BUCKETS OF MONEY

How to Retire in Comfort and Safety

Raymond J. Lucia, CFP®

with Dale Fetherling

WILEY

John Wiley & Sons, Inc.

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Dedication

To my wife Jeanne, my best friend and soul mate for over 30 years. She is a pillar of strength who has patiently stood by me, tolerating my crazy schedule of radio, television, client work, and study. Thank you for allowing me the time to write this book and pursue my passion.

To my children—Alana, Ray Jr., Dom, and Niki—who have been the joy of my life and a great inspiration. I couldn't be more proud.

To my mom and dad, who not only fed me well (a little *too* well, actually) but gave me a true sense of values and taught me that family, not money, is the most important thing.

To my brother Michael Lucia, ChFC, a terrific financial advisor whose dedication and work with clients has helped and motivated me immensely.

To my staff of financial and personal advisors—including Melissa Dotson, Rick Plum, CFP®, Rob Butterfield, JD, Marc Seward, ChFC, and the rest of my team with whom I work and learn from each day.

And to the almost 4,000 clients who are using the *Buckets of Money* strategy. They have entrusted me and my firm with their money, a responsibility we take very seriously. It is because of them and people just like them that I have written this book.

A Special Note

When I began writing this book, we were well into the middle of the greatest boom in stock market history. Talking about conservative investments for immediate income and reasonably conservative money for "tomorrow," along with a modest allocation to equities and real estate, wasn't very popular. Everyone was making big bucks on their individual stock bets, high-tech mutual funds, dot-com IPOs, day trading, and the like.

But by mid-March 2000, a brutal bear market was born. Who would have thought that many stalwart companies like Cisco Systems, Sun Microsystems, Oracle, and even Home Depot, Microsoft, Disney, and General Electric would lose up to 80 percent of their value? Then, on September 11, 2001, the country was shocked and appalled when terrorists attacked America by flying hijacked jetliners into the World Trade Center towers in New York and into the Pentagon in Washington, D.C. This further roiled the financial markets.

Anyone invested in the stock market since March 2000 has been hurt financially by the bursting of the tech bubble, which then was compounded by this terrorist tragedy. But despite the short-term impact on the stock market and the toll such events take on consumer confidence, the U.S. economy is still quite resilient, and stocks will one day return to become respectable investments. Because no one can forecast tragedy or its effect on the financial markets, it is even more critical that individuals have their *Buckets of Money* set up properly.

We know that time, for the most part, mitigates risk, and *Buckets* will help you do that. But while neither *Buckets of Money* nor a soaring bull market could ever cause us to forget those who innocently lost their lives on that tragic day, the events of the last couple of years do help us to understand the importance of planning. I hope this book will motivate you to do just that.

—R.J.L.

Note on Tax Rates

Reduced tax rates are a centerpiece of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003. But the recent tax law, like the one enacted in 2001, is a patchwork of provisions that phase in and out in sporadic fashion. So here's something you can take to the bank: The tax code will change again before long. That presents a problem for this book because some tax-rate figures could be obsolete by the time you read them.

For example, the tax on long-term capital gains and dividends has been lowered to 15 percent for higher-bracket taxpayers. But those cuts are now scheduled to expire in 2009. Similarly, the 5 percent long-term capital gains/dividend rate remains in effect for lower-bracket taxpayers (10 percent or 15 percent ordinary-income bracket), then drops to zero for 2008. These reduced rates expire after 2008 and are scheduled to revert to previous levels in 2009. Whether that will happen—or be changed again—is anybody's guess.

So, in the interest of sanity and clarity, we have stuck with the 2003 brackets—generally 35 percent, 33 percent, 28 percent, 25 percent, 15 percent, and 10 percent—as well as the 15 percent capital gains/dividend rates in our examples. If the tax laws are changed again or if these rates are allowed to expire, you may choose to mentally adjust the rates mentioned in the examples.

