

The Hidden Cost of a Guaranteed Zero

Signal, Noise, And What Matters | October 2026

What People Are Hearing

You've probably heard the commercials. They're on television, radio, podcasts, and all over the internet - *Participate in the stock market without the risk. Protect your retirement savings from market declines. Enjoy guaranteed growth and financial security.*

It sounds almost too good to be true. And that should be the first warning. Insurance companies have become extraordinarily effective at selling the idea that investors can enjoy stock-market gains without experiencing stock-market losses. But there's a reason these products are so profitable to manufacture and sell.

The insurance company isn't giving you the stock market without the downside. It's selling you a contract that can severely restrict how much of the upside you receive. And over a decade or two, that difference can be enormous.

Signal: The Promise Is Everywhere

The signal is the extraordinary marketing effort behind fixed indexed annuities. The advertisements emphasize guarantees, protection, retirement income, and peace of mind. They appeal directly to one of retirees' greatest fears: Watching their savings decline just when they need them most.

It's effective marketing because it focuses on the emotional pain of losing money. But the advertisements rarely devote equal attention to the financial consequences of missing years of investment growth. And that's where the story gets interesting.

Noise: If You Can Get the Upside Without the Downside, Why Wouldn't You?

That's the sales pitch in a nutshell. Why expose your retirement savings to market declines when an insurance company can protect your principal and still let you participate in market gains?

Because participating in the market is not the same thing as earning the market's return. An indexed annuity may advertise a 6% cap, for example. That does not mean the investor is guaranteed to earn 6%. It means 6% may be the maximum interest credited during the applicable period.

If the index rises 15%, the investor might receive 6%. If it rises 5%, the investor might receive 5%—or less, depending on the crediting formula. If it declines, the investor might receive 0%. And unlike a conventional stock investment, many indexed annuity strategies don't credit the dividends associated with the underlying index.

The marketing makes the zero sound wonderful. But it doesn't spend much time explaining the missing upside.

What Matters: How the Guarantee Is Actually Delivered

Insurance companies generally don't provide stock-market protection by generously absorbing all the market's losses while handing investors the gains. They structure contracts to limit what they must credit.

Two important mechanisms are Caps and Participation Rates. A cap limits the maximum return the contract can credit during a specified period. A participation rate determines what percentage of an index gain is used in the crediting calculation. Depending on the contract, one or both may apply.

Consider a hypothetical indexed annuity with a 60% Participation Rate and a 6% Cap Rate.

<u>S&P 500 Annual Gain</u>	<u>After 60% Participation</u>	<u>Net to You With 6% cap</u>	<u>What You Missed</u>
5%	3%	3%	2%
7.5%	4.5%	4.5%	3%
10%	6%	6%	4%
15%	9%	6%	9%
20%	12%	6%	14%

Note: Illustrative contract applying both restrictions; actual products differ. Figures exclude index dividends and additional charges.

So taken step further, if the market does exceptionally well and rises of 30%, the investor only nets 6%. Twenty-four percentage points of market appreciation never reach the contract.

Additionally, many contracts also allow insurers to reset caps and participation rates at renewal each year, subject to contractual minimums. An attractive rate advertised at purchase may not be available in later years. Meanwhile, the investor may be stuck due to surrender charges for leaving.

The insurance company can have flexibility to change the economics while the investor has limited flexibility to walk away.

The Real Cost Isn't the Market Decline. It's the Recovery You Miss.

The salesperson asks: What happens if the market falls 20%? That's a reasonable question. But here's another: What happens when the market recovers 25%, 30%, or 40%, and your contract credits only a fraction of that gain?

Stock markets have historically experienced substantial declines followed by significant recoveries. An indexed annuity's zero floor can protect against a negative index-crediting year under specified terms. But caps and participation rates can limit how much the investor benefits from subsequent positive years.

Over long periods, those forgone gains can compound into a meaningful difference in wealth. Consider \$500,000 invested for 10 years:

<u>Annualized return</u>	<u>Value after 10 years</u>
1%	\$552,311
2%	\$609,497
5%	\$814,447
7%	\$983,576

Note: Hypothetical constant annual returns, not historical results or a forecast. Excludes taxes, withdrawals, and fees.

At 2% annually, \$500,000 grows to approximately \$609,500. At 7%, it grows to nearly \$984,000—a difference of roughly \$374,000.

A conventional investment portfolio can lose value, and these figures do not compare identical risks. But avoiding losses is not the same as building wealth.

Who Benefits From the Complexity?

Some indexed annuities pay substantial upfront commissions to the agents selling them. Those commissions are generally built into product economics rather than appearing as a separate check written by the investor.

Compensation varies by product, insurer, surrender period, and distribution arrangement. It would be inappropriate to assume every agent receives the same percentage.

But the incentive deserves scrutiny. A large upfront commission can reward the sale immediately, while the investor experiences the contract's actual credited returns over the following decade.

Is this product being recommended because it is the best solution for my retirement, or because it is exceptionally profitable to sell? If someone recommends replacing an existing annuity with another, the question becomes even more important.

Questions Worth Asking

- What have the contract's actual credited returns been, rather than its hypothetical illustrated returns?
- What are the current Cap and Participation Rates, and their contractual minimums?
- How frequently can the insurer change those rates?
- How is the selling agent or agency compensated?
- How much can I withdraw without surrender charges?

- How much of the market's potential long-term return am I giving up to obtain the zero-percent floor?

Closing Thought

A guarantee is only as valuable as the problem it solves. For some investors, protecting a specific amount of principal or securing lifetime income can be worth paying for. But that doesn't make an indexed annuity an attractive substitute for long-term stock-market investing.

The financial services industry spends enormous sums advertising what these products prevent investors from losing. Investors should spend at least as much time understanding what those products prevent them from earning.

The most expensive part of an indexed annuity may not be a fee you can see. It may be the investment growth you never receive.

Sources

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Disclosure

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