PBS Ep148 AskPB Emergency Fund Transcript Audio

Patti Brennan: Hi, everybody! Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

This podcast is part of the "Ask Patty Brennan" series. You'd be surprised how often we are asked, "What should I consider when establishing and, even more important, maintaining my emergency fund?" It's a really important question.

A lot of times we talk about cool things like the economy, the markets, and how to make sure that our flood insurance is right. Really interesting stuff. What should we expect with the election and the impact of wars on our financial affairs?

The emergency fund doesn't sound like a real sexy topic. Let me tell you something. It's really, really important, because a good emergency fund gives you the opportunity to wait things out and allow the strategy that you have to work.

If you don't have the emergency fund, then you're going to feel that awful panic that happens because you don't have access to capital. Your emergency fund is first and foremost the most important principle that we talk about.

Having said that, most of you know me pretty well by now. I tend to lean a little bit more optimistic. I also think it's important to be realistic.

When we run numbers, we're always running plan A and plan B, because, as Morgan Housel says, "Room for error is underrated." Make sure you have plenty of room for error if what you're hoping for is not occurring.

Unfortunately, that does tend to occur. That necessity to employ plan B is needed a lot more often than people realize. People lose jobs. They get sick. Children that you thought were launched come back to live with you. Sometimes they come back with children of their own.

We can come up with all the greatest plans in the world, but having access to an emergency fund is, again, so very important.

What should you consider? In terms of the amount, think about what would happen if somebody lost their job. In that regard...You guys know me, I'm not big on budgets, but I do think it's important for you to understand what your essential expenses are and what your discretionary expenses are.

What I've learned over the years is that people tend to overestimate what they can cut if they did have an emergency. First and foremost, understand what your cash flow needs are going to be.

What happens if we get a wicked bear market right at retirement? You don't want all of your money invested in the stock market in that case. Give yourself a good two to three years of buffer before you retire so that if that happened to you, you wouldn't suffer long term.

We talked about reviewing your expenses. Also important is to keep in mind any major life events that might be occurring in the next year to two years. Is there going to be a marriage in the family? Are you going to need a new car? Things of that nature.

You want to make sure that you have a strategy and a really good emergency fund if those things, or when those things come up.

I have a family member who is about to buy a car and drain their emergency fund completely. This person is really going to be nervous, like, "How do I build that back up?"

Depending on your situation, you might think, if you have a bonus that you're expecting, that should automatically go to build that emergency fund back up. I'm not a big fan of relying on your 401(k) balance as a source of funds in the event of emergency, but that could be earmarked.

You may have an HSA plan for medical expenses. That can also be part of your emergency fund.

There are sources of capital that you might have that could serve as your emergency fund until you can build up that money market account again.

For those of you who may have rental properties, as you think about this, it's important for you to have a separate account with cash in that account if the property needs maintenance. If, for example, it goes un-rented for two or three months, You've got a mortgage to pay. You've got real estate taxes to pay. You've got to be able to have a buffer in a separate account for that rental property.

It's the same thing with businesses. I, as a business owner, have to have a separate account to cover expenses, payroll, and things of that nature in the event of an emergency, in the event things aren't working out as much as we hope.

Knock on wood, I've had it for 30 years. I've never had to use it. It's really comforting to know that if I did need it, it's there.

The next question that I often get is, "How much should I have in this emergency fund?" There's a rule of thumb that says you should have three months of expenses in that money market account.

The reason that came out -- that rule of thumb has been out there for 30 years -- it had to do with disability insurance, because most employers did not provide income if somebody got sick for at least three months, sometimes six months.

The emergency fund, that rule of thumb of three to six months of expenses, had to do with that. Does that mean that you don't need a three-month emergency fund?

That's where that rule of thumb came about. Now most employers provide sick pay for the first three months or for the first six months.

Does that mean that you don't have to have three to six months of expenses set aside? Not necessarily, because, depending on what we think about the economy, if we end up in a recession, companies tend to lay people off.

If you've been listening to these podcasts, you probably already heard Brad and I talking about recessions. If GDP goes down two percent, incomes are going down. That's basically the income of the nation.

I've got to tell you guys, not everybody feels a recession. Not everybody's income goes down.

Typically what happens is some people don't feel it at all. They're working. They're spending money. They're doing just fine. It's the people that lose all of it, a hundred percent of their income, that really get hurt.

Please be prepared. This stuff can happen at any time for any reason. It may not even be a recession. Could be something with the company. They might get bought. Unbeknownst to you, they're selling the company and they're going to downsize. Be aware.

With that in the back of your mind, do you think it will take just three months to find that next job? Maybe. Maybe not. For your peace of mind, be ready for anything.

Unexpected expenses can also be unsettling. It's that car accident, that illness, something around the house that has to be done that isn't covered by anything. That's where your emergency fund can come into play.

In terms of where you should be allocating this money, what you should be investing in, it's really important to have a lot of flexibility. You could put it into CDs, and things of that nature, but this is supposed to be there in the event that you have an emergency. You don't have to want to wait until something matures before you can use it.

For those of you who are a little light on that, look to your 401(k). Do they allow loans? Look to zero-percent credit cards. Don't use it, but by all means, if you don't have that buffer, see if you can get one of those zero-percent credit cards, and stick it in a glass of water, throw it in the freezer. You never want to use it unless there is that emergency. If that's the case, let the darn thing thaw. Then you can use that for expenses.

In terms of where to allocate the funds themselves, we often talk about money markets. By the way, in 2023 it was the first year in 15 years where you actually got a positive return. You actually earned some interest on that emergency fund. It was a positive return after you paid the taxes on it and after inflation. That was the first time in 15 years.

I don't even care. It's dead money. It's OK. If interest rates go back down, don't worry.

The one thing I don't want you to do is invest it into the S&P 500, because then you're going to be subject to that volatility. I don't know what's going to happen with the market, and I don't know when you're going to need this money.

Let's keep it safe and secure. Understand, that's an account that you don't need it to be growing at a particular rate. It's OK. It's there for that emergency, for your peace of mind.

Keep in mind that having an emergency fund is just one of the many principles that go into real financial planning, real wealth management. You don't have to hit all of your goals, all at once. It's perfectly OK.

Make sure that you're tracking yourself and that you feel like you're making progress. We human beings, we need to feel like we're making progress.

You don't have to hit the home run. You don't have to have every dollar earning 12 percent. Set aside this money in your emergency fund so that you don't become a victim of circumstances.

I hope this has been helpful for you. I'm Patti Brennan, and we are Key Financial -- Wealth Management with Wisdom and Care.

By the way, if you have any questions on this or any other subject, go to our website at www.keyfinancialinc.com. In the meantime, I hope you have a great day, and I hope you never, ever have to tap into your emergency fund. Take care.