



Retiring with Dividends

Important Information

Although a company may pay a dividend, prices of equity securities – including those that pay dividends – fluctuate. Investing on the basis of dividends alone may cause an investor to buy or sell certain securities when circumstances may or may not be favorable.

Because dollar cost averaging involves continuous periodic investment in securities regardless of fluctuating price levels of such securities, investors planning to pursue this strategy should consider their ability to continue purchases through periods of low price levels. Dollar cost averaging does not assure a profit, and does not protect against loss in declining markets.

All economic and performance information is historical and not indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this document, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Any investment strategy involves risk, including the possible loss of principal invested. Moreover, you should not assume that any discussion or information provided here serves as the receipt of, or as a substitute for, personalized investment advice from WBI Investments or from any other investment professional. To the extent that you have any questions regarding the applicability of any specific issue discussed to your individual situation, you are encouraged to con-

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Information pertaining to WBI's advisory operations, services, and fees is set forth in WBI's current disclosure statement, as same is on file with the United States Securities and Exchange Commission, a copy of which is available from WBI upon request.

The Dow Jones Industrial Average (DJIA or "The Dow") is a price weighted average of 30 of the largest blue chip issues traded on the New York Stock Exchange.

The S&P 500 Index includes a representative sample of large-cap U.S. companies in leading industries.

The NASDAQ Composite Index (NASDAQ) is a market-value weighted index of all common stocks listed on NASDAQ.

The Dow Jones Corporate Bond Index is an index of 96 bonds issued by leading U.S. companies designed to represent the market performance, on a total-return basis, of investment-grade bonds.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

You cannot invest directly in an index.

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Retiring With Dividends

Investors frequently ask what the secret is to building a retirement portfolio that can provide higher current income and inflation protection while sustaining capital. This paper is intended to help advisors provide not only better answers to their question, but also to understand the benefits dividend paying stocks offer as a retirement income investment solution.

Many investors approaching retirement face the unpleasant reality of never being able to retire on their own terms. Plus, a growing number of already retired investors find themselves without enough income to pay their bills and now need to return to work. As we examine the retirement income question, we will build upon an historical foundation by outlining what has and has not worked in the past.

- Today's retirement planner is faced with a myriad of perplexing planning conundrums.
- The lowest yields in 50 years on income producing investments.
- Extremely risk-averse investors who have experienced large capital losses twice in the last decade.
- An elevated probability of higher than average long-term inflation.
- Increasing odds of running out of capital as investors live longer.
- Investors who find themselves with severely diminished capital after years of saving to secure a comfortable retirement.
- Other traditional retirement income sources including pensions and social security that may not be sufficient when needed, increasing the burden on portfolios to produce more income.

We believe now is a good time for advisors and investors to reconsider conventional approaches. What should be considered now are new or less commonly used investment approaches that may help retired investors capture a more consistent return, while also seeking to protect the capital invested in volatile securities. One of the first things we learn as advisors is the importance of the present value of a dollar, or having the largest capital base possible working for you at all times. Investors who get to retirement with the largest capital base with which to produce income have a good shot at enjoying a decent quality of life. Yet the

passive "buy-and-hold" allocation approach with no active management component inherently disregards the capital destruction caused by negative market cycles. A significant loss of capital while investors are withdrawing income can cause compound liquidation to occur as investors sell a greater number of shares each month as prices decline just to meet income needs. The damage to capital can be difficult, if not impossible, to overcome.

Inflation is the Retired Investor's Greatest Enemy

Generating income in retirement to support lifestyle expenses is the primary objective for many investors. When we stop earning a living we may need our investment assets to provide income to supplement pension and social security payments. Inflation decreases investors' purchasing power as the cost of goods and services increase over time. If you live long enough, what once seemed like a princely sum can easily turn into a pauper's pittance as inflation causes prices to march relentlessly higher.¹ (**Chart 1.0**)

Chart 1.0

The Retirement Inflation Problem

Inflation Period	# of Years	Average Inflation Rate
1945-2010	65	3.93%
1960-2010	50	4.06%
1975-2010	35	4.12%
2000-2010	10	2.42%

WHAT YOU'RE LOOKING AT: A table showing the most widely followed gauge of inflation in the United States, the consumer price index (CPI). The yearly changes in inflation rate are much more dramatic than the average. With a resumption of higher inflation rates likely, it would seem prudent to plan on at least a 4% inflation rate in the future.

