

[Miller/Howard Investments Blog](#)

Income Stocks Are a Good Idea for Spenders

Wednesday, March 27, 2019

The first rule of spending is to save first. When it comes to spending, especially in retirement, conventional wisdom suggests that you “spend from total return.” In other words, you shouldn’t worry about whether returns are coming from appreciation in the price of your securities or from the dividend income these securities produce. After all, you can sell whatever you need to meet your spending budget.

A well-known principle in the retirement industry is the 4% Rule — which argues that you can spend 4% of the value of your overall portfolio, of course adjusting this value each year for inflation. History has shown that the stock market has gone up on average about 10%* annually in the last 5 years. So, the argument goes that the chances of running out of money appear to be slim.

What Could Possibly Go Wrong?

We all tend to make assumptions that may not hold true, and the real world is not always so neat and tidy.

To begin with, the logic above is based on percentages — but people don’t spend percentages, they spend actual money. They are not the same thing. If after the market goes down, and an investor sells principal to meet spending needs, that principal won’t be there to benefit when the market eventually goes up.

Let’s take an example:

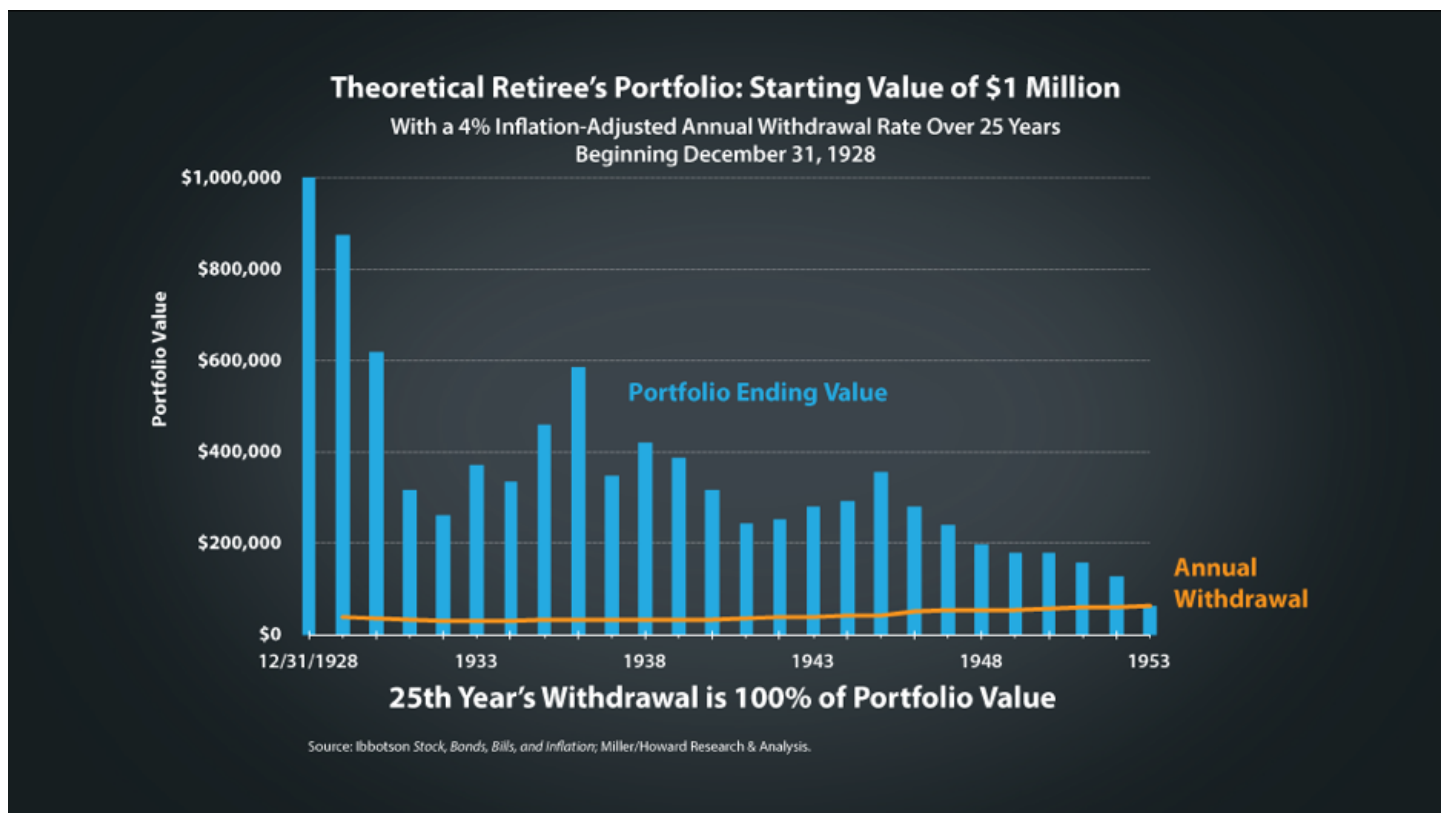
1. You start with a **\$100** portfolio.
2. The market then falls 10% (very possible occurrence) = **\$90**.
3. And then you need to take the 4% of the original portfolio value for your spending needs. That leaves you with = **\$86**.
4. The next year the market hypothetically goes up 11% bringing the stock market roughly back to its starting point, your portfolio only goes back up to = **\$95.50**.
5. You were able to spend the \$4.00 — but you have not raised any new money for the next year’s

