

# ANNUITIES

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## RETIREMENT

*Understanding the Trade-offs*



FISHER INVESTMENTS®

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# Annuities in Retirement

## Understanding the Trade-offs

### **This brochure covers:**

- How to evaluate your options for generating income in retirement.
- Why an annuity may not be your best choice.
- How annuities work and drawbacks that may not be obvious.

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## 1. INTRODUCTION

The guaranteed lifetime income offered by annuities sounds like a ticket to a comfortable retirement, but the reality is not that simple. While annuities can sometimes offer lifetime income, they are complex and can be wrought with pitfalls. Before committing yourself to an annuity, be sure you completely understand how annuities work and their pitfalls.

When used as retirement insurance, annuities can fill a role of transferring some risk from the investor to an insurance company. But when sold (or bought) as a primary investment vehicle, the long-term outcomes can range from disappointing to downright dangerous to your retirement goals.

In this guide we'll cover different annuity types and their trade-offs, as well as other strategies to generate income in retirement. Our aim is to provide you an insightful view of these products.

## 2. THE CHALLENGE: TURNING ASSETS INTO INCOME

Picture yourself on the first day of your retirement. You don't have to be anywhere. You don't have to watch the clock. The weight of work is off your shoulders. However, now reality sets in. Pension plans are mostly a thing of the past. Social security payments may be insufficient to cover your expenses. Your savings have to provide for the rest of your life—perhaps even longer for your spouse or family. How do you generate a stream of income to fund your lifestyle in retirement while trying to avoid all the worry that comes with it? For example:

- **The fear of short-term stock and bond market declines**
- **The impact of inflation on your purchasing power**
- **The risk of outliving your money**
- **The worry of leaving no wealth for your spouse or other loved ones after you pass**

### 3. YOUR RETIREMENT COULD LAST LONGER THAN YOU EXPECT

Retiring today is different than it was even a few decades ago. Most should expect to live a much longer, more active life in retirement than their grandparents. Hence, retirement savings will need to provide income for much longer as well.

Improvements in health care and life expectancy contribute, too. You need to plan to live longer than you might expect. As Exhibit 1 illustrates, the average 65-year-old can expect to live to at least 84.

#### Exhibit 1: Average Life Expectancy

Current Age	Life Expectancy	Current Age	Life Expectancy	Current Age	Life Expectancy	Current Age	Life Expectancy
51	81	61	83	71	86	81	90
52	82	62	83	72	86	82	90
53	82	63	84	73	86	83	91
54	82	64	84	74	87	84	91
55	82	65	84	75	87	85	92
56	82	66	84	76	88	86	92
57	82	67	85	77	88	87	93
58	83	68	85	78	88	88	93
59	83	69	85	79	89	89	94
60	83	70	85	80	89	90	95

Source: 2009 US Total Population Life Table (revised as of 1/6/14), National Vital Statistics Reports, Volume 62, Number 7. Life expectancy rounded to nearest year.

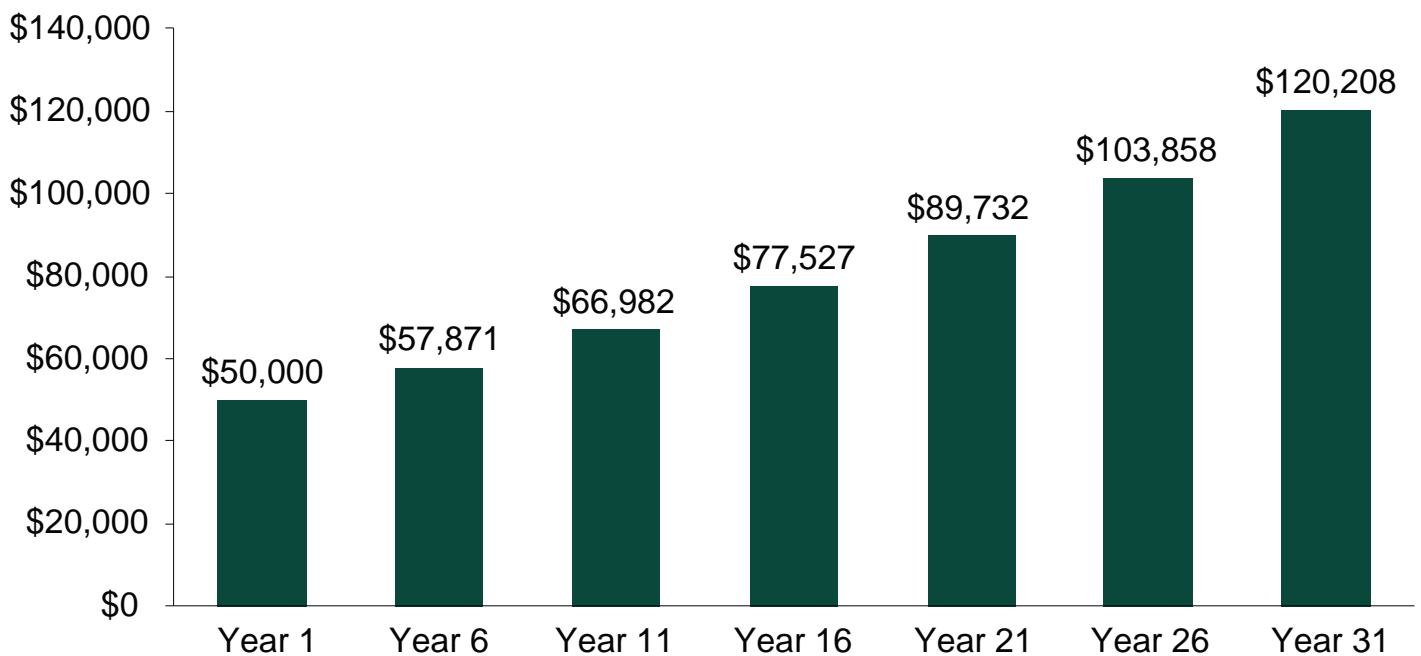
But that’s just the average. If you’re in good health and have a family history of longevity, it is possible you may add many more years to your life expectancy. These odds suggest a 65-year-old retiree should plan on living for at least a couple more decades.

Living longer, healthier lives is good news. But it also introduces “longevity risk” to your portfolio. The longer you live, the higher the likelihood your portfolio may not be able to provide for you. Even with planning and saving prudently, many can find this to be a problem. Likewise, many people who live into their 80s and 90s likely face rising costs for everything they need to maintain their standard of living, meaning they’ll need to increasingly rely on their retirement savings.

Although inflation (commonly measured by the Consumer Price Index (CPI)) has been tame in recent years, people may experience inflation differently. Your personal inflation rate may be higher or lower depending on what you spend your money on in retirement. For instance, medical expenses have been increasing at a rate much higher than the headline inflation rate. Conversely, apparel and electronics costs have been increasing at a much slower rate and in some cases have even been getting cheaper. However, it’s better to plan for inflation to be higher.

Since 1925, inflation has averaged about 3% a year.\* Exhibit 2 shows that if that average inflation rate continues into the future, a person who currently requires \$50,000 to cover annual living expenses would need about \$120,000 30 years from now just to maintain the same purchasing power.

**Exhibit 2: Rising Costs Are a Fact of Life**



\* Source: FactSet; The actual average historic inflation rate is 2.92% from 1926–2016 based on the US Bureau of Labor Statistics Consumer Price Index (CPI).



