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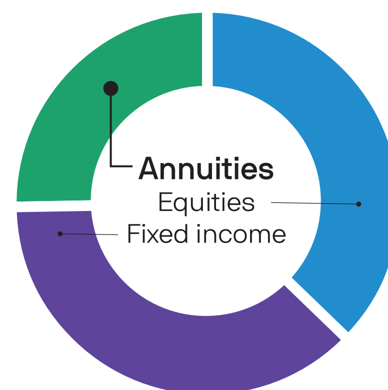
Annuities: An essential slice of the retirement pie

Annuity Insights Bulletin

When it comes to retirement planning, the greatest investment tools investors can exploit are diversification and annuitization.



Annuities have become an essential slice of the retirement pie for Americans approaching and living in retirement. As part of a retirement income solution, annuities also can be an ideal complement to other portfolios.

We believe they are very well positioned in today's investment environment. Unlike other financial instruments, these contracts issued by insurance companies combine the features of investing and insurance in a single solution. They offer a range of flexible benefits, including:

- **Lifetime income:** Annuities offer a variety of guaranteed income options that can start immediately or at a future date.
- **Growth potential:** The earlier your clients invest, the more opportunity they'll have for long-term growth potential from a broad range of investment choices. Growth will vary depending on the performance of the investment options you choose.
- **Tax-deferral:** Taxes can have a big impact on long-term investment returns — making the benefit of a tax-deferred variable annuity especially attractive for high net worth and affluent investors
- **Legacy options:** Many variable annuity contracts offer special riders (for a fee) to provide death benefit protection for loved ones.

Using annuities to solve the most common retirement challenges

Author

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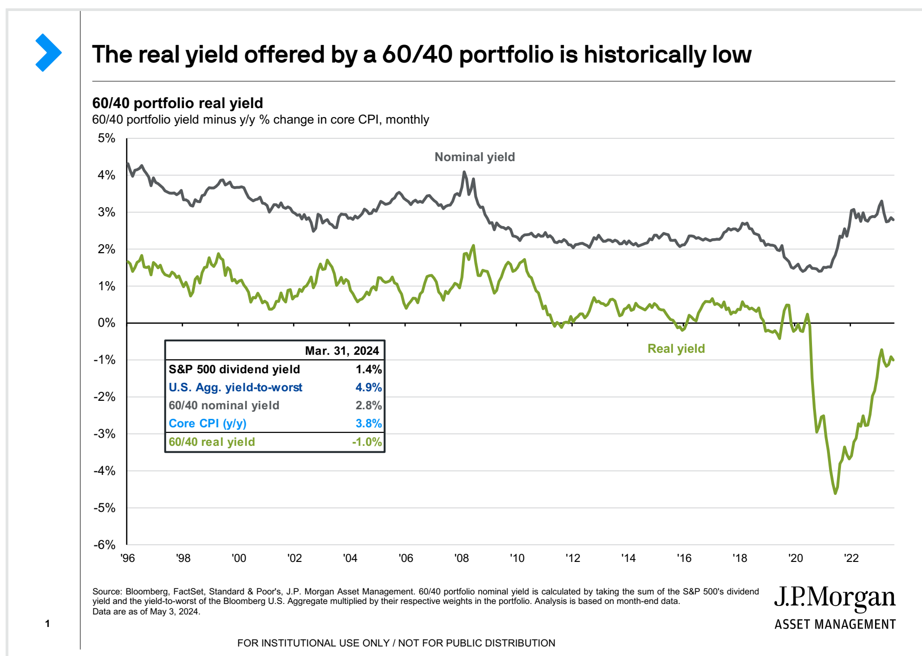
Problem 1: Income Generation

Between a rock and a hard place

The dilemma for retirement investors today is that, while they may have accumulated a sizeable nest egg, thanks to remarkable asset growth over the last two or three decades, they're unable to generate sufficient income from those assets. While interest rates have risen recently on the back of Fed tightening, they could decline if, as expected, the Federal Reserve begins to ease monetary policy in the months ahead. Dividend yields on stocks are also low by historical standards and after adjusting for inflation, remain in negative territory. Combined with elevated market volatility, retirement income planning has become more challenging than ever. It is precisely because of volatility in

interest rates and equity markets that your clients likely will need more protection for their income than historically. This requires diversifying your income generation beyond what investors can reasonably generate from dividends and interest, by accessing capital gains as well as some principal. Advisors and their clients will have to create a systematic withdrawal plan, taking some income from dividends and coupon payments, as well as from capital gains, while easing into principal. That's where annuities can play a beneficial role.



