Variable Annuities: The Truth Revealed at Last!

Fees, penalties, and contractual limitations you may not know about that could cost you money

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J.D. Mellberg FINANCIAL

Disclaimer - This report is meant to provide general information on issues that many people consider in making the decision as to whether or not they should buy annuities; and if they do decide to buy, which types of annuities and which annuity benefits and additional riders will best suit their goals and needs. This information is not designed to be a recommendation to buy any specific financial product or service.

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***Annuity riders may be available for an additional annual premium that may provide additional benefits and income guarantees.*

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Introduction

Variable annuities (VAs) are very popular financial products. In 2011, variable annuity sales grew to **$159.3 billion**, a 13% increase over 2010. (http://www.lifehealth.com/annuities.htm.) According to an article published by **Bloomberg** on February 17, 2011, in **2009**, sales of VAs were only **$128 billion**. (http://www.bloomberg.com/news/2011-02-16/u-s-variable-annuity-sales-rise-led-by-prudential-metlife.html.) Why was there a **$31.3 billion increase** in VA sales in only two short years?

We have witnessed the popularity of variable annuities among seniors and retirees. Many of them do not understand what they were sold. A number of them even think they own index annuities, when in fact they own variable annuities! False beliefs about the product are worse than ignorance. Our goal is to shed some light on the complex and sometimes confusing reality of variable annuities.

It is important to remember that the most important reasons to buy any annuity are guaranteed* income and security. As you will learn, due to product characteristics of variable annuities, you may not be receiving as much income as you hoped. The fees and the subaccount structure of VAs make it possible that your VA account value could decline by 50% or even more in just the first ten years of your retirement. (A subaccount is basically a stock, bond or other type of investment held inside an insurance wrapper.) Many seniors would not consider an investment having a 50% decline in account value to be "secure."

In upcoming sections of this report, we will show you how it is possible for a VA to lose 50% of its value in ten years or even less. By contrast, if you purchase a fixed index annuity (FIA), you should not ever lose any money (unless you surrender or cash in your FIA early).

There are a number of similarities between variable annuities and mutual funds. There are several different types of variable annuities; entire books have been written about them. As a licensed financial advisor, I could sell VAs. However, after thoroughly studying variable annuities and comparing them to the best of the newest generation of fixed index annuities, I came to the conclusion that it would be a grave disservice to sell VAs to my clients. Therefore, I refuse to do so. In fact, I feel so strongly that variable annuities are inappropriate for most retirees that I do not allow the financial advisors working for my firm to sell VAs.

According to an article titled "What's Wrong with Variable Annuities," published by **Smart Money** magazine on August 1, 2010, variable annuities "only make sense for a fraction of the population."

Whether you decide to buy a VA or not, you need to have the facts. I want you to be an informed consumer and to have the possibility of living the retirement of your dreams. With that goal in mind, we will take a closer look at variable annuities and at a fixed index annuity strategy structured to provide a "hybrid" income plan for your retirement.

If you have ever thought of purchasing a variable annuity, or if you own one now, you will want to read this report very carefully.

If you have read any of our other reports or if you have watched our comprehensive series of videos (all available free of charge), you are already fairly familiar with fixed index annuities (FIAs). Therefore, in this report we will not redefine all the basic terminology of FIAs; instead, we'll define a few VA terms with which you may not be familiar.

Variable Annuities Defined

When you purchase a variable annuity, you give your money to an insurance company, which places the money in "**separate accounts**" or "**subaccounts**." These accounts function somewhat similarly to mutual funds, except that they are held within the structure of an insurance product (the variable annuity). Gains are **tax deferred** because the subaccounts are held inside the insurance wrapper of the variable annuity. Gains are also tax deferred on all other types of annuities.

Please note that gains in any annuity are tax ***deferred*** and not tax ***free***. What this means is that if you cash in your variable annuity, you will pay taxes on any gains. Also, when you begin to take income from a variable annuity, some or all of that VA income will be subject to taxes at your normal tax rate.

For example, if your normal tax rate (combined federal and state tax rates) is 33%, you will pay that rate on any gains you receive from a variable annuity. If some of the money you receive from a VA is classified as "**return of principal**," there will not be any taxes on that money. This is because the insurance company is essentially just returning to you some of the money you placed in the VA. Since you had already paid taxes on that money, this is a nontaxable event. Consult your CPA or tax advisor for more information.

Please note that **premiums for a variable annuity are not tax deductible**.

Why do people buy variable annuities? The motivation for many people is to be able to earn a return linked to the stock market on a tax-deferred basis with the goal of building up a nest egg for retirement. Some people purchase VAs because they have contributed the maximum amount of money allowed to their IRAs, 401(k) plans or pension plans, which are also tax deferred. If someone has "maxed out" (contributed the maximum dollar amount allowed under the tax code) to their tax-deferred investment and savings choices, they may want to purchase an annuity to have the possibility of enjoying even more tax-deferred gains. Variable annuities, like fixed index annuities, offer a way to continue to earn a return linked to the stock market on a tax-deferred basis. Some people are attracted to variable annuities because they believe VAs offer a minimum guaranteed rate of return. However, **not all of them do.**You need to know if any VA you are considering has a this feature, and what the requirements are to get that return. In some cases, the VA may require you to place your investment funds into a fixed account or a bond fund during the entire term of the account. With such an account or subaccount, you do not have the possibility of earning higher returns

linked to increases in the stock market. You may be disappointed in how small the guaranteed rate of return is.

Variable annuities with high guaranteed rates of return are extremely rare. Some people might even say they are nonexistent. If you find one that does have a high rate of return, you may find the guarantee does not work like you thought it did. The higher rate of return may only be available at death, or it may only be available if you annuitize your money.

What happens if you want to receive a **lump sum** from your VA or take your money out early? You may be unable to. Depending on the contract terms, to receive the higher rate of return or to receive the guarantees* the VA promises, you may be required to annuitize the value of your variable annuity over a set number of years. You might only be able to take a percentage of that money every year for the rest of your life. If you insist you want to receive your money in a lump sum or if you do not want to annuitize, you might pay a penalty or receive a lower rate of return than you thought you were going to receive. The net effect is the same: you could receive less money from this VA than you were expecting. Being required to annuitize when you don't want to do so is a process I call "**annuicide,**"—losing control over your money by being required to annuitize over so many years.

Perhaps even worse than annuicide is the requirement that you have to die for your heirs to receive the benefits you were promised when you bought the variable annuity. This death benefit language is surprisingly common with VAs. Let's say you put **$400,000** into a variable annuity, understanding that your beneficiary would never receive less than $400,000 from it. If your premiums were placed in subaccounts that lost money (as thousands of subaccounts have over the past decade), your variable annuity may very well have a value of significantly less than $400,000. The only way your beneficiary will be able to receive that guaranteed* $400,000 is as a death benefit when you die. Needless to say, many VA owners are not very happy to later learn about this requirement for the guarantee* to take effect.

You should try to learn the **fees** and **costs** for any promised minimum guaranteed rate of return before you buy the VA. **With VAs, the total annual fees and costs to secure a minimum guaranteed* rate may actually be higher than the return itself**!

A VA may have a guaranteed rate of return of 2% per year. Why pay 3% per year in total fees and costs for a minimum guaranteed rate of return of only 2%? While this makes absolutely no sense to me, thousands of seniors and retirees do it every year. Why? Unfortunately, many of them don't truly understand the terms, and aren't aware of all the costs of the VA contract.

Why Variable Annuities Used to Make Sense

The 1980s and 1990s saw the greatest rise in the stock market in U.S. history. You probably remember those years clearly, as many exciting and positive developments unfolded. In the early 1980s, President Reagan took office and lowered tax rates. His administration also successfully conquered the high inflation that had been threatening our economy in the late 1970s. Lower tax rates meant people had more money to spend. Businesses expanded, hired more workers, and increased wages. This led to higher stock prices for many companies and a rising stock market. Many of our clients tell us that it seemed easy to make money during most of the 1980s.

The 1990s saw a high-technology boom. Personal computers were suddenly everywhere. Many tasks once done by humans were now more effectively and more economically done by computers. Businesses saved billions of dollars and productivity soared. Businesses had more money to hire workers, and wages tended to increase in many industries. The Internet boom revolutionized the world. We were all connected and able to almost instantly exchange information and knowledge. It seemed that all of the world's knowledge was at our fingertips. This led to further increases in productivity and higher profits for business.

President Clinton was also able to actually reduce the national deficit during his administration. This was one of the few times during our history that the economy was able to grow significantly without adding to our national debt. Also, during the twenty-year span of the 1980s and 1990s we had only one brief war—the first Gulf War, during which we prevented Iraq from taking over Kuwait. The monetary and human cost of that war was miniscule compared to other lengthy wars. Due to these positive economic factors, businesses flourished and the stock market soared. During this record-breaking rise in the stock market, it made sense to buy a variable annuity.

Why does a rapidly rising stock market usually justify the purchase of a variable annuity? **Many VAs have total fees of 1.5% to 8% per year**. A 4% total fee level is relatively common with variable annuities. With such a high fee burden, approximately **40%** of the original value of the VA could be eroded by fees in just the first ten years of your retirement if the stock market stays level. Just about the only way to protect the original value of your variable annuity is to purchase one only if you expect the stock market to rise rapidly over the coming years. Due to record-breaking budget deficits (both on the national and state levels), persistently high unemployment, and the financial drain of fighting two lengthy and costly wars, our economy is not in the position of strength it was in during the 1980s and 1990s.

Many states are raising taxes, and a number of experts say the United States will have to raise tax rates on the federal level to pay for record-breaking budget deficits. Higher taxes usually mean that people have less money to spend on goods and services, which hurts businesses. Remember that stock prices are primarily based on rising business profits (and to some extent, on rising dividend payouts). When businesses cannot sell as many goods or services and profits decline, stock prices often decline, stay flat, or rise only moderately.

Combine all of that with a slow real estate market, gasoline prices that drained more than $448 billion from U.S. consumers' pockets and sent a record-breaking $1 trillion+ to OPEC in 2011 (http://www.csmonitor.com/Business/2011/1210/Oil-prices-rise.-US-costs-OPEC-sales-hit-records.), along with forced austerity in many European countries due to their own budget crises, and you have a recipe for a declining, flat or low-performance stock market.

Also, since a number of European countries are laying off government workers, reducing pensions and raising taxes, many citizens in those countries have less disposable income. This means they cannot afford to buy as many American products—another fact which lowers profits and potentially lowers stock prices for American companies.

There are almost no experts who are predicting that the stock market will rise significantly over the coming decade like it did in the 1980s or the 1990s. *Given that we are likely to have lackluster or mild stock market performance over the coming decade, can your variable annuity make enough money each year to pay its fee load and credit you with a gain?*

Over the coming decade, it would not surprise us if the U.S. has some periods of good stock market performance. However, it also would not surprise us if the coming years saw significant stock market losses that take away some or all of the prior gains. And we would not be surprised if the stock markets overall experienced tiny or no gains at all over the next ten years. In this environment, VAs make much less sense today than they made in the 1980s and 1990s.