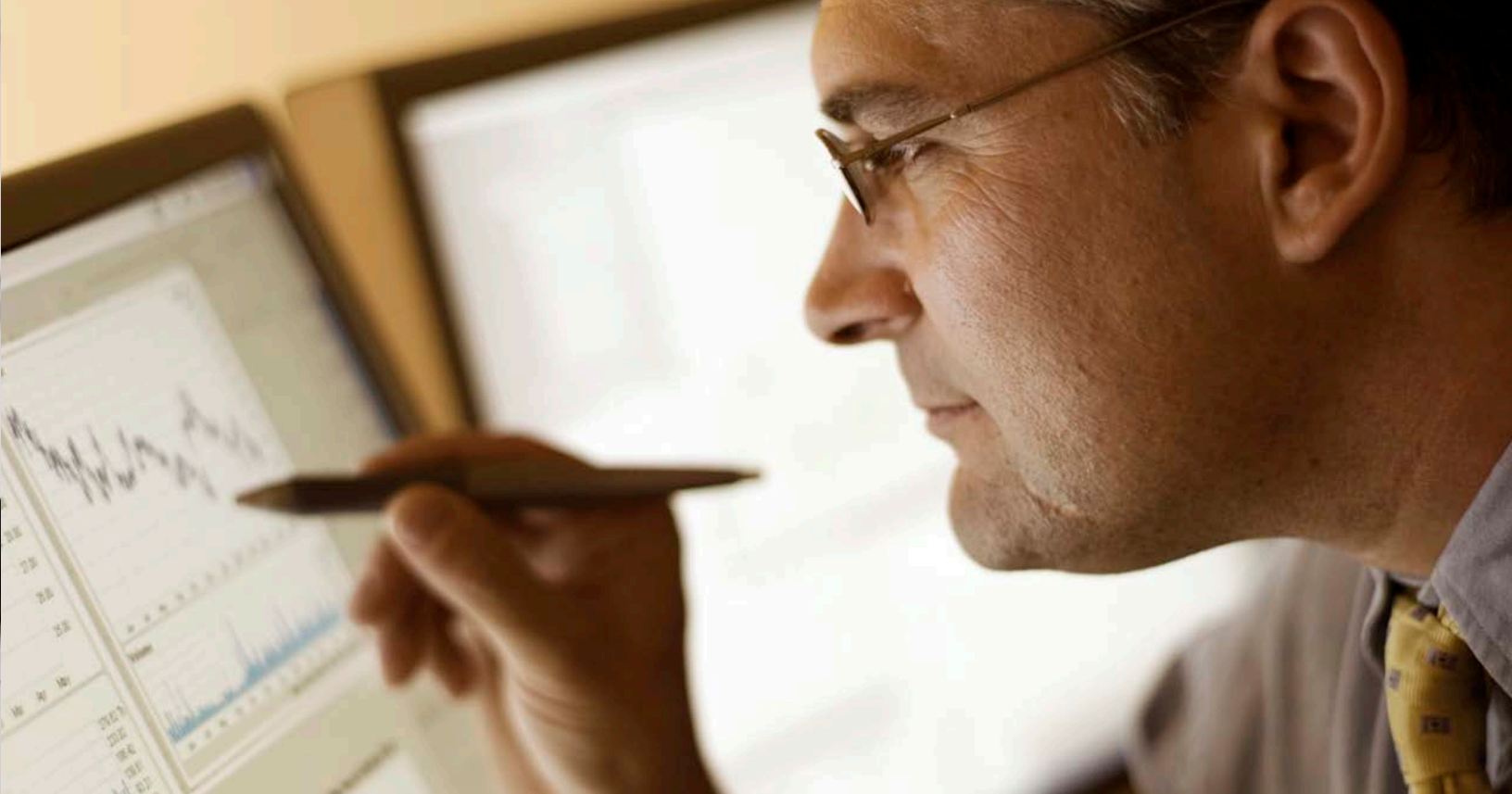
## 4. ANNUITIES' APPEAL

Many financial firms, advisers and brokers offer insurance products, like annuities, to help retirees meet their income needs. They may sell annuities as guaranteed lifetime income. This makes annuities sound like the perfect solution to the challenge of generating income in retirement.

Unfortunately, many investors discover annuities fail to deliver. Annuities may charge high fees that eat away your income and they bear an opportunity cost and can hold you back from the full growth potential of stocks and bonds. Some annuities can be useful for people in specific situations. However, in our view, since salespeople are incentivized by commissions, they are willing to sell these complex and confusing products in far too many circumstances.

We believe annuities are rarely worth the trade-offs. In this guide we will:

- **Define the different types of annuities and how they work**
- **Describe the trade-offs you need to consider with annuities**
- **Illustrate how stocks and bonds can generate income far more effectively than annuities**



## 5. ANNUITIES: INSURANCE PRODUCTS, NOT INVESTMENT VEHICLES

Have you been offered a product that is supposedly designed to address longevity risk? It may have been presented as a safe strategy, providing you with a guaranteed income stream from an annuity.

Regardless of the name, annuities amount to the same thing: an insurance contract. Annuities are an agreement between an individual and an insurance company. The individual pays one or multiple installments, known as premiums, to the insurance company. In return, the individual, and potentially their spouse, receive a lifetime income stream—either starting immediately or at a later date. The insurance company computes the payout of the annuity based on its value (how much you're putting into the annuity contract), your estimated lifetime, interest rates and any other features the annuity may have.

At Fisher Investments, we believe too many people erroneously purchase annuities as a primary investment vehicle for retirement. But annuities tend to generate far less income—and far less growth—than you may need over the course of a long retirement. Annuities are also far more complex than they sound and guaranteed income can come at a high cost many investors don't fully understand.

## 6. WHY ANNUITIES OFTEN DON'T MAKE SENSE

At Fisher Investments, we believe annuities are rarely a good idea. Many have:

- **High costs**
- **Limited upside**
- **Surrender charges**
- **Confusing guarantees**
- **Fixed payments**

Some annuities promise to protect your income stream from market volatility and guarantee growth rates. Unfortunately, annuities often have significant drawbacks which aren't readily apparent. That's because the insurance company controls most of the variables and designs annuities to be as profitable as possible while still being attractive to you. Once you've signed an annuity contract, it's unlikely the annuity company will ever change or adjust it for your benefit—typically only theirs.

To illustrate, we'll explain some of the major concerns we have with annuities.

