
Sherwood Investment Services
Financial Planning & Investment Management

Eric Linger, RIA
Registered Investment Advisor

425-898-8989
Sherwood-Investments.com
elinger@Sherwood-Investments.com

23705 NE 61st Street
Redmond, WA 98053

The Savvy Investor

Bonds Can Be Riskier Than Stocks

Overview

Historically, if you wanted income, you purchased income investments such as bonds or preferred stock. However, data suggests that stocks may be a better source of income.

This might seem implausible since most stocks do not have very significant dividends. (The average dividend of the S&P 500 is 1.3%.) **The reason hinges on the fact that as stocks appreciate over time, stock dividends also appreciate.** So you are continually receiving a higher dividend yield on your initial investment. More importantly, the price appreciation of stocks can be used as a substantial source of income.

Here Are The Facts

A study published in the AAIL Journal (February 1998) indicated that a portfolio heavier in stocks provided a better chance of a retiree meeting his/her income needs than a portfolio of all bonds.

For the period analyzed from 1926 to 1995, the data showed that if an investor wanted to draw 7% annually on their portfolio for 20 years after retiring, **a 100% bond portfolio would have been successful in delivering the necessary income only 47% of the time. On the other hand, a portfolio of stocks would have been successful at delivering the required income 92% of the time.**

If we look at the same data but only for the period since World War II, stocks show up even better than bonds as a retirement income source.

Stocks would have been successful 100% of the time in producing a 7% annual income while bonds would have been successful only 42% of time.

The best part about this study is that it takes into account that stocks can be more volatile than bonds. The study accounted for the fact that a retiree would need to take their 7% income even in years when their portfolio was declining in value and thus tests these hypothetical portfolios under a real life scenario.

Interpretation

If you've been staying away from the stock market, worrying that it's "too high" and relying on income investments to supply your retirement income, I suggest that you might be taking the more financially risky path. I know that stocks *seem* more risky because many investors focus on the *short term*. **When you look at the long-term, bonds have been the more risky income alternative since they have failed to deliver a 7% income more than half of the time.**

Bottom Line

Some bonds in your portfolio may be appropriate. But don't rely solely on bonds for income. You need to include stocks and/or mutual funds to reduce the risk of outliving your income source.

Your Next Step

If you own bonds or are looking for income, please contact us.

