

In the Press

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Allure of Fixed Annuities Fades

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NEW YORK - An unforgiving interest-rate environment is making fixed annuities a hard sell to investors.

Fixed annuities, structured to thrive amid high long-term interest rates, have lost their competitive edge as yields on short-dated securities rise comparatively higher. The phenomenon has caused a slight inversion of the Treasury yield curve and is pushing investors to alternative products such as certificates of deposit, which are currently offering more attractive rates.

“The fixed annuity has totally lost its appeal in the market,” said Michael Bischoff, a financial planner at Webb financial Group in Bloomington, Minn. “Long-term interest rates are so low and short-term interest rates are so high.

In trading yesterday, the benchmark 10-year note yield was 4.736%, while the two-year note was yielding 4.762%, a five-year high.

While the Fed is expected to end its tightening campaign

sometime this year, it is expected to have as many as two more rate increases up its sleeve. That will keep upward pressure on the near-term end of the curve.

Mr. Bischoff said he had a client recently that wanted to place \$100,000 in a conservative investment. He proposed putting the money in a one-year certificate of deposit until interest rates reversed course.

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“As an investment representative, I have a hard time locking it up in a five-year (annuity),” he said. “That is why the CDs are more appealing than these fixed annuities.”

Fixed annuities have faced stiff competition from CDs, as banks increased rates to court consumers as short-term interest rates climbed. One-year CDs are yielding about 5%, up from

1.04% in 2003. By comparison, the S&P 500 last year returned 4.9%, and taxable bond returns were 2.06%, according to Lipper Inc.

“This is a very attractive environment for CDs,” said Greg McBride, a senior financial analyst at Bankrate.com. He noted that CDs are currently yielding between 4.5% and 5% on maturities ranging from six months to five years.

Such yields are attainable with modest minimum deposits and are protected by FDIC insurance and come without fees. “Those returns...stand pretty tall relative to other asset classes,” Mr. McBride said. Investors are “getting additional return without having any additional risk. That is unheard of in investment markets.”

In an environment where long-term interest rates are higher, insurance companies can go out and invest proceeds in longer-term instruments and offer higher rates. They aren’t able to use this strategy when rates are relatively flat.