

Key Wealth Institute

# Bucketing: A Time-Tested Drawdown Strategy for Peace of Mind

Mathew Bound, CFP®, Regional Director of Planning and Investments Key Private Client

Tina A. Myers, CFP®, CPA/PFS, MTax, AEP®, Director, Planning and Advice Center



## The challenge:

Fighting our natural instincts of mental accounting, overzealous market return expectations, or coveting a conservative portfolio short of beating inflation to meet goals.

Portfolios are often allocated among equities, bonds, and cash in a way that balances the need for current income and the desire for future growth. This is often a unified approach. Another approach seeks to divide assets into several “buckets.” The bucket concept is based upon this: Assets needed to fund near-term living expenses should remain in cash or low-yielding assets,

assets that won’t be needed for several years that can be held in a diversified portfolio of longer-term holdings. The cash buffer can provide the peace of mind to ride out periodic downturns that occur in the long-term portfolio.

Doing so can help mitigate the sequence of return risk that can often derail financial plans from having to liquidate investment assets at inopportune times (having to sell riskier assets that might have gone down in value to fund near-term living expenses, instead of allowing them to potentially rebound).

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This bucket framework can be customized for the number of buckets and the type of assets in each bucket. We use a three-bucket approach.



Purpose		
<ul style="list-style-type: none"> <li>Provides the utility needed for daily spending/emergencies. It allows you to thrive through unstable markets. One might also consider including an emergency fund within this bucket to defray unanticipated expenses.</li> </ul>	<ul style="list-style-type: none"> <li>Asset accumulation to support future lifestyle spending needs.</li> </ul>	<ul style="list-style-type: none"> <li>You have a high degree of confidence your assets within the first two buckets will cover all your needs. This bucket is for long-term growth and gives you the flexibility to have a greater impact on loved ones or organizations you chose to support. It can be used to potentially leave a legacy.</li> </ul>
Investments		
<ul style="list-style-type: none"> <li>Low-risk and highly liquid assets.</li> </ul>	<ul style="list-style-type: none"> <li>Moderate-risk, income-generating assets to meet mid- to long-term goals. This could include high-quality fixed income, high-quality dividend-paying equities, or a balanced portfolio of holdings.</li> </ul>	<ul style="list-style-type: none"> <li>Growth-oriented stocks and bonds, accepting short-term volatility for long-term growth. More aggressive assets with risk tolerance that can ride out market ups and downs.</li> </ul>
Goal		
<ul style="list-style-type: none"> <li>Preserve capital and ensure quick access to cash. Funding amount is equivalent to 6 months to two years of expenses depending on life stage.</li> </ul>	<ul style="list-style-type: none"> <li>Generate stable income and/or growth to outpace inflation without high volatility. This bucket will be funding most of your lifetime spending goals. This bucket can be used to refill the Liquidity bucket as those assets are depleted.</li> </ul>	<ul style="list-style-type: none"> <li>Assets will be invested differently today to impact your beneficiaries and future legacy with estate planning. Alternatively, you can help beneficiaries immediately by gifting assets during your lifetime.</li> </ul>

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## Bucket maintenance

This isn't a set it and forget it strategy. Maintenance is required. You will need to refill the liquidity bucket as needed. And the lifestyle bucket needs to be rebalanced occasionally.

**Here is an example of how this framework works:**

- Use income and cash holdings in the liquidity bucket for daily spending/emergencies.
- Refill the liquidity bucket as needed from the lifestyle bucket, using bonds before equities.
- Rebalance the lifestyle bucket as needed. Maybe only sell equities that have increased in value. Avoid selling equities that are down.
- Take principal withdrawals from the lifestyle bucket using the lowest-risk investments first and only those that have increased in value.
- Use principal withdrawals from the surplus bucket for legacy goals.

Benefits of using a bucket strategy	Potential downsides
<ul style="list-style-type: none"><li>• <b>Reduce the sequence of return risk</b> With readily available funds in the liquidity bucket, you're less likely to need to sell investments at a loss during a market downturn to cover living expenses.</li><li>• <b>Provides peace of mind</b> You will always know that your immediate needs will be covered. You can feel more confident about your portfolio. And you could have more confidence knowing that you have certain assets and income sources set aside for future expenses.</li><li>• <b>Flexibility and customization</b> This can be customized for different risk tolerances.</li></ul>	<ul style="list-style-type: none"><li>• <b>Complexity</b> You could have multiple accounts with different asset allocations that can be more complex than a traditional portfolio.</li><li>• <b>Potentially lower returns</b> Due to the portion of assets held in low-risk, this could result in lower overall portfolio returns compared to a more aggressive portfolio.</li></ul>



