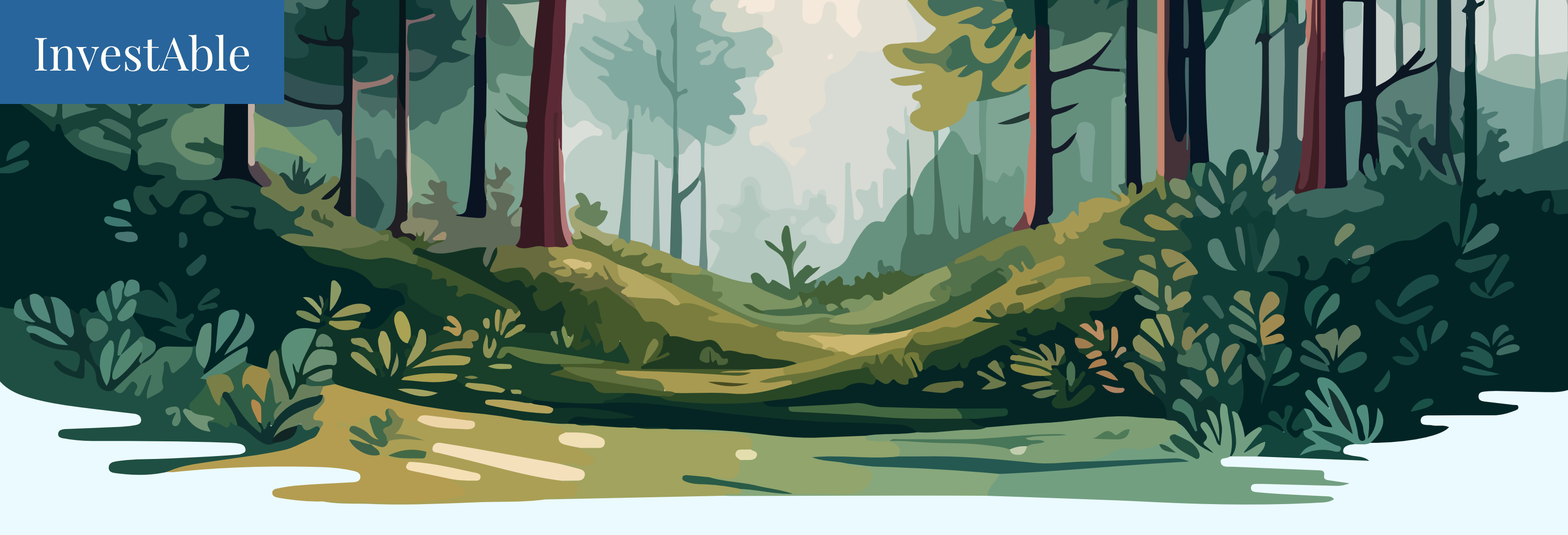
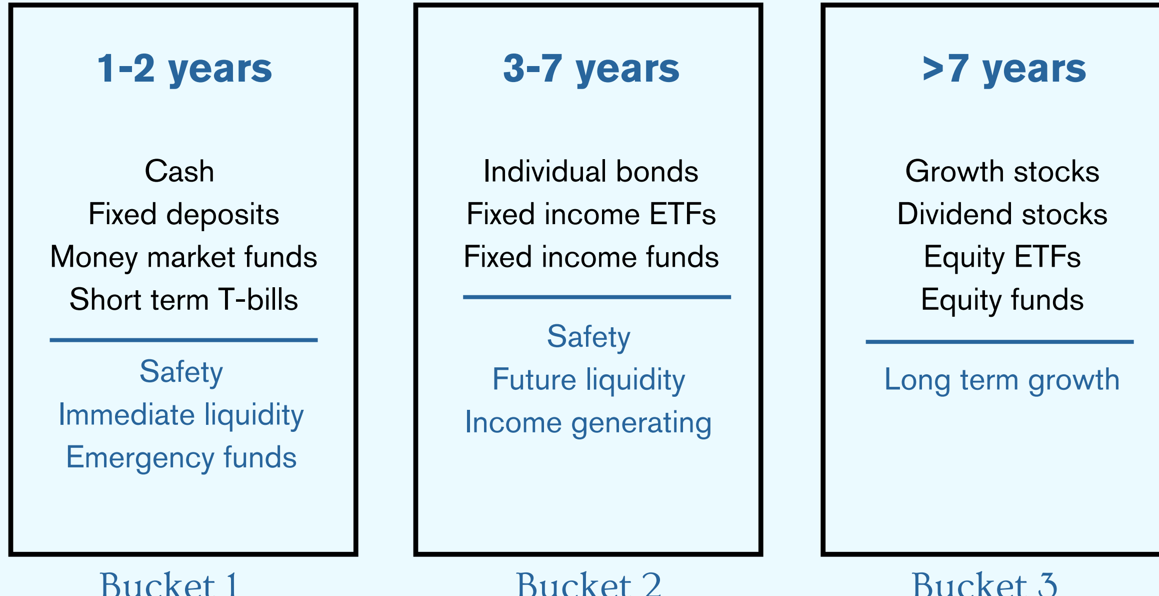


3 things you need to know

before investing your hard earned money

The first step to gaining financial control and clarity. Before going into the three crucial points, it's essential to grasp the 3 bucket strategy.

Introducing the 3 bucket strategy, each with a unique characteristic which helps us understand where our assets are.



