Creating Hypothetical Illustrations in Principia

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Overview

This document explains how to use the Sales/Hypothetical tool in Principia. The Sales/Hypothetical tool is a seven-step wizard that allows you to run a historical report showing the performance of a portfolio or a list of investments. You can also run a comparison between a set of investments.

You might find it quickest to run a hypothetical if you have already created a portfolio for a client, since the Hypothetical tool will allow you to import these without having to re-create them.

Building a hypothetical illustration involves the following seven steps:

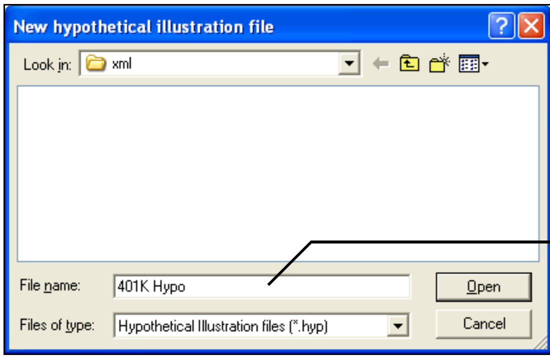
1. Select the securities (up to 20) for the illustration.
2. Choose a time period for the illustration (default is trailing 12 months).
3. Set an initial investment for the illustration (default is $10,000).
4. Denote any subsequent investments to or withdrawals from the illustration.
5. Deduct any management fees from the portfolio.
6. Decide whether to do any rebalancing or transferring within the illustration.
7. Account for any tax implications, choose a benchmark for the report, select graph options and decide which other reports to produce along with the illustration.

A PDF report is generated after the final step. This PDF file can be saved, printed, or sent via Email. Appropriate disclosure materials are included in the PDF.

How do I create a hypothetical illustration?

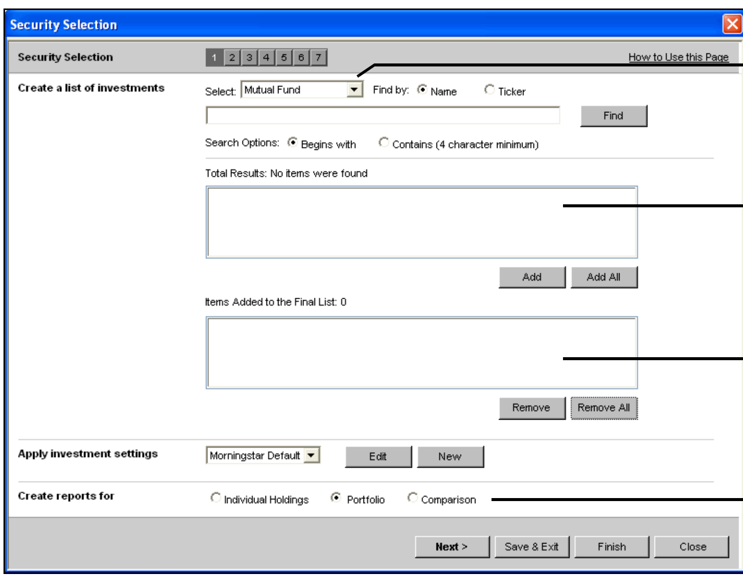
The Hypothetical Illustration tool can be opened only from Portfolio Mode. To open the Hypothetical Illustration tool, click the **Launch hypothetical** icon on the toolbar, or click the **File** menu and select **Launch Hypothetical**.

The New hypothetical illustration file dialog box appears. From here, you can either open an existing hypothetical illustration, or type a **name** for a new illustration, then click **Open**.



Type a name for a new hypothetical illustration here, then click Open.

The Hypothetical Illustration window appears, and is shown below.



Universe

Total Results box

Final List of Items box

Report options

Step 1—Selecting Securities for a Hypothetical Illustration

Overview

Step 1 of the hypothetical illustration wizard appears as soon as the tool is launched. Here you must choose the investments for the illustration. You will need to provide information in the following three sections:

- Create a list of investments
- Choose the type of illustration output report: individual, portfolio or comparison.

Creating a list of investments for the illustration

To choose the investments for the illustration, do the following:

1. From the **Select** drop-down field at the top of the screen, choose the desired universe to pull investments from.
2. Use the **Find** field to search for a security by name or ticker.
3. Click once to choose the **investments** you want to include in your illustration from the Total Results box in the middle, then click **Add**. The items will appear in the Final List box.

