Editor’s Note: The following is an edited transcript of a panel discussion that took place during “Jim Cramer’s Boot Camp for Investors,” sponsored by TheStreet.com, October 13, 2018, in New York City.

The panel description: Bet you thought buying General Electric for its amazing dividend yield in 2017 was a great idea. Shares of the iconic dividend payer have gone straight down since. The reality is people continue to make mistakes choosing investments that generate consistent, predictable income. This panel will discuss successful income investing across various asset classes, not just stocks. Industry pros will share top ideas that serve up steady income streams, which is essential whether you are a millennial investor or someone nearing retirement.

The panelists: Tony Davidow, CIMA®, alternative beta and asset allocation strategist, Schwab Center for Financial Research; Bob Dannhauser, CFA®, head, global private wealth management, CFA Institute; and Robert Norton, CFA®, chief investment officer, Wealth Advisory Partners. The discussion was moderated by Bob Powell, editor of the Retirement Management Journal.

Davidow: I agree. Everything starts with a plan. However, I do think maybe we need to revisit the plan if it’s been in place for a while. In the old days, we focused on getting to retirement and then lived off the income generated from your portfolio. Now of course, people are living longer, more active lives in retirement.

The reality is the world has changed. We need to have realistic expectations about life in retirement. We all live much more productive lives, and God willing won’t be sitting at home. We need to think about the fact that we’re likely going to be in retirement for 20 years or more.

As we think about that plan, we need to think about whether it’s set up for a long enough glide path. We also should revisit the assumptions in our models. What if the results in the future don’t match the past? The long-term historical return of the S&P 500 is 10.3 percent. What if those returns are 6.5–7.0 percent? What if we’re not getting the 4–percent income from our fixed income portfolio? And we know that cash is not going to yield 4 percent.

So, I think we need to revisit our capital market expectations. Does your plan anticipate a long productive life in retirement, or just getting to retirement?

Powell: One of the most important things about investing for income—either before or in retirement—is that you wouldn’t invest without a plan. The plan is, “What’s my monthly income target?” Let’s start there.

Norton: I would just echo the thought that it’s a cash-flow game, money in, money out, and there are two levers to that. You may not be able to control as much as you’d like what you’re getting from an income standpoint. You can
control what you’re spending. We work with our clients and we do a detailed cash flow going out 20 years. We revisit that each year. It’s done on an ongoing basis as opposed to a snapshot. The most important thing is to monitor that cash flow on an ongoing basis, what’s coming in and what’s going out.

Powell: We discussed, when we were preparing for this panel discussion, the notion of how you might allocate your assets in light of the income needs that you might have. In the old days, people were told it’s just 100 minus your age, and that becomes your stock portfolio, but it’s more sophisticated than that, is that right?

Davidow: Absolutely, and I’d also like to pick up on your previous comment about a total return or an income-oriented portfolio. We actually have multiple total return portfolios, which have the optimal combination of underlying asset classes to achieve an outcome over the long run; and income-oriented portfolios where we’re just solving for the income component within a balanced risk-return framework. You need to select what’s right and appropriate for you. As you get closer to retirement, you’re going to gravitate more to an income approach.

We have certainly seen investors chase yield over the past couple years. We’ve seen investors buy real estate investment trusts (REITs), master limited partnerships (MLPs), and high yield without regard to the corresponding risks. You still want a diversified portfolio. The value of a plan is smoothing the ride over time. We want to make sure we’re solving for the right thing over the long run. So, let’s think about the risks that we’re taking as we search for that yield.

Dannhauser: I think that’s right. You need to be much more risk-focused rather than just reducing it to a simple what’s my split going to be between equities and bonds. Maybe it’s easier to break the problem down into chunks. The current approach that’s finding a lot of favor in financial planning is a goals-based approach. You have one set of objectives that are basically to try to keep you off cat food in retirement. You want to have your basic living needs attended for. You want to be pretty certain about achieving that objective, so perhaps a funding strategy around that, and the investment strategy around that is going to be fairly risk averse, depending on how much capital you can start with.

There’s no reason why you can’t have some guaranteed income and some income that’s a little higher but not as guaranteed, and then reach for some other sources that have a higher income.

Then there’s the more fun goals and objectives that would be really nice to have, but that aren’t absolutely necessary, where perhaps you can then take more risk. From that goals-based framework I think some of the asset allocation becomes a little bit clearer, and you need not restrict yourself to thinking just in terms of equities and fixed income.

