Encouraging the long view:

How short-term market swings are a great opportunity to encourage long-term financial planning

When markets start to fluctuate, it's a given that investors will be bombarded with alarming headlines. Panic is often the reaction, with investors abandoning carefully-developed portfolios and investment plans and fleeing to the safety of cash or fixed investments. Financial professionals know that moving out of the market means no chance of participating in any rebound and therefore less chance of recouping losses experienced in the fall.

So how can financial professionals encourage clients to weather the storm and stay invested when volatility rears up? One of the most common strategies to mitigate volatility is to diversify a portfolio. When many clients hear "diversification", they think of a portfolio including a mix of stocks and bonds. But even within an equity portfolio spread out across multiple asset classes, there's still some correlation between returns; when one investment falls, others are likely to as well. Are there other tools that can be used to reduce risk for clients?

Bear markets, by the numbers

- The average S&P 500® annual return is approximately 8%.[2] The average 1-year return following the lowest point of each bear market is 47%.[3]
- Historically, bear markets have occurred an average of once every 6 years.[3]
- 50% of the S&P 500®'s strongest days in the last 20 years occurred during a bear market.[4]

Effective diversification can go further, and may implement additional tools to manage risk. One major goal of this approach is encouraging clients to include assets with different risk factors in their portfolio. Those may be assets that aren't correlated to equity markets, offer protection from losses or supplement income when markets fall. But their inclusion can make the difference between clients staying the course and sticking to their long-term plans, or falling behind and failing to meet financial goals.

Enter insurance

Insurance products and the guarantees they offer can be important components of a financial plan. Besides their most obvious benefits, such as providing protection for loved ones or guaranteeing lifetime retirement income, they can also diversify an investment portfolio's risk profile while achieving other financial goals. For example, permanent life insurance like whole life and indexed universal life (IUL) can balance asset accumulation with protection for cash value. Insurance and insurance products, including annuities, can be used to provide income, on an ongoing basis or occasionally to help protect other assets from market swings. The remainder of this piece will discuss various insurance products that may help clients stay focused on long-term goals, and where they can fit in a portfolio.

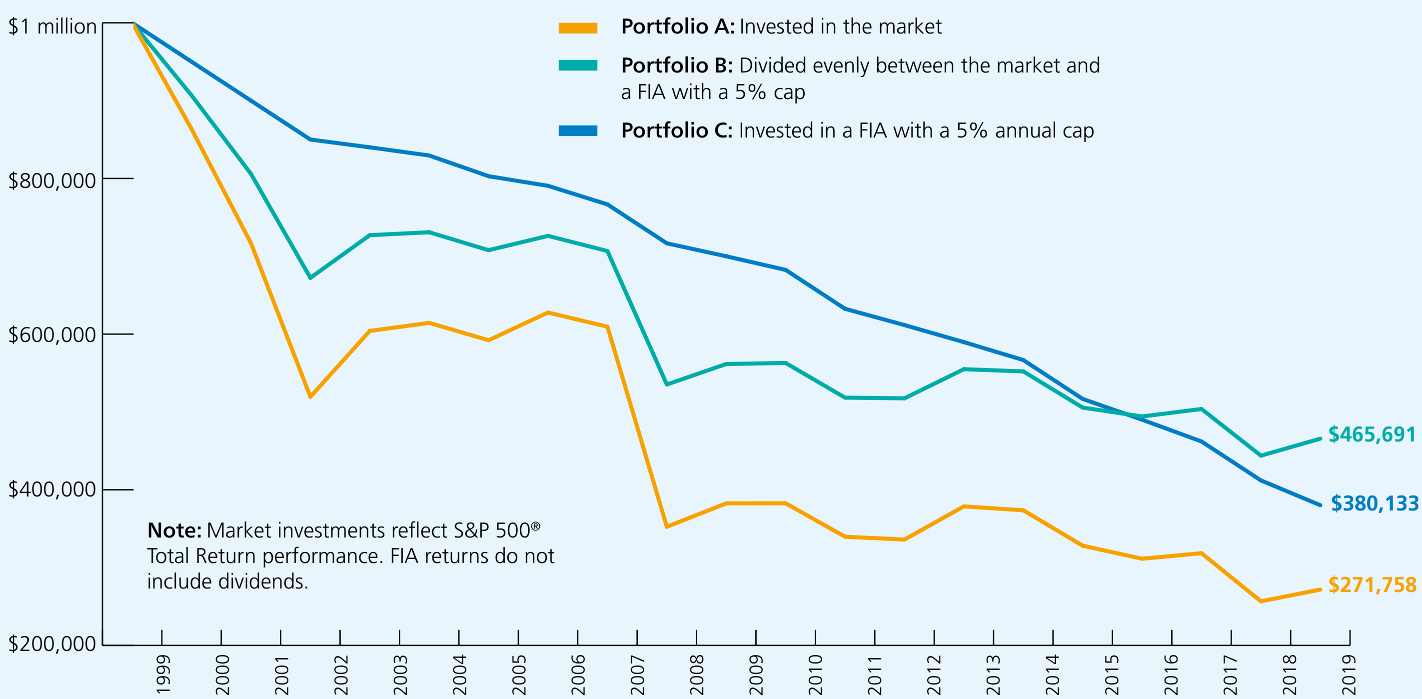
Accumulating assets:

