TENON FINANCIAL
RETIREMENT PLANNING & INVESTMENT MANAGEMENT

Retirement Planning Insights

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Tenon Financial Happenings

My recent trip to Florida

While my business is entirely virtual, it's always nice to meet people in-person at some point.

Of the roughly 45 clients I work with, only two are in New Jersey. The rest are scattered throughout the country, including Hawaii and Alaska!

It truly is amazing how efficient it is to conduct an advisory business virtually. However, even the slickest of virtual relationships can't entirely replace the benefit and feeling of meeting someone face-to-face, even if it's only once.

Considering my business started around the same time as the pandemic, meeting new clients and conducting our relationships virtually was THE only option, at least initially. But, now that the pandemic restrictions are basically behind us, I could in theory transition to doing things the old fashioned way…in-person.

However, my clients and I have found that doing things virtually is working out really well. Even my clients in New Jersey prefer to conduct our meetings via Zoom!

While running the business virtually is working out well for clients and myself, we all agree there is no replacement for meeting in-person at some point. It truly helps solidify the relationship.

With that said, my goal has always been to physically meet every client at least once. Since the world opened back up over the last couple of years, I've been making the rounds across the country to people.

I just recently got back from a trip to Florida to visit two clients I've not yet met in-person.

It was a great trip; especially coming from New Jersey…in January. I met one client in Tampa, spent a couple of days with relatives near Sarasota, and then drove down to meet up with another client in Miami.

On the last night of my trip, I went to South Beach to walk around and soak up some beautiful 80-degree weather. It was a super touristy moment, but it was fun nonetheless.

The next morning, I landed back in New Jersey and was greeted with 38 degrees and rain. ☹

I already have a Texas trip lined up for February and plan on doing a west coast trip later this year. And I'll likely do another Midwest trip, too (I went to the Chicago area last year to try to see four different clients, but flight cancellations had other plans and cut that down to only being able to see two clients).

-Andy

Retirement Planning Happenings

Plain English explanation of annuities

I did a summary of annuities in one of these newsletters a few years ago. However, considering how frequently I'm asked about annuities, and how much misinformation I routinely see about annuities (both for and against them), I thought it was worth writing about them again.

Asking someone what they think about annuities is like asking them what they think about food…it's WAY too broad of a question considering how different annuities (and food) can be from one another.

Annuities can come in different flavors that have very different looks and feels. In its simplest form, an annuity can function like a bank Certificate of Deposit (or "CD"), such as a Multi-Year Guaranteed Annuity, (or "MYGA") where you put a certain amount of money in today and are guaranteed in a few years to get back your original contribution plus interest.

Another simple form of annuity is a Single Premium Immediate Annuity (or "SPIA"), which functionally nothing more than buying a private pension where you pay a lump sum of money today in return for receiving a guaranteed monthly payment for the rest of your life.

At the other end of the spectrum are super complicated annuities that are part investment account, part life insurance, part guaranteed income stream, part long-term care insurance, etc.

All said and done, there are only a couple of things that all annuities have in common: 1) they are private contracts entered into between the purchaser and an insurance company and 2) the taxability of interest received from the annuity is deferred until money is eventually taken out.

I ask that you put aside any existing knowledge or preconceived notions you may have of annuities and read along as if you're learning all of this for the first time. Approaching things that way should help you develop a solid understanding of the fundamentals of annuities while keeping at bay any biases or misinformation you may potentially have.

There are three main annuity types:

- **Fixed** – You give an insurance company a lump sum of money. In return, they give you a guaranteed fixed payment every month
- **Variable** – You invest a lump sum of money through an insurance company via an annuity. In return, they give you a payment every month. However, unlike a fixed annuity, the payment from a variable annuity is based on the value of the money invested within the contract. If the investments increase in value, your payment goes up. If the investments decrease in value, your payment goes down
- **Indexed** – You give an insurance company a lump sum of money. In return, they give you a guaranteed minimum payment every month. The payment may be higher than the minimum if a pre-determined financial market index - such as the S&P 500 - is above a certain level

For each of these three types of annuities, you can select how long you want the payments to last. Typically, most people choose to have payments last until they die, or until both they and their spouse die. These payment options are typically called "life only" and "joint life and survivor," respectively.

