INVESTMENT STRATEGIES *to grow your* INCOME

Table Of Contents

Part 1 – Income-Producing Investment Strategies 3

Introduction 3

Variable Income Investment Strategies 4

Predictable Income Strategies 5

Guaranteed Investment Strategies 7

Which Strategy is Right for You? 9

Part 2 – Practical Tips for Investing in Income-Producing Instruments 11

Investing in Bonds 11

Investing in Bond Funds 14

General Investing Tips 17

Conclusion 18

Part 1 – Income-Producing Investment Strategies

Introduction

While it's wise to have a concern for increasing your assets, you may also wish to focus on using your investments to augment your income.

For example, if you inherited a valuable piece of artwork worth $1 million, you could hang it on your wall and increase your assets by $1 million. However, that picture on your wall does little to help you pay your expenses.

Investment strategies that focus on growing assets will generally result in greater wealth over the long-term, but it's also possible to generate a significant income via the proper investment channels.

Investment strategies that focus on income make more sense as you near retirement age. With income-producing investments, you can lower your risk. This might be especially important to you if you're too close to retirement to have the time to recover from significant asset loss.

Also, once you're retired, you'll want a reliable and consistent source of income.

The main component for determining the amount of that income is risk. The greater risk you're willing to take on, the greater the potential for a high-income stream.

There are three types of investment income: variable, predictable, and guaranteed. ***By the end of this guide, you'll have a good working knowledge of these three types of investment income and which one makes the most sense for you.***

> *"Rule No.1: Never lose money. Rule No.2: Never forget rule No.1."*
> ***- Warren Buffett***

Variable Income Investment Strategies

For those with a long time horizon, the variable income strategy can make the most sense. This strategy combines holding equities (stocks) as well as fixed income instruments.

The greatest advantage of this investment technique is that by having some stocks, ***you should be able to outpace inflation and grow wealth while you're still receiving a reliable stream of income.***
While the income will be less than that generated by a 100% income strategy, there will be some income.

Likewise, there is the opportunity to grow wealth optimally over the long-term with part of the portfolio being invested in equities.

Predictable Income Strategies

Predictable income from investments is income that can be expected but is not guaranteed. With a predictable income strategy, you generally acquire quite safe and reliable investments, but all of these investments are on a sliding scale with regards to risk.

For example, some bonds are very low-risk investments, but there are also very high-risk bonds.

Some investment vehicles that could fit into a predictable income strategy include:

1. **Dividend income from stocks.** Dividends are a portion of the profits that a company has earned and are being paid back to investors. This typically means the company can't find a better purpose for those funds. These will commonly be companies that don't have the opportunity to expand, such as utility companies.

    - ***Look for stocks that have consistently paid good dividends over many years.***

2. **Dividend income funds.** If you would rather let an expert pick your dividend-producing stocks, this can be a viable alternative. ***Dividend income funds focus on stocks that consistently pay dividends to investors.***

    * If this option sounds attractive to you, be sure to learn how to analyze mutual funds (later in this guide) for your best results.

3. **Interest income and corporate bonds.** Investing in bonds will be covered in more detail as well. In essence, when you buy bonds, you're loaning your money to a corporation. ***The likelihood of getting paid back by the corporation is dependent on the underlying strength of their business.***

    * Businesses with a riskier financial situation will pay you more for the privilege of borrowing your money. But these same companies also come with a higher risk of default.

4. **Bond funds.** If you lack the time or expertise, it can make a lot of sense to allow an expert to choose your bonds for you via a bond fund. This type of fund invests almost exclusively in bonds and other types of debt instruments.

    * ***The specific type of debt that the fund targets will depend on its focus, which can be found in the prospectus.***

- Bond funds frequently invest in corporate, municipal, government, and convertible bonds. They can also invest in other debt instruments such as mortgage-backed securities.

- Different bond funds have different rates of return, depending on the quality of the investments they make. Some bond funds target higher risk investments and have the potential to pay much higher rates of return than those bonds that target safer investments. ***Not all bond funds provide the same level of risk.***

These four sources of income are generally quite reliable, depending on the stability of the underlying companies. Remember, however, that these sources of income are *not* guaranteed.

"Money isn't the most important thing in life,
but it's reasonably close to oxygen on the "gotta have it" scale."
- Zig Ziglar

Guaranteed Investment Strategies

Guaranteed investment strategies result in returns that are guaranteed by an insurance company or the government.

Guaranteed investment strategies include investments like these:

1. **Treasury bills:** Treasury bills are very short term (maturity is less than a year) and can be purchased in denominations of $1,000. The maximum is $5 million. The maturities are typically 4 weeks, 13 weeks, or 26 weeks.

