The Light

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Annuities: The Good, the Bad, and the Ugly

By Tim Rowsey, CPA, Investment Advisor Rep.

One financial product that is frequently promoted to investors is annuities. Unfortunately, many individuals aren't provided full disclosure of all information that might help them make a wise choice. In addition, annuities are often sold to elderly clients without a clear explanation of some of the potential issues. It would be valuable to look at the good, and the bad, and the ugly of this investment option.

First, it is important to understand what an annuity is. An annuity is an investment product offered through an insurance company. The insurance company promises to grow those funds and pay them out in the future, either in a lump sum, or in payments over a number of years. The payout over time is called annuitizing.

There are four basic types of annuities:

1. An immediate annuity is an investment product that accepts a lump sum of money and immediately pays out a stream of income over time. This can be for life, or over a set time period.
2. A fixed annuity operates much like a Certificate of Deposit. It pays a fixed rate of return that may vary depending on current interest rates. Currently a fixed annuity might pay in the range of 2-3% annually. This product would <u>not</u> be FDIC guaranteed.
3. A variable annuity holds mutual funds or similar investments inside the account. These may be changed by the investor, and there is market fluctuation and potential loss in value in a variable annuity. In addition, the investment options inside this annuity may be limited.
4. Finally, equity indexed annuities are more complex investments that may offer gain tied to a stock index with a promise of no loss in value. (continued on page 2)

Don't Be Distracted By Short Term Volatility

By Tim Rowsey, CPA Investment Advisor Rep.

In investing, it is sometimes easy to get distracted by the news of the day, or by what today appears to be a major problem in our country or with our economy. The news media is full of stories of problems in our world, of decreased consumer spending or confidence, or of the next possibility of war. Sometimes, the stock market reacts negatively to this information. For prudent investors, however, it is important to keep our perspective and our focus on the longer view. In 2014, we had several examples of how this might look.

What would you think if I told you about an investment that in 2014 had four periods of 1-2 weeks where each respective return was -5.5%, -3.5%, -5.4% and -4.9%? Cumulatively for those 41 days, the investments total loss was 19.3%. These four time periods actually happened, and were in January, August, October and December of 2014. Based on this short term view, you would probably say this is a terrible investment and one that you would not want to own.

What if I told you of another investment that for the calendar year 2014 had a return of 11.4% for the calendar year? You would probably be much more interested in the second investment, and would think that it might be something that you would want to own. Interestingly enough, they are both the same investment. These are actual returns for the S & P 500 for its worst four down periods in 2014, and then also for the year as a whole.

I ran the same exercise for one of the funds we frequently use, and we see some similar but less volatile results. For the four down periods in the year this fund would have shown a return of -3.4%, -2.1%, -3.1% and -2.4%. The cumulative loss over these same 41 days was 11%. However, for the calendar year of 2014 this same investment has returned 11.2%. The mutual fund we used in this example is the Hennessy Equity and (continued on page 2)

Helping individuals navigate their financial lives.

Annuities (continued from page 1)

These can be very complex contracts with many options. There are also usually limits on the upside gain.

So what are the advantages of an annuity? The primary benefit is tax deferral. Money placed in an annuity is not taxed until withdrawn. All future interest and gains are locked into the annuity and cause no annual income. There is also no limit on the amount of money that can be placed in an annuity and no income phase-outs. An additional benefit is the potential for a guaranteed payout. At the time the owner wishes to begin taking money out, the annuitant can choose to receive benefits in the form of a monthly payment until death, or a lump sum. One final significant advantage is that money in annuities is not required to be listed as an asset on FAFSA forms for application for student aid.

