



# **Profiles Professional Desktop**

## **Distribution and Reallocation Self-Study Guide**

**Version 8.0**

EISI, Winnipeg

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# Distribution and reallocation

This self-study guide describes some of the strategies you may use to help your clients achieve their objectives.

## Learning objectives

This module will enable you to

- Designate assets to specific objectives
- Control the asset distribution order
- Reallocate and rebalance assets
- Interpret distribution and reallocation output

This guide will show you how to easily assign an asset to a goal. You will learn how to completely control the order in which assets are redeemed. You will learn to reallocate assets at multiple points of time to keep asset classes with higher rates of return from dominating the portfolio over time. Lastly, you will learn to use reports to explain how assets may be distributed and reallocated.

## Learning tools

This module includes some practice exercises using one of the sample clients provided in the application. If you want to keep this sample client case unchanged, open the *Sample 4 - Comprehensive (Jones - non-tax).fpx* client case, and then save it with a new case name.

To open and save the client case, follow these steps:

1. Start Profiles Professional.
2. Click **Open Existing Case**, and then click **Open Sample Case**. The *Open Sample Case* screen opens.
3. Click the **Open** link beside *Sample 4 - Comprehensive (Jones - non-tax).fpx*. A *Data Conversion* dialog box may appear to warn you that the planning preferences in this case differ from the global planning preferences. Click **Close**.
4. Click the **File** menu – **Save As**. The *Save Client Data As* dialog box opens.
5. Save the case with a unique name, for example, *Jones – Distribution Reallocation Self-Study Guide*.

Please keep in mind that the case we are using for this self-study guide does not have the *Tax-Sensitive* option selected.

## Designate assets to specific objectives

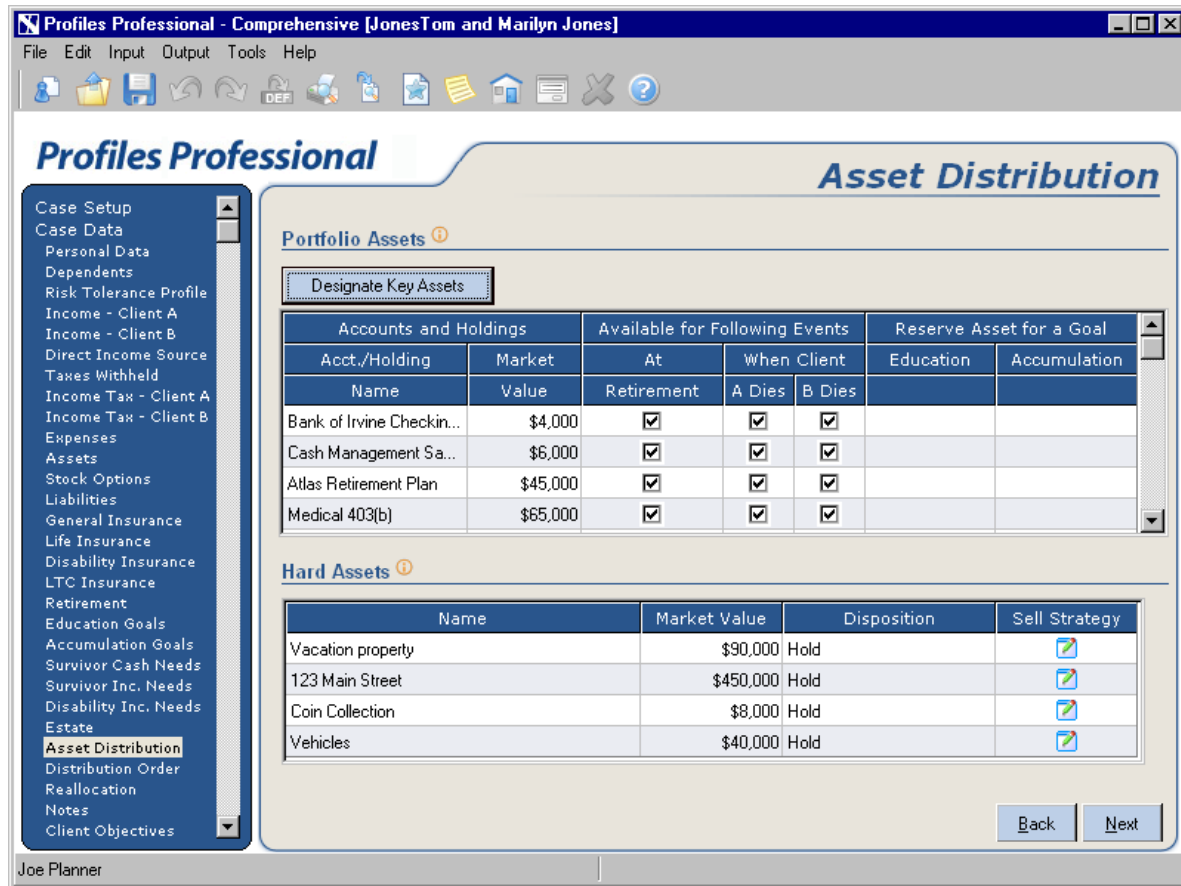


Figure 1: Case Data – Asset Distribution

The *Asset Distribution* screen allows you to designate which assets and holdings are available at retirement and death, and to assign assets to a particular goal, such as education or accumulation. By default all portfolio assets are available for both retirement and survivorship; the total market value of the asset is available to be liquidated when these events occur. You can reserve a portfolio asset for either education or accumulation, but not both.

In the *Education* column, you can specify who the education goal is for. In the *Accumulation* column, you can select a specific accumulation goal.

Hard assets include real estate property, personal property, and business assets. The *Disposition* column displays either the word *Hold* or *Sell*, depending on whether or not a sell strategy has been implemented.

