Index annuities for the “new normal”

Index annuities may be a simple method of protecting clients from the stock market's roller-coaster ride

BY JACK MARRION Published 5/1/2010

I collect actual index annuity return data. Although not every product and carrier is included, based on the data I have, the average reported index annuity return beat the actual S&P 500 return in 63 percent of actual five-year periods going back to 1997. Overall, if you compare the performance of the average index annuity with an S&P 500 index fund for periods from 1997 through 2009, the index annuity wins.

However, rather than accept this reality, some index annuity detractors argue that index annuities may have performed well since they were introduced in 1995 but these aren’t normal times. They often then compare the performance of a hypothetical index annuity with an equity investment over the last 30 years and say, “see, in normal times equities beat index annuities.” However, I submit this period is not representative of normalcy either.

Tracking the differences

The average annual stock market return over the ’80s and ’90s was 17.6 percent, but Jeremy Siegel of the Wharton School looked at the six decades after World War II and found the average annual stock market return, including reinvested dividends, was 6.83 percent. If you had a fictional annual-reset index annuity that averaged a 50 percent participation rate for the same period, your annualized return would have been 7.13 percent, 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 percent participation rate, your average annual index annuity return would have been 6.4 percent.

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

What is the benchmark?

Frankly, I don’t know if the next 10 or 20 years will be like the last, but it appears unlikely that the runaway 1980-2000 period returns should be used as “normal” times. 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 is ideal for benefiting from what may be the “new normal” stock market pattern.

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