The Bucket Approach to Retirement Income

This article describes a method to structure your accounts in order to generate a retirement income stream. I use the word "buckets" because it is easy to remember and an easy to understand concept. The bucket approach is really just another way of saying you need different types of accounts to withdraw income. The strategy basically consists of the following three buckets or accounts:

- The first bucket or account would typically be a bank or savings account and would have two years worth of income. This account needs to be very safe and secure.
- The second account would be invested in high quality bond funds ideally with a short to intermediate duration to help lower your interest rate risk and increase diversification[1]. Though the funds are subject to the risk of principal loss and fluctuations in value, the goal is to have these funds earn a higher return on the overall investment than the same balance received in a bank or savings accounts.
- The third bucket or account would have your long term stock investments primarily invested in dividend paying stocks. Such investments are based upon your risk tolerance and overall objectives and are subject to market risk, including the risk of loss.

As a hypothetical example, let's say a retiree needed to produce $50,000 a year growing with inflation over and above his/her social security and/or pension[2]. .

Using the bucket approach to retirement income, this retiree would keep $100,000 in their bank and savings account (two years worth of income), $150,000 invested in high quality short/intermediate term bond funds[3] for our second bucket (three years worth of income) and our third bucket would have $750,000 invested in a diversified portfolio with an emphasis on dividend paying stocks. If the investor's goal was to have a balanced portfolio of 50% on the stock side and 50% on the bond/cash side, the third bucket would be allocated with $500,000 to stocks and the remaining $250,000 to bond funds[4]. This would be structured so all of the interest from the bond funds and dividends from the stock would transfer to the bank and savings account for ongoing income needs. The overall balance of the portfolio needs to be regularly monitored and the original allocation maintained based upon the overall objectives and risk tolerance of the client.

This bucket approach to retirement income has many benefits for retirees. I think the greatest benefit of this approach is psychological. The income stream carries less risk for the next five years and would be continually adjusted to help maintain secure income for the immediate future. Because the income minimizes risk, investors can ride out the inevitable ups and downs of the stock funds while still receiving an income stream in the form of stock dividends replenishing the first bucket. The stock allocation does not have any guarantees although historically the returns have been much greater than the increase in the cost of living. Today's retires will need some growth and a growing income stream to outpace rising prices in the long run…especially as today's retirees live longer. Enjoy your buckets of income!

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[1] Asset allocation and diversification is a risk reduction technique, but no investment strategy can guarantee a profit or protect from a loss in a declining market,

[2] For purposes of this simple hypothetical example, all of the funds are in taxable accounts, the retiree has accumulated $1,000,000 by retirement age, and the retiree plans to withdraw 5% of initial principal.

[3] Quality of funds is based upon the public ratings of third party independent ratings agencies.

[4] Asset allocation is based upon individual needs risk tolerance, and other suitability characteristics. The allocation is customized to each client.

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