Bucket 1 offers immediate liquidity for daily transactions and emergency funds.
A low risk low returns bucket, but absolutely important to be taken care of before placing money in the other 2 buckets for mid and long term needs.

Bucket 2 tends to generate passive income from assets like bonds and balanced funds.
A moderate risk and stable returns bucket where it is suitable for mid term investment horizon

Bucket 3 focuses on long-term wealth accumulation by participating in the growth of the economy. A higher volatility and high return potential bucket where it is crucial for any meaningful long term goals. With the 3 bucket strategy clear, let's explore the three crucial considerations.

Ask yourself:

Are you able to identify where most of your assets are?
Are you putting your money in the right place for the right purpose?
Are there any misalignments due to the lack of clarification?

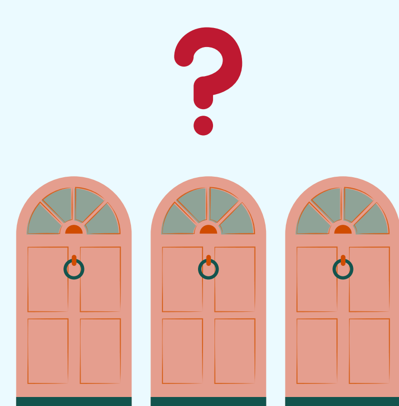
1) Risk and risk management

In investing, risk refers to the likelihood of achieving a positive outcome, which varies among assets and investment tools. For instance, fixed deposits offer high certainty but low returns, while equities entail volatility, making short-term investment challenging but potentially rewarding in the long term, with historical returns of 8-10% annually. This illustrates the principle of high risk leading to high returns.

PERCENTAGE OF POSITIVE PERIODS	1 YEAR	3 YEARS	5 YEARS	10 YEARS	20 YEARS	30 YEARS
CONSERVATIVE PORTFOLIO	90%	93%	100%	100%	100%	100%
BALANCED PORTFOLIO	76%	86%	98%	100%	100%	100%
GROWTH PORTFOLIO	72%	77%	77%	90%	100%	100%

Data source: 1 January 1970 - 31 March 2024, VT - WORLD ALL COUNTRIES, BSV - US SHORT TERM TOTAL BONDS

Presented is a table displaying 3 globally diversified portfolios with varying risk profiles.



When we look at how well the growth portfolio has done over different timeframes, we see that it had positive returns most of the time. For example, over 5 years, it made money 77% of the time. Over 10 years, it was 90% and over 20 years, it was 100%. Across all three portfolios, two trends emerge:

- Longer investment periods correlate with higher probabilities of positive returns.
- Lower risk levels require shorter durations for positive returns.

This emphasises the importance of the bucket strategy in aligning asset allocation with your investment time horizon.

2) Your target return, or need for return

As an investor, defining your desired outcome is paramount for constructing a portfolio that aligns with your goals. Money serves as a means to an end, investing with purpose requires clarity on the following:

- Target Return: Determine if you aim to beat inflation, achieve conservative returns, or pursue growth and wealth accumulation.
- Investment Horizon: Identify when you'll need the funds.

For instance, starting with $600k aiming for $1m in 5 years requires a 10.7% annualised return. If you had 10 years, you only need a 5.2% annualised return, eliminating the need for excessive risk. Understanding these factors enables the creation of a well-suited portfolio to deliver desired outcomes.

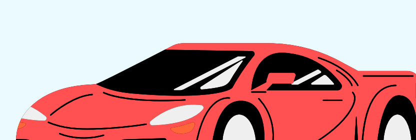
With this knowledge, you can construct a portfolio aiming for 5.2% returns annually without taking on unnecessary risks for returns that you may not need. This approach ensures you stay on track to achieve your financial goals with certainty.

3) Risk of your portfolio

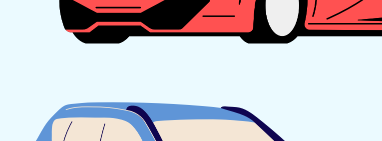
	BEST 1 YEAR RETURN	WORST 1 YEAR RETURN	ANNUALISED RETURN	ANNUALISED VOLATILITY
CONSERVATIVE PORTFOLIO	12.74%	-7.3%	4.51%	3.99%
BALANCED PORTFOLIO	35.39%	-29.76%	7.95%	10.00%
GROWTH PORTFOLIO	59.32%	-50.42%	8.58%	15.86%

Data source: 1 January 1970 - 31 March 2024, VT - WORLD ALL COUNTRIES, BSV - US SHORT TERM TOTAL BONDS

When it comes to selecting the right portfolio risk, we will pay more attention to the worst 1 year return. Because that will determine if you are able to stick to your roadmap, in order to get the outcome you desire.



Focus on the worst 1-year return to gauge portfolio resilience. Can you stay composed during market downturns?



If so, you're prepared. Otherwise, use this framework to guide your journey. Inaction may mean missing market returns, while uninformed decisions may lead to losses. Invest wisely, not speculatively.

Conclusion

Understanding the 3 bucket strategy illuminates the path to financial clarity. Short-term liquidity, mid-term stability, and long-term growth form the cornerstone of strategic asset allocation.

By assessing probabilities of profit, gauging the need for returns, and understanding the risk of your portfolios, you can craft resilient portfolios aligned with your financial aspirations. It's not just about investing—it's about investing wisely and clearly to secure your financial future.

Prefer to work with a professional? Click here to book a discovery call.