

# Advisor Workstation Training Manual: Working with Hypothetical Illustrations

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# Advisor Workstation Training Manual: Working with Hypothetical Illustrations

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This document will show you how to create and save hypothetical illustrations for your clients. The following topics are covered:

- How to launch the Hypothetical Illustration tool
- Choosing investments for the illustration
- Entering buy/sell criteria for an illustration
- Setting up reinvestment and rebalancing options
- Assigning fees to be charged for purchasing the funds and/or managing the portfolio
- Determining the tax rate to apply to the portfolio or securities
- Choosing the type of illustration you want to run (either for a portfolio, individual investments or a comparison hypothetical)
- Selecting reports you want to include (and making any changes to the report options that are available)
- Saving hypothetical illustrations
- Creating lists of hypothetical illustrations, and
- Updating the default settings for hypothetical illustrations.

## Overview

Although you can create hypothetical illustrations for individual securities, or to compare securities (e.g., mutual fund vs. mutual fund, or mutual fund vs. ETF), in this manual you will see how to create a hypothetical illustration for a client's portfolio.

- ☞ The chief difference between creating a hypothetical illustration for individual securities or a comparison vs. that for a portfolio is that you can rebalance securities only in a portfolio.

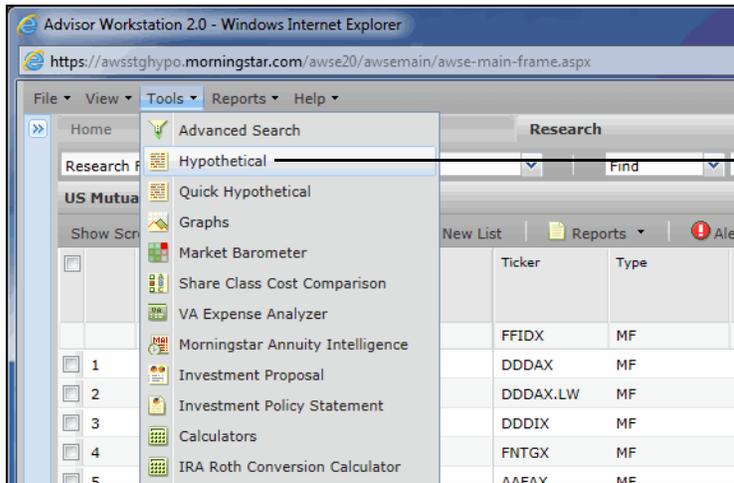
In this case, the sample portfolio will be for changing the investments in a traditional IRA worth \$200,000 (using the earliest common time period for all holdings). The scenario also includes making subsequent annual investments. The portfolio will be rebalanced semi-annually, and a 1% management fee will be applied. No taxes will be taken out.

## Training Scenario

This section explains how to launch the hypothetical illustration tool. It appears in a window separate from Advisor Workstation.

### Launching the hypothetical illustration tool from Advisor Workstation

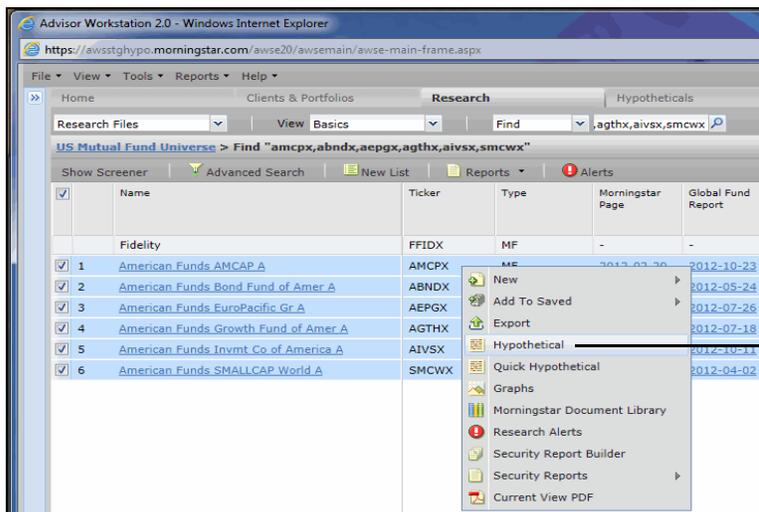
The most direct way to launch the hypothetical illustration tool is to go to the menu bar and select **Tools...Hypothetical**. This is the quickest way to launch the tool, but there are other methods which might also prove useful.



From the Tools menu, click once on Hypothetical

For instance, you can also launch the hypothetical illustration tool from the Research module. Simply select the investments you want to use in the illustration, then go to the menu bar and select **Tools...Hypothetical**. When the new window appears, the securities you selected will already be available on the Investments tab.

☞ You can also launch the hypothetical illustration tool by right-clicking on one of the selected securities and selecting **Hypothetical** from the menu that appears.



After selecting a group of securities, right-click on one of them, then select Hypothetical from the menu that appears

A further advantage can be had by launching the hypothetical illustration tool from the Clients & Portfolios module. By doing this, you will not only bring in the investments, but also the amounts assigned to each security.

