

User Guide to the Indextus

Drawdown Scenario Planner

Introduction

This User Guide will help you navigate the Drawdown Scenario Planner (available, free-to-access, at www.indextus.com/drawdown), giving examples of its use and how it can aid discussions with clients. It is only for use by professional advisers in the UK.

As income drawdown becomes increasingly used in the retirement planning of individuals, especially where a legacy bequest of some sort is preferred, challenges such as sequence risk need to be addressed. Following a research project on the subject, we published a white paper detailing how to address some of these issues by maximising the benefits of multi-pot investing. This splits a client's investment assets into three segments or 'pots', namely Cash, Reserve and Investment. An annual rebalance then keeps the pots aligned, with money for the year ahead in Cash, topped up by either the Reserve or Investment pots. For more information on the decision rules used, see our note on the topic – 'Implementing a successful multi-pot strategy'.

The Drawdown Scenario Planner allows you to consider various multi-pot scenarios, by altering the initial wealth and income requirement of the client, along with the proportions allocated to Cash, Reserve and Investments. Cash returns, inflation and time period of analysis are also adjustable. The output generated gives a projection based on data from 1990 to 2019. The Reserve returns are a peer-based equal mix of corporate bond and absolute return Funds, rebalanced annually. The Investment returns are based on a balanced multi-asset peer group of Funds. Our research shows that the use of the Reserve is advantageous when certain rules are applied at annual rebalances. It is these rules that drive the calculations of the tool and give advisers the ability to test different scenarios, with or without the various pots, to determine which income drawdown strategy is suitable for their clients.

Getting started

On the website, complete the relevant fields (shown here on the right). Begin with the time period of analysis. The default is 20, but 10, 15 or 25 years can also be used. This will convert the data (since 1990) into a series of historical paths and use these to generate the results. For example, since 1990 there have been 11 20-year paths (1990 to 2009, 1991 to 2010, etc...).

Next, enter the total wealth of the client to be used in the analysis (a default of £1,000,000 is given) and the desired income for the year ahead (£40,000 is the default). The inflation rate field (defaulted to 2%) can then be adjusted to change how this income amount increases over the lifetime of the analysis.

The expected return on cash can also be changed, with a default of 0% set initially. A cash only illustration can also be shown by ticking the relevant box.

Finally, our research concluded that 'number of years' is the most appropriate way to consider how much money should be allocated to the Cash and Reserve accounts. This is based on the money to be drawn in year one, but the analysis calculates the adjusted amounts depending of the inflation rate provided.

Finally, click on the 'calculate' button to generate the report.

Planning period (years)

 Accepts: 10", "15", "20" or "25"

Client's total asset wealth at start (£).

Money to be drawn in year one (£).

 Set expected inflation to 0% to keep constant for all subsequent years.

Expected % return on cash.

Expected % inflation rate.

 Drawdown money is increased by inflation each year.

Cash only illustration?

Number of years of drawdown money held in Cash.

Number of years of drawdown money held in Reserve.

CALCULATE

The report generated

Introductory text at the top of the report and a comment on the assumptions used (given below the charts) give a summary of the inputs used and some explanatory notes.

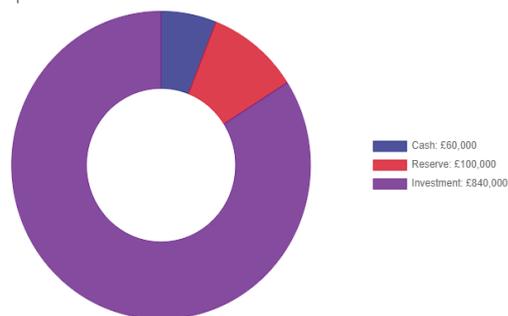
The first chart shows the initial split between the various pots selected. In this example, the £40,000 has been translated into 1.5 years in Cash (£60,000) and 2.5 years in Reserve (£100,000). The remaining balance (£840,000) is shown in Investments (assumed to be a balanced multi-asset portfolio). If the Reserve field is set to 0, then only the Cash with the balance allocated to Investments is calculated. Similarly, if the Cash only illustration is ticked, this is reflected by not showing the split data.