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Preface

What *Buckets* Can Mean for You

O.K., right off the bat, here's a pop quiz (but it's an easy one). Are you:

	Yes	**No**
■ Retired?	___	___
■ Thinking about retiring?	___	___
■ Starting to worry about whether you'll have enough money to retire?	___	___
■ Managing your own money?	___	___
■ Disturbed by the stock market's sometimes violent swings?	___	___
■ Concerned about inflation eating away at the purchasing power of the money you worked so long and hard for?	___	___

If you answered "Yes" to any of those questions, you can profit from the *Buckets of Money* strategy. In short, it's a way of *generating steady income while still taking advantage of the historically proven growth in stocks and other long-term investments.*

That's not doublespeak: Achieving both goals—income and growth—is not only doable, it's a smart and conservative way to protect *and* grow your nest egg. In fact, in almost 30 years as a financial planner who oversees nearly a billion dollars in assets, I have found nothing as simple—and as powerful—as this concept.

But first, let me be clear about what *Buckets of Money* is *not.* It's not a get-rich-quick scheme. It won't make you as fabulously wealthy as you would be if you had invested big time in Microsoft 25 years ago. (You missed that opportunity, huh? So did I.) *Buckets of Money* doesn't involve some high-wire act like futures trading, currency arbitrage, penny stocks, or dealing in distressed real estate. You don't have to predict the future, and you won't need to raise chinchillas, plant jojobas, or be atop the crest of some so-called technological wave of the future.

All you need to do is know your financial goals, divvy up your money accordingly, and then invest intelligently, according to guidelines I'm going to give you in this book. It's a conservative—but growth-oriented—strategy that hopefully will allow you to:

- Live comfortably in retirement without having to work (though you may choose to)
- Sleep well at night without worrying about your money running out

Let me hasten to add, *Buckets of Money* is not a plan without risk—*no* investment is ever totally risk-free. How the overall economy fares, the way the financial markets perform, and the ups and downs of your particular investments will affect the results you get. We do not predict any specific outcome. Having said that, let me tell you that this is a sound way to reduce risk while still taking advantage of growth. What's more, I know hundreds, perhaps thousands, of people, probably very much like you, who have used the *Buckets of Money* principle to build and enjoy a financially comfortable retirement.

Sad to say, I've also seen many people begin their retirement thinking they had enough money to live on for the rest of their lives. But the twin dangers—inflation and taxes—ate away at their financial cushion until they either had to cut back drastically on their standard of living or go back to work just to survive. Sometimes they depleted their estates so much that the legacy they hoped to leave for their children was but a fraction of what they intended. Please, *don't* let that happen to you.

Speaking Bluntly

To put it bluntly, the object of financial planning for retirement is to avoid running out of money before you run out of time. The focus of the *Buckets of Money* strategy is taking advantage of the long-term potential of stocks and other equity-type investments while securing a safe, predictable income from assets. It's especially appropriate for retirees and those looking to enhance income while reducing risk. However, the *Buckets* principle works for everyone, regardless of age, income, net worth, or investment experience.

In brief, here's how it operates: You put your money into three "buckets" and invest each in a different way. (As you become a more informed *Bucketeer*, you'll find that from time to time you may need more than three buckets because some will hold pretax money, some post-tax cash, etc. But for the sake of simplicity, let's just talk for now about the three main buckets.) The cash deposited in Bucket No. 1 goes into very stable, low-growth vehicles like CDs, money markets, Treasury instruments, and short-term bonds. Using both principal and interest, Bucket No. 1

provides a stable income stream that you can live off for a specified number of years. (Don't panic at the thought of spending both principal and interest. You'll see later why we totally deplete Bucket No. 1.)

Meanwhile, your Bucket No. 2 is growing. This bucket, depending on your tolerance for risk, may be invested in slightly more aggressive investments with better potential for returns. After Bucket No. 1 is empty, you pour money from Bucket No. 2 into Bucket No. 1 for yet another specified period of years.