☞ You can click on a single investment in the Total Results box, or <SHIFT>+click to select multiple consecutive investments, or <CTRL>+click to select multiple non-consecutive items.

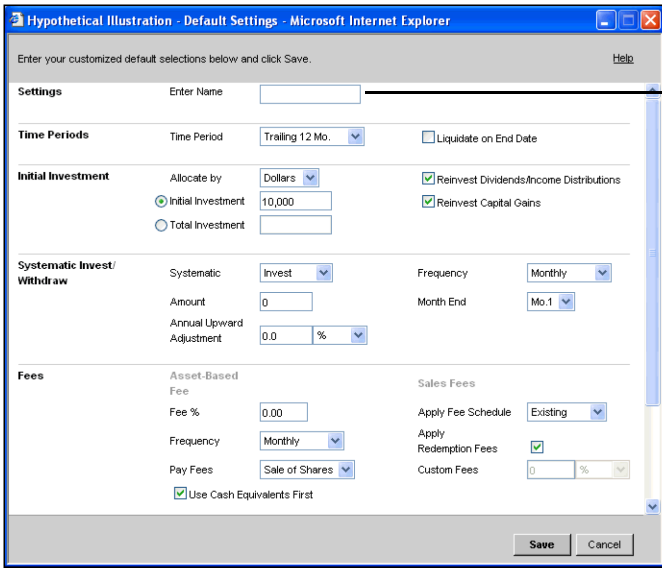
Editing or saving custom settings for a hypothetical report

Each user can save up to 10 different customized investment settings for Hypothetical Illustrations. The idea behind these settings is that you can pre-fill the values for the next six steps in the hypothetical wizard here, select the customized version you want, then jump right to the end and generate the report.

☞ You cannot edit the Morningstar Default settings.

To create a new set of custom investment settings, do the following:

1. In the Apply investment settings area, click **New**. The customized settings dialog box appears.
2. In the **Name** field at the top, type a name for these settings.
3. Fill in all other fields with the default settings you would like to use.



Type in a name, then change the settings to be applied to a hypothetical illustration.

4. Click **Save**.

Selecting a type of illustration

To decide which type of hypothetical report to run, you must choose between one of the following:

- Individual Investments
- Portfolio
- Comparison Report

See the table below for information on each of these options.

Option	Comments
Individual Holdings	Allows you to see separate information up to 20 investments, rather than as an aggregate portfolio. You cannot do any rebalancing or transferring with this option. Keep in mind that the more investments you choose, the longer it will take to produce the report.
Portfolio	The default option. Produces a single hypothetical illustration based on all investments. Limit of 20 investments.
Comparison Report	Allows you to see the hypothetical of multiple investments. The fewer investments used here, the easier the hypothetical illustration graph will be to read. You cannot do any rebalancing or transferring with this option.

Click **Next** to go to step 2 in the hypothetical illustration wizard.

Step 2—Choosing a Time Period for the Illustration

Overview

The next step is to define the Time Period for the hypothetical. You must also indicate whether the investment will be Liquidated on End Date.

For the Time Period field, you can choose from trailing periods (12 months, 3 year, 5 year, 10 year), or select from one of the following options:

- Since Inception
- Earliest Available
- Earliest Common, or
- Customized.

☞ For subaccounts, the earliest price for the illustration will be based on the inception of the underlying fund, and not the subaccount itself.

Note that in some cases, the Inception Date column for an investment might be later than the Earliest Price Avail. column. This is likely due to the fund being merged with another fund. If the Earliest Price Avail. column is later than the Inception Date column, this is due to a gap in Morningstar's database. For instance, a fund may have been created in 1933, but we have data going back to just 1949.

