

Forecaster quick guide

What is a stochastic forecast?

Investment returns are uncertain. One way to predict how they might behave is to simulate returns, based on what we know about how investments seem to move. A path is simulated with the same expected properties as the investment (in terms of how much it is likely to move each month and how fast it tends to drift upwards over time). A single path does not give any useful information, but given hundreds of paths, the expected shape of potential future outcomes starts to show. Taking the mid-point of the thousands of paths shows the value which is equally likely to be higher or lower than the actual investment value at that time. This is a good potential guide as to the expected return.

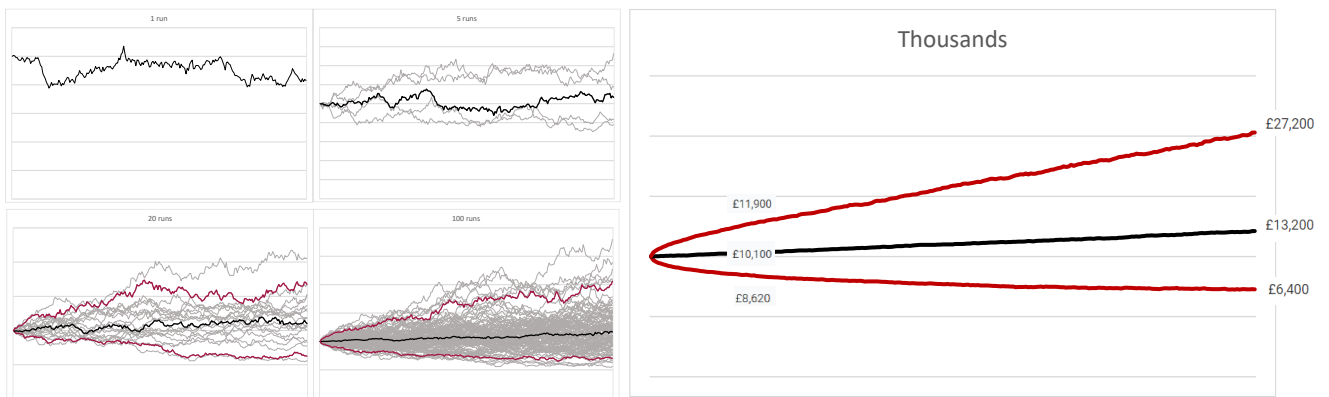


Figure 1: graphs of 1, 5, 20, 100 and 6,000 runs, the black line is the midpoint of the runs, and the red lines show the poor and very good performance bounds.

The runs are an illustration of the “bumpiness” of an investment path, but no individual path can be taken as an indication of performance. More paths give a smoother midpoint and a better indication of the distribution of investment values. With thousands of runs, an indication of poor and very good performance can be seen. The poor performance (labelled in the software as “Be prepared for this”) is the value at the border of the lowest 5% of runs at that given point in time. Similarly, the “Be pleasantly surprised” line is the border of the top 5% of runs.

