

## Index Annuities Are The New Normal

The average reported S&P 500 index annuity return beat the real S&P 500 return in 63% of actual five-year periods. Index annuity detractors often retort those bad periods were exceptions, because when you take into account the good ones, and add on reinvested dividends, you more than make up for the bad times because everyone knows” mutual funds perform much better than index annuities. However, if you had invested \$10,000 at the beginning of every five year period – a total of \$80,000 in each since 1997 – the index annuities would have grown to \$104,991 and the S&P 500 index with reinvested dividends would have been worth approximately \$103,574.<sup>1</sup>

***What if the investment markets of the last decade are not an aberration, but represent the new normal investing environment? If these times are the new normal then index annuities are the clear winners.***

However, rather than accept the reality that index annuities have proven they work the detractors fall back on their other argument, which is index annuities may have performed well since they were introduced in 1995 but these aren't normal times. Their refrain is if these were normal times the mutual funds would have won big.

The detractors typically use two “normal” periods to support their position. The first big period usually starts in the mid 1920s and ends at the millennium. It results in those 12% return numbers cited by folks like Ibbotson. The second period used is the more recent 20 or 25 years that include returns for the '80s and '90s; the average annual stock market return for those two decades was 17.6%.<sup>2</sup> The detractors then apply today's index annuity participation rates to these periods and say “see, in normal times mutual funds heartily beat index annuities”. However, I submit those periods (to say nothing of the participation rates assumed) are also not representative of normalcy.

If you could have invested \$10,000 in the U.S. stock market on New Year's Day 1980 your account balance on 1 January 2000 would have been \$253,766! However, if you had done this from 1970 to 1990 your balance would have been \$87,486, and starting in 1960 and ending in 1980 your \$10,000 would have grown to \$36,905.

Some people use Ibbotson's 12% return as representative of a normal stock market, but even using their 80 year timeframe as “normal” 96.8% of the 20 year returns will be less than the 1980-2000 period. And if you use the first 80 years of the century instead of the last 80 years as normal, the likelihood of not getting a 1980-2000 style return is 99.99%.

### **What is normal?**

Professor Siegel of Wharton looked at periods beginning after World War II and found the average annual stock market return for the next six decades, including reinvested dividends, was 6.83%.<sup>3</sup> If you could find an annual reset index annuity that averaged a 50% participation rate for the same period your annualized return would have been 7.13% without reinvested dividends.

In my modeling of the Great Depression, if you could have purchased an index annuity each month beginning in August 1929 with only a 30% participation rate your average annual index annuity return would have been 6.4%. All of this during a decade where the stock market ended 65% lower than where it began and blue chip stock market investors lost a lot of money.

The ten years following 1972 resemble the decade after 1999 in stock market movement. In this earlier era the S&P 500 finished 3.8% higher than where it began, but an index annuity annual reset approach would credit interest based on a total period gain of 124%.

Frankly, I don't know if the next 10 or 20 years will be like the last, but it appears extremely unlikely that the 1980-2000 period returns that occurred only once in the last 200 years should be used as "normal" times <sup>4</sup>.

### What about retirement income?

Many investment hypothetical comparisons begin in 1974. It's not a coincidence, 1974 was the bottom of the worst bear market since the Great Depression and if you're trying to show how high something is, it will look even taller when you're sitting in a hole. From 1974 through 1999 the S&P 500 grew at an annualized rate of 13% before reinvested dividends. A person retiring in this period could have easily withdrawn 6% a year from this portfolio without ever running out of money. But what if you retired earlier or later?

I calculated how long money lasted if you withdrew 6% each year, earned S&P 500 returns, and retired in 1960, 1961, 1962 and so on.

If You Retired In	You Ran Out Of Money In	Years Lasted
1960	1984	24
1961	1990	29
1962	1983	21
1963	1994	31
1964	1985	21
1965	1983	18
1966	1983	17
1967	1992	25
1968	1985	17
1969	1985	16
1970	1994	24
1971	2005	34
1972	1997	25
1973	1991	18

In every case the money did run out, and in over a third of the cases the money ran out in less than 20 years. I could have picked a lower withdrawal amount, but 6% is the percentage most consumers intuitively select when asked what they think is a safe withdrawal percentage in retirement.

In addition, many index annuities offer a guaranteed 6% lifetime withdrawal rate as early as age 70. This was for the years preceding the great bull period of the 20th century. The chart on page 8 examines the effect of withdrawals in the 21st.

One of the things that the table on this page and the chart on page 8 highlight is how greatly one year can affect the long-term. If you began withdrawals in 1962 or 1964 your money lasted 21 years, but if you began in 1963 your money lasted 31 years. The reasons are gaining one good year and avoiding one bad, because if you missed 1962 you avoided a 12% drop, but if you missed 1963 you didn't get a 19% gain.

It's a similar story in this century. A person beginning withdrawals in 2003 only needs to earn 4% from now on for their money to last until age 100, but begin a year earlier or later and 8% to 11% is needed. An even more vivid example is the person that began withdrawals in January 2009 needs to average 8.4% to keep taking the original 6% out; but if they could have delayed until this January earning even a 3% return hereafter means an income until 2040.