In this section, you'll learn how to select investments for a hypothetical illustration. Note the following about creating a hypothetical illustration and searching for securities:

### Choosing the investments for a hypothetical illustration

- You can include up to 40 securities in an illustration.
- You can search for more than one security at a time (see the Note below), but you can search for items by name or ticker from only one security universe (mutual funds, stocks, ETFs, etc.) at a time.
- When searching on a portion of a security's name, you must enter at least four characters.

To create a hypothetical illustration and select investments for it, do the following:

1. On the Investments tab, use the **Universe** drop-down field in the upper left corner to choose the type of investments you want to search for. For this example, we'll use the default option, **U.S. Mutual Funds**.
2. You can search for items by **Name** or **Ticker** symbol by entering those values in the search field. When you look for an item, the system searches for it by ticker symbol, name begins with, and name contains. Here, enter the following ticker symbols: **agthx,amcp,abndx,aepgx,aivsx,smcwx**.

Note: Separating items with a comma (agthx, contrafund) uses an OR methodology: find agthx OR contrafund. Separating items with a space (muni ca) uses an AND methodology: find funds that have "muni" and "ca" in the name.

3. Click **Go**. The investments you searched for appear in the Total Results box.
4. Confirm that the items are the ones you searched for, then click **Add All**. The investments now appear in the Final Results box.

The screenshot shows the Morningstar software interface. At the top, there are menu options like 'File', 'Help', 'Save', 'Save As', 'Save Locally', 'View Illustration', and 'Generate Report'. Below that are 'Update Preferences', 'Morningstar Preferences', 'Add/Edit Note', and 'Export'. The main interface has tabs for 'Investments', 'Buy', 'Advanced Buy/Sell', 'Reinvest/Reb', 'Fees', 'Taxes', and 'Report Options'. The 'Investments' tab is selected. In the upper left, 'Select Universe' is set to 'U.S. Mutual Funds'. The 'Search By' options are 'Name/Ticker' (selected) and 'Fund Family'. The search field contains the text 'agthx,amcp,abndx,aepgx,aivsx,smcwx'. Below the search field, it says 'Total Search Results: 6' and 'Page: 1 of 1'. A list of search results is shown, including 'American Funds AMCAP A(USD,AMCPX)', 'American Funds Bond Fund of Amer A(USD,ABNDX)', 'American Funds EuroPacific Gr A(USD,AEPGX)', 'American Funds Growth Fund of Amer A(USD,AGTHX)', 'American Funds Invmt Co of America A(USD,AIVSX)', and 'American Funds SMALLCAP World A(USD,SMCWX)'. At the bottom of the results list are 'Add' and 'Add All' buttons. Below the results list is an 'Investments Selected: 0' section with a large empty box and 'Remove' and 'Remove All' buttons at the bottom. Three callout boxes with arrows point to the search field, the 'Add All' button, and the 'Investments Selected' box.

5. Click the **Buy** tab at the top of the window.

On the Buy tab, the default value for each fund's Initial Investment is \$10,000, and the default time period is for the trailing one-year period. Note that you can use the drop-down fields at the top of this tab to manipulate the following:

**Setting the time horizon and initial amount to be bought for each investment**

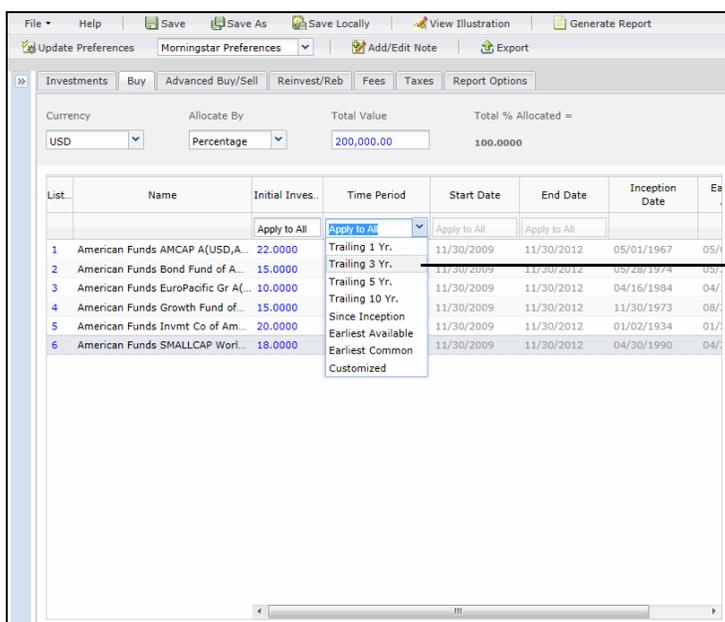
- Currency (depending on which currencies your institution has decided to include)
- Method of inputting the value (dollars, shares or percentage)
- Total Value invested for the illustration (if entering allocations by percentage), and
- Time Period for the illustration.

