Annuities improve outcomes

Four ideal client profiles to consider an annuity

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The following is based on findings from new research from J.P. Morgan Asset Management. *Annuities improve outcomes* provides profiles that illustrate client situations that potentially can improve their retirement experience by incorporating an annuity into their retirement income strategy. Please see important annuity disclosure on page six.

When it comes to using your investments to pay for expenses in retirement there isn't one approach that is right for everyone, which is one of the reasons why it is more difficult than simply saving for retirement. While there are various approaches, using protected income sources such as annuities should be carefully considered.

With access to periodic income from defined benefit plans in steep decline — 39% of today's 59- to 76-year-olds will receive some level of income from a defined benefit pension, which drops by more than half to 16% over the next 20 years — the need for predictable lifetime income is growing.[1] However, households often struggle with whether an annuity makes sense for their retirement income plan due to product complexity and potential costs. There are several clear situations in which an annuity may make a lot of sense as one part of a household's retirement income strategy because it can meaningfully improve the overall outcome. We profile four types of clients and the situations when it would be appropriate to consider an annuity.

Profile 1: Ultra-conservative investor

Individuals typically have a declining risk appetite as they get older. For more conservative individuals, the transition from work to retirement can magnify their risk aversion, resulting in a desire to have little, if any, market exposure in retirement. Over a 30- to 40-year retirement, this decision can result in significant erosion of purchasing power and increase the risk of running out of money over a long life.

An ultra-conservative investor is a person that:

- Has a low tolerance for investment risk;
- Is at risk of an overly conservative approach thereby increasing the likelihood of running out of money in retirement.

For these individuals, including guaranteed income as a part of their retirement income strategy could help them maintain a more appropriate level of market exposure through their retirement and, as a result, increase their likelihood of success.

[1] LIMRA Secure Retirement Institute analysis of 2019 Survey of Consumer Finances, Federal Reserve Board, 2020.

Additionally, when annuity income is aligned to cover a specific level of lifestyle spending needs (typically consistent spending), risk-averse individuals can make more confident decisions to include equities in their investment portfolio.

Exhibit 1 compares a conservative portfolio of 20% equities and 80% bonds to a partial allocation (20% and 40% of the initial portfolio value) to an annuity that is invested 65% in equities and 35% in bonds. The allocation raises the likelihood of being able to successfully spend $40K in inflation-adjusted spending to 85% and 92% compared to no annuity allocation which has only a 77% chance of success. Also, in the scenarios that did not last for 30 years, the annuity scenarios continue to provide lifetime income of approximately $11,500 and $23,000, respectively, whereas the non-annuity allocation is depleted.

