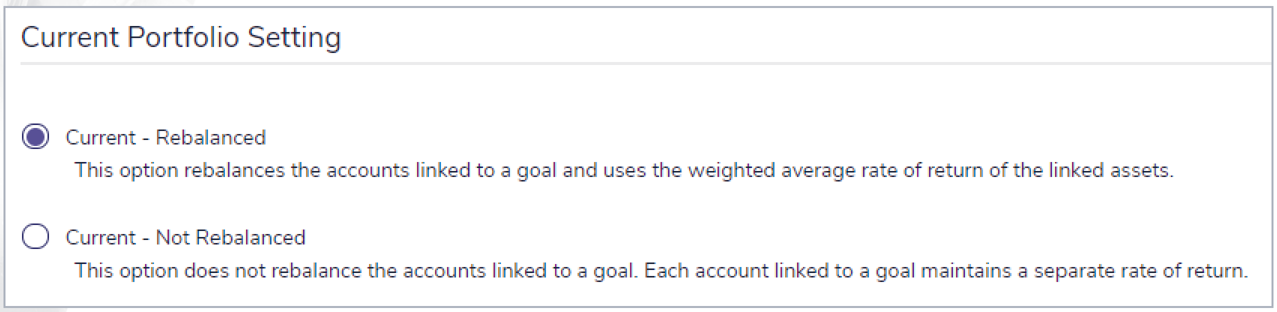
Effects of the Current Portfolio Setting on a Plan

Functions Addressed in this Document:

- What is the Current Portfolio Setting and how does it affect the plan?



Plan Management — Assumptions - Current Portfolio Setting

With asset allocation being a significant factor in a portfolio's performance, the **Current Portfolio Setting** offers a range of options to represent the clients' allocation. While various factors (i.e., varying allocations per goal and account type within a specific goal) apply primarily to the proposed plan, the asset allocation — or the option selected for **Current Portfolio Setting** — affects both current and proposed plans thus acting as a rebalancing option.

While this document applies to both **Level 1** and **Level 2 Plans**, it will focus primarily on the **Current Portfolio Setting** options in a **Level 2 Plan** with both the Morningstar Asset Allocation option and the **Retirement** module selected.

What is the Current Portfolio Setting and how does it affect the plan?

Asset allocation and the balance of asset class weightings in a client's portfolio often play an important role in plans. While some advisors evaluate their clients' asset allocation at the start of the planning process and then allow the percentages to drift with the market fluctuations, other advisors regularly (often annually) rebalance their clients' portfolio to bring the asset allocation back to its original percentages.

To accommodate advisors rebalancing preferences, NaviPlan allows users to select a default rebalancing strategy, either **Current - Rebalanced** or **Current - Not Rebalanced** (selected by default), under the **Current Portfolio Setting**.

- **Current - Rebalanced**: All accounts are rebalanced by a weighted average rate of return (ROR) applied by NaviPlan. In cases where the advisor regularly rebalances the accounts to bring the percentages back to their original values, this selection is often useful as the clients' return stays constant, and the level of risk fluctuates less.

- **Current - Not Rebalanced**: All accounts continue to earn their current ROR as the weighted average fluctuates. This strategy is often useful for advisors whose clients maintain their existing accounts throughout the life of the plan, regardless of the change in their asset class percentages. While this strategy can increase the portfolio's return, it can also cause an account with a higher return, and a higher risk, to dominate the portfolio over time, thus increasing the clients' risk exposure. To illustrate the difference between the two portfolio settings, we will look at each as applied to a specific scenario:
- Robert and Sarah plan to retire in 2035. Their retirement portfolio consists of two RRSP accounts; each account has a market value of $100,000 as of January 1, and neither has a savings strategy in place.
- Robert's RRSP is invested entirely in international equities; it earns an 11.06% rate of return and its risk as measured by standard deviation is 23.45%.
- Sarah's RRSP is invested entirely in short-term bonds; it earns a 2.94% rate of return and its risk as measured by standard deviation is 3.76%.

