T. Rowe Price®
INVEST WITH CONFIDENCE

RETIREMENT PERSPECTIVES:

HOW MUCH CASH SHOULD RETIREES HAVE ON HAND?

During your working years, it's a good idea to have money set aside in an emergency fund so that you won't need to tap retirement assets if you experience a financial shock. But when you are retired and can access money in retirement accounts without penalty, do you still need to have additional cash reserves available?

In retirement, you have savings or checking accounts for daily and regular spending. You're most likely directing regular income, such as Social Security benefits, part-time wages, dividends, and interest payments, into those accounts already. Then, you need to determine how much to draw from your retirement accounts to supplement that steady income. For convenience, you may consider having at least six to 12 months of spending needs in your daily use account.

A CASH CUSHION

A key consideration outside of accommodating your regular spending needs is how much additional cash to have on hand. This could be thought of as a safety net, or a "cash cushion." Some might even refer to it as their "sleep at night money."

A cash cushion might help sustain you should there be an extended down market. Having additional cash reserves will give you an alternative to fund your living expenses.

Besides a bank savings or money market account, you could consider other types of short-term investments, such as:

- Short-term or ultrashort bond funds,
- Tax-free short-term funds (if in a higher tax bracket), and
- Short-term certificates of deposit (CDs).

These relatively conservative vehicles may provide a bit more yield compared with a savings or money market account. Keep in mind that, unlike bank products, investments in mutual funds are not FDIC insured and are subject to the loss of principal[1].

HOW MUCH SHOULD I SET ASIDE?

Consider the likely duration of a bear market. In recent history, there have been a handful of market corrections and two bear markets—the tech bubble crash (2000–2002) and the global financial crisis (2007–2009). While the duration of these bear markets was 2½ and 1½ years, respectively, full recovery took up to five years. Based on history, smaller market corrections typically recover in a matter of months. Of course, past performance is not a reliable indicator of future performance.

> **It may be reasonable to hold cash to cover one to two years of living expenses.**

While a five-year recovery may seem alarming, keep in mind that many retirees do not have all their investments in the stock market. At retirement, we suggest taking a more balanced approach, with an allocation of 40% to 60% in stocks. A portfolio that was composed of 60% stocks and 40% bonds, recovered from those two bear markets within two years.

With those time ranges in mind, it may be reasonable to hold cash to cover one to two years of living expenses (beyond predictable Social Security and pension income) in addition to your daily use account. The exact amount you want to have also depends on your risk tolerance and the amount you have saved.

Another advantage of taking a balanced approach is that during a bear market stocks and bonds are rarely in decline at the same time. So, in addition to drawing on the cash cushion, you could potentially liquidate bond holdings to meet spending needs.

WHICH ACCOUNT SHOULD I USE?

You may want to build the cash cushion gradually, a few years ahead of retirement to avoid generating significant extra taxable income in any year. Additional cash should be in an account that affords you flexibility and accessibility. Some examples of appropriate accounts include:

Account Type	Benefits	Other Considerations
Regular bank account	Generally, this is a good choice.	Interest income is taxable, so if rates increase, retirees in higher tax brackets might consider other options.
Taxable brokerage account	Accessibility also makes this a reasonable option.	Be aware of any fees being assessed on the cash balance. Also consider taxes on interest income (noted above).

While you can use your retirement accounts to build up your cash cushion through some short-term investments and you can generally access them penalty-free after age 59½, there are tax implications to consider before using them for your cash cushion.

Account Type	Potential Uses	Tax Considerations
Roth IRA	You're already planning to draw down the account as part of your withdrawal strategy.	For money you may not need soon, keeping cash in a Roth account reduces the tax-free growth potential.
Traditional (pretax) IRA	You already know you'll need to tap into the account—for example, if you're subject to required minimum distributions (RMDs).	Distributions are treated as taxable income and subject to ordinary income rates. Drawing on the cash cushion in your IRA could put you in a higher tax bracket.
Workplace savings plan, such as a 401(k)	For amounts up to your next RMD.	Inflexible distribution rules and taxability of the pretax portion can make this a less-than-ideal location for the cash cushion.

FINAL THOUGHTS

Decisions about the amount of your cash cushion and which type of account(s) to use should be made with your overall withdrawal strategy in mind.

A cash cushion can be used to help weather periods of market downturns, allowing you to keep the bulk of your nest egg invested to take advantage of potential growth through decades of retirement.

[1]While money market mutual funds do not guarantee an investor's deposit like an FDIC insured bank account or CD, U.S. Treasury and government money market funds are required to invest at least 99.5% of their assets in fixed income securities backed by the full faith and credit of the U.S. government. Please note that bond and tax-free funds are subject to credit risk and interest rate risk. In addition, some income from tax-free funds may be subject to state and local taxes and the federal alternative minimum tax.

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