Indexed Universal Life and Fixed Indexed Annuities

Indexed Universal Life (IUL) insurance policies and Fixed Indexed Annuities (FIAs) both offer the value proposition of upside potential with downside protection. While there are differences between the two, they both offer tax-deferred growth based on market returns without exposure to market risks. Both products are subjects to caps, participation rates and other factors that prevent them from capturing 100% of the market's upside, but in exchange, they also both include a contractually guaranteed floor. A floor that prevents principal from being subject to market losses.

The guaranteed floor is one of the more attractive features of these products. As individuals approach and enter retirement, they generally become more concerned about what will happen to their retirement assets if equities suddenly plunge in a bear market. Trying to gain back lost ground is challenging, as it takes a greater return to get back principal than it took to lose it. For example, if a $1,000,000 portfolio lost 20% it would fall to $800,000. To get back to $1,000,000, the portfolio would then need to increase by 25%.

Indexed products can help protect assets from this situation with their guaranteed floors. When the market rebounds, these floors let an FIA or IUL policy start from a stronger place, which can have a major impact on a portfolio's value. To demonstrate how significant the impact might be, let's look at an example. All three strategies in this example invest $1 million and take an annual income withdrawal of $50,000.



Note: Market investments reflect S&P 500® Total Return performance. FIA returns do not include dividends.

Based on 20 years of S&P 500® returns, the guarantees built into the insurance product helped limit the impact of market losses and provided for a more robust asset total. In this example, the portfolios incorporating the FIA had greater asset totals than the pure market investment, with **the hybrid approach proving to be the most successful of the three.** This is not meant to suggest that FIAs or IUL policies should replace equities in a client's investment portfolio; these products don't offer as much growth potential as many equity investments.

However, given their ability to grow based, in part, upon market performance, **FIAs and IUL policies may offer greater accumulation than lower-yielding portions of a portfolio while contractually-guaranteed floors offer the safety against market losses** typically associated with lower-risk investments. It's important to note, however, that FIAs and IUL policies can contribute to asset accumulation goals while also providing other important types of protection such as a death benefit to a client's loved ones and income throughout retirement.

