Sherwood Investment Services

Financial Planning & Investment Management

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The Savvy Investor

Fixed Indexed Annuities
Too Good to be True

The Pitch

In this time of high market volatility, it seems sales people are putting on seminars and appealing to peoples' fear of losing money.

A good friend/client heard a presentation about how they could make money when the market goes up but never lose money when the market goes down. The investment product is called a **"fixed indexed annuity".**

She showed me a handout, showing how $100,000 invested in the annuity in 1998 would grow to $200,000 by 2014. The annuity grew more or less steadily. On the same chart it showed that if the $100,000 had been invested in the S&P 500, it would bounce around, some years losing money and some gaining. But after 14 years, it was worth the same as the fixed indexed annuity.

Who wouldn't pick the steady-growth investment, **even if it was equivalent to only a 2% annual return.**

The Truth

The flaw was that the S&P performance failed to include S&P 500 dividends. Everyone knows that to calculate the return on rental property, you have to include rental income along with the price appreciation of the property. Similarly, you have to include dividends when evaluating investment performance. **The S&P line on the chart conveniently ignored dividends.**

When dividends are included, the S&P investment was vastly superior to the annuity. $100,000 invested in the S&P in 1998 would be worth $275,000 for a 6.3% annual growth, compared to only 2.0% for the "safe" (and complex) annuity.

Finally, I was curious what would happen if we compared the annuity to $100,000 invested in the Dow Jones-30, a common market indicator. The DJ-30 $100,000 would have grown to $315,000 for a 7.4% return.

Fact

Since 1950, roughly 89% of your gains would have come from reinvesting your dividends. No wonder performance jumped so much when they were included.

Bottom Line

- Fixed indexed annuities are complex and have low returns due to their high costs, even if you are led to believe there are none. (The insurance company likes to make money.)
- If you are willing to settle for a 2% return, you may as well buy a CD. Of course, it probably won't even keep up with inflation.
- If you can live with market fluctuations and ignore the short-term fluctuations and TV

news commentators, you are much more likely to be better off in the stock market.

- **There are other ways to reduce your risk other than these high cost and complex insurance products. Please ask how, if you are interested.**
- If you still feel you want to buy a fixed indexed annuity, please let me know because I can get them for you.

If you'd like to learn more about preserving your wealth, please contact us.