CAMMACK RETIREMENT

Finding Income in a Lower-for-Longer Interest Rate Environment

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With the continuation of the economic recovery and the concerns over the resurgence of COVID-19 causing another round of closings, there is increased uncertainty about the future. The Federal Reserve has changed its policy stance, indicating that there will be low interest rates for the next three years. The primary tool the Federal Reserve uses to conduct monetary policy is the federal funds rate. This, in turn, effects other rates along the yield curve, as well as general borrowing costs. In the most recent Federal Open Market Committee (FOMC) statement, the Fed indicated, "The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to two percent and is on track to moderately exceed two percent for some time." While the pledge to keep interest rates near zero for the next few years is reassuring to borrowers and the healing economy, it poses a significant issue for income-focused investors.

THE IMPACT ON RETIREMENT PLAN INVESTORS

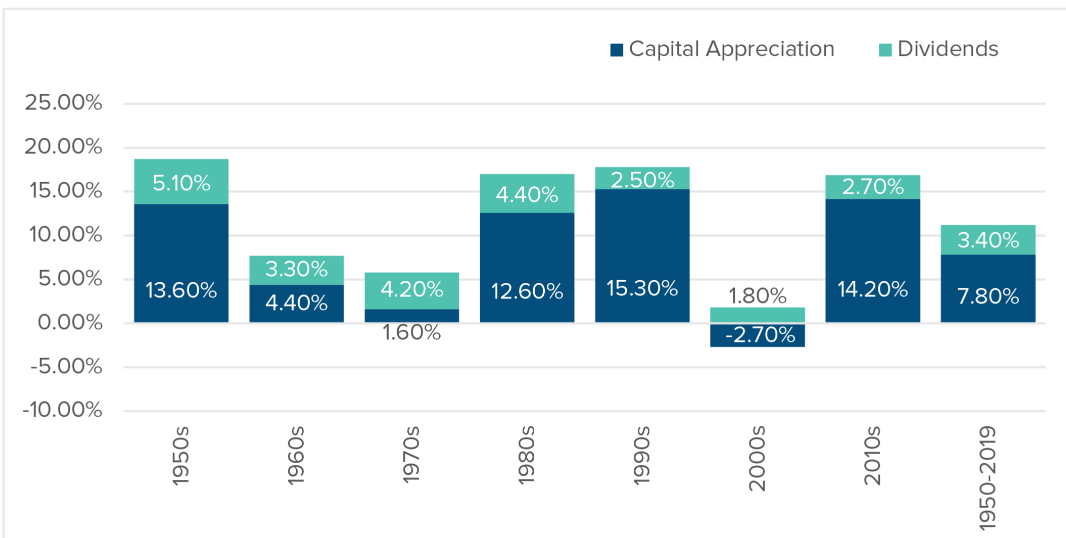
For retirement plan investors, the goal is to generate income (returns), while balancing portfolio risk. As investors near retirement, their portfolios are more likely to consist of conservative investments. However, "safer" assets, like government bonds, are likely to see a reduction in returns, as interest rates remain low for the foreseeable future. Capital preservation accounts, such as money market funds, are also likely to essentially earn 0% for quite some time. Thus, investors will need to find additional asset classes to generate needed income.

INCOME ALTERNATIVES

Particularly for older retirement plan participants, balancing risk and returns is especially important. An attractive alternative to low-yielding money market funds is a guaranteed investment contract (GIC) which, for retirement plan participants, can earn a fixed rate of interest over a specified time period. There is also the option for participants to invest in bank investment contracts (BICs), as they function similarly to GICs in the sense that they are a buy-and-hold investment. This usually means that the bank, for BICs, or insurance company, for GICs, holds the participant's money for the duration of the contract. They are both stable investments that are meant to provide guaranteed income in both 403(b) and 401(k) retirement plans.