Evaluating the Past and Present Importance of Tax Deferral

There is still another important factor to consider when trying to understand why VAs may no longer make sense for many retirees. In the 1980s and 1990s, many mutual fund and VA subaccount managers **actively bought and sold stocks**. They did so to move from underperforming sectors of the economy to stronger sectors. For example, in the late 1990s, many energy stocks declined while a number of high-tech and Internet stocks skyrocketed. To

obtain higher performance, mutual fund managers and VA subaccount managers sold some of their energy stocks or reduced their funds' positions in them and bought more high-tech and Internet stocks. When pharmaceutical stocks were outperforming, they sold other stocks and bought into that sector. When consumer staple stocks were outperforming, they sold or reduced other sectors and bought more consumer staple stocks. This active trading process was repeated, year after year, and resulted in very high portfolio turnover during the 1980s and 1990s.

Why is this important to know? A high level of active trading generates a lot of capital gains taxes. Normally, every time you sell a stock, you have to pay taxes on any capital gains. **Furthermore, capital gains taxes were significantly higher during much of the 1980s and 1990s than they are today**. That made the tax deferral of capital gains taxes very valuable to the managers of variable annuity subaccounts. (Remember that gains inside variable and fixed annuities are tax deferred.) With the tax deferral, if your VA manager booked gains of 20% during a great year in the 1980s or 1990s, your variable annuity would not owe any taxes during that year. However, if you owned a mutual fund and the manager booked the same 20% gains through actively buying and selling stocks, the mutual fund could owe a large tax bill. That is why tax deferral was so valuable.

Today the situation is much different. We currently have some of the lowest capital gains tax rates in our history. These lower tax rates make tax deferrals of capital gains less valuable now than they were in the past.

With fixed index annuities, you do not pay taxes on capital gains because index annuities are not classified as investments. FIAs are classified as savings vehicles; therefore, changes in capital gains tax rates have little (if any) impact on them. The tax deferral you receive with FIAs is a deferral of taxes on interest received. Many of our clients tell us that the annual tax deferral on FIA interest is just as valuable as ever.

Let's summarize. Some experts are predicting that we are likely to experience lower stock market returns over the coming decade than we had in the 1980s and 1990s. (http://www.ssab.gov/publications/financing/estimated%20rate%20of%20return.pdf.) When you combine lower gains with lower taxes on those small gains, you end up with a much lower tax rate on stock market profits than we had in the 1980s and 1990s. Do you want to pay high annual fees on a VA to defer taxes on stock market gains when the stock market seems very unlikely to experience rapid gains? Do you want to pay high annual VA fees to defer taxes when the taxes on those gains are near their lowest levels in recent history? It doesn't make much sense to me.

As you can see, there were good reasons to own variable annuities in the 1980s and 1990s. However, due to the changes in the world economy, the diminished outlook for the stock market, and tax code changes, most of the old reasons for buying VAs are not present today.

The Impact of Reverse Dollar Cost Averaging on Variable Annuities

Reverse dollar cost averaging (RDCA) refers to the process of taking money out of your accounts at a measured rate each month or year—perhaps 4% per year, or a fixed dollar amount. A serious problem occurs, however, when you make such withdrawals when the stock market is flat or declining. Under such conditions, the stock market, the fees of VAs, and the percentage (or flat dollar amount) you take out of your VA to meet living expenses **reduce** the value of your account. Combine all of these factors, and RDCA withdrawals in a flat or declining stock market **can erase up to 75% of the value of your savings in the first 10 years of your retirement**. Under these conditions, **a variable annuity needs to make 10% to 15% per year just for you to maintain your account value!**

Bill Gross, co-founder of Pacific Investment Management Company, manages PIMCO's $252 billion Total Return Fund and is a frequently cited expert on investing. (PIMCO is one of the largest investment management firms in the world and manages money for pension and 401(k) plans, colleges and universities, endowments and foundations, in addition to running its own mutual funds and exchange traded funds.) Bill Gross believes it is highly unlikely that the stock market will produce returns averaging 10% to 15% per year over the next ten years. When you add up all the fees, expenses and commissions of variable annuities, it seems even more unlikely that variable annuities will produce such returns. Therefore, if you buy a VA today, the odds are that you will not be able to take any money out regularly without damaging your long-term retirement funding.

Suze Orman is one of the most popular financial authors in America. Several of her books have topped the New York Times Best Seller List. Her advice is trusted by millions of Americans. Variable annuities are at the top of her "hated investments" list. In fact, despite the limitations and risks of mutual funds, Orman says that most people would be better off in mutual funds than in variable annuities. In an article on her website (www.suzeorman.com), Suze Orman compares mutual funds and variable annuities and writes:

> Let's say you buy a good no-load mutual fund geared toward growth, being careful to choose a fund that traditionally doesn't make big, taxable capital gains distributions at the end of every year. And let's say you let your money grow in this fund for the next ten years. For the most part, you won't pay taxes on this money while it's still sitting in the fund. And when you do eventually sell the fund, you'll pay the lower capital gains tax rate on the gains you've

> made, which ends up amounting to far less than the ordinary income tax you pay on withdrawals from a tax-deferred vehicle such as a variable annuity.

In an article in **Money** magazine titled "If You Knew Suze Orman…" which was published on June 19, 2008, Suze was asked about variable annuities. Her reply:

> I hate them with a passion—a passion!—especially in a retirement account like an IRA. Variable annuities have all these extra fees and tax issues and penalties, but - oh, that's okay!—because they give you a tax deferral. But a retirement account is already tax deferred without all those fees. It's absolutely ridiculous. I think variable annuities exist for one reason only: to make money for the financial advisers who sell them. (http://money.cnn.com/2008/06/19/pf/Suze_Orman.moneymag/index.htm.)

As you can see, one of Suze's major criticisms of variable annuities is "**all these extra fees**." In fact, it is the totality of these fees that lead to the phenomenon we call **double reverse dollar cost averaging**.

Double Reverse Dollar Cost Averaging

As stated before, the **fees, expenses** and **commissions** of a VA can total from **1.5%** up to **8% per year**. If your VA had a total fee, expense and commission load averaging 5% per year, in just the first 10 years of your retirement, these **expenses alone could eat up over 40% of the value of the premium you put into the variable annuity**!

You also need to know that some financial advisors charge a "**wrap fee**" or "**management fee"** on top of all of the other fees and expenses a VA charges! A common management fee is **1% per year**. Therefore, if you gave your financial advisor $500,000 of retirement savings to manage, you may pay a $5,000 management fee each year. Now a $5,000 annual management fee might not sound like much. However, remember that the VA you purchased might itself have fees, expenses and commissions that average 1.5% to 8% per

> A **commission** is usually paid in the first year of a variable annuity contract. It is not uncommon to see VAs that pay salespeople 5% or 6% in commissions. Therefore, if the VA agent spends an hour or two selling you the variable annuity, he/she might be paid $25,000 or $30,000. (Since commissions are often one-time events, when we write about the total expenses of a variable annuity per year, we are amortizing that commission over time.)

year. Therefore, if you are paying another 1% per year, the total annual drag on your retirement portfolio could be 2.5% to 9% per year. Multiply that over the first decade of your retirement and you can see how all of these fees can erase up to 50% of the value of your lifetime savings.

Adding a financial advisor's wrap fee on top of applying the reverse dollar cost averaging strategy during a down market leads to what we call "**double" reverse dollar cost averaging.** As you know, reverse dollar cost averaging all by itself can wipe out up to 50% of the value of a retiree's portfolio in just the first ten years of retirement. When you add an annual management fee on top of this, the resulting "double reverse dollar cost averaging" erodes the value of your retirement savings even faster.

Consider this example: you withdraw **5%** of the value of your variable annuity to meet living expenses and your VA has total annual fees and expenses of **5%**. That alone will erase **10%** of the value of your VA. If the stock market declines **5%** that year (not an unlikely event) and if you pay your financial advisor a **1%** management fee in addition, the combination of those forces **could wipe out 16% of the value of your VA in one year**.

Case Study: If you initially purchased a variable annuity with **$200,000**, after one year based on the above scenario, your retirement savings account would be worth only **$168,000** due to double RDCA—a decline in value of $32,000 in just the first 12 months of your retirement.

In **2008**, the S&P 500 Index® lost 37% of its value. (http://corporate.morningstar.com/us/documents/Indexes/ABetterWaytoManageYourFuture(s).pdf accessed 6/1/2012.) Given the above variable annuity expenses and a 1% management fee, your variable annuity would have lost about **48%** of its original value during that year. In other words, in one year, your **$200,000** variable annuity could have an account value of only **$104,000**. You now know why it is so important to understand how RDCA and double RCDA could damage your retirement savings and could, in fact, compramise your ability to stay retired.

Fortunately, there are **alternatives** to RDCA and to double RDCA. Fixed index annuities with income riders,** (with which you can design a **"hybrid" income plan**), are one such alternative. Keeping expenses and fees as low as possible, while still obtaining all the benefits and guarantees* you want, is another solution.

Over the years, we have examined dozens of investments and savings vehicles that could potentially help retirees generate **secure, stable, guaranteed* income** during retirement. Most investments—whether they be dividend-paying stocks, mutual funds, REITs (real estate investment trusts), oil and gas partnerships, or some other type of investment—do not meet our strict criteria because most investments have few, if any, guarantees. For example, mutual funds usually do not offer a guaranteed level of income for as long as you live. What about

dividend-paying stocks? Dividend payments from a company can be eliminated, reduced or suspended. REITs can also reduce or eliminate their dividend payments.

Most savings vehicles (bank certificates of deposit, corporate bonds, etc.) do not meet our criteria either. Some pay very low rates of interest. Sometimes there is the potential risk that a corporation that issued a bond might not be able to make the interest payments, or might file for bankruptcy. Variable annuities also do not meet our criteria due to a combination of what we perceive to be excessively high fees and expenses in many VAs, and a lack of guarantees in others. **Of all the income solutions we have examined, only certain fixed index annuities meet our strict criteria.**

We offer fixed index annuities because they have *lower overall fees and expenses than VAs, with similar benefits*. Of course, since the annuities we offer are not investments, we do not charge annual management fees.

How Can You Recover from the Impact of Double RDCA?

Some financial experts believe that over the next decade, the stock market is unlikely to see the kinds of high returns it had in the 1980s and 1990s. The low returns we are likely to experience are due to the record-breaking deficits, national debt and state debt that we are struggling to contain, persistently high unemployment and the very likely possibility of higher taxes to pay for all of the fiscal mistakes we made. Consumers will have less money to spend, which will slow down business and dampen whatever returns the stock market may be able to offer.

As you know, the stock market has gone nowhere over the past ten years. This period has been called "**the lost decade of stock investing**" by the ***Wall Street Journal.*** (http://online.wsj.com/article/SB125556534569686215.html.) If the next decade is similar to the last one will you be able to recover from the impact of double reverse dollar cost averaging? If you used your retirement savings to purchase a variable annuity with high fees and expenses, you may not be able to recover from that impact. As we showed, your variable annuity could lose **16%** of its value if the stock market lost just 5% of its value in one year. What if the stock market just stays **flat** over the next 10 years? With 5% in total variable annuity expenses and fees plus a 1% annual management fee, if you take out 5% per year to live on, your VA could lose 11% of its value annually.

