Emergency Fund Cash: Where to Save Your Cash Now

By Susan Carr-Templeton

Do you have enough cash in your emergency fund? Do you have enough cash separated from your other investments should you need it in an emergency? The rule of thumb for emergency funds used to be to have six months of cash to cover living expenses, should you lose your job. Since the financial crisis, many experts advise saving a year's worth of cash for your emergency fund as finding that new job can take a lot longer than before.

So where should you save or invest your emergency fund cash?

When deciding about your emergency fund, it's helpful to ask yourself these questions:

How long do you want to commit your funds to a cash type investment? How much risk are you comfortable with?
What tax consequences will you face with this choice? They differ depending on whether you have interest income or dividend income. What's the current economic environment? How might it affect the value of your cash over time? Will you lose opportunities by tying up your cash now?

The current less risky choices for investing cash for an emergency fund are pretty dismal.

Money market mutual funds through mutual fund families are yielding 0.03 percent. Bank money market deposit accounts in Chicago pay on average 0.60 percent.
Six-month certificates of deposit rates range from 0.45 percent to 1.30 percent. While storing your cash at a bank is safer, since the FDIC insures it, the rates are only slightly better than those paid by money market mutual funds. Regular savings accounts often pay even less. With January's economic inflation data coming in at 2.63 percent, you are losing money every day with your cash in one of these low risk choices.

Even for your emergency fund you want to beat inflation and minimize your risk. To do that, you can buy an ultra-safe U.S. treasury bond with a seven-year maturity yielding just slightly more than 3 percent. You can also sell it should you need your cash in the near future, however there are two problems. The transaction cost when you buy (unless you buy it directly from the federal government) and the transaction cost when you sell will eat away at your return.

When you're deciding how to save your emergency fund cash, you should consider interest rates. Some say that interest rates are going up over the next 12-18 months so do you really want to be holding a seven-year bond earning 3 percent when in 12 months you can get a bond with the same maturity that might be 1 to 1 1/2 percent higher in yield? And the bond that you buy with the 3 percent rate isn't going to be worth what you paid for it (unless you hold it the full seven years) because other investors aren't willing to pay the same price when they can get a similar bond that pays more.

Here are some choices for saving your emergency fund cash that might make better sense in the current environment.

If you are risk adverse and do not want to invest your emergency fund cash in anything that can fluctuate in value, then find a bank that advertises a higher rate than others and put your money in an FDIC-insured vehicle for the short-term until rates start climbing and you can lock in something much higher.

Ally Bank is now offering a 1.30 percent yield on its money market deposit fund and allows you six transactions in a month. Or invest in a CD at your bank for six months. After six months, see if rates have climbed enough to lock in a higher yielding bond.

If you're a good customer at your bank, go to the bank manager and ask him or her for a CD rate that matches what's being offered on Bankrate. When you've done your homework, your bank may be willing to match one of the higher rates to keep you as a client. I have done this successfully many times with my bank and for my clients.

In my next blog, I'll discuss some less liquid options for saving cash that you may consider part of your emergency fund. It may take longer to access the money, but you'll also earn a higher interest rate.

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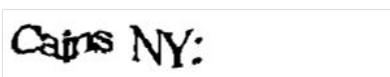

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