Common stock dividends are another vehicle for income in a low interest rate environment. Most recently, low dividend-yielding companies have been outperforming higher dividend-yielding companies. Investors may be able to generate income through investments in good quality companies with strong balance sheets. As earnings at these companies increase, dividends may also have the potential to increase. However, it is important to note that amidst the current crisis, many companies have cut their dividends. This emphasizes the importance of identifying companies with strong balance sheets that are able to sustain or increase their dividend. Many funds have an investment process that looks for companies which have the potential for growth, but also have a history of regularly paying a dividend. In past market corrections, companies that traditionally pay dividends have tended to outpace the market. This was not the case in the current market volatility, as low-dividend yield and high-growth substantially outperformed. However, some value stocks and funds that emphasize valuation performed well on an absolute return basis. As of the end of the quarter, approximately 77% of S&P 500 stocks had a higher yield than the 10-year Treasury (Merrill Lynch).

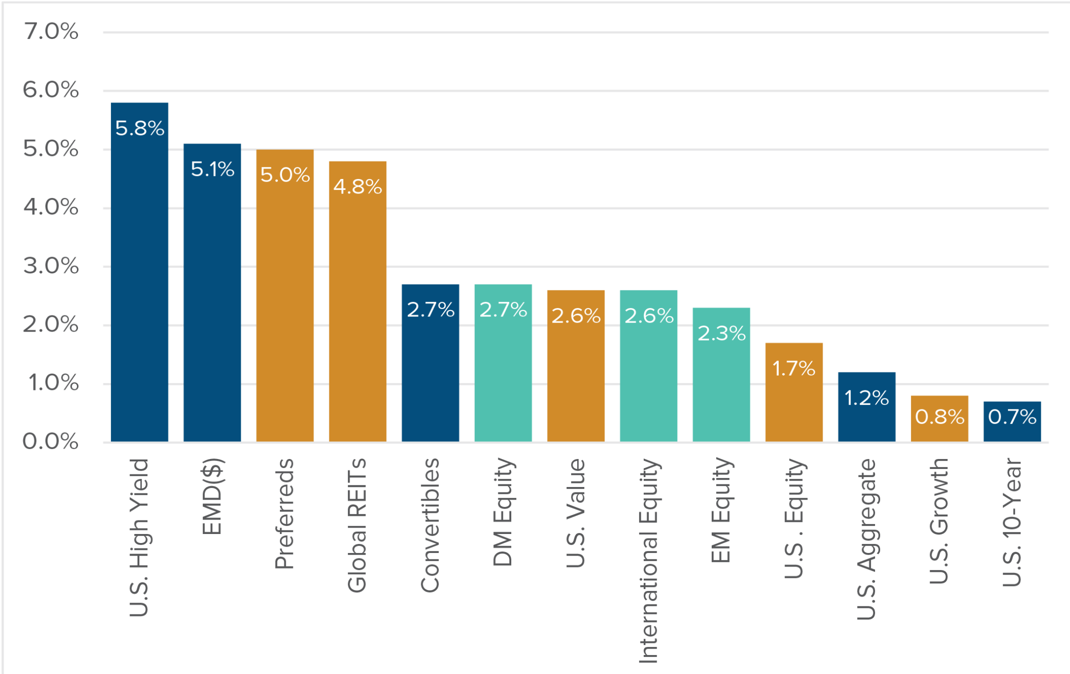
S&P 500 TOTAL RETURN: DIVIDENDS VS. CAPITAL APPRECIATION



Source: J.P. Morgan

Another option which retirement plan participants can look to is actively managed bond funds. These funds tend to purchase asset classes that are not part of the Barclays Intermediate Aggregate Benchmark. The addition of investment-grade corporate bonds, asset-backed securities, and high-yield bonds can increase income without materially adding risk. Many of these securities are now trading at attractive spreads to their comparable Treasury. While the bonds do have some credit risk and corporate defaults have risen, the default rate has been low for an extended period. A portfolio manager can analyze credit risk, diversify, and find value. Over the long term, returns on corporate bonds can provide a boost in income to participants willing to take a little more risk.

ASSET CLASS YIELDS



Source: J.P. Morgan

CONCLUSION

Ultimately, the Fed's commitment to low interest rates should not drastically affect participants earlier in their careers. For these individuals, a long-term focus and a well-diversified portfolio remain key to a more successful retirement outcome. However, in this environment, older participants should carefully review their portfolios to ensure they align with income goals and risk tolerance.

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For more information on our services, please contact **Mike Volo,** Senior Partner, at **781.997.1426** or **mvolo@cammackretirement.com**.

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