The MCP *Insider* eNewsletter

Use Caution with EIA Hypotheticals.

by Mitchell Maynard

Any historical analysis should be considered within its context. In the case of using historical hypothetical backtesting of the Nasdaq100 index, the extreme stock inflationary period of the late 1990's is an aberration that should be factored out. Otherwise, I would be concerned that any advisor providing a hypothetical analysis of a crediting method that uses this index would be in danger of presenting to their client a scenario that has little likelihood of being reproduced.

Beware. Simple ignorance of market forces aside, including the late 1990's in a historical analysis of the Nasdaq100 can be a marketing attempt by the insurance company to bolster average returns, so as to promote greater product sales and not an indicator of a superior strategy for your client. The call option seller (from which the EIA derives its interest crediting) is not going to expose himself/herself to more loss potential than is reasonable. It is my belief that there is little hope the Nasdaq100 will ever repeat the astronomical returns of the 1990s anytime soon, and this is reflected in the option's pricing.

I believe in steering advisors from setting unrealistic expectations, by demonstrating that the mathematical principal of "regression to the mean" is not in the favor of the Nasdaq100 repeating returns seen during the last decade. You should be very hesitant to present those historical returns to your clients.

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