Norton: I think the diversification in portfolios is a good concept, but you also want to diversify your sources of income. There’s no reason why you can’t have some guaranteed income and some income that’s a little higher but not as guaranteed, and then reach for some other sources that have a higher income. You’re, again, not relying on any one thing. You have some base, some foundation that’s going to keep the lights on, but over time having those diversified sources of income, you’re not going to take an inordinate amount of risk to try to reach for that yield, but you’re diversifying that income stream.

Dannhauser: Toward that end, annuities have a bad rap or have had a bad rap. They’re really complex, they can be really expensive, but I think it’s time for a fresh look at those kinds of products, because the nature of the products themselves has changed. It’s also an opportunity to take some of that risk off your plate and transfer it to an insurance company, and to lend more dependable-ity and assuredness to a stream of income. Maybe not for 100 percent of what you need to develop to fund your retirement, but perhaps for part of it.

And particularly if you approach it with the objective of hedging some of the longevity risk, if you’re lucky enough to live a really long time in high-quality years, you can buy an annuity for fairly cheap that doesn’t kick in until fairly late in your life, 85 or 90, to take you those last 10 or 15 years at a fairly reasonable price these days.

Davidow: I’d love to pick up on the goals-based comment, because I look around the room and I see people from multiple generations. I like the goals-based approach, but we must realize that everyone in the room is going to have slightly different goals.

Powell: Tony, can you explain the difference between goals-based and investment-based?

Davidow: For many years, institutions used a 60/40 portfolio as a typical benchmark. Your 60-percent allocation to stocks provided your returns, your 40-percent allocation to bonds provided income, and you may have added some cash to provide stability. As you get older, you typically would increase your fixed allocation to generate more income in your portfolio.

What we’ve seen across the industry is that a lot of people are gravitating to a

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goals-based approach. A goals-based approach may mean you’re actually solving for multiple goals. One of those goals could be sending your children to college, and another goal could be retirement. So, you align your portfolios to meet specific outcomes.

If we frame the discussion of our portfolio based on what we’re solving for, we can move clients away from their fixation on performance. Again, it’s bringing the discussion back to the plan. Are you on track to meet your goals? Do we need to make adjustments? Have there been any changes to your circumstances?

Powell: Rightly or wrongly, when I was younger I focused on reward, and now that I’m older, I, rightly or wrongly, focus on risk. The two risks that I think about a lot as I think about retirement and investing for and in retirement are longevity and inflation, and how to balance those, how to mitigate and manage those two risks given the asset classes you might have.

Bob, you mentioned annuities. I know annuities get a bad rap, but annuities are the only product where you can take advantage of mortality credits. Bonds don’t afford you that, stocks don’t afford you that, and the risk of someone dying before you and taking advantage of that is something that doesn’t exist anywhere else.

Dannhauser: But not without some other risks, right? It’s the single main credit risk of the insurer that is an issue, and also the expense. There are opportunity costs as well, versus other alternatives that perhaps you could build yourself. The whole issue of timing is getting a fresh look, too, and deservedly so. Under the old strategy, during the accumulation phase you’re willing to take some risks and have risk assets, but when you start taking money out of that pot to live in retirement, all the risk comes off and you’re depending largely on fixed income.

Well, if you come into a market environment that’s down and you’re starting to pull assets out, if you don’t have some risk assets retained in your portfolio, you’re just not going to have an opportunity to bounce back to the extent that you need to or might need to, to fund the longer tail of your retirement. You saw a lot of that happen in 2008 with some of the target-date funds that took you to the point of retirement and then cut you off from any risk exposure. A more contemporary view now is to retain some equity exposure or other risk exposure in your portfolio so that you can grow back up if, at the point you start pulling funds, it happens to be a rough patch in the market for a year or two.

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Powell: Let’s talk about some of the specific tools that people could use and pros and cons with those. Do you want to start with exchange-traded funds (ETFs) or MLPs or business development companies (BDCs)?

Davidow: I think ETFs sometimes get a bad rap in the market. ETFs are merely a fund, an ETF, or a separately managed account?

Norton: I think one interesting ETF strategy that we’ve been using with our clients is target-date bond funds. In an environment where we’ve seen the 10-year bond go from 1.5 percent to more than 3 percent in the past two years, those types of ETFs have been able to generate a positive return and then also return cash to our clients so they can reinvest at the higher rate.

It’s a way to work through a rising-rate environment that can be somewhat corrosive to principal as bond yields go up. It’s a tool, a specific thing that you can do to protect yourself, get some return now, and reinvest at higher rates down the road with your principal.

