"Achieving Successful Outcomes"

Compound Interest

CRAWFORD INVESTMENT COUNSEL Est. 1980

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SHINING LIGHT ON RETIREMENT INCOME

One of the significant, real-world issues with investing in retirement is consistency and reliability of income. Every plan looks great when an advisor is pitching to a 25-year-old that they will be a millionaire by saving monthly and waiting a long time. After all, compound growth is a powerful force that can make up for bear markets, and over time, stocks have proven to be wonderful investments.

More recently, the broader mainstream investing world has been finally taking a hard look at how to actually provide aging individuals with income in retirement. Not surprisingly, this is a very complex problem that brings in actuarial tables, lots of forecasts, and often has broad outcomes that are highly uncertain and, as a result, largely unsuccessful for individuals.

BlackRock is one of the largest investment management firms globally. The company recently introduced a new product intended to help retirees generate stable income. The program starts with target date funds, which are simply a mix of equity, bond, and other funds that are dynamically allocated and appropriately risked for individuals of a certain age. For example, a 25-year-old that will not retire until they are 65 would be predominantly invested in equities for long-term growth. On the other hand, a 65-year-old who is planning to retire in three years would be concentrated in bonds given the need for more certainty. At Crawford, we also believe investing for individual objectives is an important consideration in any investment program, and our portfolios recognize that investor priorities evolve over time.

The twist with the new offering is that around age 55, the program will begin to allocate into annuities to help produce income in retirement for individuals. An annuity is an insurance contract that requires a financial issuer to pay an individual an annual income stream. The thought is that annuities allow retirees to have more income and more certainty that they will not outlive their savings. For the purpose of this piece, we are not going to delve into the complexities of the annuity market, which has many different products.

In our opinion, annuities have several problems, but the largest is that they have not historically been great investments due to costs. The costs of selling, maintaining, complying with laws, and paying out income have typically rendered annuities as substandard investments, even when compared to bonds. The cost of removing uncertainty is so high, and the illiquid nature is so unattractive, that most sophisticated investors have avoided these investments altogether. Blackrock is solving this by bringing scale to significantly reduce the costs associated with running these vehicles. Hopefully, there will also be solutions for other traditional annuity problems, including complex tax situations, investment term miss-matches, and federal/state regulations.

So why are we writing about a competitor issuing a new product? Because it is bringing focus to one of the biggest problems for investors, which is generating long-term, sustainable income that can maintain purchasing power without reduction in principal.

At Crawford, we approach the income question for our clients in a different and, we believe, superior way. We create customized portfolios that deliver income, growth of income, and long-term principal appreciation through investments in high-quality, dividend-paying stocks. Our firm's founder likes to call this the "have your cake and eat it too" way of investing.

A good example of this is our Dividend Growth strategy, which offers investors an income premium compared to the broader equity markets and has consistently produced rising income since its inception in 1981. Not only is the level of income generated higher, but because the companies in the portfolio are picked for consistency in raising their dividends and potential for fundamental growth, the compounded growth rate of the income stream has been 7.77% over 20 years. This has produced a yield on cost of 10.05%. As the companies in the portfolio make fundamental progress and increase their dividends, growth of income compounds at a powerful rate. This growth of income allows our clients to better manage long-term plans, fund spending in retirement or when needed, and account for inflationary expenses.

Crawford Dividend Growth Strategy

	Average Yield	Growth of Income	Yield on Cost
3-Year	2.46%	9.41%	3.01%
5-Year	2.58%	7.18%	3.90%
10-Year	2.63%	7.10%	5.38%
15-Year	2.70%	8.23%	12.10%
20-Year	2.66%	7.77%	10.05%

Source: Crawford, FactSet (Data through 3/31/2024)

The biggest pushback that other investment managers would make is that annuities are guaranteed income, as opposed to dividends which are not as secure. That is, a company would pay its operating costs, interest expense, capital expenditures for growth, and debt reduction before paying dividends to investors. To this, our answer is quality. Finding the right mix of companies that have the ability to perform all of these tasks, show moderate growth, and produce excess cash flow to pay investors is the trick to successful investing.

By not chasing fads, by looking at the long term, and by lowering risk through our internal research process, we believe we can offer investors perpetual income through our dividend strategies. We believe we have an approach that provides better liquidity, more income, growth of income, and capital appreciation. We will continue to invest according to our long-held philosophy on behalf of our investors.