BUT INTEREST RATES HAVE TO GO UP! DON'T THEY?

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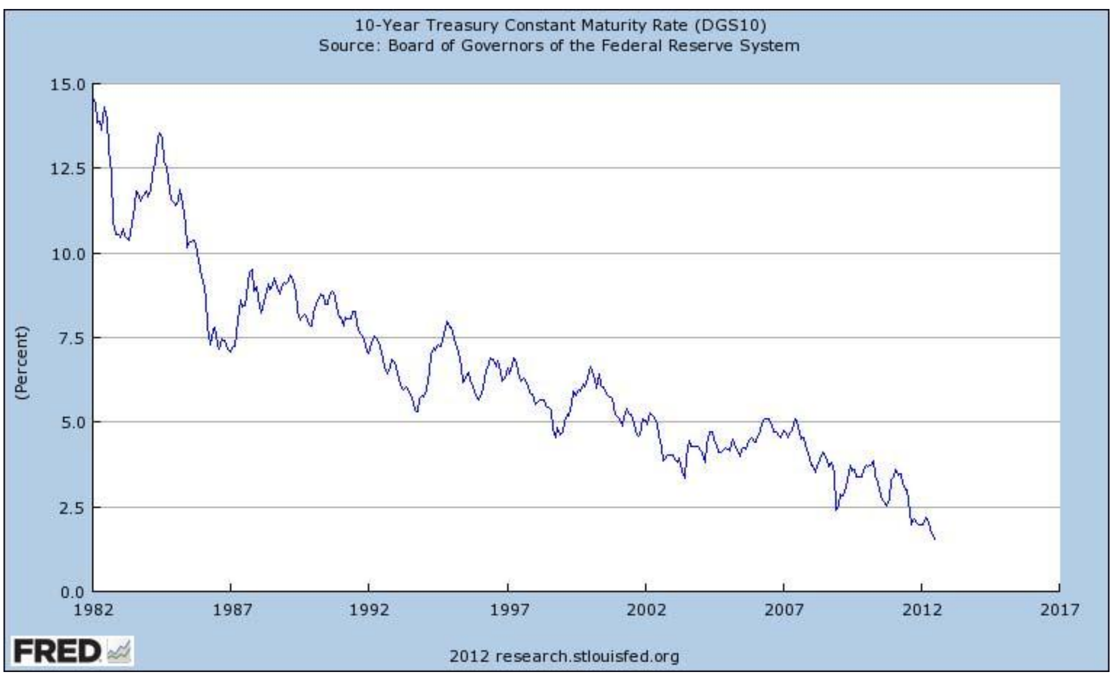
For at least a decade, the most common reason for opting against a structured settlement has been that interest rates are "too low". Everybody is certain that interest rates will rise, and they will be left behind. However, for the last decade, "everybody" has been wrong.

In fact, with some fluctuations, interest rates have been in a broadly downward trend for over 30 years. The following chart shows the interest rate on the 10-Year US Treasury from January 1982 to August 2012:[1]



1 Interest rate movements in US Treasury securities, which are published, are a reasonable proxy for interest rate movements in structured settlement annuities, which are generally unpublished.

Since 1982, the overwhelming majority of claimants received structured settlements that paid (or continue to pay) higher interest rates than they would receive today. And the potential annuitants who thought structured settlements were a bad idea because interest rates would surely rise, have seen rates fall instead.[2]

But That Was Then and This Is Now, Right?

But interest rates have to go up *now*, right? They *can't* go any lower, right?

As to the first question, I have no idea whether interest rates will go up or down. Neither do most of the so-called "experts" (though, whether interest rates go up or down, a good number of the "experts" will inevitably be "correct", and claim superior foresight). I do know two things: 1) if I could predict interest rates with certainty, I would be wealthy and retired; and 2) when the overwhelming majority of investors think something will happen, there is a strong chance the opposite will occur.[3]

As to the second question, interest rates most definitely *can* get lower. Just as the 10-year US Treasury fell from 8% to 4% to 2%, it can also fall from 2% to 1% to 0.5%. Everything is relative, and there are an infinite number of possible interest rate levels between 2% and 0%. That these numbers *sound* very low is of no significance – when interest was 8%, a rate of 2% sounded ridiculous. And when interest rates had been falling for 20 years, few expected them to keep falling for another 10 years (and counting).