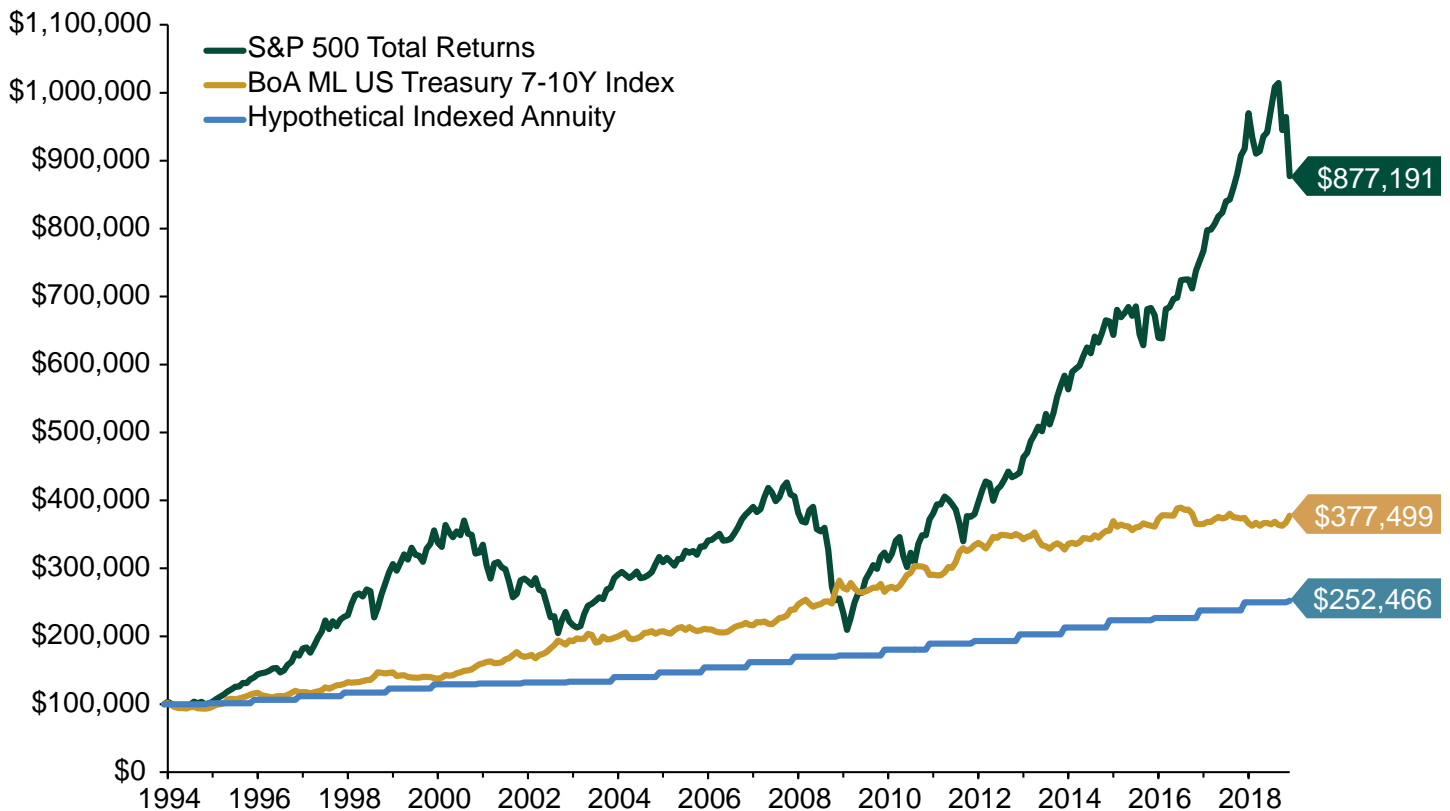
**1. High Costs:** Variable annuities (definitions of different types of annuities can be found in section 7) can charge multiple layers of fees: one for the contract, one for each rider or additional benefit you purchase and one for each mutual fund sub-account. These fees can total as much as 3.95% per year.\* Taking nearly 4% in fees from the contract per year may eat away at its value.

\*Source: Insured Retirement Institute, 2011 IRI Fact Book (Washington, DC: IRI, 2011), 36–38, 56.

**2. Limited Upside:** Separate from variable annuities, fixed indexed annuities also have downsides, which come in the form of opportunity costs we'll illustrate later. These annuities are linked to the performance of an index but may limit your participation in that index or simply place a cap on your annual credited interest (the amount added to your principal value while your annuity is deferred) even if the index rises more. They also guarantee your return will not fall below zero. While it may be a relief to know that your annuity contract might not lose value during a bear market, we believe it is not worth the limited upside potential. Annual interest-crediting caps can be around 3.5% (at the time of this writing) and may have a minimum of 2% per year or less.

An investment compounding at 3.5% may not provide the long-term growth you need in retirement. Recall: Headline inflation alone has been averaging 3% historically. We don't believe in trading the impossibility of loss for the likelihood of slim gain—especially so when you consider the insidious impact of inflation over time.

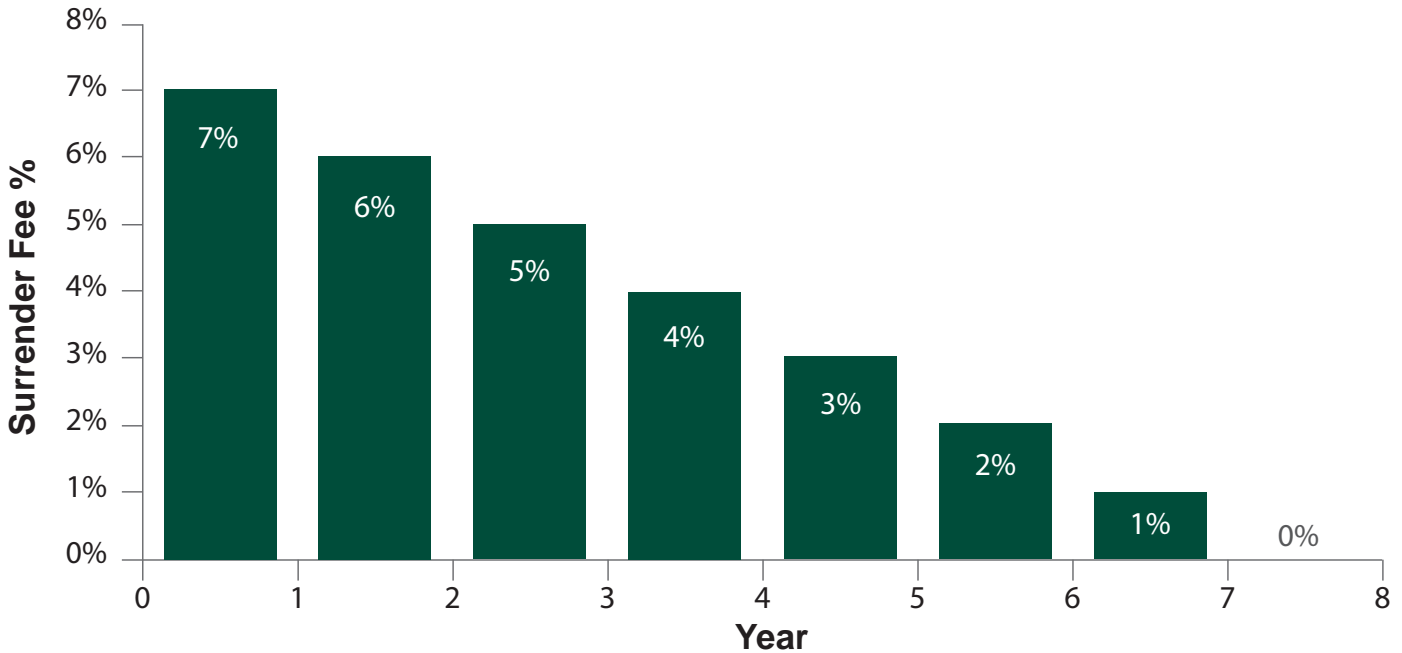
**Exhibit 3: Indexed Annuities Low Growth Potential**



Source: FactSet as of 2/27/2019. Based on an initial investment of \$100,000, S&P 500 Total Return Index, Bank of America/Merrill Lynch US Treasury 7-10-Year Index and hypothetical annuity returns from 12/31/1993 to 12/31/2018. The S&P 500 Total Return Index is a capitalization-weighted, unmanaged index that tracks the total return (inclusive of dividends) of 500 widely held US common stocks of leading companies, representative of the broad US equity market. The Bank of America Merrill Lynch US Treasury 7-10-Year Index tracks the total return inclusive of interest payments of US Treasury bonds maturing within 7 to 10 years, representative of long-term US government bond returns. Hypothetical annuity indexed to the S&P 500 Total Return Index and assumes a 1% floor, 5% cap and 100% participation rate.

