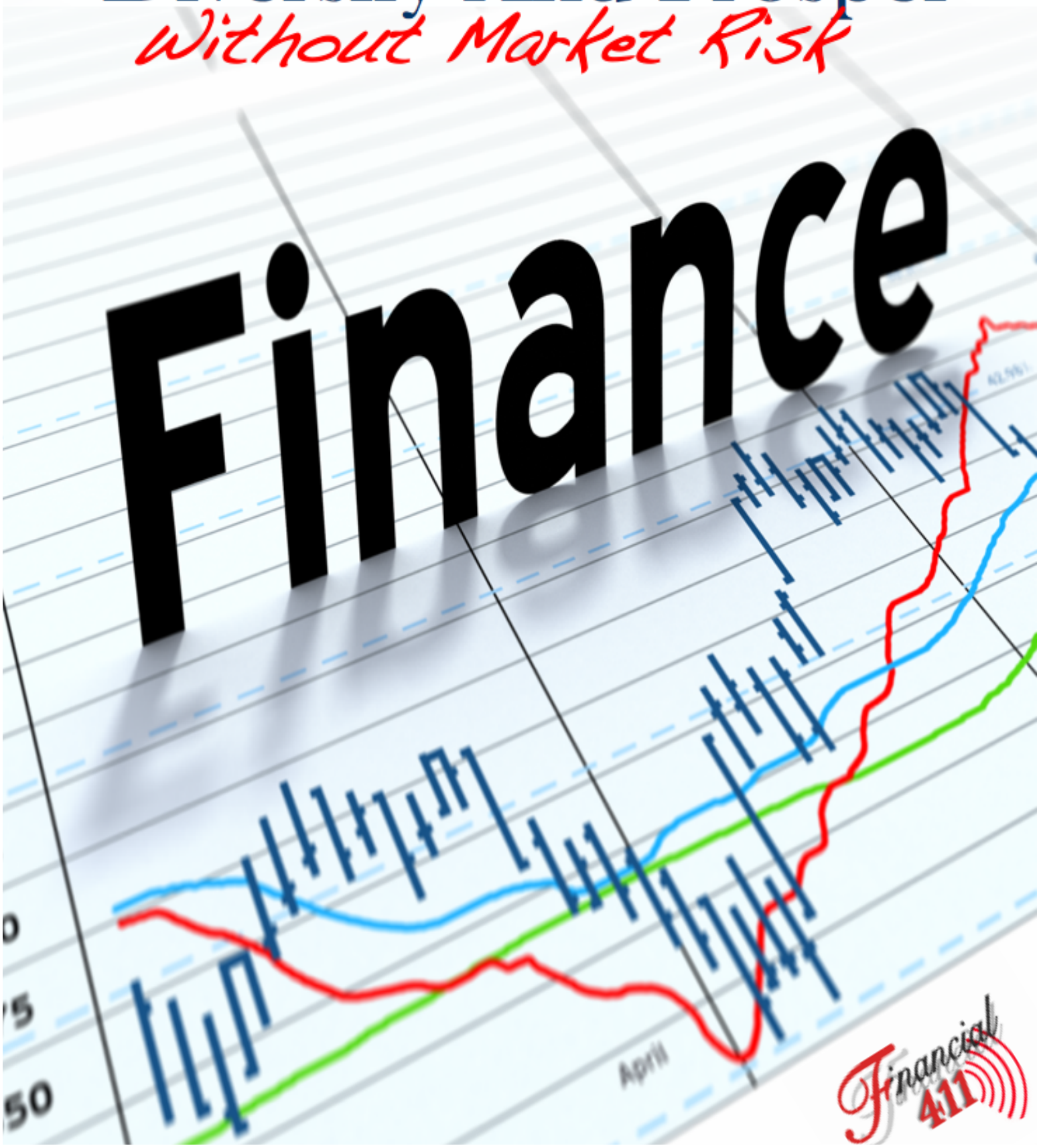
Diversify And Prosper

Without Market Risk



The world of annuities can be complicated.

