

Using annuities to offer protection when markets are turbulent



Wealth
Management

When the stock market is in flux, the fear of losing your hard-earned savings is real. Annuities can help you protect your money. It's called downside protection.

An annuity is a crucial part of a retirement portfolio. There are many types of annuities available based on your needs, including ones that are popular for providing protected retirement income. You buy an annuity from an insurance company and get payouts for a set number of years, or for your lifetime.

But certain annuities are designed to help you protect your assets by limiting or avoiding losses. In times when the stock market drops, you may be more comfortable knowing you are protecting your assets.

“With the ramifications of the coronavirus, people, especially those near retirement, are more concerned about making sure they don't lose what they've accumulated; that puts more focus on the asset protection side,” says Michael R. Harris, a senior educational advisor with the Alliance for Lifetime Income who holds CFP®, CLU® and ChFC® designations. “Their thoughts are, ‘If I can make a little money, that's fine, as long as I don't lose any.’”

For example, if you are in your 50's, you know that in the future when you retire, you'll get Social Security retirement benefits, maybe a small monthly pension, and you've built up a nice pot of savings. With an annuity, you can protect your savings—and earn something.

Annuities come in different styles, with many different features, including varying levels of downside protection. Here's what to look for if you're seeking to shield your nest egg.

If you need downside protection

With a fixed annuity, you contribute money for a certain amount of time and get a set interest rate. You get the fixed interest rate for the term of the contract, or the number of years you pick as the length of the annuity. The insurance company guarantees your full principal, confirming your downside protection.

At the end of the term—say five years—you get your money back plus interest. You can end the contract, renew it, or buy a new annuity. “There's not a lot of sizzle to buying a fixed annuity,” Harris says. That's just fine for some folks. These are the most conservative types of annuities.”

If you want downside protection with more upside potential

Like a fixed annuity, with an indexed annuity, your principal is protected. But the difference is that the annuity is linked to a market index. You're not actually invested in the market. The market index you choose acts like a kind of measuring tool. If the market index is positive, you

get earnings that are potentially higher than could be earned in a fixed annuity. If the market index is negative, you don't lose the principal investment you put in, but you may get no earnings, depending which options you choose in the contract. The earnings potential is spelled out in the contract. Usually there is some limitation in the earnings that the annuity permits, which is based on a cap or participation rate.

When comparing fixed versus indexed annuities side by side, the positive for a fixed annuity is it promises a fixed interest rate. However, the upside is limited to that fixed rate. And with an indexed annuity, you have the opportunity to make more than in a fixed annuity when markets are positive.

If you're bullish or optimistic that the stock market will go up, but still want protection in case it goes down, an indexed annuity might make more sense. If you're nervous and less optimistic about the markets, you might not want to be linked to an index, so a fixed annuity might be more appropriate.

Some people elect to buy both types of annuities to complement each other. Another approach is to buy an indexed annuity that lets you put money in different buckets in the same contract. One of those

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buckets can be fixed. So you could have one contract, with money in one bucket getting a fixed rate of interest, and money in another bucket with earnings tied to an index. This helps increase your opportunity to earn money on your annuity.

If you want even more upside potential, but still want some downside protection

A variant on the indexed annuity is one that provides some downside protection and offers even more upside potential. These are called registered indexed linked annuities. They are also called buffered indexed annuities or structured annuities.

These annuities offer downside protection, just not 100%. You choose how much you want to protect in a downturn with what's known as a floor and a buffer. If you choose a 10% buffer, you'll be protected against the first 10% loss in the market. If the market loses 15%, you've lost 5%, and protected 10%. If you choose a 10% floor, you will be responsible for the first 10% loss in the market. However, if the market loses 15%, the insurance company will protect you against any loss beyond the floor.

That's measured at the end of the term, the number of years you pick. The higher your buffer or floor, the lower your upside potential because the insurance company is giving you more protection.

Who should consider a registered indexed linked annuity? "It's for a client who is not quite as risk averse but still wants some downside protection," Harris says.

There are a lot of different options depending on your risk level. That's why it's important to seek out the help of a financial advisor who can help you choose the right options for you. A professional can help you assess your risk level, and determine how much downside protection makes sense for your retirement goals and needs.

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Some income guarantees offered with annuities take the form of optional riders and carry charges in addition to the fees and charges associated with annuity products.

There is no guarantee that any investment will achieve its objectives, generate positive returns, or avoid losses. Investments in annuity contracts may not be suitable for all investors.