Conservative Income Investors: Looming Volatility Offers Opportunities

Description

Retirees everywhere are feeling the pressure. As a conservative investor, many things can keep you up at night. Interest rates are essentially the biggest enemy of conservative income-oriented investors, who value low volatility, stability, and consistency of dividend raises. We've been in an absurdly low interest rate environment for a very long time now, so many of today's retirees likely have no idea what to expect from their retirement portfolios as interest rates rise.

If you stick with high-quality dividend payers, your income stream is safe; however, if you're expecting the same magnitude of total returns that have been enjoyed in a rock-bottom interest rate environment, you're going to be very disappointed, as the higher rate environment sets up a stage for a more modest return from some of the favourite asset classes of retirees in REITs, telecoms, and utilities.

In addition, you should get used to a higher degree of volatility similar to what we've witnessed with the entire utility sector of late. Sharp 10-20% sell-offs are quite rare for such low-beta income payers, but in a rising rate environment, you should get used to a higher magnitude of ups and downs. If you're not comfortable with that, you may be tempted to invest in safer instruments like GICs or bonds.

Are bonds a better bet for extremely conservative investors?

Neither I nor Warren Buffett are fans of long-term bonds, however, as they're really not as safe as many tout them to be. Thus, when it comes to bonds, your best bet would be to own a short-term bond fund or exchange-traded fund (ETF). They're typically less volatile than their longer-term counterparts, especially during rising interest rate environments, but the yield you'll get is so minuscule (1-2% annualized total return) that you'd probably be better off with cash in a TFSA high-interest savings account (~1% return).

What about GICs?

GICs may be the right choice for you if you don't care about liquidity, but you'll really need to go on the hunt for top rates, which may not be able to keep up with the rate of inflation. If you lock-in your principal and inflation soar, the only guarantee you'll get is the fact that your pricing power will be guaranteed to go down by the time the GIC matures!

There are riskier, higher rate GICs out there, but they may be even more illiquid, and you're essentially opening up a new can of worms by stepping into uncharted territory with non-bank financial institutions like GICs offered by alternative lenders.

Sticking with REITs, telecoms, and utilities

Unfortunately, neither short-term bonds nor GICs will be able to offer you an income that can sustain your retirement. Your best option would therefore likely be to stay the course and weather out the tough times by using this buy-the-dip investment strategy geared for retirees.

As volatility picks up, you'll really need to ask yourself if you value safety or income. If you're willing to avoid looking at your retirement portfolio, you'll still get the income and safety as long as you don't make any rash moves like selling after a dip.

The entire utility sector has fallen off a cliff of late; even rock-solid firms like **Fortis Inc.** (TSX:FTS)(NYSE:FTS) aren't completely immune to volatility, especially as rate fears continue to escalate. The Fed may raise rates three, four or even five times this year, but don't speculate on this racehorse. Just stay the course and perhaps add to your position should your favourite income payers face a nasty decline.

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