

Natural income as a practical pre-retirement solution

Fund manager David Jane reflects on some recent conversations with financial advisers about natural income. Natural income is an income gained by taking the dividend or interest payments an investment provides and leaving the capital amount untouched.

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As more people become attracted to using natural income solutions within their retirement portfolios, we are increasingly being asked how it works in practice. What is the real-world experience of using natural income pre-retirement? It is something my colleagues and I think about a lot. We have had many conversations about how this approach works in practice.

As investors move towards retirement, they may start thinking about moving from an investment strategy focused on growth to one focused on income. When transitioning from a growth strategy to an income strategy ahead of retirement, the focus naturally shifts from the overall value of a portfolio to the income it can generate.

How might retirement income work in practice?

So in the years leading up to retirement, the natural income that is generated from the different types of investments can be reinvested rather than paid out. During pre-retirement this income won't be required, so on a regular basis further income producing assets can be bought with the income generated by the portfolio rather than it being paid out. Hence, each year the individual can see an increase in their portfolio's value. This may be even greater if they are making contributions.

There are many people who are looking ahead to retirement that may not have the confidence that they are in a position to retire. Seeing their income grow over time can provide clearer reassurance and help them better understand their progress toward retirement.

Building an income strategy: a case study example

A simple hypothetical example can show the power of building an income strategy over time. Imagine a portfolio of £100,000, yielding 5% (meaning it generates £5,000 a year in income). The individual is pre-retirement and reinvesting the income.

In the first year, the portfolio generates £5,000 of income. By the fifth year, the income generated is £6,900 per annum, assuming no change in the value of the original investment pot. The longer the period of pre-retirement that the transition to an income strategy takes place, the greater the power of the income compounding (where reinvested income helps generate further income).

Income you know now, not future returns you guess

Naturally, the overall outcome an individual achieves will depend on how their investments perform over time, including both any growth in value and the income they generate.

No-one can predict the performance of a portfolio with any accuracy, but the real benefit of using natural income is that it is based on something clear and measurable today.

David Jane

Fund Manager, Premier Miton Cautious Monthly Income Fund

Glossary

Dividends

The portion of its profits or capital that a company chooses to return to its shareholders. For a fund or trust, this is the payment of fund's income to its shareholders.

Risks

Forecasts are not a reliable indicator of future returns.

In certain market conditions, companies may reduce or even suspend paying dividends until conditions improve. This will impact the level of income distributed by the fund.

The level of income paid may fluctuate and is not guaranteed.

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