life annuity specialist

Fixed-Indexed Annuities Easily Beat Bonds in 25-Year Barclays Study

The new data adds to the debate over whether financial advisors should rely more heavily on fixed-indexed annuities over bond portfolios.

By Cyril Tuohy | May 18, 2022

A fixed-indexed annuity with volatility control outperformed A rated bonds over a 25-year period ending in March, according to a new study.

The annuity did better than bonds in 98% of rolling seven-year periods from January 1997 to March 2022, according to Paul Jacoby of Barclays, in a white paper published earlier this month. It was tied to a simple stock-bond "risk parity" index with a 5% volatility target.

"Risk parity" portfolios are built so that the risk contributed by stocks and bonds are equal. Because bonds tend to have lower risk, the portfolios tend to allocate more to these securities.

From January 2004 through the end of the period, the average yearly return on the annuity was 8.45% compared with 5.34% for the single A bonds, the research found. Barclays used internal data sources to supplement Bloomberg volatility data dating back to January 2005, according to Barclays.

The best yearly gain over the period was 13.64% for the risk parity index and 8.61% for the bonds. The worst return was 3.82% for the index and 1.80% for the bonds, according to Jacoby's research.

The Barclays results could intensify a discussion over whether fixed-indexed annuities, which protect against a loss of principal, could be suitable replacements for bonds in the accounts of ordinary investors. Bonds are more exposed to interest rate changes, and the Federal Reserve has announced plans to bolster rates aggressively, if needed, to combat inflation.

Bond returns depend on their yields, which though now rising are still historically low. Indexed annuity returns by contrast can be driven by a wider range of sources, from large cap stocks to multi-asset portfolios, according to the report.

Furthermore, with an annuity, tax on income is deferred until withdrawn while corporate bond income is taxed at ordinary rates, Jacoby said.

Owners of indexed annuities benefit to a limited extent through participation rates and caps when markets rise. Since 2013, insurers have introduced volatility-controlled indexes that combine assets including equities and bonds using a version of risk parity, Jacoby wrote.

Volatility targeting reduces the cost to hedge the options in an indexed annuity, allowing owners to enjoy higher participation rates, Jacoby wrote.

The research assumed the annuity had a seven-year term with annual crediting and option hedging costs estimated using Bloomberg market data. The white paper was produced by the Barclays sales and trading division, not its research division, the company noted in a disclaimer.

In the first quarter, sales of fixed-indexed annuities rose 21% from a year earlier to $16.3 billion, Secure Retirement Institute reported.

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