CNN Money

Zero REALLY is exciting!

By Dave Mortach

Over the past few weeks, it seems like all the stock market headlines have included the words: "plunge," "freefall," and "tumble." These words alone send most investors and retirees into an outright panic.

For anyone who stores his or her finances in a volatile environment, sleeping at night doesn't come easy, much less placing faith in a reliable long-term income strategy.

You could move your money over into less risky alternatives, such as bonds or CDs. However, with interest rates still being on the historically low side, you would be hard-pressed to beat inflation, or achieve the same type of growth in a bond or CD.

So, if you're planning ahead, what can you do to help grow your portfolio, and potentially minimize the risk of loss with your long-term funds?

Stepping Out of Harm's Way – Without Closing the Door on Growth Opportunity

Given the substantial amount of market volatility that's taking place, many investors are turning to fixed indexed annuities. This is because these financial vehicles can essentially provide the opportunity to obtain index-linked interest on their retirement funds, yet without the risk of loss to principal during a market downturn.

How exactly can you achieve this "best of both worlds" scenario?

Fixed indexed annuities differ from other types of annuities because interest is credited to their account value. Typically, a regular fixed annuity only credits interest to the underlying account based upon a set rate of return. However, a fixed indexed annuity will credit interest determined by a formula based on the tracked changes in an underlying index.

The interest that is earned is usually capped at a certain percentage of the overall gain. While that may not seem fair, consider that during down markets, the annuity holder's account does not lose value. This can be beneficial in a couple of different ways.

First, it means that you won't lose principal during that time period. In other words, zero percent on your money is much more exciting than a negative percent – especially with a large negative like 10 or 15 percent.

Also, you are not expected to make up for previous year's losses. By keeping your account value the same, you already have a head start for the next period. This can essentially help intensify your gains, and then should the following period be positive, potentially increase your gains.

As with other types of annuities, the gains inside a fixed indexed annuity are allowed to occur on a tax-deferred basis. In other words, taxes are not due until the time of withdrawal. This, too, can help your funds grow and compound – especially in comparison to a taxable investment account.

When it comes time to convert the annuity to income, you will have the ability to choose the lifetime income option. This choice allows you, or you and your spouse, to receive a guaranteed stream of income for life, regardless of how long you may live.

Zero Can Really Be Exciting

Because a fixed indexed annuity is technically an insurance contract, it has the ability to guarantee the safety of your principal, while at the same time, offering you a minimum interest rate on your money. This differs from owning a variable annuity because with a variable annuity, while you may have the potential to obtain a higher return, your principal is subject to market risk will not be protected should the underlying investments perform poorly.

With a fixed indexed annuity, the insurance carrier can in fact guarantee that the value of your principal will never be less than the sum total of what you have deposited (minus withdrawals and administrative charges) – by offering the ability to exceed the fixed rate of return, if the underlying index performs well. This means that you can have stability and security, along with the opportunity to still exceed inflation. But, the worst-case scenario is still zero.

No losses can also equal added peace of mind – and, in a time of market turmoil, that alone can help you by knowing that your principal will be there for you when you need it.

If you're seeking the similar growth benefits that can be found in equities, but you aren't quite comfortable with the volatility and potential losses, then you might want to consider fixed indexed annuities. These annuities provide common ground between market volatility and losses.

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