



Sound Financial Bites 002 - Balancing your Short, Mid and Long-Term Buckets

Episode Transcription

“When people feel safe with their money, the better decisions they make everywhere.”

Hello and welcome to podcast episode 2. For Sound Financial Advice, my name is Paul Adams. I am President and CEO of Sound Financial Group, and what we're going to talk about today is something we call the buckets conversation, which has to do with not just asset allocation and investing in risk, but rather when will our money be used. Rather than the what of our money, it's the when of our money.

Before we get to that today, as you all know, we - our first mission is to help you design and build a good life. In that way, we're always open to engaging with you. Should you choose to, you can reach out to us at info@sfgwa.com, say that you want to get connected with one of our team, have a 30-minute introductory conversation. We don't know if what we do will be right for you but what we do know is that the time you take on that call will merit what you invest in it. You can go to our website. Be sure to get our newsletter. You can look at some of the videos that we have up there, as well as this list of podcasts and their subjects and look at our events page. Figure out where you can engage with us. We'd love to have you in community with us and bring some key people in your life for one of our 1-hour focus learning sessions that we tailor to ever increasing the financial knowledge of our clients just like this podcast.

You can also get the first three chapters of my book, Sound Financial Advice, for free, on our website or order the whole book right on Amazon. It can be downloaded to your Kindle long before you even finish listening to this podcast.

We always like being able to give you tips that will help you in other ways to help you design and build a good life for the rest of your life. We separate them into narratives of a good life, good life structures, and good life practices and habits, and the good life practice and habit I want to introduce you to today is the secretweapon.org. It's a website. It's got about an hour's worth of videos but it will actually teach you how to use something called Getting Things Done, which is a philosophy built by David Allen, and the secret weapon is how you can use a tool called Evernote and your email inside of David Allen's getting things done philosophy to help you stay organized, keep your commitments and really keep things on track for you, for what's important in your life.

Let's get on to the conversation around buckets and your money. There's really two major areas of placing money that most people are familiar with. They think of their short term money and their long term money. Let's talk about short term money. There's four major attributes to anything on your balance sheet that's going to be short term money. It's got to be liquid, because we might need it tomorrow. It's going to generally be low rate of return because we cannot take any risk with it. That's the third attribute. There's little to no risk with our short term capital, but it's also highly taxed, meaning that every bit of interest we do get is fully taxed as income. Those are the major attributes of our short term money, the kinds of things that fit into that bucket if you will, if you can picture there's a bucket would be like cash, CDs, money market accounts, checking accounts. Those all fit the mold of short term money or short term bucket.

Of course, we have our long term bucket, which has nearly the opposite attributes of our short term bucket. Our long term bucket is going to be illiquid generally. It's going to be higher rate of return, or certainly we're hoping for the possibility of higher rate of return. It's going to have some kind of tax benefit because there's almost no way we could leave money in place for 15 or 20 years and get a decent rate of return and have highly taxed, which is the fourth attribute is that it gets a decent rate of return, a higher rate of return, but of course it's higher risk. Those are our four attributes, that it's illiquid. It's got to be a higher rate of return, it's got to have some



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kind of tax advantage but it's going to be higher risk.

Usually, people divide their lives and their money into just these two buckets, but there's a problem with that. A great example would be if you're in your 40s, 30s, 20s, it doesn't matter, and you're looking out forward in life, and you look at all the things that are going to use money in your world. Certainly, everything is going to use money in the world isn't going to be something that uses your money today, and most of it is not going to be stuff that uses your money just in 20 or 30 years. There's going to be most of the things that you're going to require capital in your life from, kid's college to buying new cars, perhaps buying a vacation home, maybe reinvesting in your business, leasing a building, buying a commercial building, you name it. All kinds of things are going to require capital sometime between today and that long term bucket.

The problem that that creates is too often, people actually end up invading inappropriately their long term bucket with oftentimes significant tax penalties, all because they only had a short term and a long term bucket. What we want to bring to the table is this idea of making sure we always have balance between short and long term and that we have a midterm bucket. What should we work in toward the short term bucket before we even have a long term bucket? We should either currently have or be on pace to build a year's worth of liquidity in our short term bucket, helping us deal with all the fickleness that can happen in life, everything from job loss due to layoffs or corporate restructuring to wanting to start a new business to the things that can happen medically to us in our lives that would require capital, including being out of work due to sickness or injury.

We got to make sure that we either have that set aside or we're beginning to have that set aside before we move on to the midterm bucket. Here's what's unique about the midterm bucket. We don't know how long it's going to need to be there. Does our midterm bucket need to stay just like it's going to be built, which we'll talk about what assets could be in it, but it may need to get activated and put into play 2 years from now. It has to have some attributes of a short term bucket, or we might not really use it so it has to also have attributes of the long term bucket because what if we go 15 years without using it?

