Investment Solutions, Inc.

The Long Run
Newsletter

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In This Issue:

Immediate vs. Deferred Annuities

Mutual Funds vs. ETFs

For Your Information

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Immediate vs. Deferred Annuities

Despite not being as well known as some other retirement tools, annuities account for 6.5% of all assets earmarked for retirement. With about $2.2 trillion in assets, annuities hold more funds than Roth IRAs.[1]

An annuity is a contract with an insurance company. In exchange for a premium or a series of premiums, the insurance company agrees to make regular payments to the contract holder. The funds held in an annuity contract accumulate tax deferred.

For individuals interested in accumulating retirement assets, annuities can be attractive because they are not subject to contribution limits, unlike most other tax-deferred vehicles. In other words, retirement-minded individuals can set aside as much money as they would like into an annuity.

Two Phases

Annuity contracts pass through two distinct phases: accumulation and payout. During the accumulation phase, the funds accumulate until the annuity contract reaches its payout date. At that time, the total will either be paid out as a lump sum or as a series of payments over a period that can stretch as long as the account holder's life.

The funds attributed to the initial premium will not be taxed, but any earnings on those funds will be taxed as regular income.

Immediate Annuity

As its name implies, an immediate annuity is structured to provide current income. After paying the initial premium, an individual receives regular income, which can be deferred for up to twelve months. The funds remaining in the contract accumulate on a tax-deferred basis. Only that portion of each payment attributable to interest is subject to taxes; the rest is treated as a return of principal.

This article is for informational purposes only and is not a replacement for real-life advice, so make sure to consult your tax, legal, and accounting professionals before modifying your tax strategy.

Deferred Annuity

It is also possible to purchase an annuity contract that defers payout until a specific date in the future. The premiums you pay to a deferred annuity accumulate and earn interest during the accumulation phase. The annuity holder determines the amount of payments and when the payouts begin, which is usually in retirement. With a deferred annuity, the earnings credited to your contract are taxed when they are withdrawn.

Annuities have contract limitations, fees, and charges, including account and administrative fees, underlying investment management fees, mortality and expense fees, and charges for optional benefits. Most annuities have surrender fees that are usually highest if you take out the money in the initial years of the annuity contract. Withdrawals and income payments are taxed as ordinary income. If a withdrawal is made prior to age 59½, a 10% federal income tax penalty may apply (unless an exception applies). The guarantees of an annuity contract depend on the issuing company's claims-paying ability. Annuities are not guaranteed by the FDIC or any other government agency.

Variable annuities are sold by prospectus, which contains detailed information about investment objectives and risks, as well as charges and expenses. You are encouraged to read the prospectus carefully before you invest or send money to buy a variable annuity contract. The prospectus is available from the insurance company or from your financial professional. Variable annuity sub-accounts will fluctuate in value based on market conditions and may be worth more or less than the original amount invested if the annuity is surrendered.

For retirement-minded investors, annuities have some attractive features that may be worth exploring. Annuities also have certain limitations and expenses that need to be considered before committing to a contract.

Citations:

1. ICI.org, 2024

Mutual Funds vs. ETFs

The growth of exchange-traded funds (ETFs) has been explosive. In 2006, there were less than 1,000; by 2024, there over nearly 10,000 investing in a wide range of stocks, bonds, and other securities and instruments.[1]

At first glance, ETFs have a lot in common with mutual funds. Both offer shares in a pool of investments designed to pursue a specific investment goal. And both manage costs and may offer some degree of diversification, depending on their investment objective. Diversification is an approach to help manage investment risk. It does not eliminate the risk of loss if security prices decline.

Structural Differences

Mutual funds accumulate a pool of money that is then invested to pursue the objectives stated in the fund's prospectus. The resulting collection of stocks, bonds, and other securities is professionally managed by an investment company.

ETFs work in reverse. An investment company creates a new company, into which it moves a block of shares to pursue a specific investment objective. For example, an investment company may move a block of shares to track the performance of the Standard & Poor's 500. The investment company then sells shares in this new company.[2]

ETFs trade like stocks and are listed on stock exchanges and sold by broker-dealers. Mutual funds, on the other hand, are not listed on stock exchanges and can be bought and sold through a variety of other channels — including financial professionals, brokerage firms, and directly from fund companies.

The price of an ETF is determined continuously throughout the day. It fluctuates based on investor interest in the security and may trade at a "premium" or a "discount" to the underlying assets that comprise the ETF. Most mutual funds are priced at the end of the trading day. So, no matter when you buy a share during the trading day, its price will be determined when most U.S. stock exchanges typically close.

Tax Differences

There are tax differences, as well. Since most mutual funds are allowed to trade securities, the fund may incur a capital gain or loss and generate dividend or interest income for its shareholders. With an ETF, you may only owe taxes on any capital gains when you sell the security. (An ETF also may distribute a capital gain if the makeup of the underlying assets is adjusted).[3]

Determining whether an ETF or a mutual fund is appropriate for your portfolio may require an in-depth knowledge of how both investments operate. In fact, you may benefit from including both investment tools in your portfolio.

Amounts in mutual funds and ETFs are subject to fluctuation in value and market risk. Shares, when redeemed, may be worth more or less than their original cost.

Mutual funds and exchange-traded funds are sold only by prospectus. Please consider the charges, risks, expenses, and investment objectives carefully before investing. A prospectus containing this and other information about the investment company can be obtained from your financial professional. Read it carefully before you invest or send money.

At a Glance

Mutual funds and exchange-traded funds have similarities — and many differences. The chart below gives a quick rundown.

Citations:

1. ETFGI.com, July 17, 2024
2. The Standard & Poor's 500 Composite Index is an unmanaged index that is generally considered representative of the U.S. stock market. Index performance is not indicative of the past performance of a particular investment. Past performance does not guarantee future results. Individuals cannot invest directly in an index.
3. Investopedia.com, February 16, 2024

For Your Information

- We are open from 9:00 a.m. – 5:00 p.m. Monday through Thursday, and 9:00 a.m. – noon on Fridays.
- We are open during the lunch hour.
- We have a mail drop on the far north door of the building. If you have any information you would like to deliver after normal business hours please drop it off there.

"The end of the summer is not the end of the world. Here's to October.

"October is crisp days and cool nights, a time to curl up around the dancing flames and sink into a good book." — John Sinor

Long & Associates, P.C.

Assisting you with accounting, tax preparation, and tax planning

Investment Solutions, Inc.

Advising you and creating strategies for investment and retirement planning

Benefit Resource Group, Inc.

Handling employee benefits and other business services

Whether you need one of these services, or all three, you'll work with the same professional, knowledgeable staff with our Comprehensive Solutions Program

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