

The annuity advantage in a new normal economy

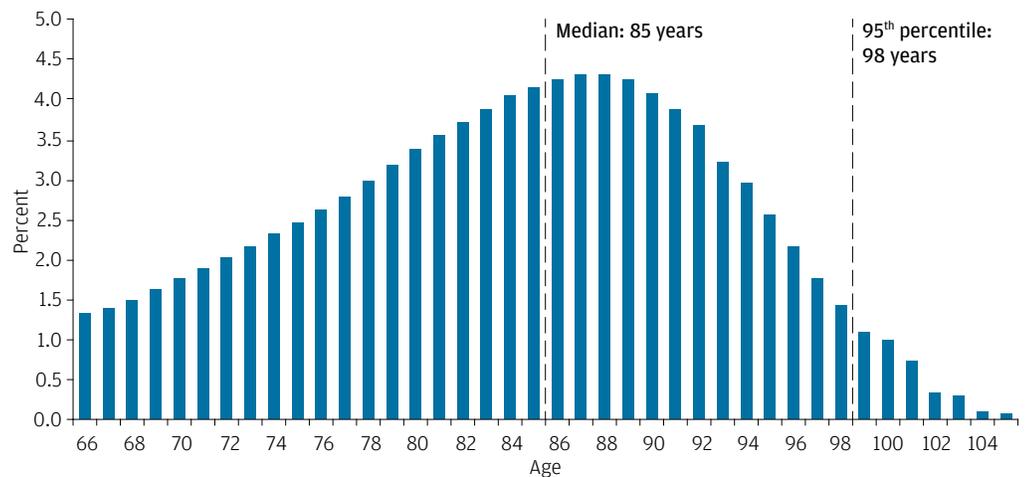
Market Bulletin

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IT IS VERY DIFFICULT TO ESTIMATE HOW LONG A SPECIFIC 65-YEAR OLD INDIVIDUAL WILL LIVE BUT IT IS VERY EASY TO ESTIMATE, ON AVERAGE, HOW LONG A LARGE GROUP OF 65 YEAR OLDS WILL LIVE. Guaranteed income-producing annuities all leverage this simplest of advantages: relying on the law of large numbers. This advantage means insurers are inherently able to provide higher income streams—and with higher certainty that payments will last a lifetime—than the average investor could do for him or herself. An individual has to plan for the worst. An insurer only has to plan for the average. If you are an individual turning 65 today, in order to be 95% sure that you are not going to outlive your retirement plan you will need to generate income for 33 years. However, an insurance company constructing an annuity only needs to provide an income stream that lasts for 21 years. 12 fewer years of payments means the payments themselves can reasonably be larger.

An individual has to plan for the worst—but an insurer only has to plan for the average

EXHIBIT 1: PERCENTAGE OF 65 YEAR OLD WHO PASS AWAY AT EACH AGE



AUTHOR



Dr. David P. Kelly, CFA
Chief Global Strategist

Source: National Vital Statistics Report: volume 66, number 4, United States Life Tables 2014, J.P. Morgan Asset Management; All information is shown for illustrative purposes only.

The graphics in **EXHIBIT 2A** (next page) demonstrate the basic annuity advantage and should be reasonably representative of the math in recent decades. Unfortunately, low interest rates and high volatility in stocks indicate that retirement income planning is more challenging than ever. Some have called the current financial climate a “new normal,” where economic growth will be slower and inflation lower than in decades gone by. We generally agree with this characterization, and consequently expect returns on both stocks and bonds to be substantially lower going forward. However, it turns out that in a “new normal” economy, the benefits of annuitization are even more powerful in relative terms.

In the “new normal” economy, the benefits of annuities are even more powerful

EXHIBIT 2A: YESTERDAY’S ECONOMY—ASSUMES 8% RETURN

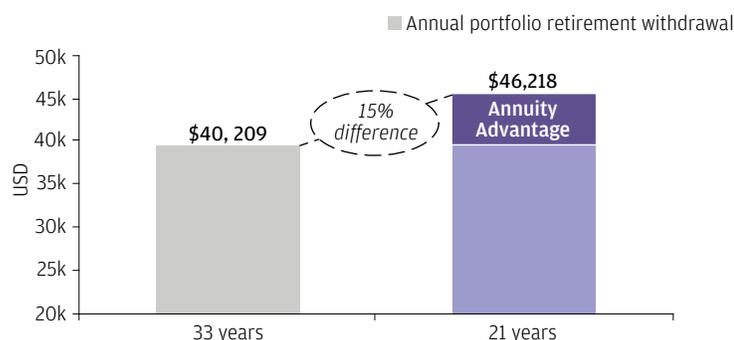
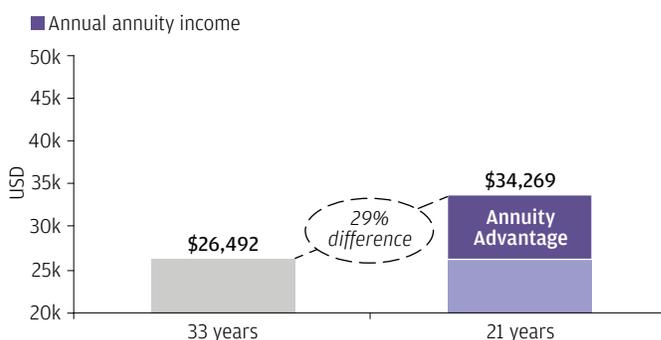


EXHIBIT 2B: “NEW NORMAL” ECONOMY—ASSUMES 4% RETURN



Source: J.P. Morgan Asset Management; data as of May 31, 2020. All information is shown for illustrative purposes only.

In **EXHIBIT 2B** we keep everything the same as in Exhibit 2A except we now assume an annual return of 4% rather than 8%. The annuity’s relative advantage versus the “do-it-yourselfer” has nearly doubled from 15% to 29%.

It needs to be stressed that this is a purely hypothetical example. However, it illustrates an important point. The annuity advantage is based on the idea that an insurance company, by averaging across individuals, can safely eat into principal more quickly and still be confident of providing a lifetime of income for their investors than any individual investing for themselves. And when expected returns are lower, this return of principal is a correspondingly more important share of that income stream.

The annuity landscape is complicated and still evolving and investors will always need to examine fees, investment choices and a multitude of different features. However, as they do so, it is important to first remember the key feature that has made annuities one of the most enduring investment solutions in the financial landscape. That feature is the ability to predict the life span of a large group with far greater accuracy than that of any individual and that advantage is more important than ever in a new normal economy.

NEXT STEPS

For more detail on specific profiles of individuals that may benefit from annuities, Katherine Roy, Chief Retirement Strategist, wrote a very informative piece [here](#). Also visit the Annuity Insights [page](#) to view the latest insights and resources to help clients plan and invest for retirement.

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