Here's what our midterm bucket needs to have in terms of attributes. It needs to be able to be liquid on a short term basis when you build and get our hands on the money. It also needs to be low risk because we cannot have the money going up and down in value. It has to have some kind of tax advantage in case we are going to leave it there for years on end. We don't want to be eaten alive by taxes, but we also need to get a decent rate of return. We cannot just leave something somewhere for 10 or 15 years and not get a decent rate of return. We talk about what would be in your short term bucket, we didn't really talk about all the things that fill your long term bucket. That's your 401(k). That's any real estate investments. That might be the ownership in your business. All those are long term assets... IRAs. Those are all long term buckets, so what's in a midterm bucket?

There's two tools that work really well inside the midterm bucket. One is a portfolio, an investment portfolio, that's what we call nonqualified, meaning it doesn't have to follow any of those tax rules. It's not an IRA, it's not a 401(k). It's just a basket of investments that are going to go up and down with the market overtime, but the good news is there's a little bit of tax advantage, because at least we're getting exposed to long term capital gains with that money.

The problem with that investment bucket is that at the very time we might need the money, the market could be down 20%. If the market is down 20%, we put ourselves in a position where a



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good decision we might make in life, we now cannot make because of the very nature of the investment we have the money in. It's down. The asset is liquid, those nonqualified investments, whether they're mutual funds or a passive structured portfolio like we put together for our clients, it's liquid. You can get your hands on it. It's what I would call functional liquidity. You can get your hands on it but it may not be practically liquid, because of our own psychology. If the market's going up 20% this year, we may not want to take the money out to do something else because we think this thing is on the rise for good and never going down, and when the market is going down, we don't want to take our money out and the reason we don't want to take our money out is simply because we now feel like we're in a lock in losses despite there may be a good thing we can do somewhere else in our balance sheet.

That's the one area that those nonqualified investments don't fit perfectly inside of the midterm bucket, but our other choice for midterm bucket is to use a tool like whole life insurance. Utilizing whole life insurance as our midterm bucket is it gets us a decent rate of return, depending on somebody's health and all that. It takes a couple or 3 years to get it rolling but after that, it's got, in the long run, 4%, 4.5% rate of return with no taxes. It's protected from creditors, and it's liquid. We can get our hands on the money when we want and the cash value is guaranteed to not go down, meaning it acts as a really great reserving pool for us.

One of the best things we've structured for most people when it comes to that midterm bucket is a blend of that mutual fund type structure and a whole life insurance contract structure, because now, we've got fixed income type money, cash that's going to grow tax free for us in the form of cash value and we've also got the opportunity to grow with the market overtime by having perhaps a more conservative portfolio as a midterm bucket than we would have for our long term bucket like 401(k)s and IRAs but that midterm bucket now between whole life insurance, cash values and nonqualified investments really allows a wonderful pivot between a short term need and a long term need.

Now we've got our three buckets overtime, we've built balance between the three. If you go back to one of our prior podcasts where we're talking about the wealth coordination academy, if you picture the graph of these three buckets, if you picture it in your mind's eye, on your left is your short term bucket, on your right is your long term bucket, on the middle is this midterm bucket, on top is your wealth coordination account. What we want to do is just create optimal financial balance between those three different buckets over time.

Balance doesn't mean they need to be the same but we need to have a lot of money in our long term bucket because it has to survive us for the long run, but we need to keep an eye on our short term bucket to make sure that it's keeping up with our current level of income and our current level of safety, which I cannot tell you, when people feel safe with their money, how much better decisions they make everywhere. That's why it's so important to have that short term bucket built up to a year's worth of liquidity, and then that midterm bucket, which even overtime if it gets large enough, for instance if you now have \$300,000 or \$400,000 in whole life insurance cash value down the road, perhaps you'll only have to keep a year's worth of cash in the bank at 0.5% rate of return anymore. That could actually move to your long-term bucket because you know you have this utility player in the midterm bucket who can become short term if need be.

As you're building your financial life, think about what are the tools that you have. There's short term money or the tools that you have that are long term money and if you're like most people when we first meet them, they have very little money that's midterm bucket, and what we want



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you to be able to do is have that midterm bucket work in your favor for the long run. Think about that. That midterm money needs to work in your favor for the long run, because even if we tap it for short term reasons, it's going to be for something that's strategically important for you in the long run.

I hope you have a great rest of your day, and glad you could dial in to our podcast and get a chance to pick up some of this knowledge. We'll always look forward to engaging with you. Don't hesitate to check out our events on our webpage and it will be great to meet you. If you get a chance to come to one of our events or client events, please come up and introduce yourself as a listener to our podcast and I'll look forward to seeing you at one of those events sometime soon, and as always, reach out to us at info@sfgwa.com because we're on a mission to help you design and build a good life.

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