For investment professionals only

thesis asset management

The Managed Income Service illustrator handbook

The Managed Income Service illustrator

The Managed Income Service aims to reduce sequencing risk for clients who rely on their investments to generate a regular income. It does this by combining two portfolios, which are dynamically adjusted over the term of the service.

A wealth accumulation portfolio, chosen to correspond with the client's risk appetite, aims to generate growth over the long term. Meanwhile, a wealth preservation portfolio takes a more defensive stance, seeking to avoid large gains or losses.

The two portfolios are adjusted quarterly to pay out the client's income and optimise the investments for the next period. Gains in the wealth accumulation portfolio can be harvested, or excess amounts in the wealth preservation portfolio reinvested in the wealth accumulation portfolio. Income is paid from the wealth preservation portfolio, removing the need to sell assets from the wealth accumulation portfolio to generate income during a market downturn, allowing it time to recover from a fall.

The path taken and the final value of the investment depend on market conditions and the amount of income withdrawn. We have created this illustrator to allow you to see how the Managed Income Service might work in a variety of market conditions. The illustrator contains a range of schematic and historical return scenarios and allows you to enter your own return assumptions to help you to gain an insight into the circumstances where the service could be beneficial to a client.

The illustrator output can be used with a client, either on screen or as a PDF, to help in your discussions with clients about whether the service could benefit them.

How to use the illustrator

Please enter the starting value of your client's portfolio and the percentage of this sum which they wish to withdraw as a fixed annual income.

In the third box please select the market conditions you would like the illustrator to use. Some of the scenarios are very stylised and others represent historical episodes in markets and then click the button to change your illustration.

If you would like to see how the Managed Income Service might function in other market conditions, please use the option to customise your own returns and then click the button to change your illustration. You will then be able to edit the percentages in the overview table to update the graph and table of results.

The parameters can be adjusted to try different scenarios. We recommend that you look at a variety of different inputs to gain an insight into the circumstances where the service could be beneficial to a client.

For simplicity, the illustrator always shows a full five year cycle with annual rebalancing. In practice, the service is rebalanced quarterly in order to provide a regular income and to react in a timely fashion to market events. In addition, you have complete control over the length of time the client spends in the service, from 1 to 5 years.

Table of results

Wealth accumulation portfolio at start of year
The proportion of the client's assets and the corresponding monetary value which is invested in the wealth accumulation portfolio at the start of the year, immediately following the annual rebalance.

Wealth preservation portfolio at start of year
The proportion of the client's assets and the corresponding monetary value which is invested in the wealth preservation portfolio at the start of the year, immediately following the annual rebalance.

Wealth accumulation portfolio at end of year
The monetary value of the wealth accumulation portfolio at the end of the year, after the market returns specified in the chosen scenario.

Wealth preservation portfolio at end of year
The monetary value of the wealth preservation portfolio at the end of the year, after the market returns specified in the chosen scenario.

Overall return
The aggregate return received on the overall combination of assets in the two portfolios.

Paid out as income
The cash withdrawn from the portfolio to provide income for the client at the specified percentage of the starting value.

Rebalanced from preservation to accumulation portfolio
The amount withdrawn from the wealth preservation portfolio and reinvested into the wealth accumulation portfolio at the annual rebalance point. Negative numbers indicate that money has been withdrawn from the wealth accumulation portfolio and recycled into the wealth preservation portfolio.

Comparison if everything had been invested in the wealth accumulation portfolio
The monetary value invested in the wealth accumulation portfolio at the start of the year if all assets had been invested in the wealth accumulation portfolio. This provides a benchmark for whether the strategy has been beneficial.

The report

The downloadable report illustrates the relative pattern of returns for the Managed Income Service versus a traditional investment portfolio. It is intended to help you in your discussions with your client.

The shaded area on the graph shows how the overall value of the investment might vary over time if market returns were to follow the chosen scenario. The coloured areas indicate how the investment is divided between a wealth accumulation portfolio, which aims to generate growth over the long term, and a wealth preservation portfolio that takes a more defensive stance, seeking to avoid large gains or losses. For comparison, the orange line shows how an investment in the wealth accumulation portfolio alone would have performed in the same circumstances. The table gives a more detailed breakdown of the value at the start and end of each year, together with figures for the income paid out and the amounts moved between the two portfolios.

The scenarios

The illustration scenarios are not an indicator of future results and should not be relied upon when making an investment decision.

The zero return scenario
The zero return scenario illustrates how the rebalancing between the two portfolios would work when there are no investment gains or losses. This is an unlikely situation in reality but helps to show the mechanics of the service. Each year an amount is paid out as income from the wealth preservation portfolio. Any excess is reinvested into the wealth accumulation portfolio until at the end of year 5 all assets are invested in the wealth accumulation portfolio.

With no investment returns the overall value of the portfolio is the same whether or not the Managed Income Service is used.

The smooth positive returns scenario
The smooth positive returns scenario illustrates how the Managed Income Service might perform when markets are rising. In reality it is very unlikely that such consistent year on year returns could be earned when investing in risky assets, however, the scenario helps to show how the service might perform in a rising market for risky assets.

