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Feature Article: Portfolio Strategies »

For Bucket Portfolios, the Devil Is in the Details

by Christine Benz

Guidance on implementing a bucket strategy in a real world portfolio, including portfolios with more than one type of account.

Portfolio Strategies »

Diversifying Through Reinsurance and Marketplace Lending Interval Funds

by Larry Swedroe

Alternative investments such as reinsurance and marketplace lending provide diversification through exposure to different forms of risk.

REITs »

Conducting Fundamental Analysis of Equity REITs

by Jaclyn N. McClellan

The primary profit and cash measures for REITs are NOI and FFO. Learn what they encompass and how to analyze them.

First Cut »

Consensus Stocks: Passing the Most Screens

by John Bajkowski

The 22 stocks passing four or more AAII Stock Ideas strategies.

Financial Planning »

Increasing Your Retirement Resources: The Power of Working Longer

by Sita Nataraj Slavov, John B. Shoven and Jason Scott

Postponing retirement by even just one year can boost a couple's annual inflation-adjusted retirement income by 6.5% to 8.0%.

AAII InvestoGraphic »

Following the Model Shadow Stock Portfolio

by AAII Staff

Instructions on how to use the Shadow Stock strategy in your own portfolio.

AAII Model Portfolios »

The Model Shadow Stock Portfolio’s Origins and Newest Stock

by Wayne A. Thorp, CFA and John Bajkowski

The Shadow Stock strategy was designed to identify small, neglected and underpriced stocks. Its rules have evolved as research has highlighted additional promising techniques.

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Briefly Noted

Current news items of interest to individual investors.

- Funds Can Switch to Paperless Delivery of Reports
- Mutual Fund Companies Conduct Limited Corporate Governance Research
- Retirement Planning Mistakes Investors Often Make
- Sleep Problems Adversely Affect Financial Decisions

Letters

Members share their opinions on grasshopper versus ant behavioral traits, asset allocation and rebalancing, and quantifying the value retirement accounts.

Editor’s Note »


Charles Rotblut, CFA
AAII Journal Editor

Simpler solutions often work better than complex ones.

This is a statement I believe applies to investing. Though some complexity is inevitable, the degree to which it is needed is far less than some in the investment industry would have you believe.

Consider asset allocation. Mathematically, it is possible to determine the proper mix of assets to achieve an optimum level of volatility for a desired return, and vice versa. For most investors, having a portfolio that sits right on the efficient frontier (where risk and return are optimally balanced) is nowhere near as important as it is to have a portfolio they understand and can stick with.

Bucket strategies sit near the simpler end of the simple-to-complex spectrum. A bucket strategy allocates a portfolio based on when withdrawals will be needed. Most commonly, three buckets are used, but the number is not set in stone. The actual number depends on your personal situation, your goals and your willingness to deal with complexity. (More buckets = greater complexity.)

I like bucket strategies because they make it easier to understand the allocation a portfolio uses. Money needed within the next few years is held in riskless assets (cash, money-market accounts, etc.). Money needed in the next three to 10 years (the actual range varies based on who you ask) is allocated to income-generating assets with low probabilities of significant losses (high-quality bonds). Money not needed for periods of at least five to 10 years is allocated to risky assets (stocks, REITs, etc.) to grow wealth.

The allocations for these buckets are no risk, a little risk and high risk. Nothing else. No complex math is required other than forecasting what the expected cash flow needs will be over the short term and intermediate term.

Bucket strategies scale easily too, both upward and downward. In his book, "Investing at Level3" (AAII, 2016), AAII founder James Cloonan suggested retirees use the equivalent of a two-bucket approach. The first bucket holds two to four years of cash and cash equivalents. The second bucket holds stocks. Withdraw from the stock bucket when the market is doing well and withdraw from the cash bucket when the market is in the doldrums.

Those in their working years can also employ a bucket strategy. A millennial should work on building a cash bucket to cover emergencies and other upcoming expenses (e.g., a down payment on a house or condo) while also building a retirement savings bucket allocated fully to stocks and other volatile assets.

Some may even find it helpful to have a separate bucket for splurging. Former supermodel Tyra Banks recently spoke to Money Magazine about her F ("frivolous") account. Her accountant encouraged to her to create it after watching Banks underspend. (She describes herself as being conservative with money.) Such a bucket could work for those who have more wealth than they'll ever need and for those who like to splurge but want to be conscious about not underfunding longterm goals.

Like any strategy, it is possible for a bucket strategy to go haywire and lead to unintended consequences. A disciplined approach is required. Morningstar's Christine Benz gives practical advice about how to manage a bucket strategy here.

One area of investing where complexity is hard to avoid is real estate investment trusts (REITs). In writing an article about how to analyze REITs, associate financial analyst Jaclyn McClellan found a lack of standardization in how two key metrics are calculated: net operating income (NOI) and funds from operations (FFO). She discusses the differences and offers suggestions on what to pay attention to here.

Both Christine and Jaclyn will be among those speaking at our upcoming Investor Conference. We have other great speakers from past conferences returning and new ones I think you'll enjoy. More information about it can be found here. I hope to see you there.

Wishing you prosperity,

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