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How To Invest In Annuities For Recurring Income

Dan Eggertsen: Hello this is Dan Eggertsen. I'd like to welcome everyone to the call today. I'm here with my dad, Karl Eggertsen and we are going to talk about annuities today. We've been getting a lot of questions about annuities and it's yet another weapon in the arsenal of investing strategies you can use at various times of your life to get a stream of income coming in. So Dad, how you doing today?

Karl Eggertsen: Doing good Dan.

Dan Eggertsen: Great. Well I've got three questions here for you and they're the three most popular questions that keep getting asked repeatedly. I'd like to ask them to you now if you're ready.

Karl Eggertsen: Okay. I'm ready.

Dan Eggertsen: The first one is, what is an annuity and who is it for? Let's start with the basics here.

Karl Eggertsen: Perfect. Okay that's a good lead in. I'm going to hit the basics. It's an insurance product. An annuity is an insurance product and it has two basic phases. One is the accumulation phase. That is where somebody makes a lump sum payment or a series of payments over months and years. The money grows tax deferred at a fixed or variable rate. Then the second phase is the payout or annuitization phase and that's where the insurer agrees to make periodic payments to you for the rest of your life.

Dan Eggertsen: Right.

Karl Eggertsen: Or for any number of years that you want it to go out to. Also in there is other options you can have such as, you can go out to over your lifetime or over what the insurance company would consider if you want to add your wife or other beneficiary over what they feel would be the maximum lifespan of like you and your wife versus just you for example.

Dan Eggertsen: Right.

Karl Eggertsen: Okay. They also have a death benefit. Annuities also have a death benefit besides the annuity part of it and the death benefit entitles your beneficiary to the value of your annuity or guarantees a minimum, whichever is greater.

Dan Eggertsen: Okay.

Karl Eggertsen: And who is it for? The ideal annuity buyer should be someone already making their maximum contributions to other retirement plans. That would be like a 401K. It could be IRAs. You want to take advantage of those vehicles first in most cases.

Dan Eggertsen: Why is that?

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Karl Eggertsen: Because they have benefits and options of any variety of investments that you can include in an IRA. With a 401K you can get your 100% matching up to a certain percent for many 401Ks.

Dan Eggertsen: And they're all tax deferred right?

Karl Eggertsen: And they're all tax deferred also.

Dan Eggertsen: Including annuities.

Karl Eggertsen: Annuities are tax deferred also. But let me go on. Okay so the ideal annuity buyer should have four of these items. They're already making maximum contributions to other retirement plans. Two, they can live without the money until they're at least age 59 1/2 and three, and whom are at least making at least in the 25% or higher tax bracket to take full advantage of the tax deferral. The fourth thing would be if a person is concerned about outliving their savings during retirement and would like a guaranteed stream of income, an annuity can help to accomplish that.

Dan Eggertsen: Great.

Karl Eggertsen: Okay? And that would be in the retirement phase and that would be where they would, what they call annuitize your annuity and that's where you start taking payout.

Dan Eggertsen: Right.

Karl Eggertsen: Okay? So that would be who it would be for.

Dan Eggertsen: Okay. Fantastic. All right well let's move into question number two and this is where we're getting into the nitty-gritty here. What are the biggest benefits of an annuity compared to a high yield bond or something? So I guess really to rephrase the question is what

are the pros and cons. Because I'm sure there're positives and negatives to annuity when you compare it to other income yielding investment.

Karl Eggertsen: The biggest benefit is a guaranteed stream of income. The guaranteed stream of income can be taken any time after you reach 59 1/2. And that guaranteed stream of income can be for your entire life regardless of what's happening in the investment markets, regardless of the economic conditions. The payment could stay the same. Okay?

Dan Eggertsen: Wow.

Karl Eggertsen: And that's what you can get through various annuity products. Some are for options like for inflation adjustments and so on. So you can add even some of these into it. So it's unique and that's the biggest power of the annuity.

