

# Annuities Can't GUARANTEE Peace of Mind

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In times of economic uncertainty, investors are hungry for any way to insulate themselves against the ups and downs of the market. It is that hunger and fear of uncertainty that many annuity sales pitches play on with promises of market gains without the risk – an impossible promise to keep, as any experienced investor well knows.

An annuity is an insurance product available to investors in several different designs and sold by stockbrokers, financial planners and insurance agents. The most common annuities are:

## *Fixed Annuity*

Pays a guaranteed interest rate similar to a certificate of deposit.

## *Variable Annuity*

Lets you invest in mutual-fund-like portfolios.

## *Equity-indexed Annuity*

A hybrid that pays a minimum rate of interest, which allows the benefit of upturns in the stock market, if held to maturity.

All of these annuity options add to an investor's confusion and make it easier for representatives to utilize sales tactics that can be often misunderstood by less than savvy consumers. The basic annuity

sales pitch portrays the products as a guaranteed remedy for every financial ill, from fear of market volatility to concern about the size of a nest egg. In reality, the guarantee comes with the cost of high upfront fees and hefty penalties for early withdrawals. Some annuities also cap earnings and although they are touted as being tax-friendly, are often not tax-efficient.

Complicating investor understanding even further is the fact that the fees and restrictions are often times not readily explained. In the case of equity-indexed annuities (EIAs), returns are based on benchmarks, such as the Standard & Poor's 500, but that doesn't guarantee that full market returns will be realized. Most EIAs cap annual gains and limit how much of the index's return an investor can collect.

In some cases, annuity providers base the return on complicated systems that involve averaging the monthly closing price of the S&P 500. While this protects investors against falling stock prices, it makes it increasingly difficult to determine – and fully understand – the returns.

A recent *Wall Street Journal* article offered the following sample of an equity-indexed annuity scenario. Over a ten-year period ending in 2006 (a time with some big gains in the stock market), the annuity would have returned an investor a cumulative 55%. That sounds good, but in contrast, the same investment in the Vanguard 500 Index Fund during that same time period would have yielded the investor 123%.

Another trap for investors is to be lured by the false security touted by annuities when rolled over from a 401(k) into an IRA. According to the research firm, Cerulli Associates, an estimated \$1.7 trillion is expected to flow into IRA rollovers between 2005 and 2010. Since IRAs are already sheltered from tax, the tax benefits of an annuity are worthless, so salespeople instead pitch extras like the guaranteed minimum income benefit. The promise of guaranteed retirement income is only a reality if the annuity is held for a long enough time period (a minimum of ten years).

It should be noted that annuities are *long-term products* that are not meant for investors who may need access to their money in the short term. One of the biggest complaints of consumers is that they were sold annuity products without full disclosure of the opportunities to access their investment. While annuities do have the potential for

growth over time, the inability to use the money in case of an emergency without excessive penalties makes the growth irrelevant for many who invested.

Annuities can't be considered completely doom and gloom – there are appropriate annuities for the right investor at the right time. However, individuals thinking about diversifying their portfolios with annuities, rolling over an IRA into an annuity product, or simply putting savings into one should exercise extreme caution. Fully understanding the fees and mechanism for calculation is extremely important as is choosing a highly-rated and reputable company in which to invest.



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