The INVESTMENT LETTER

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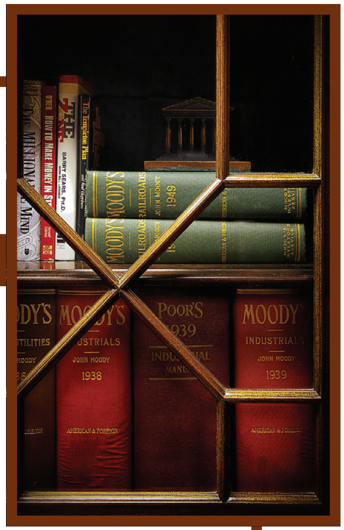

Too Good to Be True?

Would you like to invest in something that gets all the positive returns of the stock market, while ensuring there are no losses even in bad years? How about something that is as safe as a bank account and even guaranteed? What if I told you this mythical investment is already available? What is it you ask? It's the only investment that allegedly promises you can have your cake and eat it too - the annuity. If annuities are such a great solution to all your investment problems, why then are we, and others, so strongly opposed to them?

Over the last few years, and particularly immediately following the great recession, annuities significantly increased in popularity. Many investors, shocked by the losses in their investment accounts and disappointed by the yields in their savings accounts, turned to the perceived security and guarantees that brokers and insurance agents touted as the main benefits of annuities. But all is not necessarily as was promised.

Unfortunately, while annuities may have gained in popularity, they still remain very misunderstood by the average person, and while they offer some benefits the drawbacks are usually glossed over.

We hope this newsletter begins to shed more light on the complex and confusing world of insurance products; including the benefits, but particularly, the often-overlooked drawbacks of annuities. This is meant as an introduction only, as the many options available to annuitants (the owner of an annuity) are far too numerous and elaborate to address here.

What is an Annuity?

An annuity is an insurance contract (NOT an investment vehicle). Typically annuities pay out a steady income stream either over a predetermined number of years or over the course of the owner's lifetime.

Annuities come in a number of different types. Annuities can be deferred or immediate, fixed or variable.

A deferred annuity is invested for a period of time prior to any withdrawals being made, while an immediate annuity starts distributions immediately.

Similarly, a fixed annuity is one that has a static, or guaranteed, rate of interest, while a variable annuity has its return tied to some type of investment vehicle and thus varies.

There are myriad other options available as well, but they are beyond the scope of this newsletter. Options could include term or whole life insurance built in to the contract, long-term care insurance or/and provisions for the annuity lasting beyond the annuitant's lifetime. All these options, and many more, can be had… for a price.

Who are Annuities (Not) Good For?

Annuities are designed for individuals that seek a greater perceived degree of certainty regarding their portfolios, particularly with regard to the income stream. They also cater to those that are too conservative to truly invest (as we know, all investment comes with some degree of risk and no guarantees) and can sleep better at night knowing there is a 'guarantee' of sorts backing their holdings.

Annuities are not designed for people saving for retirement or those that are already retired but unwilling to trade flexibility and control for predictability. Most importantly, annuities are not designed for those that desire flexibility. These types of insurance contracts often have a period of years at the start of the contract that you cannot withdraw money without incurring significant penalties levied by the insurance firm.

Drawbacks of Annuities

In addition to the lock-up period and early withdrawal penalties mentioned above, there are

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numerous other drawbacks to annuities that you should be aware of if you are considering if it is right for you.

Annuities are typically expensive. The underlying investment vehicles in annuity contracts are often available outside of an annuity for a fraction of what the cost is inside the plan. In other words you could have the same investment performance (or better if you factor in the cost savings) by giving up the insurance and accepting the risk.

Speaking of insurance; the guarantee that annuities offer is only as good as the company backing it. Think no further than AIG, the giant insurer and annuity issuer that was the epicenter of the great recession. An annuity is supposed to provide peace of mind if nothing else. Hearing 'AIG' blared across every news program must have been hardly comforting for those holding AIG annuities

Lastly, annuities are typically sold by insurance agents and/or brokers with insurance licenses. This is critical to understand because in the case of brokers, they need only provide you with 'suitable' investment (or in this case, insurance) products, not necessarily those that are the best, in their estimation. Since annuities pay much higher commission to these brokers than most traditional types of investments, it's easy to see why they might be recommended in situations where they are not the best solution to a problem.

Are Annuities a Good Investment?

Technically, an annuity is an insurance product, not an investment. With the semantics out of the way, whether or not it is 'good' depends on what your needs are. For someone who is willing to accept less possible return for the safety and stability of a fixed stream of income then an annuity might be a viable solution.

In our experience, however, most people who invest in annuities are not fully aware of the drawbacks to these insurance products. They don't fully understand the costs and limitations, instead mainly being driven by fear.

To focus solely on the 'guaranteed income' aspect of annuities is to overlook the ability of an investment portfolio to generate capital gains and dividends in a similar manner albeit without any assurances. Properly structured and monitored, a well-diversified investment portfolio will also produce modest annual or monthly distributions without the multitude of drawbacks of an annuity.

Because of the lack of flexibility and understanding of annuities, we find that many investors who chose annuities often wish they had more carefully evaluated their options before moving ahead.

As a Registered Investment Advisor (RIA), Investment Counsel does not sell insurance products of any kind. We strictly focus on our clients' best interest and are not driven by commissions. In the rare instances that annuities are a viable option we can refer clients to reputable insurance brokers who can explain both the pros and cons of various insurance options.

By foregoing guarantees, and cutting out the insurance company, which acts as a middleman (and adds significant cost for their effort), most investors can achieve similar or even better income outcomes by employing an income focused investment strategy. Unless one of the many add-ons is a non-negotiable necessity most investors are better served steering clear of complex, costly insurance products.

In the case of annuities, the old adage holds firm: if it's too good to be true, it probably is. Despite their promises and guarantees, annuities have many, often overlooked, drawbacks; the high costs associated with them make them even less attractive. For most investors a properly diversified, balanced portfolio will provide more flexibility, significantly lower fees and the opportunity for materially superior performance.

INVESTMENT COUNSEL NEWS

Inside the Office

For the fourth year in a row, Investment Counsel has been recognized as a Five-Star Wealth Manager in Metro Detroit.

Outside the Office

Metro Detroit was hit with its third largest recorded snowstorm on February 1st. Despite over a foot of snow on the ground, Investment Counsel's offices were open for business as usual on Monday February 2nd.