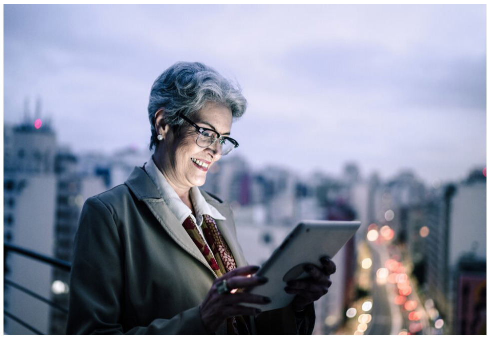
U.S.News & WORLD REPORT

ALSO PUBLISHED IN…

msn | money

HOW TO USE THE RETIREMENT BUCKET STRATEGY

Learn about the three financial buckets that can help you manage your retirement spending and investing.



By: Rachel Hartman - May 25, 2022

As you budget for retirement, it can be overwhelming to think about how to access your savings to fund your retirement expenses, especially when accounting for concerns over whether the amount set aside will be sufficient. There are also distribution factors to consider, including how to withdraw funds from different retirement accounts and investments. Some retirees rely on a system called the bucket strategy to help navigate their finances as they cover living expenses and pursue additional hobbies like travel or leave a legacy for family members.

The retirement bucket strategy:

- Is a distribution method used by some retirees.
- Splits savings between three buckets.
- Accommodates short-term, mid-term and long-term needs.
- Aims to replenish funds through investment earnings.
- Here is how a three bucket strategy works and what to consider before implementing a retirement bucket approach.

What Is the Retirement Bucket Strategy?

The retirement bucket strategy serves as a guide to take distributions from different forms of retirement savings. "The classic bucket strategy segregates your investments into three time horizons: short-term, intermediate and long-term," says Jay Perry, a fiduciary financial advisor with Turning Point Financial in Frederick, Maryland.

The short-term investments often consist of keeping 1 to 3 years worth of money in cash, including Social Security benefits and pension income, that is not subject to market fluctuations. The mid-term investments typically center on fixed income assets like bonds and CDs, which may provide some earnings and have less risk than other investments. The long-term investments tend to be invested aggressively into higher risk categories like stocks to position retirees with the chance to have investments grow over time.

When implemented, the retirement bucket strategy acts as a behavioral tool. "The focus is placed on monitoring the plan and cash flow generated from investments, instead of monitoring the day-to-day results of the investments themselves," says Justin Stevens, a financial planner and president at O'Keefe Stevens Advisory based in Rochester, New York. "Because each bucket is designed to provide a range of income coverage, there is flexibility in the plan to accommodate changing market environments."

How to Use the Retirement Bucket Strategy

The bucket strategy divides your savings into three buckets, which are each invested differently. Here's a look at the goal of each retirement bucket.

The immediate bucket. The first bucket of cash and cash equivalents provides a chance to access funds when needed. "When the market is down, you only take income from your cash reserves bucket," Perry says. It can be used to pay monthly bills and other living expenses. If you have an emergency come up, such as a home repair or vehicle replacement, this bucket could be accessed.

The intermediate bucket. The second bucket focuses on investments that typically have low risk, such as fixed income assets. "This is where 60 to 70% of the nest egg sits to maintain pace with inflation," says Larry Hendrickson, founder and managing partner of G&H Financial Group in North Canton, Ohio. "It captures 5 to 10% growth when the market does well." When the market doesn't perform as well, the goal is that these investments don't take any losses. "The intermediate bucket is looking 10 to 12 years into retirement and making sure that there is money there," Hendrickson says.

The long-term bucket. The third bucket is positioned with an aim of long-term growth. "This is the bucket that must outpace inflation," Hendrickson says. It includes a percentage of a portfolio that could be lost if the market takes a downturn. "This bucket is designed to allow you to catch the 15 to 20% growth while assuming 100% risk if the market crashes," Hendrickson says.

In this way, the retirement bucket strategy provides a bit of a safeguard against market ups and downs. When the stock market is down, you can rely on cash. When the market goes up, you might draw from the second and third buckets. Some of these funds could be used to replenish the cash bucket. You are then ready for another downturn, at which time you can fall back to accessing only from the cash bucket.

Benefits of the Retirement Bucket Strategy

For retirees who are concerned about the future performance of their investments, this method can provide a feeling of security. "The plan minimizes the need for investors to sell when markets are down," Stevens says. Instead, if stocks take a dip in value, retirees are able to draw on other funds such as their substantial cash reserves. The investments in the stock market remain positioned for long-term growth opportunities. "For some investors, this plan provides the peace of mind to stay invested when markets become volatile," Stevens says.

Drawbacks of the Retirement Bucket Strategy

Monitoring is a key component of the retirement bucket strategy, and adjustments related to market conditions may need to be made periodically. If left unattended, the buckets might not produce the forecasted results. It could take considerable effort to set up the retirement bucket strategy on your own, manage the investments and shift funds between the buckets.

There are also some potential opportunities that might be missed by using the bucket method. "It allocates more money to fixed income than is likely needed," Stevens says. "Investors could achieve better long-term results using a cash reserve and equity strategy only."

When debating whether to use the retirement bucket strategy, you can think about your risk tolerance, along with concerns about inflation, market fluctuations and the amount saved. If you're looking for an easy-to-use strategy, a financial planner could help set up the three buckets and then work with you to access the right sources at the appropriate time.