    ✴ Treasury bills do not pay interest, but rather are bought at a discount. So you actually pay less than $1,000 for a $1,000 treasury bill.

    ✴ These are frequently referred to as 'T-Bills'.

2. **Fixed annuities:** A fixed annuity is a contract issued by an insurance company that makes fixed payments over the term of the contract. The contract typically ends when the person receiving the payments dies.

3. **Certificates of deposit (CDs):** a CD is a saving certificate usually issued by a commercial bank that pays interest to the purchaser.

    ✴ The maturity date is the date you get all your money back. Maturity dates are typically 1 month to 5 years.

    ✴ The interest rate is fixed and is usually compounded daily.

- Most investors purchase "small CDs," which are CDs of less than $100,000 in value. CDs with a value of more than $100,000 are referred to as "large CDs" or "jumbo CDs."
- Just like bank accounts, CDs are guaranteed by the federal government.

Guaranteed investment income makes the most sense if you're retired or very close to retirement and anticipate needing a definite source of income.

Which Strategy Is Right For You?

Deciding on any investing strategy typically comes down to the same few questions, regardless of whether the topic is adding to your income or increasing assets.

Ask yourself these questions:

1. **What is my time horizon?** How long are you looking into the future? ***A longer time frame allows for greater risk,*** since any losses can potentially be made up for over time. However, if the timeframe is very short, investments need to be more conservative.

2. **What is my acceptable level of risk?** While the time horizon is one of the primary factors determining the level of risk, it's not the only factor. For example, someone worth $25 million can afford to take on more risk than someone that only has $25,000.

    - If you simply don't have the stomach for riskier investments, you would be better served – and sleep better each night – by investing more conservatively.

    - ***What can you afford to lose?*** Your answer to this question encompasses both the issues of time horizon and risk tolerance.

3. **What is my level of expertise as an investor?** While most people are entirely capable of making a good decision when choosing a bond fund, not everyone has the necessary expertise to accurately assess the risk of junk bonds.

    - Just as there are certain tasks around your house that are better left to the experts, such as installing a gas furnace, there are some investments that are better left to the experts unless you are prepared to invest a lot of time in your own education.

    - Try to gauge your level of expertise without letting your ego get in the way.

So which strategy is the best one for you? Your wisest option depends on your time horizon, risk tolerance, and expertise. By considering these three questions, you should be able to determine which investment strategy best fits your needs.

> *"Money and success don't change people;*
> *they merely amplify what is already there."*
> ***-Will Smith***

Part 2 – Practical Tips for Investing in Income-Producing Instruments

Investing In Bonds

The basics of investing in bonds are really quite simple. Remember that you're lending money to the company or government that issues the bond. The bond is simply an agreement to repay the face value on the bond as well as any interest that is specified within a specific period of time.

Consider these aspects as well:

1. **Risk and bond ratings. *Bonds are rated for risk.*** AAA bonds are the safest, while bonds rated BB or below are considered to be risky. Bond ratings can also vary, depending on which organization provides the grades.

    * The lower the rating, the greater the risk of default. ***To accommodate this greater risk, bonds with lower risk ratings tend to pay higher rates of interest.***

    * Risk is based upon many factors, including growth potential, financial stability, current debt, and any other factors deemed relevant by the rating organization.

2. **Buying bonds.** Most bonds are sold over-the-counter (OTC), so ***they can be bought and sold easily and quickly.*** Most bonds are also sold in $5,000 increments.

    * Bond prices are typically quoted as a percentage of the face value. For example, a bond quote of 90 means that the bond is priced at 90%. So a $10,000 bond (at maturity) would have a price of $9,000.

3. **Interest.** Interest is typically paid every six months. Keep in mind that the interest rate quoted is based on the face value of the bond. Therefore, the lower the purchase price, the higher the effective interest rate.

- For example, if you bought a $10,000 bond for $10,000 with an interest rate of 5%, you would receive interest payments every six months of $500. But you would also receive interest payments of $500 if you paid $9,000 for that same $10,000 bond. Also remember that you would get $10,000 at the maturity date.

- ***Bonds with longer maturity dates tend to pay higher interest rates.*** This is to take into account the unpredictability of the future. Market conditions can change and a company's financial stability can also change over time. To account for these potential pitfalls, these bonds will usually have higher interest rates.

There are several factors to consider when investing in bonds. First, consider your time horizon, risk tolerance, and expertise. After these factors, consider a bond's risk rating, price, and interest rate.

Bonds are frequently seen as being a little more mysterious than stocks, but the differences are minimal in many ways.

With stocks, the investor is betting on the growth and profitability of the company. With bonds, the investor is betting on the ability and likelihood of the company to make its interest payments.