Dannhauser: I’m a fan of ETFs generally, but of course know what you own. They’re cheap, they’re diversified, all good news, but there are also some potentially nasty surprises in some flavors in the marketplace. You need to do a bit of research before you commit.

BDCs have had a little bit of a resurgence, with a bit of a push from the federal government and the Small Business Credit Accessibility Act, which said that BDCs can now lever up to two for one rather than one for one.

You may be buying into something that’s quite a bit more levered than you might otherwise have expected. I have to say, too, that BDCs in general are a business model where the investment
managers’ incentives and interests aren’t as well-aligned as some other instruments in the marketplace.

So, take that leverage issue for example. You lever up, you get twice the exposure to the asset side, the manager is going to up the fee accordingly because it’s based on asset exposure. But they’re not really picking up part of the downside as well, which of course the investor is exposed to. Again, there’s a little bit of a mismatch in incentives there.

The other thing that may be worth a look these days is municipal bonds (muns). There are still some of the same concerns over interest-rate risk as the Fed begins to move us back up the curve. But there’s been again, mostly from the courts, some interesting things that perhaps make the fairly dire municipal finance situation just slightly less dire in the coming years.

These include some court decisions allowing for sports betting, which of course is taxed and regulated. There’s legalization of cannabis products, which creates some taxable opportunities for taxing jurisdictions.

There was a Supreme Court decision around the right of public employees to unionize or the necessity of the mandatory unionization of public employees. That might give municipalities and states a little bit more flexibility in negotiating their way out of some pension dilemmas that they have now. Not offering any value judgments about the equity or the fairness for public employees, but just strictly from a fiscal standpoint, that could create a little glimmer of good news. It might tend to boost the muni market a little bit.

**Norton:** Some interesting supply and demand issues are happening in the muni market and I think it’s also a market that has incredible diversity, a lot of small issues, and things that really require a fair amount of research and staying on top of. So you can find opportunities there and we think that’s actually an interesting place for active management as opposed to just buying an ETF and buying everything or just buying the big stuff.

There are definitely opportunities where we’ve seen some very good results in the high-yield muni area; again, a lot of undiscovered small issuers, full good credits, hospitals. But just off the radar you can get some really good opportunities in terms of good yield and they’ve performed well over the past number of years.

**Davidow:** You’re hearing a lot of these new ideas. I wouldn’t invest in anything unless I understood it. Spend the time to understand it, and if something sounds like it’s too good to be true it probably is.

**Norton:** Probably is.

**Davidow:** I’m aging myself here, but I go back to Watergate when I think of these new products and structures. What did Deep Throat say? “Follow the money.” Follow the money, understand how these products work, and who gets compensated, and ultimately if you understand how the money works you often find out how these products really work.

So, to pick up on Bob’s point earlier, know what you own. All these things sound great until they don’t work. If you can’t get comfortable in the way that it works, you can avoid it.

**Norton:** A corollary to that is to make sure that the structure matches the opportunity. You don’t want to be in something that is very liquid at the retail side where the underlying issues are very illiquid. That kind of mismatch generally ends in tears, so it’s something you want to be very conscious of.

**Powell:** We’ve witnessed some of what you’re talking about with non-traded REITs. Is it fair to say that folks didn’t know what they bought?

**Davidow:** Many investors did not know what they owned or the risk associated with them. As Rob said earlier, you need to understand the structure. If you can separate strategy versus structure, first decide if you want to have exposure to this type of a strategy, and then determine the best structure to own the strategy. I think there’s some potential concern there. Again, spend the time, know what you own, and know how you own it, and I think we’ll all be happier in the long run.

**Powell:** We didn’t touch on closed-end funds in terms of the income opportunities there, and there are many. Of course, they can be complicated—leverage, discounts, premiums, etc. Anyone want to take a stab at pros and cons of closed-end funds?

**Norton:** I’m somewhat familiar with the closed-end area. I think there’s an awful lot of opportunity there. Again, you really have to understand things like leverage, what do they own, and what’s going on.

I think you can be a long-term investor there, as long as you’re doing the right thing and the fundamentals are fine. You don’t want to get too upset about the price movements because you’ll have times where a closed-end fund will sell off. Maybe it creates more of an opportunity, but understand what the net asset value is, what the discount is, or what the premium is. Those are the things that you really want to do and you can generate good income from those types of products.

Again, like anything, you have to know exactly what you’re buying and what price you want to buy it at.

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