Clicking the *Sell Strategy* button opens the *Sell Asset* screen where you can enter the sale details including the timing of the sale (based on an event or specified year), expenses such as closing costs and commissions, etc. If a liability is linked to the asset, it will be paid off at the time of disposition. If

the sale is part of a strategy to downsize the clients' residence and then invest the proceeds, enter the size of the replacement residence in the *Percent to Downsize* field. For example, if the new home costs 75% of the projected value of the original home, enter 75%. The resulting 25% difference less expenses, liabilities, and taxes will be invested in the lump-sum asset.

Clicking the *Designate Key Assets* button opens the *Designate Key Assets* screen.

## Designate surplus and lump-sum assets

The list below contains the assets which are available for retirement and at death and have not been reserved for a goal. The Surplus Income Asset will receive excess income, including RMD, after total needs have been met. The Lump-Sum Asset, will receive amounts from insurance, lump-sum income sources, proceeds from the sale of hard assets, future loans, etc.

Name	Surplus Income Asset	Lump Sum Asset
Bank of Irvine Checking Account	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Cash Management Savings Account	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Bank of Irvine CD	<input type="checkbox"/>	<input type="checkbox"/>
Fidelity Global Balanced	<input type="checkbox"/>	<input type="checkbox"/>
AIM Charter A	<input type="checkbox"/>	<input type="checkbox"/>
Putnam Voyager A	<input type="checkbox"/>	<input type="checkbox"/>
CA-Muni Tax Free Bond	<input type="checkbox"/>	<input type="checkbox"/>

Close

Figure 2: Case Data – Asset Distribution – Designate Key Assets button

On this screen, non-qualified assets that are available for retirement or survivorship, but not linked to an education or accumulation goal, can be designated to receive surplus income and lump-sum funds, such as inheritance, life insurance proceeds, etc. Assets that can be used to receive these funds include bank accounts, investment accounts, and deferred annuity accounts. Only one account can be selected in each column.

- *Surplus Income Asset* – If inflows exceed outflows, this asset will receive any excess income, including required minimum distributions, after total needs have been met. This applies regardless of who owns the asset.

**Hint:** Under *Planning Preferences – Needs Preferences*, you can choose to assume surplus income is spent, not saved.

- *Lump Sum Asset* – This asset will receive funds such as an inheritance, life insurance proceeds, or proceeds from the sale of a hard asset. This applies regardless of who owns the asset.

**Hint:** It may be helpful to create a placeholder asset with a zero dollar current market value for the sole purpose of holding surpluses.

In *Comprehensive* and *Express* modes, these strategies are illustrated in retirement and survivorship reporting only. In *Detailed Cash Flow* mode, these strategies are illustrated in all years.