By the time Bucket No. 1 is again depleted, Bucket No. 3—full of stocks, real estate, and similar high-growth investments—will have had all that time to grow, and with any kind of luck at all you'll then have a nice chunk of change to see you through your sunset years. Although Bucket No. 3 is more risky, that risk is mitigated by time. So if Buckets Nos. 1 and 2 last 12 to 14 years, that should provide an ample cushion in the event the stock market takes a short-term dive requiring a few months or even a few years to recover. Also, as you'll learn later, an allocation to low-leveraged real estate investments may provide an extra cushion during a prolonged bear market for stocks.

That's the short course. Naturally, there are lots of variations, such as how much you put in each bucket, how long you let it grow, and the kinds of investments that are right for each bucket. We'll go into all that, as well as how to make sure that you're covered for emergencies that may pop up.

Among the big advantages of *Buckets* is its simplicity. Even a rookie investor can understand and make use of the basic philosophy. Another advantage is that *Buckets* is flexible enough for the more sophisticated investor, that person who likes to get every last one-quarter of a percentage point of return and who seemingly follows the financial markets with a magnifying glass. Further, you can modify your *Buckets* program as your situation changes. If you get a windfall, you need more cash to live on, or you want to increase or decrease your potential return and your exposure to risk, the strategy is easy to alter.

So, relax and enjoy this book. I've tried to make it as simple and clear as possible. Believing that an ounce of application is worth a ton of abstraction, I've used plenty of examples and have sought to avoid financial gobbledegook.

As you learn about this strategy, think about your goals and how you might adapt the *Buckets* program for your situation. Keep in mind, too, that there are no perfect solutions, no absolute answers, and no right and wrong ways to invest. Each person's investment objective, comfort level, risk tolerance, and tax situation will determine the best investment choices to fill each bucket.

What Do I Know?

Having been a financial planner since 1974, I've seen good times and bad. For over 12 years I've also fielded thousands of money questions on my nationally syndicated radio talk show (details, see www.raylucia.com) and responded to a flood of e-mails and letters. I've studied the financial markets and have seen interest rates at 18 percent and 3 percent and everywhere in between. I have watched the real estate roller coaster create moguls and paupers. I've seen quick-buck artists come and go (sometimes to jail). I've seen salesmen so slick they could sell a stethoscope to a tree surgeon, yet didn't have the slightest idea of what they were talking about.

I've seen it all, and this is what I've learned: You've got to analyze your particular situation because that situation is unique to you. Therefore, be cautious about taking advice you see in the magazines or on TV or hear discussed on the radio or at your weekly bridge game. The advice may be true for some but totally inappropriate for you. Once you've analyzed your situation, then you've got to allocate your assets in a way that's smart and sound. This takes patience and some wisdom, too.

The wisdom part, which I'll discuss in the last chapter, means knowing that money, as important as it is, is not the object of the game. Playing a good game is the object of the game. Speaking of games, I once heard someone describe a perfect football player: smart enough to understand the plays and dumb enough to think they're important. I'd propose a variation of that for the perfect investor: smart enough to know how money works but not dumb enough to think that's only what life is all about.

What does money represent in your life? A necessary means to an end, or an end in itself? Hold that thought. We'll get back to that.

How This Book Works

A few words are in order about how this book is organized. The first two chapters give the big picture on handling your money long term. In essence, because nobody is smart enough to predict what will happen to the economy next year or even five years from now, an intelligent asset-allocation program is your best bet for being able to meet rising costs without worry.

After exploring your tolerance for risk and explaining the *Buckets* principle in more detail in Chapters 3 and 4, Chapters 5 through 7 tell how to choose the best investments for each bucket and also go into some of the tax issues. The next two chapters suggest how to tweak the buckets in special situations, regardless of the kind of retirement savings—401(k), Keogh, IRA, Roth IRA, CDs, etc.—that you may have.

If the recent bear market knocked a 'hole' in your *Buckets* plan, Chapter 10 gives some damage-control pointers. Chapter 12 tells how to find a financial planner and what other steps to take to put your finances on a sound path. Lastly, Chapter 14 includes a bit of wit and wisdom. In the Appendices, you'll find a list of other books and resources I think you might enjoy and profit from.

