The enduring advantage of annuities

Market Bulletin

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Suppose you invite an actuary to your 65th birthday party. As you blow out the candles, you could ask him, in his professional opinion, how many more times you will get to perform this ritual. His brow will furrow over. Even if you tell him that he can ignore gender, genes, wealth and current health, he will radiate uncertainty. The reason is simple: he doesn't have any idea. According to the Centers for Disease Control, as of 2019, there was a 50% chance that an *individual* turning 65 today would live another 20 years to age 85. But there was a 25% chance that they would make it to 91 and a 5% chance they would live another 33 years to age 98.

If, on the other hand, you ask him how long on average Americans celebrating a 65th birthday today will live, his face will clear. That's easy, he'll say. Almost certainly that average will be between 84 and 86 years.

It is very difficult to estimate how long a specific 65-year old individual will live but it is very easy to estimate, on average, how long a large group of 65 year olds will live.

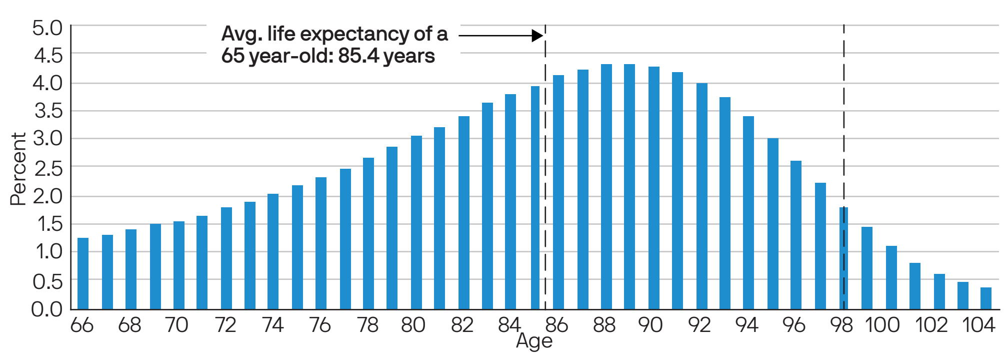
Guaranteed income-producing annuities all leverage this simplest of advantages: relying on the law of large numbers. This advantage means insurers are inherently able to provide higher income streams—and with higher certainty that payments will last a lifetime—than the average investor could do for him or herself. An individual has to plan for the worst. An insurer only has to plan for the average.

If you are an individual turning 65 today, in order to be 95% sure that you are not going to outlive your retirement plan you will need to generate income for 33 years. However, an insurance company constructing an annuity only needs to provide an income stream that lasts for 21 years. 12 fewer years of payments means the payments themselves can reasonably be larger.

High volatility in stocks and interest rates have made retirement income planning more challenging than ever. Fortunately, higher rates mean bonds now provide more

An individual has to plan for the worst—but an insurer only has to plan for the average

Exhibit 1: Percentage of 65 year-olds who pass away at each age



Source: Centers of Disease Control, National Vital Statistics Report: volume 66, number 4, United States Life Tables 2019, J.P. Morgan Asset Management. All information is shown for illustrative purposes only.

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Whether interest rates remain high or revert lower, annuities offer an advantage

Exhibit 2A: Today's economy—assumes 7% return

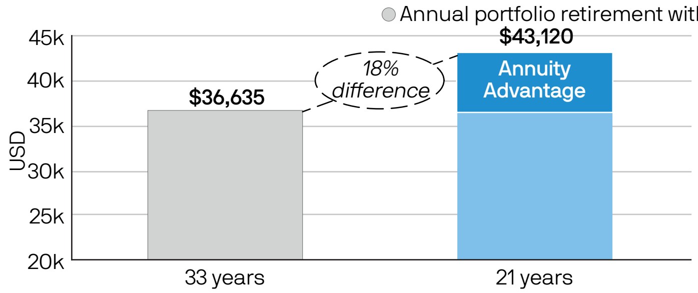
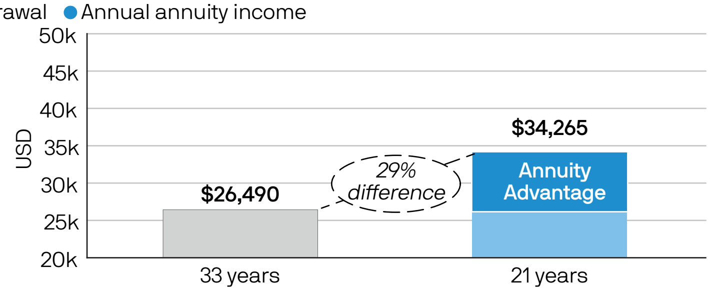


Exhibit 2B: "Low growth, low inflation" economy—assumes 4% return



Source: J.P. Morgan Asset Management; data as of January 2023. All information is shown for illustrative purposes only.

income to portfolios than they have in the past decade and lower equity valuations have boosted expectations on forward returns. **Exhibit 2A** demonstrates the basic annuity advantage over the "do-it-yourselfer" in an environment with 7% expected returns, the relative advantage is 18%.

However, after inflation stabilizes, the economy may well return to an environment of slow economic growth, low inflation and low interest rates, an investment climate reminiscent of the one that preceded the pandemic. Fortunately, even in an environment where rates revert lower, the benefits of annuitization are still powerful, particularly on a relative basis.

In **Exhibit 2B** we keep everything the same as in Exhibit 2A except we now assume an annual return of 4% rather than 7%. The annuity's relative advantage has risen from 18% to 29%.

It needs to be stressed that this is a purely hypothetical example. However, it illustrates an important point. The annuity advantage is based on the idea that an insurance company, by averaging across individuals, can safely eat into principal more quickly and still be confident of providing a lifetime of income for their investors than any individual investing for themselves. And when expected returns are lower, this return of principal is a correspondingly more important share of that income stream.

The annuity landscape is complicated and still evolving and investors will always need to examine fees, investment choices and a multitude of different features. However, as they do so, it is important to first remember the key feature that has made annuities one of the most enduring investment solutions in the financial landscape. That feature is the ability to predict the average life span of a large group with far greater accuracy than the specific lifespan of any individual, and that advantage persists across a wide range of investment environments.

Next Steps

Please visit the Annuity Insights page to view the latest insights and resources to help clients plan and invest for retirement.

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