HBKS® Wealth Advisors

Balance Portfolio Risk with a Fixed-Index Annuity

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AN ERRATIC STOCK MARKET has caused many investors to question their risk tolerance as they look for ways to protect their portfolios. The challenge many of us face is balancing risk and return. We want growth but we also want safety and liquidity.

Historically, investors would own a diversified portfolio of equities, bonds, and cash. Equities provide the growth; bonds deliver income and serve as an anchor to the portfolio; cash provides a cushion for shorter-term liquidity. But the challenge currently is that interest rates are near historical lows with the 10-year treasury hovering around .6 percent. Such rates promise to deliver "muted" bond returns through the coming years, returns that will be further negatively impacted when interest rates rise and the inverse relationship between bond prices and interest rates results in falling bond prices.

Considering the likely headwinds ahead, your investment strategy might include dedicating a portion of your core bond holdings to a solution like a fixed index annuity.

An index annuity is an insurance contract that provides, in some cases, guaranteed retirement income for life. The funds you contribute into the account are invested to protect against down markets. As opposed to being subject to the rise and fall of the markets, your account is credited with interest payments, which are based on the movement of an index, such as the S&P 500. Each contract anniversary date the crediting index is evaluated, and your annuity receives a credit based on the performance of the index. Most important in terms of risk, a negative index performance does not decrease the contract value. The income you receive is based on the value of your contract and such factors as whether it covers joint or single life income, your age, and the length of time your have been invested in the contract.

Your investment strategy might a solution like a fixed index annuity.

At each contract anniversary you choose from several strategies. Some annuities place a cap on the index allowing for some upside; others offer a participation rate where you earn a percentage of the index performance. In a year like 2020, your crediting account is most likely under water, but this does not mean that your contract value declines, because fixed index annuities do not lose value from negative market conditions. The

formula grows more attractive in subsequent anniversary years as you participate in the recovery, or at least a portion of it, from the lower market levels of previous years.

Fixed index annuities do not lose value from negative market conditions.

Before you invest in a fixed index annuity, consider the pros and cons of such investments:

The Pros :
- Downside asset protection
- No interest rate risk
- Tax-deferred contributions to non-retirement accounts
- Low or no fees

The Cons:
- Less liquidity than bonds
- Capped upside
- Income riders may have fees
- Participation rates and caps may be adjusted up or down on your anniversary

A fixed index annuity is not the sole solution to your income needs in retirement, but it may be appropriate as a piece to the overall plan.

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