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Investing for downside protection with annuities

Volatility in the market can add an additional level of complexity to retirement planning. Many investors are understandably concerned about the security of their retirement portfolio and ultimately their ability to generate sufficient income to last throughout a retirement of 30 years or longer.

Allocating a portion of your retirement portfolio to certain types of annuities can provide downside protection of principal against market losses. It's a conservative strategy for managing risk, but one that by no means should be considered the sole province of conservative investors; because by supplying a greater degree of portfolio certainty, it may empower you to potentially take on more risk elsewhere.

Considerations when constructing your retirement portfolio

During periods of market uncertainty, investors often head for the relative security but low yields of cash, CDs and bonds. Unfortunately, this can have significant negative effects on your portfolio as low interest rates struggle to keep pace with the rate of inflation.

Based on the Chief Investment Office recommendations, a conservative portfolio should be comprised of 58% fixed income, 26% equity and 16% cash. Yet as the table on the right indicates, to obtain a return over 2% on a portfolio of bonds you would need to invest in longer-term Treasuries with a 10+ year maturity and therefore a higher risk of losing value if interest rates should rise. Another strategy is to boost yield by taking on the additional credit risk of lower rated Corporate bonds.

However, by purchasing an annuity as a core holding that anchors the fixed income portion of your investment portfolio, you can reduce the risk of market losses.

Impact of bond maturity and credit rating on yields

Treasury yields by maturity[1]	
Maturity	**Yield**
30 Year	2.76%
20 Year	2.94%
10 Year	2.72%
1 Year	1.81%
Corporate yields by credit rating[2]	
Credit rating	**Yield**
Corporate AAA	3.31%
Corporate BBB	4.18%

[1] Board of Governors of the Federal Reserve System, Selected Interest Rates statistical release April 8, 2022.

[2] BofA US Corporate Index AAA Effective Yield© and BofA US Corporate Index BBB Effective Yield©, as of April 8, 2022.

Source: Richard C. Marston "Investing for a Lifetime–Strategies for Saving and Managing Wealth," September 2015.

How annuities can provide downside protection

Annuities can provide full or partial protection of principal through guarantees provided by the insurance company when you purchase the annuity contract. Some can even offer this protection along with an opportunity for meaningful asset growth during positive markets. The following types of annuities can provide one or both of these benefits:

- **Fixed annuities** provide you with a guaranteed* rate of return for a specific period of time. You know exactly how much you will receive and when you will receive it, and perhaps most importantly, your principal is 100% protected.
- **Fixed indexed annuities (FIA)** provide market-like growth by linking your investment to a particular market index, for example, the S&P 500. The insurance company provides 100% principal protection and you have the opportunity to participate in market gains up to the index cap rate, which is typically less than the actual market gains achieved.
- **Variable indexed annuities (VIA)** provide market-like growth by linking your investment to a particular market index, as well. However, they have limited downside protection primarily through the use of "buffers." Your principal is only at risk on any market losses during an index period that exceed the buffer (typically a loss of 10–30%), but your upside growth opportunity is generally higher than the cap rates offered by fixed indexed annuities.