Example 1: Current - Rebalanced

When using the Current - Rebalanced setting, NaviPlan® calculates the weighted average for the accounts linked to the goal, then applies that weighted average rate of return to each account. In the case of Robert and Sarah, whose current portfolio is split evenly between their RRSP accounts, the weighted average rate of return is 7.00%, which is calculated as follows:

MV = market value; **PV** = portfolio value

$$\left[\left(\frac{\text{MVAcct A}}{\text{PV}}\right) * \text{RoRAcct A}\right] + \left[\left(\frac{\text{MVAcct B}}{\text{PV}}\right) * \text{RoRAcct B}\right]$$

For example:

$$\left[\left(\frac{\$100{,}000}{\$200{,}000}\right) * 11.06\%\right] + \left[\left(\frac{\$100{,}000}{\$200{,}000}\right) * 2.94\%\right] = 7.0\%$$

As both Robert and Sarah's accounts grow identically and each continues to make up 50% of the retirement portfolio, their asset allocation percentages remain at 50% international equity and 50% short-term bonds, and their exposure to risk remains constant.

When looking at the **Current Plan** scenario, we can see that when using a weighted average return of 7.00%, their retirement scenario achieves 39% goal coverage. As well, throughout the pre-retirement and retirement periods, Robert and Sarah's ROR, and subsequently their exposure to risk, remains constant.

> **DID YOU KNOW?** Because the **Current - Rebalanced** setting uses a weighted average rate of return, the order in which accounts are redeemed for goal coverage can be affected because accounts grow at the same rate.

Example 2: Current - Not Rebalanced

When using the **Current - Not Rebalanced** setting, each account earns its stated ROR; in this case, Robert's RRSP earns 11.06% and Sarah's 2.94%. Looking at the following **Asset Summary** reports, we can see that the current portfolio is initially split evenly between the two accounts, as the start-of-year market value for each is $100,000.

Year	Start of Year Market Value	Total Reinvested	Deferred Growth	End of Year Market Value
2013	111,060	9,929	2,354	123,343
2014	123,343	11,027	2,615	136,985
2015	136,985	12,246	2,904	152,136
2016	152,136	13,601	3,225	168,962
2017	168,962	15,105	3,582	187,649
2018	187,649	16,776	3,978	208,403

Reports — Net Worth — Assets — Single Asset Summary *(Robert)*

Year	Start of Year Market Value	Total Reinvested	Deferred Growth	End of Year Market Value
2013	102,940	3,026	0	105,966
2014	105,966	3,115	0	109,082
2015	109,082	3,207	0	112,289
2016	112,289	3,301	0	115,590
2017	115,590	3,398	0	118,988
2018	118,988	3,498	0	122,487

Reports — Net Worth — Assets — Single Asset Summary *(Sarah)*

In this way, when using **Current - Not Rebalanced**, the asset allocation in the current plan is dynamic, in that the weighted average ROR fluctuates from year to year. While with the increased ROR David and Susan achieve 100% goal coverage, with this increased return comes increased risk.

While the example here is for a retirement goal using only RRSP accounts, the **Current Portfolio Setting** affects all of the clients' accounts (including unlinked accounts) and applies in the same way to education, major purchase, and emergency fund goals.

In plans where the goal is being funded using more than one account type (non-registered, registered, Roth), NaviPlan® calculates the weighted average for each account type. For example, if the retirement goal is being funded with both non-registered and registered accounts, NaviPlan® calculates a weighted average for each account type.

When making changes to the **Current Portfolio Setting** selection under **User Preferences**, it is important to remember that a change to this setting (as with all other **User Preferences** selections) will only affect new plans. In an existing plan, this setting can be overridden on the **Plan Management** section – **Assumptions** – **Current Portfolio Setting**.

DID YOU KNOW? Because the **Current - Not Rebalanced** option is used in the Financial Assessment, when you promote a Financial Assessment to a Level 1 or Level 2 Plan, this default is maintained, regardless of the selection made in the **User Preferences** menu. In contrast, a newly created plan (not a Financial Assessment) will use the **Current Portfolio Setting** selected.