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Is it time to invest in income funds?

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A *Moneyweb* reader asks: Is it now a good time to invest in income funds, with the rising interest rates? I have R1 million in living annuities, and withdraw four percent p.a. quarterly. I would like growth as close to inflation as possible. I am 77 years old, my wife is 72.

The answer:

The answer is more loaded than just a straight yes and no.

Firstly, one must understand what happens to income funds when interest rates increase.

Income funds consist of various underlying assets which act differently to interest rates.

Floating rate notes will benefit directly and mechanically from increasing (short-term) interest rates, as these instruments pay a spread over three-month Johannesburg interbank average rates.

Bonds have an inverse relationship with interest rates, meaning, if interest rates go up bond prices go down and vice versa.

Look at the inflation rate, which has breached the target band of three to six percent, reaching a 13-year high in June at 7.4%.

Your average income fund investment will yield around seven percent per annum before fees. Add to this calculation a drawdown rate of four percent and you are facing the reality of depreciating your capital year-on-year.

In order to achieve your goal, you will have to invest in a diversified investment.

Different asset classes have different outcomes. Your cash and bond investments are good short-term investments with low volatility but also smaller chances of real growth. Property and equities (local and global) are long-term growth assets with higher risks, volatility and rewards.

An investment must be evaluated and reviewed throughout the term. Adjustments will be needed from time to time.

Income funds definitely have a place within an investment portfolio, but are not a viable long-term investment plan.

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