Bucket Baloney

- The Buckets Approach to asset allocation is Phony Baloney. Importantly, it does not defend against sequence of return risk.
- There's a "No Baloney Better Bucket" approach that does defend against sequence of return risk.
- Better buckets bring bountiful bucks.

The "Buckets Approach" to asset allocation has become very popular, but its advantages are mostly psychological rather than economic, substituting wishful thinking for real risk management. For the most part they are Buckets of Phony Baloney that investors should stop using because their protection against market declines is no better than the protection provided by portfolios with similar risk that don't use buckets.

Behavioral scientists tell us that we like to create "mental accounts" for our savings, separating assets by purpose. For example, a popular series of buckets is as follows:

1. Bucket 1 is safe assets like Treasury Bills. It contains some number of years of spending, generally 2 to 5 years
2. Bucket 2 is long term bonds, & contains another 5 to 10 years of spending
3. And Bucket 3 is risky long term assets, primarily equities, for the balance of retirement that is intended to be spent after the first 2 buckets are depleted.

The first two buckets are designed to cushion against having to spend equities in a declining market. The idea is to avoid selling low by giving equity markets enough time to recover.

These mental accounts create the perception that it's OK to lose your money if you don't have to sell your losers; the presumption is that the losers will recover given enough time. Most who use the Bucket Approach believe that it defends against "sequence of return risk", which is the risk of losing money during the Risk Zone that spans the 5-10 years before and after retirement, but the fact is that the little protection it affords is far from adequate for reasons described in the following.

Experts Explain Why the Bucket Approach is Phony Baloney

1. ***The SEC issued a cease-and-desist order against the creator of the idea according to this Wiki:***

Buckets of Money is a phrase used by author-advisor Ray Lucia to refer to his retirement withdrawal system. It was originally described in his 2004 book, *Buckets of Money: How To Retire in Comfort and Safety*. He operates an advisory service, RJL Wealth Management, which counsels and manages client portfolios, using a system with the trademarked name *Bucket Strategy*™.

On September 5, 2012, the SEC issued a cease-and-desist order, charging Lucia with spreading misleading information about his "Buckets of Money" strategy at client seminars. The SEC's Division of Enforcement alleges that investment adviser Ray Lucia, Sr. claimed that the wealth management strategy he promoted at the seminars had been empirically "backtested" over actual bear market periods, but the SEC contends that these backtests are flawed and misleading.

In other words, the SEC believes that the developer of the *Bucket Strategy* has knowingly and purposefully misrepresented its success.

2. ***In Can Buckets Bail Out a Poor Sequence of Investment Returns? Professor Moshe Milevski, who created the words "Risk Zone", concludes*:**

These strategies are an optical illusion at best and create a potential for grave disappointment at worst....

If you decide to adopt the so-called buckets approach to retirement income planning then beware of the fact that your total asset allocation and implicit exposure to equity will fluctuate unpredictably over time. Moreover, if indeed you experience a poor initial sequence of investment returns – so that you have been forced to liquidate all your cash investment--you might find yourself with a 100% equity exposure well into retirement and possibly deep into a bear market.

3. ***In Harold Evensky on New Rules for Wealth Management, Harold Evensky, who most view as a Buckets advocate, criticizes Buckets***

Evensky criticized this approach, saying that it has some "really serious fatal flaws." He said these approaches may carry a lot of initial appeal for both the planner and the client, but the implementation is problematic. "It just does not seem practical or feasible, and no one has explained to me how it can be done," he said.

In his own practice, Evensky uses what is essentially a two-bucket approach – one that he can effectively implement and monitor. He maintains a cash reserve for clients that is sufficient to handle liquidity needs over a five-year period and invests the remainder of client assets with a longer-term horizon. He said that his firm makes some basic assumptions about where the economy is in the business cycle.

In other words, Mr. Evensky believes that two buckets are just right. Anything more is too complicated.

4. ***In The Retirement Buckets Strategy. Does it Really Work?, Forbes Magazine reports:***

In theory, it sounds great and looks good on paper. However, in practice it can quickly become a jumbled mess…it's just that most investors don't have any practical ways to bring the concept to life based on their unique situation.

5. ***In Should Financial Planners Invest Using Bucket Strategies Or Just Report That Way? Michael Kitces, a renowned industry expert, argues for plain old vanilla rebalancing***

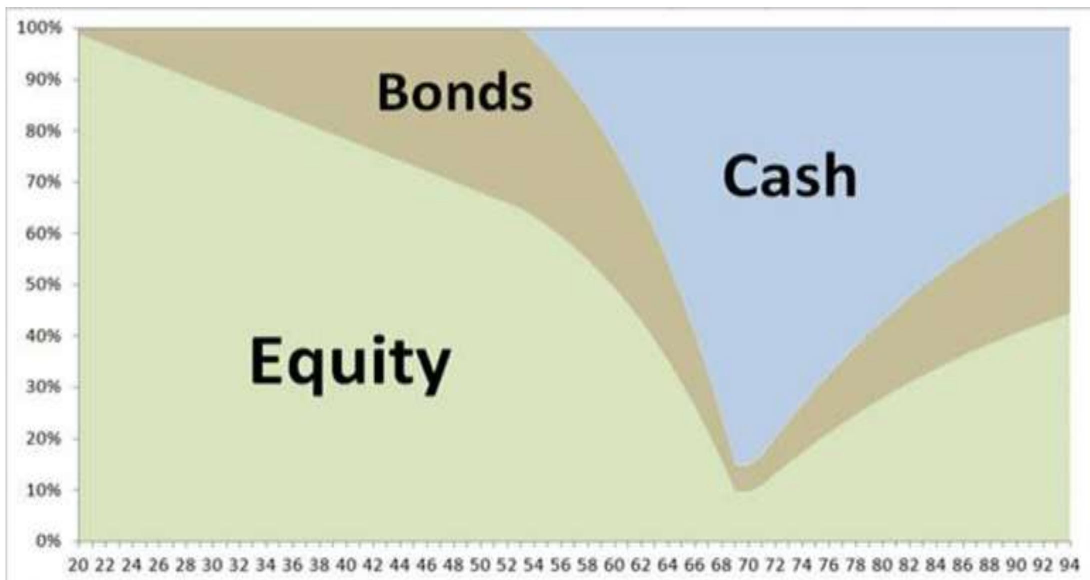
Kitces opens our eyes to the fact that traditional rebalancing achieves the desired result if that desire is avoid selling equities in a down market. In a down market, traditional rebalancing sells bonds and cash to buy stocks in order to bring the allocation back to target. Stocks are not sold; they're purchased.

6. Author observation

All of these strategies lay out spending for a lifetime, but what if assets simply won't last a lifetime, as is the typical case? Lifetime spending needs to be based on savings, which means some standard of living needs to be determined, and that standard in retirement will change. Most importantly, losses sustained during the Risk Zone that spans the transition from working life to retirement can have a dramatic effect on standard of living in retirement, as discussed in the next section.

No Baloney Better Buckets

Thanks to the introduction and evolution of target date funds, there is a better bucketing approach that defends against sequence of return risk, as described in [This Bad Gamble Jeopardizes Retirement Lifestyle](). Unlike other buckets that are expressed as "years of spending", these buckets are percentages of your portfolio, as shown in the following:



As you can see, the cash bucket for safety is dynamic, not static, and is age based, with more safety in the “Risk Zone.”The best way to reduce sequence of return risk is to invest safely in the Risk Zone that spans the transition from working life to retirement. We each pass through the Risk Zone only once, and losses can devastate lifestyle.