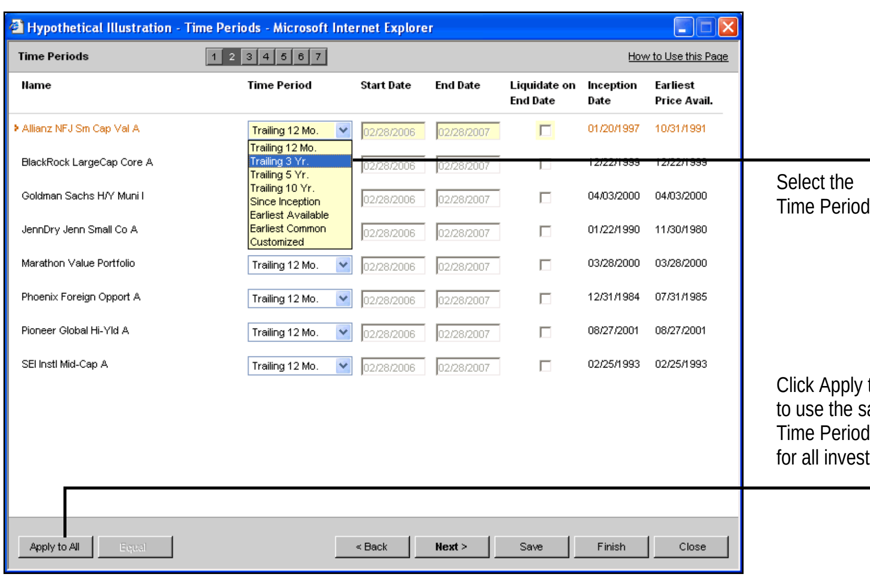
Selecting a time period for the illustration

To set time periods for the illustration, do the following:

1. From the **Time Period** drop-down field, choose an option for the first investment.

   ☞ If you are using the same time period for all investments, you can click the Apply to All button in the bottom left corner of the screen.

2. If you select **Customized** from the Time Period field, you must manually input the Start Date and End Date as: **MM/DD/YYYY**.



Select the Time Period.

Click Apply to All to use the same Time Period value for all investments.

3. Check whether to **Liquidate on End Date** for each security.
4. Click **Next** to go to step 3 in the hypothetical illustration wizard.

Step 3—Setting the Initial Investment for the Illustration

Overview

In this step, you must both enter the initial investment the client makes, and decide how to handle distributions and capital gains generated by the funds. The default is $10,000 for each investment in the illustration. You can enter different dollar, share or percentage amounts for each investment.

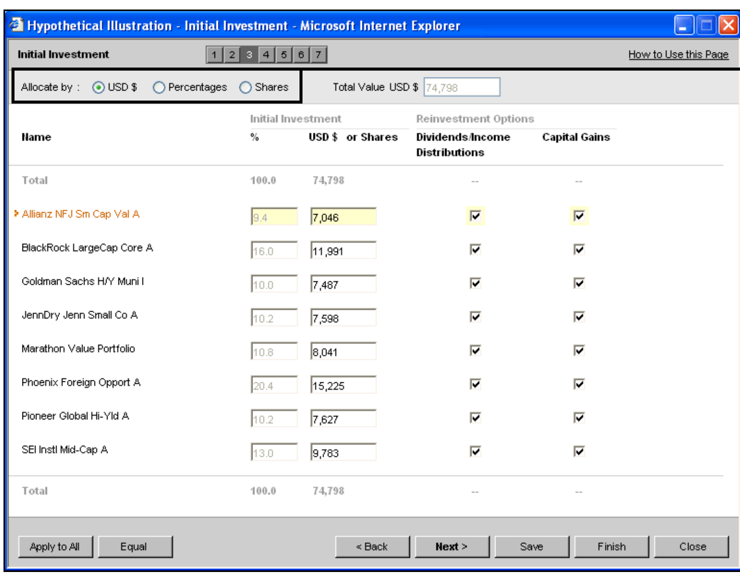
Entering the initial investment value

To enter the initial investment values, do the following:

1. Choose the allocation method (**Dollars**, **Percentages**, or **Shares**) by clicking on the corresponding option button.

   ☞ When using percentages, note that they must add up to exactly 100%.

2. Input values for the investments in the corresponding boxes. Note the following:
   - If equal dollar amounts are desired, use the **Apply to All** button.
   - If you choose to allocate using the Percentage option, the **Equal** button works the same as **Apply to All**.
   - If you created the illustration in step 1 based on a client's portfolio, the value of each investment is automatically entered here as the Initial Investment, but you can change this if necessary.



Make a selection here to choose how the initial investment will be allocated.