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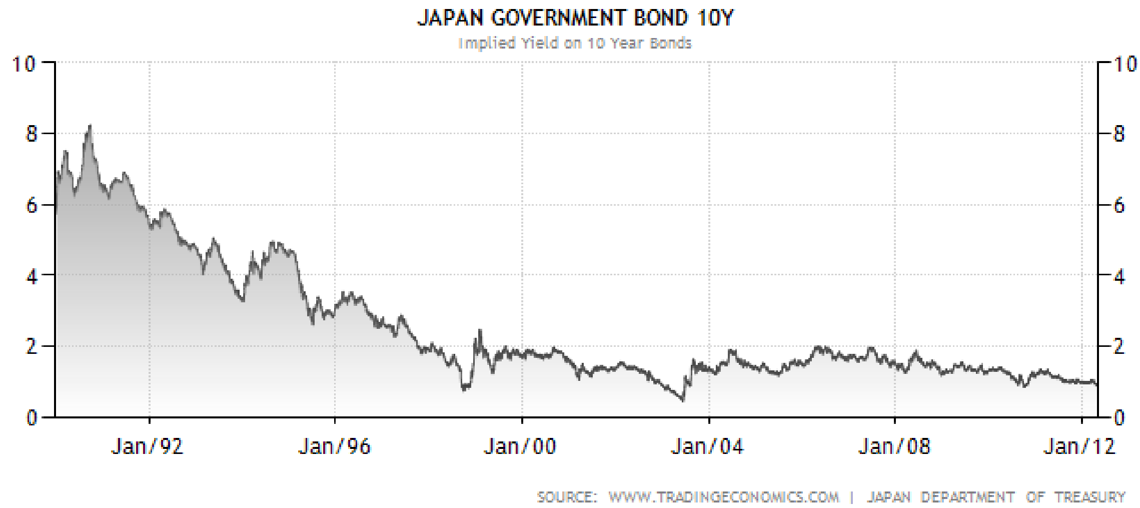
2 The stock market, on average, has also underperformed structured settlements, at least over the past decade or so. From 2002 to 2012, the S&P 500 returned approximately 1.5% on a price basis and 4% on a total return basis (*i.e.,* all dividends reinvested). From 2007 to 2012, it returned a loss on a price basis and approximately 2% on a total return basis.

3 This is not simply a case of cosmic irony. When investors share the same expectations, those expectations affect the price of the investment (or the interest rate), making the opposite more likely to occur. This is why stock prices are generally unaffected by announcements, good or bad, that are in-line with the market's expectations, and why contrarian investors are often among the most successful.

The following chart shows the interest rate on a 10-Year Japanese Government Bond, dating back to 1990:



As the chart demonstrates, except for a month here and there, the interest rate on the Japanese equivalent of the 10-Year US Treasury has been below 2% for the last 15 years. To be fair, there are unique characteristics of the Japanese economy that can cause low interest rates. However: 1) as far as economies go, the US and Japan have many more similarities than differences; and 2) the point is simply that low prevailing interest rates, over a very long period of time, are possible in highly developed economies.[4]

OK, But Interest Rates Can't Keep Falling Forever, Right?

Downtrends do not last forever (by definition, no trend lasts forever), so interest rates are likely to rise at some point. It is important, however, to maintain a healthy skepticism towards anybody who claims to know *when* interest rates will rise. Timing the market is extremely difficult, and is best left to professional investors who understand, and who are

[4] In fact, a number of prominent economists and investment professionals have noted that recent measures taken by the US Federal Reserve are similar to those blamed for creating Japan's persistently low interest rates.

capable of assuming, the risks involved. It is well-established that inexperienced investors are very likely to buy high and sell low. More importantly, even structured settlement recipients who are experienced investors, or who retain them for advice, are unlikely to be the types of investors for whom this sort of risk is appropriate.

Furthermore, even if the market could be timed correctly, waiting on the sidelines for interest rates to rise is a potentially dangerous strategy.

First, rates may continue to fall for some time. For example, in 2008, 10-Year Treasuries fell below 3% for the first time in decades. Understandably, some potential annuitants were tempted to wait for interest rates to rise from these historic lows. However, as of the date of this article, rates have instead fallen under 1.5%, and no matter what happens going forward, these potential annuitants may well have been better off locking in the "low" interest rate in 2008.

Second, even if the settlement money is invested productively while waiting for rates to rise (*i.e.*, the investor is not simply waiting on the sidelines), these investments are likely to subject the holder to risks and disadvantages that a structured settlement does not (*e.g.*, market risk, risk of loss, potential for fraud or mismanagement, etc.).

The Key Benefits of Structured Settlements Are Unrelated to Interest Rates

Structured settlements provide a personal injury victim and his or her family a unique opportunity to generate a guaranteed, tax-free, predictable stream of income, which is not subject to ongoing investment decisions or ongoing fees or commissions to advisors. The recipient can customize the timing and duration of this income, which is intended to meet medical or other basic needs. A structured settlement does indeed generate a competitive rate of return, but this is secondary to its other benefits.

An alternative investment may *promise* a higher rate of return, but in most cases this will involve exposure to risk of loss, market fluctuations, transaction costs, advisory fees, and/or other risks that result from the ongoing need for money management (e.g., bad advice, fraud, etc.). Or else, the *promise* could simply be based on past results, which are not necessarily indicative of future performance. On the contrary, future structured settlement benefits are guaranteed – past results are irrelevant.

Conclusion

There are valid reasons to opt against a structured settlement (*e.g.*, immediate cash needs), but a low interest rate environment is rarely one of them. First, interest rates may simply continue to fall. Second, even if interest rates do rise eventually, attempting to time the market is difficult and potentially risky. Third, structured settlements are designed to provide a guaranteed, tax-free, predictable stream of income. For structured settlement recipients, these benefits are significantly more important than interest rates.

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