



Investment Insights

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Get back into the market with a safety net to protect your money

A record amount of assets reside in money market funds right now, as investors seek a “safe-haven” to ride out the recent rocky performance of the stock market. According to the Money Fund Report newsletter, published by IMoneyNet Inc., money market assets totaled \$2.249 trillion as of April 23, 2002. Many investors are waiting for an opportunity to buy back into the stock market when the recent volatility has ended and a bottom is in place in equity prices. However, timing a bottom in the stock market can be as difficult as picking a top. Importantly, a substantial portion of the profits made in a bull market are typically made in the first few months of the new upward move, so missing the start of a bull market can severely reduce investment returns over time.

With that in mind, many investors have found a strategy that allows them to reinvest money back into the stock market while affording them the peace-of-mind they need during uncertain times. These investors are taking advantage of an investment known as “Indexed Annuities”, which allow a degree of participation in the upside of the stock market along with a guarantee of a minimum rate of growth in the account regardless of the performance of the stock market. For investors seeking the higher long-term returns of the stock market, but unwilling to risk the chance of losing a portion of their principal, indexed annuities may be the answer.

Annuities in general are long-term investment vehicles, often carrying terms from seven to 10 years in length. Annuities are issued by insurance companies, and it is the insurance aspect of annuities that provide the guarantee of principal many investors are currently seeking. Annuities are also tax-deferred investment vehicles, meaning that growth within an annuity accumulates tax-deferred until withdrawn. Because annuities are long-term investment vehicles, there are usually penalties for early withdrawal. Also, if the annuity owner is under the age of 59 ½, there can be additional penalties imposed by the IRS on the withdrawal of profits. Make sure you explore the advantages and disadvantages of an annuity before you invest. It is best to check with an investment professional before making a commitment to an annuity to ensure it is the right choice for you.

Unlike investments in common stocks or mutual funds, which have no guarantees of upside or downside, indexed annuities generally provide a fixed downside (a minimum rate of growth) along with participation in the upside of the market. Thus, in a basic sense, an investor can participate in the long-term growth of the stock market with the assurance that if the market is lower at maturity of the annuity, they will have the protection of earning the minimum rate stated in their annuity.

For example, an indexed annuity might carry a nine-year term, and offer investors a minimum rate of growth of either 2% interest compounded annually, or 85% of the growth of the S&P 500 stock index over the nine-year period. Thus, in nine years when the annuity comes due, an investor would get the greater of 2% per year, or 85% of the return of the S&P 500. If the S&P 500 rises over that time frame in line with its historical average of 10% per year, an investor would earn 8.5% per year (85% of 10% per year). If the S&P 500 is lower nine years from now, the investor would make the minimum rate of 2% per year.

Of course, 85% of the market return is not as great as 100%, but with the uncertainty surrounding the stock market right now, surrendering 15% of the upside of the market in exchange for having a guaranteed minimum return is well worth the peace-of-mind for many investors. With the average 7-day compound yield on money market funds hovering near 1.36% as of April 23rd, many investors are using the indexed annuity to move back into the market in a smart, safe way.

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