

# Implementing a successful multi-pot strategy

## What is multi-pot investing

Designed to aid long-term income in retirement, multi-pot investing divides a client's investment assets into several segments or 'pots' (sometimes referred to as 'buckets'). The first 'pot' is held in Cash (on deposit) and used to fund the following time period's income needs (likely a year or two). A second 'pot' is used as a Reserve account with a third 'pot' then being invested in a mixed asset portfolio. The Reserve needs to be focused on consistency of returns; be easily accessible (even at times of stress); and have a lower likelihood of losses when financial markets decline.

Meanwhile, the Investment pot accounts for most of the investor's wealth and is aimed at generating growth to fund future withdrawals. A global mixed asset portfolio is likely most suitable, tailored to the individual's own risk preferences and structured to benefit from relevant tax allowances, whether income or capital gains.

## Why is it useful

Multi-pot investing is simple to implement, easy to understand and offers an element of transparency and reassurance. Our research has shown this is particularly the case when a Reserve is used. This allows for 'rainy day' money to be invested with a capital preservation mindset. If the investment portfolio then goes through a rocky patch, these losses don't need to be realised as the Reserve can be used instead. This creates a smoothing effect and on historical data from 1990 to 2019 was shown to enhance returns over the longer-term, compared to a two-pot strategy of just Cash and Investments.

## How is it best implemented

The key to success in implementing a multi-pot strategy is a set of decision rules that maximise the strengths of each pot. Holding too much in Cash gives rise to a cash drag effect. This means too little wealth is invested for growth. Alternatively, not holding enough Cash increases the risk of having to sell Investments following losses, rather than giving them time to recover (referred to as sequence risk).

Similarly, thinking of the three accounts in a form of cascade – from Investments to Reserve to Cash – has also been shown to be less efficient. This cascade deficiency can be addressed by using a set of decision rules that actively fund the upcoming Cash requirements from either Investments or the Reserve. And excess amounts in the Reserve can be used to fund further growth by being transferred to the Investment pot.

To establish a multi-pot strategy, first consider the amount of money needed each year. From this, keep a year to 18 months' worth on deposit. Then determine a suitable number of years' worth of 'rainy day' money to be held in the Reserve (usually two to three years). Finally, structure an appropriate portfolio of mixed assets as the Investment pot.

Then, review the assets in each pot (usually annually) and rebalance as appropriate. Consider if the money required for the year ahead has changed and adjust the target amounts in the Cash and Reserve pots accordingly. Fund any top-ups from Investments, unless it is more suitable from Reserves. And then transfer any excess in Reserve over to the Investments portfolio, to capture future growth.

### Rules for Annual Reviews

- (1) Calculate Cash and Reserve targets for the year ahead.
- (2) Top-up Cash from Investments or Reserve, as appropriate.
- (3) Top-up Reserve from Investments, if required.
- (4) Transfer any excess wealth in Reserve to Investments.

## Important Information - Past returns may not reflect future performance. For information only. Not financial advice.

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