The Bucket List: How to organize your money with intent

By: Michael Liersch, Global Head of Wealth Planning & Advice

Money. It introduces both opportunities and challenges. A well-known challenge, which scientists have long recognized: When human beings think about money, they think in terms of different "mental" accounts. In other words, we assign different values to, and uses for, money based on a variety of factors, including where it came from and what we intend to do with it. Is this a bad thing? Let’s take a look ...

Think about this scenario: Imagine that you have bought tickets to a movie or a Broadway show. When you arrive at the theater, you can’t find the tickets. You rummage through your phone, bag and pockets, but they’re nowhere to be found. What do you do? Do you grab your credit card and buy new tickets or just go home?

Now imagine another scenario. You have not bought any tickets and instead arrive at the theater with a set amount of cash that you’ll use to buy them. When you arrive, you dig into your pockets (or purse) and cannot find the cash. What do you do? Do you grab your credit card and buy the tickets or just go home?

In experiments like this, Nobel laureates and behavioral scientists Daniel Kahneman and Richard Thaler found that people were much more willing to purchase the tickets after losing the money (in the second scenario) relative to losing the tickets (in the first scenario). (For more on mental accounting, see Richard Thaler’s book Misbehaving.) Rationally speaking, there should be no difference: In both situations, the same amount of money was lost, and the decision to purchase the tickets (or not) should be the same. But here’s where mental accounts come in: In the first case, it feels like you’re “double paying” for the tickets (which many people don’t like to do), whereas in the second it seems that you are only paying once (because you lost money, not tickets).

To apply this lesson to your own life, think about how you assign your money to different mental accounts. Do you use monetary gifts differently from an identical amount of money earned at a job? Does a tax refund serve a separate purpose than it would if the money had not been withheld for taxes? Do you spend or invest your bonus in a way that is distinct from how you spend or invest your salary? Do you have “play” money and “safe” money?

From mental accounts to physical ones

When you consider all of your mental accounts—the sources of your money, and how that may cause you to use the accounts differently—do you feel that your mental accounting is helping you use money in the most productive way? One way to find out is to establish a physical framework, or “buckets,” for your money that you know will be productive. You can then regularly review that framework to see if your money behaviors truly align with what you’re trying to accomplish.

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“People across the globe can find it empowering to physically place their money in four buckets: liquidity (cash), lifestyle (spending), preservation or division, and growth. In this way, they discover whether their money is organized—and utilized—in a way that supports their intentions.”

**Liquidity (cash) bucket**
People look to have enough money on hand to feel psychologically safe through the ups and downs of markets, business cycles and life events. We want to be sure that our spending or lifestyle will not be unexpectedly restricted or cause us to sell assets at exactly the wrong time (i.e., sell low). Within the liquidity bucket, we want to have enough operating cash for taxes, big purchases, business expenses and the like. Many people also say they like to have cash on the sidelines “dry powder” available for opportunistic, attractively priced investments (so when others are selling low they can buy low).

*How much liquidity, or cash, do you have on hand? Is it providing you the freedom to do what you’d like when you’d like to do it?* This bucket might include actual cash in your safe, deposits, short-duration fixed income (bonds) and money market accounts. Securities-based lines of credit or equity in a home (accessed through home equity lines of credit, for example) can also be thought of as sources of liquidity.

**Lifestyle (spending) bucket**
Many people want to bucket money in a “lockbox” strategy that they hope will reliably provide for their lifestyle needs and wants for the rest of their lives. So if anything were to happen—if, for example, they faced a large loss of capital in a business or concentrated investment, or a life event that left the principal earners unable to work—there would be money set aside that would allow for a comfortable life. The contents of this bucket are specifically tailored to an individual or family’s definition of lifestyle. It could include everything from spending on essential needs to educational funds for children and grandchildren to gifts in life for the family and the community.

*Do you have a bucket of money set aside for your lifestyle? If so, is it enough? Too much?* Often this bucket can include stocks, mid- and longer-duration fixed income (bonds), cash (to replenish the liquidity bucket regularly) and diversified alternative investments.

**Preservation or division bucket**
While the first two buckets hold money set aside for use within one’s lifetime, another bucket contains money meant to be used beyond one’s lifetime. But there’s some flexibility here. If the lifestyle bucket is drained too early due to factors such as longevity (what if you live to 105?), the preservation bucket can provide a minimum level of wealth. In addition, this bucket may be intended for family gifts—either outright or via more complex wealth planning structures—such as philanthropic gifts via donor advised funds (DAFs).

