

PSYCH 101

"THE PSYCHOLOGY OF INVESTING FOR INCOME"

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Thank you for attending Psychology 101 today. Class, here's an important question. What is the difference between investing for income and investing for other objectives? The simple answer is that people who invest for income tend to want to own companies that pay dependable dividends, or to own bonds issued by companies or government entities that pay interest. But the reality is, not only does the payment of income to investors set investing for income apart from other investing styles, it is the absolute need for income by these investors, to fund the activities of their daily life, that truly differentiates them. "Investing for income" is where people get to when they have spent enough time "paying their investment portfolio" and now need "their investment portfolio to pay them!"

By definition, income investors desire a cash return rather than growth and a high dependable yield rather than an overall total return. Income investing is as different from growth or total return investing as baseball is different from tennis or golf. In all of these sports the idea is to get a ball somewhere and win the game. In investing, the idea is to allocate capital carefully in order to achieve a certain objective. In both cases, it is very important to know which game you are playing and then to effectively pursue a strategy that will allow you to win that game. Well, you get the idea. Income investors are just playing a different game, with different rules than other investors.

That's not to say that there's anything wrong with other investment styles, just as there's nothing wrong with playing different sports. At different points in life we may have approached investing differently, just as we might have played different sports from the ones we play now. Right now we may find we're at the point where we want to use our portfolio to produce a "retirement paycheck" to fund our income needs, to provide income while we pursue a new career, or replace salaried income while we engage in a wide variety of activities. As such, it may be the time when we're ready to become an income investor.

Achieving the goals of the various investment styles requires a certain discipline. So, what are the goals of each of these investment strategies? Let's run through growth and total return investing for a minute before focusing our attention on the subject of this class, which is the psychology of income investing.

Investing for growth can be defined as "An investment strategy to increase capital by buying stocks that an investor thinks will go up in price." Investing for growth can generally be simplified to the following:

- Buy low
- Sell high
- Buy and sell things you think will go up
- Make a lot of money to do something with later in life.

Investing for total return can be defined as "An investment strategy that seeks a return on investment that includes income from interest or dividends as well as appreciation or depreciation in the price of a security over a given period of time." Investing for total return can generally be simplified to the following:

- Buy Low
- Sell High
- Get a little income while you are doing it
- Accumulate money to do something with later in life.

By contrast then, **investing for income** can be defined as "An investment strategy which emphasizes current income in the form of dividends from stocks or interest payments from bonds, rather than emphasizing growth." Investing for income could then be simplified to the following:

- Buy investments that pay dependable income
- Use the income to fund our current lifestyle
- Receive income that increases over time
- Hold these investments as long as they pay increasing income.

As you can see, these are three very different investment styles and sets of goals. In the case of income investing, we're likely to hold our investments for a very long time. With growth and total return investing, we must pay careful attention to when we buy and sell so that we accumulate money to do something else with later in life.

As income investors, when the goal is to receive income for life, we will probably want the company providing the income to, not only be in business for the foreseeable future, but to conduct their business in a manner that gives us a relatively high degree of confidence in the dependability of the income being paid. We might tend to look for stable businesses, generating dependable earnings, from which they can pay regular dividends or interest payments over a prolonged period of time. Such performance is more likely to offer the stability and low degree of volatility that is important to us as investors who rely on our investment income to fund our current activities.

We also might tend to prefer receiving stock dividends over fixed interest payments. Dividends have the ability to grow and keep up with inflation in comparison to fixed interest payments, which tend to remain constant through the life of the investment. We would also, generally, prefer an income stream that consistently grows over time, because the longer we hold our investment, the more money we receive.

And most importantly, we also should understand that it will take a certain amount of discipline to stick with our investment choice. The investment landscape is filled with opinions, ideas and suggestions that can tempt us to go off our "game". It may sometimes be tempting to follow the idea or investment fad of the week, particularly if we've not only enjoyed steady dividends, but we've also seen our principal increase over the years. But since we're disciplined income



investors we understand that cashing in on that price appreciation not only ends the dividend income stream we rely on, but also invites the tax man to the table. This is an unwelcome event that takes money out of our pockets and so the fact that the stock price has gone up tends to be irrelevant to us because we own the stock for the increasing income it provides over a prolonged period of time. In other words, we know to stick to our game plan and stay with the program.

This is rather like the dairy farmer who owns a milk cow that he hopes will produce milk for many years to come. He's unlikely to be very concerned with what the price of beef is doing after he buys his cow, since he's in the business of producing milk from the cow he owns. The dairy farmer also knows he would just have to go out and buy another cow to produce the milk he needs if he sold his milk cow. As income investors we are all like the dairy farmer because we're in the business of keeping our cows and drinking the milk, rather than turning our cows into hamburger!

So does this mean that income investing is a better investment strategy than any other. Not necessarily. It's just different and whether or not we pursue an income strategy depends on our needs. Again, we need to consider where we are in life, the risks we want to take and what we want to achieve with the money we have to invest. It's also important to understand that investing for income is fundamentally different from investing for all other objectives.

The secret to passing this class and investing wisely (Time to take notes, Class) is to be able to identify which game you're playing, what the goals of that game are and to demonstrate how well you achieve these goals. Here at good old Monthly Dividend University (MDU) the answer is, of course, that we are all income investors, and monthly income investors to boot. Remember that and you're sure to get an A+ on your final.

(Disclosure: Monthly Dividend Girl is a visiting student who is also a shareholder of and head cheerleader for Realty Income.)