The following article was published on Sunday, May 1, 2011 in the Wall Street Journal and reflects my own personal thoughts on Annuities. *Don Pearson*

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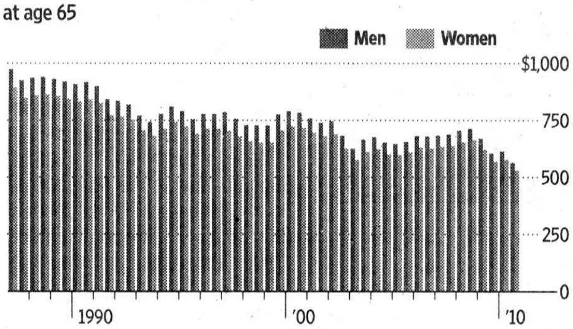
The Weekly Guide to Managing Your Money *WSJ.com/Sunday*

Retirement Income? Annuities Come Up Short.

By Brett Arends

Annuity Rates Tumble

Monthly income per $100,000 premium for a single life annuity at age 65



Source: ImmediateAnnuities.com

Turmoil in the stock market. Paltry interest rates at the bank. What are the newly retired to do?

Many are taking a look at buying a fixed annuity instead.

These products let you swap a lump sum for a fixed income for life. They're sold by insurance companies, and have long been considered a safe way to ensure a steady income in retirement.

They have a fair amount to commend them—especially in theory. They eliminate the risk that you'll outlive your savings. And they let you squeeze out extra income while you're alive, at the cost of leaving nothing for your heirs.

But there's a big problem right now. Annuity payout rates have slumped.

These may be a particularly risky bet right now. Anyone buying an annuity will be locking in today's low interest rates for life. You'll be earning a low level of return. And it could leave you at risk if inflation picks up.

Consider a newly retired 65-year-old woman who invests $100,000 in a fixed annuity today. According to ImmediateAnnuities.com, a comparison website, that will buy her an income of $590 a month, or about $7,000 a year.

Ten years ago, she would have gotten nearly $9,000.

And a generation ago, she could have gotten nearly $11,000 a year. A 90-year-old who retired 25 years ago and bought a $100,000 annuity has so far banked $270,000 in checks from the insurance company.

A 65-year-old trying to follow in her footsteps will collect $90,000 less.

The comparison isn't totally apples to apples. Inflation has played a role. The woman who retired in 1986 has seen her purchasing power erode each year. But she has, nonetheless, come out ahead. That's because inflation has turned out a lot lower than people feared it would back in the mid-80s, when she bought her annuity. She locked in a high payout rate, and landed a windfall as inflation fears fell.

Someone buying an annuity today risks the opposite problem. He or she could lock in a low rate just before inflation revives.

Naturally, there's no guarantee inflation, or tomorrow's interest rates, will be higher. If the economy tumbles into deflation, rates could yet fall further. Hersh Stern, the head of ImmediateAnnuities.com, points out that people who have held off buying an annuity over the past couple of decades, waiting for rates to recover to previous levels, have waited in vain.

But today's rates are artificially depressed. The actions of the Federal Reserve, along with governments and other political players in the bond market, have driven long-term interest rates lower than they should be. It's hardly sustainable. And today's rates leave you very little margin of safety.

"Low bond yields do make immediate annuities a fairly poor investment from a pricing standpoint right now, particularly for a new retiree," argues Ben Birken, a financial planner at Woodward Financial Advisors, in Chapel Hill, N.C. "You're locking in an income stream that's going to lose purchasing power pretty quickly."

Steve Condon, a financial planner at True Point in Cincinnati, says when you analyze the rates of return closely, "it's hard to build a compelling case for immediate fixed annuities." Few annuities offer inflation adjustments, and that, he warns, "is a significant downside."

Do the math. If inflation averages 2.5% a year over the next 20 years, the buying power of a $100,000 annuity will fall from $590 a month to just $360.

And if inflation rises to, say, 5%, the buying power will fall to $220.

Inflation isn't the only issue. The insurance companies that provide annuities typically have high costs, from administration to marketing. Sales staff often pocket the first 5% of your investment as commission. Those costs mean your returns are lower than they would be otherwise. And as payout ratios fall, these costs have become more important in relative terms, not less.

And these are on top of the perennial issues with annuities, such as that you lose control of your principal and you're dependent on the financial strength of an insurance company (although, to be fair, they are pretty closely regulated).

None of this is a blanket condemnation of annuities. In many cases, they can make a lot of sense. The key is that annuity holders who die early subsidize those who live longer, so no one risks outliving his or her money.

But the actual investment rates of return on your savings are far lower than you may realize. An annuity isn't a bond or a certificate of deposit. When a bond or CD matures, you get your principal back. When the annuity finishes—in other words, when you die—the money is gone.

So even though a payout ratio of 7% may look good in this environment, a lot of that is just your own money being sent back to you. It will take you nearly 15 years just to break even, and that's before counting inflation. You can't compare it directly with the interest rates on a CD.

For the average 65-year-old customer, who will live another 17 to 20 years, the investment return will work out around a paltry 3% a year. For the typical 75-year-old, it may only be about 1%.

What can you do if you are approaching retirement and want to make sure you'll have income that will last 20 or 30 years? There are no easy answers.

You can hold cash and wait for better opportunities.

You can brave the turmoil of the stock market in the hope of higher returns.

Or you can delay retirement, keep earning and put off taking Social Security.

All of these come with risks of their own. You could burn up a lot of your principal living on CDs earning 1%.

Anyone thinking about buying an annuity in this environment needs to tread carefully. Several advisers suggest limiting your annuity purchase—and, if possible, staggering multiple buys over several years in case rates rise.

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