

RETIREMENT INCOME + PROTECTION

Understanding Annuities: Where Protection and Lifetime Income Can Fit

An educational guide to how annuities work, where they can help, what they cost in flexibility, and why downside protection can matter during prolonged periods of difficult market performance.

FROM THE DESK OF BESPOKE FINANCIAL GROUP

Annuities are not designed to replace a diversified investment portfolio. They are insurance contracts that can be used for specific jobs inside a retirement plan - particularly protecting a portion of assets from market loss, creating tax-deferred accumulation, or converting assets into a stream of income that can last for life.

THE KEY QUESTION

The question is not simply, "Are annuities good or bad?" It is: **What job would an annuity be doing in your retirement plan, and what are you giving up in exchange for that benefit?**

What Is an Annuity?

An annuity is a contract between you and an insurance company. You contribute a lump sum or a series of payments. In exchange, the insurer provides benefits defined by the contract, which can include tax-deferred growth, protection features, and a stream of future income. Guarantees depend on the financial strength and claims-paying ability of the issuing insurer.

Annuities generally fall into several broad categories:

Fixed	Credits a stated or guaranteed minimum interest rate. Designed primarily for stability.
Fixed Indexed	Credits interest based partly on an external index, subject to contract terms such as participation rates, caps or spreads. Traditional fixed indexed annuities generally protect principal from index losses, subject to surrender provisions and insurer strength.
Variable	Value fluctuates with underlying investment subaccounts. Offers greater market participation but also investment risk.
Registered Index-Linked	Links returns to an index while using buffers or floors to limit some losses. Unlike a traditional fixed indexed annuity, losses can occur.

Two Very Different Jobs for an Annuity

1. Protection / accumulation. A retiree may use a fixed or fixed indexed annuity for a portion of assets they do not want exposed to direct market losses. The tradeoff is that upside potential is limited compared with owning stocks directly.

2. Lifetime income. Some annuities can provide payments for life, either through annuitization or an optional lifetime-withdrawal feature. This can help address longevity risk - the possibility of living longer than your portfolio can comfortably support.

NOT ALL OR NOTHING

An annuity does not have to be the entire retirement strategy. It can be one component alongside liquid investments, Social Security, pensions, cash reserves, real estate and other assets.

How a Fixed Indexed Annuity Works

A fixed indexed annuity (FIA) does not invest your premium directly in the S&P; 500. Instead, the insurer calculates interest credits using a formula tied to an index. The contract determines how much of a positive index move is credited and what happens when the index declines.

Three terms matter:

Participation rate. The percentage of an index increase used to calculate the credit. If the index rises 10% and the participation rate is 50%, a simplified credit would be 5%, before considering any cap, spread or other contract provision.

Cap. A maximum credited rate. A contract with a 7% cap would generally not credit more than 7% even if the index rose substantially more.

Spread. A percentage deducted from a positive index return before interest is credited.

Traditional FIAs commonly provide a floor against negative index-linked interest credits. That does not mean every withdrawal is guaranteed to preserve principal: surrender charges, market value adjustments where applicable, withdrawals, taxes, and other contract provisions can affect what the owner receives.

THE TRADEOFF

The insurer is taking away some of the downside market exposure. In exchange, the contract owner gives up some of the upside, plus some liquidity during the surrender period.

Why This Can Matter Near or During Retirement

Large losses become particularly disruptive when a retiree is simultaneously withdrawing money. Avoiding a major drawdown on a portion of the retirement assets can reduce the amount of recovery required before those dollars can begin compounding from a higher base again. That is one reason protection-oriented assets may play a different role than growth assets.

