Those "Horrible" Wonderful Fixed Index Annuities

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Competition By Denigration Continues

Imagine that you and your spouse are currently in the market for a new car. You have two large dogs and your three grandchildren several days each month, so you're logically thinking that a minivan or SUV would be appropriate and safe. Yet when you walk into your local car dealership to explain your needs, the salesman replies, "Oh no, those minivans and SUVs are *reeeeally* over-rated; what you want is simply a good pick-up truck—step right this way…"

You turn to your spouse incredulously, wondering aloud what part of your "needs analysis" this salesman missed. You patiently explain that you want neither your dogs nor your grandchildren riding openly in the back of a pick-up truck, exposed to the elements, unrestrained during cornering or braking, and you repeat your request to be shown a variety of minivans and SUVs. Incredibly, your salesman disputes your rationale, citing studies done by *Pick-up Truck* and *Four-Wheeling* magazine proving the popularity of trucking in the U.S., along with several articles slamming minivans and SUVs as vehicles sold to the clueless and easily-duped, and he concludes with this whopper: "Minivans and most SUVs are *bad* for you; in fact, *I don't know of a single person for whom such vehicles are appropriate*…" You leave the dealership stunned at such a biased lack of professionalism, and drive home questioning your own judgment. "…Maybe we'll just drive our old car for another year or two."

Sound implausible? The scenario I just described has been repeated annually in the offices of major brokerage firms around the country for decades, but especially during the last 14 years. Clients nearing retirement and looking for safety from market risk, have approached their brokerage firms saying, "I attended an educational seminar last week, and the (CFP/advisor/RIA) mentioned that Fixed Index Annuities credit market-linked interest when stocks advance, but can't lose those gains in a subsequent downturn. Given the huge losses we've suffered in the last 14 years, *why haven't you ever told us about such vehicles*?" Out comes the biased market studies and derogatory articles from investment magazines (90% of whose advertisers sell mutual funds and risk-based products), slamming most annuities as products sold to the easily-duped, preyed upon by the caricature of the unscrupulous insurance agent. "Haven't you heard?" asks your broker. "Most annuities are *bad* for you, sold by profit-hungry insurance companies; *in fact, I can't think of a single client for whom such vehicles are appropriate*…" Many a pre-retiree has left such encounters questioning their own common sense, wondering why their desire for safer yields was so horribly wrong.

Our firm has done decades of due diligence on every product and strategy that we offer our older clientele. I personally own many of the solutions that we recommend to our clients, and have done as well as they have in such products, including four of my own fixed index annuities (FIAs). They are but *one* tool in our toolbox, they solve a specific need very effectively, and they have steadily become the most popular product/strategy we offer, growing to over $240 million of FIA dollars now on our books.

Last month, I received an unsolicited email from David, one of our FIA clients. This man is an avid market-watcher/investor, a retired engineer, and a Ph.D. who spent many months doing his "homework" on our recommendations before becoming a client nearly 7 years ago. He was writing to tell me that he had just calculated his IRR (internal rate of return) on his FIAs, and was surprised to discover that it was 9.1 percent annually to-date. "I just thought you should know", he wrote, clearly delighted. Considering that the 85-year history of the S&P 500 is 8.3 percent, David is thus far "out-performing" market history without any downside risk, truly a remarkable achievement even as most of our longstanding FIA clients are averaging between 6 and 8 percent annually.

Last week another client, Tim, attended a class we teach on preparing for a successful retirement. Tim just retired early from a top management position at a local defense contractor, and had just met with the representatives of the investment firm that handles that employer's 401(k). After class, I asked Tim to share with the other attendees what he had just told me days earlier: During his meeting with the brokerage firm's reps, he told them he would be rolling the remainder of his sizable 401(k) into an index annuity he had purchased several years earlier through our firm, one that paid a 10 percent bonus on additional funds, and to which we had added an income rider guaranteeing an 8 percent annual increase of his income account for up to 10 years or until he decides to begin receiving payments if sooner. To Tim's amazement, these two representatives not only denigrated *the strategy* (even though their firm sells more expensive products that also offer it), they questioned Tim's judgment, the insurance company's financial strength, and even my integrity as his advisor! (These men have never met me.) Tim had never seen such a biased, unprofessional display; clearly these men were in defense mode lest word got out that a competitor from a parallel industry may have better to offer.

Consumers of financial products should ask themselves a basic question. Of the 309 million people living in the United States, over 119 million benefit in some way from annuities or pension funds, their functional equivalent. These annuities are offered through major insurance companies, an industry that employs hundreds of thousands of people, and is heavily regulated by the states which employ additional thousands to do so. Q: How plausible is it that *all* of these people are selling, servicing, or regulating "bad", harmful products—and *thriving* in business while doing so? Isn't the routine fleecing of one's clients an unsustainable business model?

In 2010, six Ph.D.s at the Wharton School of Business conducted a two-year study of fixed index annuities, comparing them to four other asset classes over the prior 14 years. In an interview after the study concluded, the lead author, Dr. David Babbel, stated that the FIA's "performed quite well, …indeed they dominated the alternatives," and that "some have performed better …than (bonds), equity-funds, (and) money markets in any combination…" As John Adams famously said, "Facts are stubborn things; whatever may be our wishes or the dictates of our passion, they cannot alter the state of facts and evidence…"

It seems that even those biased brokerage firms are catching on. Last year, there were 44 companies offering 258 different index annuity products nationally. This year there are 48 such firms offering 289 different products, continuing the trend first begun in 1995. Among them are the very brokerage firms who were the loudest in maligning them just a few years ago.

Breathe easy and spread the word,

Thom

Thomas K. Brueckner
President, Chief Executive Officer