Do the following on the Buy tab:

1. Make sure the Currency field is **USD**.
2. From the Allocate By drop-down field, select **Percentage**.
3. In the Total Value field, type **200,000**.
4. In the **Initial Investment** fields, enter the following values:

Investment	Percentage Amount
American Funds Amcap A	22
American Funds Bond Fund of Amer A	15
American Funds EuroPacific Gr A	10
American Funds Grth Fund of Amer A	15
American Funds Invmt Co of Amer A	20
American Funds Smallcap World A	18

5. To set the Time Period for the hypothetical illustration, click the Time Period drop-down field in the Apply to All row and choose **Trailing 3 Yr.** All other rows will automatically use this start date.



Select this option from the Time Period field in the Apply to All row.

6. Click the **Advanced Buy/Sell** tab at the top of the window.

On the Advanced Buy/Sell tab, we'll indicate that in addition to the starting amount of \$200,000, the client will also invest an additional \$500 in each fund every quarter.

**Entering subsequent investments for a hypothetical illustration**

In the Subsequent Invest/Withdraw area, do the following in the Apply to All row:

☞ Alternatively, you could enter different values in each row for the securities.

1. In the Type field, confirm that **Invest** is selected.
2. In the Amount field, type **500**.
3. From the Frequency field, select **Quarterly**.
4. From the Month End field, select **3**. This means the contribution will be made at the end of the third month of the quarter.

List	Name	Subsequent Invest/Withdraw				Upwar	
		Type	Amount	Frequency	Mth End	Amount	Type
		Apply to All	Apply to All	Apply to All	Apply to All	Apply to All	Apply to All
1	American Funds AMCAP A(USD,A...	Invest	500	Quarterly	3	0	USD
2	American Funds Bond Fund of A...	Invest	500	Quarterly	3	0	USD
3	American Funds EuroPacific Gr A(...	Invest	500	Quarterly	3	0	USD
4	American Funds Growth Fund of...	Invest	500	Quarterly	3	0	USD
5	American Funds Invmt Co of Am...	Invest	500	Quarterly	3	0	USD
6	American Funds SMALLCAP Worl...	Invest	500	Quarterly	3	0	USD

Enter the information for subsequent investments for all securities in this row

To make regular withdrawals from a hypothetical illustration, select **Withdraw** or **Withdraw %** from the Type field in the Apply to All row.

### What if I need to make a withdrawal?

By default, the system will begin to make these subsequent investments or withdrawals based on the Start Date you entered. If you want to illustrate delaying the contribution (or withdrawal) for a period of time, do the following in the investment's row:

1. From the Type field, select **Custom**. A new window appears.
2. You can either use the Add Systematic Transaction fields, and alter the Begin date and End date as necessary, or you can type the value to be invested or withdrawn directly into a monthly field. Note that investments are entered as positive numbers, and withdrawals are entered as negative numbers.

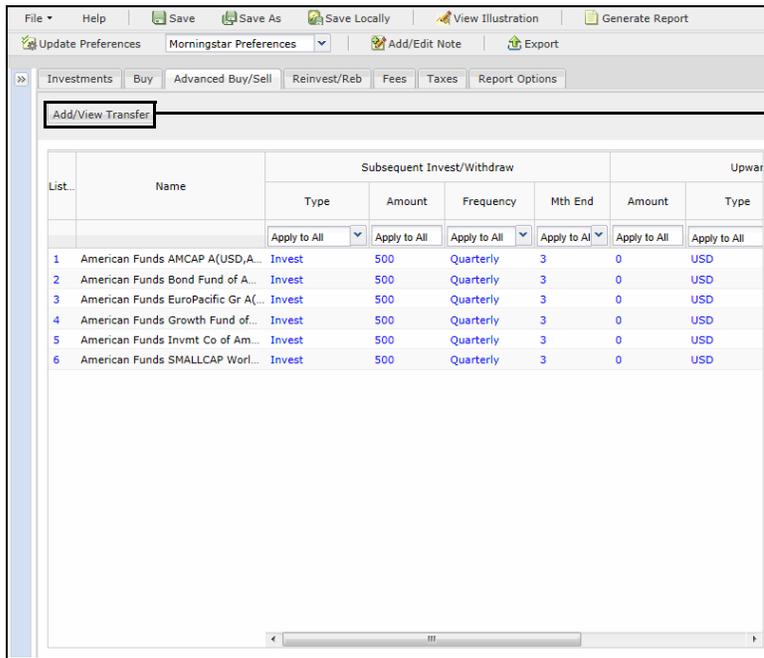
Use these fields to add systematic investments to or withdrawals from a portfolio.

Although we will not use this in our scenario, it is possible to transfer assets from one investment to another. One scenario in which you might want to do this is to allocate a majority of assets first to a fixed-income fund, and then gradually move money to an equity fund. This dollar-cost averaging process might appease conservative investors who are leery of putting a large sum of money into a stock fund all at once.