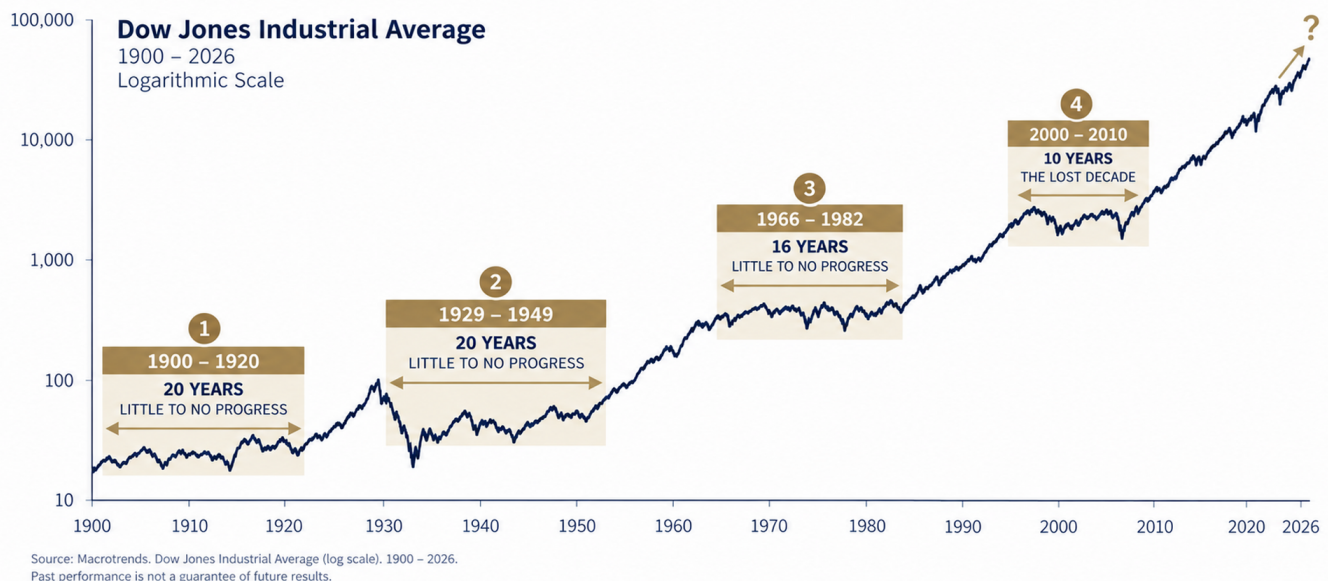
Markets Can Go Through Long Periods of Little Progress

The long-term history of U.S. equities is one of substantial growth, but that growth has not occurred in a straight line. The Dow Jones Industrial Average chart below highlights several extended periods in which the **price index** made relatively little net progress from beginning to end: 1900-1920, 1929-1949, 1966-1982, and the 2000s last decade.

The 2000-2012 period is the most recent prolonged stretch that is especially relevant to today's retirees: investors experienced the technology bubble collapse, three consecutive negative S&P; 500 total-return years from 2000-2002, and the 2008 financial crisis before a durable new expansion took hold. The exact result depends on the index, dates selected, and whether dividends and inflation are included.

Dow Jones Industrial Average: 1900 – 2026

A HISTORY OF GROWTH WITH PERIODS OF LITTLE OR NO PROGRESS



How to read this chart: This is a Dow Jones Industrial Average **price-index** illustration on a logarithmic scale. It does not include reinvested dividends and should not be interpreted as a total-return comparison. The periods shown are 20 years (1900-1920), 20 years (1929-1949), 16 years (1966-1982), and 10 years (2000-2010). Source shown on chart: Macrotrends.