This slide shows over time the nominal yield on a 60/40 portfolio has drifted down and today, even before potential rate cuts, it is well below the year-over-year inflation rate. Income from a traditional 60/40 portfolio is just not keeping pace with inflation.

Problem 2: Life expectancy

The annuity advantage

Insurance companies that issue annuity contracts deal in statistics that calculate the life expectancy for people at different ages and the probability of surviving past certain ages. They rely on the law of large numbers. **By pooling and managing investor assets, insurers are inherently able to provide higher income streams** — and with higher certainty that payments will last a lifetime — than the average investor could do on their own.

Individuals approaching retirement who have a family history of longevity and who are in excellent health are likely to experience above average life expectancy. If they haven't saved enough to achieve their desired retirement spending goal with a high level of confidence, they need to maximize the amount of income their wealth can provide for life — however long that may be. These individuals or households are excellent candidates for an annuity — preferably one that enables them to benefit from mortality credits to maximize their income at an appropriate level.

Time, diversification and the volatility of returns

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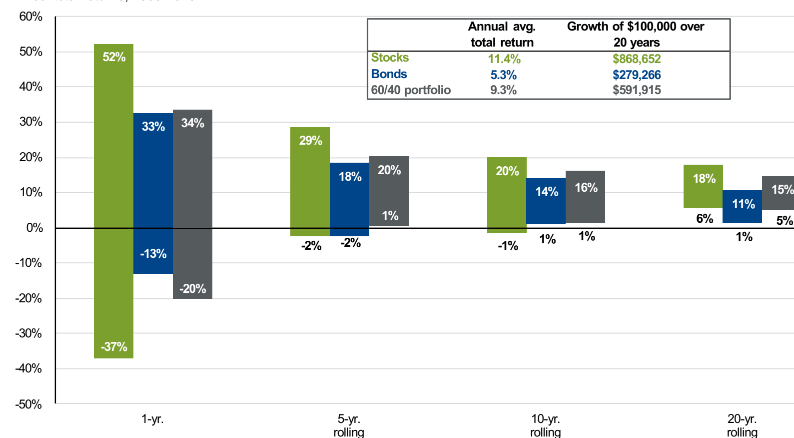
Range of stock, bond and blended total returns
Annual total returns, 1950-2023



Investing Principles

Source: Bloomberg, FactSet, Federal Reserve, Robert Shiller, Standard and Poor's, Strategas/Ibbotson, J.P. Morgan Asset Management.
Returns shown are based on calendar year returns from 1950 to 2023. Stocks represent the S&P 500 Shiller Composite for periods prior to 1936 and the S&P 500 thereafter. Bonds represent Strategas/Ibbotson for periods prior to 1976 and the Bloomberg Aggregate thereafter. Growth of $100,000 is based on annual average total returns from 1950 to 2023.
Guide to the Markets – U.S. Data are as of March 31, 2024.

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This slide from our 2024 *Guide to the Markets* illustrates why it's important to stay invested. It shows historical returns by holding period for stocks, bonds and a 60/40 portfolio, rebalanced annually, over different time horizons. It demonstrates the importance of a balanced portfolio, and an appropriate time horizon.

Problem 3: Emotional biases

Stick to a plan

Constant headlines about market volatility can fuel investor fears. Many pay a heavy cost when their feelings dictate (often poorly timed) investment-related decisions. With built-in features, including withdrawal penalties, annuities can help inhibit investors from making emotional decisions. Research shows that the longer clients remain invested, the less variable their returns. And, because **insurance companies aggregate the assets of thousands of investors, they can afford to stay fully invested through multiple market cycles.** In addition, these insurance contracts also offer optional riders for a fee, to protect assets from market risk.

Problem 4: Market returns

Timing your clients' retirement

Your clients might be able to control when they retire, but they rarely can control what market they retire into.

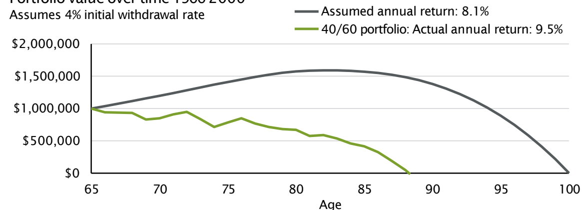
For these households, a dynamic withdrawal strategy that many variable annuities can offer may be an attractive solution to help mitigate this risk. Investors considering an annuity purchase should carefully review its benefits, trade-offs and fees to make an informed decision about how it supports their overall retirement income strategy.