**What if I want to transfer assets between investments?**

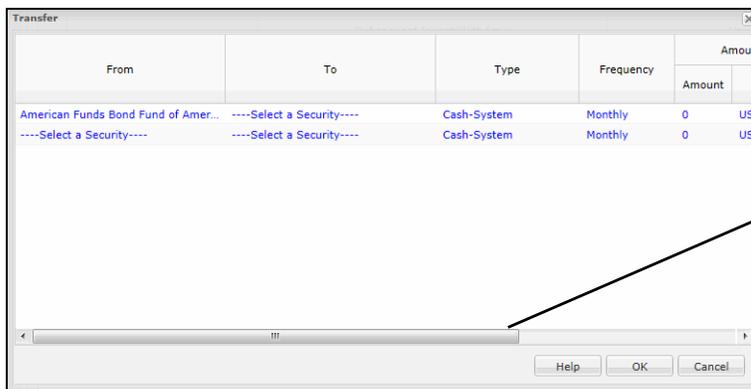
To transfer assets from one investment to another, do the following:

1. Click the **Add/View Transfer** button. The Transfer dialog box appears.



Click this button to open the Transfers dialog box

2. In the **From** field, select the investment you want to move money from.
3. In the **To** field, select the investment you want to move money to.



Scroll right to see additional fields

4. Fill in the remaining fields with the amount of money you want to move (by dollars or percentage), how often the money should be transferred, and when the transfer should begin and end.
5. If necessary, click in the next row to add an additional transfer scenario.

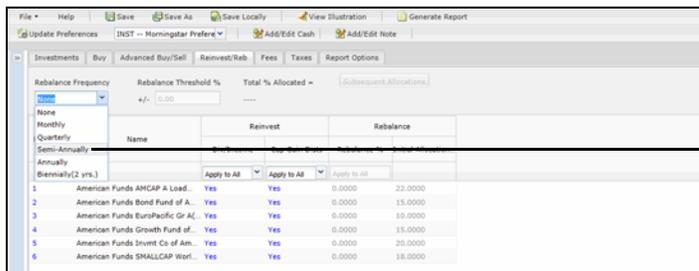
The next step is to rebalance the portfolio, to ensure the assets remain in their proper allocation.

## Setting up reinvestment and rebalancing options

- Remember that rebalancing a portfolio will incur loads and redemption fees, unless you elect to exclude these on the Fees tab.

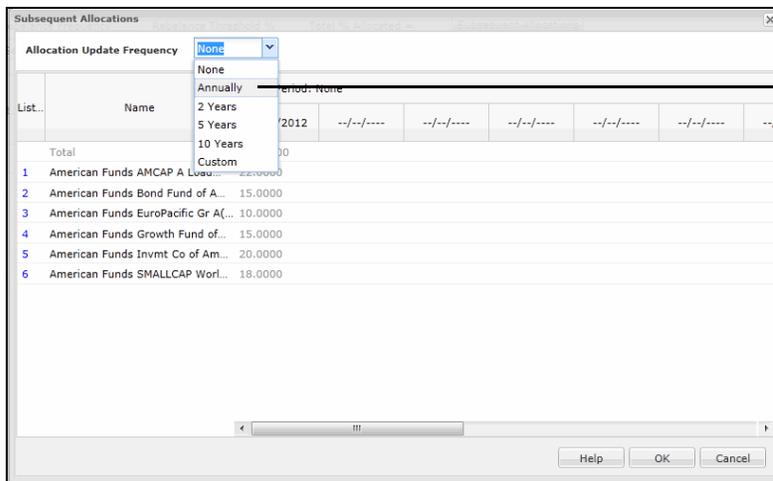
To rebalance a hypothetical illustration, do the following:

1. Click the **Reinvest/Reb** tab at the top of the window.
2. From the Rebalance Frequency drop-down field at the top of this step, choose **Semi-Annually**.
3. You can set a new rebalancing schedule for the funds if you like, or you can use the initial investment allocation.



Select **Semi-Annually** from this drop-down list

4. To enter a threshold the portfolio must reach before rebalancing occurs, click in the **Rebalance Threshold % +/-** field and enter a **percentage**.
5. To rebalance to different asset allocations over time, click the **Subsequent Allocations** button. The Subsequent Allocations dialog box appears.
6. From the Allocation Update Frequency drop-down field, select **Annually**.



Select **Annually** from this drop-down list

- You can select **Custom** from the Allocation Update Frequency drop-down list to enter up to 15 allocations with custom dates. You must use month-end dates.

7. In the fields below, you can enter new allocation values.
8. Click **OK** to return to the Reinvest/Rebalance tab.

The other aspect of this step is to decide whether dividends and capital gains will be reinvested in this portfolio. The default option is to reinvest these monies, and we will leave this setting as is. If the client did not want to reinvest the dividends and capital gains, and instead wanted to take them as distributions, you could select **No** from the drop-down field for each of those columns.