WHY THIS MATTERS IN RETIREMENT

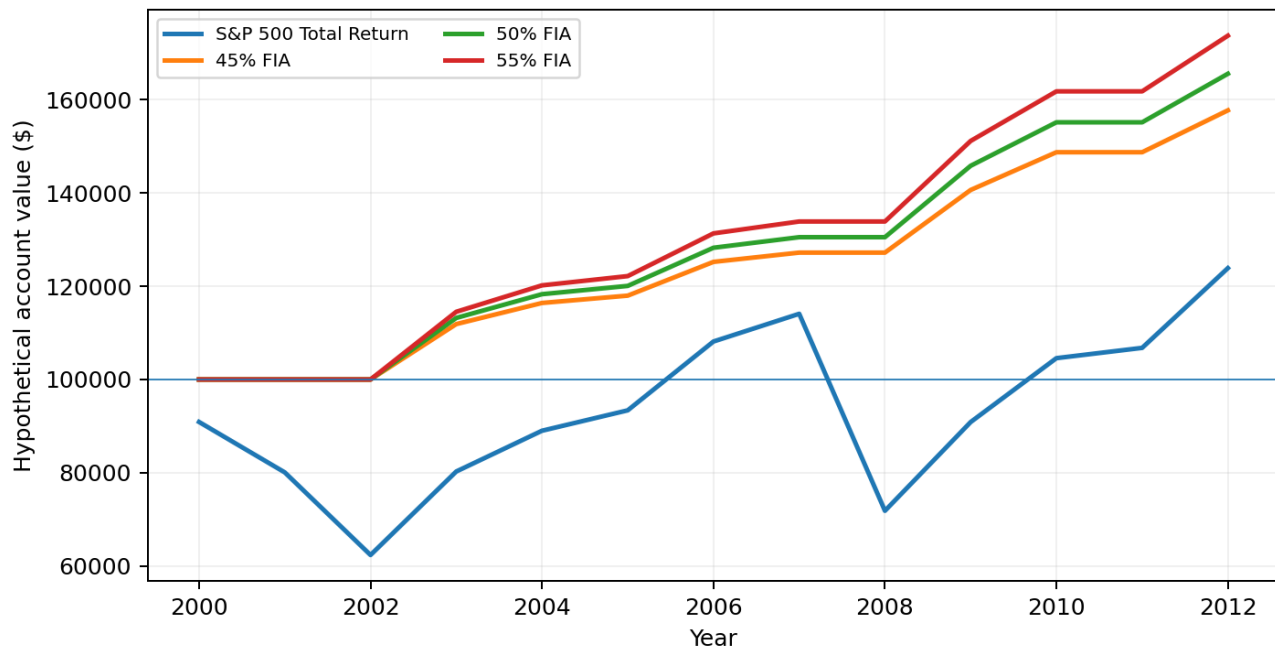
Periods like these are one reason an annuity may make sense for **a portion** of a retirement portfolio. A protection-oriented annuity can give selected dollars a different job: reduce or eliminate direct market-loss exposure under the contract terms, while other assets remain invested for liquidity and long-term growth. A lifetime-income annuity can address a different risk by creating income that is not dependent on selling investments during a prolonged market slump.

Bottom line: An annuity is not a prediction that another lost decade is coming. It is a risk-management tool that may help selected retirement assets withstand a market environment that is less favorable than the one investors hope for.

Case Study: Retiring Into the 2000-2012 Market

The period beginning in 2000 is a useful stress test. Investors encountered the technology-stock collapse, three consecutive negative S&P; 500 total-return years from 2000 through 2002, and then the 2008 financial crisis. The market ultimately recovered, but the path was extremely uneven.

To illustrate the mechanics, assume two hypothetical investors each begin with **\$100,000 on January 1, 2000** and make no withdrawals through December 31, 2012.



Strategy	Ending value	What was assumed
S&P; 500 investment	\$123,861	Annual S&P; 500 total returns, including reinvested dividends.
Hypothetical FIA - 45%	\$157,668	45% of positive annual S&P; 500 price return; 0% in negative years.
Hypothetical FIA - 50%	\$165,507	50% of positive annual S&P; 500 price return; 0% in negative years.
Hypothetical FIA - 55%	\$173,668	55% of positive annual S&P; 500 price return; 0% in negative years.

Important: This is a hypothetical educational illustration, not the performance of an actual annuity contract. It assumes annual point-to-point crediting, no cap, no spread, no fees, no withdrawals, no surrender charge, no market value adjustment and a constant participation rate for all 13 years. Real contracts may reset participation rates and use different crediting methods. The direct S&P; comparison includes dividends; the FIA illustration uses S&P; price changes because indexed-annuity crediting commonly references an index rather than direct ownership of the stocks or their dividends.

Why Did the Hypothetical FIA Finish Ahead?

Not because it captured more of the market's upside. It did not. The reason was the mathematical impact of avoiding the largest negative years.

The direct S&P; 500 total-return investment fell approximately 9.1% in 2000, 11.9% in 2001 and 22.1% in 2002. By the end of 2002, the original \$100,000 had fallen to roughly **\$62,392**. It recovered over the next several years, but then experienced a 37% total-return loss in 2008, ending that year at roughly **\$71,867** in this illustration.

Under the simplified FIA assumptions, those negative index years would receive a 0% index credit rather than a market loss. Positive years would receive only 45%-55% of the S&P; 500 price increase. Over this particular sequence, preserving the base during the severe down years outweighed giving up part of the gains.

LOSS MATH MATTERS

A 37% decline requires a gain of about 58.7% just to return to the starting value. Avoiding a loss does not guarantee a superior long-term outcome, but it can materially change the recovery math.

