Portfolio Advisor

Fall 2020

Protecting the puck: the three-bucket approach

A straight-forward approach to helping retired and cash-flow-focused investors sustain their investment income and preserve their portfolios through all market conditions.

Old risks remain, new risks emerge

For most Canadians, the coronavirus pandemic has been a healthcare crisis that has brought about an economic shock and what appears to be a relatively short-term market downturn.

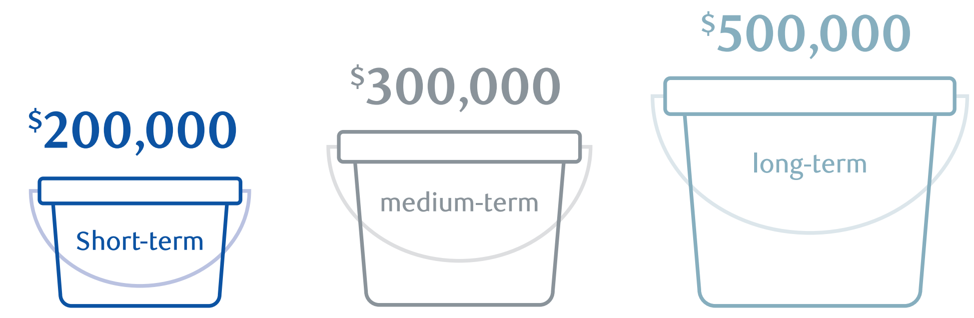
However, for most retired Canadians – the age group that is most at risk from its effects – COVID-19 is a deeply worrisome and potentially deadly risk. What's more, the pandemic brought with it the "COVID Crash" and subsequent sharp volatility. It further exacerbated the already historically low interest rate and bond yield environment that has challenged low-risk savers, as central banks slashed interest rates to stave off economic disaster.

These developments serve as an important reminder of the vulnerability of retirees and cash-flow-focused investors to economic conditions that together could threaten their ability to sustain their retirement cash flow and preserve their well-earned nest eggs. In short, it is a reminder of the need to help ensure that these types of investors don't have to change their lifestyles in the face of shrinking cash flow, or worse, face the ultimate risk of outliving their savings.

Playing portfolio defence

Fortunately, there is a way to ease these investors' minds when faced with the twin threat of low interest rates and yields on fixed-income investments and volatile markets: the three-bucket approach. As long as it is aligned to their investment objectives and suitable given their risk-tolerance, retirees – and those whose primary portfolio goal is to produce cash flow to support their lifestyle – may wish to leverage this approach to help ensure that they have enough income to provide for their short-term needs, while still growing their portfolio over the medium- and long-term:

Easy as 1-2-3:
An example of the three-bucket strategy using an initial investment of $1 million to generate required annual income of $50,000



3 years of cash flow plus emergency funds
$200,000 = $50,000 x 3 years plus $50,000 (emergency funds)

Buffer of 6 years of cash flow
$300,000 = $50,000 x 6 years

Remainder of portfolio

The three buckets:

- **Short term – Income (1-5 years):** The short-term bucket holds cash and short-term investments for cash-flow withdrawals and emergency funds, while also helping to reduce the impact of short-term market volatility on the portfolio.
- **Medium term – Buffer (6-10 years):** Holds income-generating investments, including low-risk, low-volatility equities for stable capital gains. This bucket serves as a buffer between the cash bucket and the long-term growth bucket.
- **Long term – Growth (10+ years):** Holds growth-oriented equity funds, which are more volatile but offer higher potential for capital growth to sustain the portfolio for the later years of retirement.

The best defence is a good offence

While hockey fans know that protecting the puck is a critical part of maintaining a lead, the other part is not getting so defensive that you are hemmed in to your own end by your opponent – more often than not, playing too safe leads to a loss. In order to protect your portfolio from impact of ongoing cash-flow demands, as well as the ravages of inflation, investors can use a well-structured and considered strategy that, if properly aligned to their investment objectives and risk tolerance, can help ensure they meet their long-term cash-flow needs and help preserve their retirement nest egg.

Speak to us today to discuss how we can help you or your loved ones "protect the puck" with risk-appropriate strategies like the three-bucket approach.