PATRICK H. YANKE, CFP® | Financial

Creating Retirement Income with Less Common Securities

One of the challenges of investing during retirement is providing for annual income while balancing other considerations like liquidity needs, longevity of funds, risk tolerance, and anticipated rates of return for various types of investments. A well thought out asset allocation in retirement is essential. My most recent article discussed some common retirement income vehicles—bonds, equities, and annuities. Let's tackle some less-common income vehicles here that may help diversify portfolio risk and sources of income.

PREFERRED STOCKS

Dividends on preferred stocks are different from dividends from common stocks. The rate is fixed and they're paid before any dividend is available for common stockholders. That fixed payment means that prices of preferred stocks tend to behave somewhat like bonds so preferred stockholders do not participate in a company's growth as fully as common shareholders would. Preferred shares usually pay a higher dividend rate than common shares though most preferred stockholders do not have voting rights.

Since preferred stocks tend to behave like bonds, shareholders should be aware of interest rate movements. While bonds have a maturity date and duration, these shares do not. They can be more volatile when long-term rates are fluctuating. *They may provide greater yield than commons shares and the bonds issued by a company but that may come at the expense of a higher risk profile.*

PASS-THROUGH SECURITIES

Pass-through securities act as a conduit for income from underlying assets. For example, mortgage-related securities represent an ownership interest in mortgage loans made by financial institutions. The most basic of these represents a direct ownership interest in a trust that consists of a pool of mortgages such as those issued by the Government National Mortgage Association (Ginnie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal National Mortgage Association (Fannie Mae).

Investors should be aware that (unlike bonds) the income and principal of these entities are not guaranteed nor insured. Depending on the interest rate environment, they may provide a higher yield.

AUTOMATED INFLATION FIGHTING

Some investments are designed to fight inflation for you. Treasury Inflation-Protected Securities (TIPS) pay a slightly lower fixed interest rate than regular Treasuries. However, the principal is automatically adjusted twice a year to match changes in the Consumer Price Index (CPI). Those adjusted amounts are used to calculate interest payments.

The inflation adjustment means that holding a TIPS until maturity will likely result in repaid principal being higher than when purchased (the government guarantees it will not be less). However, investors can still lose money if they sell a TIPS before maturity. Inflation rates change, and other interest rates can affect the value of a TIPS. If inflation is lower than expected, the total return on a TIPS could actually be less than that of a comparable non-indexed Treasury. Also, federal taxes on the interest and increases in your principal are owed yearly even though additions to principal aren't paid until a TIPS matures. Inflation-linked CDs function much like TIPS, but you'll generally owe federal, state, and local taxes each year.

In a rising inflation environment where traditional retirement income vehicles tend to struggle, TIPS are one solution to preserving and growing wealth.

DISTRIBUTION FUNDS

Distribution funds are designed to provide an annual income stream. Available as part of a series, each fund designates a percentage of your assets to be distributed each year as scheduled payments, usually monthly or quarterly. Some funds are designed to last over a specific time period and plan to distribute all of your assets by the end of that time; others focus on capital preservation, make payments only from earnings, and have no end date. You may withdraw money at any time from a distribution fund; however, that may reduce future returns. Also, payments may vary, and there is no guarantee a fund will achieve the desired return.

The benefit to this approach is having certain income for a certain period. The downside is the fact that income will end at a pre-determined date—and that could cause problems later in retirement.

Always consult appropriate tax, legal, and investment professionals to determine which are appropriate for your financial situation.

Patrick Yanke is a Raleigh-based financial advisor. Opinions expressed here are mine and not necessarily those of Raymond James. The information is not a complete summary or statement of all data necessary for making an investment decision and does not constitute a recommendation. This article is not meant to provide tax or legal advice. Please consult the appropriate professionals. www.yankefinancial.com.