Remember that if you experience a loss of **X%** one year, you need a gain of MORE than X% the next year to make up for that loss. Let's say that you purchased a **$400,000** variable

annuity. If your VA account balance declined 11% in the first year due to a flat stock market, and you took out some money to live on, and if you add the eroding effects of all the VA fees and expenses and management fee, your VA account would be worth only **$356,000**.

Some people think, "Well, if I lost 11% in my VA last year, I need to make 11% this coming year to break even." No, in fact, you need to make **more** than 11%. To get back to even, your VA needs to make **$44,000** over the next year. A return of $44,000 on a $356,000 balance equates to an annual return of **12.3%,** not 11%. Actually, you would need to make much more than 12.3% the next year just to break even. Remember that you will ***continue*** to pay 5% in total annual maintenance fees and expenses and 1% per year in management fees. If you and your spouse do not take even one penny from your VA for living expenses the next year, the variable annuity will have to rise in value by **18.3%** the next year for you to break even. This 18.3% required gain is based on the aforementioned **12.3%** to recover from your prior year's loss, plus **5%** in the current year's variable annuity fees and expenses plus a **1%** management fee.

Remember that this example assumed that the stock market was **flat** for one year, and you would have had to earn 18.3% to break even. In a year in which the stock market declines, your losses would be even greater; therefore, your VA would have to post even higher than 18.3% gains.

What if we experience another lost decade of stock market performance? Of course, even during some years of a lost decade, stocks will rise. However, during other years, they could fall dramatically as they did during 2008. We could experience another lost decade due to the many economic challenges that our country and the rest of the world currently face. If we do, how likely do you think it might be that your variable annuity would be able to rise by about 18% per year to make up for the fees, expenses and reverse dollar cost averaging impact?

Remember that the performance of most variable annuities is tied to a major stock market index or a combination of stocks. How likely do you think it is that the stock market will rise by **18% per year** over the coming decade? Given the economic problems our country faces—record-breaking debt, high unemployment and rising foreign competition which drives down U.S. wages—we believe it is unlikely that will happen. In fact, in doing some research on this, we could not find even one highly respected financial expert who is making a prediction that the stock market will rise anywhere near 18% per year over the coming ten years.

In saving and investing, it is essential to have **realistic expectations**. Especially when it comes to your retirement savings, you cannot hope for a miracle to save you. You want to take prudent steps *now* to **protect the nest egg** that you worked so hard for. One of the best ways to protect that nest egg is to make sure that it is used to purchase guaranteed* vehicles that have relatively low fees and expenses while still providing you with all the features, benefits and guarantees you want.

Concern About Variable Annuity Fees and Expenses: We often ask new clients, "What led you to select J.D. Mellberg Financial to help you generate retirement income?" Many have told us they felt that the commissions and fees on variable annuities were "rip-offs." Given the facts about how these fees and expenses can impact VA account value, their anger may be justified.

Currently, this practice of a financial advisor charging a management fee on a variable annuity that is already being managed by the insurance company, its managers or subadvisors, is still permitted under law. However, at J.D. Mellberg Financial, we do not charge annual fees or management fees on the fixed index annuities that our clients purchase. We are paid commissions by the insurance companies offering the annuities. It is important for you to know that the money we are paid does ***not*** come out of your annuity. The insurance company pays commissions based on their projected earnings over and above your guaranteed* rate of return. If you purchase a $400,000 fixed index annuity, every penny of that $400,000 will go to work for you immediately. In fact, in many cases, we are able to get our clients **5%** or **10% bonuses** on their initial premiums. If we got you a 10% bonus on your $400,000 initial premium, you would have **$440,000** going to work for you from day one in your fixed index annuity!

Please note that bonus annuities (annuities that credit your account with immediate bonuses as soon as the annuity is issued) may carry higher fees and charges than annuities without the bonus feature. Also, if you pull the money out of the annuity early, any bonus paid will be taken back by the insurance company.

"Look at How Much Money You Made in Your Variable Annuity!"

Over the years, we have had people call our office thinking that they have found a variable annuity with the ability to rise in value no matter what the stock market does. In one recent phone call, a retiree told us that he had found a variable annuity that rose an astonishing **30%** just from 2009 to 2010. Let's take a look at what really happened during this time period.

Anyone who purchased almost any product linked to the stock market in early 2009 was likely to show a phenomenal return on that investment through the end of 2010. The reason is that in early March of 2009, Standard & Poor's 500 Index hit **666**—the lowest level this index has fallen to since about 1996. ***Why did the stock market bottom out at this low point in early 2009?*** Millions of people were panic-selling stocks and mutual funds in late 2008 and early 2009. After this overreaction to the downside, the stock market went on to **soar** in value. Therefore, *almost any* stock-market-related investment that anyone bought in early 2009 skyrocketed in value.

What has that variable annuity produced since 2009? Well, the S&P 500 produced returns of **26.46%** in 2009 and **15.06%** in 2010. Therefore, an investment in a simple, low-cost S&P 500 index fund would have produced a return of about **41.12%** over the same time period. In other words, the variable annuity actually underperformed the S&P 500 by a whopping **11.12%** over this time period.

Why should you pay annuity expenses and fees each year for an investment that has often been shown to underperform a simple S&P 500 index fund? It makes absolutely no sense, and yet many seniors are buying VAs every year. You need to be very cautious when you think you've found a hot variable annuity that outperformed the market. Look carefully at the start date of this so-called, high-performance VA.

The years **2001** and **2002** are also very suspicious start dates. The stock market rose significantly in 2003, 2004, 2005, 2006 and 2007. Therefore, ANY investment linked to the stock market that was purchased in 2001 or 2002 likely showed handsome returns over those years.

What You Need to Do to Get a More Accurate View of the Performance of a Variable Annuity: To arrive at a more true and accurate assessment of the performance or lack of performance of any VA, you need to determine how the VA in question performed compared to the S&P 500 over a longer period of time. Say, for five years or longer. You are likely to

find that the performance of the variable annuity cannot match the performance of even a simple, low-cost S&P 500 index fund.

It pays to be cautious. Your caution could help you save tens of thousands in cumulative fees and expenses (depending on how much premium you put into annuities) by avoiding high-fee products that are likely to underperform the stock market over time. Relatively few variable annuities have outperformed the S&P 500 over five years or longer. However, we can show you fixed index annuities that have.

A landmark study titled ***Real World Index Annuity Returns*** was published in **The Journal of Financial Planning** in March of 2011. **The Journal of Financial Planning** is considered by financial professionals to be "the bible" of financial planning magazines. This journal publishes research that is based upon sound scientific investigation and that uses rigorous statistical testing. This study, authored by Geoffrey VanderPal, Jack Marrion and Professor David Babbel, proved that over the time periods studied, index annuities outperformed the S&P the vast majority of the time.

The researchers analyzed massive amounts of data to compare the performance of FIAs starting in **1997** (about the time index annuities started becoming popular) up through **2010**. Their findings are summarized in Figure 1, which is from the article:

Figure 1

Table 1: Annualized Five-year Returns

Period	S&P 500 Index Returns	FIA Avg. Return	Number of FIAs	Return Range
1997-2002	9.39%	9.19%	5	7.80%-12.16%
1998-2003	-0.42%	5.46%	13	3.00%-7.97%
1999-2004	-2.77%	4.69%	8	3.00%-6.63%
2000-2005	-3.08%	4.33%	28	0.85%-8.66%
2001-2006	5.11%	4.36%	13	1.91%-6.55%
2002-2007	13.37%	6.11%	23	3.00%-8.39%
2003-2008	3.18%	6.05%	19	3.00%-7.80%
2004-2009	-1.05%	4.19%	27	2.25%-6.83%
2005-2010	-1.47%	3.89%	36	2.33%-7.10%

As you can see, fixed index annuities outperformed the S&P 500 index for the majority of time periods studied. In five different time periods, holding the S&P 500 would have LOST you money, while if you owned an FIA during the same time periods, you would have MADE money!

It is also important to note that **FIAs never lost money during any of the time periods studied**. This is despite the fact that the stock market was quite volatile between 1997 and 2010.

If you are a risk-averse investor who does not want to lose money in the stock market, you need to pay special attention to this study. This research has now helped show that fixed index annuities have helped their owners reduce volatility and avoid losses during these recent tumultuous years. The S&P 500 fails this crucial test.

If you want to own a savings vehicle that produces a reliable, guaranteed* income, and that is likely to never lose but only gain value, serious consideration must be given to fixed index annuities. The same claim cannot be made for variable annuities.

What accounts for the remarkable **stability** and the steady **money-making performance of index annuities**? But fixed index annuities do not invest directly in stocks or mutual funds, and they do not have high fees and management expenses.

An Examination of "Low-cost" Variable Annuities

No matter where you put your money, there *will* be some expenses. You might think that you can help protect yourself by buying a so-called "low-cost" variable annuity that will not erode the value of your retirement savings with high fees. While lower-cost VAs offer some advantages, you lose some benefits and some protections with these VAs. If you are considering buying a variable annuity or if you own a VA, this low-cost option is an important subject for you to understand.

If you own a low-cost variable annuity and the stock market takes one of its periodic major drops like it did in 2000 – 2002 and again in the collapse of 2008, your **VA subaccounts** (the accounts which make up the value of your variable annuity) **could lose 30% or more of their value.** If you had planned to annuitize this VA after one of those stock market crashes, you might have been unpleasantly surprised at how little income you would have received.

What about the **death benefits** of variable annuities? According to the ***Smart Money*** article of August 10, 2010, which we cited earlier:

> The death benefit basically guarantees that your account will hold a certain value should you die before the annuity payments begin. With basic accounts, this typically means that your beneficiary will at least receive the total amount invested, even if the account has lost money.

Note that your account will hold its beginning value if you die BEFORE the annuity payments begin. However**, many people want to start receiving annuity payments as soon as they retire.** What happens if you retire, receive a few annuity payments, and then die? Think about what happened to those people who retired in 1999 and 2000 and who started receiving annuity payments from their variable annuities. Due to the stock market crash of 2000 – 2002, their heirs might have received a fraction of the VA's original account value.

In our research, we have found that **very few of the variable annuities sold in 1999 or 2000 have recovered their original account value—even after 11 years**! During the same period of time, not one fixed index annuity has lost any value due to the ups and downs of the stock market. In fact, many of them have significantly increased in value.

The **preservation of value** offered by FIAs can give you greater peace of mind. With a fixed index annuity, you never have to be concerned about your heirs receiving less than what was originally outlined in your annuity contract, minus any withdrawals you have taken. You never have to be concerned about not personally receiving all the income* you counted on when you signed your annuity contract. (The only exception is if you cash in your annuity early.)