List	Name	Reinvest		Rebalance	
		Div/Income	Cap Gain Dists	Rebalance %	Initial Allocation...
		Apply to All	Apply to All	Apply to All	
1	American Funds AMCAP A(USD,A...	Yes	Yes	22.0000	22.0000
2	American Funds Bond Fund of A...	Yes	Yes	15.0000	15.0000
3	American Funds EuroPacific Gr A(...	Yes	Yes	10.0000	10.0000
4	American Funds Growth Fund of...	Yes	Yes	15.0000	15.0000
5	American Funds Invmt Co of Am...	Yes	Yes	20.0000	20.0000
6	American Funds SMALLCAP Worl...	Yes	Yes	18.0000	18.0000

You can use these fields to illustrate the effects of reinvesting back into the portfolio, or taking distributions

Here are some factors to consider when determining the fees for a hypothetical illustration:

- Will the fees be paid by selling off shares from the portfolio, or will the client pay the fees out of their own pocket?
- Will the fees be paid at the beginning of a time period, or at the end of one?
- If the fees are to be paid by selling off shares of the portfolio, should the cash position be used before equity or fixed-income holdings are used?
- If you elected to rebalance the portfolio, are you going to apply transaction fees for the rebalancing?
- Are you going to use the Standard front-end loads for the funds, or enter a custom charge?
- Is there a Letter of Intent for future purchases to consider?

☞ To see the front-end sales charges and LOI period for a fund, scroll to the right on the Fees tab and click the **View** link in the Standard Fee Schedule column.

### Assigning the fees that will be charged for the hypothetical illustration

Standard Fee Schedule	
Standard sales fees are listed here, when available. The values are taken from Morningstar's internal databases.	
<b>Front-end Sales Charges</b>	
USD0 - USD24,999	5.7500%
USD25,000 - USD49,999	5.0000%
USD50,000 - USD99,999	4.5000%
USD100,000 - USD249,999	3.5000%
USD250,000 - USD499,999	2.5000%
USD500,000 - USD749,999	2.0000%
USD750,000 - USD999,999	1.5000%
USD1,000,000 -	0.0000%
<b>LOI Period</b>	13 Months

This window appears when you click the **View** link in the Standard Fee Schedule column

To set the fees for the portfolio, do the following:

1. Click the **Fees** tab at the top of the window. Since we'll be using the same rate for each fund, you can enter all of the following values in the Apply to All row.
2. In the Annl Fee % field, type **1.00**.
3. From the Frequency field, click the drop-down arrow and select **Quarterly**. (This means that each quarter, 25 basis points will be applied to the portfolio to determine what fees will be charged for managing the portfolio.)
4. To avoid charging both an annual fee and the load for a fund, click the **Load Type** drop-down field, select **Custom** and ensure the Amount field is **0**.

List...	Name	Asset-Based Fee		Sales Fees		Redemp
		Annl Fee %	Frequency	Load Type	Amount	
		Apply to All	Apply to All	Apply to All	Apply to All	Apply to All
1	American Funds AMCAP A(USD,A...	1.0000	Quarterly	Custom	0.0000	%
2	American Funds Bond Fund of A...	1.0000	Quarterly	Custom	0.0000	%
3	American Funds EuroPacific Gr A(...	1.0000	Quarterly	Custom	0.0000	%
4	American Funds Growth Fund of...	1.0000	Quarterly	Custom	0.0000	%
5	American Funds Invmnt Co of Am...	1.0000	Quarterly	Custom	0.0000	%
6	American Funds SMALLCAP Worl...	1.0000	Quarterly	Custom	0.0000	%

Enter the fee information in the Apply to All row.

To assign the tax rate for the hypothetical illustration, do the following:

☞ Illustrations that contain subaccounts for a variable annuity will not be able to apply taxes.

1. Click the **Taxes** tab at the top of the window.
2. From the Filing Status drop-down field, select **Married Filing Jointly**.
3. In the Taxable Income field, type **110,000**.
4. Click anywhere on the screen. Note that the Federal Income field automatically updates with the correct value. You can overwrite this value, or any of the other tax fields, if necessary.

### Determining the tax rate to be applied to the portfolio

Calculate Tax Information	Filing Status	Married Filing Jointly
	Taxable Income	110,000
	Pay Taxes	Out of Pocket
Tax Rate %	Federal Income	25.0000
	Capital Gain	15.0000
	State	0.0000

You can overwrite the values in these fields, if necessary

The final tab in the hypothetical illustration tool requires the following decisions:

## Selecting the report options

- What type of hypothetical illustration are you going to run: Individual Holdings, Portfolio or Comparison?
- What reports will you include along with the hypothetical illustration?
- How frequently will returns be displayed for the hypothetical illustration?

To set the report options, do the following:

1. Click the **Report Options** tab at the top of the window.
2. From the Report Type area, make sure the **Portfolio** option button is selected.
3. In the cover page area, fill in the fields for **Client Name** and **Prepared By**.
4. Click the **check box** for each report you would like to include along with the hypothetical illustration. Each report is briefly described in the table below.

 The reports you see in your version of the application will be those your institution has subscribed to. They might differ from those listed below.

