

Investor Insight

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Income Investors: Where to Now?

Many income investors have been challenged by the current investing climate. Retirees were once able to rely on lower-risk investments like government bonds and guaranteed investment certificates as a means of generating retirement income.

Today's low interest rates have made these more traditional sources of income less viable. This is expected to continue, at least in the near term. As such, many investors have turned to dividend-paying stocks and funds to generate income. Although many quality dividend-paying stocks are still available at reasonable prices, other income-generating options may be considerations depending upon an investor's risk tolerance and specific requirements. Here are some alternatives.

Corporate Bonds — Generally more risky than government bonds, the price and risk of bonds issued by corporations are correlated to the company's credit rating. Investment-grade corporate bonds have the highest corporate bond ratings and offer fairly modest interest payments that are generally higher than the yields of government bonds. High-yield bonds offer better yields but at the cost of a lower credit rating and a higher default risk of the issuer. Bond mutual funds and exchange-traded funds (ETFs) may also be suitable options for investors looking for more diversified exposure.

Preferred Shares — Preferred shares are hybrid securities that have equity and fixed income characteristics. The term "preferred" comes from the ranking of this class of shares ahead of common shares, but behind bonds, in the event of issuer liquidation. Typically, holders of preferred shares don't have shareholder voting rights. Similar to bonds, preferreds pay distributions that are generally predetermined upon issue. Higher quality issuers normally offer lower yields. These distributions are considered dividends and offer the benefit of being eligible for the dividend tax credit for qualifying Canadian corporations.

Preferred shares work particularly well in low interest rate environments, but, like bonds, if interest rates rise, the value of the preferred may decline. Many types of preferreds exist, with varying terms such as maturity dates, call terms and dividend rates. Investors should pay particular attention to call terms when purchasing preferred shares.

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Real Estate Investment Trusts (REITs) — REITs offer a relatively liquid way of participating in the real estate market. These trusts invest in different types of real estate assets, such as shopping centres, office complexes or retirement homes. REITs pay distributions including a portion that may be considered a return of capital that isn't taxed in the year it is received, deferring the taxes on that portion of income until the capital asset is sold. These payments also reduce the investment's adjusted cost base. However, this may result in a higher capital gain when the investment is eventually sold or transferred. Lower interest rates have helped many REITs to finance their holdings and keep expenses low. More recently, however, the REIT sector has struggled due to slower economic growth, which may provide opportunities to purchase investments in this asset class at lower prices than have been available in recent years.

We Are Here to Help

If you are an investor seeking income-generating opportunities, we can assist in finding the right alternatives to meet your needs. As with any investing decision, we can help you to carefully evaluate the alternatives, while considering your own personal goals and objectives.