Is Buying An Annuity In A Bear Market A Good Idea?

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In *Safety-First Retirement Planning: An Integrated Approach for a Worry-Free Retirement*, I explain how including annuities with lifetime income protections alongside other investments can lay the foundation for a more robust retirement

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As the stock market experienced unprecedented growth over the past eleven years, however, many people were naturally less interested in the lifetime income options from pensions or annuities. Who wouldn't rather have all the assets today so they ca invest them with the idea of earning high returns? Research conducted by Indiana University's Alessandro Previtero concludes that individuals extrapolate recent stock market returns into the future and become more comfortable with investment-based strategies when the market rises.

What a difference a month makes. Given the dramatic selloff in equities following th coronavirus outbreak, many Americans who are approaching retirement, or are already retired, are inevitably asking themselves if an annuity may be a good idea after all. Previtero's research demonstrates that annuities are more popular after sto markets decline.

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When thinking about the role of annuities in a retirement plan in today's extraordinary climate, however, many people will contemplate if it is prudent to buy an annuity after the market has already dropped. Should one wait for markets to rise again?

The easiest way to answer this question is to think in terms of the *funded ratio* for retirement. This requires calculating the household's total assets and liabilities. Asse include values for the financial portfolio and other real assets, as well as the present discounted value of other potential income sources, including Social Security, pensions, annuities, part-time work, etc. Liabilities include current debt such as a mortgage or loan balance, as well as the present value of lifetime spending needs and taxes.

Next, divide total assets by liabilities to determine the funded ratio. If it is 1 (or 100% then sufficient assets are available to cover liabilities. The plan is precisely funded, b vulnerable to losses derailing it. If the funded ratio is greater than 1, a retiree enjoys the flexibility which comes with having more than needed. If it is less than 1, a retire is underfunded. When underfunded, options include reducing spending plans, working longer, or making a Hail Mary pass and taking on more risk with one's investments. (The final option is not recommended.)

In today's bear market, we are more interested in those who were overfunded before the recent market losses on account of the prolonged bull market. Today, those who have experienced portfolio losses will be less funded than before, but for those who still have enough assets to meet their goals, an annuity can still be a viable option. After all, the goal of true retirement income planning is not to earn a high investmen return, but rather to actually be able to fund all of their financial goals for retirement including have enough income to cover essential monthly expenses in retirement.

Following a steep market downturn, deferred annuities are particularly attractive given their guaranteed lifetime income provisions that offer both liquidity and upsid growth potential, while providing downside protection to support spending even if th market continues to drop. With these deferred annuities, one does not have to "lock losses" as the underlying assets can still have the opportunity to grow. They may just grow a bit less than otherwise because of the cost for the insurance to protect spending from further market losses. But if this protection helps a retiree to keep invested in the markets because they don't have to be as concerned about market losses, then it can provide a great benefit. Their goal is protected on the downside bu still keeps exposure on the upside.

Annuities can also offer some advantages in terms of tax deferral when purchased inside of a taxable account. But the problem with taxable accounts is the need to sell assets and pay taxes on the gains. A potential silver lining of the recent market losses is that taxes due may be less and there may be opportunities to harvest losses on mo recent purchase that can offset gains as a part of funding the annuities, without leading to a big tax bill.

This is an excerpt from Wade Pfau's book, Safety-First Retirement Planning: An Integrated Approach for a Worry-Free Retirement. (The Retirement Researcher's Guide Series), available now on Amazon AMZN.

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