



## *WHAT's on TAP* *at Fulcrum*

# ANNUITIES

### **ANNUITIES COME OF AGE AS BOOMERS START TO RETIRE**

As the baby boom generation prepares to enter the retirement phase of their lives, they hope to have the resources in place to enjoy the same level of financial security they had during their working careers. But for some this will be difficult for the simple reason they don't have access to the same kinds of retirement plans their parents did. Retirees in prior years left the working world secure in the knowledge that for every month of every year for the rest of their lives they would receive a check from the trusty company pension plan of their employer.

But these days it has become a regularly occurring event when another Fortune 500 juggernaut announces the imposition of new cost-cutting measures aimed at "helping them grow their bottom-line." The problem is, they are often doing so at the expense of their traditional defined benefit plan, their corporate pension plan. For baby boomers who began their working careers with traditional pension plans only to see them disappear, this has created an especially urgent need for them to make their own arrangements for retirement income.

As investment advisors, one of our jobs is to help people prepare for this time in their lives by recommending investment vehicles and programs that are specially designed to address their unique retirement needs and, get them where they want to be financially by the time they are ready to retire. While everyone has their own special set of requirements for retirement, there is one thing that every current and future retiree has in common, their need for a dependable ongoing stream of income to fund them for the remaining years of their lives.

Although still very much misunderstood, one tool growing in popularity is the variable annuity. For years, variable annuities have offered two main benefits to their investors, tax deferral on investment gains, and a death benefit. Death benefits assure that the annuitant's beneficiaries receive either the current account value of the annuity at the time of the annuitant's death or, the amount that was initially invested, whichever is greater.

**Demystifying Annuities. . . Plain and Simple.** For investors who are not familiar with them, learning about annuities can seem a daunting and somewhat overwhelming proposition. To solve that problem, we offer the following thumbnail primer:

An annuity is a contract between an investor and an insurance company - The investor gives the insurance company money (either in a lump sum or through payments over time), and in return, the insurance company provides an ongoing stream of income. These income payments can begin either immediately or sometime in the future, depending on the annuity. Annuities come in all shapes and sizes and offer a variety of features. Here is a general description of the four main types of annuities:

*“Sooner or later we’ll all need access to retirement income & an annuity may be just the ticket”*

**Fixed Annuities:** Simply put, fixed annuities provide a guaranteed rate of return for a specified period of time with the underwriting insurance company assuming the market/interest rate risk. For the investor, this means that regardless of how the insurance company performs when investing the annuitant's premium, the investor/annuitant is guaranteed the rate of return specified in their original annuity contract. The interest rate earned by the investor will be adjusted periodically but it will never go below the guaranteed rate outlined in their original contract.

**Variable Annuities:** Variable annuities typically offer the potential for a greater return on investment than do fixed annuities, but they do so at increased risk to investment. By enabling investors to choose among various professionally managed investment options, variable annuities make it possible for people to play a more hands-on role in how their annuity is invested. Investors can also move their money between investment options without incurring any tax liability. Unlike fixed annuities, the investment risk of a variable annuity is passed through to the investor but so too is the potential benefit for greater returns. Depending on the investment options selected, returns on variable annuities will fluctuate more than returns on fixed annuities. It is important to be aware that because the investment risk is borne by the investor, the principal investment could potentially be lost. Helping you determine which investment options would best suit your needs while protecting you from downside risk is just one more way in which your Fulcrum Advisor can advise you.

**Immediate Annuity:** An immediate annuity is a contract between you the investor and the issuing insurance company. Under the terms of an immediate annuity contract, you pay the insurance company a lump sum in exchange for which they promise you an immediate stream of income. You determine if you would like the

## ... Annuities Come of Age

income payments issued on a monthly, quarterly, semi-annually, or annual basis. The duration of the income payments can be established for either a fixed period of time or, for life (or “joint lives”). Immediate annuities can be fixed or variable, as outlined above.

**Deferred Annuity:** Deferred annuities are purchased according to either a lump or periodic payment schedule. Earnings in a deferred annuity are not treated as taxable income until they are withdrawn. Withdrawals made prior to age 59 ½ may be subject to a 10% Internal Revenue Service penalty. With a deferred annuity, investors can select the point at which they would like to convert the accumulated principal and earnings from their annuity into an income stream.