3. To automatically reinvest the Dividends and Capital Gains, leave the boxes checked in the **Dividends/Income Distributions** columns next to each item.
4. When all values are entered, click **Next** to go to step 4 in the hypothetical illustration wizard.

Step 4—Determining Subsequent Investments or Withdrawals

Overview

This step allows you to assign investments to or withdrawals from each investment, following the initial investment. You can opt to systematically do one of the following on a regular basis:

- Invest
- Withdraw (by dollars or shares), or
- Withdraw %.

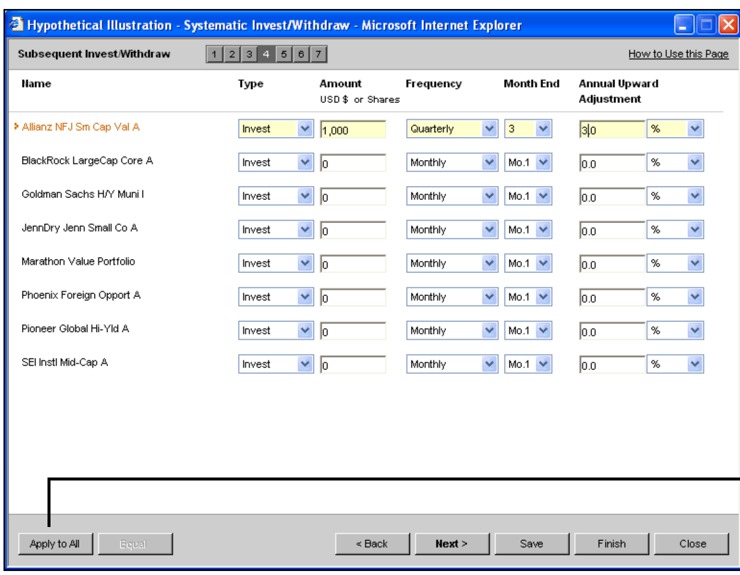
You also have the option of entering customized investments or withdrawals.

The other item to attend to in this step is to determine whether the investment or withdraw amount should be adjusted upward each year, to account for inflation or salary increases.

Setting the values for subsequent investments or withdrawals

To set the values by Invest, Withdrawal or Withdrawal%, do the following:

1. Choose a type of action (**Invest, Wthdrwl, or Wthdrwl %)** for the first investment.



Use the Apply to All button to copy the settings from the highlighted row to all other rows.

2. In the Amount ($ or shares) field, type the **dollar amount**, **number of shares** or **percentage amount** (in the case of withdrawals) to invest or withdraw.
3. In the **Frequency** field, select how often the transaction should take place.
4. In the Month End field, select which **Month End** the investment or withdrawal should be made. For example, if you want the investments to be made at quarter's end then you would set the Frequency field to **Quarterly**, and the Month End field to **3**.
5. If applicable, include an **Annual Upward Adjustment** value using a dollar or percentage increase. Make sure that when using this feature that you have correctly chosen $ or %.

   ☞ If these settings will apply to all investments, click Apply to All.

6. Click **Next** to go to step 5 in the hypothetical illustration wizard.

How can I set up a customized investment or withdrawal schedule?

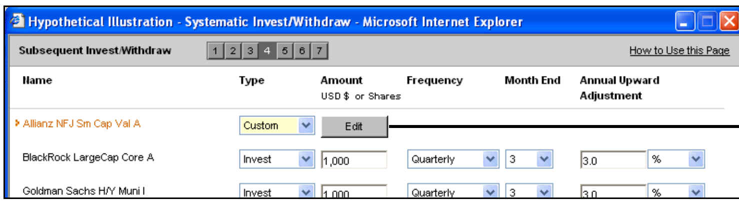
You have two options when customizing a schedule for investments or withdrawals:

1. You can enter month-by-month changes to a portfolio or investment.
2. You can set up a systematic investment or withdrawal schedule similar to what you would do in the standard screen, but you here you can set a custom start and end date.

> ☞ All custom transactions are executed on the last day of each month. The last available date for a custom transaction is the last day of the last complete month of the investment period.