"Most people work just hard enough not to get fired and get paid just enough money not to quit."

-George Carlin

Investing In Bond Funds

Bond funds are similar to stock mutual funds. The only significant difference is the type of investments the fund manager utilizes.

However, bond funds and dividend funds are frequently less volatile than stock funds and can also provide you with a steady stream of income.

As with all mutual funds, there are different levels of risk and return. Ensure that the fund you choose is a good match for your risk tolerance.

Here are some things to look at when analyzing funds:

1. **Expenses.** The cost of something is always relevant. Since these mutual funds typically have lower rates of return than stock funds, the expenses are even more pertinent.

- ✳ There is no good reason to purchase a fund with over-average expenses. ***The average expense-ratio for US bond funds is a little less than 0.9%.***

- ✳ Keep in mind that fund expenses are related to costs, not the expected returns.

- ✳ When interest rates are lower, your income stream from your fund investment will be smaller. This makes the expense ratio have even more impact.

2. **The fund's credit risk.** Always remember that bonds are loans. Just as banks grade consumers on their credit risk, you can consider the credit worthiness of the mutual funds you mull over, based on which bonds they invest in.

   - ✳ ***There are risks besides default.*** Certainly when a company fails to make an interest or dividend payment, there is reason to be upset. But it is also possible that higher risk bonds and dividend-paying stocks can also lose intrinsic value. This would lower the value of your investment and reduce your income stream.

   - ✳ Even with the added risk, low-rated bonds have their place in the investment world because of the higher returns. ***You don't have to avoid high-risk funds, provided you understand the risk involved and it fits in with your investment strategy.***

3. **Interest Rate Risk.** This is simply the risk that interest rates will be higher or lower in the future than they were when a bond was purchased. If a bond is purchased when the interest rate is 3%, that bond has less value on the open market if interest rates rise.

   ✳ Check how long the mutual fund in question typically holds its bonds. ***The shorter the duration, the less its bonds are subject to interest rate risk.*** Long-term bonds are more sensitive to the potential rise in interest rates.

   ✳ Interest rate risk is frequently higher when interest rates are low. Since bond prices rise when interest rates rise, there is more potential for bonds lose value if they're purchased during times of very low interest rates.

The great thing about mutual funds is the time you save while being able to spread your risk across many investments. Instead of spending all your time researching individual investments, you have a professional managing your money for you, freeing you up to do other, more enjoyable activities.

"I never attempt to make money on the stock market.
I buy on the assumption that they could close the market
the next day and not reopen it for five years."
- Warren Buffett

General Investing Tips

Regardless of your investment strategy, there are a few important items that can really make a big difference in your investing experience and profits.

Keep these techniques in mind for your best results:

1. **Have a budget.** By knowing where all your money is going, you have the opportunity to cut your expenses and have more money for investment purposes. All else being equal, the more money you can invest, the more investment income you can generate.

2. **Invest automatically.** ***The more your investment activities can be put on autopilot, the more likely you are to invest money consistently.*** Consider 401(k)s, automatic account withdrawals, investing money first before paying your bills, and similar strategies.

3. **Avoid moving your money around too much.** Most people have a natural knack at moving their money at exactly the wrong times. Once you've found a good place for your money, try to leave it alone.

4. **Stay on top of your investments.** Even if you have professionals investing your money for you, it's important to be informed. It's your money. Ensure you know what's going on with it. ***Don't be afraid to ask questions.***

5. **Keep learning.** Even if you're not investing your money yourself, the more you know, the better off you'll be.

Keep these tips in mind, regardless of your investment plans. Cut your expenses and invest as much as you can, as consistently as you can.

Conclusion

There comes a time in most people's lives where income is more important than the value of one's assets. As with any other type of investing, it's important to be aware of your goals. Do you need to have an investment income of $1,000 a month, $5,000 a month, or more? ***There's no right answer, but you need to know the answer.***

By asking yourself about your time frame, risk tolerance, and level of expertise, the best investments for you become relatively obvious.

Be aware of your timeframe. Do you need this income in 3 years or right now? Avoid the temptation to be greedy and abide by your timeframe.

How much risk can you subject your investments to? How much can you afford to lose in the near future? ***Remember that most forms of investment have risk associated with them.*** Simply pick investment instruments that match your risk tolerance.

If you lack the expertise to invest in fixed income investments, don't hesitate to get professional assistance. There are many experts out there waiting to help. For many people, use of mutual funds makes a lot of sense. ***With mutual funds, you get an expert buying your stocks and bonds at relatively little expense.***

Always continue to learn more about money and investing. The more you know, the better decisions you'll make.

Use these tips and take action today to augment your income. You'll be glad you did!