When we write about your heirs not being fully protected from stock market losses in a variable annuity, we will be referring to the period of time after you start receiving annuity payments. With a fixed index annuity, you never have to worry that if you start receiving income from your annuity and pass away, your heirs will receive less than the remaining value.

How would your husband or wife be doing financially if you had bought a low-cost **variable annuity** in 1999 or early 2000 and passed away in 2002 or 2008? If you had started to receive annuity payments any time before you died, there is a possibility that your spouse might only receive 50 cents on every premium dollar you paid into that variable annuity! In fact, thousands of people have experienced these kinds of losses with VAs. The spouse or heir of someone who owns a fixed index annuity never has to be concerned about this possibility.

Why do unprotected VAs lose so much of their value when the stock market drops? These losses are due to the drop in stock value (represented in your VA as subaccounts) plus the **fees** and **expenses** that have been extracted from your variable annuity each year.

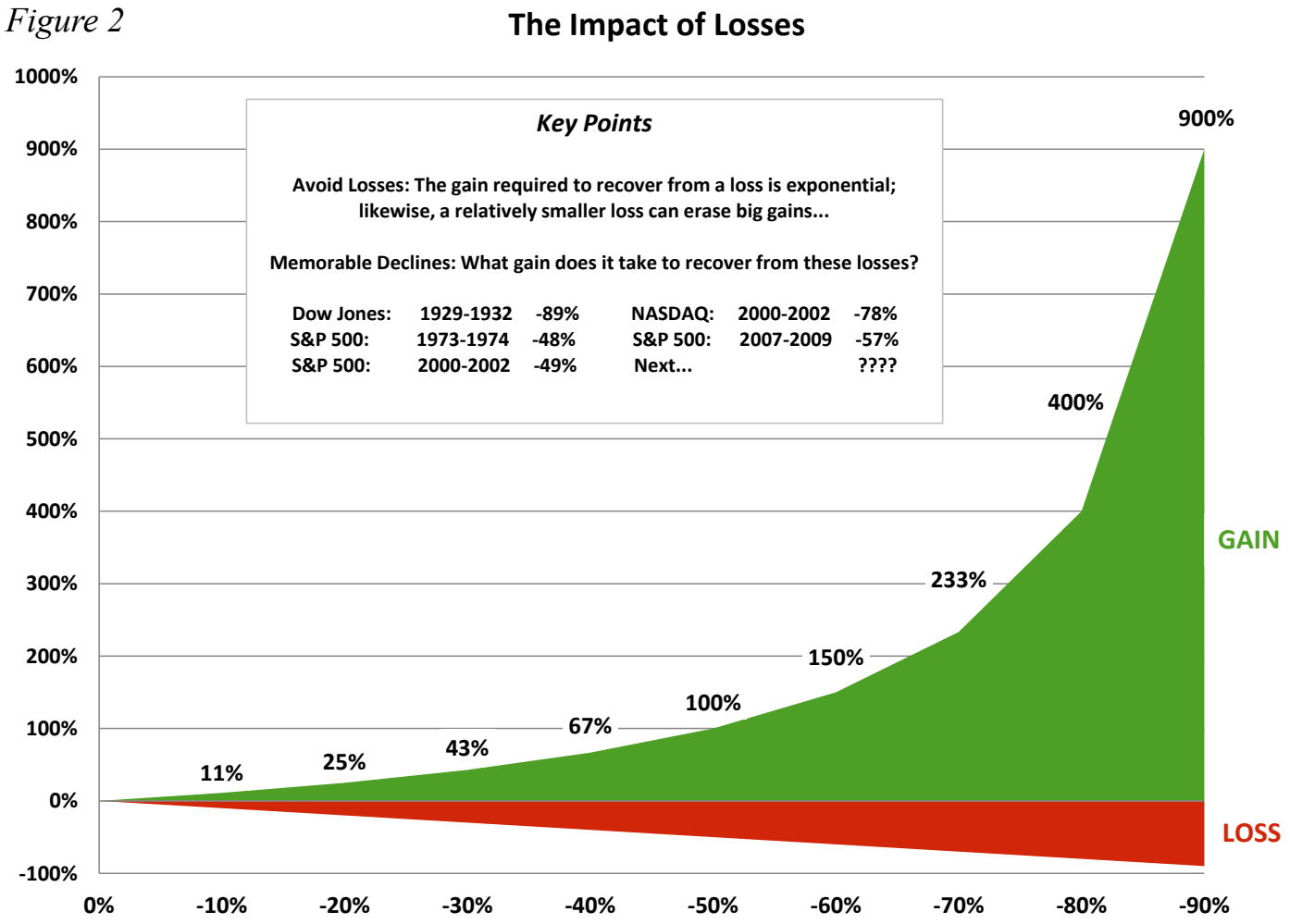
For example, if a variable annuity had 4% in fees and the gross return in your subaccount was 10% for that year, your VA would be credited **6%** (10% subaccount return - 4% fee = 6% return). If the market declined by 10%, you would lose approximately 14% (-10% subaccount performance, plus 4% fees = **14% loss**). So, the net return is **up only 6% when the stock market gains 10%** and is **down 14% when the stock market loses 10%.** This shows that a VA gains significantly less than the stock market in good years and it loses significantly more

than the stock market in bad years. This process repeats itself. Even if the stock market was flat for a few years, this VA would lose 4% per year for each and every one of those flat years. You can see how difficult it can be to make money with variable annuities just due to the constant drag of fees.

Of course, NO variable annuity is going to have a series of sequential years during which the subaccount makes 10% one year and loses 10% the next year. We are using this example to clearly illustrate that a 10% loss in a subaccount is NOT corrected with a 10% gain. Instead, the variable annuity must produce much more than a 10% gain in order to get back to even after a 10% loss. This is because:

1. The gain required to recover from a loss is exponentially larger than the size of the loss. In other words, **a relatively small percentage loss can erase a larger percentage gain**.
2. You also have to consider the depleting effects of 4% annual VA fees over time. As that 4% is taken out each year, the loss accumulates, so that after year 6, approximately 24% of your account value has been depleted. The impact of these losses on a variable annuity's account value is powerfully illustrated in Figure 2. By studying the graph, you will be able to see just how large a gain you would need to make up for different sizes of losses**.**

Figure 2



This chart was reproduced by associates at J.D. Mellberg Financial using data obtained from Crestmont Research.

As you can see, for losses of any size it takes bigger gains to bring the account balance back to its previous level. Combine this with nonstop annual VA fees of 3%, 4% or more, and you begin to wonder: **How long can a retiree's money really last in a volatile stock market?** The impact of the cumulative fees and expenses of variable annuities is one of the primary reasons we do not recommend or sell variable annuities. Remember that with fixed index annuities you never have to be concerned about stock market losses because **your annuity can't lose money* when the stock market declines in value.** It is vitally important to avoid losses in a retirement income strategy because losses of any kind hurt assets more than subsequent gains of the same magnitude will help.

If you were to lose 50% of your assets due to the stock market crashing, what percentage gain would it take to make your money back and get back to even? **It takes a 100% gain to make up for a 50% loss**. If you have $100,000 and lose 50% ($50,000), **you would have to make 100%** ($50,000) to get back to even.

Fixed index annuities pay an interest rate that is **linked to** but is not directly exposed to the risk of the stock market. How can they pay you a contractually set rate of return when the stock market goes up and yet guarantee* that you will not lose money when the stock market declines? The reason is that **these annuities do not own stocks directly**. Because of that, the money you have in FIAs will experience much less volatility than the stock market itself. Furthermore, during good years for the stock market, your FIA will increase in value. Your fixed index annuity will never lose money due to a declining stock market and will gain value during years in which the stock market rises. The net result is that your FIA has a very high likelihood of increasing in value over time.

An Important Difference between the Protections Offered by VAs and by FIAs

A fixed index annuity can offer you a number of different types of protection, some of which come through riders.** One of these is **protection against inflation**. This asset that rises in value over time at a rate equal to or greater than the rate of inflation.

As you know, the stock market tends to rise in value over time. Over the past 100 years, the stock market has far outperformed every other investment class. The stock market has greatly outperformed real estate, bonds, commodities (gold, silver, wheat, etc.), artwork and collectibles. (http://money.cnn.com/magazines/moneymag/money101/lesson4/index.htm, accessed 6/1/2012.)

The stock market has also far outperformed inflation over that same period. (http://seekingalpha.com/article/134843-stock-market-s-total-return-outperforms-inflation-by-about-7-a-year, May 3, 2009.) Just by owning a fixed index annuity, you have the opportunity to participate in stock market gains (which are higher than inflation over time), without the risks and volatility inherent in owning individual stocks or mutual funds.

With variable annuities, the insurance companies take out substantial fees each year, and the stock market risk is up to 100% on the owners of the VAs. In many cases, the only way the owner of a VA can protect himself/herself against stock market risk is to buy a rider** in order to obtain principal protection.

With fixed index annuities, the stock market risk is taken on by the insurance companies—not the annuity owner. Protection of principal is built-in. There is nothing extra you have to buy.

You know from the first day that 100% of the premium you placed in that annuity is totally protected against stock market crashes.

When you are comparing VAs to fixed index annuities, it is crucial to keep these distinctions in mind. These differences can have a huge impact, not just in terms of how much **income** you have in retirement, but also in terms of how much **peace of mind** you may be able to enjoy in retirement. Would you or your spouse be comfortable owning an annuity that offers little or no protection against the stock market crashes that seem to happen at least once a decade? If not, then you need to think twice about buying a variable annuity that does not offer protection against stock market losses.

Be extremely cautious about purchasing a **"low-cost" variable annuity**. Almost all low-cost VAs put your retirement savings at risk of a stock market crash. Very few provide options to protect stock portfolios. Not offering options is one of the ways these low-cost variable annuities keep their expenses low. However, due to the absence of option protection, the premiums you place in many low-cost VAs may be fully exposed to the volatility and risks of the stock market. Low-cost variable annuities may save you some money in the short-term, but the ultimate cost could be losing 20%, 30% or more of the value of your VA due to a stock market collapse.

If you want protection against stock market crashes with a low-cost VA, you will probably have to buy a rider.** When you purchase a fixed index annuity, you do NOT have to buy a rider and you do NOT have to pay an extra fee to have protection against stock market corrections. That essential protection is already built in to your FIA!

There are variable annuities that offer protections against stock market crashes. However, those VAs tend to come with the **highest expenses** of almost any annuity available. The costs of those VA protections are much higher than the costs associated with fixed index annuities. In upcoming sections, we will directly compare these costs.

Understanding VA Contracts

The terms, provisions and guarantees* of a variable annuity are described in a contract. The insurance company is legally obligated to perform in accordance with this contract. The terms, provisions and guarantees* of a fixed index annuity are also described in a contract that the issuing insurance company is legally obligated to honor. Both contracts provide certain benefits, but only one is supported by the guarantees* from the insurance company who issues it.

