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- CAPITOL CONNECTIONS -

The Bull Marches On

By Keith Burbank

After setting bull market highs in January of this year, some people began to question if those highs would ultimately mark the end of the current bull market which is the second longest in history. We now know with certainty that it was not the end, as the S&P 500 broke through those highs in August and has continued higher through the end of the third quarter.

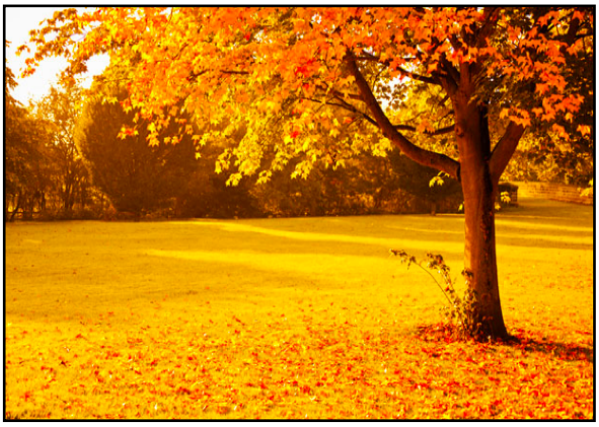
US stocks continued to outperform the rest of the world in the 3rd quarter. Earnings growth, fueled by last years' tax cuts, remained robust and overshadowed any simmering concerns around the escalating US-China trade war. The strength of the US economy continues to offer long-term support to the equity markets with second quarter GDP coming in at 4.2% and economists now expecting 3% growth for all of 2019.

The Fed continued to remain focused on fighting inflation by raising rates for the third time this year, with plans for another hike in December. The Fed no longer considers their stance as accommodative, removing the language from their post meeting statement. At the same time, the committee does not describe their stance as restrictive, but believes they are taking a neutral stance at this point in time. Regardless of the language, yields have been inching higher with the 10-year yield now above 3%.

With three quarters of the year now behind us, we enter what is typically the strongest quarter of the year for stock market performance. S&P 500 earnings are once again estimated to see gains of 20% year over year. This earnings growth, combined with a continued strong economy, and a neutral Fed, should be enough to keep this bull market intact into 2019.

Annuities: Some Reflections

By James G. Steproe, J.D.



At first glance variable annuities might seem like the perfect retirement vehicles. You put in a lump sum or make periodic payments; the principal is guaranteed with an insurance benefit and the nice person selling you the annuity promises an attractive monthly payment for life. It all sounds too good to be true, and we all know what that means.

On the other hand, annuities represent a huge and growing business, over $200 billion per year. So, what is the big attraction? For those people disinterested in managing their own finances, annuities offer a simple menu. The participant must make only three decisions: lump or periodic contributions, deferred or immediate income and fixed or variable returns. The very big attraction for those selling these annuities are commissions that typically range between 6% and 10%. These extraordinary commissions also telegraph that these annuities are a big attraction for the insurance companies as well.

To be fair, annuities do offer retirees dependable regular payments for life, and unlike qualified plans such as 401k's and IRA's, there is no limit to the amount that can be contributed to an annuity. Annuities also grow on a tax-deferred basis and they are exempt from probate. In addition, many states mandate that all monies that are placed inside annuities cannot be attached by creditors. However, the numerous options, confusing technology, complex paperwork and imperfect transparency about costs and fees make buying annuities challenging and uncomfortable for some.

Unlike stocks and mutual funds with readily available price listings, the only way to get a sense of what annuities cost is to shop around. However, given all the variations and complexities, there just is not an easy way to compare prices and the problem is exacerbated by fees that can be buried deep within an annuity's contract. These include the aforementioned commissions, underwriting fees and fund management fees if the annuity invests in a mutual fund, as most variable annuities do.

Fixed annuities offer the investor a guaranteed rate of return. What many don't read in the fine print is that usually this rate is re-evaluated in one to five years due to market variances. Annuity companies simply cannot guarantee 6% if the fund manager is only making 5%. Insurance companies did not grow to their current size and build those huge towers in various downtowns by signing suicide pacts.

There are some other disadvantages as well. For example, the cost basis of variable annuities does not step up when they are inherited. The beneficiaries will pay tax on the entire contract value that has grown from the date of the initial purchase. Although annuity contracts grow tax-deferred, they impose the same 10% early withdrawal penalty as traditional IRA's and other qualified plans. Furthermore, some contracts will charge transactions fees after a certain number have been made and living and death benefit riders also subtract periodic fees from the contract balance. Finally, most contracts also come with a substantial back-end surrender charge schedule that can last 10 years or longer.

Annuities: Some Reflections - cont.

After considering all the above, it is important to remember that your investment could be at risk if the insurance company behind the contract is financially unsound. In the case of variable annuities, the "mutual funds" within the annuity are simply used to determine the annuity's value. An owner of the annuity contract does not own the mutual funds used in the contract and the diversification from owning different funds is not available. In other words, if the annuity company fails, an annuity contract written by that company is at risk. (There are, however, some state protections for some annuity funds, but they are limited. In New Hampshire the total protection per owner per member company is $250,000.00 for all annuity contracts).

The current low interest rates and the market downturn in 2008 have complicated investment decisions for many. Variable annuities would seem to offer one solution to the problem of securing a good rate of return, while maintaining some downside protection should security markets experience a sharp decline. The most important thing however, is to fully understand what one is purchasing and that may require some effort on the part of the investor.