Retirees: Preserve and Grow Your Nest Egg in Retirement. Here’s How

Description

Running out of money in retirement is a fear that many retirees and soon-to-be retirees share, even if they’ve followed all the rules in retirement planning, such as the 4% rule (which I believe is outdated) and jumping into lower-risk, higher-yielding securities that will hold up even through the worst of recessions.

While “battening down the hatches” for a potential recession is a must when approaching retirement, going all-in on extremely high-yielding securities can limit the growth of your nest egg over the long haul, even though the income you’ll receive upfront is suitable to sustain your lifestyle.

With high-yielding securities like REITs at the core of your portfolio, you’d be hard-pressed to obtain any sort of capital gain over the many decades in your retirement, leaving your nest egg as is, assuming you don’t spend any of your principal.

While the 4% rule, whereby an investor budgets to live off an annual income of 4% of their invested principal, seems easy to follow on paper, you could run into a wall once you’re actually in the middle of your retirement.

Unexpected expenses happen, whether we’re talking about accidents, deterioration of health, or your grandchildren’s education. And if you don’t budget for these unexpected expenses, you could find that your living standards could deteriorate in your golden years, especially if you’re forced to dig into your invested principal. It’s these unexpected expenses that we all fear, even if we think we’re ready to hang the skates up.

Although the upfront distribution yields on REITs may seem significant, they come at a trade-off.

The bigger the upfront yield, the less distribution growth you’re likely to see over the years. So, if you’ve grown to expect frequent and generous dividend hikes through stocks, you’re going to be disappointed, especially if you plan on holding on to your securities for many decades.

With that in mind, I’d encourage retirees to think of the payouts from REITs (or any other high-yielding securities) as static. While a raise may be in the cards, you should by no means expect one on a consistent basis because you're setting yourself up for disappointment and may not have enough of a cushion to fall back on.

REITs are required to pay out a majority (90%) of their income to shareholders, leaving less capital available for investing in forward-looking growth initiatives. Although other high-yielding industries, like telecoms and utilities, aren't subject to the same requirement, they too are less able to invest in growth with a large chunk of cash flowing back into investors' pockets.

Thus, when retiring, I'd encourage investors to consider the trade-offs between upfront yield and forward-looking dividend/distribution growth. For example, consider two retiree favourites: **Fortis Inc.** (TSX:FTS)(NYSE:FTS) and **RioCan Real Estate Investment Trust** (TSX:REI.UN) with yields of 4% and 5.9%, respectively.

While RioCan seems like the better bet on the surface due to its higher yield, Fortis offers far more significant potential for both capital gains and dividend growth. While RioCan's payout is entirely safe, even through the worst of recessions, the distribution isn't going to increase at the same rate as Fortis.

Fortis is a dividend aristocrat, and although the upfront yield is 2% lower, you're going to get a single-digit raise every single year, regardless of the state of the economy, thanks to its highly regulated operating cash flow stream.

With a commitment to hike its dividend by 5% over the foreseeable future, with more promising growth projects on the horizon, if your plan is to retire conservatively and comfortably, Fortis is the far better bet if you're able to live comfortably off the lower yield for the time being.

Foolish takeaway

Today's retirees are living longer, so it's not too far-fetched to think that they'll need money to live off of for three (or even four) decades if they plan to exit the workforce in their 60s.

With Fortis and its growing payout, you're nearly guaranteed to get a 5% raise every single year. With RioCan, you'll give up years' worth of superior income growth, and I don't think that's a good trade-off to make, especially if you want to continue growing your nest egg after you crack it open.

Stay hungry. Stay Foolish.

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