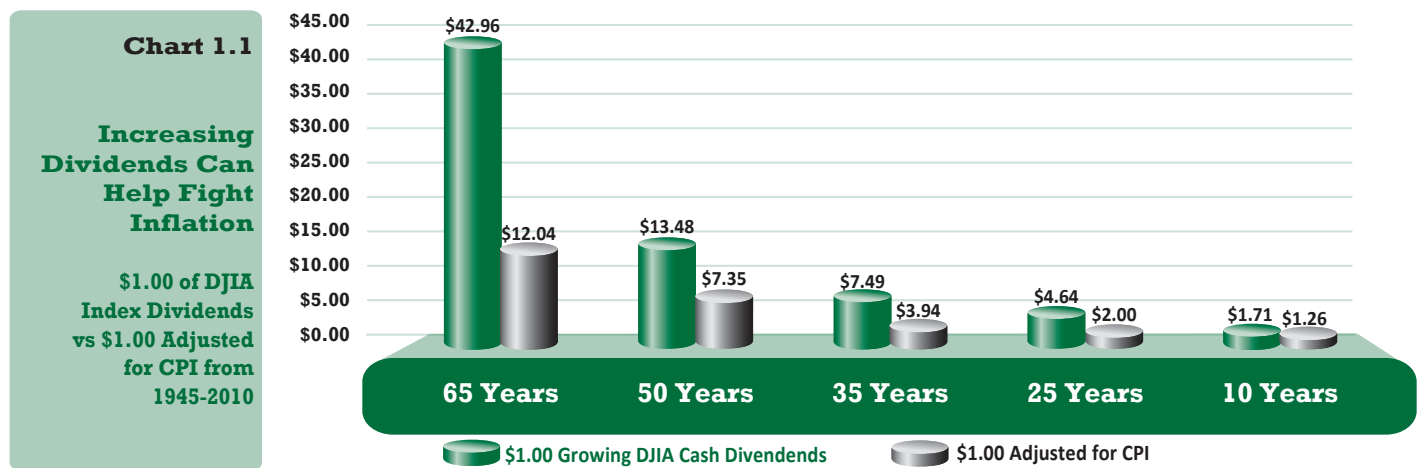
WHAT THIS TELLS YOU: The highest periods of inflation occurred during the early 1970s. Historically, each high inflationary period has seemed to follow a period of significant fiscal stimulus employed by the Government in an attempt to end a major financial crisis.

WHAT THIS MEANS: It takes years longer than most investors think for inflation to build after a financial crisis. However, inflation's history suggests it may be prudent to plan for a fairly steep increase in the cost of living in the near future.

The Inflation Hurdle After a 10-Year Bear Market

The serious capital losses that many investors have taken over the past decade make the challenge of helping these investors rebuild sufficient capital to generate the retirement income their individual needs dictate seem daunting. Overcoming the hurdle of inflation compounds the problem. It is our opinion that investing in equities to capture the higher returns offered through a combination of dividends and price appreciation is mandatory. Dividend paying stocks

offer retired investors two sources of inflation fighting protection. First, from price appreciation (which can increase capital balances) and second, and more importantly, from rising dividend income streams as companies periodically increase dividend payments to shareholders, making their stock more attractive. When waging a battle against inflation, investors need to make sure that they are using the right tools. Over the past 65 years, the 3.93% average inflation rate has been more than offset by the 6.29% average increase in cash dividends paid by Dow Jones Industrial Average Index companies.² **(Chart 1.1)**



WHAT YOU'RE LOOKING AT: A chart that shows a hypothetical investment of \$1.00 in the Dow Jones Industrial Average Index from 1945-2010 and the inflation fighting benefits of rising dividend payouts versus \$1.00 adjusted annually for increases in the Consumer Price Index (CPI).³

WHAT THIS TELLS YOU: The past 65 years encompasses two very long-term investment cycles, including long-term bull and bear market cycles. Over each period studied, increasing dividend income more than offset the rise in cost of living caused by increases in the CPI.

WHAT THIS MEANS: With today's longer life spans, investors have to make sure they build an asset base large enough to not only generate current income, but to also reinvest to keep pace with rising inflation costs. Our review of market return dynamics strongly suggests that dividend-paying stocks, not growth stocks, should be the building blocks of the portfolio construction process, especially for retired investors.

Hope for Investors Building for Retirement

For investors who have not yet retired, dividends can also be reinvested to promote compounding and dollar cost averaging, ideally increasing capital and the opportunity to reach investment goals in retirement.

