

Office for Financial Success – Financial Tip of the Week

A service of the Personal Financial Planning Department
College of Human Environmental Sciences
University of Missouri-Columbia

EMERGENCY FUNDS

“Pay off your debt.” “Max out a Roth IRA.” “Buy a house.” Personal finance professionals bombard us with a litany of things we ought to do in order to achieve financial independence. All of the things that need to be done can become extremely overwhelming. Where’s a person to start?

Most tend to agree that the first thing you should do — after meeting basic needs, and while reducing spending — is to start an emergency fund.

What is an emergency fund?

An emergency fund is an easily accessible source of money for use *only* in case of emergency. Emergencies do not include a new car, a PlayStation, a vacation ... [I think you get the idea]. It is for use *only* in the case of an emergency.

Why do you need an emergency fund?

- A golf ball smashed your windshield.
- Health problems.
- Mole problems.
- Job layoff.
- Because “life” happens.

Insurance is purchased protection to assist with many of life’s emergencies. It won’t, however, cover everything – in addition, there will normally be a required deductible or co-pay as part of the insurance coverage.

People with an emergency fund tend to be in better shape than those without one. Studies show that those without emergency savings are more likely to accumulate debt. It may feel like you can’t afford to have one, but the truth is you can’t afford *not* to have one. Emergency funds are essential, even for college students. Why? There is a tendency for people that don’t have an emergency fund to turn to credit cards, payday loans [and other forms of debt] to cover the emergency if they don’t have the savings otherwise.

How much is enough?

Though personal finance experts agree emergency funds are necessary, there’s no consensus on how much is enough. Some say you need to save a year’s salary. Others believe \$1000 is sufficient. Most advice tends to fall someplace in the middle. My recommendation is to do what will suit you. There is not one right answer. Examine your situation — your income and your needs — to decide how much you should save. I would look at an emergency fund in a vastly different way if I were a tenured professor than if I were self-employed.

What do the “experts” say?

The *Wall Street Journal’s Complete Personal Finance Guidebook* says: “How much is enough? The answer is different for different people in different situations. For those

in careers with a large, ongoing demand or who have relatively strong job security, three months' worth of expenses is probably enough of a cushion. Those with bigger career demands, such as higher-paid managers and executives or couples who work in the same industry or at the same company, might want nine months to a year's worth of expenses in the bank.

In *You Don't Have to Be Rich*, Jean Chatzky recommends three to six months of living expenses. *Your Money or Your Life* recommends six months of living expenses, but only once you've achieved financial independence.

In Dave Ramsey's *The Total Money Makeover*. Ramsey's very first step is to save \$1000 in an emergency fund. Then he advocates eliminating debt; then he recommends building a three- to six-month cushion.

How do you get started?

Starting an emergency fund can be as simple as depositing a little money into a savings account. I think it's wise to keep your emergency money someplace that's not too easy to access. In other words, I wouldn't advise that your funds be kept in your checking account or a savings account that you use regularly. Put it somewhere where the money is easily accessible, but not a regularly used account for other purposes. Many experts suggest money market accounts as the best place to park emergency fund money. I'm a big fan of the high-yield online savings accounts – ones that are FDIC insured with no fees and no minimums. HSBC (hsbcdirect.com), ING (ingdirect.com), and Emigrant Direct (emigrantdirect.com) are all good examples that are currently paying above 5% in some instances.

(SOURCE – Get Rich Quick Slowly Blog)