How Inflation Affects Annuities

Inflation levels are at the highest we've seen since the 1970s. Increased prices will have a significant impact on retirement portfolios, as retirees are forced to withdraw more money each year than they expected just to maintain their current standard of living.

Here's how to protect your overall retirement portfolio, gain the benefits of guaranteed lifetime income, and mitigate at least some of the effects of inflation.

Cost-of-living-adjusted annuities

Unfortunately, annuity companies are no longer offering any products that directly link income benefits to inflation. The last such inflation-indexed product disappeared in 2019.

However, you can still easily buy an annuity that will increase your benefits each year by a fixed amount вЂ” a feature called a cost-of-living-adjustment (COLA) rider.

The catch: Your starting income payout with a COLA rider will be much lower. The younger you are, the greater that difference is likely to be. It may take a number of years before you reach the "break-even point" with a COLA rider.

Who needs an annuity COLA rider?

A COLA rider on your annuity may make more sense in the following circumstances:

You are renting, and therefore exposed to future rent increases. If you own your home outright, or with a fixed mortgage, you have neutralized a major source of inflation risk.

You are in very good health, and likely to live well beyond the average life expectancy.

Conversely, you may not need as much COLA protection if you own your home, or you are in poor health, or you smoke.

Annuity laddering

With this powerful technique, you only annuitize part of your portfolio at a time. You leave the rest of your portfolio to compound, gaining the potential for better returns. Every couple of years, you calculate how much additional income you need to maintain your desired lifestyle, and then buy another small annuity.

This allows the investment side of your portfolio a chance to grow to keep up with inflation. Furthermore, lifetime annuity payouts increase as you get older.

Social Security maximization

Social Security is a guaranteed lifetime income annuity with excellent inflation protection, especially if you can delay taking benefits until age 70. For every year you can delay benefits after age 62, your monthly benefits increase by 8%. And then you get an automatic COLA increase each year based on the initial inflation rate.

If you want to retire early, one strategy is to buy an annuity to provide a guaranteed "bridge" income for a few years, from retirement until you can max your Social Security at age 70. The payout rate will be much higher for a term-certain annuity.

Annuities are paying better

Thanks to higher interest rates, payout rates on newly issued annuity contracts have increased substantially since the beginning of 2022: By 11% for men, and by 13% for women, as of May 2022, according to CANNEX Financial Exchanges, Ltd.

So, if it's been a while since you looked at locking in a guaranteed lifetime income with an annuity, now might be a good time to take a second look.

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