On Course Financial Planning
Facing the Future with Optimism and Courage
June 2026
Vectors
geo@oncoursefp.com
425-861-9997

The Fantasyland Investment

I was recently asked for my opinion about the allocation of a $190,000 church endowment fund that is currently invested in 3 year CDs. The stated goal for the endowment fund is – *"Fund principal shall be invested conservatively with the goals of preserving principal and providing for modest long-range growth of the fund through investments in stocks, bonds, and government securities, as well as cash."* The question I was asked was that since there is no short-term need for the money, should a portion of the fund be invested in stocks to increase the fund's return?

It is impossible to calculate how much money Wall Street firms have made selling investments that promise what the endowment fund committee is hoping for - and which no one on Wall Street can deliver – long range growth with little or no short-term volatility. I call this the Fantasyland investment because that's where it belongs – along with Mickey, Minnie, Donald, Daisy and Goofy. The Fantasyland investment looks something like this –

- Its value will grow at a steady pace, with no violent swings from one year to the next and no losing years.
- Its after-tax return will outpace inflation.
- It is liquid. This means that you can sell it at any time at its fair market value.
- It will yield stock-like returns – 10% per year would be just about perfect.

Each year, Wall Street's Fantasyland factories roll out products that pretend to offer these benefits. They are purchased by investors who don't understand that it is impossible for such an investment to exist. If one appeared, the demand for it would be off the charts and its price would quickly rise to the point that its yield approximated that of US Treasury bills. A U.S. Treasury bill or FDIC insured certificate of deposit carries virtually no risk of principal loss — and so it pays very little. In order to receive a greater return, you have to accept volatility and the possibility of loss. This is not a theory; it is a fundamental economic truth. For the past century, the S&P 500 Index has yielded an average annualized return (including dividends) of about 10%. That's the good news. But that 10% was accompanied by numerous frightening temporary declines along the way. Here are the top 5 –

#1	#2	#3	#4	#5
−79%	−54%	−51%	−45%	−43%
Great Depression	2000 – 02 Dotcom Crisis	2007–09 Financial Crisis	1937 Recession	1973–74 Oil Crisis

Each of these declines was eventually erased by a recovery and new market highs. Investors who maintained discipline, resisted panic selling, and stayed invested through the past century's demoralizing, unpredictable temporary declines were handsomely rewarded. The greatest risk of a permanent loss isn't from temporary declines; it's from panic selling during the decline.

Probably the most aggressively marketed product offering "upside participation" with "principal protection" is the fixed index annuity, (FIA) also known as an equity indexed annuity (EIA). The commissions are large, the products are complex, and the sales presentations are deliberately misleading. Few investors understand how they work and full disclosure marketing pitches are the exception rather than the rule. A common sales channel is a free meal at a local restaurant, marketed as an "educational dinner seminar" that positions the presenter as an educator rather than a commissioned salesperson. The "educational" content is a pretext. The objective is to identify prospects with significant liquid assets from IRAs, 401(k)s or other assets that can be rolled over into a fixed index annuity. Widows and widowers making financial decisions independently for the first time are also prime targets.

Sales pitches lead the unwary into believing that they are investing in a stock market index such as the S&P 500 and, by some complex financial magic, they will receive the return of the index in up years and experience no principal loss in down years. How does the insurance company do this and not lose money? Well, your money is not invested in any stock or index fund. You are buying a contract with an insurance company. The insurance company deposits your money into an investment pool that holds primarily investment grade bonds and fixed income instruments. The insurance company uses a small portion of the interest generated by the portfolio to purchase call options on the S&P 500 Index. If the index

rises during the crediting period (typically one year), the options pay off and the insurer credits your account with a gain — but not the full gain of the index - the upside return is limited by a crediting cap. If the index falls, the options expire worthless, no gain is credited, but your principal is not reduced. Once interest is credited, it is typically locked in and cannot be lost in future market declines. So, the wise investor must ask, "What does the insurance company gain by absorbing the downside risk for me, and why would they do that?"

Investing in a FIA removes downside risk but in exchange for this benefit you take on additional risks and expenses that the S&P 500 Index fund investor doesn't have.

You won't receive dividends. Dividends historically have accounted for roughly 40% of total S&P 500 returns. FIAs track only the price return of the index — dividends are excluded. Sales materials showing hypothetical back-tested FIA returns alongside the S&P 500's price return deliberately exclude dividends. This comparison understates the index's actual performance while making the annuity appear far more competitive than it is. This is one of the most significant and least-discussed performance gaps between FIAs and a simple S&P 500 Index fund.