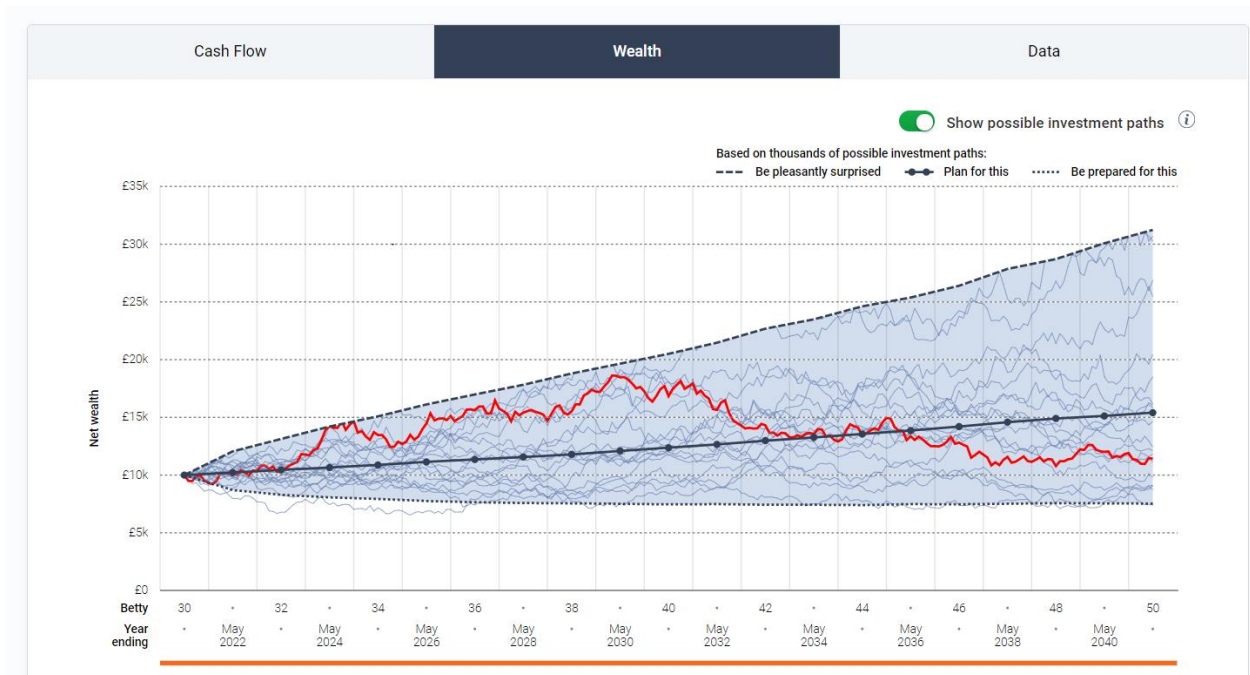
Value of investment	Be prepared for this	Plan for this	Be pleasantly surprised
Initially	£10,000	£10,000	£10,000
After 1 year	£8,620	£10,100	£11,900
After 5 years	£7,460	£10,700	£15,400
After 10 years	£6,880	£11,500	£19,200
After 20 years	£6,400	£13,200	£27,200

Figure 2: losses and gains table

The potential losses and gains table is a snapshot of the forecast at various times.

The paths correspond to values in the losses and gains table. There is no single path that follows the paths of poor, average, and excellent performance (labelled “Be prepared for this”, “plan for this” and “Be pleasantly surprised”) so the columns on this table do not represent an investment path. Just because an investment is in line with the “Be prepared for this” after the first year, does not mean it will continue to track this path in the future. Some runs might experience times close to any of these ranges, or outside. Similarly, the poor or very good investment

return can not easily be broken down to a growth rate. The losses and gains are extreme in the first year (as it’s not uncommon to have a bad year) but the annualised value over 20 years is much less extreme (it is very uncommon to have 20 bad years in a row).



How are charges used in Dynamic Planner?

Client profiling – risk profiling – in the ‘Potential losses and gains’ table

- ▶ The Risk profiling section has no charges.

Client review

- ▶ The client review is an entirely backwards looking tool, and so has no charges.

Cash flow

- ▶ Assumed Charges inputted in the arrangement tab - one percentage only.

Recommendations

- ▶ Charges – on screen:
 - ▶ If the ‘basis of forecast’ filter is set to ‘Your risk profile’ or ‘Current risk profile’, no charges are included in the forecast, as current charges are backwards looking and so inappropriate for the recommendations
 - ▶ If the ‘basis of forecast’ filter is set to ‘Recommended risk profile’, we send the recommended charges as entered by the user to the forecast. Any ‘initial fees’ are not applied; this is looking at the future growth of a pre-existing fund.
- ▶ Charges – in the report:
 - ▶ If the user has NOT toggled on the ‘Include charges statement in report’ option, the forecast chart in the report contains no charges, not even benchmark ones.
 - ▶ If the user has toggled on the ‘Include charges statement in report’ option, the forecast chart in the report includes the recommended charges as entered by the user (even if they are 0.00, and excluding the ‘initial charges’, if any).



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