This guide was designed to help explain the different types of annuities, allowing you to make better-informed decisions for your retirement.

Everyone needs a place to live in the future, which means a house, condo, apartment or maybe even the possibility of assisted living.

For retirees that means considering the costs of owning, paying off or renting one or more of these living accommodations.

In addition to having a place to live, basic necessities including food, clothing and other costs should be taken into account.

Although food prices are fairly constant, things like inflation and energy prices can increase the standard costs of such items over the years.

Inflation: Effects Over a Twenty Year Period

	Food	Gas	Utilities	Health Care
	+72%	+191%	+109%	+129%
1998*	$3,748	$932	$1,747	$1,298
2008*	$6,443	$2,715	$3,649	$2,976
2028*	**$11,637**	**$4,904**	**$6,590**	**$5,374**

*Source: United States Department of Labor, http://stats.bls.gov/data/. October 2011.
**Assumes an annual inflation rate of 3%.

This increase in cost of goods is called inflation.

Like many goods, inflation can have an impact on transportation costs. (The cost of fuels such as gasoline and diesel have increased over the last few years.) Although no one knows for sure what prices will be like in the future, the CPI historically grows at approximately 3% annually on average.

Healthcare is another industry that may see significant changes in pricing over the next twenty years. It is also a future need that should be addressed when planning for retirement. Medicare, long-term care and other types of private insurance are all things to look into as potential costs during retirement.

The longer you live, the longer your retirement savings *will need to last*.

None of us know exactly how long we are going to live and that is why it's so important to plan for the unknown.

There are two things that every soon-to-be retiree should be thinking about when it comes to their money: Staying Flexible and Protecting Their Principal from downside market loss. Both of these things can potentially lock a retiree into a particular product or situation or create potentially significant losses.

Portfolio losses due to market fluctuation can severely impact the ability of a portfolio to sustain reasonable payouts twenty years down the line. Most retirees' needs change over the course of their retirement.

In order to address this, they must remain flexible. One of the most common concepts used in retirement planning is the Rule of 100.

This rules says that 100- retiree's age = the max percentage of retiree's portfolio that should be exposed to downside market risk. This means that if someone were 70, they should have no more than 30% of their nest egg in riskier investments.

One of the most popular types of retirement products that can offer principal protection of from downside market risk is a Fixed Indexed Annuity.

Annuity Basics

Annuities are designed to provide a guaranteed, steady stream of income over one or more lives. They protect the "annuitant" from running out of money during their lifetime.

There are two basic types of annuities: immediate and deferred. Deferred annuities have several variations, such as fixed and indexed. Immediate annuities are the simplest kind of annuity.

Immediate Annuity

An immediate annuity is a contract between the insurance company and annuitant in which the insurance company promises to make periodic payments to the annuitant in exchange for an upfront lump sum of money. Immediate annuities are designed to provide recipients with a steady stream of income and are in fact, the oldest form of annuities. Immediate annuities are so named because the annuitant usually begins receiving income from the annuity almost immediately.

A downside to an immediate annuity is the loss of control of your lump sum. The annuitant gives up control in return for an income stream. Should needs change, that income stream cannot simply be turned on and off and the annuitant is essentially locked into those payments by contract.

Annuity Basics Continued....

Payouts may end upon the death of the annuitant or spouse, or continue to survivors for a certain number of years. Immediate annuities were designed to provide an income stream and usually don't have comparable death benefits to other retirement income vehicles such as deferred annuities with riders or life insurance.

Deferred Annuities

This describes any annuity for which taxation and income are initially deferred. Deferred annuities can be purchased with a single lump sum payment, but some allow for periodic or flexible premium payments into the annuity. However, instead of immediate payments being made back to the annuitant, the premium payment sits in an account and accumulates interest or investment gains during a deferral period. The type of interest or investment gains depends on the type of deferred annuity that the owner chooses, such as fixed or indexed.