**3. Surrender Fees:** Variable and fixed indexed annuities can charge sizable surrender fees. A common surrender fee for a variable annuity starts at 7% of the premium and 10% for a fixed indexed annuity and declines to zero over time. Knowing you have to pay a surrender fee in order to get out of the contract may make you feel locked into a product that doesn't fit your needs. It also poses significant liquidity risk should a situation arise where you need to access these funds.

**Exhibit 4: Representative Annuity Surrender Fees**



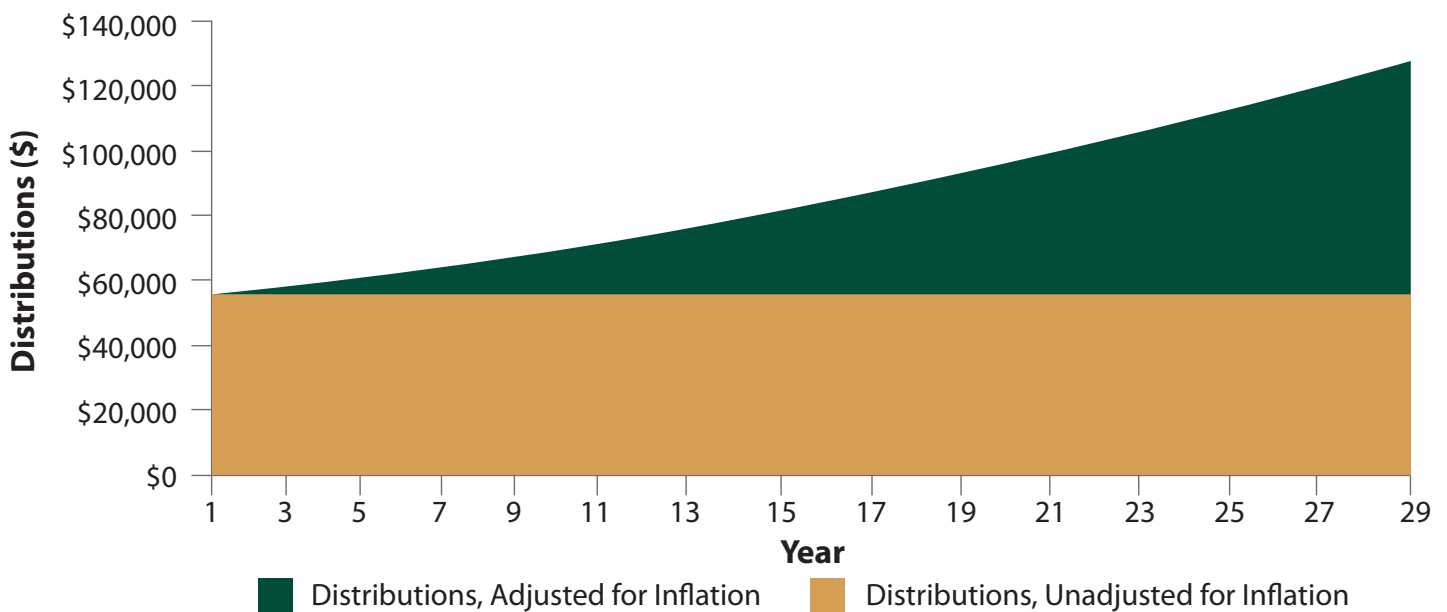
**4. Confusing Guarantees:** Financial advisers who sell variable annuities tend to trumpet “guaranteed growth.” That makes it sound like your income is guaranteed to increase each year, doesn't it?

Unfortunately, when you look closer you'll see a different story. Annuity owners often do not realize the 5% or 6% “guarantee” they believe they have is not actually a return on their premiums, but rather an increase on the “income benefit base.” The income benefit base is merely an accounting figure used in calculating the withdrawals the investor can take, defined by the insurance company. These income features promise lifetime payments for the owner and sometimes a spouse, but in reality it is a withdrawal of the premium you have already paid.

**5. Fixed Payments:** The income stream from fixed annuities is generally not adjusted for inflation. This offers little help to retirees who need a plan to keep up with rising costs over 30 years in retirement.

For example, if your living expenses total \$45,000 per year, and you purchase a guaranteed income stream of \$55,000 at age 65, you may feel your retirement is secure. But how will you fund your \$94,679\* in expenses at age 85 if you're drawing the same \$55,000 in income from your annuity?

**Exhibit 5: Typical Annuity Distributions Over Time**



Of course, the annuity company will happily sell you an inflation benefit, or rider, that promises to adjust your income each year. But every feature you add comes with higher expenses, which ultimately reduce your income payment.

\* Source: FactSet; The actual average historic inflation rate is 2.93% from 1926–2016 based on the US Bureau of Labor Statistics Consumer Price Index (CPI).

## 7. UNDERSTANDING DIFFERENT ANNUITY TYPES

Each annuity contract has specific terms, features and fees. However, annuities can generally be understood by asking a few questions:

### 1. Does the annuity start paying income right away or at a later date?

As its name suggests, immediate annuities begin paying income to the owner as soon as they are purchased. Deferred annuities start paying income at a later date and may grow until they do.

### 2. How are funds in the annuity invested, how do they grow and how are they paid out?

The answers to these questions help you determine whether it is a fixed or variable annuity.

#### **Immediate Annuity (often called a SPIA—Single Premium Immediate Annuity):**

The owner pays a single lump sum (or a “premium”) and that money is converted into a guaranteed stream of income through periodic payments. The payments can last for a set number of years or for the life of the owner and his or her spouse—if the investor is looking to transfer their longevity risk to an insurance company. On the surface, this may sound terrific, but these rarely, if ever, make fiscal sense because the internal rates of return on these products are low relative to competing investment options, similar to their variable and fixed annuity relatives.

At a minimum, immediate annuities are straightforward and easy to understand. Generally, there are no confusing guarantees and no loopholes that allow the insurance company to change the rules down the road. In our view, the direct nature of these contracts makes them the only type of annuity an investor should ever consider—if they are comfortable with the trade-off. At Fisher Investments we caution investors to carefully consider the significant opportunity costs.

