New Frontier

Paul Erlich

Senior Research Associate

Paul Erlich has over 20 years of professional experience in quantitative finance and joined New Frontier in 2012 as Senior Research Associate. He holds a B.S. in Physics from Yale University.

Income Investing Done Right

by Paul Erlich

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Many investors, especially those in retirement, have a rational preference for investments that provide dividends and income at higher rates than a market portfolio of stocks or both stocks and bonds. All else being equal, many retirees prefer to live off the income generated by their portfolio rather than worrying about the timing and pricing of stock or bond sales. Recurring dividend payments, being much less volatile than prices, tend to retain most of their dollar value during a market crash – while selling assets to raise needed cash during such troughs can eat up a dangerously large percentage of principal. The problem is that, although there are a number of popular products that are promoted as dividend-focused investments, these are not well-designed to provide sustainable income throughout a typical retirement period. Instead, they express a short-term, tactical view that dividend-paying stocks are likely to be favored over the rest of the market in the immediate future. But an investor with a dividend objective should, by his or her very nature, be a long-term investor rather than one seduced by recent high returns of dividend funds.

There are many wrong ways to invest for income. One of the most common approaches merely targets high dividends and income, using any available assets to reach that target, hence taking on a good deal of exposure to extra-market risk and resulting in higher long-term volatility than a market portfolio. Due to the effects of compounding, this volatility puts the retired investor at risk of capital depletion within his or her lifetime. Excessively high income targets can also result in depletion of principal over a typical retirement horizon because no investment can consistently pay outsized dividends without a concomitant reduction in capital appreciation to negligible or negative levels. By the same token, insurance-style retirement products such as annuities provide payouts that fail to keep pace with inflation and can leave a retiree struggling to keep up with rising living costs – not to mention the excessive fees and default risks associated with such strategies.

To summarize a number of the main differences between our approach to income investing at New Frontier and the approaches of our competitors:

- Unlike annuities, our investments are transparent and liquid.
- Unlike single-asset-class funds, we provide a complete, diversified, risk-managed portfolio.
- New Frontier's portfolios are managed using our own patented,

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world-class optimizer, generating portfolios that experience less risk for a given level of average return (or yield) compared with traditional optimization methods.[1]

- Unlike competing MAI strategies, we offer three portfolio solutions to accommodate a range of risk tolerance and return expectation levels, which an advisor may switch between if a client's circumstances change.
- Unlike other MAI focusing solely on current income, we optimize for both income and growth of capital – providing a sustainable solution that protects against principal depletion while still providing very substantial yields (particularly in today's low-rate environment).
- Unlike "conservative" portfolios filled with junk bonds, each of our three MAI funds is a total portfolio solution with moderate risk exposures across all asset classes.

Over five years ago, New Frontier offered our solution to the dividend investing problem: risk-targeted global ETF asset allocations optimized for income. Created and maintained at three different stock/bond ratios – allowing the advisor to take investor risk tolerance into account – the Multi-Asset Income (MAI) portfolios optimally combine market risk premia, sources of fixed income, and available well-designed dividend-tilted exchange traded funds to produce long-term sustainable investments with attractive yields (as of 9/30/17, trailing 12-month yields of 3.54, 3.72, and 3.80% for our Conservative, Balanced, and Growth MAI portfolios respectively). We encourage the reader to log into advisor.morningstar.com[2] and compare the five-year performance of all three against Multi-Asset Income portfolios[3] offered by other firms.

Contact New Frontier today to talk about investing for yield for your clients.

1 https://newfrontieradvisors.com/research/new-frontier-innovations/michaud-optimization/
2 http://beta.morningstar.com/etfs/etf-managed-portfolio-screener.html
3 And "Multi Asset Income"