How to Retire Early on a Growing Passive Income

Description

Building a retirement portfolio that provides an income in older age may sound like a difficult task. Doing so and aiming to retire early may seem to be an impossible goal in some people's eyes.

However, by investing in long-term growth companies and reinvesting your profits, it may be possible to generate a surprisingly large nest egg by the time you wish to retire.

Then, investing in reliable income shares that can provide consistent dividend growth could be a sound means of providing a passive income in older age.

Investing for growth

One of the challenges facing investors at the present time is the lack of returns on some mainstream assets. Cash and bonds, for example, offer relatively modest real-terms returns. Therefore, buying stocks could be a good idea. Indexes such as the S&P 500 and FTSE 100 have recorded high-single digit annual returns over the long run, which could turn modest sums of money into a large portfolio.

Of course, buying stocks means that investors will be exposed to short-term volatility. Any company can experience a difficult period of time, and any stock market index can fall heavily in a short space of time. However, the vast majority of investors who are seeking to build a retirement nest egg are likely to have a long-term time horizon. Therefore, they have sufficient time available for their shares to recover from a downturn. As such, buying and holding companies that offer long-term growth, albeit with short-term volatility, could be the most effective means of building a retirement portfolio.

Reinvesting profits

It is tempting to spend dividends received prior to retirement, and even to use some capital gains to pay for a variety of expenses. However, this will reduce the potential size of your retirement nest egg, since it does not allow compounding to have its full impact on your capital.

For example, an annual return of 7% may not sound especially impressive over a short time period. However, over a 20-year period it can cause an investment to increase almost 300% in value. As such, keeping as much of your capital in a retirement fund until it is required could be a sound move. It could be the difference between retiring early and continuing to work.

Furthermore, with a variety of growth shares currently trading on low valuations due to investor fears regarding the world economy's outlook, there may be buying opportunities on offer for your capital.

Passive income stocks

Once you have built a sizeable investment portfolio and are ready to retire, focusing your capital on dividend stocks may be a sound idea. They can provide a relatively high income return, as well as dividend growth, over a sustained period of time. This may make them significantly more appealing than other mainstream income-producing assets.

Through diversifying across a range of income shares and ensuring that the companies you hold can afford their dividends, it may be possible to improve the reliability of your passive income. With many income shares currently trading on high yields, now could be the right time to buy dividend shares to create a generous income stream in your retirement.

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