

PERSPECTIVES

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Financial and estate planning

Return assumptions for financial plans – Part 3: Our solution

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In part three of this series on our 100-Year Stress Test, we discuss our solution to the problem of using a rate of return assumption over long periods of time. As presented in parts one and two, the issue is: Even though our return assumptions are based on long-term historical results, we don't know which part of history we're going to get, going forward.

Previously, we discussed doing a 30-year financial plan, basing our return assumption on results over the past 100 years. But, during the past 100 years, there have been some very good 30-year periods, very bad 30-year periods and lots of in-between periods. The issue is: We don't know which kind of history is going to happen in the future – and that will have a significant impact for your results. It makes a big difference when the up

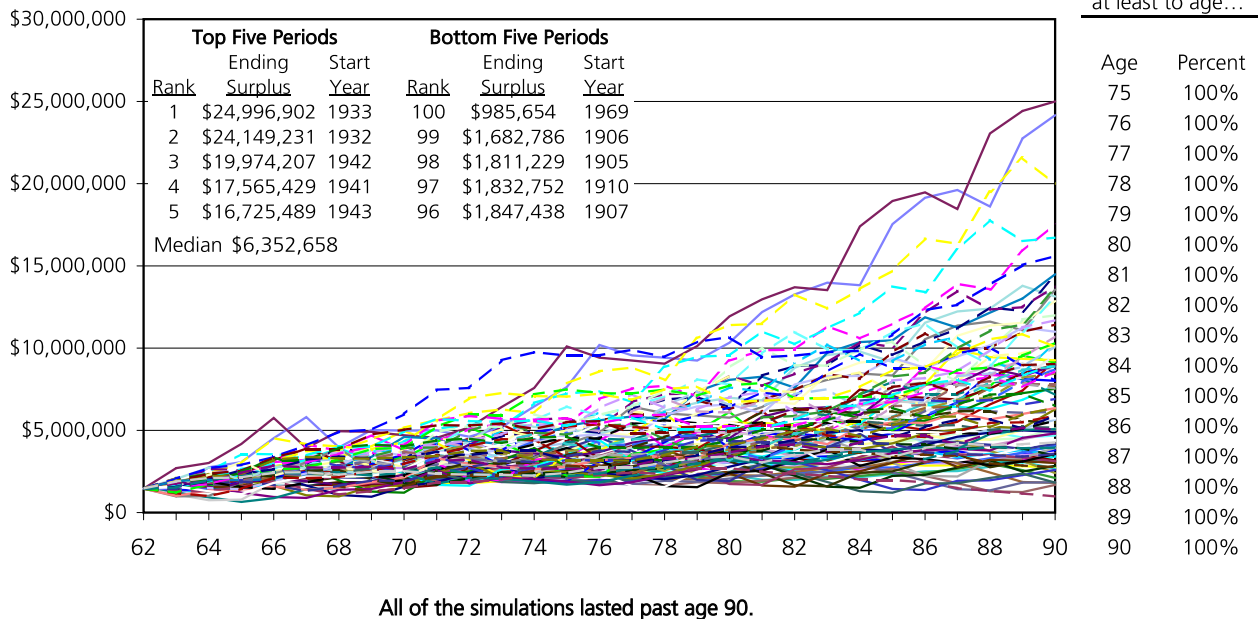
and down years are, relative to when we are adding or withdrawing money.

This is where we do something different from most financial plans. We run your plan through our 100-Year Stress Test. In this case, we test the plan through every 30-year period over the last 100 years. For example, we'll pretend we're in the year 1900. We test the resiliency of your plan for the next 30 years with actual historical returns and inflation. Then, we'll do it again – but starting in 1901, then again in 1902, until all the data is exhausted.

As you can see in the chart below, each of the squiggly lines represents the plan over a 30-year period, each with a different starting year.

100 Year Stress Test™

This graph shows how your total financial assets would have fared using actual historical returns and inflation over the past 100 years.



"100 Year Stress Test" is a trademark of Stan Clark and the Stan Clark Financial Team.



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As expected, some lines do very well; some lines not so well. But most of them cluster somewhere around the middle. Basically, this gives you a picture of your best- and worst-case scenarios. We then go through each of the tests, and see if there were periods when the plan came up short – which means, running out of money. In this plan, none of the scenarios came up short, which is good. If there were lots of scenarios that came up short, it would indicate to us that we need to make some adjustments. These adjustments might involve increasing current savings, or reducing future spending. We also come up with a median outcome, to give us a likely scenario of what will happen.

There have been many periods of market declines in history, and no doubt there will be many more in the future. Although market fluctuations are a normal part of investing, they can still pose challenges to investors – especially those who are near, or already in, retirement. This is why our 100-Year Stress Test is important. No one knows if the market is going to be strong,

average or weak. So, we have to go through all the scenarios and see how resilient your plan is. We're mostly worried about the bad periods. If the test can survive all the historical scenarios, then that gives us confidence in your financial plan.



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