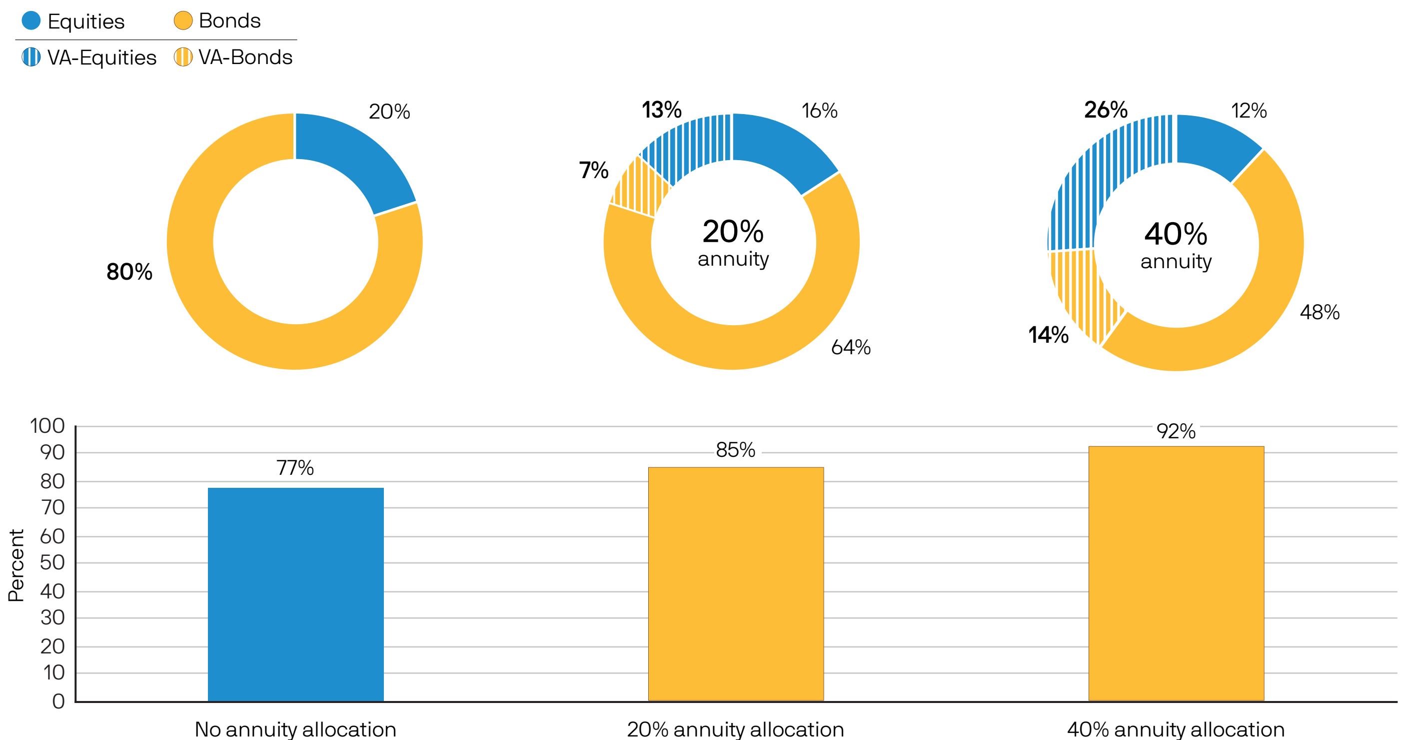
Profile 1: Outcome

For this profile, the variable annuity can improve outcomes by offering greater market exposure with guaranteed step ups and income protection. The amount of income protection will be based on amount of annuity purchase and specific annuity benefits.* Our research finds that the annuity provides greater upside opportunity, and benefits from annual guaranteed rollups as well as step ups for ten years prior to income being drawn at an approximate 5% withdrawal rate beginning at age 65.

*Dependent on the claims paying ability of the insurer.

Likelihood of success: $500k fully invested vs. partial variable annuity (VA) allocation at age 55

Exhibit 1: $40k spending at age 65*

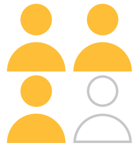


Source: J.P. Morgan Asset Management. See important annuity disclosure on page six.

*The growth rate applied to annual spending is a long-term forward-looking inflation assumption adjusted for observed spending behavior.

Investment management costs are not included because they are assumed to be the same in the annuity and the investment portfolio. $40k spending is approximately 5% of the median modeled non-annuity portfolio at age 65.

Profile 2: Retirement de-risker



3 out of 4 de-risk at retirement

17% Average decline in equity allocation

1 out of 4 reduce equity allocation by > 55%

Source: “In Data There Is Truth: Understanding How Households Actually Support Spending in Retirement,” Employee Benefit Research Institute & J.P. Morgan Asset Management, 2021.

A common strategy to mitigate against sequence of return risk is to de-risk in advance of retirement to a more conservative allocation. This usually means a shift from equities to fixed income — but what if bonds are challenged to provide sufficient returns? In addition, a downshift after a market decline could expose individuals to sequence of return risk. In this scenario, is an annuity a more attractive alternative for the percentage of equity assets that needs to be reallocated? Based on our analysis, the answer is yes.