## Control the asset distribution order

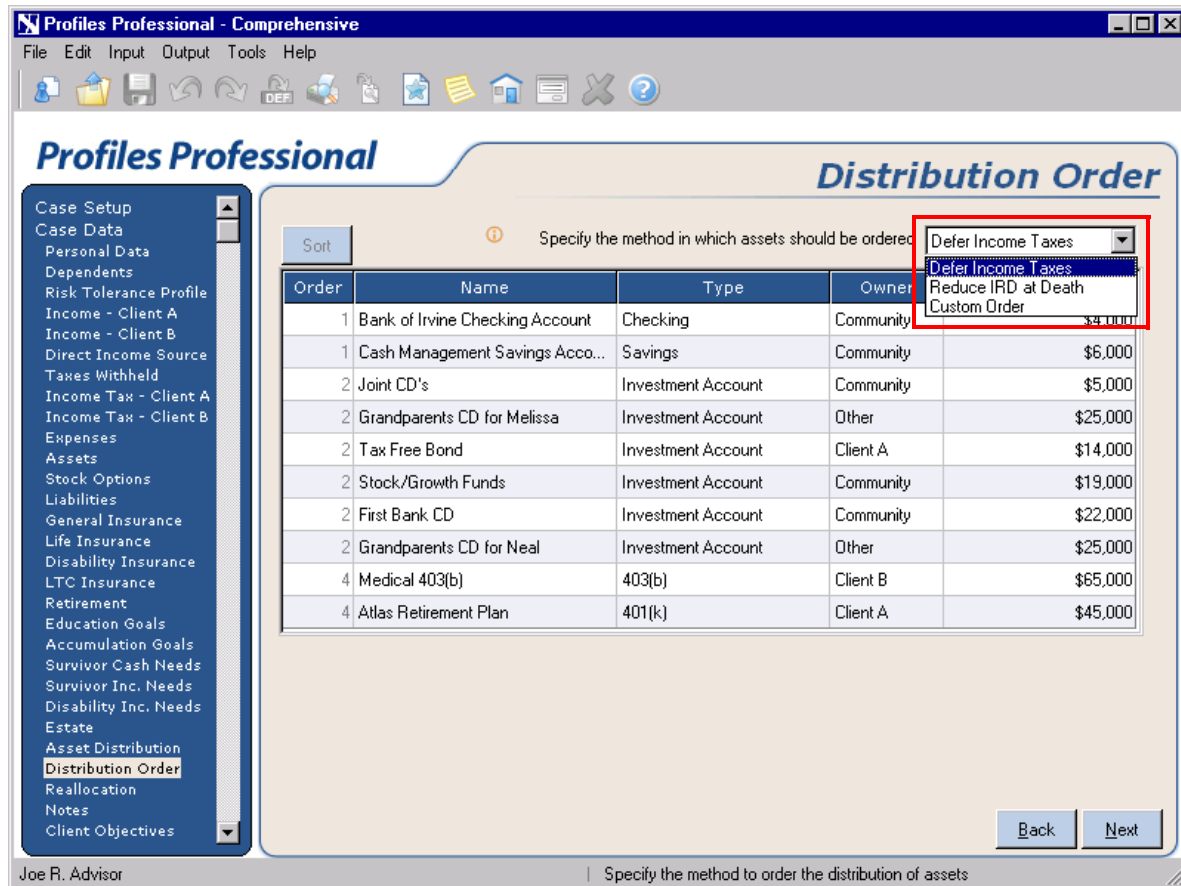


Figure 3: Case Data – Distribution Order

The *Distribution Order* screen in version 8.0 replaces the *Liquidation Order* screen in version 7.6. On the *Distribution Order* screen, you can control the order in which investment assets will be liquidated to cover retirement or survivorship needs by assigning an order number to each asset. Please note that pre-retirement needs are only covered in *Detailed Cash Flow* mode.

From the *Specify the method in which assets should be ordered* list, three distribution order options are available.

- *Defer Income Taxes* – Orders assets in the most tax efficient manner. This is determined by asset type. For example, bank accounts are distributed before investment or qualified assets. This option is selected by default.
- *Reduce IRD at Death* – Reorders the list so that qualified assets are used prior to other investment assets to reduce the income in respect of a decedent.
- *Custom Order* – Allows you to control the distribution order of each asset (the *Order* column becomes accessible).

When assets have the same distribution order number, they form a group of assets. Distributions are pro-rated, based on the market value of the accounts, between all assets in that specific group until the group is exhausted. For example, if all bank accounts have a distribution order of 1, distributions are pro-rated between all accounts, based on market value, until there is no money left in the accounts. Note that assets retain their original tax characteristics and return rates. Only when a group is completed liquidated and funds are still needed will the next group be formed. For example, if all investment accounts have a distribution order of 2, they are used only when all of the assets with a distribution order of 1 are depleted.

## Reallocate and rebalance assets

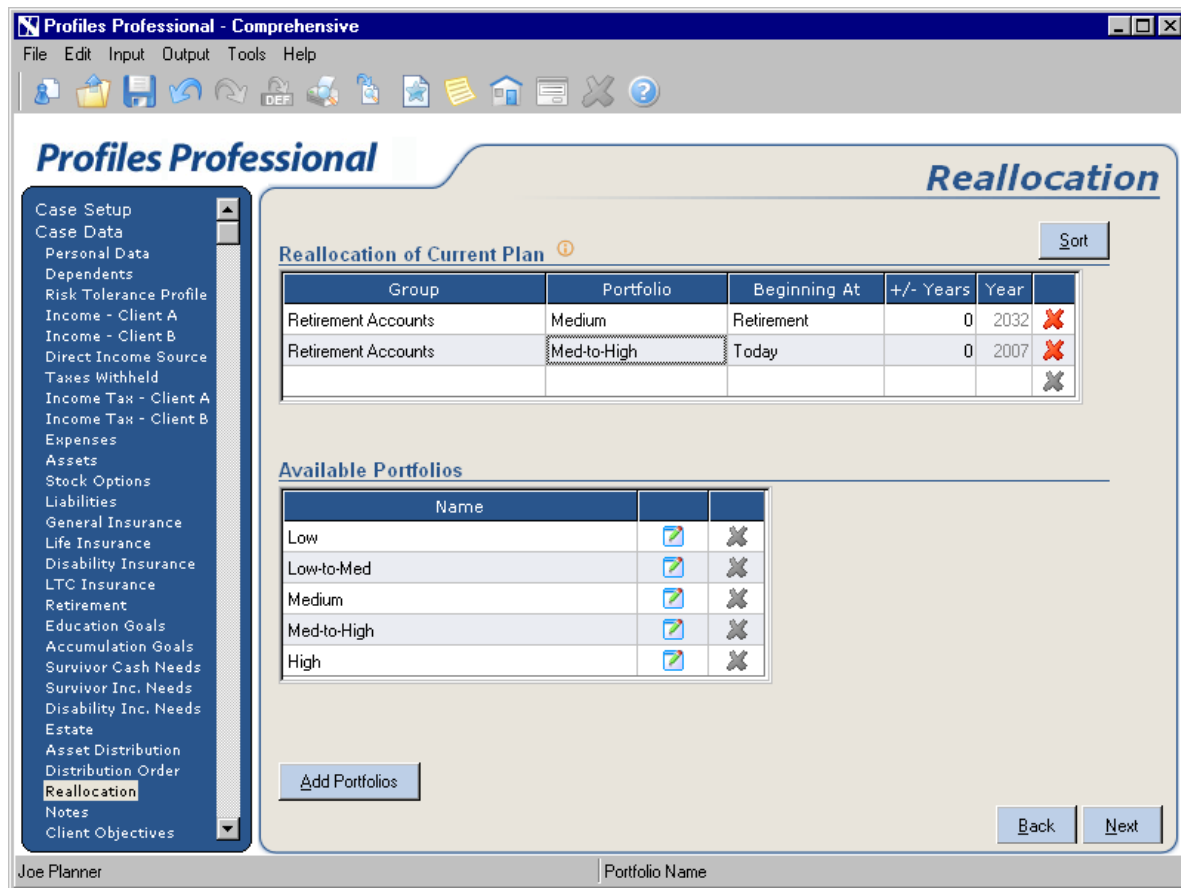


Figure 4: Case Data – Reallocation

The *Reallocation* screen allows you to reallocate groups of assets at many different points throughout the case. In the *Group* column, you can select, for reallocation purposes, a group of accounts allocated to a specific objective. In the *Portfolio* column, you can select the portfolio to which you wish to reallocate the assets. The suggested portfolios are based on the Ibbotson Asset Allocation model, but also include new portfolios that you have added. In the *Beginning At* column, you can indicate when the reallocation event occurs. You can also offset the reallocation event by entering the desired number of years in the *+/- Years* column.

