Where should Stu Gots place his money? Under the mattress or in a shoe box?

A good friend and client named Stu Gots recently approached us because a couple of CDs were coming due. Stu is close to retirement and has heard so much conflicting information on the different financial investment options. He wasn't sure what to do.

As an investor, Stu is a conservative person and the return of his money is more important than the return on his money. Ultimately, he would like some certainty about his returns and does not want the fluctuations of the stock market to impact his retirement.

What are Stu's investment options? Where is the best place to invest Stu's money based on his situation and risk tolerance? Can he find a better place than the mattress, the backyard or a shoe box? We think so!

Stu's CD money added up to just over $100,000 and is considered non-qualified (meaning that Stu has already paid taxes on these funds). Stu is eligible for Social Security and will be turning on that faucet soon. He is not going to need this money to live on in the near future.

His first option is he could continue with the one year CD which earns a higher rate of return than a savings account. The highest return on a 1 year CD at the time of this printing is 1.3%. Locking into a CD with a longer fixed term is not an option as interest rates are expected to increase in the coming year. Plus a long term CD does not provide any liquidity without penalty.

A bond mutual fund is another option as the dividend payout or yield is typically higher than a CD. However, the principal will continually fluctuate and could have a loss. Stu wants to protect his principal so this is not a viable option.

The next option to consider is a tax-deferred annuity that has a fixed interest rate. An annuity is similar to a CD in that you can lock into an interest rate for a specific amount of time. Annuities carry a guaranteed minimum interest rate which means that even in bad times your principal will earn interest.

Unlike a CD, you can make a maximum annual withdrawal from an annuity of 10% of the account value. Withdrawals can also be made for things like nursing home care without penalties. This could provide Stu with the liquidity he is looking for.

Best of all, the interest that you earn in an annuity is not taxed until it is distributed. Tax deferral allows for your funds to grow faster since you are delaying the taxes.

After researching numerous companies, we found an annuity that has a first year interest rate of 3.25% with a minimum guarantee of 3.0%. In year 2, the interest rate will be based on the current market rates but will never be lower than 3.0%. At the end of 5 years, we will evaluate the market to find the best financial product for him.

Based on Stu's risk tolerance, age and liquidity needs, this annuity was the best option for him. The principal is secure and earning a higher rate of return than he would currently receive from a CD. Plus he can make a withdrawal in the event of an emergency or to buy a new town car.

Here are some tips when investing in annuities:

Be cautious before purchasing a plan with a large first year bonus rate because the surrender periods are longer and the rates of return are usually lower in the subsequent years. Also, you lose flexibility as you are locked into that plan until the surrender period ends.

Be cautious before purchasing a plan with a surrender period that is longer than 5 years. Since interest rates are going to increase in the future, you want the have the flexibility to earn a higher rate of return at the end of the surrender period. Termination of an annuity during the surrender period could be costly.

Ask to see an interest rate history from your financial representative for the annuity company that is recommended. Make sure the company is financially stable. If there is a Market Value Adjustment included, make sure you fully understand the impact.

As always, Stu should check with his tax advisor before placing money in any product since all have different tax consequences. This should be simple since it is tax season.

Tax-deferred annuities are a great investment alternative. When investing in an annuity do pay attention to the tips above. Unfortunately there are some financial representatives that do sell these plans based on commissions and those plans may not be in your best interest.

Stu Gots is very happy that he doesn't have to dig a hole in the frozen yard. His mattress doesn't have a lump and the shoe box can go in the recycling bin!

Always ask lots of questions before making any investment and do what works best for your situation. Hope everyone has a great year in 2011!!