Report Name	Description
Distribution and Withdrawal Summary	This report shows you the dividends, capital gain distributions and withdrawals that were either taken from or reinvested back into investments over the hypothetical period.
Portfolio X-Ray*	This report details a portfolio's holdings in terms of broad asset class exposure, style box breakdown by Equity and Fixed-Income holdings, and regional exposure.
Portfolio Snapshot*	This report shows both holdings and performance information for a portfolio of investments.
Stock Intersection*	This report shows you the overlap for the top 25 net stock holdings in a portfolio, ranked by percentage of portfolio net assets.
Risk/Reward Scatterplot**	The report shows the standard deviation and mean return for each holding, as well as the portfolio itself, and the benchmark. In contrast to the Risk/Reward Scatterplot on the Portfolio Snapshot report, this version provides a numbered and color-coded key to understand which dot on the scatterplot reflects each holding.
Correlation Matrix**	This report demonstrates the relationship of return patterns among investments. If a strong positive correlation is present among all holdings, you might not be getting true diversification for the portfolio. Up to 20 holdings can be shown here.
Rolling Returns**	This report shows the returns for each holding in the illustration, and it reflects the time period for the illustration as well. The largest positive and negative return period is shaded gray on the chart.
Total Annual Return	This report shows the total return (after fees and expenses) for the trailing 12 months for each holding. Up to 10 securities (selected based on alphabetical order) can be displayed.
Investment Details	This one-page report summarizes the information for each investment in the portfolio.
Price and Distribution Report	This report shows you the change in NAV for a fund going back to its inception date (or the earliest price available in Morningstar's database. You can also see the dividend and capital gain distributions for a fund on this report.
Disclosure Materials	This material must be included in order for the illustration to be FINRA compliant.

 \*These reports are available only when you run a Portfolio hypothetical. They are not available for Individual Holdings or Comparison hypothetical illustrations.

\*\*You need to select the time period (available at the bottom of the Report Option tab) to be used with these reports.

- From the Display Return on Report field, select **Semi-Annually**. This will allow us to see returns every six months for the portfolio.

The screenshot shows the 'Report Options' dialog box in Morningstar software. The 'Report Type' section includes radio buttons for 'Portfolio' (selected), 'Individual Holdings', 'Portfolio Comparison', and 'Holdings Comparison'. The 'Display Return on Report' dropdown is set to 'Semi-Annually'. There are two checked checkboxes: 'Include Net Amount Invested' and 'Include Benchmark in Illustration'. The 'Select Benchmark' dropdown is set to 'S&P 500 TR'. The 'Return Calculation' section has radio buttons for 'NAV' and 'Market Price' (selected). The 'Graphic Display' section has radio buttons for 'Line', 'Mountain' (selected), and 'Stacked Bar'. The 'Scale' section has radio buttons for 'Linear' (selected) and 'Logarithmic'. The 'Page Included' section has a checked checkbox for 'Cover Page'. Below this, there are text input fields for 'Report Title' (Hypothetical Illustration), 'Client Name', 'Prepared By', 'Prepared By Title', 'Firm Name', and 'Date' (12/11/2012). An 'Additional Information' link is at the bottom.

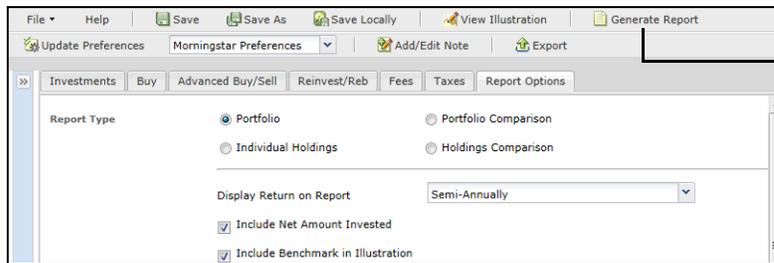
Review all of the options here before generating the report.

- Leave the boxes checked for **Include Net Amount Invested** and **Include Benchmark**. The default benchmark is the S&P 500 Total Return index, but you can change this. The Include Net Amount Invested field will include a third line on the Portfolio Summary hypothetical illustration chart. The first line shows the performance of the hypothetical, the second shows the performance of the benchmark, and the third is the total number of dollars the client has invested over time.

Note: if you did not make any subsequent investments in the hypothetical, it is not necessary to check the Net Amount Invested box, because this will simply produce a flat line on the hypothetical return graph at the amount of the initial investment.

Now that all of the variables for the illustration have been entered, click the **Generate Report** button at the top of the window. The reports will appear as a PDF in a separate window.

