A Question of Premium: Is Life Insurance a Sound Investment?

Life insurance may protect your family, but can it pad your portfolio?

Whole life insurance can make your portfolio more complete by offering steady balance and also help subsidize retirement planning.

By Lou CarlozoAug. 14, 2015 | 9:19 a.m. EDT+ More

If portfolio investments were people at a party, then the cool kids – growth stocks, real estate, retirement accounts and exchange-traded funds – would huddle in a closed circle. Those dull-yet-dependable bonds would stand just outside, trying to fit in. And alone in a corner, not far from the annuities, you'd have whole life insurance: complicated, frumpy and arguably not worth the time and trouble.

Indeed, the notion of skipping life insurance as an investment – and plowing the saved cash into more profitable areas – has its allure for some investors. Term life policies, while they don't build cash value, are more affordable, simpler to grasp and easy to comparison shop.

"If you're pricing out term and permanent life policies, and term will provide sufficient coverage, consider buying the term policy," says Melinda Kibler, portfolio manager with the Palisades Hudson Financial Group in Fort Lauderdale, Florida. "Use the difference in premiums to add to your investment portfolio, as opposed to using the permanent life policy as an investment option."

And so the question arises: Is life insurance a good investment at all?

"Life insurance products – whether they are term life, whole life or another variety – are meant to be financial protection for your heirs," says Jim Poolman, executive director of the Indexed Annuity Leadership Council. "They are not meant to be investment products and shouldn't be regarded as such, because they will never live up to products designed as investment vehicles."

"There is merit to the negative argument among non-annuity insurance products," says Andrew Murdoch, president of Somerset Wealth Strategies in Portland, Oregon. He cites the variable annuity universal life policy, which invests in sub-accounts such as mutual funds under a life insurance wrapper. "This type of account has to perform well enough to pay for the cost of insurance and provide growth over and above it."

Murdoch characterizes life insurance as "more a peace of mind play than a growth play." But he adds: "Not all insurance investments are bad. Annuities issued by insurance companies are generally good and the only product offering guaranteed income for life."

If not all are bad, could insurance investments possibly be good, then?

"Most circumstances don't call for whole life insurance with the exception of estate planning, buy-sell arrangements, executive benefits or pension maximization," says Mike Chadwick, CEO of Chadwick Financial in Unionville, Connecticut. "Almost all other situations call for term insurance, and it's far less costly."

That's not to say others don't reap rewards from whole life – those who push it, that is. "Insurance is certainly sold, and there are very sophisticated sales techniques to sell it," he says.

But some contend that most objections to whole life are simply unfounded.

"Insurance has been a smart investment for years," says David F. Keefe III, a financial adviser for 4-Point Financial in Waltham, Massachusetts. Keefe cites the Great Recession as an example: "If you needed cash from your portfolio in January 2009, and you had $50,000 in a mutual fund and $50,000 cash value insurance, where would be the best place to take it from? Over a six-year period to now, that could have saved you $50,000 in additional mutual fund growth."

Whole life can also build up tax-sheltered savings that can subsidize retirement planning, and make portfolios more complete by offering steady balance, insurance experts say.

"Insurance products are used to complement and balance the risk of an investment portfolio," says Mark S. Cardoza, founder of the Retirement Education Resource Center of North America. "Whole life insurance within a mutual company will produce 6 to 8 percent growth between interest and dividends during a down market, thus at times outperforming the market."

Poolman says that annuities, a close cousin of life insurance and sold by the same agents, can serve a key purpose in a portfolio. Those products guarantee income streams upon retirement; "It can never be outlived, which is a solution to one of the most significant financial obstacles aging Americans face today," he says.

And while it's not an investment move, life insurance policies with cash value – whole, universal and variable – can serve as part of a broader tax strategy.

"Once cash value is built up in your policy, you can use it as collateral to take a loan from the insurance company," says Sean A. Quigley, author of "The Cash Play: Capitalizing on the Opportunity Value of Cash."

Here's how it works: "You set up your own unstructured loan with no repayment schedule, which allows you to skip traditional bank financing. Since it's a loan and not a direct distribution, you do not owe any income tax," Quigley says.

Even if you want to bypass whole, don't overlook life insurance as a whole; that's the equivalent of flying without a financial safety net. "The question of whether or not to buy whole life shouldn't be confused with whether or not to buy life insurance at all," says Jeremy Hallett, founder and CEO of Quotacy, an online term insurance marketplace. "Everyone needs life insurance if they have others who depend on them financially in any way."

And so let's return to the portfolio party, where whole life may never make it into that charmed investment circle. But it shouldn't be kicked out on a whim, either – it might just be, if you will, a life saver.

"Insurance and investment portfolios should be kept separate and managed separately," Cardoza says. "The purpose for investing in insurance products should be to protect the individual from the risk in an investment portfolio – or life in general."