# The Buckets Strategy

Retirement Planning is all about being informed and being organized. Or having someone that acts on your behalf that is informed and organized. Without it, fear sets in and we go into hiding. The following article is all about helping you get informed AND organized. I hope it helps you remove some of the financial fear you might have in your Retirement Plan.

## Spend It Down Vs. Buckets

A standard approach to retirement is to "protect" all of one's assets and hope those assets last to the end. That's called a Spend Down Approach. This approach is often called the "Stress Free" approach to retirement because it focuses on avoiding the daily ups and downs of the market. Typically, this strategy ends up with an annuity and a 4% distribution on the remaining assets. Also typically, this strategy misses out on the gains of the market and leads to high **opportunity** costs - in terms of gains, lifestyle and generational wealth that you could have had.

Thanks to a man named Harold Evensky, the Buckets Strategy was created. This strategy uses cash for near term expenses, bonds for 2-5 years and stocks for the 5+ year time horizon. As time progresses, the stocks feed the bonds which feeds the cash. This is a great strategy for a few reasons. The main one is that it compartmentalizes the approach to investing and helps people understand when their dollars are going to be spent over time. In turn, this leads to allowing people to take on more market risk and more market rewards. However, it falls a bit short because it doesn’t compartmentalize our spending. It doesn’t identify *where* are dollars are going to be spent. That’s why I recommend a combination of Evensky's Bucket Strategy and Dave Ramsey's Envelope System, which I call Spending Buckets.

## Spending Buckets - The First Step

The reason many people struggle with retirement planning is they have all of their money in one "pile". There may be multiple accounts, but none of the money really has a purpose. This leads to all of it being for everything - and nothing. "I'm spending your inheritance." is a funny line people tell their kids. But behind that line is a lot of truth and stress.

Humans need to compartmentalize things in order to get a handle on the situation. We just aren't smart enough to do it any other way. This is why I bring in the Spending Buckets approach to retirement planning. In total, there are 4 buckets:

1. The Living Expenses Bucket - This is where Evensky's Buckets comes into play.
2. The Vacation Bucket - Florida when the market is up! Staycation when it's down.
3. The Inheritance/Charity Bucket - Fund your grandkid's *retirement* first.
4. The Long-Term Care Bucket - Invest this based on the appropriate Time Horizon.

To summarize, if you don't have these buckets identified and funded, then you are going to be scared to spend your money. More importantly, you'll be scared to LOSE your money. Because of this, you'll probably end up with a portfolio heavy in bonds or an insurance product with a high **expected opportunity cost** of money, lifestyle and generational wealth.

## The Numbers - How I Would Do It

Let's look at a common situation: a 65 year old couple with $500,000 that just decided to retire. If that was me, the following paragraphs show how I would allocate that money. Please note that this strategy is based on plans and expectations. In the Army we say “No plan survives first contact!” However, you have to start somewhere and adjust as the future unfolds.

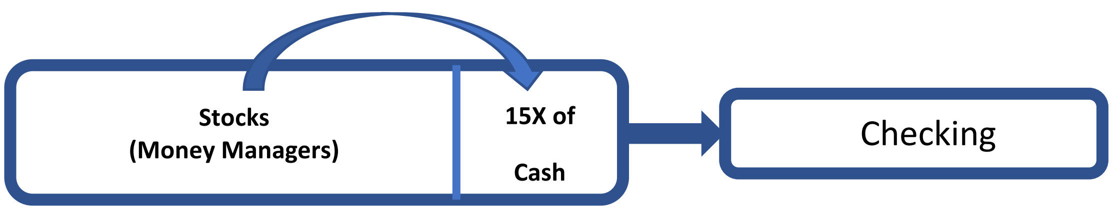
First, I would start by paying for my future needs and Bucket #4 – Long Term Care. (I do not want to end up living with my daughter!) I would PLAN to start my long term care plan at the age of 80. If I earmarked $40,000 for that today and put it all in the market, I would expect it to be $218,942. That's at 12%. If I get 20 years (85 years old) of 12% growth, it will be worth about $385,851. Side note: Staying healthy becomes more and more important as you age. If you are eating out quite a bit, you are probably spending a lot of money on junk food. Not smart!