On the other side of the ledger, there are some significant disadvantages to annuities. One of the most significant is the ultimate taxation of annuities. While annuities grow tax free, at some point they must be disbursed. When they are disbursed, all gain is taxed at ordinary income rates. For many investors, this would be a higher rate than capital gains rates that might be paid on other types of investments. Another factor that is not always considered is that the gain inside an annuity that is left to a beneficiary is taxable to that beneficiary. Once again, ordinary income tax rates would apply. As I often tell clients, someday someone will pay tax on the gain in an annuity, and it is always taxed at ordinary income rates.

Costs, including commissions, fees, and penalties, are another significant disadvantage of annuities. Most annuities pay out a commission to the salesperson who sells the annuity. This can be from 3% to 10% of the value of the annuity. For example, a person purchasing a $100,000 annuity may have a commission paid out to the salesman in the range of $3,000 to $10,000. Because of this commission payout, most annuities have significant surrender charges. This is a fee for pulling money out of the annuity within the first few years of purchase. For some annuities it may take 5-10 years before the surrender charge would no longer apply. The surrender charge in the first year can be as high as 12%. Typically this charge declines by one or two percent each year until it expires. This may make the investment very illiquid, and lock in funds for long periods of time unless the investor cashes in early and pays significant penalties. Another potential fee is an internal annual fee. This is especially common in a variable annuity. Many annuities can have a total internal cost in the range of 2-4% per year. An additional potential problem with an annuity is the 10% withdrawal penalty on any funds withdrawn before age 59 ½. So as you can see, there are many costs associated with annuities that may or may not be fully or clearly disclosed at time of purchase.

Some states have fined insurance sales people for deceptive practices relating to annuities. In July of this year, LPL Financial was ordered to pay nearly $3 million in fines for not maintaining records on documenting why advisors switched clients from one annuity to another. An obvious incentive for the salesperson was their commission. Unfortunately, this may not have been in the client's best interest.

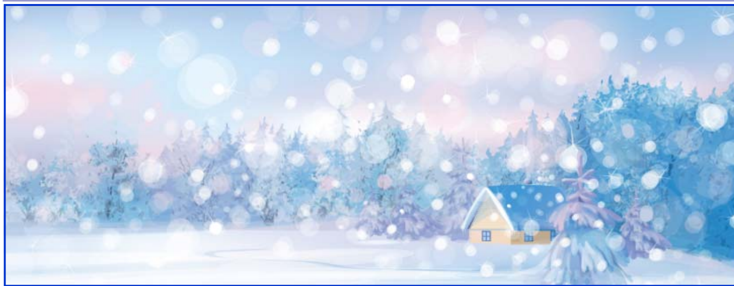
With Certificate of Deposit rates declining, more and more banks are directing their customers to look at fixed annuities as an alternative. While this may be appropriate for some investors, it is always wise to look at all alternatives and be informed about the product you are purchasing. While an annuity itself is not necessarily good or bad, unfortunately, they are often pushed on investors who don't have all of the information to make an informed choice.

While I am a licensed insurance agent and can sell annuities, I find that in most cases a client's interest can be better served using other investment tools that have more flexibility, and lower costs to the clients. At Lighthouse, we operate as a fiduciary and put our clients' interests first. We will always inform you of the options and costs associated with any investment, and would be glad to discuss your investment goals and needs. ■

Distracted (continued from page 1)

Income fund.

It is easy to become distracted by the news of the day, or by short term declines in investments. For most investors, however, their goals are really long term goals. For these individuals it is good to keep the long term perspective in mind and let time smooth out the short term fluctuations. Moving out of the market during short term down-turns is not usually a prudent step to take. Rather, keeping our eyes on the long term goal will ultimately help us achieve higher returns. ■



New Limits for 2015

By Tim Rowsey, CPA, Investment Advisor Rep.

