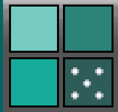

MCP Premium

MCP Insider: EIA Software Newsletter

Don't Dismiss Hypotheticals

by Mitchell Maynard

I found myself to be very troubled by the recent Jack Marrion article 'Think Carrier, Not Crediting' where he stated: "Using today's rates, regardless of which product and which method you look at, the average historical hypothetical returns of the different products pretty much come out within 50 basis points of one another over the long run."

Since I am the developer of EIA analytical software and a former investment advisor, I find the message this statement sends to advisors is inherently inappropriate. Mr. Marrion minimizes the uniqueness of differing index crediting methods and implies that advisors need not concern themselves with which credit method may be most applicable for a client's investment time horizon.

When I wrote to Jack about his study, he replied that he used "rolling" 10 year periods from 1954 to 2004. However, averaging all the returns in each of the 10 year periods would be the only way he could come up with those values. A Monte Carlo simulation would be a better method to anticipate potential returns an investment may yield. Instead of lumping yearly returns into an average, it randomly selects a series of returns to yield the total return. The use of Monte Carlo has become a preferred method of investment performance forecasting; even the NASD voiced its approval in February of this year.

Avoiding historical modeling is a great injustice to the public at large and is in contradiction to Nobel Prize winning finance theory. Some of the most valuable intellectual benefits of Modern Portfolio Theory come as the result of historical analysis.

Jack did admit to me that in the short term, there are variations in credit method performance. I believe it is important to use a time period that most annuity purchasers will actually hold their annuities: the surrender period. Using my software, I compared two

July 2005 MCP Insider

Contents

Hypotheticals
Web Cast Training
Upgrade Released!

CONTACT US

Premium Producers Group, LLC
333 City Blvd. West, Suite 870
Orange, CA 92868
877-773-4774
mcppremium.com

Annual Reset EIA Crediting methods: Monthly Averaging, 0 asset fee, 100 participation, 8% cap and a 5% Bonus; versus Point-to-Point, 0 asset fee, 55% participation, 0% cap and a 7% Bonus. The historical time period used was January 1995 to January 2005. $100,000 invested in the Monthly Averaging EIA yielded a total value of $169, 921 (5.44%) and the Point-to-Point was $252,300 (9.70%) By the way, these products over the 30 year period 1975-2005 yielded the following: $411,970(4.83%) and $896,013 (7.58%), respectively.

In short, dismissing the use of historical analysis is irresponsible.

Learn More in Web Casts
Software customers: You can learn more about our hypothetical and Monte Carlo tools and how to use them effectively, by attending our weekly web casts. If you haven't been receiving the email notices, please let us know! Pre-recorded training is available 24/7 from our web site. See All Tutorials

Upgrade Released!
Make sure that you are keeping your software up to date. Although we notify you monthly by email, you can check the web site at any time for downloads.
Current Downloads

'MCP Insider' copyright 2005 Premium Producers Group, LLC. All rights reserved.

Thank you! You are receiving this Newsletter because you requested to be on our list or you have purchased our software products. We appreciate your interest.
Need software tutorials or training? Browse the 'Support' page for help!