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New and Improved Bucket Planning?
by Mitchell M. Maynard

In the last month, there has been a lot of discussion regarding a new and supposedly improved bucket planning strategy. In my white paper on the failings of bucket planning, "Bucket Planning is a House of Cards" (January 2006), it was hard to dispute my empirical historical analysis, which revealed the bucket strategy to be more of a sales tactic and not a valid financial planning strategy. New modifications were apparently in order to continue the proliferation of the bucket sales tactic. So, I thought it would be good for me to take the time to help you analyze this latest bucket planning 'break-through'.

The modification to the bucket planning program has replaced annuitization with simple withdrawals from a fixed annuity. Is this a real solution? Why has the bucket planning strategy changed? The reasoning behind the change is that the IRR (Internal Rate of Return) on annuitized annuities is too low and the fixed interest rate is superior. Let's ask ourselves a question; "Is improving an already inadequate sales tactic a proper financial planning solution?" The answer is "No!"

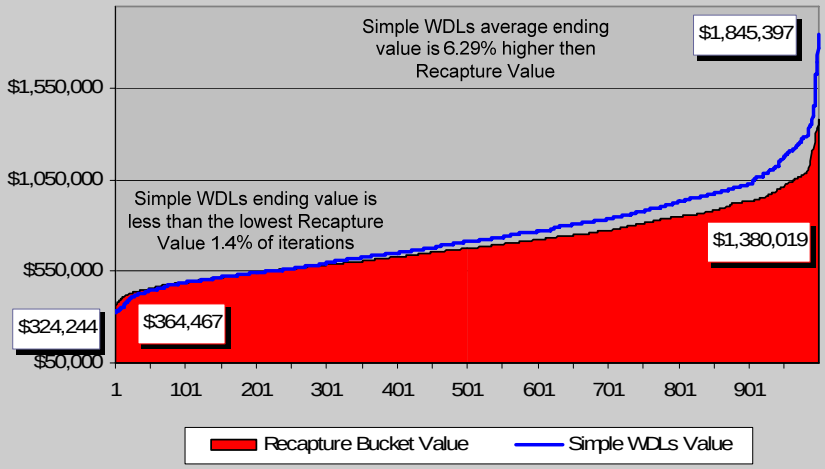
First of all, I hope your client doesn't need their income for 5 years, because the amount allocated to the fixed annuities will not produce enough income due to surrender charges. However, in the study that I conduct below, I will assume that the full income need can be met without any surrender charges.

As I proved in my earlier paper, the ending results were that the bucket strategy paled in comparison to simply taking withdrawals. In all cases simply taking withdrawals produced account values that were hundreds of thousands of dollars greater. To analyze the new bucket strategy, I chose a model that evaluated the financial outcomes of this new tactic versus simple withdrawals by using Monte Carlo Simulation. This will help to accomplish two primary goals:

1. Disprove the belief that EIAs have significant risk in income planning
2. Prove simple withdrawals from an EIA has superior risk adjusted results

Why is Monte Carlo a fair way of analyzing the two strategies? Monte Carlo is a process of creating randomized returns so that we can statistically evaluate potential financial planning/ retirement planning outcomes. It is a necessary (and frequently used) tool for anyone analyzing risk. Average rates of return

assume a constant rate of return (typically drawn from historical averages) over the entire scenario. Alternatively, the Monte Carlo techniques implemented for this study eliminate the historical return bias by allowing the computer to generate returns between a range of highest return and lowest returns.



The chart above shows the 1,000 ending values generated for both strategies. You will see that the small sliver of red represents the only range in which the modified bucket strategy has greater ending values than that of the simple withdrawals strategy. This represents only 7.5% of the time and there is only a 1.4% probability that the simple withdrawals strategy would ever be less than the lowest ending value for the modified bucket strategy.

The study also communicates that the average ending value of the simple withdrawals strategy is 6.29% higher than the bucket strategy's recapture bucket. This represents a difference of $44,005.71 in favor of withdrawals. Additionally, over 70% of the time the simple withdrawal strategy has at least a 1% greater ending value.

The simple withdrawal strategy is superior.

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