When the annuitant is ready or after a certain amount of time has passed, the annuity begins to pay out an income stream based on the accumulated value. Income payments are usually received in one of three ways: (1) withdrawals, (2) riders, or (3) by annuitization.

(1) The annuitant can choose to simply withdrawal amounts as needed, but you are required to withdrawal the interest or gains first which may be taxable to you.

(2) Some annuities contain riders that will guarantee a certain withdrawal amount, allowing the annuitant to receive payments even after the account is depleted.

(3) And finally, annuitization refers to simply converting the deferred annuity into an immediate annuity.

Rebounding From A Market Decline

Look what can happen when income is being withdrawn during a downturn in the market

$100,000 starting value · 3 year market decline 26.1% cumulativ
· 35% return needed to get back to $100,000

Year	Market Return	5% Withdrwl/Yr	Year End Value
2000	-6.17%	$5,000	$89,139
2001	-5.35%	$4,457	$80,151
2002	-16.76%	$4,008	$63,382

In 2002, due to negative market deductions, a 5% withdrawal generated only $4,080. This means it would take a 58% return to increase the principal back to the original amoount so that the 5% annual withdrawal would again equal $5,000.

Deferred annuities also have a surrender period. This surrender period is the amount of time the annuitant must keep their money in the annuity in order to not be charged a surrender fee for taking it out.

Like in a CD, if moneys are withdrawn before that surrender period the annuitant may be required to forfeit gains or even principal.

However, the surrender period usually only applies to withdrawals; income from riders or by an annuitization are not generally affected by the surrender period.

All of the guarantees found in annuities are subject to the claims paying ability of the insurance carrier, so it is important to choose a highly rated insurance company.

Now that we have discussed the *"textbook definitions"* of the different types of annuities, let's look into what you may encounter while looking around for an annuity that is right for your unique situation.

Fixed Annuities

'he Fixed annuity is a deferred annuity with very similar structure to a certificate of eposit (CD) where a guaranteed minimum nterest rate is set by contract.

'ixed annuities may also have a "bonus" ate, an additional interest rate credited for a ertain period of time.

Fixed annuities typically offer interest rates hat are higher than CDs. Fixed annuities are not subjected to market risks and are not guaranteed by any bank or the FDIC.

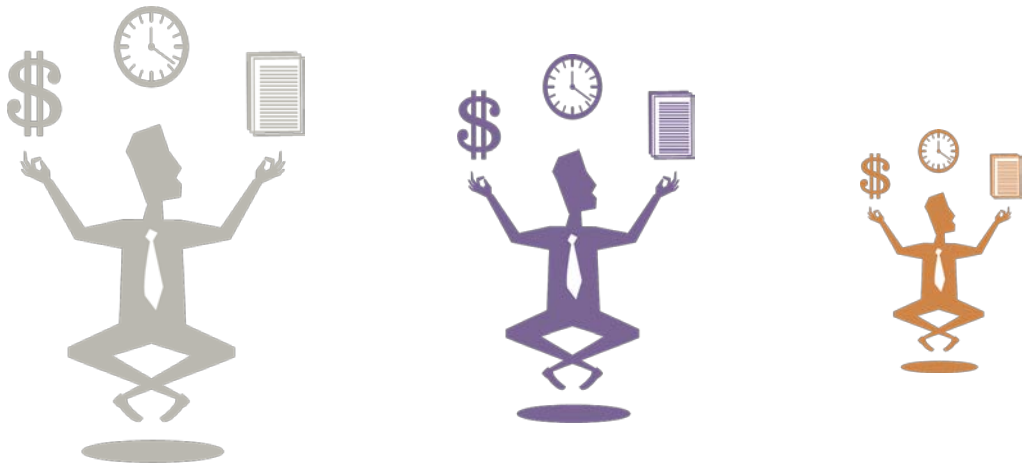
Fixed Indexed Annuities

Fixed indexed annuities are perhaps the most popular annuities on the market today. Instead of delivering a guaranteed minimum rate of return like a CD, a portion of the principal is allocated to an index such as the S&P 500™.

