Episode 294: Should I Buy an Annuity Now or Wait Until a Recession?

Hi, welcome to another episode of Monday Script Monday. My name is Brian Manderscheid and today, I want to answer the question “should I buy an annuity now or wait until a recession?” Now there's a lot to unpack here, and there's a lot to even determine if an annuity makes sense for you, such as your income needs, your liquidity needs, and your overall financial plan. However, if you're looking to create additional lifetime income that’s over and above your Social Security or even a pension, longevity insurance in case you live too long, or even inflation hedge with increasing income, an annuity may be right for you or portion of your liquid assets. Specifically, those that are underemployed, such as cash and or lower yielding bonds.

Again, today I want to answer the question should I buy an annuity now or wait until a recession? To do that, I'm going to give you two different examples, one buying a house and two buying an annuity. The reason being is both financial decisions are based on the underlying interest rate environment, which I'll get into later. First, let's look at the buying the home example.

Think back to the middle of pandemic we you know, there's a lot going on there. There were job losses, unemployment, massive stimulus packages injecting the economy, shutdowns, and everything else that happened. Essentially the Fed was forced to respond by lowering interest rates to near 0 and Congress injected trillions of dollars of stimulus into the system.

Now if we look at buying a house back in the middle of pandemic, the 30-year fixed mortgage back in August of 2020 was 2.875%. Probably a generational low in mortgage rates or in interest rates. Now if we fast forward to today, July 2023, the average mortgage rate is well over 7%. Additionally, if we look at the average US home price back again in the pandemic, the average home price in the US was roughly $400,000. Fast forward to today, and it is $516,000, significantly more than what it was just three years ago.

Not only are interest rates a lot higher today than they were three years ago, so are home prices. Now putting these two things together, let's look at a payment example with 20% down. Let’s look at buying a house three years ago with lower prices and lower interest rates versus buying a house today with higher prices and higher interest rates. The payments go from $1,320 a month, principal, and interest to $2,788. Over a 100% increase in the mortgage payment by buying a house today versus buying a house three years ago. If we could jump in that time machine, obviously we would have and purchased the whole neighborhood if we could, or maybe even bought an investment property, secondary residence, or Airbnb considering prices were much lower and interest rates were at what we believe is a generational bottom and the lowest in this interest rate cycle.

Now that's buying a house, let's next look at buying an annuity. Again, both of these products, a mortgage and an annuity, are priced based on the underlying interest rate environment. We typically look at the 10-year Treasury to get an idea of changes in both mortgage rates and changes in annuity rates. To give you guys a visual, let's take a look at the 10-year U.S. Treasury to show you where we've been in the interest rate cycle and where we are today, to help you make an educated decision on buying an annuity now, at what we believe are the peak interest rates, or if it makes sense to defer the decision to down the road when interest rates may in fact be lower.

If we were to buy an annuity three years ago, that $100,000 purchase would have provided this client $272,000 of cumulative projected lifetime income through age 95. Said in another way, for every $1.00 this client paid in premiums, he was getting just about 2.7 X in lifetime income over his lifetime. If we were to buy the same exact annuity, same carrier, same product, but today, four years later, with the same person buying the same with the same exact premium, that $100,000 provides $577,000 of cumulative income, through age 95. That’s roughly double or 112% increase buying that same annuity now, while interest rates are what potentially can be the top versus buying an annuity when interest rates were the bottom.

To go back to the housing example, you can see the increase in payments versus the increase in annuity income are roughly the same. So, to go back to that underlying question, “should I buy an annuity now or wait until our recession”, we actually have to ask another question and that is what do you think happens next? If you believe interest rates are going to continue on this path, then buying an annuity could potentially make sense now. Or if you believe interest rates are going to fall as a response to either reduced inflation or a recession, buying annuity in the future may result in less benefits than buying the annuity today.

We believe that the interest rate environment is at or near its peak and at some point, in the future to be determined, we believe that interest rates will be forced to come down. This means that somebody buying annuity, potentially whether three months or three years, will get less benefits than the person buying an annuity today.

Ultimately, we don't want you to have that same “I wish I had that time machine” type of reaction, just like we talked about in the in the housing example, of “I wish I would have bought that annuity three years ago when interest rates were much higher” versus buying that same annuity today in a lower interest rate environment. If you have any questions about if an annuity makes sense for you or what types of annuities may work best in your financial plan, please contact the advisor who sent you this video to get started today. Thank you very much. We'll see you next time.