Alternatively, you can choose to have payments last only for a certain fixed amount of time, such as 10 years. You can also select one of the lifetime payment options mentioned above, but layer on a "period certain" to ensure the payments last at least a certain length of time in the case where you – and your spouse, if married – die within that length of time.

You can also choose a "cash refund" option; if you die before receiving enough payments to recoup your total payments into the contract, the insurance company will pay the difference to your beneficiaries.

In the summaries above for fixed, variable and indexed annuities, it was assumed the annuity was "annuitized," which is when you irrevocably hand over your lump sum of money to the insurance company in return for receiving your selected choice of payments.

In reality, many annuities don't get annuitized immediately, if at all. Which brings me to the next point:

You can also select when you want payments to start. The two main payment start options are:

- **Immediate** – Payments start no later than 12 months from the date you buy the annuity
- **Deferred** – Payments start later than 12 months from the date you buy the annuity

If you buy a deferred annuity, the amount of money you put into the contract will increase or decrease based on the annuity type you chose:

- the value of a fixed annuity in deferral will increase by a fixed amount of interest
- the value of a variable annuity in deferral will increase or decrease based on the performance of the investments chosen within the annuity (e.g. if you invest the annuity in a stock fund and that stock fund declines in value, so will your annuity value)
- the value of an indexed annuity in deferral will stay the same or increase, based on the performance of the indices referenced within the annuity
    - Unlike variable annuities, the interest credited to an indexed annuity will never be less than zero. In return for having the benefit of not participating in market losses, the interest will be limited on the upside

In addition to combining the various payout types, payment lengths and payment start options, there are also various bells and whistles - or "riders" - that can be added to annuities. For example, you can add in a feature that guarantees the return of your initial investment if you die before a certain age, or one that guarantees you a minimum amount of payments during your life even if your annuity value declines due to poor performance of the investments in the annuity (in the case of a variable annuity).

A common area of misinformation about annuities is their fees. Some annuities have no fees, others have lots of fees.

To be clear, "no fee" doesn't mean "no cost." To help make this point easier to understand, think about a typical bank savings account; there is likely no fee, meaning there is no specific expense charge deducted from the value of your account.

Instead, the bank makes money on the account by paying you less interest on your deposits than what they earn on using/investing them. For example, assume they pay you 0.10% interest on your deposits and turn around and earn themselves 1.00% on using said deposits; they're making 0.90% on the account.

While there is no fee in this case, there is still a cost. Specifically, the cost is that you could likely get better than 0.10% on your money if you put it somewhere else. In other words, the "cost" is that the bank is paying you less than you could otherwise get. To be fair, the bank needs to somehow get compensated for offering the account. If they're not charging you an explicit fee, they need to get paid via the "spread" between the interest they earn on your money, and the interest they pay you. All annuities have this same idea of spread that comes into play, even if there isn't any outright fee; they're investing and making more on your money than what they pay you.

Additionally, some (but not all) annuities do have actual outright fees that get deducted from the value of your contract. Specifically, annuities typically have a "surrender fee," which is a charge you have to pay if you cancel or withdraw more than a certain amount of your contract within a certain amount of time; generally within the first 5-10 years (but could be shorter or longer, depending on the particular annuity).

Also, many riders have an explicit fee that gets deducted from the value of the annuity. For example, if you add a rider that guarantees you the ability to withdraw a certain amount during your life, even if the value doesn't perform as expected, there will likely be a rider fee that gets deducted from the value of your annuity each year.

In summary, annuities aren't inherently good or bad. They are simply tools. Like all forms of tools, they have their cases where they're the right solution. And they have their cases where they're not the right solution.

If you're considering an annuity, first ask yourself what specifically you're trying to solve with it. If you come across an annuity that can best meet your needs, it could be right for you.