Income Investing - Is It Time?

Income investing is coming back into the spotlight these days as investors seek security and income from investments that pay a regular dividend or rate of interest at regular intervals during the year.

Income investing is not a substitute for other investment strategies, but rather a way to balance a portfolio and add stability and an income flow. It's an investment strategy that has merit for many investors. Are you one of them?

Here are some questions to be asking:

Does an income investing strategy suit my current needs?

There comes a time when preservation of capital and income support trump growth as primary investment objectives. Retired investors need some income-producing investments. Younger investors may be saving for a home or financing college-bound children. In these cases, the predictability and relative stability of income investing strategies can give peace of mind and a predictable rate of return.

What kinds of investment options are available?

Popular debt investments include high-quality government and corporate bonds and Guaranteed Income Certificates (GICs) that pay a fixed rate of interest and pay back the principal at a set maturity date. While GICs have a maturity date ranging from one to five years, bonds may have maturity dates ranging from one to 30 years. Popular equity income investments include corporate preferreds and common stocks that pay a dividend. Some preferreds are redeemable at a fixed price and pay a regular dividend and perform much like a bond. Some have a convertibility option that allows a swap for common shares. This makes the issue perform more like a stock than a bond, in which case the potential for capital appreciation may also play a role in determining its investment quality. However, unlike a bond or GIC, the preferred share is equity, not debt, and dividends are not secure if the company runs into financial trouble. It's usually the senior "blue-chip" common shares that pay dividends, but they are typically lower than those found on preferred shares. Common share dividends are also unsecured.

Equity investments are measured by their current yield - a rate of return calculated by dividing the dividend by the cost of the investment and expressed as a percentage. Yield to maturity is the most common measure of a bond's value, which will tell the investor the total return received if the bond is held to maturity. Yield to maturity includes all interest payments and any capital gain or loss whereas the current yield of a bond is the annual return on the cost of the bond regardless of maturity.

Bond prices rise when interest rates fall, and vice-versa. One way to dampen the impact of interest rate fluctuations over the long-term is by creating a debt "ladder" that staggers maturity dates over a period of years.

What are the tax implications?

In your RRSP or RRIF, tax is deferred on income from interest, dividends and capital gains. Outside those registered plans, the rules are different. Interest income is taxed at the investor's top marginal rate. Dividend income is taxed at a lower rate. Capital gains attract the lowest tax rate of all. All calculations are based on an investor's tax bracket. And, taxes on interest and dividend income are payable in the year the income is paid or deemed paid. Capital gains tax is paid when the security is sold. This makes registered accounts (RRSPs, RESPs, etc.) the best place to hold interest- and dividend-paying investments.

Income investing can be complex. Your Raymond James Financial Advisor can help you decide on a sensible approach and suggest how to structure your portfolio to reflect your current and future income needs.