A new approach to income investing

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The investment landscape is changing, and income strategies that worked in the past may not work in the future.

Columbia Threadneedle Investment Team

The Federal Reserve recently announced that it's going to hold off on raising interest rates and is dialing back projections of 2019 rate hikes because of a slowing economy and tame inflation. Countries like Germany and Australia followed suit by pumping the brakes on rate increases — many are set to cut rates if they haven't already. Market volatility is on the rise due to a combination of trade fears with China, slowing economic data, Brexit and the looming 2020 U.S. election. There's no shortage of unknowns and variables at play in the market right now, and spikes in volatility leave advisors wondering how to choose the most promising income investments for their clients. The good news? Volatility often opens the door to new opportunities.

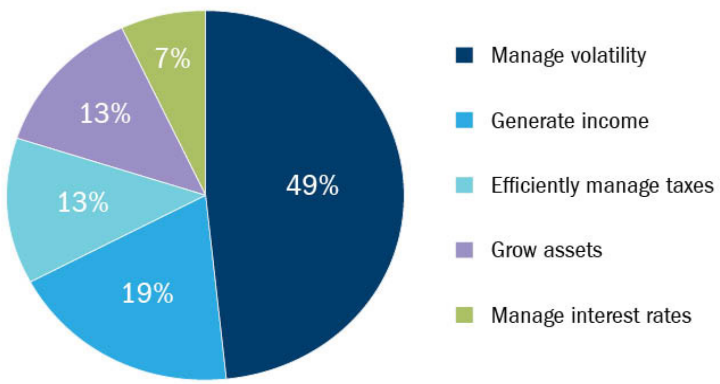
As the global economy slows, it's important for advisors to embrace the changing investment landscape and understand: income strategies that worked in the past may not work in the future.

The challenges of income investing

Advisors face many pain points when it comes to income investing. We commissioned a recent survey of advisors and found that almost half (49%) believe that managing volatility is the most challenging investor goal.

Survey: Volatility is the biggest concern

Half of advisors said that managing volatility was the most challenging goal to navigate in an investment portfolio.



Source: 2018 Schwab IMPACT Conference, Columbia Threadneedle Investments Stealth Survey of 103 financial advisors in October 2018. Figures may not add up to 100 due to rounding.

Many advisors struggle with how to manage volatility and break away from low risk/low yield investments, and it's time to consider new income solutions. As Anwiti Bahuguna, Head of Multi-Asset Strategy, has explained, diversification is as important for an income-generating strategy as it is for any other investment goal. An income strategy that includes less traditional asset classes like convertible securities, securitized fixed income and floating-rate loans can increase portfolio diversification and mitigate the effects of volatility.

Passive investing may not work for fixed income

Many advisors might look to index investing as a way to diversify investments and make decent returns. The most widely accepted bond market index is the Bloomberg Barclays U.S. Aggregate Index (the Agg). While it's tempting to think about that as the "S&P 500 of bonds," bond indices are built differently than equity indices. When products track a bond index, investors get the largest exposure to the most indebted issuers, not necessarily the best opportunities.

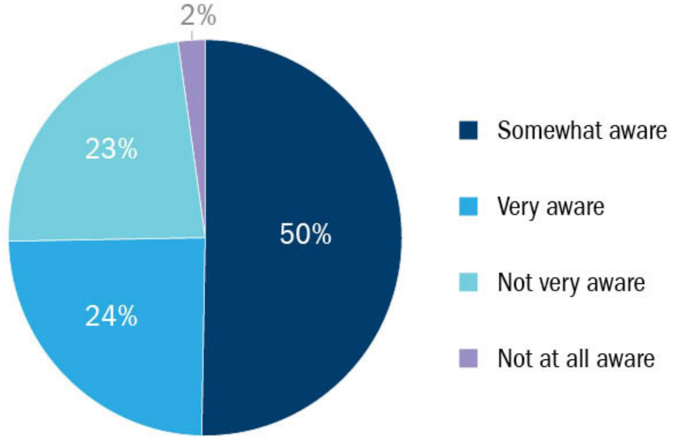
The Agg is also very concentrated and lacks diversification because it's composed of roughly 40% government-issued bonds. This means it's concentrated in interest-rate risk; most of its returns are explained by changes in government bond yields. So while many passive investors think they're getting exposure to a wide variety of debt, in reality, they're taking unintended sector bets.

An opportunity for advisors to add value

Advisors should weigh the benefits and risks of strategies that can deliver higher yields than what low-risk bonds currently offer. Educating clients about new solutions for income investing is critical, especially since our survey found that a majority of clients (76%) were not well-versed in investing for income when they started working with their advisor. And yet, income is a key driver of total return for both equities and fixed income. This gap in knowledge positions advisors to provide value and meaningful advice.

Survey: Many investors lack awareness about income investing

The majority of advisors surveyed said income is not top of mind for their clients at the onset of their engagements.



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Bottom Line

Managing volatility while investing for income is no easy task for advisors. But advisors who are willing to embrace new solutions will be well-positioned to help their clients achieve their goals.

The S&P 500 or Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies.

The Bloomberg Barclays U.S. Aggregate Bond Index (U.S. Aggregate) is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

It is not possible to invest directly in an index.

Diversification does not assure a profit or protect against loss.

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