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Guidance

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Saving for Emergencies

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How much cash should you maintain for life's emergencies – a job loss, a big medical bill, a legal liability? The older you get, the more you need.

Early in adulthood, we need lower emergency cash savings. Then life gets more complex. You likely have more people who rely on you, and so the risks of job loss are greater. Maybe you work in a cyclical industry or are self-employed.

This involves parking a chunk of your income in cash instruments: bank savings accounts, certificates of deposit (those without long maturities so you can access your money more easily) and Treasury bills. Here's a recommendation of how much in living expenses to have:

YOUNG ADULTS. For individuals, couples or families just starting out on their financial journeys, *three months* is the bare minimum. But you may need to achieve this goal through slow and deliberate savings. Start by setting aside $10 to $20 per month and living within the remainder. If you can do more, do more. Increase this as you are able, but keep it right at the edge of your comfort zone and only dip into the savings for true emergencies.

MIDDLE YEARS. When you are in the middle of your working life – say, 35 to 50 years old – you probably are busily investing to meet goals like retirement and college payments. Meanwhile, there is the added risk of job loss, or perhaps simply job dissatisfaction. You may want to make a change before it is too late. Odds are you have a family to support.

You need a bigger safety net: *six to 12 months*. This kitty pays for living expenses while you are out of work, or if you change direction and quit a job. I have heard this money referred to as F.U. savings, for when you just can't take your boss for one more day.

This is more and more important as companies maintain profitability through layoffs. People are working harder to keep their jobs. Even if you never use the emergency money, having it gives you financial confidence.

NEARING RETIREMENT. When you are nearing that magical moment of maximum freedom, retirement (meaning approaching age 60), keep *one to two years* years in safety money.

This is because, with pensions sparse, your entire future retirement income is probably tied up in assets invested in unpredictable markets. During the past 12 years, the stock market has plunged twice. You need a buffer to protect you and keep your plans on track – a place to draw from not subject to those fluctuations.

Otherwise, a major market drop may force you into taking a later retirement.

IN RETIREMENT. Ideally, once retired, you need *a minimum of two years* of emergency savings ready, just in case markets take a major tumble.
When I tell clients about building emergency savings, I often hear this objection: “There is no return on these safe assets." True, cash returns are incredibly low these days. But I point out that, given the uncharted waters we are in economically, it makes sense to enhance our safety nets.

I am a huge optimist, and I believe the future will be incredibly rosy. Still, I don't know when those big temporary setbacks will occur. So we should plan for them to arrive when we don't expect them.

Another client objection: Taking care of both investments to meet life goals and a large safety net requires even more of their income. To this I say: Yes, absolutely. If you don’t fund your safety net, you can divert more money into a higher standard of living for today or into greater investment assets for tomorrow.

But eventually, something will happen in their lives, an event that calls for a sum of cash waiting patiently on the sidelines. My firm creates a comprehensive plan for folks they allows them to see the wisdom of a balanced approach that includes a sizable safety net.

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