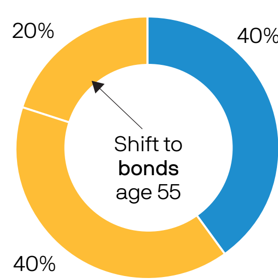
For this profile, illustrated in **Exhibit 2**, we assume that the pre-retiree owns a 60% equity and 40% bond portfolio. The advisor and client have established a 40% equity risk target — so the question is what to do with the 20% in equities that needs to be reallocated at age 55.

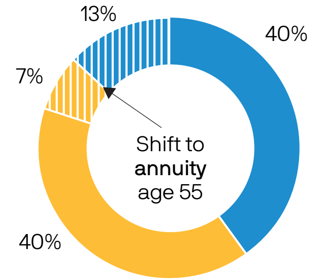
We compare the reallocation of that 20% to fixed income vs. a variable annuity with a 65% equities/35% bonds investment strategy.

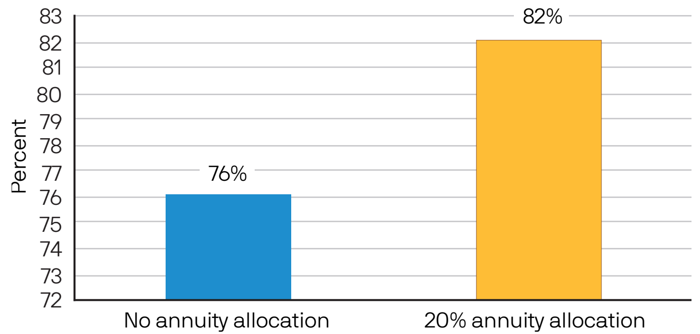
Likelihood of success: $500k invested vs. partial variable annuity allocation at age 55

Exhibit 2: 20% of portfolio shifts to bonds or annuity at age 55; $45k spending at age 65*

Equities Bonds
VA-Equities VA-Bonds







Source: J.P. Morgan Asset Management. See important annuity disclosure on page six.

*The growth rate applied to annual spending is a long-term forward-looking inflation assumption adjusted for observed spending behavior.

Investment management costs are not included because they are assumed to be the same in the annuity and the investment portfolio. $45k spending is approximately 5% of the median modeled non-annuity portfolio at age 65.

