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THE TRUTH ABOUT ANNUITIES

I am not sure if there is a product in the financial industry that can generate as much difference of opinion as an annuity does. Many people seem to think that annuities are some of the best financial products out there, while others seem to think that they are the worst. The real truth is that there are features that can benefit you (principal protection, upside growth, lifetime income) and other features that can limit you (surrender periods and less investment choice). The bottom line is that you deserve an honest, objective assessment of how these products work so you can make the best decision for you and your family.

It is not a question of whether a financial product is good or bad, but are there bad uses or fits for such products. For example, why do we never hear anyone saying that a screwdriver is a bad tool? Well, if we were trying to pound a nail into a wall we wouldn't want a screwdriver. If we were trying to smooth down a rough surface we wouldn't want to use screwdriver. However, we understand that while a screwdriver is a great tool there may be situations when it is the wrong tool and makes no sense to use. The same is true regarding annuities. It is important that we first understand the financial problem we are trying to solve. Then identify the best products and strategies to solve that problem. This report is designed to help individuals truly understand the pro's and con's to annuities. This may help them decide whether an annuity should be included in their financial toolbox.

Not All Annuities are Created Equal

There are multiple types/styles of annuities on the market today that offer vastly different features. Yet, when we hear someone on a TV commercial or in a news headline bash annuities they fail to mention that. The 4 most popular types of annuities are as follows:

1. Immediate Annuity - Take a lump sum and immediately turn it into a guaranteed income stream. The length of the payouts can vary from a fixed number of years to the lifetime of you or your spouse.

2. Fixed Annuity - Take your lump sum and allow your account to grow and earn interest at a fixed rate. Your principal is guaranteed to never lose value. It’s similar to holding a certificate of deposit (without FDIC insurance).

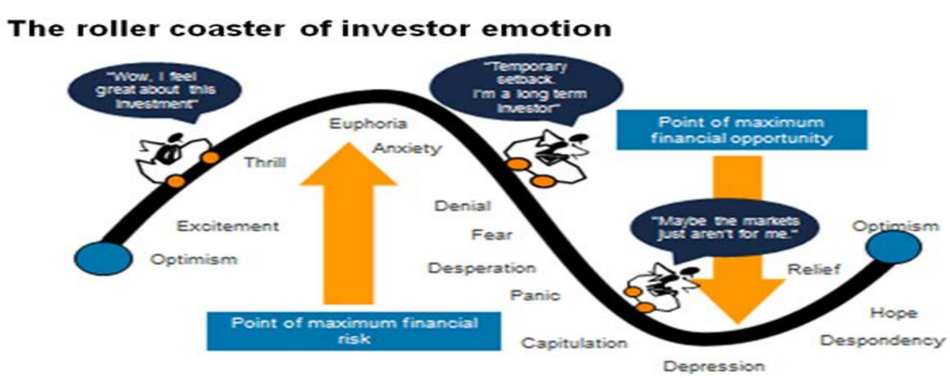
3. Variable Annuity - Allows you to choose how your lump sum will be invested. The interest rates and payments are generally dependent on how those investments perform. This means your principal can go up with your investment choices or go down in value due to your investment choices - hence the term variable. Mutual funds are most common investment choices. Variable annuities are considered securities, and as such are regulated by the SEC.

4. Indexed Annuity - Will allow you link your lump sum to a certain equity based index, such as the S&P 500. This will allow your principal to grow/participate in years when the index performs positively. However, in years when the index is negative your principal will not go down in value. For this reason these products are sometimes referred to as hybrid annuities. They carry upside potential based upon your index choice (like a variable annuity), yet your principal is protected from losing value (like a fixed annuity).

As you can see these 4 types of annuities are vastly different in terms of how the operate. I feel it is a true disserve to consumers when they are lumped together and markets simply use the word annuity to either bash or praise these products.