Why is this important? Many people commit 50% to 90% of their retirement savings to annuities in the hope that they will have a reliable stream of guaranteed* income coming in during retirement. The annuity contract provides details of how much money you might receive from the annuity under different market conditions. You can, of course, read the annuity contract to figure out what your annuity's losses or gains might be under different stock market scenarios. The challenges are that many variable annuity contracts are several hundred pages in length, and that parts of these contracts can be rather complex. The members of the J.D. Mellberg Financial team have more than 100 years of collective experience in reading and evaluating annuity contracts. Even with all of our experience, we still sometimes find it difficult to analyze many variable annuity contracts.

We are not saying this to dissuade you from reading VA contracts. In fact, we encourage you to do so, just as we encourage all of our clients to fully read the contract of any annuity before they purchase it. We believe it is crucial that a person understand exactly what protections any annuity does or does not offer before purchasing that annuity. If you don't understand the contract, you will have no accurate idea of how much or how little income you might receive under different stock market scenarios.

The Investment Offerings of VAs vs the Earnings of FIAs

Both variable annuities and fixed index annuities offer the possibility of **growth beyond a simple rate of interest**. You do not buy a variable annuity or a fixed index annuity just to receive 3% interest per year (although when the stock market is crashing, 3% interest per year can look pretty good).

Variable annuities offer the possibility of growth because they contain **subaccounts** that own stocks or other investments. The way that index annuities offer the possibility of growth is that they commit to pay an additional interest rate that is linked to (but does not directly participate in) the growth of a stock market **index**.

Some variable annuities do offer growth based on a stock market index. However, **the vast majority of VAs do not use subaccounts based on stock market indexes,** but offer

Note: The variable annuity takes the performance of the subaccount (which is similar to a mutual fund owning individual stocks), and figures a **credit** or a **debit** to your account based on the performance of that subaccount. You do not actually own the stocks yourself. The VA does not actually own the stocks itself. The subaccounts of the VA buy and sell stocks. To avoid repeating all of that every time we discuss this aspect of VAs, we will use shorthand to subaccounts that own stock.

subaccounts that own individual stocks. This ownership of individual stocks is one of the factors that can bring additional risk and extra expense to variable annuities.

Let's compare the subaccounts of variable annuities that own stocks with fixed index annuities that potentially pay an increased rate of interest linked to a stock market index.

Expenses and Fees of VA Subaccounts

Variable annuity subaccounts that buy and sell stocks incur many expenses that fixed index annuities do not incur. First of all, the subaccount must pay **fees** to the **managers** of the subaccounts.

Research has shown that VA subaccounts tend to underperform stock market indexes over time. In one study, annuity subaccounts were compared to the performance of the Vanguard 500® index fund from June 1998 through June 2008. (http://www.boston.com/business/personalfinance/articles/2008/08/27/variable_annuities_still_a_better_deal_for_the_insurance_industry_than_for_investors/.) A "large-blend" variable annuity subaccount is composed of many different stocks of large publicly traded companies, just as the Vanguard 500 is a blend of approximately 500 stocks of large publicly traded companies.

Over the 10 years studied, the Vanguard 500 returned **2.81%** annually, and the large-blend variable annuity subaccounts returned **2.02%** per year. While this difference may seem small, the Vanguard 500 index fund **outperformed** the variable annuity subaccounts by **39%** on an annual basis (.79% performance difference divided by 2.02% performance of the VA subaccounts = 39% annual performance difference over 10 years). A 39% annual performance difference compounded year after year can have a significant impact on the value of your retirement account.

The author of this study concluded that with only 1,318 out of 5,488 large-blend VA subaccounts beating the Vanguard 500, the buyer of the variable annuity had **only a 24% chance** of doing better than the index fund, and that "**the deck is loaded against the investor**" who buys the variable annuity.

Bear in mind that the time period being studied included some years of strong stock market performance, some years of negative performance, and some years where the stock market was relatively flat. Thus, it compared the performance of VA subaccounts over a broad range of stock market conditions.

Variable annuities can post good performances during some years. However, the same can be said for most investments. **The real test**—the one in which you should be most interested—is not short-term performance, but **long-term performance**.

We have studied the long-term performance of variable annuities and could not find even one study of any ten-year period when VAs outperformed a simple stock market index fund. Nevertheless, the managers of these subaccounts must be compensated for their work. While VA owners do not pay the fees directly to the managers of VA subaccounts, these fees are bundled in with all of the other fees charged automatically to their VAs. Management fees are normally taken out each quarter. Some variable annuities offer dozens of different subaccounts. If you select several subaccounts within your variable annuity, you will pay a fee for each and every subaccount.

You might think that subaccount fees in variable annuities are no big deal—until you take a closer look. Subaccount fees commonly range between 1% and 2% per year. If your VA subaccount fee is **2%** per year, you could pay 20% of the value of your VA in subaccount fees in the first ten years of your retirement on just this one fee. If your goal is to preserve and potentially grow the value of your variable annuity, you need to hope that the subaccount grows in value enough to pay for all the annual fees and costs of the VA.

While it is possible that your subaccount value might grow during the stock market's best years, in bad years, some variable annuities lose 20% or more of their value.

Given the impact of the fees and expenses on the performance of variable annuities, we at J.D. Mellberg Financial decided to do some in-depth research to increase our understanding of the total expenses of **thousands** of variable annuity subaccounts.

Perhaps the most trusted name in investment research in the world is **Morningstar**, which has developed comprehensive databases to study mutual funds, variable annuity subaccounts and other investment choices. Morningstar subscribers can use its powerful Principia software to analyze tens of thousands of data points to reveal the actual expenses of different investment products. ***Forbes*** magazine used the Principia software to analyze **69,123 variable annuity subaccounts.** In an article published in ***Forbes*** on June 6, 2010, titled "*Annuities: Good, Bad or Ugly?"* author Mel Lindauer uses a table to summarize the total expenses of variable annuity subaccounts. Keep in mind that subaccount fees are NOT the only fees that variable annuities charge. There are a number of other fees that drive up the total expenses of VAs. Figure 3 illustrates just how much of a variable annuity's value could be paid out for subaccount expenses.

Figure 3

Total Expenses	Number of Subaccounts Charging This Amount	% of Subaccounts Charging This Amount
Greater than 1.5%	65,876	95%
Greater than 2%	56,105	81%
Greater than 3%	6,216	9%
Greater than 5%	289	<1%

Lindauer divides variable annuity **subaccounts** into **four separate categories**: those with total expenses of more than **1.5%** per year, more than **2%** per year, more than **3%** per year, and more than **5%** per year. As you can see, **95%** of VAs have **subaccount expenses** of more than **1.5%** per year, **81%** have subaccount expenses of more than 2% per year, and **9%** have subaccount expenses of more than **3%** per year. Finally, that there are **289** VAs (less than 1%) with total expenses of more than **5%** per year. After only 10 years of your retirement, the subaccount fees alone could potentially wipe out **50% of the value** of a VA if all the subaccounts were in that category. Unless the stock market somehow skyrockets upward, it is unlikely that such a VA will be able to pay the level of retirement income the purchaser expected. If the stock market has one of its periodic corrections, the losses your VA could incur (combined with annual subaccount fees) could cause your retirement dreams to suffer significantly if you relied solely on the income pulled from your VAs.

Putting VA Fees into Real-life Terms

As a financial advisor specializing in retirement income planning, I find that some people do not fully understand the impact of fees if they are expressed as percentages. Upon first glance, the difference between 3% and 4% does not seem that large. Even the difference between 2% and 4% might not seem very large. But such seemingly small percentages can have a major impact on the kind of retirement they can or cannot afford.

Here is a real life example. Recently, a retired school teacher contacted my firm to help her with her retirement planning. She told me that she was thinking of buying a variable annuity. I asked the teacher the name of the VA and the subaccount she was considering I then looked up the total fee loads on this variable annuity and found that they were approximately 4% per year.

When I shared this information with her, she did not seem very concerned. I realized that she did not have a firm grasp on how such an annual 4% fee could impact her lifestyle in retirement;

so I decided to put this seemingly innocuous 4% fee into real life terms.

"How much premium are you planning pay for that variable annuity?" I asked.

She answered, "$400,000."

"Well," I explained, "that means that the managers of this VA will take about **$16,000** each and every year out of your VA to pay for all the fees. The exact amount will depend on your account value. If your account value rises, they will take out more and if the account value falls, they will take out less. How do you feel about having to pay about $16,000 each and every year for this product?"

"That is a lot of money," she answered.

"About how much money were you paid when you started teaching?" I asked.

"Only a little bit more than $16,000 per year." She said the words slowly and I could sense that she was now starting to put this into perspective. She went on, "So I am paying about $16,000 a year in fees to the managers for this VA, which is what I made for a year of hard work when I started teaching."

"Let's put this into monthly terms," I suggested. "You are going to be paying about **$1,333** in management fees every month if you buy this variable annuity. The fees will be automatically deducted from your VA. They take out the fees each month for as long as your VA has any account value."

From the conversation that followed, I could see that the retired school teacher now finally understood the **impact of a seemingly small 4% annual fee**. I was able to help her find a fixed index annuity that had lower fees than the variable annuity and had income benefits and guarantees* that the VA could not match.

If you are considering buying a variable annuity or if you currently own one, you may want to translate the fees and expenses of the VA into **real-world terms**. Many people tell us that they find this exercise very enlightening. Find out the total fees for the VA in question. If you cannot find the total fee load for the VA, contact us and we will be happy to do the research for you. Normally, these fees and expenses will be stated as a percentage, not as a dollar amount. Once you know what percentage of your account value will be taken out of your VA each year in fees, multiply that percentage times the dollar value you plan to place in the variable annuity. For example, if you planned to place $350,000 in the VA and the total annual fees are 4.3%, you would be paying approximately **$15,050** per year in management fees.

Then think back over your working career. Ask yourself how many hours of hard work you had to do to earn that amount of money. When you make this real-world comparison, it is very likely that you will see VAs and VA fees in an entirely new light.

Some of our clients like to take the annual dollar fee charged on that variable annuity and break it down into **monthly fees**. For some reason, when the charge is expressed as a monthly dollar figure, many people really start to understand how VA fees and expenses can detract from the value of their retirement savings. Continuing with our above example, if you had planned to place $350,000 in a variable annuity with a 4.3% total fee load each year, the **monthly fees** for your VA account value would be about **$1,254** to start with. Depending on the VA account value, the dollar amount of those monthly fees could rise or fall**. Is it worth it to you to pay $1,254.00 a month, every year for the duration of your ownership of the VA?** Think of what else you could do with that $1,254 each month if you were not paying it in management fees.

Of course, every financial product has some fees. But why not pay lower fees if you can still get **all** the features and benefits you want from a financial product? We have found that carefully selected fixed index annuities offer a combination of guarantees,* principal protection and income that few (if any) variable annuities can match over longer periods of time.

If the stock market soars, a variable annuity may never be exhausted by fees. However, if your fees start at $1,254 per month and the stock market rises, you will pay even MORE than $1,254 per month in fees because some of the fees are based on account size. **The more the stock market rises, the more some of your VA fees may also rise.** Therefore, the more your VA increases in value, the more fees you pay. While variable annuities have the ***potential*** of lifetime income, they have the ***reality*** of lifetime fees. And in some cases, these VA fees and expenses can increase over time.

