Karl Eggertsen: Yeah and still retaining total return concept of having at least 40% stocks, real estate investment trusts, some growth. You know, what they call equity assets. Those assets that their primary value is the ability to grow, stay ahead of inflation, keep the portfolio value up so you don't run your portfolio down to zero before your retirement's over.

Dan Eggertsen: Right. Yeah a lot of people are asking this type of stuff. "If I could just find a way to have enough money to invest in high yield bonds and have the interest just pay my mortgage or most of my bills, man that would be great." I've often thought that myself too. Geez, if I could find a way to make a million dollars, and a million dollars isn't that much these days. It's not as much as it used to be anyway. If I could just find a way to make a million dollars, then I would put the whole thing in a high yield bond and pull \$10,000 a month of interest. I could live for the rest of my life like that.

Karl Eggertsen: Well it's possible to do that and again, if somebody who is able to, who has the money, who has a big salary – but if you have a big salary you can still pay your bills. If you have a smaller salary, you're not going to have as much to be putting away to be pulling out of your... you know, it's a catch 22.

Dan Eggertsen: Yes.

Karl Eggertsen: It's a smaller income. You're going to have less to save and you want to get every ounce you can into your savings to prepare for the future and compounding, part of compounding over a 30 year working career, you're going to be a millionaire; and a millionaire in 30 years from now in the value of the dollars then.

Dan Eggertsen: Yeah.

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Karl Eggertsen: So the point is, it's not the best idea. Do it as little as possible. I don't see why anybody who's able to invest in income assets and draw the income off of that, they're certainly going to have the money to pay those bills out of their salary anyway.

Dan Eggertsen: Anyway. Yeah.

Karl Eggertsen: I personally think the best thing is to save as much as you possibly can, to budget your money, still live a comfortable life, and let time and compounding work it's miracle for you.

Dan Eggertsen: The final question, number three. I think you've pretty much covered it but let's go through just in case there's anything you feel you missed. Here's the question, "What are dividends..."

Karl Eggertsen: Oh, oh, oh you wanted to know what types of income, investments I have? I'm sorry.

Dan Eggertsen: Okay. That's the second part of question two.

Karl Eggertsen: Yeah and I'll do this very quickly. I mentioned some of those but I have dividend income from the blue chip stocks, you know the Standard & Poor's 500 blue chip stocks. You know the income dividends on the average from those big blue chip stocks is around 3% right now. But I don't take that, I reinvest it because that's part of my growth portfolio, growth side of my portfolio.

So I just reinvest the dividends because I don't need the income and it's important I think on your equity investments, your growth investments to keep them growing as fast as possible. I had the real estate investment trust which is commercial real estate all over the country. It's invested in apartment buildings, industrial, commercial buildings and it's drawing like 9% right now.

Dan Eggertsen: Wow.

Karl Eggertsen: So that's part of my income. It's strong, it's solid.

Dan Eggertsen: So you actually take the income from that one.

Karl Eggertsen: Oh yeah I do. I have some high yield bond index ones and they're getting in just under 9%. They were getting as much as 11% just a few months ago.

Dan Eggertsen: What's the worst they will do?

Karl Eggertsen: The worst I've ever seen them do is 6%, 7%.

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Dan Eggertsen: Oh wow.

Karl Eggertsen: Yeah. I have a total US bond index fund which is made up of a whole variety of different types of bonds, corporate bonds, treasury bonds, government agency bonds, mortgage backed securities like Ginnie Maes, Fannie Maes. It's getting roughly just under 5%.

Dan Eggertsen: Right.

Karl Eggertsen: I have a lot of that. A lot of diversifications you can tell in the type of income and investments that I have and then I have municipal bonds that are national; from states all around the country into a big – it's a mutual fund through Vanguard. And then I have a California municipal bonds.

And this is the only one that Morningstar really recommends because of the state of California right now but it has the highest rated, you know triple A, double A municipal bonds and it's very diversified and very well managed. I get tax free income from the municipal bonds.

Then I have foreign bond fund that gives me even more diversification from countries outside the US. So I have a whole variety and this whole portfolio I tailored for my retirement. I'm just talking about the bond side, the fixed income side mainly but it's a whole variety of different investments that provide me the income that is pretty safe and diversified. So that was I think the second part of that question.

Dan Eggertsen: Yeah that was and you covered it really, really well.

Karl Eggertsen: Okay.

