FIAs: Providing Certainty in an Uncertain Financial World

By Casey Weade

Today's retirees face a war on seniors with lower interest rates than any living generation can recall. Retirees are living longer than ever, with some potentially spending more years in retirement than they spent in their working career. Stock market volatility is reaching all-time highs, and the risk of losing big in those first few years of retirement has never been higher. And finally, the era of the gold watch and lifetime pension is coming to an end.

When thinking about how to help my clients in this changing environment, I begin by focusing attention on the fixed income market. The bond market is in shaky territory today with high quality bonds yielding barely 3 percent and often requiring terms well beyond a decade. Making the situation worse is that many municipalities are up to their ears in debt. The past decade has seen some of the biggest bond defaults in history over the last decade and they have created anxiety among advisors and investors alike.

Enter the fixed index annuity (FIA) with shorter terms and typically more potential than what you would find in the bond market, not to mention a higher degree of safety. FIAs are becoming the alternative that you need for your retirement portfolios. How would you feel about a 60/40 portfolio without the interest rate and default rate risk present with the typical bond/equity mix? This is yet another reason the FIA may be appropriate for you today.

Guaranteed lifetime income is the reason the FIA was first invented in the first place. Pensions gained popularity in the 1920s and '30s as a way to create a guaranteed lifetime income for retirees. Many uneducated investors may say they ***"hate annuities",*** but those same people never say they hate their pensions. They love their pensions. The pension has given them the ability to spend their life savings without the worry of the stock market ripping their beloved retirement right out of their hard-working callused hands. Well, that's what an annuity with a guaranteed lifetime withdrawal benefit can do for you.

My cross-country coach always told me that the closest distance between two points is a straight line, so take the inside line. The same thing should be true for your income planning. Find the most efficient vehicle to accomplish that specific goal. Annuities generate more guaranteed income than any other investment tool, so use them for the purpose for which they were originally designed - **income**.

With that, please keep in mind that annuities aren't the solution to all of your needs. Annuities are only one piece of the puzzle giving them an outlet for conservative growth and guaranteed lifetime income. Equities, exchange-traded funds, options, bonds, alternative investments and insurance still have their place.

You may think that you can achieve your financial goals more efficiently through the use of securities, such as individual bonds, but I think you will most often find that many sacrifice potential growth for the peace of mind of a fixed annuity. There is a reason that a fixed annuity doesn't fall under securities regulations and it's because that a fixed annuity gives you a guarantee of principal that securities cannot provide.

One of the most important tools you have is the internal rate of return calculation. Internal rate of return is a simple calculation helping to determine the effective rate of return you are receiving from a series of cash flows, which is exactly what you are buying with that fancy income rider. You may be surprised to find that the guaranteed 7 percent you are getting with that income rider is equivalent to less than a 2 percent rate of return at your life expectancy. Other riders with lower roll-ups may be giving you an effective rate of return exceeding 4 percent at their life expectancy, but you will never know without running the numbers for yourself. Remember that it's not about how big the roll-up is, but how big the withdrawal rate is on the back end.

You should also not discount the idea of using more than one company to satisfy your lifetime income. We know that the guarantees provided to you are backed by the claims paying ability of the issuing insurance company, so diversifying your income streams makes sense.

On another note, you may get more income by generating income streams from different companies over different time periods. While one company might offer the best guaranteed income over the first 10 years of retirement, another may deliver the best guaranteed income with a 10-year deferral.

Finally, don't forget the low interest rate environment that we are in today won't last a lifetime. Watch your fees, spreads and caps. This will give you the ability to move the funds down the road if interest rates rise. It may be prudent to avoid income riders altogether and seek a simple protected growth strategy.

It's my responsibility to ensure you live a confident retirement. It is not my job to make you rich, it is my job to ensure you will absolutely never be poor. Annuities can give you that ability.