# Annuities and Market Risk: What You Need to Know

Market risk is something all investors worry about, but those close to retirement have limited time to recover from the loss. If you're within ten years of retirement, your investments are at a critical stage to continue to gain value and avoid loss. Without thinking through the dynamics of gains and losses, investors leave themselves open to **market risk** that could prematurely deplete their retirement assets.

One way that investors avoid loss is by including annuities in their retirement portfolio. Annuities, which are becoming more widely used in the financial services industry, are a contract with an insurance company to provide investors with a guaranteed stream of income in retirement. They offer tax-deferred growth of earnings similar to other traditional tax-deferred investments. However, many investors still don't fully understand the different types of annuities, how they work, or the fees associated with them.

The three types of annuities widely used in financial planning are fixed annuities, fixed-indexed annuities, and variable annuities. Like any financial product, there are pros and cons to each type of annuity, and due diligence of investigating *any annuity* should take precedence before purchasing one for your retirement portfolio:

***Fixed Annuity Pros:***

- Provides a fixed rate of return the insurance company generates from investing in high-quality corporate and government bonds.
- Grow on a tax-deferred basis.
- The interest rate is typically guaranteed the first ten years of the contract, and a guaranteed minimum interest rate sets after the initial guarantee period to protect against declining interest rates.
- Provides a guaranteed lifetime income and protection against longevity risk; annuity payments continue the rest of your life.

***The Cons:***

- When the guaranteed rate expires, the rate is adjusted based on the earnings in the insurer's investment account. If this occurs during a low- interest rate or unfavorable stock market environment, a lower rate of return may apply.
- Can have high surrender rates from one to fifteen years and withdraws over ten percent during the surrender period incur fees.

***Fixed-Indexed Annuity Pros:***

- Your principal is protected during a down market, and you won't lose your initial investment or accumulation.
- Grow on a tax-deferred basis.
- The return is based on an index (ex. The S&P 500), which grows the annuity's value over time.
- Provides a guaranteed lifetime income and protection against longevity risk; you receive annuity payments for life.

**The Cons:**

- Some are complex, costly, and aren't always necessary for the investor.
- Is not a growth-market product. Ask for written information from the insurer about the annuity product and don't just accept a verbal explanation so you fully understand the product.

***Variable Annuity Pros:***

- Grow on a tax-deferred basis like fixed and fixed-indexed annuities.
- Include pre-selected mutual fund subaccounts for the initial investment.
- Offer unlimited contributions (some restrictions apply from the insurer).
- Include both living and death benefits through contract 'riders.' Beneficiaries can choose between the current contract values, its highest value on the contract anniversary, or determine a value based on a guaranteed hypothetical rate of return.

**The Cons:**

- Are expensive and come with many fees and charges, which decreases the accumulation.
- Are market sensitive and may incur a loss to the investor.
- Both the salesperson and the investor often misunderstand this complex product.

Annuities offer many benefits to investors and have their place in retirement planning, but only if suitable for the investor and a part of an investment strategy using other types of investments and accounts. Investors should fully understand the risks associated with annuities before purchasing them. If you have any questions about annuities, now is a great time to visit.

**Disclosure: An annuity is intended to be a long-term, tax-deferred retirement vehicle. Earnings are taxable as ordinary income when distributed, and if withdrawn before age 59½, may be subject to a 10% federal tax penalty. If the annuity will fund an IRA or other tax qualified plan, the tax deferral feature offers no additional value. Qualified distributions from a Roth IRA are generally excluded from gross income, but taxes and penalties may apply to non-qualified distributions. Consult a tax advisor for specific information.**

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