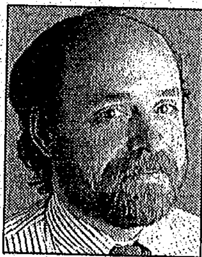
Investing

Betting on a long life? Try an annuity

It can stretch your retirement funds

If you're nearing retirement, you may be thinking that your best plan is to take up smoking, heavy drinking and motorcycle stunts. But before your first test jump over the alligator pit, you might consider a few alternatives to make your retirement kitty go further.



By John Waggoner

Most studies have shown that if you take more than 4% a year from your retirement savings, there's a decent chance you'll run out of money over a 30-year retirement. That's a dauntingly small figure: A $100,000 portfolio would generate just $4,000 of income a year.

One way to get more mileage: an immediate annuity. An annuity pays you an income for life. The catch: If you walk into an open elevator shaft two years after you sign the papers, the insurance company keeps your money. If you live to 110, however, the annuity company has to keep up the payments.

With an annuity, people who smoke in bed subsidize those who eat whole-wheat bread and exercise. When one person dies, his money goes to pay the others in the pool. That's why annuities can pay a bit more than a conservative withdrawal program.

You're betting against the house. Insurance companies study mortality rates carefully and calculate when the average person in an annuity pool will go die. And hey build in a cushion to ensure their profits and to pay brokers, who typically earn commissions equal to about 2% to 3% of the value of the contract.

Your monthly payment depends on:

▸ **The time covered.** If you buy a period-certain annuity, you'll get payments for a set time. If you die, your beneficiaries will get the remaining payments. The shorter the time period, the higher your payout. But once the period is over, the money is gone.

▸ **The people covered.** It's cheaper to get an annuity for a single male than for a couple because men tend to die earlier than women.

▸ **The interest rate used.** When rates are low, you get a lower payout.

When you buy an annuity, you're contracting with a company to keep up payments for 30, 40 or even 50 years. You don't want the company to expire before you do. So examine an annuity company's soundness before you invest. A good place to start: insurance company rater A.M. Best (www.ambest.com).

Be mindful that even insurance companies with the best ratings can sometimes meet unforeseeable, um, accidents. So make sure you understand the insurance coverage available from your state guaranty association. Most will only insure an annuity contract for $100,000, so if you have more to invest, it makes sense to diversify contracts among different companies.

Even if you're retired, there's no burning need to invest in an immediate annuity immediately. The benchmark 10-year Treasury note yields just 4.08%. If you must have some level of guaranteed income, consider taking a smaller immediate annuity now and putting money aside to buy another one later.

Immediate annuities have many detractors. "If you like consistency, annuities almost always underperform other investments," says Gary Schatsky, a New York financial planner. "You can normally get a higher rate of return from similar riskless investments."

Immediate annuities have another problem: They typically don't compensate for inflation. That's a big drawback. If you get a $2,500 monthly payment now, it will have the buying power of $1,844 in 10 years, assuming inflation raises prices at the rate of 3% a year. Unless you take up underwater toaster repair, you'll have to give yourself a raise sooner or later.

That means buying another annuity or perusing another strategy. If you are comfortable with some risk and some variation in your income, you might consider share-cost averaging as a supplemental strategy.

Most investors are familiar with dollar-cost averaging: investing a set amount into a mutual fund each month. Share-cost averaging is the inverse: You withdraw a set number of shares each month or year.

Suppose, for example, you bought 10,000 shares of Vanguard Wellington, a conservative stock fund, in December 1974. That would have set you back about $72,000 back then, says Morningstar, the mutual fund trackers. Had you withdrawn 800 shares a year, your income would have risen from about $7,000 a year in 1975 to about $24,000 last year.

Bumps in the road? Plenty. Your income would have fallen from $22,500 in 2000 to $19,600 in 2002. Because you reinvested dividends and gains in the fund, however, your number of fund shares grew enough to overcome withdrawals. Furthermore, you're still left with nearly 6,000 shares.

No one strategy is best for retirement withdrawals, so it's wise to take several. And they're all better than taking that human cannonball job in retirement.

Paying in for sufficient payoff

If you want $2,500 a month in income, you'll need to pay this much for an immediate annuity at age 65:

Amount	Type
$257,457	10 years guaranteed
$382,175	Male, your life only
$405,923	Female, your life only
$461,723	Joint, both age 65
$472,099	Joint, payments guaranteed 20 years

Source: totalreturnannuities.com Based on Virginia residency

▸ Figuring what you need for retirement, Managing your money, 4B

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