You can reallocate a group of assets using many different points in time throughout the case. For example, the *Retirement Accounts* could be reallocated to a *High* asset allocation beginning *Today*. Then they could be reallocated to a *Medium* asset allocation beginning at *Retirement*, and to a *Low-to-Med* asset allocation fifteen years after retirement (*Retirement +15*).

If the same assets are reserved for several goals, the asset reallocation of the goal that occurs first will take priority. For example, the education goal asset reallocations remain in place until the goal is complete.

The list under *Available Portfolios* is based on Ibbotson’s suggested portfolios. These portfolios cannot be edited. However, you can add your own custom portfolios as needed by clicking the *Add Portfolios* button.

Note that the output pages will reflect the reallocation strategies modeled here. When generating the *Asset Allocation Time Horizon – Retirement Accounts* presentation page, the retirement scenarios previously mentioned on the *Reallocation* screen will appear.

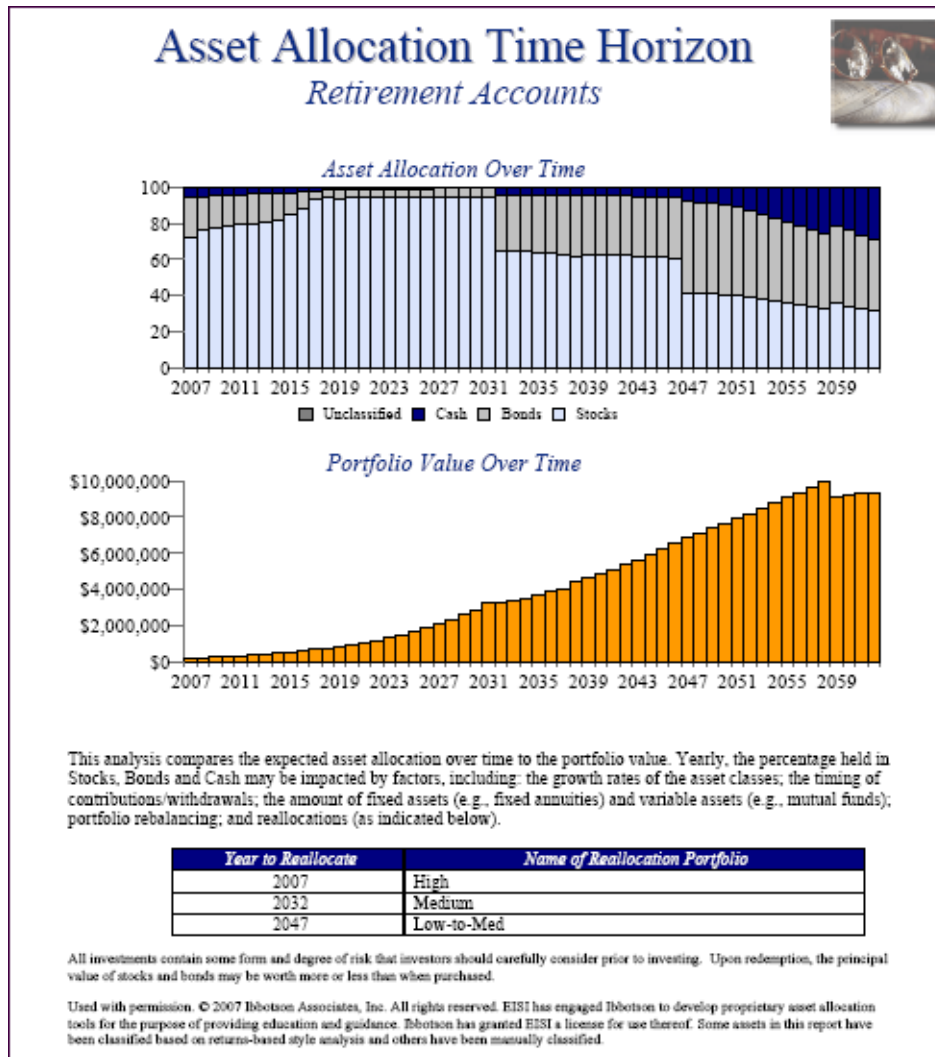


Figure 5: Client Presentation – Asset Allocation – Allocation of Retirement Accounts – Asset Allocation Time Horizon - Retirement Accounts (presentation page)

The graph on this page visually helps the clients to understand asset allocation between stocks, bonds, and cash, as well as portfolio values over time.

The text and table explain asset reallocation and identify reallocation points and portfolios for each individual time period.

## Rebalance assets annually

Asset Class	Ibbotson Expected Return	Client Expected Return
Large Cap Growth	9.99	9.99
Large Cap Value	11.32	11.32
Mid Cap Equities	12.26	12.26
Small Cap Equities	14.38	14.38
Intl Equities	10.98	10.98
Emerging Markets	18.30	18.30
Long Term Bonds	4.60	4.60
Intermediate Term Bonds	4.09	4.09
Short Term Bonds	3.57	3.57
High Yield Bonds	6.96	6.96
Intl Bonds	4.57	4.57
Cash	3.13	3.13

Figure 6: Case Setup – Asset Allocation Settings

The *Asset Allocation Settings* screen allows you to modify how asset allocation is managed. The *Asset Allocation Management* field determines the groups of assets that are available for reallocation on the *Reallocation* screen. There are several options to choose from.

By default, *Separate Allocation for each Objective* is selected. The asset allocation options are grouped by each objective included in the plan, (for example, the retirement goal and the education goal, as well as any purchase goals, if applicable). Other options include *One Allocation for All Accounts*, *Separate Allocation for Qualified vs. All Other Accounts*, and *Separate Allocation for Each Account*.