spending. That missing \$0.50 is the cost of having to sell when the stock market is down, a sort of negative compounding!

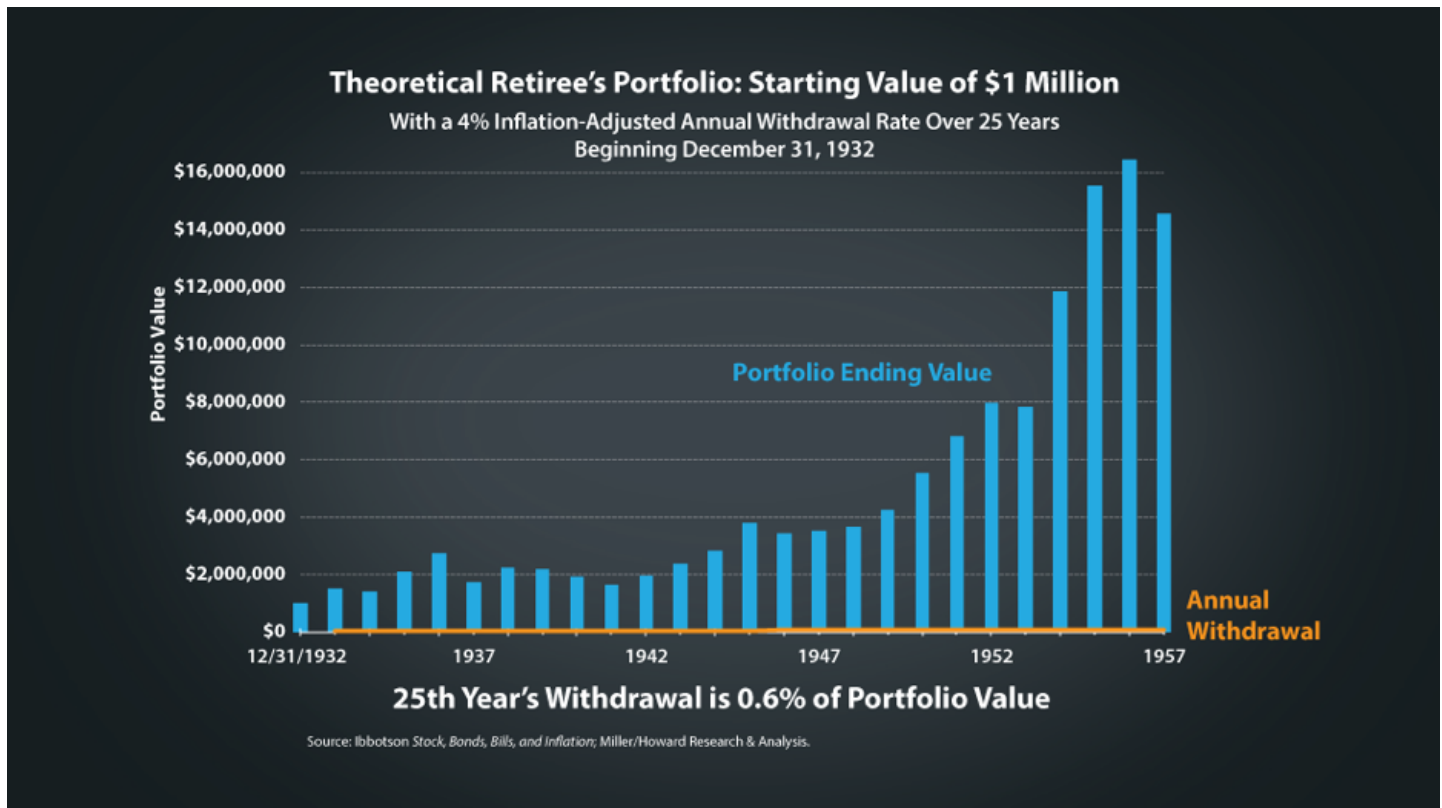
How well this rule works is very dependent on when you retire. Using Dr. Roger Ibbotson's long-term stock market returns, we constructed a model to see how this rule would have worked over a 25-year retirement, starting at various points of time. Our assumption is you started with a \$1 million portfolio, and your returns are based on an investment in Large Company Stocks, as Ibbotson calculates them.