Dan Eggertsen: The third one I think you pretty much covered but let's just skim over it if there's anything else you need to add. "What are dividends and do you recommend I take the dividends and use them to pay bills, etc.?"

Karl Eggertsen: Yeah it's kind of going back to some of the things we've already said is...

Dan Eggertsen: You don't recommend it basically.

Karl Eggertsen: For somebody who's not retired? No because that's approaching 50% of many of the solid blue chip stocks dividends. I mean yeah. Total return is what I meant to say. Dividends for the blue chip stocks are approaching 50% of the total return of the stocks. I just recommend you reinvest the dividends. A dividend is a company's distribution of the share of earnings to investors. So the company gets earnings, profits.

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They call them earnings that they distribute a percentage of the company's earnings to investors so they can share in the income profits and that's along with the appreciation of the shares that you purchase of a company. So this is the income part of it, is what a dividend is. No I do not recommend that anybody who's not retired, unless they really need to that they don't take the dividends because you're really cutting, in some cases in half your potential for growth over your working years.

Dan Eggertsen: Right.

Karl Eggertsen: So it's really going to cut back on the value of your retirement portfolio when it comes time that you think about retiring. So what I'd like to do is kind of, if that answers that question on dividends. Is there any more that you wanted to ask about that?

Dan Eggertsen: Just a quick question on dividends and how they work and maybe you know this, maybe you don't. You probably do. "How does a dividend distribution work in terms of? Is the company required to give dividends if they're showing a profit and if so, does the company determine when it will distribute dividends or are they forced to distribute dividends? How does that work?"

Karl Eggertsen: They're not forced.

Dan Eggertsen: So they don't have to distribute any dividends at all if they don't want.

Karl Eggertsen: They don't have to. A lot of companies in these tough times are in a stop dividends. Financial stocks like banks and stock brokers and so on typically pay some of the better dividends along with utility companies pay dividends. But they're not really required to.

Dan Eggertsen: Why is it in a company's interest to pay dividends? Just to attract more investors?

Karl Eggertsen: That's right. Yeah and the bigger a company and the more solid it gets, the more dividends that they can provide to investors because the bigger companies like General Electric and companies that have gotten very big and been around a long time is they've kind of gotten to the point where they're not growing very fast anymore. So they're not going to be as attractive as a younger company growing like gangbusters like Google.

So to compete with investors, they offer income. And the income is going to be of course really more attractive to older investors than it is the younger ones because the younger ones are going to be jumping into the Googles and those fast growing companies that don't have as many, if any dividends. Many technology companies don't offer any dividends because they reinvest their profits totally back into the company for more growth.

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Dan Eggertsen: And if you think about it, young people would be better off if they would invest in some of these solid, old companies as well because in many of the considerations people take on what stocks to buy, what mutual funds to buy, hardly anyone factors in dividends into the equation, they just look at the value of growth of the thing. If you add in dividends, that can add a considerable percentage points to your growth.

Karl Eggertsen: It can. It depends on the stock. That's absolutely right. So what I'd like to do is summarize real quick for those listening. Don't tap your nest egg until you're ready to retire unless there's an emergency, you have to, like you're out of work or whatever, health or sickness issues. Let it compound and grow over your working years and you'll have a lot more at the end and you'll be much the better for it.

Think of total return when you do retire. Do start taking income. Don't just draw from the fixed income and focus just on that but have a portfolio that still has substantial stock equity. Composition your portfolio so that you can tap not only interest from bonds but you can also tap stock dividends a little bit as needed and also any capital gains.

When I say capital gains, liquidating principle is not going to hurt as long as you distribute your draw from all three of those; your fixed income, dividends, and capital gains. And keep rebalancing that portfolio so that you keep it the same balance. For example, if you have 50%, 60% bonds, you want to maintain that 30% to 40% bonds, you know fixed income type investments along with some cash. So that you keep that balance. You keep your risk return ratio as appropriate for where you are in your lifetime.

Dan Eggertsen: Right.

Karl Eggertsen: So those I think are the main things I think we got out of this.

Dan Eggertsen: Well fantastic Dad. Excellent job. We covered a lot of ground and it was a very interesting call. So thank you everyone for being a part of this and thank you Dad for your time as always. We'll talk to you next time.

Karl Eggertsen: Okay Dan. Take care.

Dan Eggertsen: All right. Bye-bye. All right that was a good one.

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