

financial fitness

By Erik Ford



A Different BUCKET LIST

We have all heard of the bucket list: The things you would like to do before you “kick the bucket.” In personal financial planning, there is an approach to asset allocation that uses the concept of buckets. When managing your personal investments, how and where you take risk is one of the most critical factors in reaching your long-term goals. No one wants to see their portfolio decline in value, but the honest truth is that over time any portfolio that takes risk will have its ups and downs. Experiencing these fluctuations can be difficult emotionally for an investor and may result in decisions that reduce the probability for long-term success.

The bucket strategy is a way of breaking down your assets by purpose and is actually quite simple. It is a method of dividing your assets into “buckets” based on the intended purpose of funds. For example, if you plan to use funds within a relatively

short time period, keeping those funds conservatively invested to manage or help to minimize the chance of loss probably makes sense. Leaving these funds in cash, money market accounts or certificates of deposit, while not providing much return in the current interest rate environment, does protect you from market risk. If you are saving for a planned home purchase, a car purchase, college tuition or just a special trip, you do not want to incur a drop in value just before you need the money. As we have discussed in previous articles, the pain of losing a given amount of value is psychologically more painful than the pleasure realized from an equivalent gain. The pain of loss is only increased if you had immediate plans for the funds.

In contrast to short-term funds, assets intended for a long-range goal can more comfortably endure the ups and downs of higher-risk investments, which have higher expected returns over time while exhibiting more volatility. To achieve long-term goals, most notably your retirement goals, investing at the appropriate risk level can be a critical decision. By isolating your long-term assets into a long-term “bucket”, it may be easier to take the longer-term perspective and be more aggressive with these assets. Knowing these assets are isolated in your long-term bucket and that you have your short-term funds isolated can be very comforting as markets fluctuate.

Now that we have described how the bucket strategy can be applied for short-term and long-term targets, how does it work in between? Goals requiring funding between short or near-term time frames and a longer-term period like retirement may require more attention to reallocation as medium-term moves toward short-term. An example of this is college savings. If you start saving for college when the child is very young, more volatility can be accepted because there is time to recover. As the child ages and college becomes closer, volatility becomes less tolerable and the “bucket” needs to shift toward a short-term orientation. This same thinking can apply toward other medium-term goals.

So, if an investor or saver thinks that dividing their assets into “buckets” will allow them to have a better allocation toward their goals, they may want to consider this strategy. Dividing and investing savings into buckets may just give you a better chance of fulfilling your other “bucket list”. Please keep in mind that this is just one strategy and may not be right for everyone. Diversification and asset allocation strategies do not assure profit or protect against loss. Investing involves risk. Depending on the type of investment, there may be varying degrees of risk. Investors should be prepared to bear loss, including total loss of principal. This article is not intended to be specific advice for the reader.

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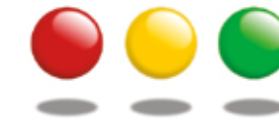
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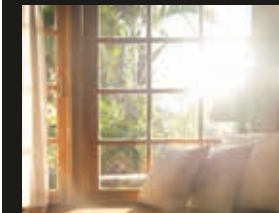
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