Why have you likely not heard of SPIAs before? It’s because these contracts are not very lucrative to salespeople or insurance companies. Instead, advisers are more likely to sell annuities with added features that come at a steep cost to the purchaser—and that pay higher sales commissions. Word to the wise: If you are shopping for a SPIA, you may get pitched a deferred annuity, oftentimes because they compensate the insurance salesperson up to three times more! The proof is in the numbers. As of 2015, sales of fixed immediate annuities (SPIAs) totaled just \$9.1 billion, while sales of all other annuities totaled a whopping \$227.6 billion.\*

\*Source: LIMRA, Secure Retirement Institute, US Individual Annuity Sales Survey, 4th quarter 2015. <http://www.limra.com/Posts/PR/Data-Bank/PDF/2015-4Q-Annuity-Estimates.aspx>

**Deferred Annuity:** During the accumulation period, the annuity owner deposits funds into the contract all at once or in installments. The funds can grow by a certain rate or at a rate based on the performance of underlying investments. During the accumulation period, the funds may grow tax-deferred. At the end of the accumulation period, the owner can choose to:

- **Take their full cash surrender value**
- **Begin to take regular periodic payments from the contract through annuitization**

**Fixed annuity:** This annuity type credits the owner with a fixed level of interest during the accumulation stage. The insurer sets the accumulation rate with a guaranteed minimum or floor. For example, a fixed annuity might offer a 5% rate of return for the first two years after the contract is issued and a minimum guaranteed rate of 1% for the term of the contract. After the first two years, the insurer could change the accumulation rate, making it higher or lower than the initial 5%. However, it is guaranteed to be no lower than 1%.

When the owner decides to turn on the income from the annuity, he or she will receive a fixed payment based on the value that had accumulated in the contract. This payout rate will neither increase nor decrease over owner's lifetime. The insurer guarantees the fixed payments.

One popular type of fixed annuity is called a fixed indexed annuity or an equity indexed annuity. The owner of this product is able to participate in the some of the performance of a stock or bond index while avoiding a temporary decrease in value if that index declines. These products typically have no fees. However, the annual allowable interest crediting of the index is capped to no more than a certain percentage of the index's growth—often as low as 2% per year—severely limiting the growth potential these products provide.

**Variable Annuity (VA):** With this type of annuity, funds an owner deposits into the contract are directed into various mutual fund-like investments. The performance of these underlying investments determines the growth of the contract value.

Unlike fixed annuities, VAs do not guarantee a minimum return on the contract value. If the investments decline, so will the value of the contract. Most variable annuities are sold with a rider, or additional benefit, that guarantees lifetime income when the buyer activates the income stream.

If the underlying investments perform well, however, the owner has greater growth potential than that offered by fixed annuities or conservative investments such as certificates of deposit (CDs) and government bonds.



## 8. WHAT ARE THE TRADE-OFFS?

Assume a SPIA purchased by a 65-year-old couple for \$1 million will generate \$45,000 per year in income and adjust higher at 2% annually to account for inflation. Meaning, a \$45,000 per year stream of income that adjusts higher by 2% annually over that 65-year-old couple's expected lifetime would cost \$1 million. The income stream would grow to \$88,000 per year by the time the couple turned 90.

That growth rate should help you keep pace with inflation. But remember that a SPIA requires you to give up access to the lump sum value of your premium in exchange for that guarantee.

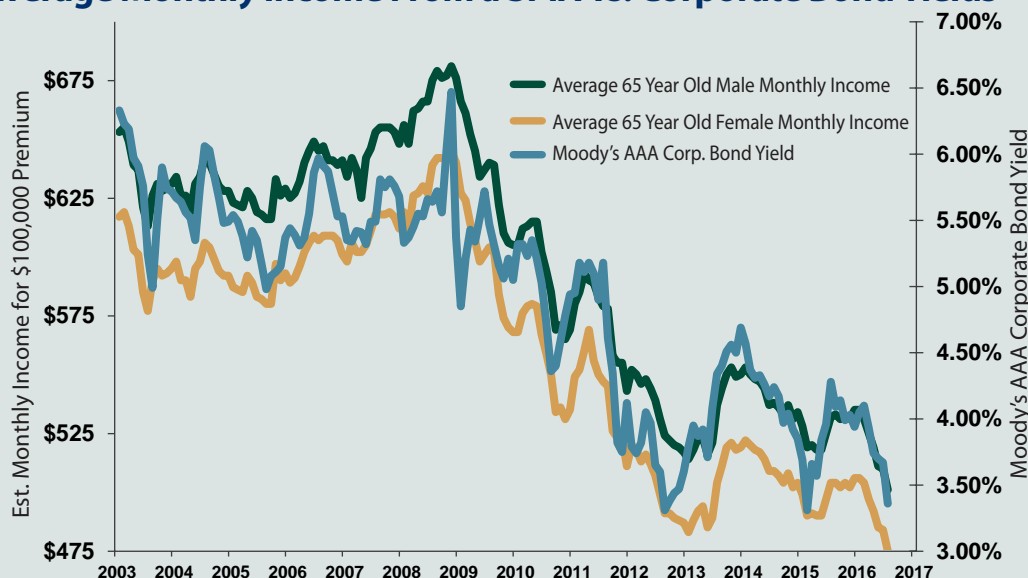
This means you no longer have that \$1 million if unexpected expenses arise, such as medical bills or home repairs. Likewise, there is no remaining contract value that could be passed on to your heirs. You cannot change your mind and cash in your SPIA. We believe the certainty of the SPIA guarantee comes at a high price—in this case \$1 million.

## IN FOCUS: THE CONNECTION BETWEEN INTEREST RATES AND ANNUITIES

The interest rate environment has a considerable impact on the guaranteed lifetime income level that an annuity company can offer. As insurance companies compete for your business, they seek to offer the highest guaranteed income rate they can relative to their competitors while maintaining profitability to attract buyers. That rate is largely dependent on the returns they can earn from bonds in order to underwrite their guarantees.

Exhibit 6 shows the correlation between the Moody's AAA Corporate Bond Yield and a SPIA for a 65-year-old male and a 65-year-old female, respectively. Though it is not a perfect correlation, it is fairly close.

### Exhibit 6: Average Monthly Income From a SPIA vs. Corporate Bond Yields



Source: *immediateannuities.com; Male 65/Female 65 Life & 10 Years Certain Annuity Rates and Moody's AAA Corporate Bond Yield*

