Alternatives to CD and Money Market Accounts—When Zero is Your Hero

“Rule No.1: Never lose money. Rule No.2: Never forget rule No.1” -Warren Buffett

When we start talking about investing or retirement planning there are many options from which to choose. There are qualified accounts like IRAs, 401Ks, and non-qualified. There are stocks, bonds, mutual funds, annuities, and cash value life insurance just to name a few. These are all viable products for the right person at the right time and for the right reasons. However, it can get very confusing choosing the right one—even for an experienced investor.

Your broker may be telling you that stocks, bonds or mutual funds are the best option. Then your insurance agent will talk to you about safety of annuities or tax advantages of cash value life insurance. Well, in my humble opinion it all depends. All of those products are just tools, and as with any other tool, if it is used for a right project then it will work. You wouldn’t use a hammer to cut down a tree, right!? That doesn`t mean that a hammer is a bad tool. It is a great tool but for a completely different job.

If you are in your 30s or 40s and looking for higher returns, your risk tolerance might be a little higher and you may not lose any sleep when your portfolio takes a huge dip one year. If that`s sounds like you , then maybe a proper mix of stocks, bonds, and mutual funds would be a great fit for your goals and objectives.

If you are in or near your retirement years and the most important thing for you might be capital preservation or a guaranteed income stream for the rest of your life. In this case, a product such as a fixed or indexed annuity with a good Guaranteed Income Rider might be the right solution for you.

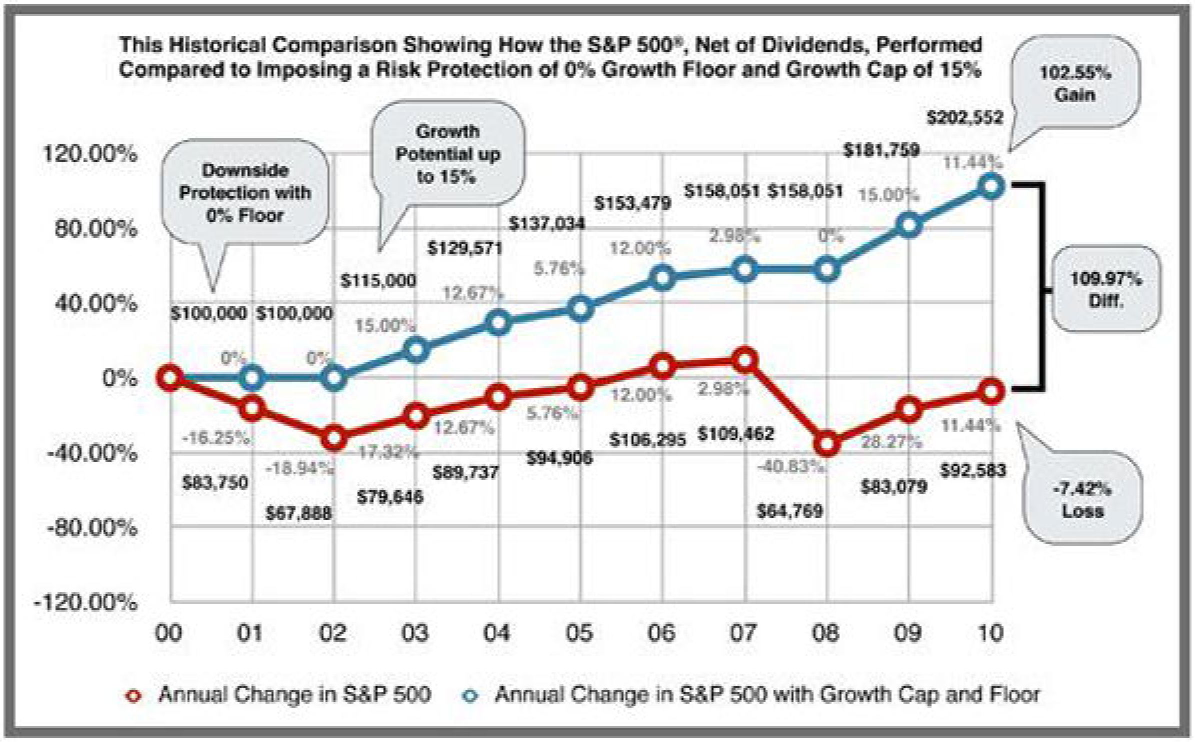
Like I said, these are just tools that should be used for a specific job.

I would like to talk to you about a great tool that is sometimes overlooked when comes to financial, retirement, or estate planning. But before we use this tool, let`s take a look at the job description:

1. You are looking for an alternative to CD or Money Market accounts with historically low rates of return.
2. You want better growth than those accounts, let`s say 4-6% on average net of any fees.
3. You want that growth to be on tax-deferred basis.
4. You want our money to be totally safe from market losses.
5. You want our money to be fully liquid and accessible without any penalties and restrictions in case we need it.

The tool or a product that I would talk to you about is single premium Indexed Universal Life Insurance policy. You may say, “Wait a minute, why life insurance?” Let`s take a closer look at why this product might be the right tool for the job.

Look at the graph below.



The past performance of the S&P 500 is not an indication of future performance. The above graph is intended to demonstrate how the S&P 500, net of dividends, would be impacted by a hypothetical growth cap of 15% and hypothetical floor of 0%. This is not a prediction of how any indexed universal life policy might have operated over the time period depicted above as performance may have been higher or lower than assumed.

What are you seeing is a red line that represents S&P 500 index and the blue line how Indexed Universal Life policy gets credited with interest.

For instance, if you purchase a mutual fund at $100,000, and it grows 10% in the first year, your account would reach approximately $110,000. However, if the following year nets you a 40% loss, your account would only be at $66,000. If your third year produced a 10% rate of return, you'd still be below your original investment at $72,600minus fees and expenses.

However, in an Indexed IUL the "reset" every year means you never earn less than zero. So, if you put $100,000 in a single premium Indexed IUL and receive 10% growth your first year, your end result is $110,000. Continuing the hypothetical scenario, say the markets drops 40% in the second year. You'll lose nothing. After your second year, your account will still be at $110,000. In the third year, your account grows 10%, which means you'll have $121,000 minus fees and expenses. So what you get is a potential for upside of the market with no downside risk.

In above graph example the floor is 0% and the cap is 15%. That means that if the S&P index gains 10% for a year your will get 10% into your contract minus fees. If the index moves 20% you will only get 15%. This is the cap that means that you cannot get credited more than that. But if the index loses 10% you will not lose anything. Your contract will get 0% for that year minus policy fees. That`s when the zero is your hero. In the properly structured MEC policy fees are usually around 2%.

Historically, in properly structured IUL policies cash values grow on average 7-8% annually. If you deduct around 2% for policy fees you may net 5-6% annually.

Again, all of your money is liquid from day one, principle and interest. It grows tax-deferred and there is no market risk, but there is a chance for a market gain up to 13-15% annually minus fees.

Also, since it is a life insurance policy you will get other benefits. A fairly healthy 65 year old would get over $200,000 of tax free death benefit with a $100,000single premium payment. Many of these policies have additional benefits like Terminal Illness rider and Chronic Illness rider included. These are called Living Benefits, which allow you to use a bigger portion of the death benefit when you get terminally or chronically sick.

Like I said before, this is just a tool. It will make sense for many but not for everyone, of course. However, I bet that you will look differently at your CD and Money Market accounts from now.

You may even ask yourself why you have never heard about it from your financial advisor.
Well, there could be a lot of reasons why but let`s leave this for another time…