

How Much Emergency Reserves Are Enough?

There is agreement amongst most in the financial services world that somewhere between three to six months of expenses is the right level of emergency reserves. What is the right number for you? That is a decision that is impacted by your risk tolerance, the riskiness of your job or business, how large your household that relies on the reserve is, whether you are a home owner, or own any other asset that could require significant repairs or maintenance. As you can see, the list goes on.

What it all boils down to, though, is to just have reserves. When you get to three months, that's a much better time to make decisions about whether you want to keep going to six months or if you want to save three months of gross income rather than net income. In fact, that will likely be a great time to seek the advice of a professional. Meanwhile, just get to three months of expenses.

That's easy enough to say, but how do you do it? Have you ever heard the saying "How do you eat an elephant?" "One bite at a time." If you could put 10% away, you'd be at 3 months of reserves in 2 1/2 years. If you can only do 5%, then it will take you 5 years. That seems soooooo long. But in 5 years you can be 5 years older still without any reserves, or you can be 5 years older with 3 months of reserves. Which sounds better?

Along the way, you follow the 1/3 rule: 1/3 of any extra money you get goes directly into emergency reserves. And that's any extra money. You'll be amazed that it will grow more quickly than you expected.

And what if you can't do 5%? Do something. Even \$100/month, or \$50 provides you more of a safety net than you had the month before. I've even had people put \$5 away. Not for the \$5, but for building the habit.