How the Lower Fees of FIAs Help Protect Your Account Value

As you know, you will have no concerns about a stock market correction if you own a fixed index annuity. When you own an FIA, no matter how much the stock market declines, your annuity will not decline in value. However, the savings and protections afforded by an FIA go far beyond protecting you against stock market losses. In addition to ALWAYS providing protection against stock market downturns, **fixed index annuities protect your account value by charging lower fees.**

One of the ways to make up for the fees and expenses of any stock market investment—whether it is a mutual fund, ETF (exchange traded fund), closed-end fund, or any other equity investment—is by earning gains during good years in the stock market. If those gains are large enough during some of the good years, they could potentially make up for the cost of fees and expenses.

How likely is it that the stock market will post a high level of gains over the next decade? While no one has a crystal ball, it can be worthwhile to consider the opinions of those who have successfully navigated the investment markets for many years.

Earlier, we mentioned Bill Gross, head of PIMCO which manages approximately $1 trillion in assets. Due to the many huge challenges faced by European countries and the exploding debt of the United States, Gross believes it is unrealistic to expect the stock market to rise significantly over the next decade. It is not just Bill Gross who holds this opinion. At a recent panel of top-level academics and leading investment professionals, none of the experts predicted a return to the levels of stock market performance we saw in the 1980s and 1990s. (http://www.advisorperspectives.com/newsletters12/Jeremy_Siegel_Rob_Arnott_and_Other_Experts_Forecast_Equity_Returns.php, 2/7/2012.) We agree with Bill Gross and many other top investment experts who say that stock market returns may be lower over this coming decade than they have been in the past. If you also share this concern, you may want to consider savings choices that have l**ower fees**.

How do the fees of fixed index annuities **protect** your account value? Obviously, high fees on any financial vehicle have the potential to ***reduce*** account value through their constant eroding effect. When fees are lower, as they are with FIAs, more account value is preserved. Low fees mean less money comes out of your account each year. **In addition, the fees and expenses of FIAs don't come out of your initial purchase amount.** Instead, **100% of the money you place in an FIA goes to work for you immediately**. The insurance company will not take any deductions from your account.

More good news: With an FIA, you see the **return you are guaranteed* to receive** at age 65, 70, 75 or whatever age. You will receive all of that income—regardless of what the stock market does in the interim. And you will receive all of that money without paying any extra fees. The only extra costs to you with FIAs are for **riders** that offer **enhanced benefits**. And remember that those riders are **optional**.

Moreover, most riders on an FIA tend to take fees of **less than 1%** total from your initial premium. So, the total fees on fixed index annuities with selected riders can be less than the total fees on variable annuities.

Remember that when you purchase a fixed index annuity, you do not have to pay subaccount fees. FIAs do not have subaccounts. Instead, their potential earnings are based upon the increases in widely recognized indexes, without actual participation in them. FIAs have low guaranteed rates of interest, and pay additional interest that is based upon the return of a major stock market index.

Research has shown that stock market index funds almost always outperform actively managed VA subaccounts over longer periods of time. Historically the longer you leave your money in a subaccount, the more likely it is to underperform a major stock market index such as the S&P 500.

Therefore, stock market indexes generally offer better performance over time than actively managed VA subaccounts and they do so with lower expenses and fees. **With FIAs, only rider fees are taken out of the account value.** What's not to like? With a fixed index annuity, you get both higher performance and lower cost.

Questions to Ask Yourself before Purchasing a VA

Many retirees purchased VAs, succuming to the bright lights of the "high performance" of a hot VA subaccount when it was near its peak. This high performance almost always proves to be ephemeral. Before you buy such an annuity or place your money in a hot subaccount, you need to ask yourself several questions.

1. "**What is my intellectual reason for buying this variable annuity or for investing in this subaccount?"**

If your answer is that you are looking for super-high performance, you need to think again. Past performance is no guarantee of future performance. This fact is so well established that the Securities and Exchange Commission mandates that this statement has to be printed on securities offerings.

Past "strong" performance of a hot VA subaccount DOES NOT mean strong performance in the future. If you are hoping for super-high performance from a VA, you are taking **significant risk**. Super-high performance investment vehicles almost never have low risk. High-performance and low risk go together about as well as oil and water. United States Treasury Bills, which are short-term debt obligations backed by the full faith and credit of the U.S. government are recognized as some of the most "secure" investments around. They also

pay the lowest returns of just about any investment. That is the trade-off you make when you buy a lower-risk investment: you accept a low risk in return for a high level of security. The flip side of this scenario is that if you are seeking out a super-high return investment, you are going to have to accept the possibility of high losses.

There are virtually no exceptions to this rule! The risk/reward trade-off is true and present for virtually all investments, and even for savings vehicles. Simply put, **higher potential return = high risk**. If you buy for super-high performance, you are buying high risk. When you buy a fixed index annuity that is based on a major stock market index instead of a hot combination of stocks, you are placing your money in an income-producing product that CANNOT lose money due to the stock market. **When you buy a fixed index annuity, you are buying low risk***, and you also are guaranteed* to receive a **steady stream income** in retirement. Many retirees think that is a pretty good deal.

When we speak about risk, always bear in mind that all investments and all savings vehicles involve some risk. Even bank certificates of deposit involve some risk. FIAs offer some risk. Before you purchase or even consider purchasing any annuity of any type, you should learn about whatever risks and expenses may be involved.

2. **"If this high-performance VA subaccount takes a dive, will I have the time to make the money back?"**

Will you have ten or twenty extra years to wait out the stock market and hope it rises so that you can make back some or all of the money your VA subaccount lost? If not, reconsider the idea of purchasing a VA that may have posted a recent hot performance. Remember that many once-hot investments (Internet stocks, high-tech stocks, real estate, etc.) cost investors billions of dollars in losses when those investments inevitably cooled down. No investment goes up forever**. High performance is almost always a temporary phenomenon.**

3. **"What is driving my decision to invest in this hot performance VA subaccount?"**

In the first question, you looked at your intellectual reasons for buying a particular variable annuity. Now you need to look at your **emotional reasons.** Emotions influence **all** of the purchase decisions we make. Whether we are buying a car, a house, a piece of clothing or music, emotions influence what we buy. Advertisers know this. Multi-billion-dollar advertising is based upon influencing both the minds and the emotions of buyers. Emotions also influence the kinds of investments we buy. It has long been observed that what drives Wall Street are two major emotions: **fear and greed**.

There is now a well-established field of study on how emotions combine with human reasoning, logic and cognitive processes to influence our investment and savings decisions. It is called "behavioral finance," and there are thousands of articles and dozens of books on it. I recommend ***Beyond Greed and Fear: Understanding Behavioral Finance and the Psychology of Investing*** by Hersh Shefrin, a well-known economist and researcher. Shefrin cites research studies that have investigated how human emotions influence logic and reasoning, having a profound influence on the investment decisions we make.

I've been studying investments, insurance, annuities and savings vehicles for a number of years now and I have never heard anyone say that two major **intellectual reasons** drive Wall Street. It is always pointed out that **emotions (**fear and greed) drive investment decisions. Before you buy, ask yourself what is driving you to want to buy a hot VA or a hot VA subaccount. If the answer is **fear for your future, expectations of high earnings, or even hope of the same,** stop yourself before you sign the check.

When you are seeking retirement income, placing your savings in **secure, conservative products** that generate steady income and that can't lose money* is the way to go. Buying investments based on hope that a "hot streak" will continue is a risk most seniors cannot afford to take. We are believers in fixed index annuities because we believe that retirees can have more peace of mind by using secure, conservative products* that generate steady income and that can't lose money rather than by taking risks to try to earn high returns.

Questions to Ask an Advisor before Purchasing a VA

Once you've asked yourself the key questions, consider these that you should ask any advisor before making a purchase decision.

1. "What is the long-term performance of this VA subaccount?"

You are most likely to hear one of two answers to the question. Neither of these answers seems particularly reassuring to me. One is that, "The long-term performance of the currently hot subaccount is about average or not very good." Why would an advisor recommend a VA that had only **average** long-term performance? The reason is the **"recency effect,"** wherein human beings tend to focus more on recent events (such as the recent strong performance of a particular investment) rather than on past events. This occurs in everyday life and also in investment behavior. For example, if it has been a little hotter than normal recently, most people will talk about the recent hot weather rather than the very cold winter we had. If a

sports team is on a winning streak, even if it has only gone on for a few games, more people will talk about the recent winning streak than about all the games they lost earlier in the season. Due to the recency effect, if we are given a list of items to remember, we tend to remember the last few items mentioned rather than the items mentioned in the middle of the list. In the investment world, you can observe the recency effect on a regular basis by simply looking at the covers of the most popular money magazines. Some of the topics you will see listed on these magazine covers are, for example, "The 10 Hottest Mutual Funds You Must Buy Now" or "The Five Best Energy Stocks to Buy Now."

Unfortunately, hot-performing investments do not remain hot. No investment can continue to rise at a high rate forever. That is why it is so crucial to find out what the long-term performance of a variable annuity is before you make a purchase decision. As detailed in previous sections, in part due to the relatively high expenses of variable annuities, VAs have historically underperformed even simple stock market indexes. If a VA subaccount does NOT have a good long-term track record, why buy it? Do you think this track record will suddenly change? What exactly would be the catalyst for this change? **Compare the long-term performance of the VA subaccount to the long-term performance of the S&P 500**. Since your retirement is likely to be 20 years or longer, you should compare the 20-year performance of a stock market index to the performance of the VA subaccount you are considering.

Variable annuities were invented in **1952**—60 years ago. Our own research has shown that **NO variable annuity can match the performance of the S&P 500 stock market index from 1952 to the present.** Why invest in a VA subaccount that is unable to match even the performance of a low-cost stock market index?

The second answer you are most likely to hear is that the subaccount does not have a long-term track record. The reason you are likely to hear this is that many of the VA subaccounts that are now being marketed have only been created recently. If a VA does not have a long-term track record or even a medium-term (five years or longer) track record, why take a chance by buying it?

Fixed index annuities are based on **major stock market indexes** which have been existence for, in most cases, many decades. These are tried and proven indexes which have shown their ability over time to outperform the vast majority of mutual funds and individual stocks. Thus, you are not taking nearly as much risk when you select an FIA.

For brief periods of time, almost any investment might appear to be a "star." However, given just a little more time, these are almost always revealed to be **shooting stars**. VA subaccount "stars" can quickly come crashing back down to earth and lose a great deal of their value. **Why take that risk?** Remember that over the long term, the stock market has been the

greatest investment of all. The stock market has significantly outperformed real estate, bonds, CDs, commodities, collectibles and virtually ALL other investments. The stock market has also greatly outperformed inflation.

History and scientific research show that the best way to "bet" on the stock market is through the use of low-cost major indexes. That is why so many major endowments, university investment funds and big pension funds have placed billions of dollars in the stock market over the past 30 years. Fixed index annuities offer interest crediting based on major stock market indexes—not on any specific collection of stocks.

2. "What are the total subaccount fees?"