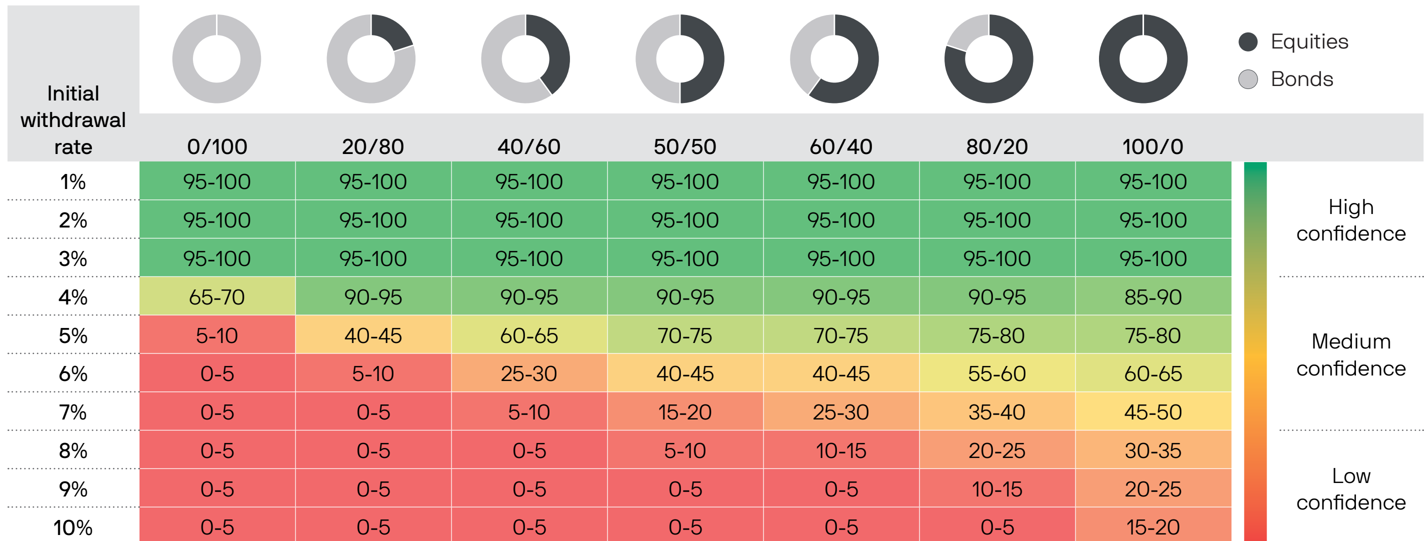
Profile 2: Outcome

The reallocation to the variable annuity improves outcomes to over 80% and provides an estimated $11,500 in protected lifetime income from the amount allocated to the annuity, starting with a withdrawal rate of roughly 5% at retirement.*

*Dependent on the claims paying ability of the insurer.

Likelihood of success after 30 years in retirement

Exhibit 3: Various withdrawal rates and asset allocation



Initial withdrawal rate	0/100	20/80	40/60	50/50	60/40	80/20	100/0
1%	95-100	95-100	95-100	95-100	95-100	95-100	95-100
2%	95-100	95-100	95-100	95-100	95-100	95-100	95-100
3%	95-100	95-100	95-100	95-100	95-100	95-100	95-100
4%	65-70	90-95	90-95	90-95	90-95	90-95	85-90
5%	5-10	40-45	60-65	70-75	70-75	75-80	75-80
6%	0-5	5-10	25-30	40-45	40-45	55-60	60-65
7%	0-5	0-5	5-10	15-20	25-30	35-40	45-50
8%	0-5	0-5	0-5	5-10	10-15	20-25	30-35
9%	0-5	0-5	0-5	0-5	0-5	10-15	20-25
10%	0-5	0-5	0-5	0-5	0-5	0-5	15-20

Source: J.P. Morgan Asset Management. See important annuity disclosure on page six.

Profile 3: Long lifer, inadequate saver

Longevity risk is the risk of running out of assets before running out of time — and is a primary concern for most Americans. Individuals approaching retirement who have a family history of longevity and who are in excellent health as the result of making good lifestyle decisions are likely to experience above-average life expectancy. If they haven't saved enough to achieve their desired retirement spending goal with a high level of confidence, they need to maximize the amount of income their wealth can provide for life — however long that may be. And if they need to take out more than 4% of their portfolio initially, it is even more difficult to have money last for a lifetime.

The long-lifer, inadequate saver profile is likely the most ideal candidate for an annuity — a household that enjoys relatively good health, has not saved enough, and has a high likelihood of running out of money. They would benefit especially from an annuity to ensure they will have at least a base level of income, however long they may live.

Profile 4: Good saver, fearful spender

The good saver, fearful spender household has successfully accumulated more than enough wealth to cover their spending needs and then some — yet has a difficult time spending any principal out of fear of longevity risk.

The best savers are very good at allocating monthly income between current spending needs and future savings goals, and generally have experienced growing wealth over time. As those households shift into retirement, the idea of depleting their wealth to support their retirement lifestyle can feel daunting. In this situation, an annuity can translate a portion of a portfolio into a consistent level of lifetime income that can be used to enhance the household's retirement lifestyle.

More income generally means more spending. Households with pensions and annuities tend to spend more than households who don't have these income streams.

This is not a surprise because the pension represents additional means or ability to fund higher spending. A key question: do households with higher levels of

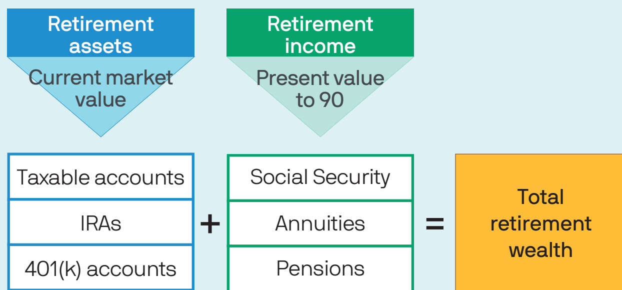
Profile 4: Outcome

Our research shows that households that have less of their total retirement wealth in the form of retirement income spend less than similar households that have greater retirement income. Households with $3–5M in total retirement wealth who have 20–40% in retirement income, spend 35% less than households that have 60–80% in retirement income (See **Exhibit 4**).