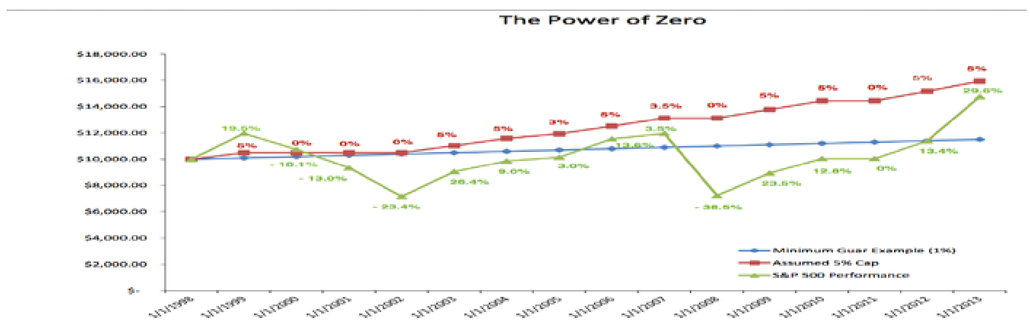
The Power of Zero

As mentioned above, both the Fixed Annuity and Indexed Annuity give your principal protection. For the remainder of this paper I am going to be focusing on the Indexed Annuity product. Here is a dirty little secret, most equity investors tend to underperform the benchmark of the S&P 500. According to an annual study published by DALBAR (The nation's leading independent financial services research firm) - In 2015, the 20 year annualized S&P return was 8.19% while the 20-year annualized return for the average equity mutual fund investor was only 4.67%, a gap of 3.52%. A large part of the underperformance is due to investors making emotional decisions. They typically will buy when the market is reaching a peak and sell when the market is nearing a bottom, fear and greed can truly reek havoc on investors long-term goals.



When emotions kick in many, equity investors flee to cash, as they crave the security and certainty that cash can provide. The downside to this is that cash offers little to no upside growth potential. This is why we see such a large gap between the returns of the S&P 500 and the average investor. However, what if the investor was assured that no matter what happened in the market the worst return he could have was 0% in a given year. That would help minimize the rollercoaster ride of emotions that many investors feel. This is exactly how most Indexed Annuities work.

Indexed Annuities, as mentioned above, allow you to participate in an equity linked index while protecting your principal from market losses. They may limit your maximum upside potential (using caps, spreads or participation rate) but they allow you to potentially earn in years the market performs well, and stay steady in years the market may be negative. The chart below shows an illustration of how this would work (using a 5% annual cap):

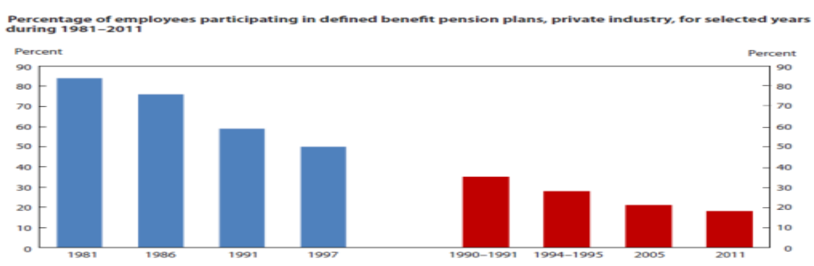


Index growing with annual change in S&P 500 Index: 100% of premium reflecting fluctuation in the S&P 500 Index for the dates indicated. Account Value: 100% of premium accumulating at an indexed interest rate based on an annual point-to-point crediting option with a 5% cap and actual S&P 500 values for the dates indicated. Actual guaranteed accumulation rate of 1%.

As the chart shows, the annuity line shows positive growth. You can also see the other benefit—it is a much smoother line than the S&P 500. This will limit that emotional rollercoaster and hopefully lead to more nights of sound sleep.

