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What's a retiree to do?

By ALEX PETROVIC

These are really tough times for investors who need income, as most retirees do.

The Federal Reserve has kept fixed short term interest rates at very low levels to help stimulate the economy. The Federal Reserve has recently indicated that these low rates may remain so through 2014. As a consequence, savings accounts, CDs and money market accounts, currently are providing very low returns. These types of investment vehicles are those that retirees have traditionally relied on for safe, reliable income. To make matters worse, the current returns are generally not sufficient to keep up with the current 2% rate of inflation.

It is so tempting, in this low rate environment to respond by "chasing yield", putting your money into investments that promise higher income. There are many investments available that offer income exceeding those available from CDs and money markets, what's also certain is that there is no free lunch in the investment world. So while you may choose to allocate some of your funds to higher yielding investments, it's wise to do so only within a strategy that recognizes the elements of risk and return. If you pursue higher income, you will be taking on additional risk, there is no way around that.

Investors who are in or nearing retirement may want to think of their income as falling into one of three sources: guaranteed income, stable income, and money that may become income at some time in the future but for now is a growth investment, such as stocks or property. Pensions, Social Security benefits, annuities, and even CDs where the payout is known and secure can be thought of as guaranteed income. Income from bonds and similar fixed income investments where the payout is known can be regarded as stable income, but not guaranteed and reliable income. Remember though that this group is not guaranteed and even highly rated bonds may be secure, but the principle value of bonds will fluctuate as interest rates change.

If you are leaning towards taking on more risk with your safe money, it would be a good time to really think about your tolerance for risk and how that stacks up against your discretionary spending. In other words: What's more important to you-feeling secure about your investments or reaching for additional income so you can take a vacation?

An additional consideration for your investment consideration is your time horizon. Generally speaking, the longer your ability to own an investment allows you to take on some more risk. The thought is a longer time horizon allows for the normal up and down movements of the bond market and other fixed income investments. Whatever your individual situation, both your tolerance for risk and your time horizon have to be considered carefully.

I have one word of caution regarding fixed annuities. The current low interest rate environment has also driven down the return on fixed annuities. Generally speaking, fixed annuities purchased now will have very low rates of interest and don't expect those rates to go up after your buy the annuity. I believe you will be better off to wait for those rates to go up before your make that purchase.

The cliché about something being too good to be true definitely applies to investments, so talk things over with your advisor before making any moves. And last but not least, remember that the current low interest rate world won't last forever. If you are feeling a little pinched now but can find a way to get through the next couple of years, you may find that interest rates have returned to more normal levels, making investment vehicles that don't look attractive right now far more interesting. Instead of chasing yield, patience might be the virtue to practice at this time.

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