

How much of my savings should go to annuities?

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(Money Magazine) -- **Question:** What portion of my 401(k) and savings should I move to annuities? -- Jack S., Alliance, Ohio.

Answer: That depends. Many annuities have such onerous fees and other drawbacks that you're better off avoiding them altogether.

There's one type, though, that I've long believed can play a useful role in some retirement portfolios. I'm talking about immediate income annuities, where you turn over a lump sum to an insurance company and in return receive guaranteed monthly checks for life, regardless of how the economy and markets fare.

But while most people should at least consider devoting some money to such an annuity at retirement, don't assume that buying one is the best move for you.

For one thing, retirees automatically qualify for an immediate annuity of sorts -- Social Security, which provides guaranteed, inflation-adjusted lifetime payments. If you'll be collecting a pension on top of that, you may very well have the assured income you'll need to cover enough of your expected outlays in retirement without an annuity.

What's more, if you have large balances in your 401(k)s and other retirement accounts, you might be able to draw enough from them with little risk of outliving your assets.

Finding the right mix

But if that's not the case, how do you decide how much of your savings should go into an annuity?

There's no one correct answer -- other than you wouldn't want to invest all or nearly all of your savings in an annuity. That's because once you hand over your stash to the insurance company and "annuitize," you typically can't get the money back for emergencies, unexpected expenses, or to pass on to heirs.

One strategy is to devote enough to an annuity so the payments, combined with Social Security and pensions, cover all or most of your essential living costs (like food, utilities, and health care). You can then tap your portfolio to meet discretionary expenses (like travel and entertainment) where there's wiggle room.

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Keep in mind that combining annuity payments and draws from your portfolio is likely to give you better odds of sustaining the income you'll need throughout retirement than relying on portfolio withdrawals alone. You can see how different mixes of annuity payments and portfolio withdrawals affect your chances of getting your target income by going to the Retirement Income Planner tool at fidelity.com.

Commit to annuities gradually over time

Early in retirement it's tough to gauge exactly how much guaranteed income you'll need. So even if an annuity makes sense, think about buying in stages. A gradual approach also prevents you from investing all your money in an annuity when interest rates -- and payouts -- are at a low point, as they appear to be now.

Since you'll be depending on the insurer to make those annuity payments throughout retirement, limit yourself to those that get high financial ratings from Standard & Poor's and A.M. Best. And as an extra precaution, spread your annuity money among a few different insurers, and go to nolhga.com to make sure the amount you invest with any firm falls within the coverage limits of your state's insurance guaranty association (typically that's at least \$100,000).

One last thing: Most immediate annuities pay you a fixed amount each month, so even if inflation runs a modest 2.5% a year, the purchasing power of those payments will have declined by almost 40% in 20 years. If you want to avoid an income crunch later in life, go with an inflation-adjusted annuity.

You'll have to put in about 35% more for the same initial payment as the fixed-income version, but as Vanguard economist and annuity expert John Ameriks notes, "If you're buying insurance against running short of income, you want it to pay off."



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