It is very important that you ask to see the subaccount fees in writing. Only when you see the total subaccount expenses in writing will you know with any certainty what that total expenses are. It is important to see these fees because there are many of them and they can vary significantly from one VA to another. Even within one variable annuity, there can be major differences. For example, there can be dozens of management fees among different subaccount choices in one VA.

Is it relatively common for a VA subaccount to have **3%** or **4%** in total **annual** subaccount expenses. **Multiply the annual total expenses by 20,** because you are likely to be retired and living off the income from this variable annuity for the next 20 years. Even if the subaccount expenses are only **3% per year**, that means that over the course of your retirement, you could end up paying almost **60%** of the value of your variable annuity just for subaccount expenses if the market stays flat.

Full disclosure: if the market rises, you can show a profit in the variable annuity. However, you will need to earn at least 3% per year plus the rate of inflation just to maintain your purchasing power in any given year. For example, if the rate of inflation is 3%, you would need to earn a minimum of **6%** during a given year just to maintain your purchasing power (3% in VA expenses + 3% rate of inflation = 6%).

3. "What are the total expenses of the variable annuity including subaccount fees and all other fees and expenses?"

Remember that subaccount fees are among several fees for VAs. Be sure to include the cost of any riders or protections you might want. For example, if you want a rider to protect the value of your VA if the stock market crashes, have the agent show you that fee in writing. If you want a rider on the VA that will help you pay for nursing home or skilled nursing expenses, ask to see the cost of that in writing. Ask to see the costs of any other riders in writing as well.

When you add up all those fees and expenses, don't be surprised if the **total annual expenses** of the variable annuity are **6% per year** or even more. After just ten years, this could potentially eat up almost 60% of the original premium you paid for the VA!

Again, remember our full disclosure: if the market rises, you can show a profit in the variable annuity. However, you will need to earn at least 6% per year plus the rate of inflation just to maintain your purchasing power in any given year. So if the rate of inflation is 3%, you would need to earn a minimum of **9%** during a given year just to maintain your purchasing power (6% to cover the total cost of all expenses and riders + 3% to cover the rate of inflation = 9%).

If the stock market loses 3% in a given year (a relatively common occurrence), you will need to earn at least 12% that year just to maintain your purchasing power (6% to cover the total cost of all expenses and riders + 3% to cover the rate of inflation + 3% to cover the losses in the stock market that year = **12%** needed to maintain purchasing power).

Just asking these three questions and listening to the answers could save you tens of thousands of dollars of your retirement savings!

Comparing Annuities

One of the best ways to understand the differences between fixed index annuities and variable annuities is to look at tables comparing the **benefits** you could receive from either, for **various dollar amounts used to purchase each annuity**. Before we jump into those comparisons, we need to discuss the concepts of withdrawal benefits and withdrawal percentages.

Withdrawal Benefits and Withdrawal Percentages: All annuities offer withdrawal benefits. However, these withdrawal benefits vary widely among different annuities.

Your **guaranteed* withdrawal benefit** is determined by applying a **withdrawal percentage** to your **annuity account value**. For example, if your annuity account value is **$400,000** and the withdrawal percentage is **5%,** you could take out **$20,000** every year for the rest of your life.

Some annuities increase the withdrawal benefit over time or when the annuity rises in value. Some annuities give you the ability to lock in a higher withdrawal benefit or higher payout once a year. We normally suggest that you want to own an annuity that locks in increases as often as possible. However, this is not the only criterion we assess in selecting the most suitable annuity for any client. We also look carefully and in-depth at the financial strength of the life insurance company that issues the annuity, and we look at and evaluate any bonus that may be offered. We carefully study all of the fees and expenses, strengths and weaknesses of any annuity before we recommend it. We usually spend hours thoroughly assessing an annuity. Most important of all, we ask ourselves, "Will this annuity help my client reach his or her financial goals?" This is not just a matter of posting high returns. Many clients tell us that enjoying more **financial security** and greater **peace of mind** are two of their most important goals, and we honor those objectives.

Having strong withdrawal benefits is a goal of many retirees and pre-retirees. In most cases, you will benefit from owning an annuity that requires less time to increase your withdrawal percentages. ***Why wait an unnecessary amount of time to increase your withdrawal percentage?***

Consider an example where the product features for two annuities are exactly the same with the exception of how often withdrawal percentages increase. One annuity increases the withdrawal percentage annually and the other annuity increases the withdrawal percentage once every 10 years. ***Which annuity would you rather own?***

While the payout amounts are the same for certain ages such as 60 and 70, an annuity that locks in the increase every year will **have higher overall income** than an annuity that locks in increases only once every five or ten years. Therefore, as a smart consumer, you want to select the annuity that increases withdrawal percentages annually. (This assumes that the annuity has the other features and benefits you want. Never buy any annuity for just one feature or just one benefit. **You want to select an annuity based on the total package of benefits it offers.**)

Below is an example of the different **payout amounts** you might see for different annuities:

- **Annuity A** – Payout % = 5% at 60, 6% at 70, 7% at 80 and above
- **Annuity B** – Payout % = 5% at 60, 5.5% at 65, 6% at 70, 6.5% at 75, 7% at 80, 7.5% at 85 and above
- **Annuity C** – Payout % = 5% at 60, 5.1% at 61, 5.2% at 62, etc.…up to 8% at 90

For a retiree who wants to take income at a "**step-up age**," (usually 5-year increments) there is no difference. For example, if two retirees each wanted to start their income at **age 70**, it would not matter if they purchased Annuity A, Annuity B or Annuity C. In each of these three cases, the payout starting at age 70 would be 6% per year. However, there might be other differences among these three annuities that would lead you to select one annuity instead of the other two. If the retirees wanted to turn on their income at different ages, there could be a big difference between the three annuities shown. Annuity C increases the payout amount annually. All else being equal, if a retiree wanted to turn on his or her income at a younger age, or at some point between prescribed step-up intervals, selecting **Annuity C** could make a difference of thousands of dollars of income over time.

If one of your goals in retirement is to receive the ***maximum amount of guaranteed* income at the youngest possible age***, one of my insurance-licensed producers will be happy to help you find the most suitable annuity with the best withdrawal percentage. There is no charge for a consultation with us.

How an FIA Can Save You $100,000 or More over a VA

You can **spend much less money** to buy an FIA and still, over time, receive the same amount of income you would receive from a **variable annuity with higher fees and expenses**. For the same amount of money, an FIA could produce more income over your retirement years than the VA.

This powerful ***combination of benefits*** may not be available in future years. If you are interested in taking advantage of this unique blend of features, you may want to contact our office as soon as possible.

To achieve this, we use a type of FIA that increases the withdrawal percentage every single year. Moreover, the income account value growth of this FIA is one the highest available.

In this illustration, we will use a 55-year-old client who wants $3,000 of monthly income ($36,000 annually) beginning in 10 years. To get this benefit, the **fixed index annuity** requires that you purchase a face amount of **$270,566.81**. The **variable annuity** requires you to purchase a face amount of **$402,044.24** to receive the same income! In other words, **the VA costs $131,477.43 more—48.59% more—than the FIA, and you will receive the same income benefit in year 10!**

When you work with us, we are happy to compare the fixed index annuities we have available to any variable annuity. Over the past ten years, it has been our experience that **the best FIAs will always win** over VAs when it comes to the total combination of features, benefits and cost. Getting the most out of your money is always an important goal to keep in mind. As you have seen, a properly selected fixed index annuity can help you reach your income and retirement goals while requiring less premium than variable annuities might require. **You worked hard for your money. Why not make your money work hard for you in retirement?**

By purchasing the fixed index annuity that is most suitable for your situation, you can feel confident you will be receiving **one of the highest income streams currently available** from a conservative, secure retirement income product, no matter what amount of premium you pay.

Unlike other savings vehicles such as an IRA, 401(K) or pension plan, there is currently no limit on how much premium you can place in a tax-deferred annuity. Remember also that your fixed index annuity increases your income stream for every extra dollar of premium.

A Closer Look at a VA with a Daily Lock-in

One variable annuity that is being offered now is a variable annuity which offers a **daily lock-in of the highest account value**. What could possibly be better than a daily lock-in of the highest account value achieved? As you will learn, there are a number of limitations. First of all, **the daily lock-in of the highest account value only lasts until you take your first withdrawal from the variable annuity**.

What if you retire at age 65, purchase this variable annuity and start taking some withdrawals *immediately* to meet your living expenses? As soon as you take your first withdrawal, **the daily lock-in benefit ceases**.

There are many reasons why retirees may need to start taking withdrawals from their annuities as soon as they retire, or at an early age. You could develop a health problem at any time, and you may decide it is better to receive *some* money now and enjoy it while you can. Like many retirees, you might need extra cash to pay for medical bills and that may require you to take one or more withdrawals before you had anticipated you would need the money. You might also need money to provide financial assistance to a child or grandchild. Yet, when you take the first withdrawal from the variable annuity, the daily lock-in of the highest account value benefit stops. In other words, as soon as you take even one withdrawal from this VA, you lose what may have been the primary reason you purchased the annuity.

In making an informed purchase decision to buy an annuity, you need to look at the **totality** of features, benefits, expenses and fees in that annuity. If you focus on only one potential benefit, (such as a daily lock-in of the highest account value), you may end up losing or neglecting to have a variety of other benefits that could, in their totality, prove much more valuable.

One of the major reasons to purchase an annuity is for the **income**. An annuity that fits your needs best might be one offered by a financially strong insurance company that offers you the highest rate of income, contractually guaranteed.*

You also want to make sure the annuity you **purchase cannot lose money**. A number of VAs do not offer protection against a falling stock market, or they offer protection only through purchasing an extra rider, which may add significantly to the annual cost of the VA.

ALL fixed index annuities offer protection against stock market losses—and **you do not have to buy a rider to obtain this valuable protection with an FIA**.

Before buying any annuity, you need to look at your reasons and motivations for doing so. You should NOT buy an annuity to play the stock market. There are better, lower cost ways of playing the stock market, such as buying index funds. You should not buy an annuity because you find its recent performance exciting. (Remember the recency effect.)

What is a good reason to buy an annuity? A major reason is to receive an annuity income.

Do you really need a daily lock-in of the highest account value to obtain the income you want? Before buying a VA with this feature, ask yourself, "**Will I ever need to take income from this annuity?**" If so, realize that as soon as you receive your first payment from the annuity, the daily lock-in feature, which might have been your major motivation for buying the annuity, will be gone.

Then ask, "Do I really need a daily lock-in of the highest account value as compared to a monthly or even annual lock-in of highest account value?" Annuities are most appropriate for people with longer-term investment and/or income perspectives. Your time horizon should be several years or longer. If you want to play **day-to-day** changes in stocks, then you should probably buy stocks and day-trade them, rather than buy an annuity with a daily lock-in.