Creating Your Own Pension

Pensions are becoming rarer and rarer for private sector employees. In 2011, only 10% of all private sector employers provided a defined benefit plan(pension). The chart below further illustrates the disappearance of pension plans:



NOTE: Information shown for 1990–1991 and 1994–1995 uses combined data from separate surveys of small and large private establishments.
SOURCE: U.S. Bureau of Labor Statistics.

Many employers no longer want the risk of securing or guaranteeing a worker's retirement. As life expectancy has continued to climb it has become more expensive to do so. Now most companies offer defined contribution plans (ie 401k). These plans will not guarantee a future outcome, but allows for individuals to invest and grow their accounts based on the allocation choices they choose. However, wouldn't it be nice to be able to create your own pension? Through the use of an investment tool that could guarantee you a income for as long as you live, no matter what, YOU CAN!!!

Annuities can offer income guarantee riders. The income guarantees are an option that you select and they usually carry an annual fee of around 1%. The benefit you receive for this fee is a lifetime income that you can "turn on" at some time in the future. Typically, the longer you defer, the higher the income benefit. To illustrate the mechanics of these annuity features refer to the table below. Please keep in mind this is not an actual annuity or company, it is only an annuity for illustrative purposes.

The original deposit is $200,000. There is also an "account value" not shown that is separate from the "income value" that can be invested in any number of indexes. In fixed indexed annuities, the credit or growth from year to year on the "account value" can vary based on index performance, While there are many ways to structure how the accounts will grow, in almost all cases, indexed annuities participate in upside growth without downside risk. In other words, they provide principal protection on your deposit.

Age	Income Value	Payout Rate	Annual Income
55	$200,000	4.5%	$9,000
56	$210,000	4.6%	$9,660
57	$220,500	4.7%	$10,364
58	$231,525	4.8%	$11,113
59	$243,101	4.9%	$11,912
60	$255,256	5.0%	$12,763
61	$268,019	5.1%	$13,669
62	$281,420	5.2%	$14,634
63	$295,491	5.3%	$15,661
64	$310,266	5.4%	$16,754
65	$325,779	5.5%	$17,918

In this example, you have the option of when to turn on the income. You can also start and stop the distributions. The longer you defer, the larger the benefit. Most companies allow for single life and joint life payouts with the indexed annuities. Finally, to the extent you do not go through the "account value" you may either move the funds to another account or upon death it goes to your beneficiaries.

Illiquidity and Surrender Penalties

Just like most things in life annuities have pro's and con's. Now that we have covered some of the main benefits of Indexed Annuities we need to discuss some of the main con's as well. Probably the biggest negative aspect to annuity products is their surrender penalty. The annuity company (just like banks) want to know that money you invest is going to be with them for a set amount of time so they can do what they need to do with their portfolios in order to remain profitable while ensuring the guarantees they provide to you. Most Indexed Annuity products carry 7-10 year surrender costs. However, many will allow you to pull out 7%-10% of the principal every year after the first contract year.

In Summary

It is always important in life to make informed decisions. First, is to truly understand the problem and then form the best solution possible to solve it. You can purchase annuities with after tax dollars or with IRA monies as well. They can be used to: compliment what you are doing already in your brokerage accounts; used to smooth about the overall "risk level" of your plan by providing principal protection; or used to provide a guarantee of future income. By better understanding the various annuities available, it may make sense that they become part of your financial toolbox. Most of you already own an annuity and probably haven't realized it yet. Social Security is an annuity payout that many people are eligible to receive.

The first step in any process is usually the most difficult. Regardless of whether you are closing in on retirement, or already in retirement, the information provided and the process suggested is a good exercise to go through. It may uncover some things you were unaware existed. Sit down with pencil and paper to run an analysis of your plan. Better yet, contact us and we can sit down with you and develop a personalized plan for you. There is no obligation and the analysis is complementary. Take advantage of this today and give us a call.

If you would like any additional information on the ideas covered above, please visit our website, www.alphawealthgroup.com or contact our home office at 630-519-4742.