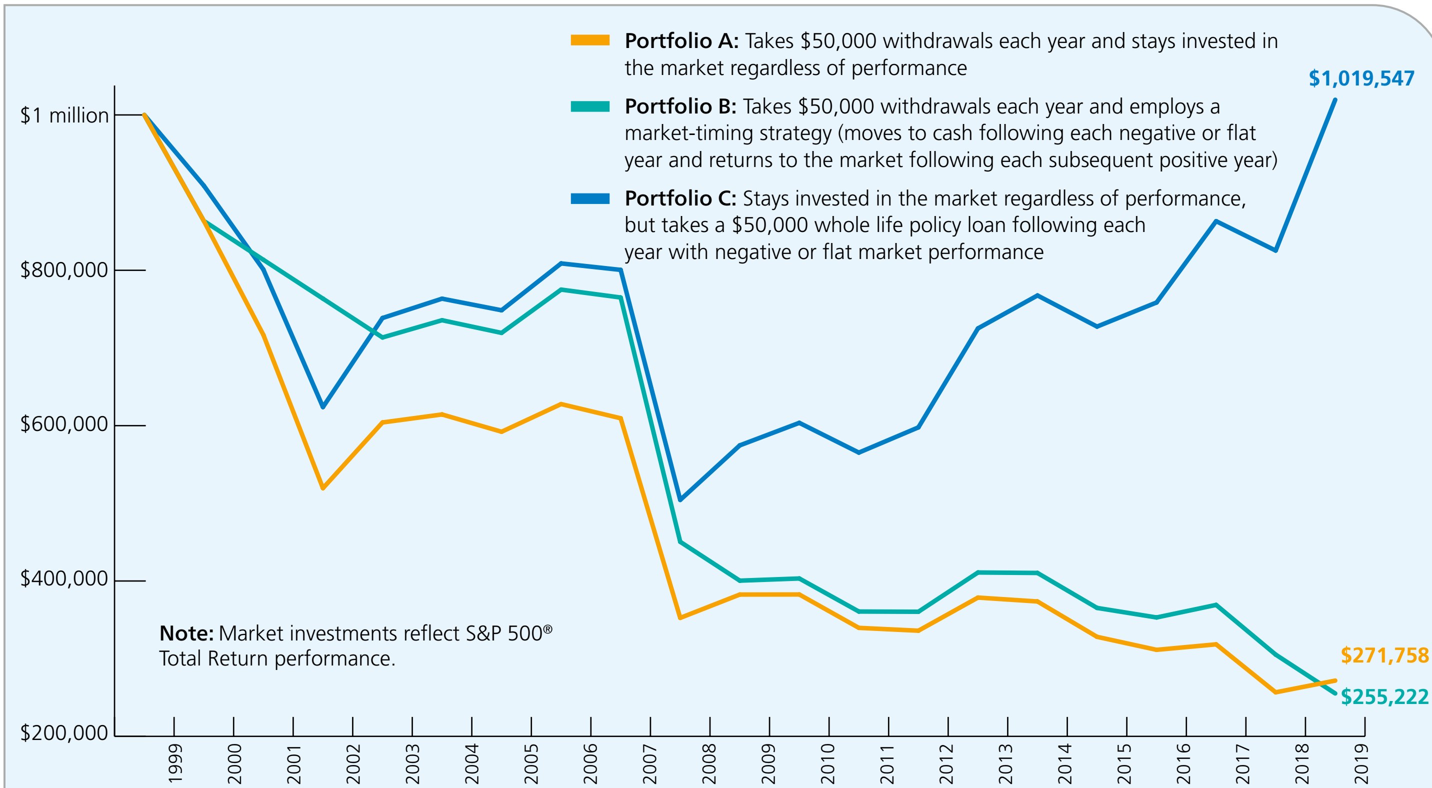
Protection from the storm:

Whole life as a buffer against volatility

But FIAs and IUL policies aren't the only insurance products capable of reducing the impact of volatility, and safer asset accumulation isn't the only goal insurance can help clients achieve. Other insurance products offer features that let them serve as buffers against market swings and downturns, with whole life insurance acting as a prime candidate for this role and an ideal asset for many clients. With a whole life policy, clients are guaranteed to experience growth in their cash value, even when markets fall, and there's little direct correlation to equity market performance. And when dividends are reinvested and used to purchase additional coverage, these policies have the ability to increase their cash value accumulation potential. With a death benefit that's also increasing, the policy holder is building up protection not only for their future needs, but also for their loved ones simultaneously.

