INVESTMENT INCOME

The low interest rate environment coupled with a stock market that is trading at very high index levels is causing great anxiety for retired investors who need to generate an income from their investments. Unfortunately, this is also an environment that is good for scammers who offer solutions such as guaranteed income or capital with very high growth rates. If you are an investor looking for income, you should not stray too far from shares, listed property and government retail bonds for your income.

INFLATION SHOULD BE YOUR REAL CONCERN

When I speak to retired investors, I always highlight the problem of inflation rather than volatile stock markets. Stock market volatility is highly unsettling but I view market moves in the same way a sailor considers the tide, you cannot control it, so rather ensure that you can operate in high tide and low tide. If you avoid the stock market because you don't like volatility, you are ensuring that your capital is going to be eroded by inflation. Shares, listed property and government bonds are your primary inflation-beating investments and of these, shares are usually your best performer. So, avoiding the stock market is not your best strategy for fighting inflation, even Mohammad Ali could not win with one hand tied behind his back! If you are really worried about a stock market crash, you can always reduce your equity exposure to the minimum. I feel that the lowest exposure you can have to shares is 35% if you still want to beat inflation. Don't get too wrapped up in the hype from doomsayers who constantly predict stock market crashes, you are investing for income and a crash might lead to a reduction in your dividend income but most likely the share prices of your companies will be more affected than the dividends they generate.

SHARES BEAT INFLATION

I do not think that retirees should place all their money in shares but they should be a part of any income generating portfolio. A portfolio that has 100% invested in cash is certain to generate interest and not lose money but it is also guaranteed not to beat inflation over the long term. You only need 35% in shares to get sufficient inflation protection. You can keep the remaining 65% in cash (still not the best idea) and you should still be okay over the long term. To understand why shares are so important, I love the example provided by Alan McConnochie who is a Director of Robert Cowan Investments. He did some research on the price of a Wimpy meal vs. the share price and dividend increases of Standard bank shares from 1983 to 2010. Over this 27 year period, the price of a fairly typical Wimpy meal rose by 9.98% per year. By contrast, the price of Standard Bank rose by 19.36% per year whilst the dividends went from 4c to R3.86 (18.45% p.a.) As McConnochie puts it, "In those days it would have taken the dividends on 313 shares to buy your meal – now it only takes the dividends on 42 shares to buy your meal." If you wanted to sell shares to buy your meal, in 1983 you would have needed 13 shares whilst today you would need just 1.45 shares.

As you can see from the Standard Bank dividends and share price performance, the volatility of shares will not impact you over the long term, provided you are patient and have a diversified portfolio of investments. Investing a significant portion of your capital in shares with the remainder in listed property, government bonds and a smaller portion in cash will ensure that you can earn a good income from your investments and beat inflation over the long term. Don't listen to promises from smooth talking salesmen who offer guaranteed returns, if you are not being scammed, you are certainly paying a lot of money for the guarantee!