Spending

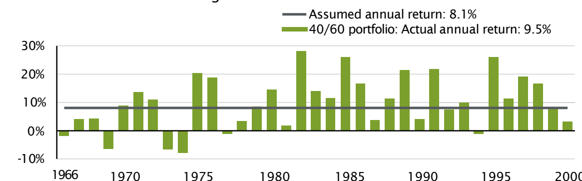
Dollar cost ravaging: timing risk of withdrawals

GTR 34

Portfolio value over time 1966-2000
Assumes 4% initial withdrawal rate



Rate of return: actual vs. average 1966-2000



Sequence of return risk

Withdrawing assets in a volatile market early in retirement can ravage a portfolio. Consider investment solutions that incorporate downside protection such as:

- Balanced risk and diversification at the beginning of retirement
- Annuities with guarantees and/or protection features
- Investments that use options strategies for defensive purposes

Assumptions (top chart): Retire at age 65 with $1,000,000 and withdraw 4% of the initial portfolio value ($40,000). Withdrawal amount increased by historical inflation (CPI-U) each year. Returns are based on a hypothetical portfolio, which is assumed to be invested 40% in the S&P 500 Total Return Index and 60% in the Bloomberg Capital U.S. Aggregate Index. The assumptions are presented for illustrative purposes only. They must not be used, or relied upon, to make investment decisions. There is no direct correlation between a hypothetical investment and the anticipated future return of an index. Past performance does not guarantee future results.

Annual inflation (CPI-U) increased from 2.4% in 1966 to 6.3% in 1970; 10-year U.S. Treasury rate increased from 4.93% in 1966 to 7.35% in 1970.
Source: J.P. Morgan Asset Management; U.S. Bureau of Labor Statistics; Department of the Treasury.

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ASSET MANAGEMENT

This slide from our 2024 *Guide to Retirement* illustrates what can happen when clients retire at the beginning of a declining or bear market. Poor market returns at the beginning of retirement can negatively impact their financial situation. The bottom chart shows the returns experienced from 1966 to 2000, with below average and negative returns in the first 10 years, resulting in the accelerated depletion of assets by the age of 89.

Next Steps

For more information about annuities, visit the Annuity Insights page at jpmorgan.com/annuity to view the latest insights and resources to help clients plan and invest for retirement.

J.P. Morgan Asset Management

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It is important to consider a number of factors before making an investment in an annuity. Because variable annuities invest in securities they are subject to "stock market risk" meaning that stock prices in general (or in particular, the prices of the types of securities in which a fund invests) may decline over short or extended periods of time. When the value of a fund's securities goes down, an investment in a fund decreases in value. Due to various features, benefits, limitations, early surrender charges, penalties and possible tax implications that may apply to a particular annuity; it is important to read the prospectus, contract, statement of additional information and offering material, and to discuss your particular needs and circumstances with your Financial Advisor to determine the type of annuity that may be best suited for your investment needs. You should consider the risks and objectives of the annuity and match them to your own goals and risk tolerance. In addition, you should fully understand the costs associated with your investment.

Fixed annuity contracts have a set interest rate return that is "fixed" for a specified period of time. The interest rate and payment of investment principal are backed by the ability of the issuing insurance company to pay the amounts from their resources. Variable annuity contracts generally offer the ability to invest assets in an annuity contract in the market through sub-accounts (held within the annuity) that invest in the securities markets. There are generally diversified investment objective options available with varying levels of investment risk to meet each individual investor's risk tolerances and objectives. Investors may change the sub-account allocations, however; the issuing insurance company can limit the number of times a sub-account change can be made per year. Because variable annuities invest in securities they are subject to "stock market risk" meaning that stock prices in general (or in particular, the prices of the types of securities in which a fund invests) may decline over short or extended periods of time. When the value of a fund's securities goes down, an investment in a fund decreases in value. The returns with a variable annuity will depend upon the investment performance of the sub-account(s) that are selected by the investor. It is important to consider a number of factors before making an investment in an annuity. Due to various features, benefits, limitations, early surrender charges, penalties and possible tax implications that may apply to a particular annuity and, in many cases, the assets invested in the underlying annuity sub-account(s) are subject to current fluctuation due to market risk; it is important to read the prospectus, contract, statement of additional information and offering material, and to discuss your particular needs and circumstances with your financial professional to determine the type of annuity that may be best suited for your investment needs. You should consider the risks and objectives of the annuity and match them to your own goals and risk tolerance. In addition, you should fully understand the costs associated with your investment.

Annuity guaranteed benefits, such as guaranteed income for life or death benefits are only as good as the insurance company that gives them. While it is an uncommon occurrence that the insurance companies that back these guarantees are unable to meet their obligations, it may happen.

It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yields are not reliable indicators of current and future results.

Guarantees are subject to the claims-paying ability of the issuing insurer.

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