Our study of the Dow Jones Industrial Average Index (DJIA) provides insight on the benefits that compounding with dividends can have over long periods of time. Excluding dividends, a hypothetical \$100,000 invested in the DJIA on January 1, 1945 would have

grown to \$760,078 by the end of 2010. Over the same time period, the same \$100,000 invested with dividends reinvested would have increased to \$9,341,181. This 65-year period represents a normal investment lifecycle for investors, assuming they typically start investing at about age 25, after they have had a job for a few years, and reinvest for 40 years until they reach retirement age. At this point they begin to take income to fund lifestyle expenses for approximately another twenty-five years in retirement.⁴

The Classic Dividend Story

The following is a hypothetical illustration. The numbers used in the following represent what would have happened based on historical, back-tested data.

As the owner of a grocery store in New York City who saved most of what he made during his life, Joe was one of the fortunate people who came through the Depression with some cash. In 1945, he gave \$10,000 to his son Robert. Though \$10,000 was a princely sum in those days—almost enough to buy a modest home—his only proviso regarding the gift was that Robert not spend the money, but instead invest it against a rainy day.

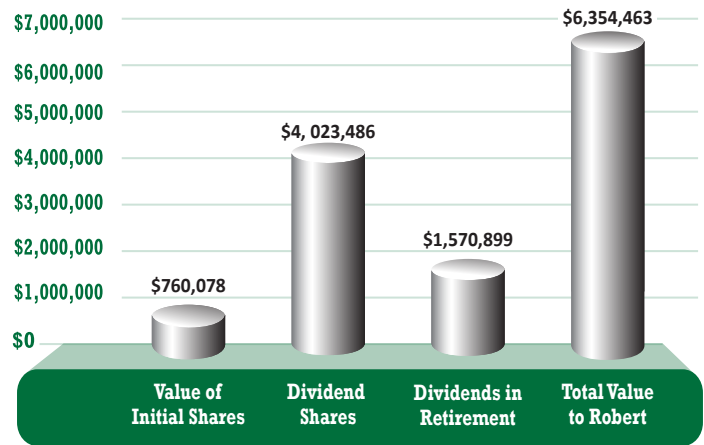
Like everyone else, Robert didn't know where to invest the money. His father suggested buying big-name companies in the Dow Jones Industrial Average (DJIA) Index, those stocks that had survived the economic collapse caused by The Great Depression. He also told Robert to let his dividends work for him by reinvesting them. Robert took his Dad's suggestion and bought the companies that made up the DJIA. He also allowed his dividends to reinvest until he retired in 1985 when he needed his dividend income to help support his lifestyle.

By 2010, Robert's initial \$10,000 investment increased in value to \$767,000, but the additional shares he bought by reinvesting his dividends grew in value to more than \$4 million. Since he retired in 1985, he has collected more than \$1.5 million in dividends. His initial \$10,000 investment generated more than \$6.3 million in total value.⁵ *Now that's inflation protection. (Chart 1.2)*

Chart 1.2

Robert's Dividend Investment Story

Hypothetical \$10,000 Investment in DJIA 1945-2010



WHAT YOU'RE LOOKING AT: A chart illustrating the power that systematic dividend re-investing can have over an investor's lifetime. In this hypothetical example, a relatively modest initial investment, aided by time, increasing dividend payouts, and compounding helped the fictional character of our story build a retirement nest egg that not only generated retirement income but also helped him keep pace with inflation in his retirement years.

WHAT THIS TELLS YOU: That reinvested dividends and the benefits of compounding and dollar cost averaging can have a dramatic effect on your investments. Systematic reinvestment can help risk-averse investors buy low, something they rarely do during high-risk periods.

WHAT THIS MEANS: The potential to turn \$10,000 in dividend-paying stocks into millions is not some get-rich-quick tale, but it is a valuable history lesson.

Two Important Investment Forces

By reinvesting his dividends, Robert relied on two investment forces—compounding and dollar cost averaging—to build his wealth. Compounding builds your shares as dividends are reinvested to buy more shares each quarter. As the number of shares increase, so does the dividend payment, which drives your share balance higher. Dollar cost averaging is the practice of

systematically investing money (reinvested dividends) usually monthly or quarterly, over a long period of time.

Systematic investing leads to lowering the average purchase price of shares as stock prices fluctuate. When share prices are lower, you purchase more shares.

If you find these results almost unbelievable, join the club. Many people are still unaware of the benefits that dividend investing provides.