Growth during market declines is an obvious benefit to clients, but where whole life policies truly shine is their ability to turn that growth into usable assets. Whether it's used to support a small business, pay college tuition for children, provide retirement income or any other purpose, policy owners can access the cash value that's been built up in their policy over time via tax-free loans. And if clients choose to do this while the market rebounds from a downswing, it can give their assets tied to equities the ability to participate in the recovery.

To demonstrate this point, we'll compare three portfolios being used to generate income. All three represent an initial $1 million market investment and each provides $50,000 of annual income.



These results are based on the last 20 years of S&P 500® returns, and the difference between the experiences is dramatic, with **Portfolio C's value at the end of this period even higher than the original investment.**

Withdrawals from assets tied to equity markets during or following a downswing act as a double whammy, with both events reducing the overall value and leaving fewer assets to build from when markets recover. In this example, market-timing strategies fared as expected, missing out on the growth opportunities associated with market rebounds.

Whole life policy loans can reduce or eliminate the need for income withdrawals from assets in the market, letting clients stay invested and dedicated to their long-term plans. In fact, according to Dr. Wade Pfau and Dr. Michael Finke, **a retirement income strategy that included whole life insurance as a buffer against volatility was more efficient and offered more overall income throughout retirement.**[1]

Helping clients focus on the next quarter century instead of just the next quarter

Make no mistake, insurance products aren't an overnight fix for volatility. They aren't intended to be. Whole life and IUL policies take time to build up their cash value. FIAs have surrender charges that typically last for a five- to ten-year surrender period and reduce the amount of income available in the early stages of the contract by applying penalties for excess withdrawals. The examples go on, but the point remains the same: these are long-term products, many of them intended to provide benefits for a lifetime.

But sudden, unexpected market drops are the perfect opportunity to remind clients of the importance of long-term planning and the critical function these products can serve. Most investors will experience multiple bear markets or corrections during their life, and buying insurance today is a strategy that can help soften tomorrow's market blows.

Conventional wisdom tells us we need to pay attention to market cycles rather than each individual peak or trough, because when the market falls, it's often followed by a strong rebound. We can help make clients more resilient to losses and swings with a focus on long-term goals, rather than short-term returns. And long-term goals are exactly what insurance products are designed to address.

The planning process is critical to prepare for market unknowns. A portfolio that relies entirely on the market is much more vulnerable to volatility than one that features multiple products, with each offering varying degrees of correlation and different protection features. Volatility simply isn't as frightening when guarantees are in place to protect portions of a portfolio and reduce its total risk profile. The right mix of assets can provide a stability that makes client conversations about a portfolio's resiliency, its ability to meet financial goals or any number of other topics go more smoothly.

The unique features and benefits of insurance products can have a similar effect, smoothing out the impacts of volatility. Safer methods of asset accumulation, guaranteed growth even during periods of market turmoil, buffer assets that can supplement other sources of income more closely correlated to equities and important protection clients need such as death benefits are some of the features these products offer, and their inherent long-term focus can play a major role in helping clients achieve their long-term financial goals.

[1] Pfau, W. & Finke, M. (2019). Integrating Whole Life Insurance into a Retirement Income Plan: Emphasis on Cash Value as a Volatility Buffer Asset

[2] What Is the Average Annual Return for the S&P 500? (2020, February 19). Retrieved from https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp

[3] Bear market basics: Looking at history can help you become "bear aware." (2020, April 7). Retrieved from https://www.fidelity.com/viewpoints/market-and-economic-insights/bear-markets-the-business-cycle-explained

[4] 10 Things You Should Know About Bear Markets. Retrieved from https://www.hartfordfunds.com/dam/en/docs/pub/whitepapers/CCWP045.pdf

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Early withdrawals or surrenders from an FIA may be subject to surrender charges. Withdrawals are also subject to ordinary income tax and, if taken prior to age 59½, a 10% federal tax penalty may apply.

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