Emergency Fund Planning: How Much Cash Should I Have on Hand?

Having accessible cash for financial emergencies or general spending can help keep your financial goals on track and offer some peace of mind.

Judith Ward, CFP®
Thought Leadership Director

KEY INSIGHTS

- An emergency fund can serve as your personal safety net during periods of financial stress.
- While you're working, we recommend you set aside at least $1,000 for emergencies to start and then build up to an amount that can cover three to six months of expenses.
- When you've retired, consider a cash reserve that might help cover one to two years of spending needs.

The events over the last few years certainly illustrate how life can throw you a curveball. At the same time, stock market volatility continues to be a concern for investors. These circumstances can throw a wrench into your current budget and make you anxious about the longevity of your retirement savings.

For years, financial experts have stressed the importance of an emergency fund for such events during an individual's working years. When you retire, however, those savings are more of a "cash cushion" to have alongside what you need to fund your daily living expenses.

Whether you are currently working or in retirement, having cash on the side can serve as your personal safety net during periods of financial stress.

If you are still working:

The primary purpose of an emergency fund is to keep your financial and savings goals on track should you lose your job or expect a change in income for a brief time. It can also help cover large, unanticipated expenses that you may not have included in your budget. Having this money handy can save you from putting unexpected expenses on a credit card or taking money out of retirement accounts—and likely paying taxes and penalties as a result.

For starters, try to save $1,000 immediately for emergencies. Then, gradually build up to an amount that can cover three to six months of expenses if you are in a two-income household. If you only have one income, or your income is less predictable—such as with freelance or commission-based

Having cash on the side–outside of your retirement accounts–can help you maintain control and weather these periods of uncertainty.

work—you may want to set aside enough for six months or more.

After you tap into this account for an emergency, make sure you start building it up again.

If you are retired:

Retirees may view their need for available cash differently. They think of this as money separate from the savings and checking accounts used for daily and regular spending. It's more like a cash cushion than an emergency fund. One of my friends refers to this as his "sleep at night money."

The cash cushion can be in a savings account or money market account or in other short-term investments such as short-term bond funds, short-term certificates of deposit, or tax-free short-term funds. The latter makes sense if you are in a higher tax bracket. Keep in mind that, unlike bank products, investments in mutual funds are not FDIC-insured and are subject to the loss of principal.

This money can be used as an alternative to fund living expenses if there is an extended down market. You can draw from this account instead of having to sell investments at an inopportune time and locking in a loss. Consider these two bear markets—the technology bubble crash in 2002 and the global financial crisis in 2009 that lasted 2½ and 1½ years, respectively. Both recovery periods took almost five years.

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 in your portfolio allocation, with 45% to 65% in stocks. A hypothetical portfolio that was composed of 60% stocks and 40% bonds during the last two bear markets recovered within two years.* Of course, past performance is not a reliable indicator of future performance.

Given this backdrop, it may be reasonable that a contingent cash account, or "cushion," should cover one to two years of living expenses in addition to accounts used for regular spending.

For both workers and retirees, a financial shock or a declining market environment can be emotional and cause anxiety. Having cash on the side—outside of your retirement accounts—can help you maintain control and weather these periods of uncertainty.

*Stocks are represented by the S&P 500 Index. Bonds are represented by the Bloomberg U.S. Aggregate Bond Index. The evaluation periods for stocks from peak to trough to recovery were 3/00–5/07 and 10/07–3/13. The evaluation periods for a 60% stock/40% bond portfolio from peak to trough to recovery were 3/00–11/03 and 10/07–12/10.

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

To learn more, please visit troweprice.com.

T. Rowe Price®

Important Information

All investments are subject to market risk, including the possible loss of principal.

This material is provided for general and educational purposes only and is not intended to provide legal, tax, or investment advice. This material does not provide recommendations concerning investments, investment strategies, or account types; it is not individualized to the needs of any specific investor and is not intended to suggest that any particular investment action is appropriate for you, nor is it intended to serve as the primary basis for investment decision-making. Any tax-related discussion contained in this material, including any attachments/links, is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding any tax penalties or (ii) promoting, marketing, or recommending to any other party any transaction or matter addressed herein. Please consult your independent legal counsel and/or tax professional regarding any legal or tax issues raised in this material.

CCON0143246
202403-3430197