The *Rebalance Managed Accounts* check box rebalances accounts annually between reallocation points. This check box is selected by default. The following example demonstrates the usefulness of this feature. If you reallocate to a 80% stock/20% bond portfolio, the stocks will likely outperform the bonds after one or two years. Your assets will move to an 85% stock/15% bond split, changing the original asset allocation settings. Over time the allocation becomes skewed. When the *Rebalance Managed Accounts* check box is selected, Profiles Professional adjusts the asset holdings each year to maintain the selected portfolio. You can use the *Asset Allocation Time Horizon – Retirement Accounts* page (shown in Figure 5) to help clients understand the importance of rebalancing and meeting annually to update their case.

## Interpret distribution and reallocation output

You can use the output pages to explain asset distribution and reallocation to your clients. The first page of the *Risk Tolerance Assessment* audit report explains how an appropriate asset allocation is derived based on the clients' needs.

6. I am comfortable with investments that may frequently experience large declines in value if there is a potential for higher returns.

a. Agree (15 points)  
 b. Disagree (8 points)  
 c. Strongly disagree (0 points)

**Your Risk Tolerance Score: 62 out of 100**

In the table below, you will find a description of the risk tolerance profile that most closely fits the score above.

Risk Tolerance Profile		
Score	Profile	Description
0-19	Conservative	The conservative investor is particularly sensitive to short-term losses, but still has the goal of beating expected inflation over the long run.
20-39	Moderate Conservative	The moderate conservative investor is sensitive to short-term losses, but is willing to accept more risk than the conservative investor in order to pursue higher potential returns over the long-term. The safety of investment and return is of relatively equal importance to the moderate conservative investor.
40-59	Moderate	The moderate investor is willing to accept some risk, but is probably not willing to accept the short-term risk associated with achieving a long-term return substantially above the inflation rate.
60-79	Moderate Aggressive	The moderate aggressive investor is concerned primarily with wealth accumulation over an intermediate to long time horizon. A greater importance is placed on the return potential of an investment than on its safety. A moderate amount of risk aversion tempers the pursuit of higher returns.
80-100	Aggressive	The aggressive investor values high returns relatively more than other types of investors. The aggressive investor is able to tolerate both large and frequent fluctuations in portfolio value in exchange for a higher return.

### Part 2: Time Horizon Score

*Measuring the impact of time on your asset allocation choice*

Different objectives may have different time horizons. You may be planning for an accumulation objective that is right around the corner, while also planning for another that is off in the distance. Furthermore, objectives can have varying durations -- those that are single sum or short term versus those that may last for a number of years.

For each accumulation objective, the following two questions were answered and the points totaled to arrive at a time horizon score. Those scores are recorded below.

- When do you expect to begin withdrawing money for your objective?
  - Less than 1 year (0 points)
  - 1 to 2 years (1 point)
  - 3 to 4 years (3 points)
  - 5 to 7 years (7 points)
  - 8 to 10 years (9 points)
  - 11 years or more (11 points)
- Once you begin withdrawing money for this objective, how long do you expect the withdrawals to last?
  - I plan to take a lump sum distribution (0 points)
  - 1 to 4 years (2 points)
  - 5 to 7 years (4 points)
  - 8 to 10 years (5 points)
  - 11 years or more (6 points)

Time Horizon Score	
Objective Name	Score
Retirement	17
Melissa	11
Neal	13
Vacation Home	11
Melissa's Wedding	11

Next, refer to the table on the Asset Allocation Portfolios page to align your risk tolerance and your time horizon scores with an appropriate asset allocation.

Figure 7: Client Presentation – Asset Allocation – Risk Tolerance Assessment (audit pages)

Part I of the report shows the clients' answers to the questions, the weighting given to each answer, the clients' overall score, the suggested portfolio and its description. The clients' tolerance for risk is indicated by a description highlighted with a grey background. The clients' overall score is based on their answers to questions regarding their comfort level when investing. There are six questions in total. Based on the answers to each question, a score for risk tolerance and a suggested profile is determined. In the example in Figure 7, the clients fall into the profile of Moderate Aggressive with an emphasis on wealth accumulation.

Part II of the report shows the scores for the Time Horizon questions (start date and the duration of the objective).