This book will teach you the basics of *Bucket* planning and *Bucket* filling. If you carefully follow the strategies discussed you will become a master *Bucketeer*, and, I truly hope, live a financially fulfilling life!

A Product of Many Hands

This book is a product of many hands. My sincere thanks go to all who contributed to it, especially Rob Butterfield, Jr., Esq.; Rick Plum, CFP®; Michael Lucia, ChFC; Marc Seward, ChFC; Melissa Dotson; Ray Lucia, Jr., CPA; Lyn Rowe, CFP®; Janean Stripe, CFP®; John Dean; Bill Izor, CFP®, CLU, ChFC; Ryan Bowers, CFP®; Susan Bowers, CFP®; Mike Sztrom; LuAnn Porter; and Dale Fetherling.

PART I

Introducing the *Buckets*

CHAPTER 1

Everybody's Got an Investment Idea— But Is It a *Good* Idea?

If there's anything we've got plenty of in our Information Age, it's advice about how to make a bundle. Money gurus promise wealth without risk. Financial magazines trumpet the latest trends. The Internet virtually bristles with offers. Our neighbors or co-workers eagerly share their astounding stock market secrets. The daily mail overflows with wealth-building tips.

As a result, many of us are surrounded by opportunities, flooded with information—*much of it wrong*—and are often totally confused about how to build a nest egg so we can enjoy a decent retirement. Actually, what most people want to know is simply:

- How can I retire in reasonable comfort?
- How can I know my retirement funds will keep pace with inflation and taxes?

- How can I protect myself from the short-term swings in the stock and bond markets?

Those are increasingly urgent questions for an astounding number of people. Here's a startling statistic: The number of Americans 65 and older will grow almost five times faster over the next 40 years than those in the 20-to-64 age group. What that means is that tens of millions of workers—far more than in any other era in our history—will soon reach the end of their working lives. So "How can I retire successfully?" is a question that's quickly moving to the top of the agenda for many of us.

The answer needn't be complicated. But like all things worth doing, becoming investment savvy requires some study and some perseverance. I'm going to try to cut through the fog. I'm going to talk straight about why and how you should be thinking about your money and your future.

I'm not out to prove I'm smarter than you are or that I have all the answers. In fact, I know I don't have all the answers, and I may not be smarter. But I'm smart enough to know you shouldn't need a fancy financial vocabulary or a degree in finance to do some common-sense planning for your future.

My Bias

Right up front, here's my bias: *I like facts.* I like proven principles, not just accepted wisdom or broad generalizations. I agree with Oliver Wendell Holmes, who once said, "I never heard a generalization worth a damn, including this one." So I'm going to emphasize what is provable and scientific and show you the fallacy of so much of what is generally believed. I'm going to tell you, based on more than a quarter-century of helping people with their money, what really works and what doesn't. Further, I'm going to promulgate *Lucia's Laws*—many of which may be the direct opposite of the investment axioms you've heard for years. And with any kind of luck, you will not only learn some things but also have a few grins along the way.

Why All the Concern about Retirement, Anyway?

Americans are living longer, a lot longer. A century ago, life expectancy was 47.3 years. Now it's 76.5 years on average, and in a few decades it will be 82.6. Millions upon millions—quite possibly you among them—will live to be more than 100. (The future Willard Scotts will be very, very busy.) In fact, already the number of people 65 or older has grown by 56 percent since the 1970s. For the first time in history, there are more seniors than teenagers!

Meanwhile, workers are retiring earlier, voluntarily or otherwise. Although your parents and grandparents may have died on the job or within a few years after retiring, many of your generation will live 20, 25, or 30 years after quitting work. All this is good news for those of us in our middle or later years, right? Sure—*if* you plan for it. But consider:

- There's enormous uncertainty about life spans. One study showed that even if you toss out extreme cases—where both spouses died quickly or lived to be very old—among those who remain, the second spouse to die might live to be 83 or last to age 97. If you're in that big middle group, you may need to fund an 18-year retirement, *or* one that lasts 32 years. That's an enormous range.
- Seventy percent of all couples 65 or older will have one or the other spouse in a nursing home. The average stay in a nursing home is 2.7 years at approximately $52,000 a year, or about

$140,000, almost none of which is covered by Medicare. And the costs are accelerating at a rate that far exceeds inflation.