Each year the IRS releases updated information for the coming year. For 2015 there were modest changes to some of the contribution limits compared to 2014. 401(k) limits and SIMPLE plans, plus the associated catch up deferrals, all increased for 2015. IRA contribution limits and catch up contributions remained the same. In addition the annual gift exclusion also remains at $14,000. The IRA allowable mileage rate for 2015 increased slightly to $0.575 for the new year. The chart below shows some of the limits that might be helpful for your planning purposes including limits on contributions to IRA's and 401(k) plans, annual gifting amounts and mileage rates. ■

Limitation	2014	2015
IRA Contribution limit	$5,500	$5,500
IRA Catch up contribution (age 50 and over)	$1,000	$1,000
401(k) elective deferrals	$17,500	$18,000
401(k) catch-up deferrals (age 50 and over)	$5,500	$6,000
SIMPLE IRA elective deferral	$12,000	$12,500
SIMPLE IRA catch-up deferral (age 50 and over)	$2,500	$3,000
Income phase out for ROTH (MFJ)	$181,000	$183,000
Other information		
Income subject to Social Security tax	$117,000	$118,500
Maximum earned income before SS benefits are reduced for those collecting SS before full retirement	$15,480	$15,720
Annual Gift Exclusion	$14,000	$14,000
Standard Mileage Rate	$0.56/mile	$0.575/mile
Social Security Cost of Living Adjustment	1.5%	1.7%

Market Recap

How the major indices performed in the 4th Quarter 2014

DOW JONES INDUSTRIAL AVERAGE
4th Quarter return 4.6% YTD return 7.5%

S & P 500 COMPOSITE
4th Quarter return 4.4% YTD return 11.4%

RUSSELL 2000
4th Quarter return 9.4% YTD return 3.5%

BARCLAYS AGGREGATE BOND
4th Quarter return 1.9% YTD return 6.0%

Market Update

By Tim Rowsey, CPA Investment Advisor Rep.

The fourth quarter continued to be very volatile for equities but overall showed gains.
During the fourth quarter Ebola was in the news and fears of a global slowdown rattled the markets in October. December also had a significant decline early in the month, only to rebound and see the Dow Jones Industrial average cross the 18,000 barrier for the first time. For the quarter, the Dow did increase by 4.6% and managed to bring its YTD gain to 7.5% for the year. The broader market, as represented by the S & P 500, also did well for the quarter with a 4.4% gain. Small cap stocks, as represented by the Russell 2000, finally improved in the fourth quarter with a 9.4% gain. The Federal Reserve stimulus came to an end in October, as expected. Oil was in the news in the fourth quarter, as the price per barrel plummeted and consumers saw gas prices drop under $2.00 per gallon.

Bonds had a strong quarter.
The Barclays aggregate Bond index increased by 1.9% for the quarter. While the Federal Reserve ended their QE3 stimulation as expected, European banks began their own programs to stimulate the European economy. This, in turn, helped the US bond market. For the year, the Barclays index ended with a 6% gain.

Market conditions are favorable as we begin 2015.
The huge decline in oil prices was a blessing to consumers as gas and heating prices fell dramatically. In addition, many businesses benefit from lower transportation costs, which helps them improve profitability. The continued low interest rate environment and positive employment and economic news may set the stage for a good year for the markets as we begin a new year. ■

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At Lighthouse Wealth Management, we want to help our clients reach their financial goals and have plenty of peace of mind along the way. We offer a holistic, full service approach. We start by getting to know and understand our clients' wants, needs, and dreams. We partner with them to help them navigate all the financial challenges of life. We can help answer financial questions, help with tax planning and preparation, and guide our clients with their investments to help them reach their ultimate financial goals.

Just as a Lighthouse provides guidance to passing ships, Lighthouse Wealth Management provides our clients with solid, trusted, conscientious guidance to help them navigate risks and lead them to their financial goals.

Lighthouse Wealth Management believes in giving back. We give 10% of our profits to charities, including CURE, International. **www.cure.org**

Our Services

- Investment Advisory Services
- Individual Portfolio Management
- Retirement Planning
- 401(k) Rollovers
- Individual Tax Preparation
- Financial guidance in all areas

Helping individuals navigate their financial lives.