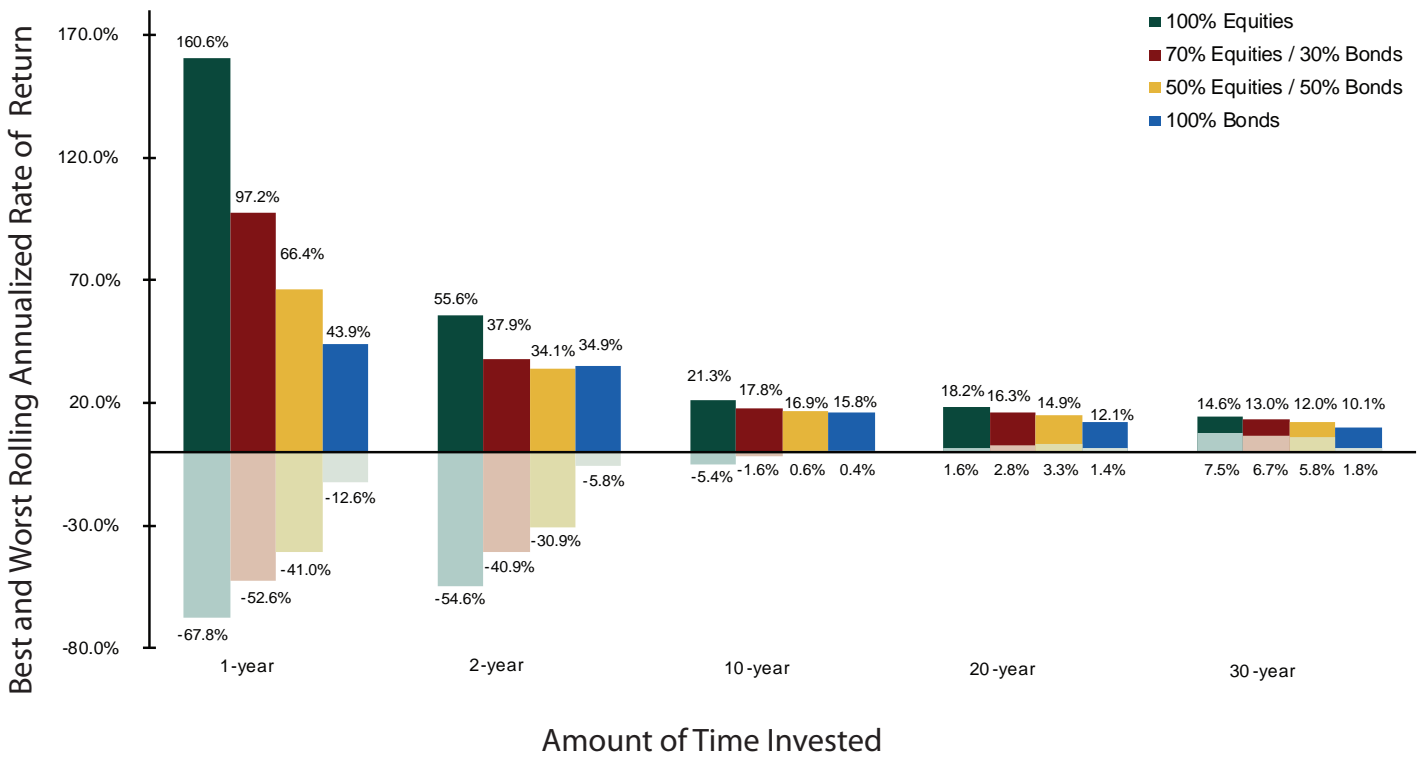
What does this mean to you? When you consider the level of guaranteed lifetime income you can expect to receive from an annuity company, understand rates have not been this low in decades.

Instead of locking yourself into a guarantee that puts strict limits on your flexibility, consider what kind of income you could receive from an investment portfolio that is fully liquid.

We believe investing a lump sum in a mix of stocks and bonds instead of purchasing an annuity offers a different—and more palatable—set of trade-offs.

Many retirees object to stocks because of market volatility, specifically, market declines. Market volatility tends to be easier to accept if it is understood and expected. As we examine the frequency of market declines, we find they become less of an issue over longer time horizons. We've already demonstrated most people should expect their retirement to last 20, 25 or 30 years.

**Exhibit 7: Volatility Declines as Time Horizons Lengthen**



Source: Global Financial Data, Inc., as of 11/14/2016. Average rate of return from 12/31/1925 through 9/30/2016. Equity return based on Global Financial Data, Inc.'s S&P 500 Total Return Index. Fixed Income return based on Global Financial Data, Inc.'s USA 10-year Government Bond Index.

Returns on stocks and bonds can be negative over shorter time periods with significant volatility between the best and worst periods. But as the length of time invested increases, negative returns are muted. The chart shows only a handful of negative 10-year periods, with a narrower spread between the best and worst periods. The best 10-year period for the all-stock portfolio saw a return of 21.3%, far outpacing the worst 10-year loss of 5.4%.

As we approach the 20-year mark, you can see that the average returns for stocks become uniformly positive. If you are 65, you likely have a 20-year time horizon. Over that length of time, the risk of outliving your money starts to seem more likely than the risk of suffering a permanent loss in markets.

There have been 60 rolling 30-year periods since 1926. In every single period, investment portfolios—whether they held all stocks, all bonds or a blend of both—posted positive returns. Even during the worst-performing 30-year period, which included the Great Depression, a portfolio of stocks was still in positive territory.

## 9. USING YOUR PORTFOLIO TO GENERATE RETIREMENT INCOME

We've seen that diversified portfolios invested in stocks and bonds have appreciated in value over the long term, even though they tend to experience periodic declines in the short term. Now how can we use that knowledge to formulate a retirement income strategy?

In *Debunkery*, Ken Fisher explains that a portfolio of stocks and bonds can produce cash flow in several ways:

- **Taking dividends from the stocks you own**
- **Receiving interest payments from your bonds**
- **Selectively selling stocks, bonds or both, which will likely appreciate in value over time. We call this "homegrown dividends."**

To avoid depleting your portfolio, you should be sure to take no more than 5% per year out of your portfolio. At this rate, the rising trend line of stocks and bonds is likely to outpace your withdrawals, despite the occasional market downturn. Keep in mind that your withdrawal rate could be different based on your specific situation, including your age, health and family history of longevity.

Additionally, it's a good idea to keep two months' worth of your necessary income in cash at all times. During a market decline, this cushion may prevent you from having to sell stocks at low prices to generate income. Additionally, the small cash position should not hinder the overall growth of your portfolio.

Selling stocks for income carries other benefits, as well. If you sell stocks that have declined in value, you can generate a tax loss that can offset gains elsewhere in your portfolio, reducing your overall tax bill. When an asset's allocation grows beyond its desired weight in your portfolio, selling that position can help you rebalance your asset mix.

### IN FOCUS: CONSIDER HOW ANNUITIES ARE TAXED

Don't lose sight of taxes when designing your retirement income strategy. The money you draw from annuities is taxed as ordinary income. For most people, that rate is higher than the capital gains tax rate that applies to investment appreciation. If you own annuities in retirement, you might expect to pay more in taxes. If you invest in a portfolio of stocks and bonds, your rate could be lower, and you can control which investments you sell and when. The homegrown dividends strategy offers a clear advantage.

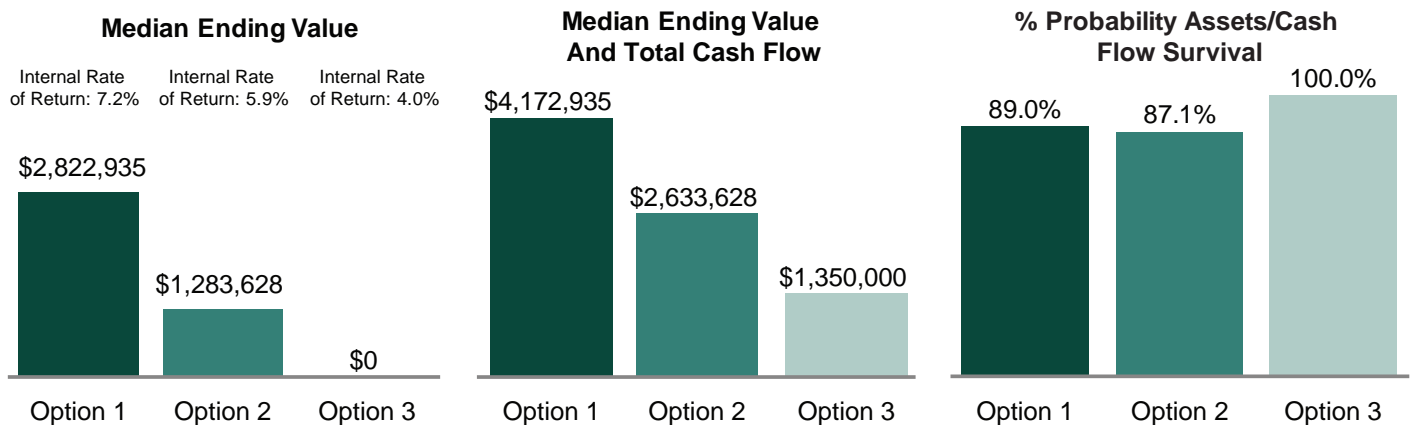
## 10. HOMEGROWN DIVIDENDS

Let's see how this strategy might work in practice. Imagine a hypothetical retiree decides to invest a nest egg of \$1 million in stocks and bonds instead of purchasing a SPIA with that money.