When the index performs well, the portion that i allocated to an index will increase accordingly, subject t any caps or participation rates. If the index perform poorly, the principal is still guaranteed and losses are no carried over. Most FIA's boast the ability to delive higher rates of return than regular fixed annuities whil still protecting the principal.

Not all FIA's work the same; some FIA's have fee structures that can actually invade the principal.

It is important for you to understand how rider fees ar calculated and taken out because in certain products they can actually dip into your principal.



Riders

There are riders that address many different needs, and they may vary significantly by each insurance company. Riders perform a specific function and cost a fee. These may include death benefits, nursing home care, income, inflation and premium bonuses.

Riders can significantly alter the form and function of the annuity, so it is important that you understand how they work on your particular contract.

Rider fees are referred to in a unit of measurement called a basis point. Each basis point fee is equal to a tenth of a percent. (1 BP= 0.1%) Fees are based upon the actual account value or a hypothetical account, depending on the particular contract.

Once you find an annuity that addresses your future needs, it's still important to stay financially flexible.

No one knows what the future may hold.

Taxation

The taxes on interest or investment gains in deferred annuities are deferred until money is withdrawn.

Once the annuitant begins withdrawing income, the taxable interest and gains are required to be withdrawn first. Once all interest and investment gains are withdrawn, the annuitant will withdraw his "untaxable" portion.

For immediate annuities or deferred annuities that have been annuitized for income, the taxes due on each payment are based on an exclusion ratio.

An exclusion ratio simply means that only a part of the income payment will be taxable to the recipient.

Hypothetical Example:

Joe buys a FIA for $100,000 and he decides to purchase the optional income rider. With this rider Joe will have a fictitious account called an "income account" that will start at $100,000 (Joe's initial premium) and grow at a fixed rate – in this example, 10% compounded annually.

The fee for this particular rider is 100 basis points and is based off of the income account but taken from the account value.

Here's what that really means in plain English. Joe's 'income account' is going to grow at 10% compounded annually and whenever he decides to turn on the income stream the amount of payout will be determined, in part, by the value of the 'income account.'

The 100 basis point fee is actually a 1% fee that increases or decreases based on changes in the income account. That annual fee will be equal to 1% of the 'income account.' That fee comes out of the account value.

In other words…

In year one, Joe's fee is $1,000 (100 basis points –aka- 1% of $100,000). In year two, Joe's fee is $1,100 (100 basis points –aka- 1% of $110,000).

In year three, Joe's fee is $1,210 (100 basis points – aka- 1% of $121,000). This continues until Joe decides to take income at which time the fee becomes stagnant. Unfortunately for Joe, his account value has been reduced every year by at least $1000 because of that fee.

Not all products work this way, but many do. There are some products that only take fees from earnings or only take fees based on the account value, not the income account. Although you may see a product out there advertised with high guaranteed growth rates, such as "10% guaranteed annual growth", the old adage of, "if it's too good to be true it usually is," may apply. Ask the right questions. "Is that 10% guaranteed on the income account or the actual account value?"

Some annuities offer attractive bonuses on the premium deposited, but these bonuses are often a two way street: some may only apply to the fictitious "income" account, while others may have clawback features that strip the bonus away if accessed too early in the contract.

When shopping for annuities, it's best to keep in mind the known future needs of the retiree. Once those needs are addressed we, implore our clients to stay financially flexible in case needs change down the road. By protecting principal and understanding that financial needs are likely to change, one can position themselves for secure retirement with peace of mind.

he income riders' income account is not the same as the Accumulated Value of the base annuity contract, and it is never available for lump sum withdrawal; it is only used for calculating the income amoun vailable under rider provisions.

Questions? Need More Information?

Feel free to contact us.

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