
Searching for an Oasis

By Kerry Pechter Wed, Jun 13, 2012

This roundup of investment flow reports from Beacon Research, Strategic Insight, Morningstar and the Insured Retirement Institute suggests that investors are looking for shelter from an economic sandstorm in which visibility has declined to zero.

Where to turn for returns? Like thirst-maddened wanderers in the desert, mistaking a dune for an oasis, investors seem to have resorted to drinking sand (read: investing in bonds), because there's no better refreshment (read: equity returns) in sight. Blame it on Bernanke. Blame it on the Europeans. Blame it on election-year paralysis.

"US investors' psyches have been battered with a stream of negative news, whether disappointments in job growth or disappointing progress on the euro-zone problems. This has exacerbated the caution that many investors already felt," said Avi Nachmany, SI's Director of Research, in his latest report. "Until we see sustained improvement in employment growth and real progress on Greece and the euro, caution will probably favor bond fund flows over stock fund flows."

How interesting are these times? In one notable anomaly, an income annuity—New York Life's Lifetime Income Annuity—was the quarter's bestselling fixed income product, according to the Beacon Research *Fixed Annuity Premium Study*. That's never happened before. Year over year, sales of income annuities were up almost 23% in the first quarter of 2012, while indexed annuities, which accounted for almost half of all fixed annuity sales, advanced nearly 9%.

"Both product types did well despite lower interest rates due to demand for guarantees in general and reliable retirement income in particular," said Beacon Research CEO Jeremy Alexander.

"The success of New York Life's deferred income annuity also helped boost overall income annuity results, and indexed annuity cap rates looked comparatively good relative to CD and annuity fixed rates," he said. "As carriers respond to the low rate environment, we expect to see more MVAs, unbundled product features, and GLWB rollup rates that vary based on credited interest."

Industry-wide, sales of all types of annuities topped \$53.1 billion in the first quarter of 2012—down about 2.5% from \$54.5 billion during the previous quarter.

Variable annuities

Variable annuities are attracting much less new money this year than last.

Variable annuity total sales were down only 2.7% to \$36.2 billion from \$37.2 billion in the fourth quarter of 2011, according to Morningstar. And, despite the dip, the market value of variable annuity subaccount assets reached an all-time high of \$1.61 trillion in the first quarter, up 7.2% from \$1.50 trillion during Q4 2011.

But, according to Morningstar, quarterly *net* variable annuity sales decreased 34.5% year-over-year. New money fell to \$3.8 billion in the first quarter of 2012 from \$5.8 billion during the same period in 2011. (There were \$24.3 billion in qualified sales and \$11.8 billion in non-qualified variable annuity sales in the first quarter.)

Relative to the second half of 2011, the rate of new money coming into variable annuities dropped by about 50% in the first quarter. Net inflows of variable annuities—premiums net of surrenders, withdrawals, exchanges, and payouts—fell to only 10.6% of sales (\$3.823 billion) after averaging 21% (about \$8 billion) in the second half of 2011. This may have reflected the general retrenchment of the industry, as several carriers exited the VA market and others reduced the generosity of their benefits in light of low interest rates, flat or volatile equity markets, and accounting pressures.

Stock and bond mutual funds

On the other hand, the slowdown in VA inflows may simply reflect a larger trend. According to Strategic Insight, U.S. investors put just \$14 billion in net inflows into stock and bond mutual funds in the US in May 2012 (in open-end and closed-end mutual funds, excluding ETFs and funds underlying variable annuities). That was a drop from the \$24.5 billion in net inflows to stock and bond funds in April.

May's numbers also marked the lowest volume of positive net flows since long-term mutual funds experienced net outflows in December 2011, Strategic Insight said. In May, domestic equity funds saw net outflows of nearly \$5 billion, during a month of poor stock returns: the average US stock mutual fund lost 4.2% in the month, on an asset-weighted basis. That brought total US equity fund flows to -\$7.4 billion for the first five months of 2012—a sharp reversal from the first five months of 2011, when US equity funds enjoyed cumulative net inflows of \$40 billion.

International/global equity funds drew net inflows of \$5 billion in May, but that was down from the \$6.5 billion they took in the prior month. In the first five months of 2012, international equity funds drew aggregate net inflows of \$27.6 billion.

Fixed annuities

Returning to fixed annuities: At \$16.94 billion, first quarter 2012 fixed annuity sales were down 2.2% from the previous quarter and 8.8% from the year-ago quarter. Fixed non-market value adjusted annuities were down 2.9% from the previous quarter and down 32.6% from Q1 2011. Fixed market value adjusted annuities were up 1.6% from the previous quarter but down 10.4% from a year ago.

Great American joined the quarter's top five sellers for the first time, coming in fifth. Aviva USA moved up a notch to take second place and New York Life advanced two notches to place third. Allianz continued as sales leader, and American Equity remained a top-five company.

In terms of sales by product type and distribution channel, the leading companies were unchanged from the prior quarter. The success of New York Life's Lifetime Income Annuity made it the first product of its type to be a quarterly bestseller. The other leading products were once again indexed annuities issued by

Allianz, Aviva USA and American Equity.

| <u>Rank</u> | <u>Company Name</u> | <u>Product Name</u> | <u>Product Type</u> |
|--------------------|----------------------------|--------------------------------|----------------------------|
| 1 | New York Life | NYL Lifetime Income Annuity | Income |
| 2 | Allianz Life | MasterDex X | Indexed |
| 3 | Aviva | Balanced Allocation Annuity 12 | Indexed |
| 4 | American Equity | Bonus Gold | Indexed |
| 5 | Aviva | Income Preferred Bonus | Indexed |

Bond funds

Taxable bond funds saw net inflows of \$9 billion in May, the smallest amount of net inflows they'd experienced since they attracted just over \$8 billion in December 2011. Investors continued to use bond funds as income-producing solutions amid extremely low rates. Short- and intermediate-maturity bond funds were the most popular types of mutual funds in May, leading the way with nearly \$6 billion in combined net inflows. Emerging market bond and global bond funds followed in popularity.

Taxable bond funds have drawn an estimated \$110 billion in the first five months of 2012, far ahead of the \$80 billion in net flows that taxable bond funds took in over the course of 2011's first five months.

Meanwhile, muni bond funds saw net inflows of \$5 billion in May. Muni bond funds drew \$24 billion in net inflows through the first five months of the year, as long-term muni bond issuance has risen substantially from year-earlier levels.

Money-market funds saw net outflows of \$2 billion in May, which was an improvement over April's net outflows of \$22 billion. Ultra-low yields continued to hamper demand for money market funds even as more investors turned to them as a safe haven.

ETFs

Separately, Strategic Insight said US Exchange-Traded Funds (ETFs) saw roughly \$2 billion in net inflows in May 2012. That brought total ETF net inflows to \$60 billion for the first five months of 2012—a pace that could result in the sixth straight year of \$100 billion or more in annual net inflows to US ETFs. At the end of April 2012, US ETF assets (including ETNs) stood at \$1.13 trillion, down from \$1.2 trillion at the end of April 2011.

Bond ETFs were the only major category to post net inflows in May, drawing net nearly \$8 billion. Equity ETFs saw an estimated \$6 billion in net outflows, with both domestic and international equity products seeing net redemptions. Real estate and gold ETFs also saw significant net inflows. "ETFs are often used to

express investor sentiment regarding the financial market, and so the redemptions from stock ETFs are sending a clear message,” said Loren Fox, SI’s head of ETF research.

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