If you look at day-to-day changes in the stock market, there is frequently not much difference. The market may be up one-quarter of 1% one day and down one-half of 1% the next day, then up one-third of 1% the next day. Few, if any, of these small changes will have much influence on your lifestyle. If you compare **month-to-month** performance of the stock market, you will see a slightly larger range of values. Yet even on a monthly basis, the stock market usually does not have huge moves up or down. If you look at the stock market on a 6-month basis, you will see a slightly wider range of values. And year-to-year, you will see bigger changes in value. In our opinion, it is annual changes in stock market value that may have much more of an impact on your lifestyle than daily or even monthly changes.

Most FIAs offer **monthly, quarterly or annual lock-ins** of the highest account value. I believe that these frequencies are sufficient. As you saw earlier, the study titled ***Real World Index Annuity Returns***, found that fixed index annuities significantly outperformed the stock market (as represented by the S&P 500) over the vast majority of time periods studied. What is significant to note here is that NONE of the fixed index annuities in the study had daily lock-in of highest account value. They ALL had monthly, quarterly or annual lock-ins. Yet they STILL outperformed the S&P 500!

It is also important to note that the time periods studied included some of the most volatile in the entire history of the stock market, including the crash of 2000 – 2002 when the S&P 500 lost about **42%** of its value. Yet, unlike VAs, **index annuities lost NONE of their value,**

even without daily lock-ins! The study also included the crash of 2008, when the S&P lost **37%** of its value. Yet again, unlike VAs, FIAs lost none of their value during this extremely volatile time. Fixed index annuities achieved this feat *without* using daily lock-ins.

The ability of FIAs to handle major stock market downturns without incurring losses is one of the primary reasons why we specialize in index annuities at J.D. Mellberg Financial. Our clients are *not* gamblers. **Our clients want their money to be secure and they want guaranteed* income they can count on**. That is exactly what we provide to our clients all over the United States.

Based on these facts, you have to ask yourself, do you even need daily lock-ins? If you think you do want them, **what price are you willing to pay for them**? As you will learn, you may end up paying for a feature that is not even necessary for you to achieve your retirement income goals.

The Price You Pay for a Daily Lock-in

The **price** you pay for the **daily lock-in** feature for the type of variable annuity we've been discussing ranges up to **.85% per year**. Note that this charge could rise or fall in the future. In other words, you are paying almost one percent per year for a feature which you may not need. This .85% fee is in addition to all the other fees and expenses you pay. Over the first ten years of your retirement, if you didn't take any annuity payouts, the lock-in fee could cost up to **8.5%** of the value of your VA. On a **$500,000** variable annuity with this feature, over 20 years (if you did not take out any annuity payments), this fee by itself could reduce your VA by about **$85,000**! And this is in addition to the other fees that you pay. If the stock market rose steadily during this time, your VA could be reduced by even more than $85,000 because the .85% annual fee would be applied to a larger and larger account balance each year. If the stock market declined during some of these years, the total fee just for the daily lock-in feature would be less because the .85% charge would be applied to a smaller account balance.

Depending on the mix of stocks in your subaccount, the stock market as measured by the Dow Jones or the S&P 500 indexes could actually RISE in value, but the mix of stocks in your subaccount could DECLINE in value during the same year. **That's right**, **the stock market could rise in value but at the same time your VA could decline in value, because most VA subaccounts underperform major stock market indexes.**

Let's now turn our attention to the total fee and expense load of a variable annuity. If your VA has total fees and expenses of **4%** per year, the value of the stocks in your VA subaccount must rise at least 4% for you to just break even. If inflation is 3% per year, to overcome the eroding effects of VA fees and inflation, the value of your VA's subaccount must increase by at least 7% per year (4% to cover fees and 3% to cover inflation = 7%) just for you to maintain your spending power. Having a daily lock-in feature on your VA would not protect you from this. Of the hundreds of variable annuities I have studied over the years, I have only rarely seen a VA that could post 7% annual returns consistently. I have not seen any VA that posted 7% returns annually for the past decade. Why pay a high annual fee each year for a daily lock-in feature that cannot protect you from the two factors that have the biggest effect on VA account values?

How Much Money Will Your Heirs Receive from the Annuity?

Many people wonder if their heirs will receive the highest value of the VA when they die.

Let's look at what might happen if the stock market crashed. If you had started to receive your annuity payments, this VA with the daily lock-in feature would turn off the lock-in. Assume you had purchased a **$100,000** variable annuity with daily lock-in of the highest account value. If the stock market crashed and this VA lost 40% of its value, your annuity would have an account value of about **$60,000**.

You might think your heirs are protected because of the guarantees* your annuity offers. Let's say you had been taking out only $5,000 a year to help pay your bills. If you had done this for three years, you would have received **$15,000**. You might think then that your loved ones would still receive the original $100,000 with which you purchased the annuity, minus the $15,000 in annuity payments you had received (**$85,000)**. In fact, your loved ones are likely to receive LESS—maybe only **$75,000**. Here's why.

The contract formulates what is called a "**pro-rata adjustment**." This means that the annuity payments you receive will reduce the amount your heirs will receive by a proportion (percentage) of the account value. To clarify the impact the **pro-rata adjustment** could have, let's say you purchased a $100,000 VA with a daily lock-in of highest account value. You started to receive annuity payments. Then the stock market crashed. The account value of the VA declined to $60,000. You then passed away. By the time you died, you had received **$15,000** in annuity payments. As a proportion (percentage) of **$60,000** (the account value after the stock market crash and after your annuity payouts), the **$15,000** you had received

is **25%**. Therefore, instead of your heirs receiving $85,000 (the original amount of $100,000 minus the $15,000 in payments you had received), the pro-rata payout would be **$75,000** ($100,000 amount minus 25% pro-rata adjustment = $75,000). (The exact size of the pro-rata reduction in value will depend on how much your annuity's account value has declined and on how much money you had received from the annuity.)

What if you lived longer than 3 years from the date you purchased the annuity?

If you lived 10 years from the date you bought the daily lock-in VA and had withdrawn $5,000 a year, you would have withdrawn **$50,000**. To continue with the above example, let's assume the stock market had a correction and was down 40% over this ten year time period.

Your loved ones might think that they would be receiving $50,000 from the insurance company ($100,000 original annuity value - $50,000 in annuity payments received = $50,000). In fact, due to the pro-rata adjustment feature of the daily-lock VA, they would receive much less.

You withdrew $5,000 a year from the annuity ($50,000). The company then applies their **pro-rata adjustment.** The total amount of your withdrawals ($50,000) divided by the remaining account balance after the stock market correction ($60,000). This results in a pro-rata adjustment of **83.33%** ($50,000 divided by $60,000 = .8333). The insurance company then applies the pro-rata adjustment of 83.33% to the original amount of $100,000 ($83,330). The insurance company adjusts your account balance by **$83,330** and arrives at a figure of **$16,670 to pay your heirs**.

So, instead of your heirs receiving $100,000, as you may have thought they would, they may only receive this adjusted amount.

Summary: You may not even need daily lock-ins of highest account value. You'll remember that research shows that from 1997 to 2010 (one of the most volatile periods in stock market history), FIAs did not lose any money. This is not true for VAs.

We reviewed the high hidden cost of the daily lock-in feature. Over a twenty year retirement without market gains, the daily lock-in alone could cost approximately **17%** of the value of the original VA premium (**.85% annual cost** x 20 years = 17%).

Remember that there are many other fees and expenses in this type of VA, and all of these other fees and expenses will *further* erode the VA's value. We also showed how your heirs might only receive a fraction of the amount of the original VA premium.

Some of the retirees who own this variable annuity will be surprised to learn about its limitations and weaknesses in future years as these weaknesses become better known. Remember that **knowledge is power**. You now have more knowledge about this variable annuity than most people do. Use your knowledge about this and other strategies to help make the best retirement income decisions for yourself and your family.

How FIAs Provide You with More Income for Whatever Premium You Can Afford

While we worked hard to write this report in clear, easy-to-understand language, you might be feeling a little overwhelmed by everything that was covered. That is perfectly fine. Variable annuities are complex products and it does take some time to understand their complexities. After studying variable annuities and fixed index annuities for many years, we have come to one very powerful conclusion: Over a period of ten years or longer, for ANY dollar amount of annuity purchase, there is most likely a fixed index annuity that can deliver more income than a comparable variable annuity.

You may be skeptical of this claim. We'd like to prove it to you. Let us know of any VA you are considering. We will fully inform you of its strengths and weaknesses and of how much guaranteed* income it might be able to produce under different stock market conditions.

You don't want to just look at how much income an annuity might produce under ideal stock market conditions. With a strongly rising stock market, a large number of VAs and FIAs can potentially produce a relatively high level of income. For your own financial security and peace of mind, you may also want to look at how much guaranteed* income a VA or an FIA might produce if the stock market stays flat or if it declines. Performing that kind of evaluation is complex and can be time consuming, but in our opinion, it is absolutely necessary, because your life savings (or a good portion of it) may be at risk.

We will perform that analysis for you free of charge. You have nothing to lose by obtaining this knowledge, and it may potentially save you a great deal of money. This analysis can also potentially enable you to securely earn a higher return.

To illustrate for you the power of this analysis, we will share with you here the findings of one recent study we did of a VA that a retiree was considering, and an FIA.

This retiree had $402,000 with which to purchase an annuity. In **year 10** for the **variable annuity**, the retiree would be receiving **$36,000** in income. That is an income of **8.95%** annually on original premium for the VA.

After doing some research, we found a **fixed index annuity** that we were very excited about. This FIA was able to produce the same $36,000 in annual income that the VA produced. Why were we so excited about this FIA? Because the fixed index annuity is able to produce this income starting in year 10 with a lump-sum premium of only **$270,566.81**. This fixed index annuity gives you an **income payment of 13.3%** based on the original premium amount, whereas the VA provides an income of only 8.95% based on the original premium amount.

What if you were willing to pay the premium of approximately $402,000 into the fixed index annuity? With an initial premium of that size, your FIA would give you an **annual income of approximately $53,471.88 in year 10 of the annuity. That's $17,471.88 more income** in year 10 than the VA! Just think of all the things you can do with that extra $17,471.88 in income!

The higher income you receive with a fixed index annuity is not a one-time event. This higher level of income will continue for as long as you live. If you purchase a joint-life** FIA, this higher level of income will continue for as long as you or your spouse are alive. Even if one of you lives to 100 years of age or older, this FIA will continue to pay out this high level of income each and every year.

In addition, FIAs offer protection from stock market losses that many VAs do not. Before you purchase any annuity, give us the opportunity to provide you with a second opinion, free of charge. It pays to compare!

The FIA illustrated here is just one of many we offer our clients**. No annuity is perfect for all clients**. Once we know your goals and what you want to achieve with the premium you pay for an annuity, we will search the universe of fixed index annuities to find the one that we believe can best help you meet your specific goals. And we are happy to compare that annuity (or several suitable FIA choices) to any variable annuity you would like us to analyze.

For all of these reasons, regardless of how little or how much premium you have to purchase an annuity, you may want to investigate the full range of benefits a fixed index annuity can offer you and your spouse.

If earning a high rate of interest from a savings vehicle protected from stock market losses appeals to you, we invite you to call us today. Our toll-free phone number is:

1-888-565-8995

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