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For some people that would be something that they need or mentally, psychologically, emotionally feel most comfortable with is having at least part of their retirement income being guaranteed. That opposed to a portfolio of bonds, even high yield bonds and stock dividends and the interest from bonds and other interest bearing or dividend bearing investment vehicles, they have their ups and downs unexpectedly and you don't know what's going to happen.

Somebody in retirement gets hit by what we've been hit with the last couple of years, which is extremely unusual since the last time it occurred was in the 1920s. But something as bad for the markets and economy as this has been, but with the right annuities set up in the right way, you wouldn't have been affected with your annuity income.

So that's the big powers. The other thing of course is tax deferral. Not unique to annuities since other investment deferred retirement plans have tax deferral. But that's the secondary advantage of an annuity it's one of those vehicles that can give you tax deferred savings and growth.

Dan Eggertsen: Okay. All right great. Well thank you so much for that one.

Karl Eggertsen: I wanted to mention one other thing real quick here. Annuities, through these two questions here I wanted to mention that it's best to do annuities in general, in moderation.

Dan Eggertsen: Okay.

Karl Eggertsen: For one reason in particular is if it's overdone, you lose flexibility.

Dan Eggertsen: Oh you do?

Karl Eggertsen: Yeah because once you annuitize an annuity. Annuitize means you're locking in your money to a specific stream of income for a specific number of years, if not your lifetime.

Dan Eggertsen: Right.

Karl Eggertsen: You can't get your money back.

Dan Eggertsen: You can't?

Karl Eggertsen: Your lump sum back. It's locked. It's done. It's in a contract. All's you can get is what you've agreed to in a contract every month. Now prior to annuitization, you can take any amount of money out of that, any lump sum or whatever out of that annuity anytime you want to after the age of 59 1/2 and in many cases with no penalty whatsoever.

Dan Eggertsen: Okay.

Karl Eggertsen: Okay? So that's why it's important to do it in moderation.

[08:48.2]

Dan Eggertsen: And that's the downside is that it really does lock up your money once you annuitize.

Karl Eggertsen: Once you annuitize an annuity and you've put its power to work for you in the payout phase, in the annuitization phase they call it, you're locked in – yes you got guaranteed income but you lose the flexibility for that money. Now you wouldn't want to do that to your whole portfolio in most cases because you may need some emergency money. Something comes up that you need some money for and you can't get it. It's locked. Okay?

So I wanted to emphasize that. It's best to do it in moderation like any part of your portfolio. You don't want too many stocks, you don't want too many GE stocks, or too many shares, too much of your portfolio in one mutual fund with one mutual fund company. You want to be diversified and an annuity can fill a place in some cases for certain people where it makes sense.

Dan Eggertsen: Fantastic. Okay and that kind of answers the third question then. Can I sell my annuity at any time to get my money back and the answer is no. The answer is - and correct me if I'm wrong Dad - when you annuitize your money, you are actually signing a contract for a certain amount of years or months...

Karl Eggertsen: Or a lifetime.

Dan Eggertsen: ...or a lifetime. Your money is tied up as long as that contract is valid.

Karl Eggertsen: Yeah and that could be to the end of your life or to the end of the number of years that you agreed to where it's going to be valid. But yeah.

Dan Eggertsen: Now whereas with a, if you invest in a high-yield bond like in your brokerage account, your taxable account, yes you can get a stream of income there from a high yield bond but you can also sell it at any time.

Karl Eggertsen: Yeah. That's why I say to diversify in every way you can imagine. In the type of investments you have as well as the variety of stocks and bonds and mutual funds that you have. You want a great deal of variety and not depending on any one company or any one mutual fund or any one type of investment. You want to be very diversified and an annuity can fill a hole that could be important for some people. Not everybody should go to annuities.

Dan Eggertsen: Right.

Karl Eggertsen: But for some people it could make sense. So back to the question again, can I sell my annuity at any time to get my money back. I want to give a few specifics on that besides what you just said Dan, what we've been talking about here.

Dan Eggertsen: Okay.