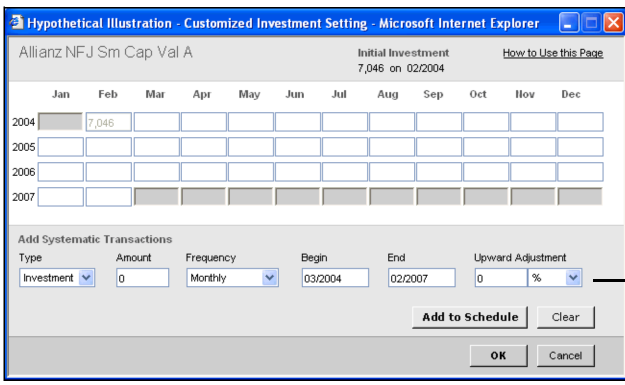
To set up a customized investment or withdrawal schedule, do the following:

1. From the Type drop-down field, select **Custom**.
2. Click the **Edit** button that appears. The Customized Investment Setting dialog box appears.



Click the Edit button to enter customized investments or withdrawals.

3. To enter lump-sum amounts by month-by-month, click in the month and enter the **dollar value**.



Enter month-by-month investments or withdrawals, or use the systematic fields at the bottom of this dialog box.

> ☞ Enter a positive value for Investments. Withdrawals are entered as a negative value, using the minus sign. For example, a withdrawal of $1,000 should be entered as -1000.

4. To enter investments or withdrawals using customized systematic settings, use the fields at the bottom of the dialog box. Click **Add to Schedule** when done.

> ☞ The start date cannot precede the inception date of the holding or the earliest price Morningstar has available for the holding.

5. To save these changes and return to the main Hypothetical window, click **OK**. Otherwise, click **Cancel** to remove these changes and return to the main window.
6. Click **Next** to go to step 5 in the hypothetical illustration wizard.

Step 5—Deducting Plan Fees from the Illustration

Overview

All expenses associated with investments will automatically be deducted by the wizard. This step is for you to record management fees against the portfolio.

In this screen, you must do the following:

- Decide how often to take out fees from the portfolio
- Determine what to charge for front-load fees, and
- Determine whether to charge back-end or redemption fees

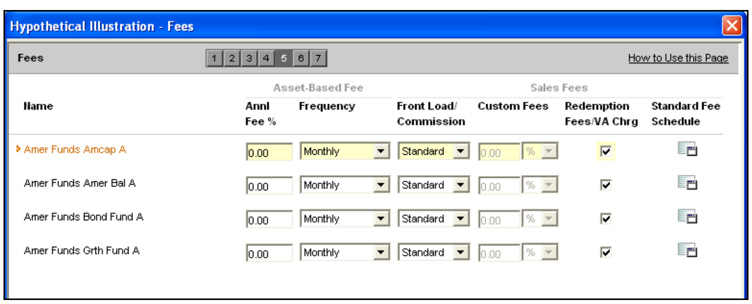
☞ The hypothetical wizard does not calculate rights of accumulation charges.

Deciding how to take out management fees

You can deduct management fees by having a client pay them out of pocket.

To determine how to pay these fees, do the following:

1. Enter a value in the **Annl Fee%** field for one of the investments. The Asset-Based Fee Options fields at the top of the screen become available.
2. In the **Annl Fee%** field, type the annual rate you will charge. Use two decimal points; for example, **1.00**.
3. In the **Frequency** drop-down field, select how often these fees will be withdrawn. For instance, if you charge 1.00% annually, and you select Quarterly from the Frequency field, 25 basis points will deducted each quarter.
4. In the Front Load/Commission field, decide whether to use the **Standard** rate, or a **Custom** one. You can click the icon in the Standard Fee Schedule column to see what the standard rate would be.



Use these fields to decide how to deduct management fees from a hypothetical illustration.

5. In the Redemption Fees/VA Chrg field, uncheck the box if you do not want to charge this fee.
6. Click **Next** to go to Step 6 the hypothetical illustration wizard.

Step 6—Rebalancing or Transferring Investments

Overview

You cannot both rebalance a portfolio and transfer assets from one investment to another; only one method can be chosen. By default, the tool assumes no rebalancing or transfers.

In most cases, assets can be rebalanced on a monthly, quarterly, semi-annual or annual basis.

