

Emergency savings: How Much is Enough?

We all need an emergency fund, but what's considered "an emergency?" Any unexpected hit to your finances, including layoffs, unanticipated illnesses, and natural disasters. Car insurance premiums and regular home maintenance are (or should be) anticipated, so those things are not emergencies. The same is true of credit card bills for vacations and visits to the dentist's office. An emergency fund is designed to keep your life intact during temporary setbacks and to help you avoid unnecessary debt.

How much emergency savings is enough? In general, your emergency fund should cover three to six months of expenses. How much you will need will vary based on your financial situation, including the vulnerability of your income. For example, a one-earner household is more vulnerable than a two-earner household when it comes to paychecks. So the one-earner family generally should set aside more for emergencies. If you don't have disability insurance, you might consider setting aside a bigger balance in an emergency account. Some companies provide payment for accrued vacation and/or sick leave to laid off employees. If your company provides such benefits and you maintain significant balances in these accounts, you may not need as much in an emergency fund (at least to help you weather an unexpected layoff).

Another factor to consider is your ongoing debt payments. Putting excess cash toward high interest credit card balances might make more sense than funding a savings account that earns four percent interest. Also, in a true emergency some spending can be reduced and postponed, such as retirement plan contributions, vacations, and entertainment. Ask yourself, "How much will I need to cover my minimum monthly expenses without resorting to credit cards or lines of credit?" That's a good starting point for determining how much to set aside in an emergency fund.

Once you have a savings goal in mind, don't wait. You can start small and increase contributions as you receive pay increases or windfalls. The money should be liquid – easy to get at – so don't put it in investments with withdrawal penalties. A savings or money market account is a great place to set aside cash for a rainy day.

Then post a sign on the account: "Use only in case of emergency."

We hope these tips are helpful. If you need professional help with personal or business financial matters, we are available to be a resource. We can help or provide names of referral providers with whom we maintain referral relationships. inquiries@mangoldcpa.com or 512-327-0909