This Does Not Mean an FIA Always Beats the S&P; 500

It absolutely does not. During long, strong bull markets, a direct equity investment can substantially outperform a fixed indexed annuity because the investor receives full market appreciation and dividends, while the FIA is limited by its crediting formula. The 2000-2012 period was deliberately chosen because it demonstrates the value of downside protection during an unusually difficult sequence.

The appropriate comparison is therefore not "Which product always wins?" No product does. The better question is: **Which risks does each dollar in the retirement plan need to take?**

Where Lifetime Income Fits

Protection during accumulation is only one potential use of an annuity. The other major use is creating a predictable stream of retirement income.

A retiree might decide that certain essential expenses - housing, food, utilities, healthcare premiums - should be supported by predictable income sources. Social Security and pensions may cover part of that need. An annuity can potentially fill part of the remaining gap by converting a portion of retirement assets into contractually defined income.

Depending on the contract, lifetime income may be created through annuitization or an optional guaranteed lifetime withdrawal benefit. These are different mechanisms and should be evaluated carefully. Income guarantees, withdrawal percentages, fees, death benefits, liquidity and what happens to remaining contract value vary by product.

A RETIREMENT PAYCHECK

The goal is not necessarily to maximize the return on every dollar. For some retirees, the value of an annuity is that a portion of the plan has a different job: **produce income that does not depend on selling investments during the next market decline.**

When an Annuity May Be Worth Considering

An annuity may deserve consideration when a retiree values principal protection on a portion of assets, wants to create additional lifetime income, is concerned about longevity risk, wants tax-deferred growth in a nonqualified account, or wants to reduce the amount of the retirement plan directly exposed to market losses.

It may be less appropriate for money needed for near-term expenses, investors who require full liquidity, investors seeking maximum equity-market participation, or situations where the costs and restrictions outweigh the value of the guarantees.

The Bespoke Approach: Give Every Dollar a Job

We do not believe retirement planning should begin with a product. It should begin with the retirement plan.

Some assets may need to provide liquidity. Some may need to grow over decades. Some may be earmarked for heirs. Some may need to generate current income. And some may be better suited to protecting principal or creating a predictable lifetime-income floor.

Annuities can be useful when their guarantees solve a specific retirement problem. They can also be inappropriate when they are purchased without considering liquidity, costs, surrender provisions, insurer strength, taxes, other income sources and the rest of the portfolio.

THE BESPOKE QUESTION

Instead of asking, "Should I buy an annuity?" ask: **What risks am I trying to remove from my retirement plan, and is an annuity the most efficient way to remove them?**

Want to See How an Annuity Would Fit Into Your Retirement Plan?

Bespoke Financial Group can help you evaluate how your investments, Social Security, pensions, cash reserves, insurance products and other income sources work together - and whether adding a protection or lifetime-income component improves the overall plan.

[Schedule a Complimentary Retirement Strategy Review](#)

Important Information

This material is for general educational and informational purposes only and is not individualized investment, tax, legal or insurance advice. Annuities are long-term insurance contracts. Guarantees are subject to the financial strength and claims-paying ability of the issuing insurer. Withdrawals may be subject to surrender charges, market value adjustments where applicable, ordinary income taxes and, before age 59 1/2, potential federal tax penalties. Indexed annuities do not invest directly in a market index, and indexed interest is subject to contract-specific crediting provisions. Past market performance does not guarantee future results. The hypothetical illustration is not the performance of any actual annuity and should not be used to predict the performance of a specific product.

Sources

1. U.S. Securities and Exchange Commission, Investor.gov, "Annuities" and "Managing Lifetime Income."
2. FINRA, "The Complicated Risks and Rewards of Indexed Annuities," July 14, 2022.
3. National Association of Insurance Commissioners, "Buyer's Guide to Fixed Deferred Annuities."
4. S&P; 500 annual historical return data: SEC-filed S&P; 500 historical performance table and published annual total-return data. Direct-investment figures include dividends; hypothetical FIA calculations use annual S&P; 500 price returns.
5. Historical Dow Jones Industrial Average chart supplied for this guide; underlying source identified on the chart as Macrotrends. The chart is a price-index illustration on a logarithmic scale and excludes reinvested dividends.