A representation of the projected future income withdrawals of the period of analysis is given. These withdrawals take the initial required income (in this example £40,000) increased annually by the rate of inflation. To reflect a constant level of income, set the inflation rate to 0 in the field. On screen, hover the cursor over any column on the chart to reveal the underlying data point.

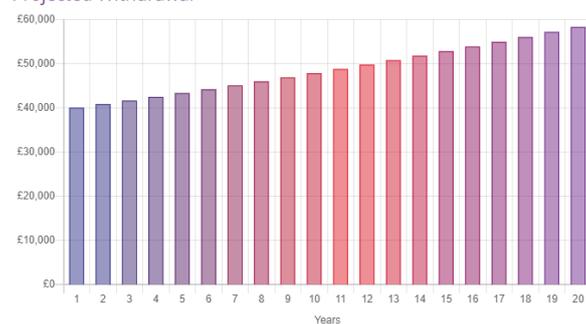
To add further colour to the Initial Split pie chart above, the analysis then looks at each of the historical paths in the analysis and averages them into the various pots selected. In this case, all three pots have been used in the scenario. This gives a projected set of asset splits based on averaging all the individual years in the analysis. As cash is withdrawn in the final year, but the rebalance is not calculated, this accounts for the dip in cash at the end of each analysis. Again, hover the cursor over the chart to reveal the underlying data points.

Finally, we look at each of the historical paths in the analysis to see what returns would have been in the past. For each time period of analysis selected, the relevant paths are calculated from 1990 to 2019. The chart then selects which path did best, which worst and the closest to middle. An upper middle and lower middle set of years are also calculated. Each of these past return comparisons are then shown on the chart, from the highest final-value return to the lowest. This gives some context of the range of outcomes that may occur in the future, but are only an historical guide. In the example shown, it can be seen for a client with a starting value of £1 million and taking a withdrawal of £40,000 each year (increased annually by a 2% inflation rate), the year you start investing has some material consequences. From a start in 1991 (in the midst of the end-80s recession) with an ending value in 2010 of £2.1m; through to a starting year of 2000 (just ahead of the dot-com bust followed by the Great Financial Crash) and ending in 2019 with a wealth of just over £400k, the results give a guide to future paths. By running the scenarios with and without the various pots and at differing levels of allocation, the end values in this chart can be compared to test for client suitability.

Initial Split



Projected Withdrawal



Projected asset split using historical averages



Past return comparisons



Conversations with clients

For a client with a lump sum saved, of say £1 million, the academic guidance on what is a sustainable, inflation adjusted, level of income is £40k. This 4% 'safe withdrawal rate' is a useful starting point for analysis but changing it (along with different levels of expected inflation) will show clients the impacts on their potential future wealth.

One useful way the Drawdown Scenario Planner can be used is to build up a picture of the various options available. In the following example, a 20-year period of analysis has been used as a starting point for considering income in retirement. First, tick the cash only illustration as this shows how the income requirement (projected withdrawals) grows to over £58k over the period (assuming a 2% inflation rate). By not investing, the annual money withdrawn will have depleted the starting cash completely by about the 20th year.

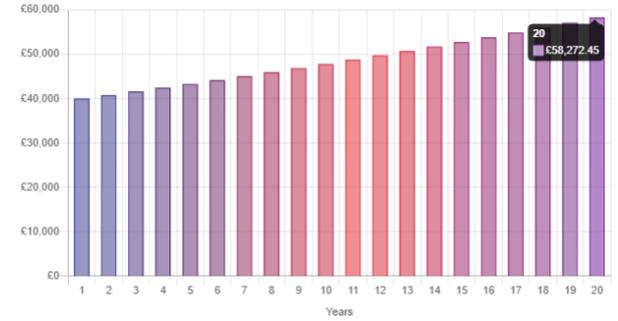
However, a balanced multi-asset portfolio will likely form the backbone of any growth plan. This can be shown next, by unticking the cash only illustration, setting the Reserve to 0 and deciding on how many years of cash you want to have in hand. The standard approach is likely to see 2.5 years' worth of desired income held on deposit, with the rest invested. The most interesting chart generated now is that of the past return comparisons. This considers the best and worst 20-year periods (or whichever planning period is selected) since 1990, along with the mid, upper-mid and lower-mid periods. In this example, if a client had experienced the returns of 1991 to 2010, they would have withdrawn their required income and still have doubled their original lump sum. But, starting again in 2000 would have cut their value by nearly two thirds. This highlights the problems of sequence risk.

