The Great Depression and index annuities

"Even if the future has lousy financial markets, the index annuity concept can provide competitive returns."

The Dow Jones Industrial Average ended August 1929 at 380.3—a monthly close it would not exceed until November 1954, over a quarter of a century later. By June 1932, the Dow was at 42.8—down 89 percent from three summers prior. How would an index annuity approach have coped with the Crash of '29?

The Thirties were horrendous times for investors. Even though the market rallied back from its 1932 low to close at 187 by February 1937, that was still less than half of where it had been in the summer of 1929. Adding insult to injury, the Dow then gave back roughly half of these gains by 1938.

Some speculation

Although there is no way of knowing what rates might have been for a fictional "New Deal Annuity," I applied a 30 percent participation rate to any annual gains, and looked at what the annualized 5-year returns would have been if I could have bought an annual reset index annuity every month, beginning in August 1929, for the next five years. In my exercise the first five year period ends in August 1934, the last one ends August 1939, and I computed the annualized returns for each period.

An index annuity approach

The advantage of annual reset index annuities is they reset annually. What this means is we treat nasty periods—like from June 1931 to June 1932 when the Dow dropped 71 percent—as years with zero returns, and we also get to take advantage of low points to calculate next year's gains. So, how much of these gains did we share?

▷Your take-away: Doing some conceptual math, FIAs still would have held up in the middle of the worst times in modern history.

During the five years ending August 1934, the Dow lost 75 percent of its value. By contrast, the 30 percent participation rate method would have produced an annualized return of 2.3 percent for this first 5-year period. Over the 1930s, annualized 5-year returns for the index annuity ranged from 1.8 percent to 10.8 percent, depending on the period. If you could have purchased one every month, beginning in August 1929, your average annual index annuity return for the Great Depression would have been 6.4 percent. All of this during a decade that ended 65 percent lower than when it began.

This was just an exercise. These results do not show what index annuities would have done in the Great Depression, nor are they a prediction of future returns in the current financial climate. However, I believe they do illustrate that even if the future has lousy financial markets, the index annuity concept has the potential to provide competitive returns.

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