Your gain is subject to an annual cap. FIAs are priced to be profitable for the insurance company, which sets cap rates (a maximum annual return typically 10–15%) or a participation rate (e.g., 50% of index gains). In a bull market year where the S&P 500 returns 25%, you might receive 12%. The insurance company pockets the difference. The opportunity cost of forfeited dividends and capped gains is a real economic loss that never appears in your quarterly statement.

Illiquidity. FIAs typically carry surrender charge periods of 7–10 years. Withdrawing funds before the surrender charge period ends triggers penalties that can be substantial. This is a meaningful constraint for retirees who may need liquidity.

Counterparty risk. Your principal protection is only as strong as the insurance company's financial health. FIAs are not FDIC insured. They are backed by state guaranty associations, which vary by state and typically cap coverage at $250,000 — far below the amount that an affluent retiree might place in a FIA. A fixed index annuity is an insurance contract with an index-linked crediting formula. It is not a CD, not a bond, and not an investment account. Anyone comparing it to one of these is either confused or lying.

Compounding shortfall over many years. Due to participation rates and performance caps, you will receive less than the S&P 500 Index's return every year that the index has a positive return (historically three years out of four). Those forfeited gains are permanently lost and cannot compound for you over the years. Over a multi-decade retirement horizon, those forfeited gains compound for the insurance company instead of you. On the other hand, 100% of the dividends and price appreciation of the S&P 500 Index compound continuously over the years for the index fund investor.

Higher Tax Rates. Gains in annuities are taxed as ordinary income, not at the lower long-term capital gains rate. In fact, for 2026, there is no capital gains tax for a married couple filing a joint return if taxable income is less than $98,900 or a single person with a taxable income less than $49,450.

Since 1950, 47% of all trading days have yielded losses for the S&P 500 Index. This drives most investors crazy and seeking a solution to their angst. But 79% of the time the index has gone up on a one year basis, 93% of the time it has been positive over 5 years and 100% over 12 years according to Returns 2.0. Insurance companies are happy to absorb the short term downside risk for purchasers of FIAs because the risk slowly disappears and the gains accrue and compound for them as the years go by.

Most FIA salespeople are insurance agents, not fiduciaries. They operate under a suitability standard — meaning the product only needs to be suitable for you, not necessarily in your best interest. FIA commissions are substantial — typically 6–8% of the initial investment, paid entirely by the insurance company. FIA salespeople can truthfully say "There's no cost to you." It's true that you won't pay a commission to purchase a FIA, but the cost of forfeited gains and surrender charges can be substantial. A $500,000 investment generates $30,000–$40,000 in commission to the selling agent. This incentive is rarely disclosed clearly, and it is one of the most powerful forces behind FIA recommendations.

Regulatory agencies have ramped up scrutiny of fixed index annuities in recent years, with the SEC, FINRA (the Financial Industry Regulatory Authority), and state insurance commissioners all taking action against insurance companies and financial advisors who have misrepresented fixed index annuities. FINRA has published explicit investor alerts warning that free-meal seminars are a primary vehicle for annuity fraud targeting retirees. In numerous state-level enforcement actions, agents have been sanctioned or had licenses revoked for:

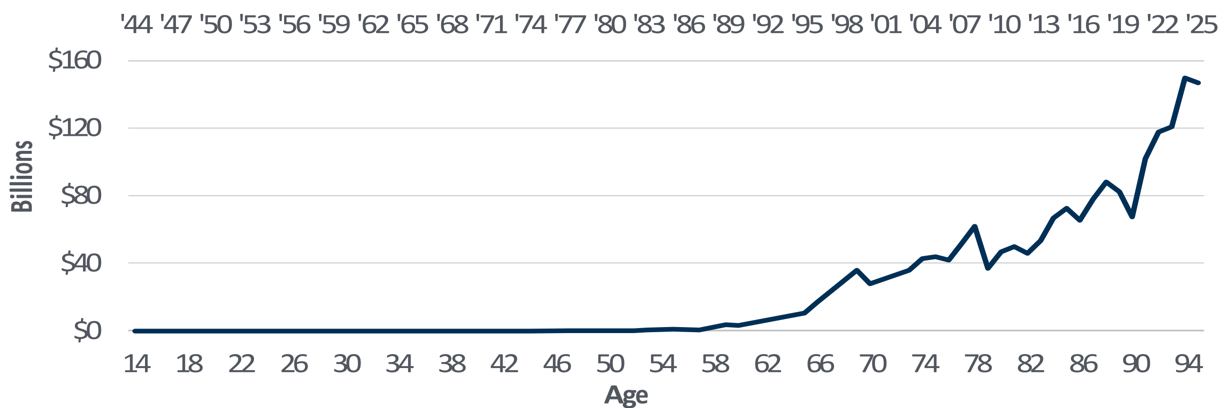
- Misrepresenting themselves as "retirement educators", not disclosing that the seminar's purpose is to sell annuities.
- Using fabricated or misleading return illustrations at seminars.
- Collecting personal financial information under the guise of a "free portfolio review" and using it to pressure sales.
- Targeting recently widowed individuals who have received life insurance proceeds or pension lump sums.