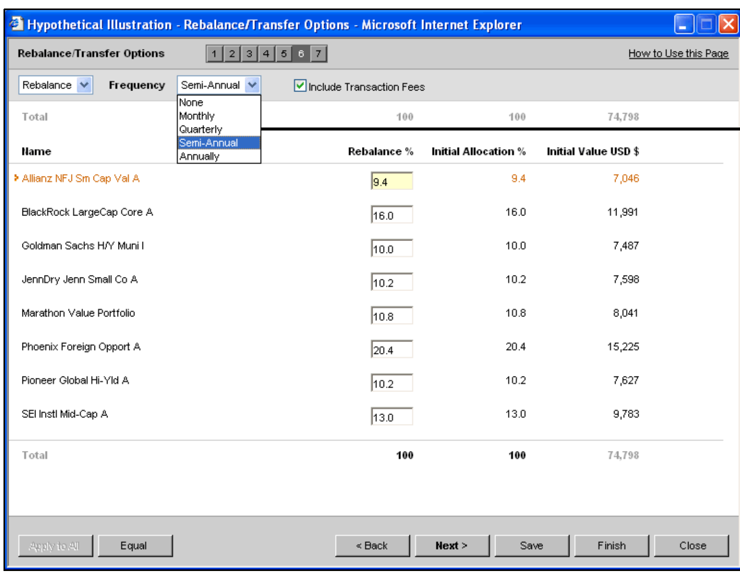
Note the following rules about transfers:

- For variable accounts, the only option is to use a Cash transfer (1-time or Systematic).

How to rebalance investments

To rebalance investments, do the following:

1. From the drop down menu in the upper left corner, make sure **Rebalance** is selected.
2. From the **Frequency** drop-down field, choose one of the following:
   - Quarterly
   - Semi-annually, or
   - Annually.



Select the Frequency for rebalancing from this field.

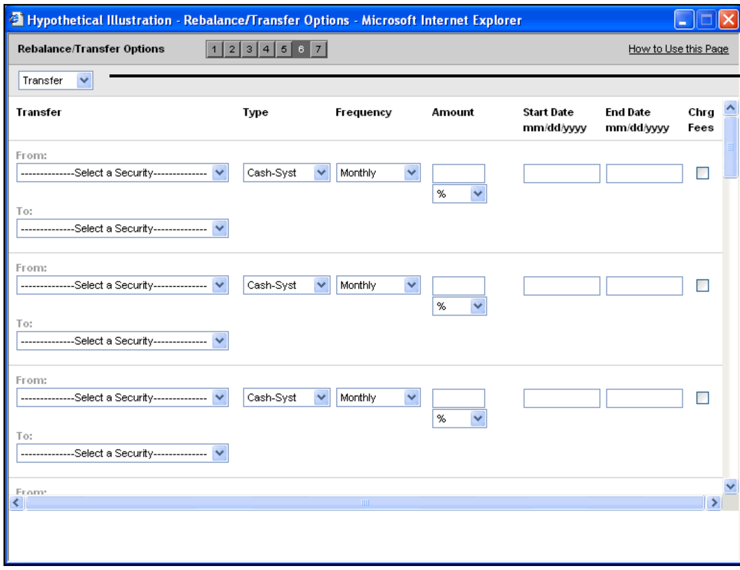
3. Input the desired rebalancing percentages. It defaults to equal amounts for qualifying investments. Note that the total must equal 100%.

   ☞ Any fixed account will not be included in the future rebalancing calculation.

How to transfer investments

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

1. From the drop-down menu in the upper left corner, select **Transfer**. Note the changes to the interface (shown below).



Note how the screen changes in Step 6 when you select Transfer from this drop-down field.

2. In the **From** drop-down field, select an investment to transfer holdings from.
3. In the **To** drop-down field, select the investment the holdings will be transferred to.
4. Define the transfer **Type** in the next menu based on the information in the table below:

   ☞ The types available to you will depend on the kind of investment you are working with.

Type	Meaning
Cash-Syst	This setting transfers dollar/percentage amounts systematically. You must choose a **Frequency** when selecting this option.
Cash-1 Time	This option is for a one-time dollar/percentage amount transfer. You do not need to choose a frequency, only the **Start Date** of the transaction.
Cap Gain + Inc	Transfers both capital gains and income.
Income	Transfers income only.
Cap Gains	Transfers capital gains only.

