Income Stability Stream

Portfolio

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The Income Stability Stream portfolio is designed to generate regular cash flows by investing in assets such as bonds, treasuries, real estate, and dividend-paying stocks, often using ETFs and mutual funds that focus on these types of assets. While this portfolio may not provide as much growth potential as a portfolio focused on capital appreciation, it can provide a steady stream of income, making it useful for retirees or investors seeking a reliable source of cash flow, with income generated by this type of portfolio fluctuating depending on the underlying assets performance and interest rate changes.

The main decision behind where to invest within the portfolio comes from analyzing 3 components. First we look at whether interest rates are rising, falling, or staying within a range. We include different parts of the bond market in order to stay well diversified and the weighting is determined by interest rates. Next we look at yield-to-duration scores. Third we look at including dividends and real estate.

Each part will be explained, the goal is to try and protect the value of your investment as much as possible, capital preservation, while still providing the highest income possible. Balancing the two can be tricky, but our main goal is to stick the right balance and that is how we arrived at the name Income Stability Stream.

Let's take a closer look to see how we do it.

Decision Drivers

Rates

Coordinating Risk & Return

Rates can have a large impact on bond prices and are a primary factor in our analysts determining where in the bond space we focus on to best balance the risk of losing principal with providing the highest income possible.

Yields | Duration

Navigating Opportunities

Duration is a measure that expresses a bond's price sensitivity to changes in interest rates. It helps investors understand how much the bond's price should change as interest rates move.

Dividends | REIT

Additional Sources

Provided the right environment, dividends from profitable companies and income from real estate investment trusts (REITS) can add value and diversification to income streams.

Navigating The Income Universe

As we mentioned above, we first look at interest rates when constructing our income stream. This is because a primary source of income comes from bonds and their relationship to interest rates is important. When interest rates rise, new bonds issued will pay a higher interest rate than existing bonds. As a result, the market value of existing bonds may decrease, because investors would prefer to buy new bonds with higher interest rates. Conversely, when interest rates fall, the market value of existing bonds may increase, as their fixed interest rates become more attractive compared to new bonds with lower interest rates.

We then attempt to determine if interest rates are rising, falling, or staying roughly the same. We can never be certain the direction and so we also want diversification of bond types because they carry other risks besides just interest rates. Credit risk, inflation risk, reinvestment risk, liquidity risk, call risk, or even political risk and currency risk. We balance all of these and weight different categories based on rates, and these other risks. The categories are core holding, extended core, and extended sectors.

No one category will hold more than 60% regardless of the rate environment.

Yields

Duration

What Is It

Yield to duration is a measure of the sensitivity of a bond's price to changes in interest rates. In simple terms, it tells us how much the price of a bond is likely to change if interest rates go up or down.

A bond's yield to duration is calculated by dividing its yield by its duration. The duration is a measure of the average time that it takes for the bond's cash flows to be received, taking into account the present value of each cash flow. The higher the duration, the more sensitive the bond's price is to changes in interest rates.

In general, longer-term bonds have a higher duration and are therefore more sensitive to changes in interest rates than shorter-term bonds. This means that if interest rates rise, the price of a long-term bond is likely to fall more than the price of a short-term bond.

How To Use It

If you are looking for stability and low risk, you might prefer a bond with a low yield to duration. This means that the bond's price is less sensitive to changes in interest rates, which can provide a more predictable and stable investment.

On the other hand, if you are looking for higher returns and are willing to take on more risk, you might prefer a bond with a high yield to duration. This type of bond is more sensitive to changes in interest rates, which can result in larger price swings. However, it also has the potential for higher returns if interest rates fall.

In general, investors in the middle of their investment time horizon might prefer a moderate yield to duration, balancing both stability and the potential for higher returns.

Rate Environment

Rising interest rate environment: In a rising interest rate environment, bond prices tend to fall, and longer-term bonds are more vulnerable to price declines than shorter-term bonds. To balance yield to duration in this scenario, you might consider investing in short-term bonds with lower durations and yields, or bonds with floating rates that adjust to changes in interest rates.

Falling interest rate environment: In a falling interest rate environment, bond prices tend to rise, and longer-term bonds benefit more from price appreciation than shorter-term bonds. To balance yield to duration in this scenario, you might consider investing in longer-term bonds with higher durations and yields.

Range-bound interest rate environment: In a range-bound interest rate environment, interest rates are stable and bond prices are less likely to experience significant swings. To balance yield to duration in this scenario, you might consider investing in bonds with moderate durations and yields, which can provide a combination of stability and potential for moderate returns.

Dividends and REITs

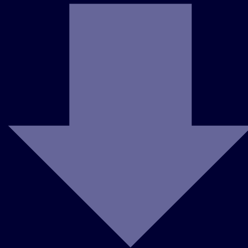
Income Diversification

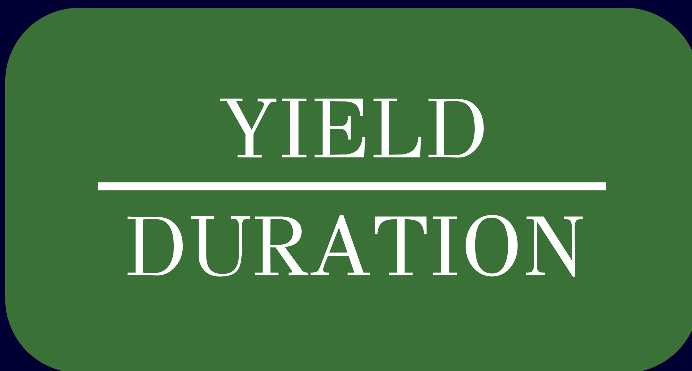
Dividends are payments made by a company to its shareholders out of its profits or reserves. Essentially, when a company makes a profit, it can choose to reinvest that profit back into the business, or it can distribute a portion of it to its shareholders in the form of dividends. They provide a regular stream of income that can supplement other sources of income. It's important to note that dividend payments are not guaranteed. The second risk is that the company's stock price may decline, which can offset any gains from dividend income. We include them if we are confident that the stock market environment and the companies can provide enough stability to be reliable.

REITs (Real Estate Investment Trusts) provide income in the form of dividends paid to shareholders. The income generated by a REIT typically comes from rental income earned on properties that the REIT owns and manages, as well as from capital gains on the sale of properties. REITs come with potential risks that investors should consider before investing, including market risk, interest rate risk, property risk, management risk, liquidity risk, and regulatory risk. Including a REIT for income may make sense for investors who are seeking a steady stream of passive income and who have a long-term investment horizon. A low-interest rate environment can make REITs attractive, as they often offer higher dividend yields than other types of stocks.

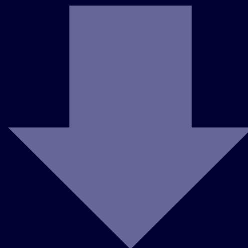
Building Blocks

Diversified Bonds Weighted Based On Interest Rates





Additional Bonds Based On Sensitivity To Interest Rate Changes



Additional Diversification With Dividends and REITS If In The Right Environment

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