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How to build emergency fund

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NEW YORK — A sudden financial jolt — such as the wave of layoffs that recently rattled the lives of some Wall Street workers — could leave you scrambling to pay rent and eking by on credit cards.

One way to prepare for such a scenario is to build an emergency fund.

Without a cash reserve you can easily tap, an unexpected expense could turn into a quicksand of debt. That's why financial planners widely encourage people to set aside some cash for life's surprises, whether it's a layoff, medical scare or home-repair bill.

Wall Street workers aren't the only ones feeling tentative these days, either. Last month, national unemployment bolted above 6 percent for the first time in five years. Economists say the figure will only climb in the months ahead, driven in part by unemployment claims arising from Hurricanes Ike and Gustav.

"Nobody knows where the market is going to be in a few months. We need to be carrying a little more cash now for a lot of reasons," said Lisa Kirchenbauer, a certified financial planner and president of Kirchenbauer Financial Management & Consulting in Arlington, Va.

So if you don't already have an emergency piggy bank, some points to remember as you get started.

How much do I need?

A rule of thumb is to save between three to six months of expenses. Where you fall in that range depends on how quickly you think you'd find a job if you were laid off.

These days, you may want to err on the side of safety — especially if you work in a volatile industry.

"Even nine months may not be too much, if you think it's going to be difficult to reposition yourself," said Ellen Siegel, a certified financial planner and president of Ellen R. Siegel & Associates in Miami.

People higher on their industry's pay scale may also find it tougher to recover from a layoff, she said.

Those who work in an industry where demand for labor is high — such as nursing — might feel comfortable having just three months of expenses on tap.

The next step is figuring out how much money you need to get by each month. You should start by tracking your expenses, both fixed and variable. As you figure out a target savings goal for what you may need during a period of unemployment, recognize that you can probably be a bit conservative as you'll likely be able to spend less than you normally would.

"Food and clothing — that's a lot more variable. You can really cut back with careful shopping," Siegel said.

Don't factor potential unemployment benefits into the equation, because you might not be eligible. Your financial emergency also may not be related to a job loss — it could be an unexpected medical, car or home expense.

What if money is tight?

A lot of people think they can't squeeze any more savings from their budgets. But the simple exercise of writing down how you spend your money could be a big wake up call. (Who knew you were spending \$500 a month eating out?)

"Just like any good therapy, if you can figure out what you're doing wrong, you have a heightened awareness of your actions," Kirchenbauer said.

There are less obvious ways to cut corners, too. Using credit-card points, clipping coupons or buying generic brands at the supermarket are just a few examples. If you still think saving three to six months of expenses will be impossible, just squirrel away whatever you can.

If you're juggling credit-card debt, don't feel you need to clear it before starting an emergency fund. Split the difference, so you're paying off debt while still building an emergency fund, Kirchenbauer said. Without a fund, an emergency could just throw you deeper into debt.

Where do I keep it?

The key to an emergency fund is that it's readily accessible and in a safe place, such as a money-market account, which is FDIC insured and has a higher yield than typical savings accounts.

Howard Pinson, a principal of Pinson Wealth Management in Baltimore, suggests checking with your financial adviser, bank or online comparison sites (such as www.bankrate.com) to find out the best rates.

A short-term CD of three to six months is another option, if you're confident about your job security and feel you have a good safety net of family and friends, Siegel said.

And don't fret that your emergency fund isn't earning big returns — keep in mind the purpose of the money. The point is that the money is safe and will be there when you need it.

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