Although no one investment has all the characteristics of the Fantasyland investment, it is possible to create a portfolio that holds funds in different asset classes, each of which satisfies one or more of our criteria. Historically, stocks have been the best performing, inflation beating liquid asset over the long term. But over the short term they have had unsettling price volatility. CDs and U.S. Treasury securities rarely outpace inflation on an after tax basis but tend to moderate portfolio volatility during times of market turmoil. Short-term U.S. Treasury securities are the "safe haven" investment for global investors whenever the stock market spumoni hits the fan. Their low yield is the insurance premium investors pay for their price stability. An easy to understand portfolio of index funds — with the right allocation between equities, fixed income, and liquid reserves — can deliver the growth necessary to sustain distributions, outpace inflation, and keep short-term volatility within acceptable limits. It will possess risk and return characteristics close to those of the Fantasyland investment in a low cost tax efficient package with instant liquidity and no hidden expenses.

We live in an era in which many unproven investments are peddled as brilliant innovations. They are designed to take advantage of the fact that most potential marks (pardon me, investors) lack education in financial topics. The financial advisory business is full of people who promise more than they can deliver. This is a business in which you can make a small fortune by telling intriguing stories to people who cannot distinguish between fact and fiction. When pitched: "More money, less risk," many misguided investors say: "Where do I sign?" instead of: "This is too good to be true, what are you not telling me?" The global capital markets price equity risk 24/7/365 and it cannot be eliminated, although it can be hidden or transformed into a different type of risk.

Returning to the original question about the church's endowment fund, preserving principal should not be the goal of the portfolio. A proper conservative goal would be to preserve "purchasing power" - in other words, portfolio growth that keeps up with inflation. Unfortunately, with the fixed income portion of the portfolio in the safest bonds, CDs and cash, the best that can be hoped for is a return that approximates the rate of inflation. If the CD interest is withdrawn and spent every year, then the real (inflation adjusted) value of the endowment fund will decline over time. Putting a portion of the endowment fund into a total stock market index fund will help sustain its purchasing power but will likely lead to years in which the fund loses money, to the dismay of its trustees who, I suppose, don't understand that preserving principal is not as important as preserving purchasing power. So, my advice is, stick with the CDs.

Warren Buffett's Net Worth



Last month I mentioned the benefit of starting to invest as early as possible because the last doubling of your portfolio is what puts you over the top. This chart from First Trust is a pictorial example of that truth. It shows Warren Buffett's net worth from the time he made his first stock investment of $115 at the age of 11. Warren Buffett didn't become a billionaire until he was over 50. Today, his net worth is around $147 billion, meaning over 99% of his wealth was accumulated after turning 50. His wealth accumulation is a testament to the power of time and compound growth. The earlier you invest, the sooner compounding works its magic, potentially turning modest early investments into substantial wealth over time. The vertical scale of your wealth accumulation may never be measured in billions, but building meaningful wealth over time isn't limited to stock market wizards, it's accessible to anyone with patience, discipline, and time on their side.

Disclaimer - The information in this newsletter is educational in nature and should not be considered as personal investment, tax, or legal advice. Each reader must determine how its content should be applied to their investment portfolio. This newsletter is not a solicitation to sell investment advisory services where such an offer would not be legal. Investing in stocks and mutual funds involves risk and the potential loss of principal. Historical data has been obtained from sources believed to be reliable. Past performance is not an indication of future returns. The calculations or other information in this newsletter regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are shown for illustrative purposes only. Unless otherwise noted, rates of return reflect historical annual compounded total returns including the reinvestment of dividends but do not include taxes, fees, or operating expenses. If included, these additional costs would materially reduce the results. Index performance is provided as a benchmark and is not illustrative of any particular investment. It is not possible to invest directly in an index. All expressions of opinion are subject to change. OCFP accepts no responsibility for losses arising from the use of the information contained herein.