**Getting In, Getting Out.** As we have said, paying for an annuity can take the form of either a single premium payment or, multiple payments made over a period of time. Investors in annuities also have several choices regarding the payout method of their annuity including, lump sum payments, payments for life (or joint life), payments for a predetermined period of time or, a combination of all three. Investor’s can also select options when investing in an annuity that enable their beneficiaries (or their joint annuitant e.g. spouse) to continue receiving payments even after the primary annuitant has died.

Aside from providing retirement income, another significant benefit of investing in an annuity is the potential to earn tax-deferred growth. As annuities appreciate in value and they earn income, neither the growth nor the income are subject to tax until the monies are actually withdrawn. By the same token, the owner of the annuity can switch, tax free, between the various investment vehicles offered through the annuity. Annuities give investors a wide range of investment selections covering virtually all investment disciplines. They also include the option of making unlimited contributions. Annuities are not subject to probate in the case of death.

**Available Since Forever, Annuities Have Stepped To The Fore.** It was not until the stock market boom of the late 1990s, and subsequent bust in 2000, that the world of annuities clearly began to differentiate itself by offering investors what are called *living benefits*. Although living benefits differ somewhat from annuity company to annuity company, there are two basic types; One provides 100% principal protection, the other a guaranteed income payment for life. Both versions incorporate additional features such as offering a quarterly or annual reset on the annuitant’s protected amount which then locks in the appreciated value of the annuity and further protects the future income stream.

For example, by investing in a variable annuity, an investor with a \$500,000 rollover from say their employer’s 401K plan could receive a 5% income of \$25,000 for life beginning day one. If, however, they chose a variable annuity with an annual reset benefit, and if the invested account value grew by 10%\* to \$550,000 in its first year, the living benefit would adjust upwards and the protected amount would now be locked in at \$550,000. This would create a new lifetime annual income amount of \$27,500 - The investor has increased by 10% both the market value of

their account and, their annual income. Later on, if disaster struck and the market value of their annuity dropped from \$550,000 to \$1, they would still have the comfort and security of knowing that because they chose a variable annuity with an annual reset benefit, their new revised living benefit was protected and their income stream of \$27,500 secure. The investor can participate in the Stock Market's upside without jeopardizing their annual income.

**Taking a Closer Look At Fees.** Over the years, one of the greatest criticisms of annuity products has been that they are too expensive. And, while there are additional costs associated with investing in annuities (rather than say no-load mutual funds), the question investors really should be asking is, "what do I get for the additional cost?" In the case of annuities the answer is simple, part of that extra cost goes toward the types of guarantees and protection that only annuity products can provide. When choosing other investment options, investors must be especially vigilant and continuously ask that all important question, "how much of my nest egg can I afford to risk if the stock market suffers huge losses and, is this investment right for me?"

In actuality, what is particularly interesting when taking a closer look at the fees associated with investing in a variable annuity (rather than say the fees associated with investing in a managed portfolio of mutual funds) is that in some cases, the difference could be as little as 1% to 1.25%.\*\*

It doesn't sound like much but let's take a closer look at how valuable that additional 1% might be. First, divide your car insurance premium by your car's current value - The answer is the percent you are paying to insure a vehicle that is continuously losing value. For example,  $\$1,000/\$25,000 = 4\%$ . Now think about paying an additional 1% to protect your retirement nest egg which, unlike the value of your automobile, has the potential to grow and increase in value especially if invested in the many world class investment choices now offered by annuity companies - It is something to think about.

For its part, the insurance industry has heard the complaints about the costs associated with investing in their annuity products and have changed their fees accordingly - They are now more affordable than ever before. Finally, investors of all ages including retiring boomers have an investment solution that is competitively priced and provides an income strategy for life.

**For further information about this product or any other, contact  
your Fulcrum Securities Investment Advisor.**

*\* Past performance is not indicative of future results. The example given is for illustrative purposes only.*

*\*\* It is important to always ask for and read the product's prospectus in order to understand the features, benefits and costs associated with making any investment.*



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