## Generating the report(s)



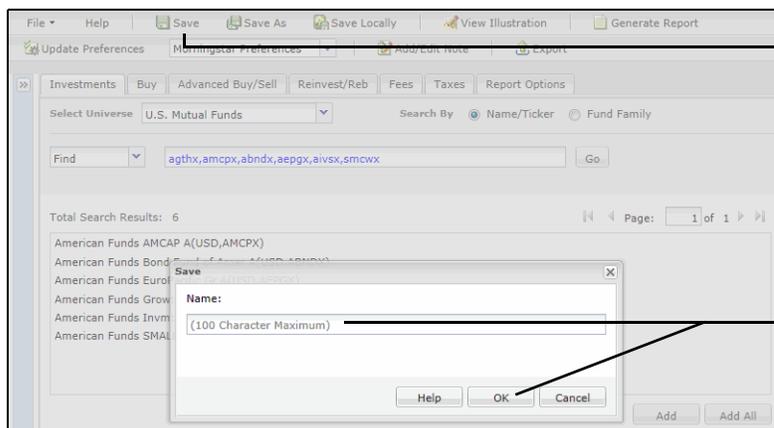
Click this button to generate the reports.

You can save a hypothetical illustration at any point as you are creating it. The illustration will be saved to the main Advisor Workstation window. From the Hypotheticals tab, you can double-click the name of a saved hypothetical to open it for editing.

## Saving hypothetical illustrations

To save a hypothetical illustration, do the following:

1. Click the **Save** button at the top of the screen. The Save dialog box appears.
2. Type a **name** for the hypothetical illustration.
  - ☞ If you would prefer to save the illustration locally in an encrypted XML file, click the **Save Locally** button instead. You will be prompted to choose a name and destination for the file.
3. Click **OK**.



Click this button to save a hypothetical illustration.

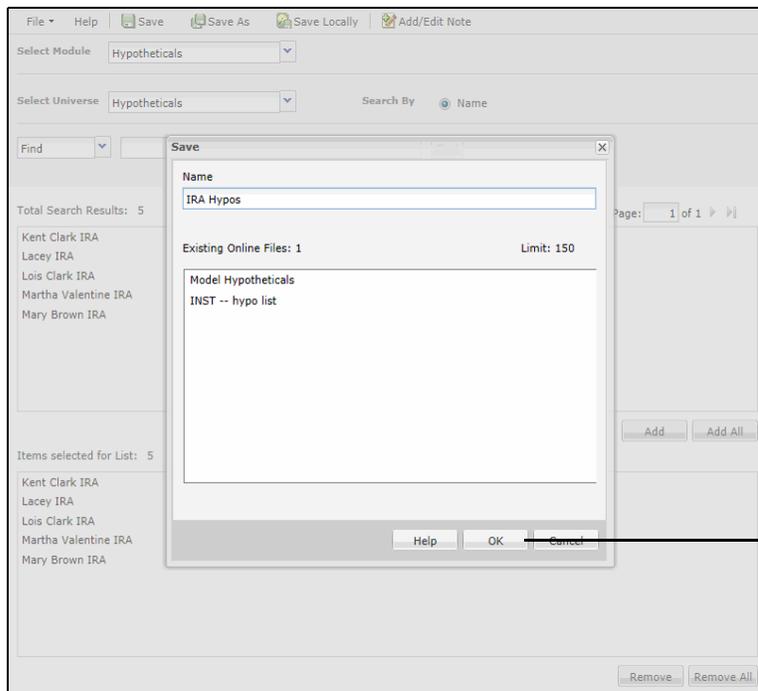
Type a name for the illustration here, then click OK

You can organize the hypothetical illustrations you have saved online into a series of lists. (This is not available for illustrations you saved locally.)

## Creating lists of hypothetical illustrations

To create a list of saved hypotheticals, do the following:

1. From the Hypotheticals tab in Advisor Workstation, click to select the **hypothetical illustrations** you want to include in a list.
  - ☞ You can use <SHIFT>+click to select multiple consecutive records, or <CTRL>+click to choose multiple non-consecutive records.
2. From the menu bar select **File...New...List**, or right-click and select **New...List**. The List dialog box appears. The records you highlighted appear in the Total Search Results area.
3. Click **Add All** to move the saved hypotheticals from the Search Results area to the Items Selected for List area.
4. Click **Save** at the top of the dialog box.
5. In the Save dialog box, enter a **name** for the list.



Enter a name for the list and click OK

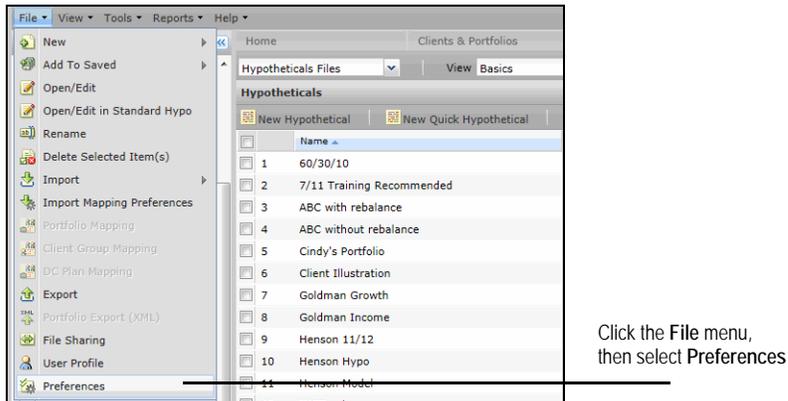
6. Click **OK**, then close the List dialog box.
7. In the left-hand navigation pane, click once on the **Hypo Lists** item under the Hypotheticals User Files folder to see the list you've just created.
8. To see the items that comprise a list, double-click its name. The List dialog box appears again. You can also add or remove saved hypos from the list with this dialog box.

