BALANCE℠
FINANCIAL FITNESS PROGRAM

Emergency Savings Accounts

What if your income stream suddenly stopped? Would paying for the essentials be difficult? What if an unexpected expense, such as a medical bill, popped up? Would you be able to pay it? Many people turn to credit to help them make ends meet in difficult times. While it may provide temporary relief, it could cost you, as interest accumulates on your balance if you cannot pay it in full. Not to mention, it may be a struggle to make the payments each month.

An emergency savings fund will help you be self-reliant and take care of bills if you have an unexpected expense or your income is reduced or eliminated without relying on credit. The size of the fund should be based on your family size, expenses, and personal comfort level. Most financial planners recommend three to six months worth of living expenses be set aside.

Keeping savings in your checking account is usually not a good idea because you may be tempted to spend it prematurely. So where can you put it? Minimal investment risk and easy access are the most important aspects for an emergency fund – while a high return is nice, it is not a priority. Here are some recommendations for keeping your stash safe (and under the bed is not one of them).

Savings account

You deposit your cash and make withdrawals at any time without paying a penalty. (However you are restricted in the number of withdrawals you can make.) Savings accounts are insured by the FDIC (for banks) or NCUA (for credit unions), so you won't lose your money even if your financial institution goes out of business. In exchange for total liquidity and stability, savings accounts usually provide a very low investment return.

Money market deposit account

Money market deposit accounts are similar to savings accounts, but the interest rate is variable, not fixed, and usually higher as well. They are insured and may come with limited check-writing privileges.

Money market mutual fund: Money market mutual funds are mutual funds that invest in short-term debt obligations, such as Treasury bills and CDs. While generally safe, money market mutual funds are not insured and provide no guarantee against loss.

Certificate of deposit (CD)

CDs are insured and typically offer a higher interest rate than savings accounts or money market deposit accounts. The catch – if you withdraw money from the CD before it matures, you usually have to pay an early withdrawal penalty. This can be problematic for an emergency fund because you don't know when you will need the money. Still, it may be a good choice if the additional interest you earn compared to other options is greater than the penalty.

Treasury bill (T-bill)

T-bills are debt obligations of the U.S. government with a maturity of a year or less. T-bills are sold at auction, and your return is dependent on how much under the face value you purchase them for. Although T-bills are not insured, they are a fairly safe investment. After all, the government can always print more money to meet their obligations! If you need to cash them in before the maturity date, you have the option of selling them, but it's best not to depend entirely on T-bills for your emergency fund, since you won't necessarily get your money immediately.

Whether you decide to go with only one of the above option or diversify, an emergency savings account is a safety net that everybody should have. Saving three to six months of living expenses may seem like a daunting task, but by setting aside just a little every month, you can get there in less time than you might think.

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