For the withdrawal rate, we assumed a 4% rate of the original portfolio value adjusted annually using the most widely quoted US inflation measure, the US government's Consumer Price Index for All Urban Consumers.

Let's look at what turned out to be the worst-case scenario: retiring at the beginning of 1929. By the end of 25 years, the retiree had less than one year's worth of spending left in the portfolio. The retiree ran completely out of money.



Now, if the individual, instead, retired just four years later in 1933, the outcome would have been dramatically different. At the end of 25 years, the retiree's next withdrawal amount would have represented a minor 6/10th of 1% of their portfolio rather than the 100% in comparison to the person who retired in 1929.



That short four-year delay in retirement meant the difference between having \$62 thousand or over \$14 million 25 years later — between outliving their money or leaving their heirs with a sizable inheritance.

The main points we are making are:

- There are risks inherent in spending from total return versus the peace of mind that can come from spending out of a reliable and stable income stream.
- If you have a portfolio of high-yielding dividend stocks that can maintain their dividends, or better yet grow their dividends, you can spend out of the income that your portfolio generates.
- Then you won't need to sell when the market is down. You won't need to erode your principal when you need it most — to recover from a stock market decline.
- You won't need to worry about the market volatility as much because your spending needs are covered by the cash flows that your portfolio generates for you. Financial independence means being able to live off of your income.



[WATCH THE VIDEO](#)

** Does not include transaction costs, taxes, and fees.*

DEFINITIONS

Ibbotson® Large Company Stocks Index is represented by the S&P 500 Composite Index (S&P 500) from 1957 to present, and the S&P 90 from 1926 to 1956.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the US and various geographic areas. Average price data for select utility, automotive fuel, and food items are also available.



[JOHN E. LESLIE III, CFA](#)
[PORTFOLIO MANAGER](#)

John (Jack) E. Leslie III, CFA, adds extensive experience in quantitative modeling and screening in the equity markets to his analytic strengths, and brings a high level of expertise in both fundamental and quantitative research skills, as well as experience managing large pools of institutional assets. Jack focuses on the materials, consumer staples, consumer discretionary, industrial, and healthcare sectors. Prior to joining the firm, he was a portfolio manager at Value Line Asset Management, M&T Capital Advisors Group (a division of M&T Bank Corp.), and Dewey Square Investors Corp. (now part of Old Mutual Asset Management). Jack has been interviewed by the *Wall Street Journal*, *Barron's*, *Fortune*, and *Forbes*, and been a featured guest on *Thestreet.com*, *After the Bell* on Fox Business, and *Money Life with Chuck Jaffe*. He earned his BS degree in Finance from Suffolk University and an MBA from Babson College.

DISCLOSURE

INVESTMENT PRODUCTS: ARE NOT FDIC INSURED - MAY LOSE VALUE - ARE NOT BANK GUARANTEED

Opinions and estimates offered constitute Miller/Howard Investments' judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. All investments carry a certain degree of risk, including possible loss of principal. It is important to note that there are risks inherent in any investment and there can be no assurance that any asset class will provide positive performance over any period of time. The material may also contain forward-looking statements that involve risk and uncertainty, and there is no guarantee they will come to pass.

The information above is from sources deemed to be reliable and is provided strictly for the convenience of our investors and their advisors. These materials are solely informational. Legal, accounting and tax restrictions, transaction costs, and changes to any assumptions may significantly affect the economics of any transaction. The information and analyses contained herein are not intended as tax, legal, or investment advice and may not be suitable for your specific circumstances; accordingly, you should consult your own tax, legal, investment, or other advisors, at both the outset of any transaction and on an ongoing basis, to determine such suitability. Any investment returns — past, hypothetical, or otherwise — are not indicative of future performance. Investment Decisions: Do not use this report as the sole basis for investment decisions. Do not select an allocation, investment discipline, or investment manager based on performance alone. Consider, in addition to performance results, other relevant information about each investment manager, as well as matters such as your investment objectives, risk tolerance, and investment time horizon.

Past performance does not guarantee future results.

[Contact Us](#)[Privacy Policy](#)[Disclosures](#)[Cookies](#)