### Avoiding losses is key

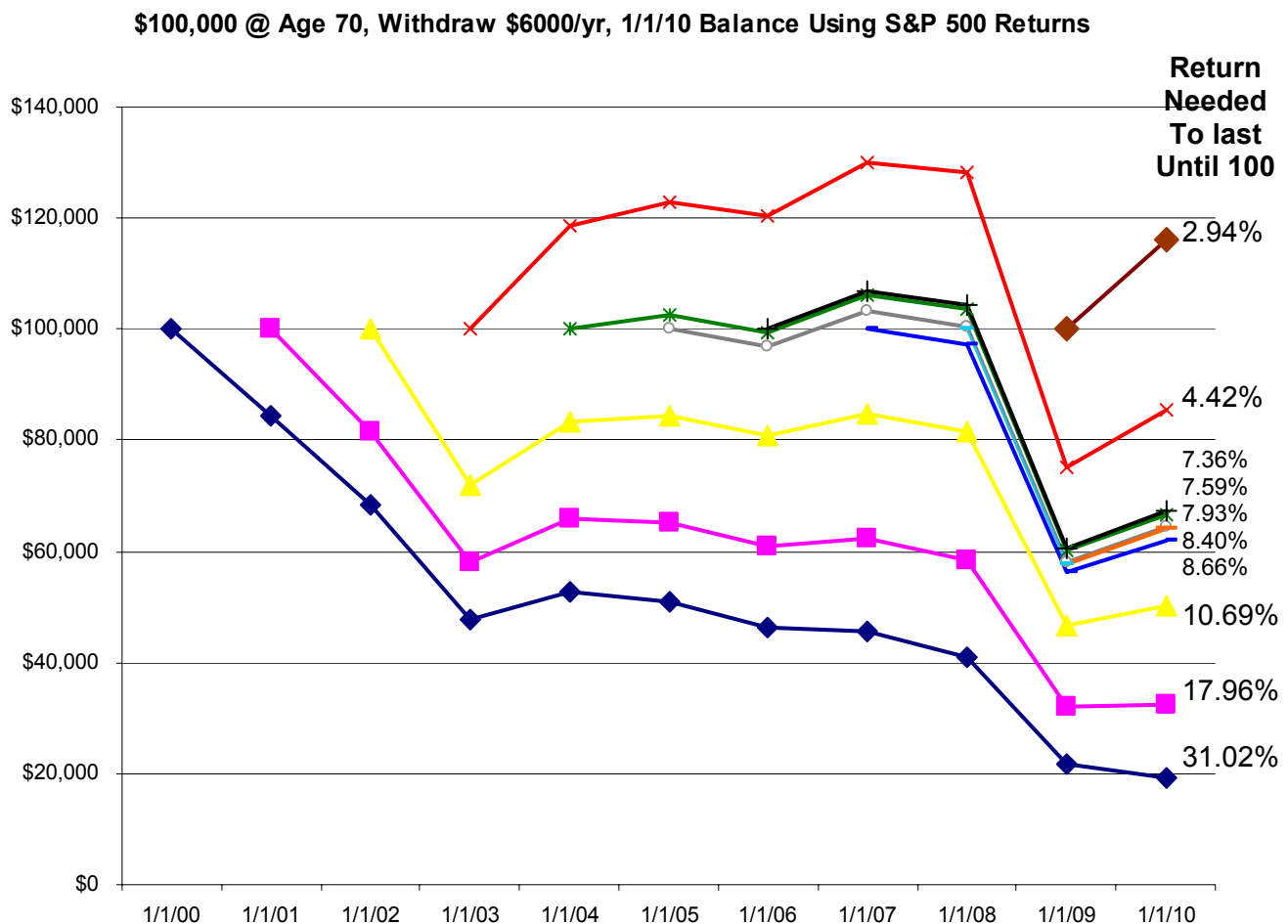
The 1980s had eight years in a row wherein the S&P 500 ended higher. With the exception of a 1% dip in 1994, the 1990s were gain after gain. So far the patterns of this century look a lot more like the historical stock market than those decades and that supports an annual or biennial reset.

If the next stock market era resembles the broader strokes of the past two centuries it will have frequent peaks and valleys. This type of market is distressing enough when one is building for retirement, but it can be devastating if you are already retired and spending it down. An index annuity, especially with lifetime benefit features, is ideal for benefiting from what may be the new normal stock market pattern.

## Retirement Roulette Or Guaranteed Lifetime Withdrawal Benefits

Each line of the chart below represents a 70 year old with \$100,000 that began withdrawing \$6,000 a year. The blue line began withdrawals 1 January 2000, the pink line began in 2001, the yellow in 2002, and so on. The right side of the chart shows how much each has left in their account on 1 January 2010 based on movements of the S&P 500. The final column states the return they would need to earn each year from today forward to be able to continue to withdraw \$6,000 a year until age 100.

If you retired a year ago you are now age 71, your account is worth \$116,043, and if you earn 2.94% a year you can keep taking \$6,000 for 29 more years. But if you retired in 2000 you're now 80 with \$19,258 left. You'd need to earn 31.02% to make it to 100...unless you'd bought a GLWB annuity.



1. The index annuity returns are actual policy returns for 5-years periods generally beginning and ending at or around 30 September. The \$103,574 index return assumes reinvested dividends of 1.72%, which was the S&P 500 dividend average yield from 1997 though 2009

2. Bogle, John, 2003. The Policy Portfolio in an Era of Subdued Returns. Bogle Financial Center.

3. Siegel, Jeremy (1992) The Equity Premium: Stock and Bond Returns Since 1802, *Financial Analysts Journal*; 48, 1; pg 28

4. Schwert, G. William. 1990. Indexes of U.S. Stock Prices from 1802 to 1987. *The Journal of Business*. 63, 3; 399