Retirees: 3 Ways to Create a High Passive-Income Stream Using ETFs

Description

Retirees with a large investment portfolio ($1,000,000 or more) generally attempt to optimize their holdings to maximize passive-income potential while ensuring preservation of principal.

The goal here is to sustain a safe perpetual withdrawal rate (usually around 4%) every year to provide for your retirement costs without depleting your nest egg too early.

Although you could pick a handful of dividend stocks and set up a GIC ladder, a better option might be to use exchange-traded funds (ETFs). These ETFs can provide high monthly income and annual yields by holding a variety of assets, including dividend stocks, preferred shares, and even options.

Option #1: High-dividend stocks

Retirees favouring the most vanilla, passive-investing approach should consider using an index ETF that tracks a portfolio of high-yielding dividend stocks. A great pick here is **Vanguard FTSE Canadian High Dividend Yield Index ETF** (TSX:VDY).

VDY passively tracks the performance of 39 Canadian stocks characterized by high dividend yields and is heavily weighted in the financials (58.7%) and energy (23.4%) sectors, which is expected, given the plethora of high-dividend-paying stocks represented there.

Currently, VDY costs a management expense ratio (MER) of 0.20% to hold, which is costlier than broad indexes but not expensive for a specialty fund. The 12-month dividend yield stands at a respectable 3.46%. For a $1,000,000 portfolio, this means $34,600 in dividends every year!

Option #2: Preferred shares & corporate bonds

Preferred shares are company stock with dividends that are paid out to shareholders before common stock dividends are issued. If the company enters bankruptcy, preferred stockholders are entitled to be paid from company assets before common stockholders.

Corporate bonds are debt issued by a company, as opposed to those issued by the government. Because investing in corporate debt is riskier (the Fed always pays its debts, after all), the investor is paid a higher coupon, resulting them being compensated with a higher yield.

iShares Canadian Financial Monthly Income ETF (TSX:FIE) holds both preferred shares and corporate bonds, paying a high distribution yield of 5.65%. For a $1,000,000 retirement portfolio, that equals to $56,500 in annual passive income paid out. However, the MER is significantly higher at 0.82%.

Option #3: Covered calls

Our third candidate uses a derivative called a call option to significantly boost yields. If you are unfamiliar with the topic, I highly recommend reading this article first to understand how they work and what their risks are. For use cases and comparisons of popular covered call ETFs, I recommend reading this article.

Investors looking for the highest monthly income possible can buy **BMO Canadian High Dividend Covered Call ETF** (TSX:ZWC): This ETF holds 35 Canadian dividend stocks from the financials, energy, telecom, utilities, and industrial sectors with a covered call overlay.

ZWC has a very high distribution yield of 6.01%. For a $1,000,000 retirement portfolio, this will create $60,100 in annual passive income without having to sell any shares. The MER is also lower than FIE at 0.72%. However, this is still rather high compared to a “vanilla” ETF.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:FIE (iShares Canadian Financial Monthly Income ETF)
2. TSX:VDY (Vanguard FTSE Canadian High Dividend Yield Index ETF)
3. TSX:ZWC (Bmo Canadian High Dividend Covered Call ETF)

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