Our research concludes that annuities can:

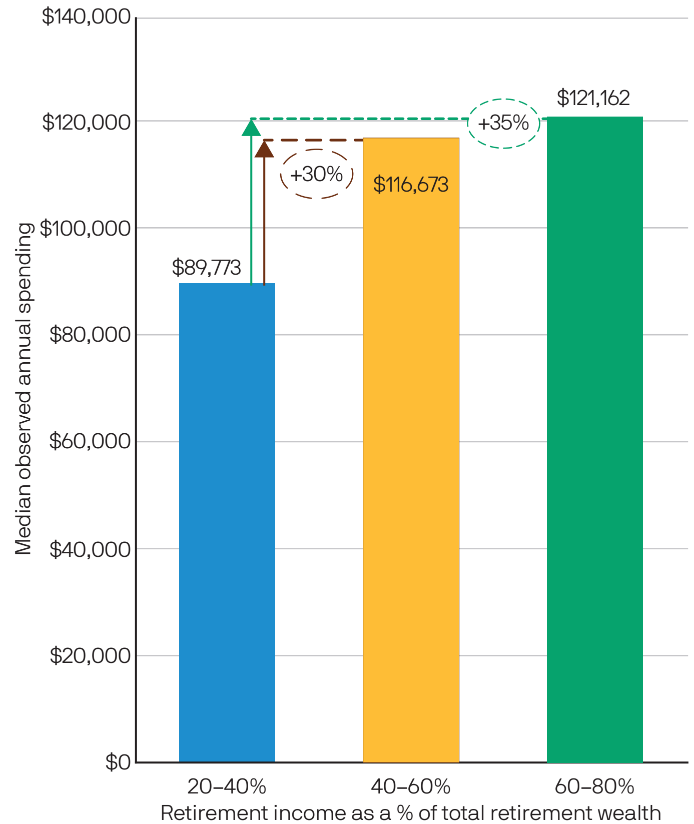
- Protect long-lifers, inadequate savers by providing some income that will last as long as they live.
- Provide a periodic payment that can supplement other sources of income like Social Security to enhance the retirement lifestyle with greater confidence.

Total retirement wealth is the combination of retirement assets and sources of income. It represents the total means that a household has for retirement spending.



Spending based on level of retirement income ages 70–75

Exhibit 4: Median annual spending



Source: Chase data including select Chase credit and debit card, electronic payment, ATM withdrawal and check transactions in 2022. Information that would have allowed identification of specific customers was removed prior to the analysis. Asset estimates for de-identified and aggregated households supplied by IXI/Equifax, Inc.

consistent income — in the form of pensions, annuities, and Social Security — spend more than those with less income but equivalent means? The answer is yes.

Using de-identified Chase data for households that do a majority of their spending through their Chase relationship, we estimated each household's total retirement wealth which is comprised of the current value of their investable wealth and the present value of their observed sources of income to age 90, essentially creating an asset equivalent of their Social Security, pensions and/or annuities.

We then grouped households with similar total retirement wealth together and observed their annual spending behaviors.

In conclusion

Annuities are an important tool in the toolkit for households approaching and living in retirement to carefully consider allocating a portion of their wealth when determining their retirement income strategy. These profiles are prime candidates for using annuities to meet a specific retirement need.

Allocating part of a portfolio to an annuity is valuable when the annuity is being used to provide a base level of lifetime income or to provide guarantees through market cycles. Households considering an annuity purchase should carefully review its benefits, trade-offs and fees to make an informed decision about how it supports their overall retirement income strategy.

Next steps

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