The Benefits and Risks of Income Investing

Income investing is a strategy that seeks to provide investors with passive income from the assets they hold. This strategy may be attractive to people working toward financial independence or who need a predictable stream of income in retirement. Investors looking to embark on an income investment strategy may consider adding dividend stocks, bonds, and real estate to their portfolios.

Dividend stocks
One way to make money on stocks is through capital appreciation. When you buy a stock, you become a partial owner of that company. If the company grows and is profitable, stock prices may go up, and you can sell the stock at a profit. The other way to make money on stocks is through dividends, profit shares that large, stable companies pay out on a regular basis. Most companies pay dividends quarterly, though some may make dividend payments only once or twice a year.

When choosing a dividend stock, look at a company's track record for paying dividends, especially during tough economic periods. Prioritize stocks that pay dividends from profits and not cash reserves or special sales of assets, which can run out.

Bonds
Bonds are a type of fixed-income security that generates income through interest paid to you. When you purchase a bond, you are lending money to a company or government for a certain

amount of time. In return, the issuer agrees to return your money at a predetermined date in the future. In the meantime, they make regular interest payments, also known as a coupon.

Real estate
Real estate is a tangible asset that appreciates in value over time. You can rent out property and collect rent from tenants to generate passive income.

That said, not everyone wants to be a landlord. Instead of directly owning property you may invest in a real estate investment trust (REIT). These are companies that own and operate real estate properties, such as office buildings, apartment complexes, retail centers, and medical facilities. Investors can buy shares of REITs listed on major stock exchanges. The companies generate income, which is then paid to shareholders in the form of dividends. By law, REITs must pay 90% of their taxable income to shareholders.

The risks of income investing
The most obvious benefit of income investing is the potential to generate a steady, passive income with returns you can rely on. The assets you might choose for an income investing portfolio — like bonds, dividend stocks, or real estate — potentially offer less risk than traditional stocks, protecting your portfolio from volatility.
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That said, no investment strategy is without potential downside.

For example, if you hold dividend stocks, be aware that some companies may struggle to make payments during times of financial difficulty, which can interrupt your income stream.

Keep in mind, too, that inflation, which drives up the cost of goods and services, can have a big impact on how far your income can be stretched. Inflation, as measured by the Consumer Price Index, was 7% as of December 2021. Some income investments, such as bonds may have trouble keeping ahead of inflation at these levels. REITs, on the other hand, tend to perform well in inflationary environments because of their ability to raise rents.

Finally, there is some opportunity cost to income investing. By pocketing dividends instead of reinvesting them, individuals miss out on potential market returns.

Income investing is a long-term prospect, and it can take years to build up enough wealth to generate a consistent income. But with the right strategy, this approach can help you build a source of cash to supplement your current income or provide cash flow when you retire.

Sources:

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