In a scenario where taking risk is rewarded, the wealth accumulation portfolio outperforms the wealth preservation portfolio. As a result, the client’s investments would grow to a lower overall value if invested in the Managed Income Service, compared to investing in the wealth accumulation portfolio alone.

Depending on their willingness and ability to take risk, some investors might judge that this underperformance in rising markets is an acceptable price to pay in return for the cushion provided by the service in a less favourable scenario.

The V-shaped drawdown scenario
The V-shaped drawdown scenario illustrates how the Managed Income Service might perform if there was a sharp fall in markets in year 2, followed by a relatively rapid recovery over the subsequent two years. In year 2 the wealth accumulation portfolio would fall by a greater amount than the combination of two portfolios in Managed Income Service. The service is also better positioned to take advantage of the market rebound, with the income payment for year 2 generated by selling assets from the wealth preservation portfolio rather than needing to sell assets from the wealth accumulation portfolio after its fall, and a further amount rebalanced from the wealth preservation portfolio to the wealth accumulation portfolio which helps to benefit from the market’s rise.

The end of the five year period sees a higher overall value from the service, compared with investing in the wealth accumulation portfolio by itself. Moreover, the Managed Income Service journey has been less volatile than it would have been if only the wealth accumulation portfolio had been used.

The U-shaped drawdown scenario
The U-shaped drawdown scenario illustrates how the Managed Income Service might perform if there was a sharp fall in markets in year 2, followed by a return to growth without any significant rebound in prices. In year 2 the wealth accumulation portfolio would fall by a greater amount than the combination of two portfolios used in the Managed Income Service. The service is also better positioned to take advantage of the market rebound, with the income payment for year 2 generated by selling assets from

the wealth preservation portfolio rather than needing to sell assets from the wealth accumulation portfolio after its fall, and a further amount rebalanced from the wealth preservation portfolio to the wealth accumulation portfolio which helps to benefit from the market's rise.

The end of the five year period sees a higher overall value from the service, compared with investing in the wealth accumulation portfolio by itself. Moreover, the managed income journey has been less volatile than it would have been if only the wealth accumulation portfolio had been used.

The 2007-2011 scenario
The 2007-2011 scenario illustrates how a strategy similar to the Managed Income Service might have performed during the 2008/9 financial crisis. Year 2 represents 2008 when equity markets fell substantially. 2009-10 saw a rapid rebound, but 2011 was another negative year for riskier assets as a result of the Eurozone debt crisis.

In year 2 the wealth accumulation portfolio would fall by a greater amount than the combination of two portfolios used in the Managed Income Service. The service is also better positioned to take advantage of the market rebound, with the income payment for year 2 generated by selling assets from the wealth preservation portfolio rather than needing to sell assets from the wealth accumulation portfolio after its fall, and a further amount rebalanced from the wealth preservation portfolio to the wealth accumulation portfolio which helps to benefit from the market's rise.

The end of the five year period sees a higher overall value from the Managed Income Service, compared with investing in the wealth accumulation portfolio by itself. Moreover, the managed income journey has been less volatile than it would have been if only the wealth accumulation portfolio had been used.

The 1972-1976 scenario
The 1972-1976 scenario illustrates how a strategy similar to the Managed Income Service might have performed during the 1973-4 stock market crash and the associated currency and oil price shocks. Years 2 and 3 represent 1973 and 1974 when equity markets fell substantially. 1975 saw a rapid rebound.

In years 2 and 3 the wealth accumulation portfolio would fall by a greater amount than the combination of two portfolios used in the Managed Income Service. The service is also better positioned to take advantage of the market rebound, with the income payment for year 2 generated by selling assets from the wealth preservation portfolio rather than needing to sell assets from the wealth accumulation portfolio after its fall, and a further amount rebalanced from the wealth preservation portfolio to the wealth accumulation portfolio which helps to benefit from the market's rise.

The end of the five year period sees a higher overall value from the managed income strategy, compared with investing in the wealth accumulation portfolio by itself. Moreover, the managed income journey has been less volatile than it would have been if only the wealth accumulation portfolio had been used.

Custom scenarios

The managed income solution results in the higher value:
In this customised return scenario, the end of the five year period sees a higher overall value from the managed income strategy, compared with investing in the wealth accumulation portfolio by itself. Moreover, the managed income journey has been less volatile than it would have been if only the wealth accumulation portfolio had been used.

The wealth accumulation only solution results in the higher value:
In this customised return scenario, the client's investments would grow to a lower overall value if invested in Managed Income Service, compared to investing in the wealth accumulation portfolio alone.

Depending on their willingness and ability to take risk, some investors might judge that this underperformance is an acceptable price to pay in return for the cushion provided by the service in a less favourable scenario.

The two approaches result in an equal value:
In this customised return scenario, the client's investments would grow to a similar overall value irrespective of whether they invested in Managed Income Service or in the wealth accumulation portfolio alone.

Depending on their willingness and ability to take risk, some investors might judge that there is still a benefit in the cushion potentially provided by the Managed Income Service in a less favourable scenario.

not an indicator of future results and should not be relied upon when making an investment decision. TAM1803_09.