5. Choose the **Frequency** (only necessary for Cash-Syst type transfers) of the transfer.
6. Determine whether transfer is in **dollars** ($) or **percentages** (%).
7. Enter the dollar or percentage **Amount** to be transferred.
8. Input the **Start Date** and **End Date** for the transfers.

   ☞ Cash-1 time transfers require only a Start Date. Multiple Cash-1 time transfers can be made with the same two investments to simulate random transfers.

9. Decide whether to **Charge Fees** for the transaction.
10. Click **Next** or **Finish** to advance to step 7 in the hypothetical illustration wizard.

Step 7—Choosing the Options for the Output Report

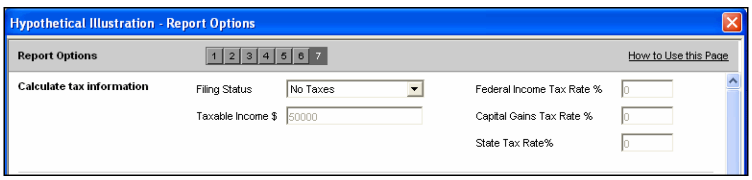
Overview

The final step of the hypothetical wizard allows you to do the following:

- Determine whether and how much to deduct for taxes
- Specify whether a benchmark will be included on the output report
- Decide how the performance results will be displayed
- Include other report materials, including a customized cover page, Portfolio Snapshot report and Investment Detail report on the individual holdings of the portfolio

Determining taxes for the portfolio

At the top of step 7, you can determine whether to include tax information for the client. See the table below for information on the fields in this section.



Calculate the tax information for the illustration here.

Field	Description
Filing Status	Defaults to No Taxes, but you can also choose from the following: • Single • Married Filing Jointly • Married Filing separately • Head of Household
Taxable Income	Enter the client's taxable income here. The Federal Income Tax Rate% will be calculated automatically based on what you enter here.
Federal Income Tax Rate%	Defaults to the appropriate amount based on the value you entered in the Taxable Income field, but you can overwrite it here.
Capital Gains Tax Rate%	Defaults to 15%, but you can adjust this if necessary.
State Tax Rate%	Type in the client's state income tax rate, if applicable.

Specifying display options for the illustration

In the next section in step 7, you can determine the following:

- Whether to include a benchmark on the illustration
- Which benchmark to use
- Whether to display returns on a monthly, quarterly, semi-annual or annual basis
- Whether to show net dollars invested in the portfolio, and
- Whether to show the Holdings Summary on the report as a Mountain graph, or Stacked Bar chart.

To specify the display options for the hypothetical illustration report, do the following:

1. In the Portfolio Summary section of the report, click the **Benchmark** checkbox to include a benchmark. A menu box appears, giving you the option of over 100 indices to choose from for the benchmark.

Click here to
select a benchmark.

2. Click **OK** to accept the benchmark and close the pop-up window.

   ☞ If you select the wrong benchmark by accident, click Change Benchmark.

3. Choose type of **Holdings Summary** graph (Mountain or Stacked Bar).

Selecting reports for the hypothetical illustration

In addition to the hypothetical analysis, you can also include the following:

- Custom cover page
- Portfolio Snapshot report
- Investment Detail report (for each investment in the portfolio), and
- Disclosure Materials

☞ Note that the Portfolio Snapshot report is available only when you create a Portfolio hypothetical, and not when running a hypothetical based on Individual Holdings, or a Comparison hypothetical.

Check the box next to each option to include it.

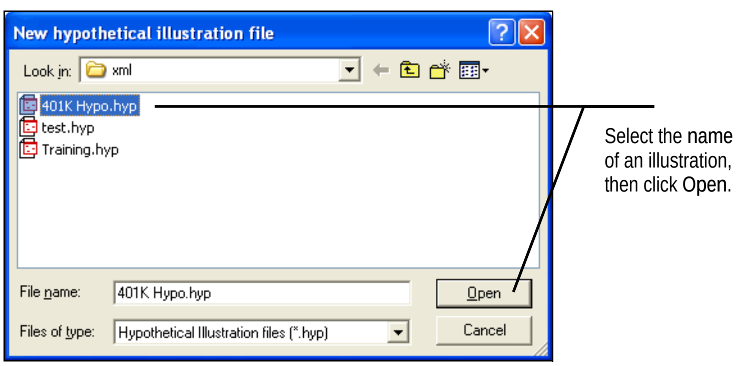
Generating the hypothetical report

To generate the hypothetical illustration, click the **Generate Report** button. The Hypothetical Illustration opens in Acrobat as a PDF.