[11:19.7]

Karl Eggertsen: Before you annuitize for a set income stream contract, you need to think about are you going to have any surrender charges? Surrender charges would be there's many annuities have like around a seven year, I think that's about average, about a seven year period where if you take any money out you're going to pay surrender charges and they could be 6% or 7% anyway.

And you're going to be paying income tax. The other thing you're going to be paying is – and that income tax would be on the amount of money above what you contributed yourself to the annuity, in other words, the growth of it, the compounded growth of it. You're going to pay on all that amount of money.

No matter how much you take out, they're going to take their income tax. The IRS is going to take the income tax, as much as they can on what you owe. So if you take out \$6000 and you may owe taxes on maybe \$30,000 or \$40,000 something like that, they're going to take all they can in that \$6000. So you'd be paying high income taxes on any amount that you take out up to the total tax that it's going to be and they take the tax as quick as they can.

Dan Eggertsen: They do? Okay.

Karl Eggertsen: Okay? There's also going to be a 10% penalty if you're under the age of 59 1/2. You see between surrender charges, income tax, and 10% penalty under the age of 59 1/2 if that was the case, there're a lot of costs. Once you're in an annuity, one has to be very careful and understand what the costs are going to be before they invest into an annuity and when they're going to really need that money and if they really needed an annuity. Again it has tremendous power for a guaranteed income but you're locked in and you're not going to be able to get your money back very ease, if at all. After you annuitize you're not going to get it back at all, you're just going to get it in income. So...

Dan Eggertsen: Great.

Karl Eggertsen: So that's the way it is. It's something that really needs to be thought through before you invest.

Dan Eggertsen: Yes. That's true and really the goal of all this is to create a portfolio that is right for you; your specific time of life, and your age, and your situation and turn it into a machine that works for you in terms of building value and also if need be, additional streams of income. So thank you very much for your great insight in this. This tool, it's just another tool to add the tool belt of investing strategies.

Karl Eggertsen: Yeah. I was just looking at a couple of little notes I made to myself and there's just a couple of things I'll say very quickly too. There are options besides just pulling your money out of the annuity, just carte blanche pulling it out. You could move it through a 1035 exchange to another annuity product before you annuitize.

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Dan Eggertsen: Right.

Karl Eggertsen: During the savings phase of your annuity, when you're contributing to your annuity and before you annuitize, if you choose to you can do what they call a tax deferred 1035 exchange and you can move your annuity amount of money to another annuity. In fact, I did that. I personally did that myself. I moved from one company to another because the company happened to have much lower costs and had had better options to invest within the annuity.

Dan Eggertsen: Right.

Karl Eggertsen: It was overall better. It was cheaper and it had better product overall than the one that I left. And it didn't cost me a dime. It just took time. I was only out of the market one day. So you cannot roll over to any IRAs or any other investment vehicles that I know of. I know that IRAs are a no-no and I know that obviously you couldn't move an annuity to a 401K at a company that you have.

But you can go from annuity to another annuity but other than that, you really can't, as you can see you're pretty inflexible. Once you're in an annuity, you're going to be in an annuity unless you pay heavy costs, in many cases, to get your money out and get out of annuities entirely. So it's a valuable vehicle for some people but people who are investing well and have good investment products for their retirement, they may have some real estate they own and things like this. They may have a good pension already.

I personally have an annuity that's in the form of a pension from the Federal Government. So I already have an annuity and it's guaranteed for life as long as I live. And even Sharden, my wife is going to be able to tap a certain percentage of that if she should live longer than me. So I already have an annuity. Some people do not have a guaranteed income and they feel the need for it then an annuity can make sense for certain people but you need to think it through.

Dan Eggertsen: Yeah.

Karl Eggertsen: Okay.

Dan Eggertsen: Well thank you very much for your time and thanks everyone for being on the call. We'll talk to you soon Dad.

Karl Eggertsen: Okay Dan. Bye.

Dan Eggertsen: Okay bye.

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