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CD annuity delivers a real punch

Scott Burns

Let's take some bets. What odds would you give the average five-year CD-type annuity of beating the average government bond funds? Slim to none? Tiny to miniscule? As likely as a snowball fight in Cancun?

A quick look at current information doesn't give much hope. As this is written, the average five-year CD-type annuity is yielding 5.65 percent, a five-year Treasury is yielding 6.48 percent and government securities mutual funds are yielding still more, with 175 of them showing a preceding 12-month distribution rate of better than 6.48 percent. Some show distribution rates of more than 7 percent.

On the surface, the five-year CD type annuity simply doesn't look competitive.

Well, guess what? Based on a study of 43 five-year periods, the average CD-type tax-deferred annuity beat the average net return of 20 major government securities funds two-thirds of the time. Here's the story:

As I said in last week's column, after seeing that the average government bond fund had managed to lose principal during a bull market in bonds, I wanted to find alternatives for fixed-income investors, particularly retirees who spend their interest income. So I made an index of 20 major bond funds, measured the income produced during all those 60-month periods, adjusted for principal lost to capital losses or commissions and compared the result with an easy alternative: purchase of a five-year Treasury note.

The surprise finding: A five-year Treasury beat the average government bond funds in 33 of 43 time periods. That's what some people like to call a "counter-intuitive" result. Who would have guess it?

After that surprise, I called Danny Fisher, sole proprietor of the nations largest database on tax-deferred annuities and creator of the *Fisher Annuity Index*. His monthly publication now lists nearly 900 contracts from 148 different insurance companies. In addition to traditional tax-deferred annuity contracts, his data include figures for five-year CD-like annuities as well.

Could he find data that went a little further back than his monthly publication so I could do another comparison?

Sure thing. He faxed the figures from his North Dallas office, I plugged into my spreadsheet and …guess what? The average five-year CD-type annuity beats the average government bond fund two times out of three.

Those odds present some interesting possibilities. They can be improved.

How? Simple. Find a five-year CD-type annuity that has a yield equal to, or better than, a five-year Treasury.

Sadly, this isn't a lead pipe cinch. Examining a multi-year listing of CD-type annuities that Mr. Fisher publishes each month, there's a five-year yield as low as 4.9 percent offered: If you bought this stunning product from Lincoln Benefit Life, you would have accepted 75 percent of a five-year Treasury. That makes Lincoln Benefit Life a pretty good substitute for the Internal Revenue Service, tax deferral not-withstanding.

In fact, the current list has no contracts that yield higher than a five-year Treasury. It does, however, have three that are within a few points and one from a company with very high credit ratings, US Guaranty Life.

What does this mean? If you shop for a Treasury-competitive yield, you'll have about a 75 percent chance of beating the average government fund and the joy of tax deferral of five years. While the most common CD-type annuity contracts are for one and five years, they are available, from different companies, in maturities of one to 10 years. This means you also could build a ladder of CD-type annuities.

Cherry-picking CD annuities with maturities of two, four, six, eight and 10 years in the current market would create a tax-deferred average yield of 6.10 percent with an average maturity of six years, only about 20 basis points less than a comparable Treasury ladder. As each contract matures, it could be rolled with a 1035 exchange to a new 10-year contract. The benefit would be lower risk, a short average maturity, a competitive return and tax deferral for those who elected to accumulate the income.

Does it make sense, instead, to just buy a regular tax-deferred annuity – one that isn't structured like a CD?

Maybe. Maybe not. The problem, according to Mr. Fisher, is the near Byzantine nature of insurance products. Most annuity contracts don't guarantee your yield for more than a year, and, even more problematic, there really is no such thing as a standard contract. Variations in fine print, Mr. Fisher says, make the task of comparing very difficult.

Bottom line: The five-year annuity CD contract can be a competitor for the $130 billion committed to government securities funds.

(Single copies of the Fisher Annuity Index, which is updated monthly, can be obtained for $25 by calling 1-800-833-1450.)

Questions about personal finance and investments may be sent to: Scott Burns, The Dallas Morning News, *P. O. Box 655237, Dallas, Texas 75265; faxed to (214) 977-8776; or e-mailed to scott@scottburns.com. Check the Web site www.scottburns.com. Questions of general interest will be answered in future columns.*