

RETIREMENT

Do You Need More Than 3 Buckets?

Determining how many retirement buckets are enough.



Christine Benz • **Susan Dziubinski** • May 22, 2024



Key Takeaways

- Bucket 1 consists of cash, Bucket 2 is your high-quality, short- and intermediate-term bond portfolio, and Bucket 3 is the growth engine that will hold the remainder of the assets.
- For some retirees, there is a case for a fourth bucket to hold assets that aren't necessarily covered in the first three buckets, like long-term-care expenses.
- It might be reasonable for some people to set up a separate discretionary bucket.

- Tax considerations might be another reason to set up distinct buckets.

Susan Dziubinski: Hi, I'm Susan Dziubinski with Morningstar. A standard Bucket portfolio for retirees consists of three buckets, but some retirees might benefit from adding an extra bucket or two. Joining me today for a refresher on the bucket strategy and for whom a fourth bucket might be in order is Christine Benz. Christine is Morningstar's director of personal finance and retirement planning as well as host of The Long View podcast and author of a new book that's coming out this fall, *How to Retire: 20 Lessons for a Happy, Successful, and Wealthy Retirement*.

Nice to see you, Christine.

Christine Benz: Good to see you, Susan.

What Are the Three Buckets of Retirement?

Dziubinski: Let's start with this bucket structure. Walk us through this. You often talk about it and write about it. It consists of three buckets. Go.

Benz: Right. The basic idea is that you have this cash bucket that you're using to meet your near-term living expenses, maybe a couple of years' worth of portfolio withdrawals in cash. That's Bucket 1. Bucket 2 is taking a little bit more risk, not a lot. So, that's primarily a high-quality, short- and intermediate-term bond portfolio. And then Bucket 3 is the growth engine of the whole thing. It's going to hold the remainder of the assets. So, if you have two years' worth of portfolio withdrawals in Bucket 1 and maybe another five to eight in Bucket 2, everything else is going into that Bucket 3. That's going to be primarily a globally diversified equity portfolio. It's where I would also hold other higher-risk, higher-return categories: so, high-yield bonds potentially if you wanted to hold them, or precious metals, which are volatile on a short-term basis. I'd keep them in my very long-term bucket. That's the basic setup. I think it's an intuitive way to arrive at an appropriate asset allocation for retirement.

Do Retirees Need a Fourth Bucket in Their Retirement Bucket Strategy?

Dziubinski: For a lot of retirees, they can set up this bucket structure and call it a day and just refill their buckets as time goes on. But you think there might be for some

retirees a case for a fourth bucket. What is that bucket?

Benz: Right. This is something I've kind of played around with for the past several years. Might call it a last-call bucket. But the idea is that it's going to hold assets that aren't necessarily covered in those first three buckets. So, a big category for many retirees is long-term-care expenses. Many retirees do not have long-term-care insurance so will be self-funding long-term care expenses. That would be potentially something that could go into this bucket number four because you wouldn't want to use that for your spending until you absolutely needed it. If you didn't need the money for long-term care, you could use it if you had a very long life. If you happen to live longer than the standard 25 or 30 years that we usually construct a retirement bucket portfolio for, the last-call bucket could encompass those funds. And then if you didn't deplete that bucket during your own lifetime, the assets could pass to heirs. I think it's a nice way to think about holding other assets that wouldn't necessarily be addressed by those first three buckets.

Is a Discretionary Bucket Right for Your Retirement Portfolio?

Dziubinski: You also say that it might be reasonable for some people if they're inclined to set up a separate, what you call, discretionary bucket. Talk about how that one would work, how a retiree might rightsize how large that bucket should be, and what types of assets would go in something like that.

Benz: In thinking about this, I was really influenced by talking to the financial planner Jonathan Guyton, who uses something similar with his own clients. The basic idea is that he wants to empower them to direct their own discretionary spending. So, for travel or for gifts to children or paying for weddings or whatever the case may be, he doesn't want that to affect their annual spending. So, they set up this discretionary bucket at the outset of retirement. Maybe it's for charitable giving during your lifetime, for example. And I think it's kind of an elegant way to address the fact that many of these discretionary expenditures are lumpy. With travel spending in particular, we know that retirees tend to do their heavy travel oftentimes in the first 10 years of their retirement and may do much less travel later in retirement. The discretionary bucket really does help address those lumpy outlays. In terms of rightsizing it, I think since it

would be money that would be carved off separately from the retirement spending portfolio, it really does make sense to put some pen to paper, think about how much you can afford to put into the discretionary bucket. And it seems like it would be very individual, household-specific.

Tax Considerations for Retirement Buckets

Dziubinski: And then you also say that tax considerations might be another reason to set up distinct buckets. Talk about that.

Benz: Right. We often talk about this three-bucket structure, but the fact is many of us are bringing in multiple tax silos when we enter retirement. So, we might have traditional tax-deferred accounts as well as taxable accounts as well as Roth accounts. And you probably, if you've done some work around how you plan to take withdrawals in retirement, you probably have an idea of which of those silos you'll be spending from first. And that, in turn, I think could argue for having multiple buckets within each of those silos, unfortunately. So, it gets a little bit more complicated. But think about your taxable bucket. It's oftentimes front of the queue in terms of retirement spending. Well, maybe that just consists of Bucket 1 and 2 assets because you'll spend through that in say the first 10 years of your retirement or whatever the case might be. So, you would use your planned withdrawal sequencing to influence how many buckets you hold within each of those silos.

Dziubinski: Well, Christine, thanks for your time today. This sounds like some interesting enhancements for some of us with those bucket strategies. We appreciate it.

Benz: Thank you so much, Susan.



Dziubinski: I'm Susan Dziubinski with Morningstar. Thanks for tuning in.

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