Part Two

Those 'Horrible,' Wonderful, Fixed Index Annuities

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Last month, I told you about an ongoing trend in financial services; that of the denigration of annuities as a product line by brokerage firms in competition with the product. One notable firm actually runs national ads with the slogan "Why I Hate Annuities."

Our firm has done decades of due diligence on every product and strategy that we offer our older clientele. I personally own many of the solutions that we recommend to our clients and have done as well as they have in such products, including four of my own Fixed Index Annuities (FIAs). They are but one tool in our toolbox, they solve a specific need very effectively, and they have steadily become the most popular product/strategy we offer, growing to more than $240 million of FIA dollars now on our books.

Last month, I recounted receiving an email from one of our FIA clients, an avid market-watcher/investor, a retired engineer, and a Ph.D. who spent many months doing his "homework" on our recommendations before becoming a client nearly seven years ago. David was writing to tell me that he had just calculated the internal rate of return on his FIAs and was surprised to discover that it was 9.1 percent annually thus far. Considering that the 85-year history of the S&P 500 is 8.3 percent, David's yield is truly remarkable. Most of our longstanding FIA clients are averaging between 6 percent to 8 percent annually, with most netting around 6.8 percent. These folks are getting 82 percent of the upside with none of the down, to which one equally elated client said, "Show me a marriage like that!"

Last week, another client named Tim attended a class we teach on preparing for a successful retirement. Tim just retired early from a top management position at a local defense contractor and had met with the representatives of the investment firm that handles that employer's 401(k). After class, I asked Tim to share with the other attendees what he had just told me days earlier: During his meeting with the brokerage firm's reps, he told them he would be rolling the remainder of his sizable 401(k) into an index annuity he had purchased several years earlier through our firm, one that paid a 10 percent bonus on additional funds, and to which we had added an income rider guaranteeing an 8 percent annual increase of his income account for up to 10 years or until he decides to begin receiving payments, if sooner.

To Tim's amazement, these two representatives not only denigrated the strategy (even though their firm sells more expensive products that also offer it), they questioned Tim's judgment, the insurance company's financial strength and even my integrity as his advisor! (These men have never met me.) Tim had never seen such a biased, unprofessional display; clearly, these men were in defense mode lest word got out that a competitor from a parallel industry may have better to offer.

Consumers of financial products should ask themselves a basic question. Of the 309 million people living in the United States, more than 119 million benefit in some way from annuities or pension funds, their functional equivalent. These annuities are offered through major insurance companies, an industry that employs hundreds of thousands of people, and is heavily regulated by the states that employ additional thousands to do so. Q: How plausible is it that all of these people are selling, servicing, or regulating "bad," harmful products—and thriving in business while doing so? Isn't the routine fleecing of one's clients an unsustainable business model?

In 2010, six Ph.D.s at the Wharton School of Business conducted a two-year study of Fixed Index Annuities, comparing them to four other asset classes over the prior 14 years. In an interview after the study concluded, the lead author, Dr. David Babbel, stated that the FIA's "performed quite well … indeed they dominated the alternatives," and that "some have performed better … than [bonds], equity-funds, [and] money markets in any combination."

As John Adams famously said, "Facts are stubborn things; whatever may be our wishes or the dictates of our passion, they cannot alter the state of facts and evidence."

Last year, there were 44 companies offering 258 different index annuity products nationally. This year there are 48 such firms offering 289 different products, continuing the trend first begun in 1995. Among them are the very brokerage firms who were the loudest in maligning them just a few years ago. ■

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