Sweetgum Labs

Insights

Three Buckets

One of our first steps to asset management is to identify and sort assets that a client intends to invest. We prefer to guide clients into a three-bucket strategy. This bucket identification method allows us to easily identify liquidity needs and gives us tactical flexibility to help minimize market tribulations.

> ***"Our rationale for the three buckets hinges on the fact that a typical market downturn is 2-3 years."***

Financial planning has *evolved.*

The Buckets

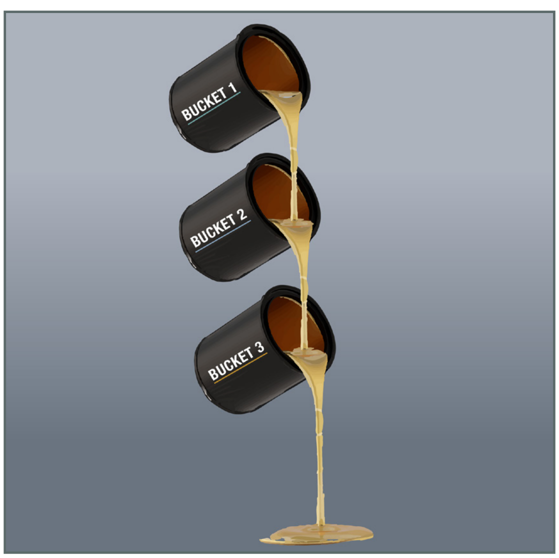
Bucket 1

This is your spending account. We typically suggest having 1–3 months of expenses in this account (typically checking or savings)

Bucket 2

Your emergency/rainy day fund that should target between 3 months – 3 years of expenses. These funds are typically in money markets, cd's and short-term high-quality bonds (that can be reasonably expected to pay and are liquid.)

Accumulation Phase



Bucket 3

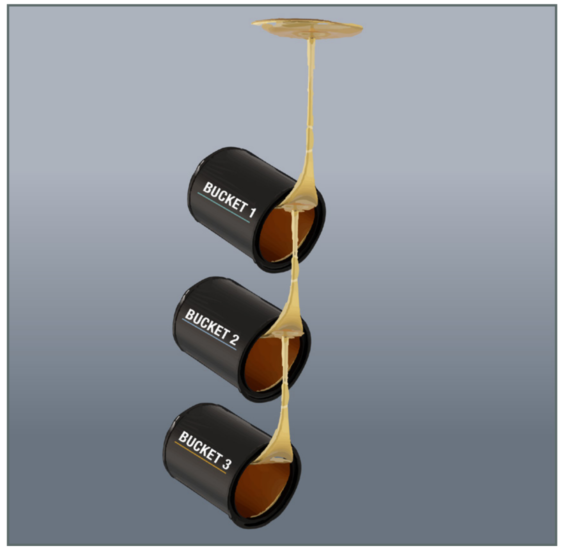
These assets are for investing and should have a time frame of at least 3 years.

In the accumulation (working years) phase; Bucket 1 feeds Bucket 2, which in turn feeds Bucket 3. In the distribution (retirement) phase the tide turns; Bucket 3 feeds Bucket 2 and in turn Bucket 1, as liquidity is needed.

It may sound like a lofty goal to have over 3 years of expenses and we agree that it isn't the easiest thing we ask of our clients.

However, if you start to contribute as little as $50 a paycheck, a $40,000 bucket 2 can be created in 25 years. The younger you start funding these buckets the greater the odds of success.

Distribution Phase



Admittedly, factors such as taxes, growth, extreme volatility and diversification make this half-art and half-science (since the factors are not necessarily correlated). We still prefer this strategy because empirically we have witnessed humans panic in crisis.

"Yes, the market isn't ideal, but based on a fully funded bucket 1 and 2 the current market conditions should not impact your lifestyle for over 3 years."

Being able to have this conversation helps clients' maintain a level frame of mind and minimizes any distraction from the most productive work of ongoing financial planning.

Why Buckets?

Our rationale for the three buckets hinges on the fact that a typical market downturn is 2-3 years. If you have a fully funded bucket 1 and 2 this provides capacity to help protect bucket 3 from liquidity needs during downturns and avoid further piling on principle values.

The biggest drag in Monte Carlo Analysis[1] is retiring during, or immediately before, a drawdown in the equity markets. Limiting distributions (by raising liquidation standards) during those volatile years will limit the long-term impact to your lifestyle.

To drill down a little further; protection is created by tactically slowing down or speeding up transfers from bucket 3 to 2 during the distribution phase.

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[1]Monte Carlo Analysis is a risk management technique that is used for conducting a quantitative analysis of risks. This mathematical technique was developed in 1940, by an atomic nuclear scientist named Stanislaw Ulam. It's meant to be used to analyze the impact of risks on your project.

Sweetgum Labs, LLC