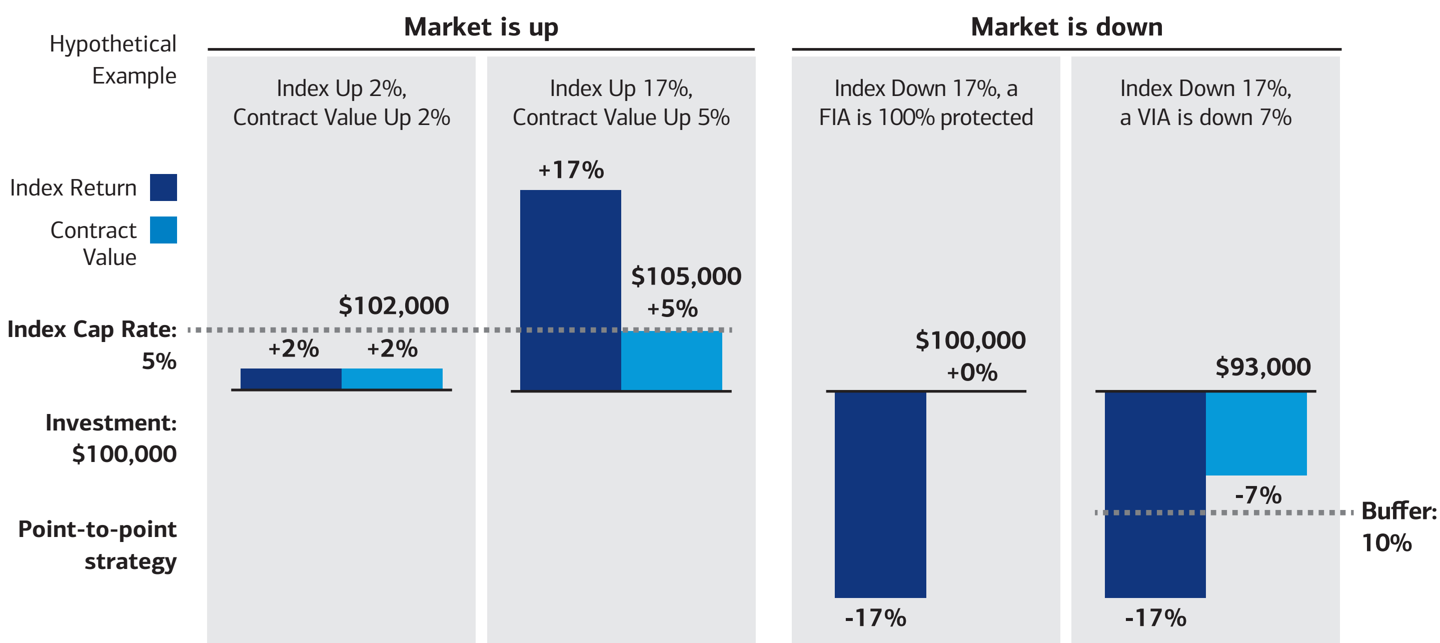
How fixed annuities work

Fixed annuities offer a conservative way to save for retirement. At purchase you lock in a guaranteed* rate of interest for a specified time period, which can run from one to ten years (five years is typical). At the end of each guarantee period, you can elect a new guarantee period and most annuities come with a minimum guaranteed rate for the life of the contract.

When you enter retirement, fixed annuities can be used to generate a guaranteed stream of income for life. The amount of income you will receive is based on a number of factors, including how much money (premium) you pay to buy the contract, your current age and life expectancy, interest rates at the time you purchase the annuity and the payout options you select.

Upside return potential with some downside protection

An indexed annuity is designed to afford some protection for your investment while allowing you to participate in any type of market environment. Whether up, down or flat, an indexed annuity provides some downside protection and the potential for gains linked to the performance of a market index without investing directly in the markets.



Examples are for illustrative purposes only and do not represent any actual investments.

How indexed annuities work

When you purchase an indexed annuity, your premiums are allocated to an index-linked strategy. At the end of each index period, you receive credits based on the performance of the underlying index. It's important to note, however, that any amounts withdrawn from the annuity during the index period generally do not receive any return for that index period. Typically, fixed indexed annuities have index periods of one to two years and variable indexed annuities have index periods of one to six years. While index-linked interest can be credited based on several factors, the most common, and the only two methods available through Merrill, are:

- **Performance trigger** – if the index return for the index period selected is greater than or equal to zero, the indexed interest credit is equal to the declared trigger rate (or specified rate). If the index gained 1% but your annuity has a 5% trigger rate, then the return credited to your annuity would be 5%. The renewal trigger rate may vary.
- **Point-to-point index cap rate** – a maximum rate of interest that your annuity can earn for a given index period. If the index gained 12% but your annuity has a 7% index cap rate, then the return credited to your annuity would be 7%. The renewal index cap rate may vary.

When comparing indexed annuity products in the market, it's important to review the indexing methodologies. Some products incorporate the following, which may reduce the performance of the contract:

- **Participation rate** – a fixed percentage of the index's gain that is used to compute your annuity's return. For example, if the index rises 9% and your participation rate is 80%, the return credited to your annuity would be 7.2% (9% x 80).
- **Spread fee** – a fixed percentage that is deducted from the index's gain that is used to compute your annuity's return. If the index gained 10% and the spread fee is 3%, then the return credited to your annuity would be 7%.

With fixed indexed annuities, you can also choose to allocate a portion of your premium to a fixed rate account. The fixed account typically has a guaranteed minimum interest rate and works much like the interest rate guarantee periods of a fixed annuity.

