Don't Confuse "Income" with "Yield"

Doing So Could Increase Your Risk Or Lower Your Returns

financial fitness

By **Rocky Mills**, North Ranch Resident

You're not alone. Many people use "income" and "yield" interchangeably. But, they're not the same and understanding the distinction can help you address your risk and manage your returns.

First, for this discussion, let's define the two:

Yield - How much cash is generated by a stock and bond portfolio in a given year. The cash comes in the form a dividend or interest payment.

Income - The amount of money you want or need to withdraw from a stock and bond portfolio in given year. The cash can come from any source: dividends, interest, sales proceeds, capital gains distributions, etc.

Let's say you have a $1 million portfolio: 60% is in stocks that pay a 2% dividend; 40% is in bonds paying 3% interest.

Your total yield on this portfolio is $600,000 at 2% + $400,000 at 3% = $24,000, or 2.4%.

But you've determined that the income you desire is $30,000, or 3%. What are your choices?

1. If you believe that all income must come from yield, you'd have to sell all of the 2%-paying stock and buy more of the 3% bonds. This, of course, eliminates any upside potential you had in the stocks.
2. Again, if you believe that all income must come from yield, you could sell your 3% bonds and replace them with bonds yielding 4.5%. Now your total yield would be $600,000 at 2% + $400,000 at 4.5% = $30,000. But in going from bonds yielding 3% to bonds yielding 4.5%, you likely increased the risk in your bonds by either (a) reducing their quality or (b) going out longer in maturity.
3. But all income does NOT have to come from yield. To get from $24,000 to $30,000 per year, you could keep the portfolio pretty much as it is – you'd simply have to sell $6,000 worth of securities (or just 0.6% of the portfolio).

The amount of "desired income" still has to be reasonable. For further information, take a look at Bill Bengen's seminal research on "The 4% Rule" (Journal of Financial Planning, 1994).

This is a hypothetical example and is not representative of any specific situation. Your results will vary. The hypothetical rates of return used do not reflect the deduction of fees and charges inherent to investing.

Robert A. "Rocky" Mills is president of Westlake Investment Advisors in Westlake Village. 805-277-7300.**www.westlakeia.com**.

He is a registered representative with and securities offered through LPL Financial, Member FINRA/SIPC. Investment advice offered through Westlake Investment Advisors, a registered investment advisor and separate entity from LPL Financial.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual.

The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time. Stock investing involves risk including loss of principal.
Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.