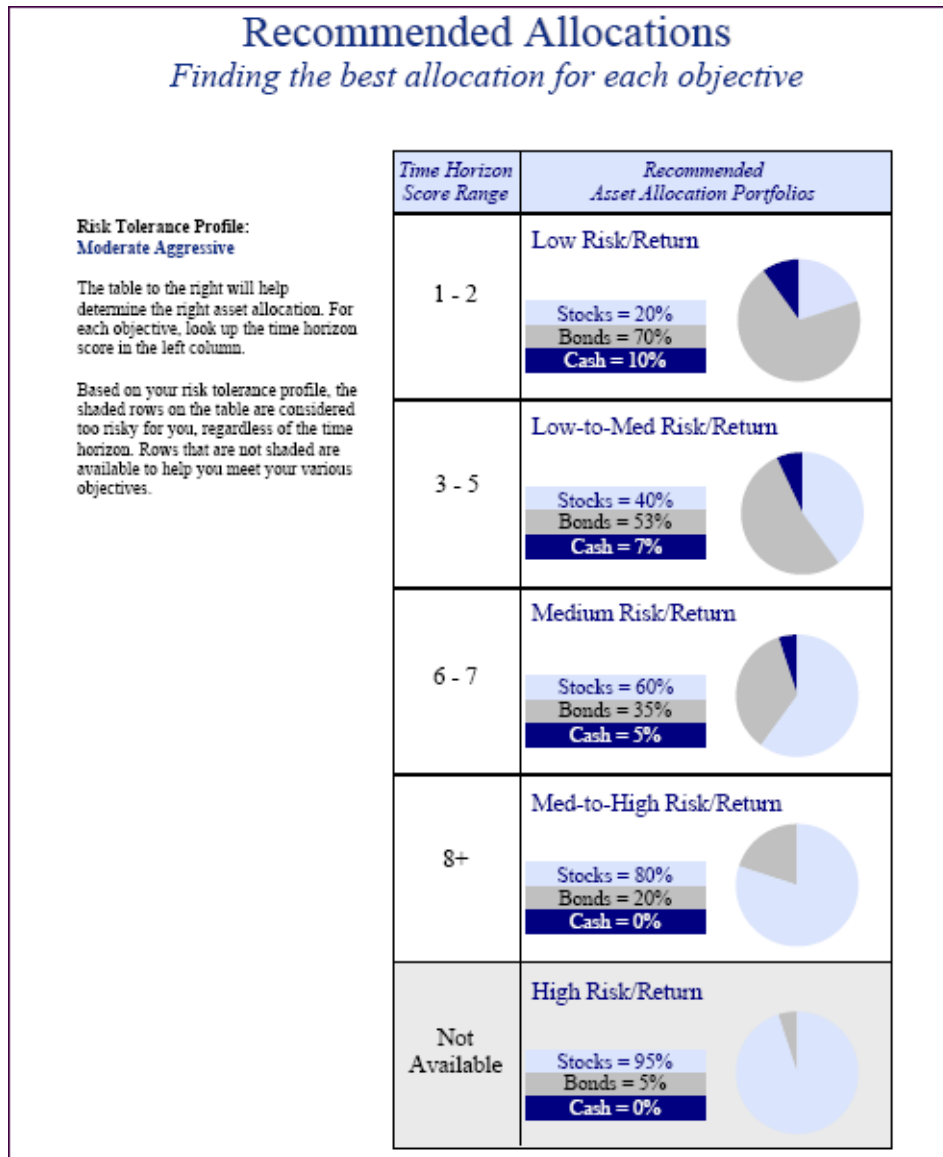


Figure 8: Client Presentation – Asset Allocation – Recommended Allocations (presentation page)

The *Recommended Allocations* presentation page illustrates the clients’ risk tolerance profile of Moderate Aggressive. The table helps determine the right asset allocation for the suggested profile, based on the time horizon. In other words, it combines Part I and Part II, to indicate which allocations are appropriate. The clients’ risk tolerance profile remains the same, but the recommended allocations may differ based on the time horizon.

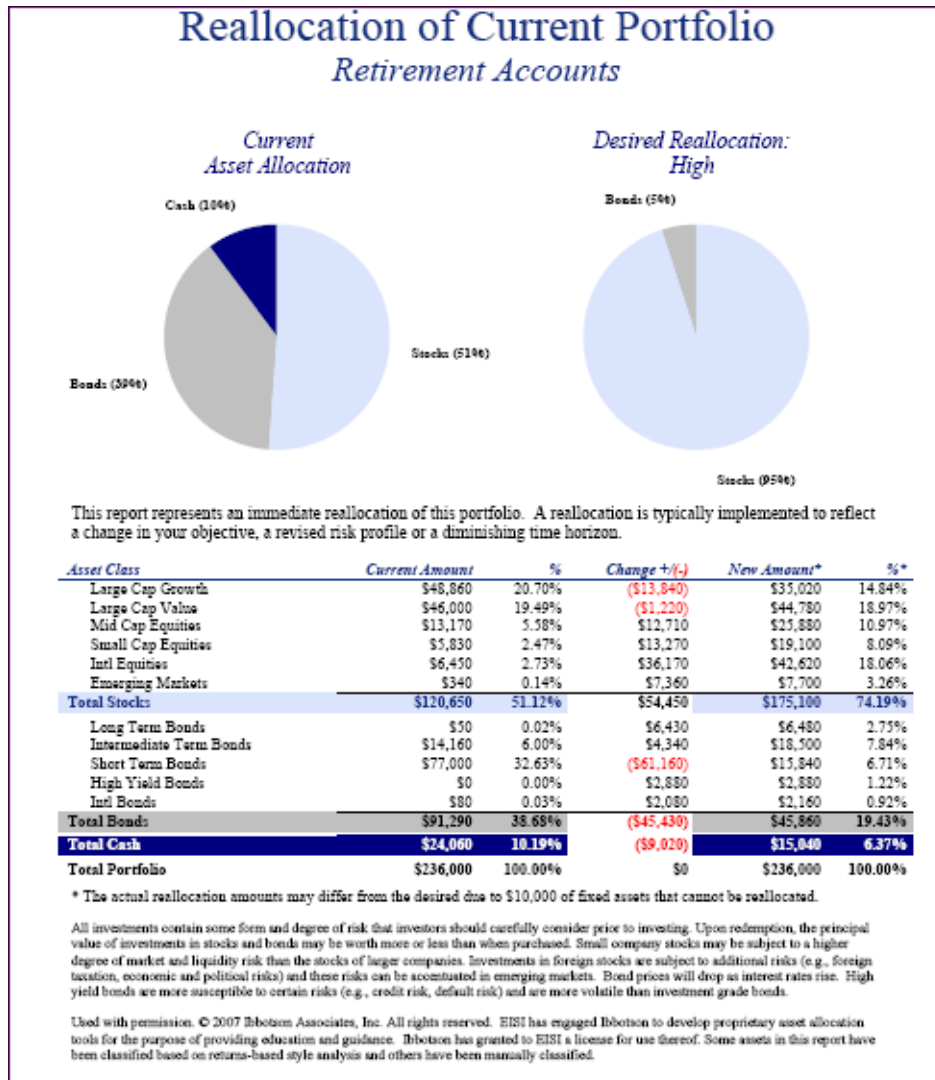


Figure 9: Client Presentation – Asset Allocation – Allocation of Retirement Accounts – Reallocation of Current Portfolio (presentation page)

The *Reallocation of Current Portfolio* presentation page includes a graph at the top of the page, that illustrates the current allocation for the goal's accounts (if allocated) compared to the first reallocation performed for retirement. The bottom table illustrates specific dollar and percentage weightings for the current and new allocation, as well as a change column.