As with the SPIA we discussed on page 10, the retiree withdraws \$45,000, or 4.5%, from the portfolio in the first year. Every year, he or she increases the withdrawal amount to keep up with inflation. We ran a simulation of how the portfolio, allocated three different ways, might perform over a 30-year period.

In Option 1, the retiree allocates 100% of their portfolio to stocks while in Option 2 they allocate 70% of their portfolio to stocks and 30% to bonds. Option 3 shows what might happen when they allocate all their money to a SPIA.

### Exhibit 8: Asset Allocations and Ending Values





## Investor Assumptions

**Starting Portfolio Value:** \$1,000,000

**Your Annual Cash Flows:** \$45,000

**Simulation Time Frame:** 30 Years

## Future Investor Probabilities

	Option 1	Option 2	Option 3
<b>Allocation:</b>	100% Stocks	70% Stocks and 30% Bonds	100% SPIA
<b>Probability of Asset/Cash Flow Survival:</b>	89.6%	87.1%	100%
<b>Internal Rate of Return:</b>	7.2%	5.9%	4.0%
<b>Median Ending Value:</b>	\$2,822,935	\$1,283,628	\$0
<b>Median Ending Value and Total Cash Flows:</b>	\$4,172,935	\$2,633,628	\$1,350,000

*Median ending value: in today's dollars. Median ending value + total cash flow: both in today's dollars. Inflation assumption: 2%. All probabilities were constructed using Monte Carlo simulations.*

*This informational analysis makes numerous assumptions, including but not limited to the use of S&P 500 Stock Index and/or the US 30-year Treasury yield for fixed returns and our forecasted data for domestic equities, fixed income, cash and inflation to project the ending value of your portfolio in the future or cash flow availability from your assets. All values are expressed in today's dollars. To reduce the impact of statistical outliers, the top 2% and bottom 1% are omitted from simulation results. FI uses the Monte Carlo analysis and our proprietary software program to help determine the recommended asset allocation for the portfolio.*

*Year 1 cash flow represents the next 12 months of cash flows from your Fisher Investments managed portfolio. Additional years of cash flow referenced in this document refer to subsequent 12-month periods, not calendar years.*

The all-stock portfolio, Option 1, was best able to deliver a growing stream of income while continuing to appreciate in value. Despite the occasional temporary market decline, our hypothetical investor was able to fund their retirement while growing their nest egg. At the end of 30 years, the portfolio was worth more than \$2.8 million—and it belongs to the investor, not the insurance company. Compare this to the SPIA, Option 3, which was worth nothing at the end of the owner's life.

Further, in Option 1 the portfolio generated a total cumulative outflow (Median Ending Value and Total Cash Flow) of approximately \$4.17 million, compared to only cash flow of the SPIA at \$1.35 million—again, a massive difference of about \$2.8 million.

The blended portfolio also fared better than the SPIA. A 70% stocks/30% bonds mix generated sufficient income, was worth almost \$1.3 million at the end of the period and had totaled \$2.63 million in growth and income.

### 11. WHAT DOES CERTAINTY COST?

We believe our example shows the viability of using homegrown dividends to create retirement income. But of course, there is the slight possibility that a stock portfolio of \$1 million paying out \$45,000 per year with an annual inflation adjustment will not last. The probability of the portfolio having a value at the end of 30 years is 89.6%.

By comparison, the \$1 million SPIA has an ending value of zero but a 100% probability of payments continuing because it is guaranteed.

What does our hypothetical retiree give up in order to slightly increase the likelihood the income stream will last their entire life? Because the SPIA has an ending value of zero, in our scenario they missed out on the appreciation that the other portfolios provide. The 100% stock portfolio gained more than \$2.8 million while providing the same cash flows as the SPIA. The 70% stock and 30% bond portfolio increased by more than \$1.2 million while producing enough cash to cover living expenses.

Does exchanging that potential growth for the small increase in certainty make sense for you?



## 12. WHY A COMPROMISE STILL DOESN'T WORK

Some advisers suggest a way for risk-averse individuals to split the difference between annuities and investments. They may propose you buy an annuity to fund your non-discretionary expenses—what you need to spend—and invest in stocks and bonds to pay for your discretionary expenses—what you want to buy.

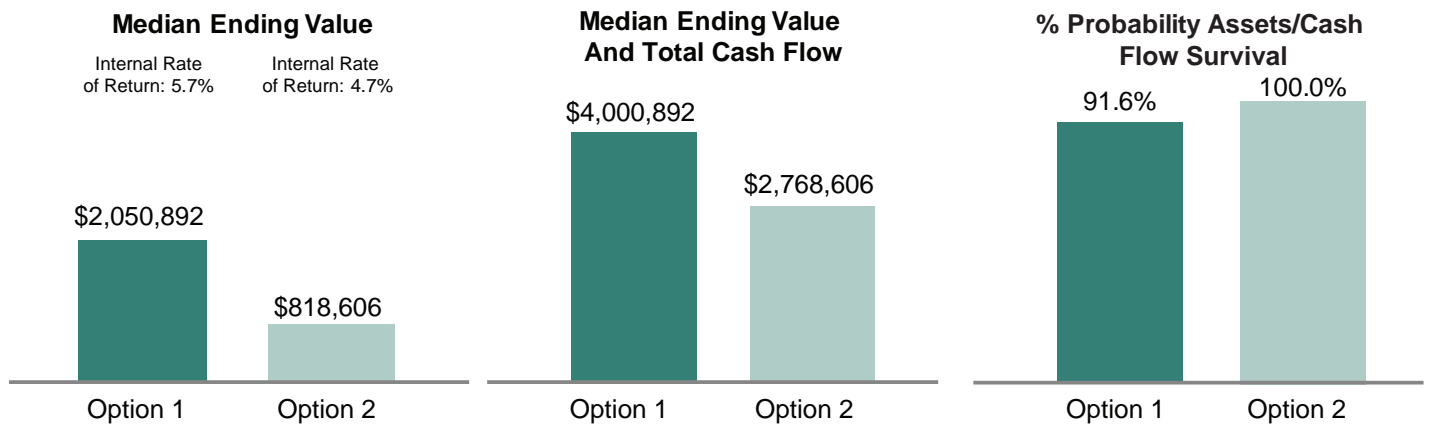
This may seem like a good way to help protect against a market downturn. But we believe the opportunity costs are still too high.

To test this, we created two scenarios for a hypothetical retiree with a nest egg of \$1.5 million. The retiree's non-discretionary expenses total \$45,000 per year and discretionary expenses cost an additional \$20,000.

In Option 1, the retiree invests the entire \$1.5 million in a 70% stock/30% bond portfolio and draws \$65,000 per year in homegrown dividends, with annual adjustments for inflation.