- Despite these demographics, the median savings among adults in their late fifties—just the age when we start thinking seriously about retirement—are less than $10,000.

Even if you're lucky enough to stay out of a nursing home and avoid a big nonreimbursable medical expense, living longer is likely to erode your resources as inflation eats up more and more of your savings. Although you may plan to leave money to your kids or favorite charity, you might end up needing every penny saved—and then some.

I'm not trying to scare you with these statistics. But I am trying to make you aware that the reality of retirement is that—unless you plan ahead and act on those plans—you can very easily run out of money before you run out of years. And that's not so good. It's not good for you, for your children, or for society. And what's more, it's in many cases a preventable problem. That's what this book is all about: helping you become self-sufficient in retirement. Which leads us to . . .

LUCIA'S LAW 1

The government isn't going to take care of you.

I'm sorry. I wish it were otherwise. But even if its much-discussed problem of too many beneficiaries being supported by too few workers is fixed, Social Security just isn't going to be enough. Social Security was intended to be a financial side dish, not the main course. Don't assume you're going to be pleased with what's on your plate if Uncle Sam is the only cook you're counting on.

Meanwhile, the number of active workers covered by company pensions is fast declining. The reasons are numerous. Employees now are less likely to stay at one firm for a long time. Pension plans are costly to run. Pensions at some firms have taken a back seat to stock options and other benefits. Thus . . .

LUCIA'S LAW 2

Don't count on your employer to take care of you, either.

Company pensions are being dismantled in favor of plans like the 401(k), the 403(b), Simple IRAs, and others that shift the burden of saving and investing from employers to employees. These plans can be confusing. But they also give the retiree lots of opportunities.

So the bad news is that it's up to you to make plans. But the good news is that for most people, that's doable. With a bit of smarts and some time, we ought to be able to do this. And we *can.*

The Twin Demons—Inflation and Taxes

In addition to greater longevity, inflation and taxes are two other factors to keep in mind as you begin to think about your retirement nest egg. You're probably old enough to remember the late 1970s and early 1980s—leisure suits, *Mork and Mindy,* and double-digit inflation. Rates on CDs (certificates of deposit) got up to 15 percent or more. A great time to be an investor, right? *Wrong.* Returns after taxes and inflation often were in negative territory, meaning that although you received higher interest payments, your purchasing power—your "real" rate of return—actually declined. (Figuring your real rate of return is easy. Take the yield on your fixed investment, subtract the percentage you'll pay in taxes, and then subtract the rate of inflation.) When interest rates were 15 percent, inflation was also in double digits. And the real rate of return on fixed investments was under water.

Compared to then, inflation right now is relatively tame. Still, inflation is always present and over time will rob you. Even with inflation at 3 percent, the purchasing power of a dollar is cut in half in a little more than 23 years. That means in two decades you'll need twice as much money to buy what you do now.

Similarly, taxes can take away much of what you make. So we need to think about tax-managing our money. One example I often use in my seminars illustrates the effect of such taxes. Let's say Christopher Columbus, when he sailed across the ocean blue in 1492, put $1 in a savings and loan and let it earn interest. What do you think that'd be worth today?

Well, 500 years is a long time (longer than *my* investment horizon). But at simple interest, Chris would now have amassed only $26—that's $25 in simple interest, plus his original investment of one buck. Aha, you say, what if the interest were compounded? If the interest was compounded but earnings were taxed annually, Columbus would now have $6.9 million. Interest on interest is a *beautiful* thing!

But here's the kicker: If the interest was compounded but the taxes were deferred, the good captain would now have $39 *billion*, with a "*B*." So you see just how important compounding in a tax-controlled environment can be. Keep that in mind. We'll come back to that.

And Your Point Is . . . ?

My point is that in any investment strategy you choose, you not only want to make your money grow, you also need to take inflation and taxes into account. Which leads to . . .