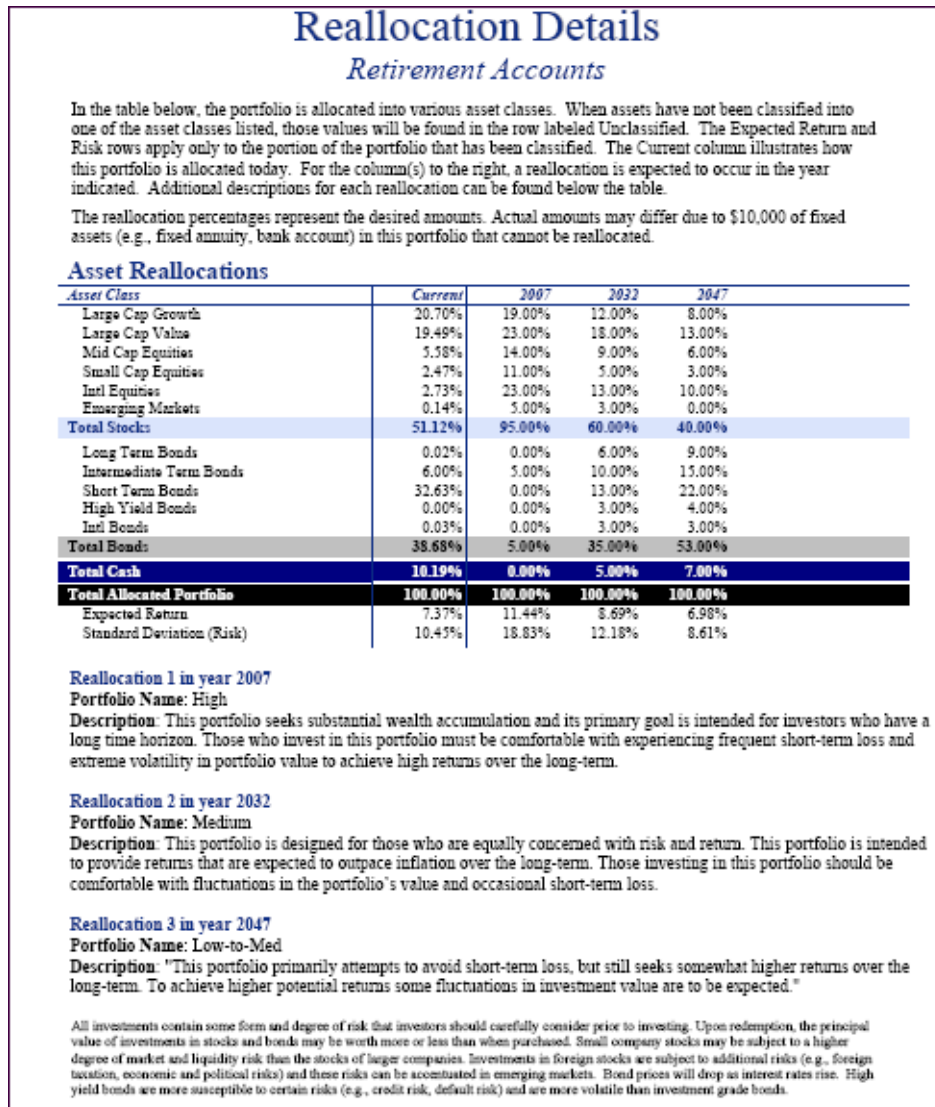


Figure 10: Client Presentation – Asset Allocation – Allocation of Retirement Accounts – Reallocation Details - Retirement Accounts (audit page)

The *Reallocation Details – Retirement Account(s)* output page illustrates, at different time periods, the asset allocation of the clients' portfolio. The table shows the allocation of current assets (if allocated) and each of the subsequent reallocations. This audit report provides lots of detail and can be helpful when used with the *Asset Allocation Time Horizon* presentation page (shown in Figure 5), as it provides supporting information.

