

Spend Some Time with a “Supermodel”

How a Monte Carlo simulation will help you retire.

By Glenn G. Kautt, CFP, EA

Who is going to “guarantee” your financial future? Of course, only you can “guarantee” your financial success through hard work and perseverance. However, you can increase the odds of success by working with a competent and well-trained professional advisor Certified Financial Planner and creating a financial blueprint through the use of a Stochastic Model.

What’s wrong with the old methods?

Most financial advisors still use an old model of retirement analysis to determine if their clients will be able to afford to retire. A wide array of planning tools sprung from the popularity of electronic spreadsheets, and they all share one trait. Stated technically, they are all deterministic models. Stated in plain English, these models give a single answer. Deterministic models use variables such as rate of return, or inflation and the outcome is usually stated as a single set of numbers or a graph. These models give literally average results. The problem is your life isn’t average, and the chances of your actual future coming out exactly average is quite remote. Thus, a deterministic model’s result is usually inconsistent with reality.

Your future with a supermodel

Stochastic Modeling, delivers a more realistic range of projections with up to a 95% probability of occurrence. This technique, also called “Monte Carlo,” simulates thousands of lifetimes based on a rate of return, a standard deviation, and a measure of volatility. This analysis exhibits numerous projections of possible results and provides users with a specific range of probability of occurrence. Knowing the probability of the outcome allows you to modify your goals and portfolio investments to boost your odds of success.

Stochastic Modeling is not a new mathematical concept. In fact, some of the statistics used to develop these planning models were developed over 100 years ago! Previously, statistical modeling was performed on a centralized mainframe computer, and the process was slow and inefficient. Calculations might have taken several hours to complete, with a comprehensive analysis lasting weeks or months and costing thousands of dollars. Now computers have become powerful enough for financial planners to run these complex calculations in only a few minutes.