Second, I would set aside some money for an inheritance for Bucket #3. But I do this differently. At this stage, my kids are probably already in their 40s and I have not saved enough to create trust fund kids. However, I can create trust fund **grandkids** if I "tell" some money today that it is for my grandkid's retirement. That's probably 55 years of growth. Therefore, I would set aside $5,000 for each grandchild and I would expect it to be worth $2,546,603 PER grandchild! How fun is that? That also takes the stress off of my kids to provide an inheritance for those kids. What about college? Tell them to join the Army! Or more likely, go to a Community College or a Trade School. More importantly, this sets a family "pay it forward" tradition and "walks the walk" on telling the following generations to start saving early. Now my kids will have to do the same for their kids. And so on and so on. You are instantly creating Generational Wealth. You’re just going to have to skip a generation to make it happen. So let's call that $25,000 out of the $500,000 for a total of $65,000 for Buckets 3 and 4.

Third, I'm going to fund Bucket #2 - Vacations. I'm going to set aside $50,000 and fund these vacations from the gains. I will expect 12% each year because I will have it all in the stock market. (Aggressive Risk Tolerance) That should generate $6,000/year on average. If I get that or more in a year, I might spend it all on taking the family to a nice VRBO in Florida. If it's a down year, I'm going to tighten it up and wait for the investments to recover. If I really need to get out of town, I can tighten my belt on the next account, Living Expenses, and squeak out a trip somewhere. I might be able to fund a trip from this bucket if I have seen a good return over a few years and am quite a bit above the original $50,000.

To fund Buckets 2, 3 and 4, I’ll need a total of $115,000 out of my $500,000. That leaves $385,000 for my last Bucket: Living Expenses. This is where Evansky's Bucket Strategy comes in to play and things get a little trickier. As an Aggressive Growth Investor (sounds scary, doesn’t it?!), I am not a fan of bonds or insurance. I can look at the history of the stock market and feel just fine with that volatility. However, I still need to manage it. The way I do that is to use cash as a TIME HEDGE against market volatility. According the Hartford Funds, the average bear market lasts 9.6 months with a frequency of 3.6 years. Let's say that I need an extra $2,000/month after Social Security and I want to have a 15-month cash buffer. 15 months x $2,000 = $30,000. So that's going to be the bucket that I use to help me sleep at night when the market decides to take a dive. I'm also going to use this as my operating account. Meaning, it's my checking account. I'm then going to have an investment bucket. Evansky would fund this cash bucket with bonds (or a bond fund, which is easier to sell). But, as you know, I’m not a fan of bonds or annuities because of their opportunity cost. Plus, I have my cash buffer. So I’m going to put the rest of the funds, $355,000, into the market. Then, each month, I will sell

$2,000 of stocks to replace the $2,000 I spent. When the market goes down significantly, then I will stop the selling of the stocks. I'll continue to draw down on the cash and hope that the market comes back up in the next 15 months. If it does, then I'll replenish the cash account back to the $36,00 level and we are back to normal. When the market drops again (it will), then I shut off the stocks (cut out this arrow) again and redo the process. Here it is graphically:




- Based on all of this math, I will have $500,000 - $65,000 (Buckets 3 and 4) - $50,000 (my vacation bucket) - $30,000 (my cash buffer/time hedge bucket) = $355,000 in this final bucket. To note, this bucket will be funding my checking account each month. I set it up on "automatic pilot" so it feels like a paycheck.
- Based on my 12% assumption, I will expect that account to generate $42,600/year. Remember, I am **expecting** to spend only $24,000 each year from this account. That means I **expect** to **grow** this account by $18,600 each year.
- Working backwards, I need a 7% return to generate $24,000 from this account. ($24,000/$355,000 = 6.8%)
- If the market cooperates for a few years, then I'm going to be in an even better financial situation than from when I started retirement. If it doesn't, then I have my cash buffer to buy myself time until it does.

**Summary of the Numbers**

LTC Bucket #4: $40,000
Inheritance Bucket #3: $25,000
Vacations Bucket #2: $50,000
Living Expenses Bucket #1: Cash Buffer has $36,000; Investment Account has $355,000

The above example is based on my risk tolerance and I hope it makes sense. But let's say that you aren't quite as "cowboy" as I am. If you are at "50/50" right now, you might have a hard time moving to an all stock portfolio. However, you might be able to stretch out a bit to 60/40. Then, as time moves on and your comfort level with the market increases, you might continue to stretch out. Of course, this can be facilitated by increasing your cash bucket and giving yourself even more of a time buffer. For example, if I did **5 years of cash**, that would be $120,000 and would leave $265,000 in the investment account. I would **expect** that to generate $31,800/year, which is still more than the $24,000 I'll be spending.

**Summary of the Approach**

If you don't have something like the above laid out, then I think you are probably unsure of a few things in your plan. Question marks in a retirement plan aren't fun and cause people to shut down the volatility, and the gains, in their portfolio. However, I hope you see that it's not that hard to get it all organized if you use the buckets approach to financial planning. Then, you can sit back, relax and enjoy your Golden Years!