What happens if you need your money sooner?

While a surrender charge may apply to early withdrawals, some annuities allow for certain withdrawals without charge (e.g., up to 10% of contract value each year). Some fixed annuities offer a principal protection feature where you are guaranteed the return of your initial premium if you choose to take a complete withdrawal anytime during the surrender charge period.

Some annuities may also apply a Market Value Adjustment (MVA) if you make a withdrawal or annuitize the contract before the end of a guarantee period. The MVA could be positive or negative depending on the relationship between market interest rates at the time of the withdrawal and the interest rate guaranteed in the annuity. Therefore, it's essential that you carefully review the terms and conditions associated with any annuity.

Keep in mind that any withdrawals of annuity earnings are subject to ordinary income tax, and a 10% additional federal tax may apply to withdrawals taken before age 59½. In addition, withdrawals will reduce the annuity's death benefit and cash surrender value.

How you can learn more

Annuities are complex products that include many features and factors. A prospectus, when available, will outline the specific details for the annuity you are considering. Since not all fixed or indexed annuities are sold with a prospectus, your financial advisor can provide you with more complete information on behalf of the insurance company and help you determine if an annuity may be appropriate for your needs.

Retirement confidence starts with a conversation

Regardless of your age, asset level or life priorities, both fixed annuities and indexed annuities can help you grow your retirement savings while helping to protect against the loss of principal during times of market turbulence. They can provide a predictable source of retirement income along with the reassurance of a guaranteed death benefit for your beneficiaries; and in the case of indexed annuities, a unique opportunity to participate in upside growth when the stock market is rising.

Learn more

Take time to talk to your Merrill Lynch Wealth Management Advisor about the role annuities might play in your retirement plan. Your advisor will work with you to assess your goals, risk tolerance, investing style, time horizon and liquidity requirements, and will review the costs associated with all the options to find an appropriate income strategy and annuity solutions to meet your needs.

* All annuity contract and rider guarantees, or annuity payout rates, are backed by the claims-paying ability of the issuing insurance company. They are not backed by Merrill or its affiliates, nor does Merrill or its affiliates make any representations or guarantees regarding the claims-paying ability of the issuing insurance company.

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Annuities are long-term investments designed to help meet retirement needs. An annuity is a contractual agreement where a client makes payments to an insurance company, which, in turn, agrees to pay out an income stream or a lump sum amount at a later date. Annuities typically offer (1) tax-deferred treatment of earnings; (2) a death benefit; and (3) annuity payout options that can provide guaranteed income for life. The fees and charges associated with annuities may include, but are not limited to mortality and expense risk charges, administrative and distribution fees, as well as charges for the underlying investment options and optional benefits. Early withdrawals may be subject to surrender charges, and taxed as ordinary income, and in addition, if taken prior to age 59½ an additional 10% federal tax may apply. Withdrawals reduce annuity contract benefits, values and optional guarantees in an amount that may be more than the actual withdrawal.

Index annuities are not a direct investment in the stock market. They are long-term insurance products with guarantees backed by the claims-paying ability of the issuing insurance company. They provide the potential for interest to be credited based in part on the performance of the specified index, without the risk of loss of premium due to market downturns or fluctuations. Index annuities may not be suitable or appropriate for all clients.

The features of fixed and indexed annuity contracts — including the terms, costs, guarantees and caps — can vary substantially. Before purchasing any annuity, speak with your Merrill Lynch Wealth Management Advisor about the costs, risks and how the variables (such as the participation rate and/or spread fees) are calculated.

It is important to note that indexed annuity contracts commonly allow the insurance company to change the participation rate, cap, and/or margin/spread/ on a periodic — such as annual — basis. Such changes could adversely affect your return. No single index crediting method will provide the highest interest credit in all market scenarios. The guaranteed minimum cap rate/maximum spread rate are established when the annuity is purchased and disclosed in the annuity contract. Read your contract carefully to determine what changes the insurance company may make to these features.

Most variable indexed annuities are sold by prospectus only. Your Merrill Lynch Wealth Management Advisor can provide you with more information, including a current prospectus. The current contract prospectus and underlying fund prospectuses contain more complete details on the investment objectives, risks, fees, charges and expenses, as well as other information about the contract and the underlying portfolios which should be carefully considered. Please read the prospectuses carefully before investing. Investing in securities involves risks, and there is always the potential of losing money when you invest in securities.

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