If you find yourself using the same inputs (initial investment, time horizon, rebalancing, fees, etc.) for a hypothetical illustration over and over again, you can save those settings as your default options.

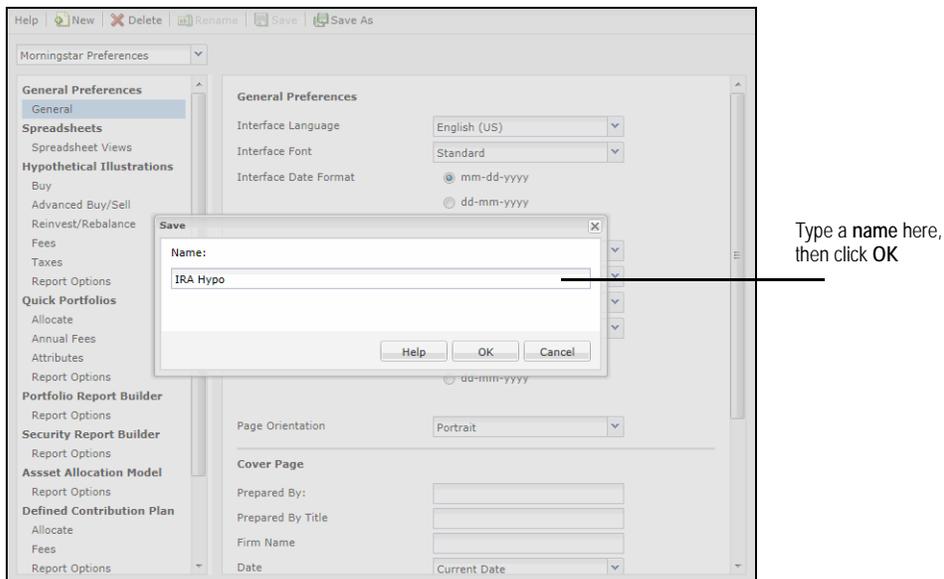
## Updating the default settings for hypothetical illustrations

To update the default settings for a hypothetical illustration, do the following:

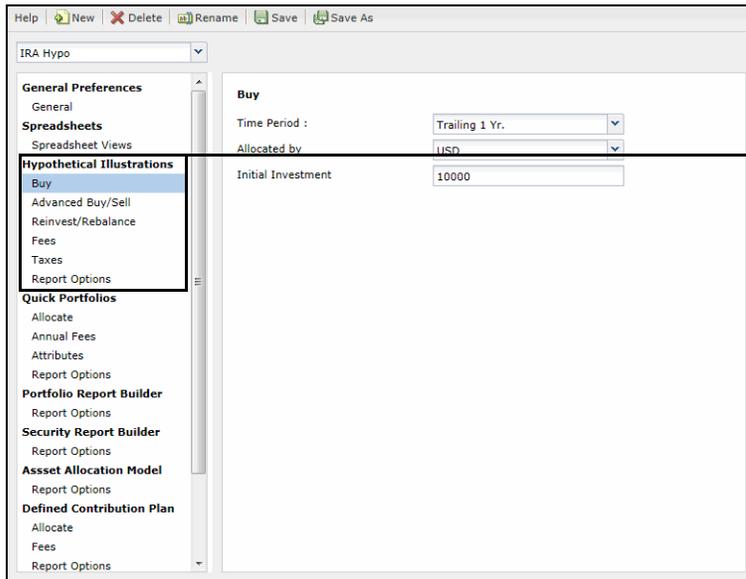
1. From the **File** menu, select **Preferences**. The Preferences dialog box appears.



2. At the top of the window, click **New**. The Save dialog box appears.
3. Type a **Name** for this set of preferences, then click **OK**.

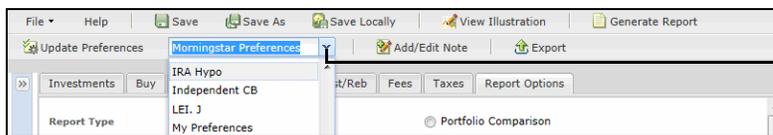


- Under Hypothetical Illustrations, select a main area (**Buy, Advanced Buy/Sell** etc.) from the left-hand navigation panel, then update the default preferences for each area.



Click each option here to change your default settings for each section of the hypothetical illustration.

- Click **Save** to save your preferences.
- To select your set of preferences while working in the hypothetical illustration tool, click the **Preference** drop-down field at the top of the window and make a selection.



Click this drop-down field and make a selection to use a set of preferences you have created