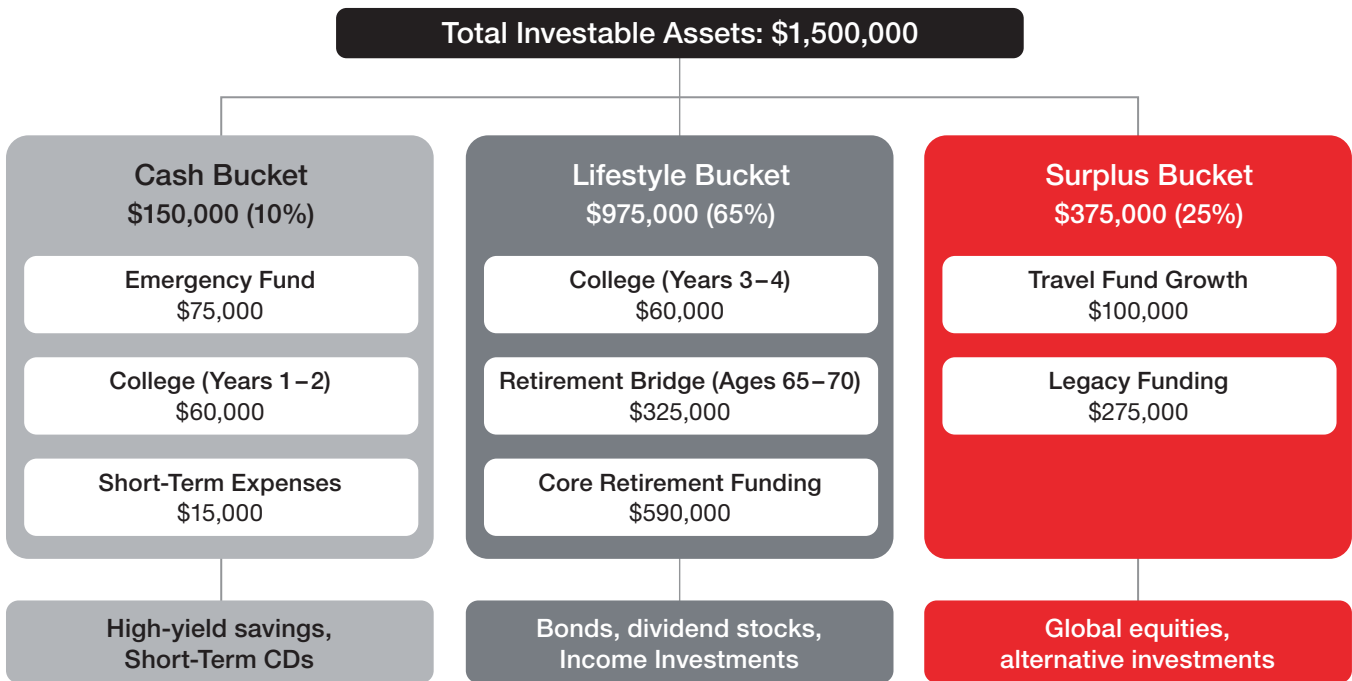
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## The Johnson family

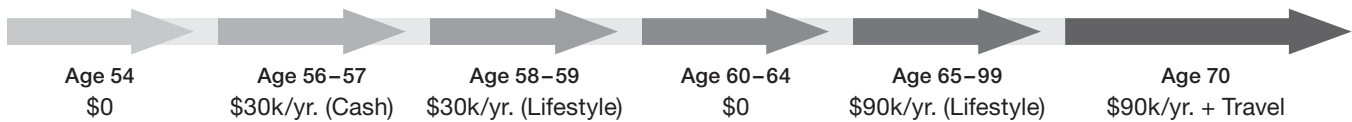
The Johnson family thought of their assets like most of us: one big pot. They thought of it like a blended soup rather than a complete meal where each part complements the other. After gathering all their statements from checking, savings, CDs, 401ks, and elsewhere, their financial picture started coming together. The following chart shows how after building a goals-based plan, the Johnsons' assets could be bucketed to complement each goal's amount, time horizon, and importance

paired with the appropriate risk level in each portfolio. For the Johnsons, after the cash bucket was appropriately funded and allocated, a large portion of their assets resided in the lifestyle bucket. This portfolio strikes a balance between growth and stability to fund their children's college and retirement. Finally, the remaining funds would be allocated toward the surplus bucket with an aggressive growth focus for travel and legacy funding for future generations.

## The Johnson Family Bucket Strategy



### Lifestyle Spending Timeline



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## Conclusion

One challenge we all face is the uncertainty in the market and unknowns of life. Don't be caught flat footed. Bucketing can bring more clarity, comfort, and intent to your investment decision-making.

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For more information, please contact your advisor.



### About the Author

As the Regional Director of Planning and Investments for Key Investment Services, Mathew Bound serves as a trusted business partner to Private Client Advisors in the Central Region. Through individual case consultations and group trainings, he enables advisors to build relationships based on comprehensive financial planning.

Mat graduated from the University of Akron with a BBA in Corporate Finance. He earned his Financial Planning Certificate from Boston University and completed the Certified Financial Planning (CFP®) accreditation in 2020. He is currently pursuing the Chartered Special Needs Consultant accreditation.



### About the Author

In her role, Tina Myers is responsible for managing the Central Planning Team and overseeing the Key Wealth Institute and any financial planning content distributed. She works with our Regional Planning Strategists to help facilitate our best thinking and advice delivery to clients.

Before joining Key, Tina worked in the public accounting industry, where she focused on taxes, specifically individual, trust, estate, and gift tax planning. She also held roles at a small public accounting firm, a regional firm, and the private client group of a large multi-national firm.

Tina earned an M.Tax from Virginia Commonwealth University and holds several industry-standard licensures. She received the Circle of Excellence Award for Key Private Bank in 2016 and 2018. She was selected to attend the 2024 Key Wealth Education Symposium, which recognizes top performance and extraordinary commitment to serving our clients and growing our business.

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