How do I open a saved hypothetical illustration?

To open a hypothetical illustration, do the following:

1. From Portfolio mode, click the **Launch hypothetical** icon. The New hypothetical illustration file dialog box appears.
2. Click once to select the **name** of the illustrating you want to open.



3. Click **Open**. The hypothetical's settings automatically appear in the wizard. You can click **Finish** to go to the final step and generate the report.

Lab 1—Selecting the Investments for a Hypothetical

Goal

In this exercise, you will practice selecting a list of investments for a hypothetical illustration.

Exercise

We will create a hypothetical illustration for five mutual funds. Do the following:

1. In Portfolio Mode, click the **Launch hypothetical** icon.
2. In the Find by: field, select the option button for **Ticker**.
3. Type in the following set of ticker symbols: **CTBIX, CGMFX, FMAGX, SLASX, VINIX**.
4. Click **Find**.
5. Click the **Add All** button to move these five funds into the Items Added to the Final List area.
6. Click **Next** to go to step 2.

Lab 2—Selecting the Time Period

Goal

In this exercise, you will set the time period in step 2 to define the illustration.

Exercise

To define the time period for this illustration, do the following:

1. In the Time Period drop-down field for the first investment, select **Trailing 3 Yr.**
2. Click the **Apply to All** button in the lower left corner.

Lab 3—Setting the Initial Investment

Goal

In this exercise, you will enter a dollar value for each of the investments in the portfolio.

Exercise

Enter the following dollar amounts for each investment in the portfolio, then click **Next** to go to step 4:

Fund Name	Amount
ABN AMRO Bond I	10,000
CGM Focus	7500
Fidelity Magellan	2500
Selected American S	3000
Vanguard Inst Idx	2000

Lab 4—Subsequent Investments and Withdrawals

Goal

In this exercise, you will schedule subsequent investments for the portfolio, and adjust the contribution amount to account for raises the client will receive.

Exercise

To note the additional dollars the client will add to the portfolio, do the following for the first investment:

1. In the Type field, make sure **Invest** is selected.
2. In the Amount field, type **200**.
3. In the Frequency field, select **Quarterly**.
4. In the Month End field, select **3**.
5. In the Annual Upward Adjustment field, type **3.0**.
6. Click **Apply to All**.
7. Click **Next** to go to step 5.

Lab 5—Assigning Fees

Goal

In this exercise, we will assign the necessary management fees to the portfolio

Exercise

To enter your fee, do the following for the first investment:

1. In the Annl Fee% field, type **1.00**.
2. In the Frequency field, select **Quarterly**.
3. In the Front Load/Commission field, select **Custom**. (The Custom Fees should be 0.00).
4. Click **Apply to All**.
5. Click **Next** to go to step 6.

Lab 6—Rebalancing the Portfolio

Goal

In this exercise, you will set the portfolio to rebalance each quarter.

Exercise

To rebalance the portfolio on a quarterly basis, do the following:

1. In the Frequency field at the top of the screen, select **Quarterly**.
2. Check the **Include Transaction Fees** box if it is not already checked.
3. In the Rebalance % field, type in the following for each investment:

Fund Name	Rebalance %
ABN AMRO Bond I	30
CGM Focus	30
Fidelity Magellan	15
Selected American S	15
Vanguard Inst Idx	10

4. Click **Next** to go to step 7.

Lab 7—Generating the Report

Goal

In this exercise, you will put the finishing touches on the hypothetical illustration and produce the report.

Exercise

Make the following changes in step 7:

1. Skip the tax information section at the top.
2. Check the **Include Benchmark** box. When the dialog box appears, select the **S&P 500 TR**.
3. In the Returns Displayed on Report field, make sure **Annually** is selected.
4. In the Include Additional Reports section, include the following reports:
   - Cover Page
   - Portfolio Snapshot
   - Investment Detail Report
   - Disclosure Materials
5. For the Cover Page, type in a **Report Title** and **Client Name**. Type your name in the **Prepared By** field.
6. Click **Generate Report**.