In Option 2, the retiree purchases a \$1 million SPIA to generate \$45,000 per year to cover the non-discretionary expenses. This amount increases each year to accommodate inflation. The remaining \$500,000 is invested in a blended portfolio of stocks and bonds to fund \$20,000 in annual discretionary spending also accounting for inflation. Let's see how the two scenarios compare:

**Exhibit 9: Modeling a Compromise**



In Option 1, the \$1.5 million portfolio was invested in a mix of stocks and bonds. The portfolio successfully funded all of the retiree’s needs over 30 years of rising costs. At the end of that period, the portfolio had grown to over \$2 million and had a total cumulative outflow of over \$4 million. Despite the lack of an annuity guarantee, the investor didn’t experience meaningfully higher levels of risk—the portfolio had a 91.6% probability of survival.

In Option 2, the retiree was able to draw the required income from the SPIA and to keep up with the price increases of the non-discretionary items. However, as we’ve noted, the retiree had no access to that \$1 million and was left with no account value at the end of 30 years.

The discretionary portion of the retiree’s assets fared well, growing to more than \$800,000, even after 30 years of withdrawals. The invested portfolio had a compelling survival rate of over 94%. Yet even though the retiree didn’t run out of money, the total cumulative outflow of the Option 2 strategy was only \$2.7 million—so the retiree missed out on a big opportunity compared to Option 1.

Also, keep in mind that during market downturns, people can always decide to cut back on their discretionary spending until things have recovered. This would enhance the survival probability and the ending value of the portfolio.

As we’ve clearly seen, purchasing an annuity looks like a serious mistake for investors who have \$500,000 or more to fund a homegrown dividends strategy—particularly when that strategy offers a comparatively higher probability of growth.

**Investor Assumptions**

**Starting Portfolio Value:** \$1,500,000

**Non-Discretionary Annual Cash Flows:** \$45,000

**Discretionary Annual Cash Flows:** \$20,000

**Simulation Time Frame:** 30 Years

**Future Investor Probabilities**

	Option 1	Option 2
<b>Allocation:</b>	70% Stocks and 30% Bonds	<b>Allocation 1</b> 100% SPIA
<b>Starting Value:</b>	\$1,500,000	<b>Starting Value:</b> \$1,000,000
<b>Annual Cash Flow:</b>	\$65,000	<b>Annual Cash Flow:</b> \$45,000
<b>Probability of Asset/Cash Flow Survival:</b>	91.6%	<b>Probability of Asset/Cash Flow Survival</b> 100%
<b>Internal Rate of Return:</b>	5.8%	<b>Internal Rate of Return:</b> 4.0%
<b>Median Ending Value:</b>	\$2,050,892	<b>Median Ending Value</b> \$0
<b>Median Ending Value and Total Cash Flow:</b>	\$4,000,892	<b>Median Ending Value and Total Cash Flow:</b> \$1,350,000
		<b>Allocation 2:</b> 70% Stocks and 30% Bonds
		<b>Starting Value:</b> \$500,000
		<b>Annual Cash Flow:</b> \$20,000
		<b>Probability of Asset/Cash Flow Survival:</b> 94.7%
		<b>Internal Rate of Return:</b> 5.7%
		<b>Median Ending Value:</b> \$818,606
		<b>Median Ending Value and Total Cash Flow:</b> \$1,418,606
		<b>Combination: Both Allocations from Option 1</b>
		<b>Internal Rate of Return:</b> 4.7%
		<b>Median Ending Value</b> \$818,606
		<b>Median Ending Value and Total Cash Flow:</b> \$2,768,606

Median ending value: in today's dollars. Median ending value + total cash flow: both in today's dollars. Inflation assumption: 2% All probabilities were constructed using Monte Carlo simulations.

This informational analysis makes numerous assumptions, including but not limited to the use of S&P 500 Stock Index and/or the US 30-year Treasury yield for fixed returns and our forecasted data for domestic equities, fixed income, cash and inflation to project the ending value of your portfolio in the future or cash flow availability from your assets. All values are expressed in today's dollars. To reduce the impact of statistical outliers, the top 2% and bottom 1% are omitted from simulation results. FI uses the Monte Carlo analysis and our proprietary software program to help determine the recommended asset allocation for the portfolio.

Year 1 cash flow represents the next 12 months of cash flows from your Fisher Investments managed portfolio. Additional years of cash flow referenced in this document refer to subsequent 12-month periods, not calendar years.



### 13. HOW FISHER INVESTMENTS CAN HELP

Our investment professionals can work with you to design a retirement income strategy that makes sense for your particular situation. We offer an Annuity Evaluation Service that you can use—with no obligation—to better understand any annuities you own or are considering purchasing.\*

Our analysis will likely give you insights about income, fees and penalties, death benefits and more, so you can differentiate between alternatives that fit your needs and those that don't.

We can also run simulations to determine how your nest egg might be able to produce homegrown dividends to support your income needs.

Ultimately, we will give you the information you need to help you assess and develop your retirement income plan.

*\*For qualified investors with \$500,000 in investible assets.*

## 14. HOW WELL DO YOU KNOW YOUR ANNUITY?

We hope this report has shown how complex annuities can be. If you own an annuity or are considering purchasing one, how confident do you feel that you can answer the following questions?

- **What type of annuity do you own?**
- **What does the annuity cost each year, both in fees and in missed opportunities?**
- **Is there a charge for withdrawing assets early from your annuity?**
- **Are there performance caps or market participation rates?**
- **Is your income stream adjusted for inflation?**
- **Who benefits the most from the complexity of your annuity contract?**
- **What are the trade-offs incurred by owning your annuity?**

If you are unsure about any of these details, our Annuity Evaluation Service can help you get the answers you need and evaluate what you own or are considering purchasing.\*

### **Talk to an Investment Professional at Fisher Investments**

Fisher Investments is a nationally recognized money management firm that has helped guide thousands of investors on the path toward their financial goals. If you'd like to feel more confident about your retirement plan, talk to us. Call 800-568-5082 or visit [www.fisherinvestments.com](http://www.fisherinvestments.com) to learn more.

*\*For qualified investors with \$500,000 in investible assets.*

## Facts About Fisher Investments to Compare With Your Current Adviser

	Fisher Investments	Your Investment Adviser
Your portfolio is tailored to your specific needs, taking into account your investment objectives, time horizon for the assets, cash-flow needs and other factors specific to you.	<input checked="" type="checkbox"/>	?
You get proactive service from your own Investment Counselor, who will keep you up to date on your portfolio and on track towards your goals.	<input checked="" type="checkbox"/>	?
You have the opportunity to meet the actual people making investment decisions through in-person events in various formats.	<input checked="" type="checkbox"/>	?
Your portfolio is managed by a team with over 140 combined years of industry experience.	<input checked="" type="checkbox"/>	?
Your firm's Chairman wrote for <i>Forbes</i> for over 30 years and continues to write for <i>USA Today</i> and the UK's <i>Financial Times</i> . He has also written 11 books on investing and wealth creation—including 4 <i>New York Times</i> bestsellers.	<input checked="" type="checkbox"/>	?
You get a disciplined approach to your investment strategy that goes beyond just stock picking.	<input checked="" type="checkbox"/>	?
You can take advantage of global investing opportunities with our significant experience investing domestically and overseas.	<input checked="" type="checkbox"/>	?
You won't be limited to a single style of investing (like "growth" or "value") as we can shift our strategy based on our forward-looking view of market conditions.	<input checked="" type="checkbox"/>	?
Your annual management fee is competitive and transparent, and helps align our incentives with your best interests.	<input checked="" type="checkbox"/>	?

# FISHER INVESTMENTS<sup>®</sup>

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