A bird in the hand or two in the bush?

When it comes to investing, there are numerous strategies that you can follow in an attempt to build your wealth. Two of the most widely observed strategies are “growth” and “income” investing — and each centres on what their name suggests, with the former concentrating on investments that offer the best growth prospects while the latter focuses on those that offer the best income generating opportunities.

Growth investing is definitely the sexier of the two strategies given that it can generate comparably higher returns in short-order in a bull market environment. The companies whose stocks fall into this category are typically the flashier names that are expanding at a rapid pace and garner much ink in the financial press (think of the FAANG stocks — Facebook, Amazon, Apple, Netflix and Alphabet/Google — as an example).

But the offshoot to the potential for strong gains is that it comes with greater risk — while growth stocks typically outperform in periods of strong economic growth, they are also typically subject to significant downside risk when growth slows or contracts, or if sentiment swings negative. Moreover, market timing is an important aspect of growth investing — you need to get in while the getting is good, not simply chase prior gains, in order to reap the rewards.

In contrast, income investing is a more staid strategy that focuses on mature and stable companies paying high (and consistently increasing) dividends to their shareholders (examples include Utilities and Telecom companies). While the upside potential in these companies’ stock prices is comparatively lower than that of growth stocks, the regular cash flows paid out create an opportunity for reinvestment which can generate compound returns.

Compounding is important with respect to building wealth, allowing your portfolio to experience the “snowball effect” as initial investments build upon themselves — in fact, Nobel-winning physicist Albert Einstein once referred to compounding as the “eighth wonder of the world” and “the most powerful force in the universe”.

Accordingly, income should be a significant component of all investment portfolios, not just those investors looking for cash flows for spending in retirement. Many investors acknowledge the complementary nature of growth and income investing and will include parts of both in their portfolio. The security overlap is likely quite low, adding to diversification and potentially smoothing the return profile of your portfolio.

The success of the income investing is less dependent on when you invest — “timing” the market is not as important as “time in” the market. While growth investing may prove to be better in the short-run, over longer periods, income investing can be the more profitable strategy — income stocks may well rise by less in up-markets, but they also typically fall by less in down-markets as these companies are generally more defensive in nature and the high dividends serve to provide an added cushion to total returns.

In recent years, growth has been the more lucrative tilt, with numerous Health Care and Information Technology companies rewarding investors handsomely. But you should be mindful that all strategies go through intervals of good and bad performance. While it may be the case that income investing has not necessarily been the top performing strategy in recent years, investors with a long-run focus on wealth building will see the benefits of maintaining a disciplined and consistent income-focused investment approach over the entire business cycle — over time you can realize that the bird in your hand can prove to be worth more than the two in the bush.

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