Finally, therefore, consider the impact of introducing a Reserve. In this case, the cash held can be reduced, to say 1.5 years (assuming an annual re-balance but with time to have meetings and complete the relevant paperwork), with 2.5 years of 'rainy day' money held in Reserve. Now check back with the past return comparison and see how having the ability to take money from Reserve and so not depleting Investments in down years changes things. As can be seen, the highest end-value has increased modestly, while the lowest end-value is more materially improved, by over £80k.

Although the tool simplifies the Investment pot to a single balanced portfolio a more complex portfolio of holdings will likely be used. This would include tax allowances, risk profiled investments and what is suitable based on other assets held. The tool does not require this complexity to remain meaningful, offering advisers the flexibility to tailor their advice to the needs of their individual clients.

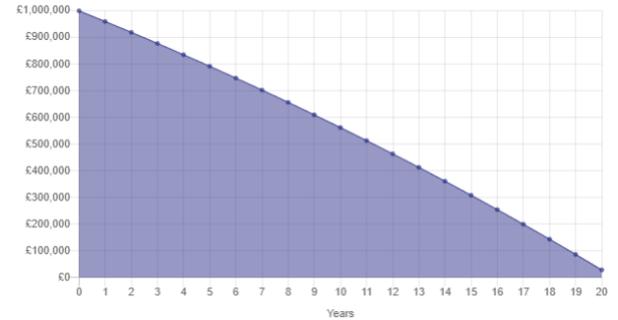
First, consider the likely growth in income withdrawals...

Projected Withdrawal



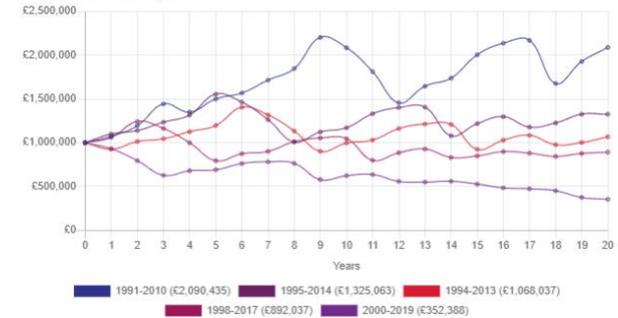
...and note how quickly they eat into a cash lump sum...

Projected asset value



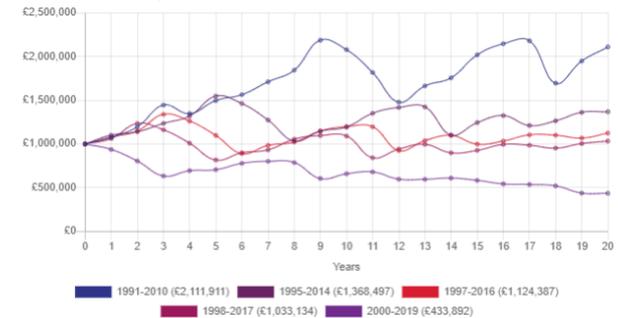
...adding investments helps maintain wealth, but is volatile...

Past return comparisons



...using a Reserve alleviates this sequence risk, adding value.

Past return comparisons



Printing and saving reports

Once a report has been generated, a 'print results' button is displayed (on the left of the screen under the 'calculate' button). This will convert the report to a two-page A4 portrait document ready for either printing or saving as a pdf file.

Additional resources

The Drawdown Scenario Planner is just one element of a wider project Indextus set up to consider the use, and address some of the issues connected with, income drawdown as part of an individual's decumulation strategy. A white paper giving a more in-depth look at how multi-pot investing can tackle issues such as cash drag, cascade deficiency and sequence risk is available on request from support@indextus.com. Further supporting literature is also available from the website - www.indextus.com/drawdown.

Important Information - Past returns may not reflect future performance. For information only. Not financial advice.

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