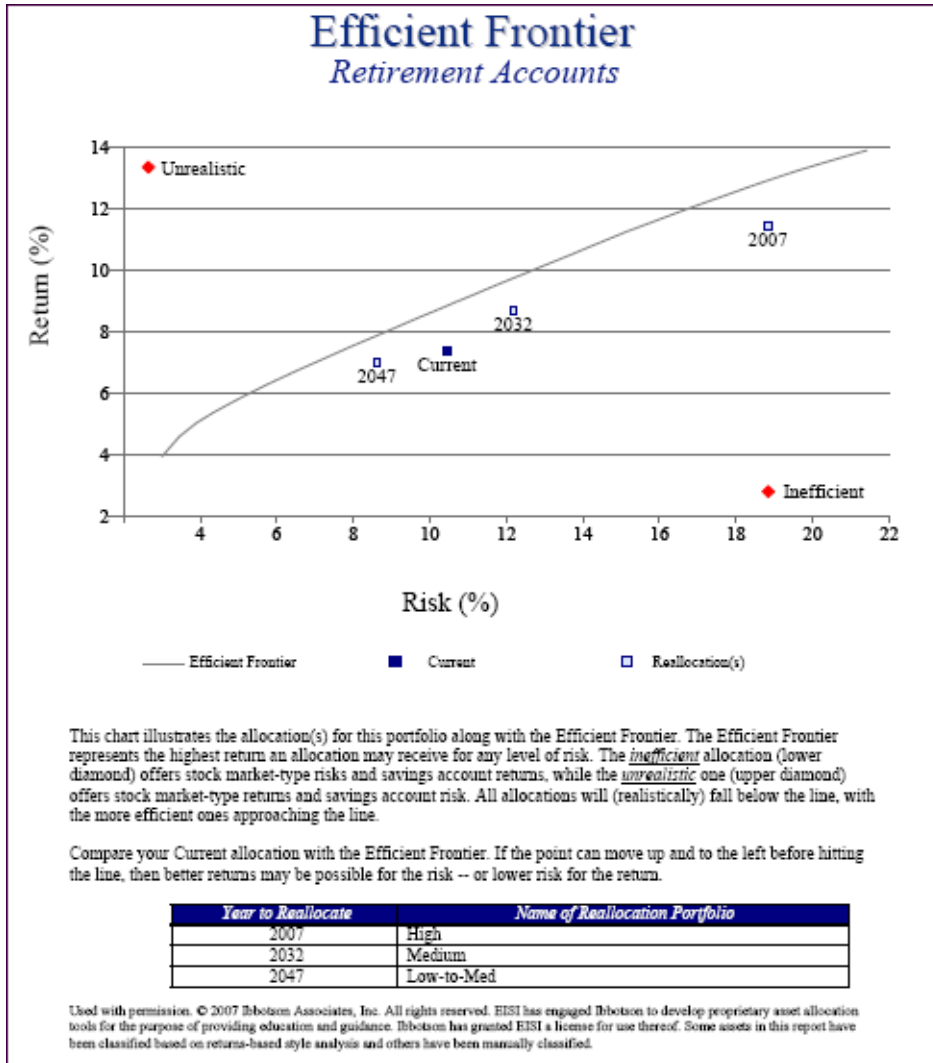


Figure 11: Client Presentation – Asset Allocation – Allocation of Retirement Accounts – Efficient Frontier - Retirement Accounts (presentation page)

The *Efficient Frontier – Retirement Account(s)* output page illustrates the relative risk/reward combination of portfolios in the case. The text at the bottom of the page explains the graph in plain language. The table recaps the reallocation years and portfolios selected over time.

## Exercises

These exercises have been designed specifically for this module and assume that you are working with the original data in the Jones sample case. If you want to keep the sample case intact, open the original Jones sample case, and then save it as a new case as follows:

1. Click the **File** menu – **Open Sample Case**. The *Open Sample Case* screen opens.
2. Click the **Open** link next to the *Comprehensive (Jones non-tax).fpx* case.
3. Click the **File** menu – **Save As**. The *Save Client Data As* dialog box opens.
4. Enter a unique name for the case (for example, *Jones – Distribution Reallocation Exercises*).

### Exercise 1: Designate assets to specific objectives and control asset distribution order

1. The CD accounts owned by Tom’s parents should only be used for the education goals. Ensure that they are not available to fund any other needs.

**Hint:** You can designate assets to specific objectives on the *Asset Distribution* screen.

2. In your most recent meeting, you discovered that the Jones plan to downsize their home five years after retirement and use about 50% of the proceeds to help fund retirement. Enter this strategy, and any closing costs or commissions you feel are appropriate, into the case.
3. How can you control where the proceeds from the sale of a hard asset will be directed?
  - a) By designating a key asset to receive surplus income
  - b) By designating a key asset to receive lump-sum income
  - c) By creating a lump-sum savings strategy to an asset
  - d) Proceeds will be handled by the software automatically
4. Which of the following is not one of the options available to help you sort the distribution order of assets?
  - a) *Defer Income Taxes*
  - b) *Reduce IRD at Death*
  - c) *Custom Order*
  - d) *Pro-rata*

5. When multiple assets are assigned the same *Order* number they will be treated as a group of assets for distribution and any withdrawals taken to cover needs will be pro-rated between all the assets in the group.
  - a) True
  - b) False

## Exercise 2: Reallocate and rebalance assets

1. By default, does the software automatically reallocate assets for your client to match an appropriate portfolio?
  - a) Yes
  - b) No
2. Which of the following is not one of the available *Asset Allocation Management* options?

**Hint:** This is part of *Case Setup*.

- a) *Separate Allocation for each Objective*
  - b) *Separate Allocation for Today vs. Start of Goal*
  - c) *One Allocation for All Accounts*
  - d) *Separate Allocation for Qualified vs. All Other Accounts*
3. In general, you can only reallocate once for each *Beginning At* event (for example, *Retirement*).
    - a) True
    - b) False
  4. Generate the *Asset Allocation Time Horizon – Retirement Accounts* presentation page, and then save it as a PDF so that you can make comparisons in the next question.
  5. By default, Professional rebalances the clients' assets each year to help maintain the allocation you've selected. Clear the **Rebalance Managed Accounts** check box on the *Asset Allocation Settings* screen, and then regenerate the *Asset Allocation Time Horizon – Retirement Accounts* presentation page. What differences do you notice between this page and the previous page you saved as a PDF?

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## Answers to case study exercises

### Exercise 1: Designate assets to specific objectives and control asset distribution order

3. b) By designating a key asset to receive lump-sum income
4. d) *Pro-rata*
5. a) True

### Exercise 2: Reallocate and rebalance assets

1. b) No
2. b) *Separate Allocation for Today vs. Start of Goal*
3. b) False
5. Answers will vary