*What are your intentions—if any—to preserve your money or divide it among people or organizations beyond your life?* Nearly a quarter of our clients have said that they have no intention of leaving money to others beyond their lifetime, which may mean this bucket isn’t relevant to you. (See *The power of intent* for more information about what clients say they intend to do with their money). *But if it is, what does your preservation and/or division bucket look like?* A wide range of strategies can be effective here: life insurance, trusts, complex wealth structures, general investments, home, art, jewelry and more. People sometimes choose to borrow against assets in this bucket (for example, art) in order to supply money to fill other buckets (such as lifestyle).
**Growth bucket**

It’s important to note that the contents of the first three buckets—liquidity, lifestyle and preservation or division—are meant to be consumed. The fourth and final bucket has a different purpose altogether. It’s meant to provide capital growth in perpetuity. Assets in the growth bucket are typically accompanied by a clearly articulated succession plan (e.g., via a business, will or trust) in which growth assets are meant to be stewarded by future generations.

*Do you have money that is meant to grow forever? If so, how much? And have you communicated that with the human beings or organizations that are meant to steward that wealth?* Typically, this bucket includes long-term investing strategies that are more aggressive, concentrated positions or investments, businesses, and investment real estate (typically not family residences). Borrowing to enhance investment returns (“levered” investments) may also fit in this category.

**Aligning buckets with your intentions**

After you’ve identified the buckets that may apply to you—as well as what and how much is in each of those buckets—challenge yourself to identify what those buckets should look like. To do this, try to assign a desired dollar amount, time horizon and priority level to each bucket.

This matters because different buckets with different amounts, time horizons and priority levels will have different sizes and wealth strategies. Let’s take lifestyle as an example. For a 40-year-old who has a lifestyle goal to spend $250,000 per year starting at 65, that strategy may look very different than it will when the same individual is 65 and already spending $250,000 a year from the lifestyle bucket. And the composition of the assets in the bucket may be completely different when that individual is 90 and spending the same amount. In particular, the strategy is likely to be invested in less risky assets over time, for a variety of reasons—not least because the need for cash flow becomes more essential when money can’t be earned through activities such as work. A more conservative mix may be required to ensure that the required $250,000 cash flow is actually realized.

And depending on when the individual started filling the lifestyle bucket, the amount that must be dedicated to that bucket may vary quite a bit. If an individual started investing at 40 for her future lifestyle needs, she would typically dedicate much less to the bucket than if she started later, because the compound growth of investments would be on her side. So—no matter what your wealth level or stage in life—the time to start identifying the time horizons, money amounts and priority levels of your buckets is now so that you can align strategies to get where you want to go.
Here’s an example of how $250,000 might be allocated differently depending on these factors.

<table>
<thead>
<tr>
<th>Label</th>
<th>Time Horizon</th>
<th>Dollar Amount</th>
<th>Priority Level</th>
<th>Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy second home</td>
<td>6 months</td>
<td>$250K</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Education for two kids</td>
<td>4 years each, 5 years out</td>
<td>$250K</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Lifestyle</td>
<td>25 years out</td>
<td>$250K</td>
<td>Low</td>
<td></td>
</tr>
<tr>
<td>Bequest for kids</td>
<td>50 years out</td>
<td>$250K</td>
<td>Low</td>
<td></td>
</tr>
</tbody>
</table>

**From awareness to action**

Aligning your intentions with your wealth strategies is an ongoing process. And it can start at any point in time—whether you are early, mid or late stage in your journey with wealth. The strategies that serve your various goals, or buckets of wealth, may also evolve over time. For example, when you’re younger you may not want to lock in a strategy that divides or preserves for future generations. Perhaps you’re not certain of how much wealth you will accumulate or you may not have identified to whom or how much you’d like to give, if anything at all. But as you get older you may transition to more irrevocable wealth structures as you gain more clarity about the dollar amounts you can and want to give to your family or community. Whatever your intentions, get started. Move your mental accounts to physical ones. When you formally identify the buckets of money that you have and align those buckets with your intentions, you can have much greater confidence in your wealth strategy.
The example below illustrates how a certain amount of capital may be aligned to your wealth strategies to serve your various goals.

<table>
<thead>
<tr>
<th>Goal</th>
<th>Target Portfolio</th>
<th>Capital Needed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liquidity</strong></td>
<td>○</td>
<td>$500K</td>
</tr>
<tr>
<td>$500K for one year spending and liquidity buffer for big expenses/purchases</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Lifestyle/Spend</strong></td>
<td>○</td>
<td>$2.5MM</td>
</tr>
<tr>
<td>$250K/year</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Preserve/Divide</strong></td>
<td>○</td>
<td>$750K</td>
</tr>
<tr>
<td>$500K for children upon death</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Grow</strong></td>
<td>○</td>
<td>$250K</td>
</tr>
<tr>
<td>Fun money for big purchases</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>$4MM</td>
</tr>
</tbody>
</table>

With confidence, you’ll be able to directly address some basic but important questions: Where, exactly, is my money? Is it doing what I want it to do? Will I have enough in a crisis? Will my wealth have the intended effect on my family? Explicitly bucketing your wealth, making mental accounting physical, can also help answer these questions over time. This can in turn give you the peace of mind that your wealth is having its intended impact.

For a more detailed discussion on this topic, please contact your J.P. Morgan Advisor. He or she is always available to answer your questions and to help you with your financial strategy needs.

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