High Risk Growth Stock Systematic Withdrawal Plans Should Be Abandoned

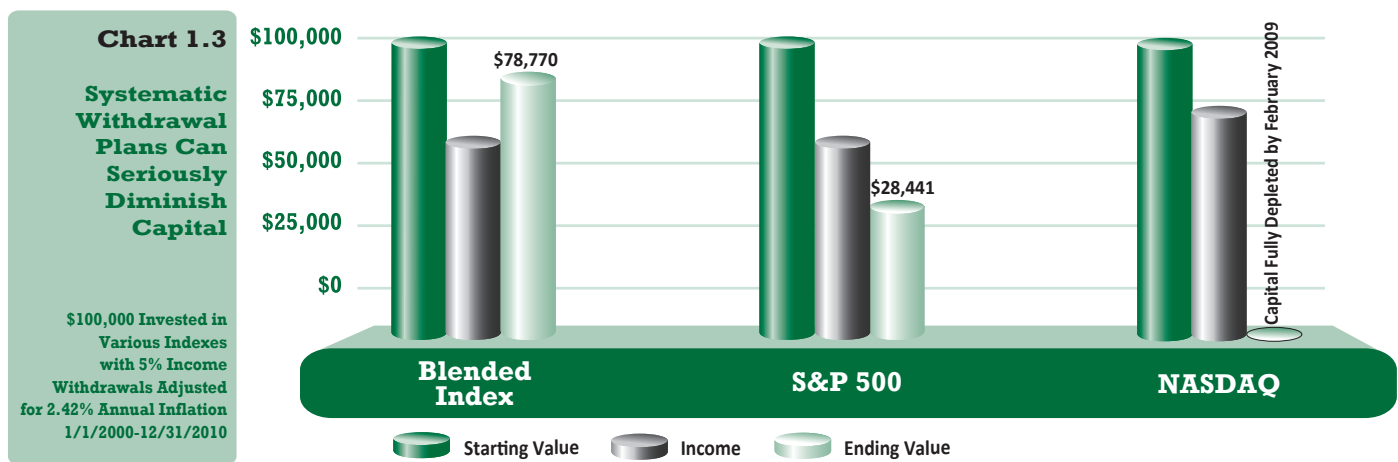
During the 10-year bear market cycle, we witnessed the carnage inflicted upon scores of investors who were blinded by the illusion of easy gains during the 1990s Bull Market’s spectacular run. They didn’t fully appreciate the risk factors involved in chasing the high returns offered by growth stocks. Many of these investors were retired people who needed income to support their lifestyles, yet they abandoned more conservative income generating portfolios to get more growth.

They invested in growth stocks or funds and adopted systematic withdrawal plans to support their income needs. We call this process “dollar lost averaging” because it turns compounded growth into compounding liquidation in negative market cycles. It is dollar cost averaging’s evil twin, requiring more and more shares to be sold at lower prices to fund income withdrawals.

During secular bear markets, systematic withdrawal plans can cause investors to completely liquidate all of their capital to fund income before the next bull market begins. An investor who invested \$100,000 in the growth stock focused NASDAQ at the start of 2000 (the beginning of the current secular bear market trend) would have completely liquidated their account by

January of 2009 by taking a 5% systematic withdrawal adjusted for the average annual inflation rate of 2.42% for the period. Long-term bear market periods don’t favor price appreciation and create the “dollar lost averaging” effect that leads to compounding liquidation of investment capital. The S&P 500 Index fared only slightly better, ending 2010 at \$28,441 for a 72% loss in value.⁶

Ideally, retirement income solutions should be designed using a balanced blend of bonds and high-yielding dividend paying stocks to generate interest and dividend income to support withdrawals. A balanced blend of 50% Dow Jones Corporate Bond Index and 50% S&P 500 stocks held up materially better at \$78,770. While the balanced blend held up better than the other two examples, it still experienced a substantial decline in value. A 21% loss of capital can be difficult to overcome, even as markets recover in the next bull market cycle. As investors need to take more income to keep pace with rising lifestyle expenses, they can continue to liquidate capital faster than a bull market’s returns can build it back. As noted above, a systematic withdrawal approach using the growth stock focused NASDAQ Composite Index would have run out of capital in the first quarter of 2009, before the markets started to recover. When you run out of capital the game is over.⁷ **(Chart 1.3)**



What Should Advisors Do Now?

Portfolios should be managed to generate enough income to support lifestyle withdrawals without depending on rising prices. Managers need to develop a loss control system to attempt to control loss of capital in bear market cycles and prevent the “dollar lost averaging” effect. A lower risk, balanced approach can give investors a chance to allow their account values to recover in the cyclical bull market rallies that eventually follow bear market declines.

For retired investors needing income, conventional wisdom suggested that advisors could use a systematic withdrawal plan from growth funds. It was assumed that this approach would provide them with a higher level of current income and more growth of capital over time. However, this approach also failed.

