Income: A Scarce Resource

The challenge of finding attractive income sources in a low-yield world has increased to a degree perhaps unfathomable a decade ago.

Income-oriented investors seeking to adapt to this new world should understand that (i) historically, low-rate environments have tended to be remarkably persistent;¹ (ii) many income-oriented portfolios today bear substantial depletion risk;² and (iii) alternative sources found in private markets may be part of the answer for yield-starved investors.

FIGURE 1: Milestones on the Path to Zero / Near-Zero Interest Rates

I. The Stubborn Persistence of Near-Zero Interest Rates

A series of factors have combined to drive interest rates near zero in the United States, mirroring to some degree patterns seen earlier in Japan and the euro-zone. In the U.S., the Federal Reserve expects to hold rates near zero until the end of 2022.³ To the extent that historical precedents are useful, they suggest that low-rate environments tend to be stubbornly persistent. In the U.S. context, factors including sluggish economic growth and challenging demographics may add an additional headwind to rates. Demographics may be particularly bleak in terms of their yield implications. The last of the massive Baby Boomer cohort is not expected to turn 65 until 2030. We believe this could suggest that this generation’s propensity to bid up the prices of income-generating assets and suppress these assets’ yields is unlikely to abate.⁴

¹ Source: Based on publicly available policy benchmark and interest rate data in Europe and Japan, 1995-2020.

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II. Significant Portfolio Depletion Risk

Accordingly, in our view many income-oriented portfolios today may face substantial depletion risk. That is, we believe portfolios may be at risk of being exhausted or permanently impaired while their owners are still living and/or still face financial obligations that they intend to meet with portfolio income.

The sheer math when comparing the yield of a traditional 60/40 portfolio today—which is 1.4% as of 12/31/2020—versus a representative portfolio distribution of, say, 4% a decade ago is daunting. Yields on the 10-Year Treasury, AAA-rated corporate bonds and municipal bonds (Figure 3) stand anywhere from a fraction to less than half their levels a decade ago, when the first of the Boomer cohort began to retire. Investors who require a 4% distribution face the possibility of withdrawing money at perhaps twice the rate that portfolio yields can supply it, forcing those investors to rely on market appreciation and/or drawing down capital to meet their anticipated living needs.

This may be particularly risky at a time of heightened market volatility. Sharp drops in asset value in our opinion only serve to heighten depletion risk, since the withdrawal of a fixed percentage after a market decline all else holding equal represents a larger relative percentage of the total portfolio.

![FIGURE 2: Annualized 60/40 Portfolio Yield from 2008 to 2020](image)

Source: Bloomberg, Morningstar, as of December 31, 2020. Hypothetical portfolio allocated 60% to the S&P 500 Index, 40% to the Bloomberg Barclays U.S. Aggregate Bond Index. The yield on the traditional 60/40 portfolio was calculated using the S&P 500 Index dividend yield and the annualized Bloomberg Barclays U.S. Aggregate Index yield. Portfolio yields are shown from December 2008 to December 2020.

![FIGURE 3: Yields When the First Boomer Retired (2010) vs. Yields Today](image)

Source: Bloomberg, Morningstar, as of January 2021.

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III. Potential Solution: Introducing Alternative Sources of Income

Income-oriented investors today may want to revisit private market alternatives as a potential solution for their yield challenges. In particular, portfolios with private credit and private real estate allocations compared to a traditional portfolio (Figure 4) may offer greater yield potential and a higher likelihood of closing the above-discussed income gap.

In the hypothetical portfolios presented on this page, investors in the dominant asset classes today face yields which may be below their targets—in some cases, half the traditional yield target of 4%.

Allocating just a portion of the same portfolio to asset classes such as private real estate and private credit may bring significant potential yield enhancement. In the hypothetical illustration here, the portfolio yield rises to 3.5% from 1.4%.

We see private real estate as a compelling portfolio holding, one with attractive total return potential, a considerable portion of which may be delivered in the form of income. Private credit in our view is primarily a source of high income potential, and also warrants consideration as a long-term portfolio holding.

As a trade-off of investing in private market alternatives, capital is often locked up for specified periods. This means investors must plan around the lack of liquidity of the investment. In practice, this often means investors must source liquidity from other parts of their portfolios. For some investors, a semi-liquid investment structure may represent a middle ground between liquid and illiquid investments.

FIGURE 4

Traditional 60/40 Portfolio

1.4% Annualized Yield
8.0% Annualized Return
9.9% Annualized Volatility

Portfolio with Private Market Alternatives Allocation

3.5% Annualized Yield
7.8% Annualized Return
5.8% Annualized Volatility

This information is not meant to be predictive of the performance of any particular fund, nor is it meant to suggest that all private funds result in positive returns or may avoid loss of principal. Private equity investments involve significant risk and typically high levels of leverage. Hypothetical performance results have many inherent limitations and no representation is made that any investor will, or is likely to achieve, results similar to those shown. Opinions expressed reflect the current opinions of Blackstone as of the date hereof and are based on Blackstone’s opinions of the current market environment, which are subject to change. Information herein may discuss general market activity, industry or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice. There can be no assurances that any Blackstone fund or investment will achieve its objectives or avoid substantial losses, or that alternative investments will generate higher yields than other investments. Annualized yields as of December 31, 2020. Annualized returns and volatility are based on the quarterly returns over the 15-year period from January 2006 to December 2020.


The yield on the traditional 60/40 portfolio was calculated using the S&P 500 Dividend Yield and the annualized Bloomberg Barclays U.S. Aggregate Bond yield. The yield on the portfolio with a private market alternatives allocation was calculated using the S&P 500 dividend yield, the annualized Bloomberg Barclays U.S. Aggregate yield, the annualized quarterly income for the Cliffwater Direct Lending Index and the annualized quarterly income for the NCREIF ODCE Index. There can be no assurance that any Blackstone fund or investment will achieve its objectives or avoid substantial losses, or that alternative investments will generate higher yields than other investments. Annualized yields as of December 31, 2020. Annualized returns and volatility are based on the quarterly returns over the 15-year period from January 2006 to December 2020.

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