In order to acquire price appreciation, your clients need a process that would have mitigated market volatility in order to help them stay invested. It’s a very human problem. Human survival instincts are genetically hardwired to spur investors to get out when the market drops, which is the central issue as to why investors can lose when using the “buy-and-hold” approach to investing. Instead of hanging on during tough market conditions, their fear can lead them to sell out their positions.

What some advisors have been missing is a focus on dividend paying stocks combined with a responsive methodology designed to conserve capital as the risk of capital loss increases in down market cycles.

We think now is the time for advisors and investors to reconsider conventional “buy-and-hold” growth stock approaches. Dividend-based portfolios have the potential to generate returns from price appreciation as well as from dividends. Dividends may provide a source of return independent of price appreciation, which can bolster portfolio performance even during bear market cycles. Dividend payouts may also increase income over time, helping to offset the rising cost of living caused by inflation.

The persistent cash flow from dividends may help wary investors stay invested through good and bad market cycles. Historically speaking, reinvested dividends have automatically provided the benefits of compounding and dollar cost averaging. This type of plan forces investors to buy low, something they rarely do on their own.

We think investors need to embrace a more active and responsive risk-managed approach that seeks to protect capital by controlling losses during negative market cycles. A strategy that can deliver downside protection in bear markets has the potential to build capital more consistently, while helping risk-averse retired investors stay invested. A larger invested capital base also enhances growth and income, providing a more efficient and consistent means of expanding investment wealth.

We suggest new retirement investment management approaches incorporate a three-step process to help investors buy low and sell high by process.

- First, they should focus on value, which we define as buying stocks when they are cheap. Our experience indicates that normal price movements will take a stock’s price from undervalued to overvalued and back to undervalued on average within 18 months. Instead of “buy-and-hold,” we think it’s smart to attempt to buy low when the stock is cheap and then sell high after the stock has appreciated, but before it falls again in value.
- Second, investors need to collect a significant cash flow return from dividends that is not dependent on price appreciation. If higher income withdrawals are needed than can be supported by dividends alone, then a portion of the portfolio should be allocated to bonds to drive higher interest income.
- And third, investors should attempt to manage the risk to invested capital with a dynamic trailing stop-loss process to systematically harvest gains on bonds and stocks when available (sell high), while also attempting to limit losses during negative market cycles. Adjusting duration to attempt to reduce rising interest rate and inflation risk can further mitigate bond risks. In designing the management process, care should be taken so that the stops and goals used result in an unemotional response to changes in risk at the individual security level and to changes in risk in the overall market.

Historical evidence supports the idea that investment capital is the engine of income and

growth. Based on this evidence, we propose that new investment approaches attempt to capture returns during “up-market cycles” while limiting losses during “down-market cycles.” We believe a responsive risk-managed strategy can deliver downside protection in bear markets, while having the potential to provide solid outperformance compared to conventional buy and hold strategies over long periods of time.

End Notes

- 1 Data for CPI Provided by U.S. Department Of Labor Bureau of Labor Statistics
- 2 Dow Jones Industrial Average data source www.globalfinancialdata.com
- 3 Dow Jones Industrial Average data source www.globalfinancialdata.com,
Data for CPI Provided by U.S. Department Of Labor Bureau of Labor Statistics
- 4 Dow Jones Industrial Average data source www.globalfinancialdata.com
- 5 Dow Jones Industrial Average data source www.globalfinancialdata.com
- 6 Dow Jones Industrial Average data source www.globalfinancialdata.com
- 7 Index Data from 2000-2010 is Provided by Thomson Reuters Baseline

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Don is CEO and founder of WBI Investments, Inc., a money management firm offering unique risk-managed portfolios focusing on value and dividends. Don is a member of WBI's Investment Committee. He is co-author of "All About Dividend Investing" released by McGraw Hill in December of 2005. The updated 2nd edition was released in August 2010.

Don is also the author of "Building a World-Class Financial Services Business: How to Transform Your Sales Practice into a Business Worth Millions", which was released by Dearborn Trade Publishing in July of 2001. A popular speaker, Don is often called upon by the press to provide perspective on dividend investing and the investment markets. Don's media credits include major newspapers and magazines, as well as regular appearances on Bloomberg, CNBC, and Fox News. Don attended Susquehanna University (Class of 1977) where he completed a Bachelor of Science Degree in Business with a major in Finance. He is a CERTIFIED FINANCIAL PLANNER™ practitioner since 1984 and is a member of the Financial Planning Association (FPA).

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