Optimizing your Cash on Hand

Best practices for keeping your emergency fund

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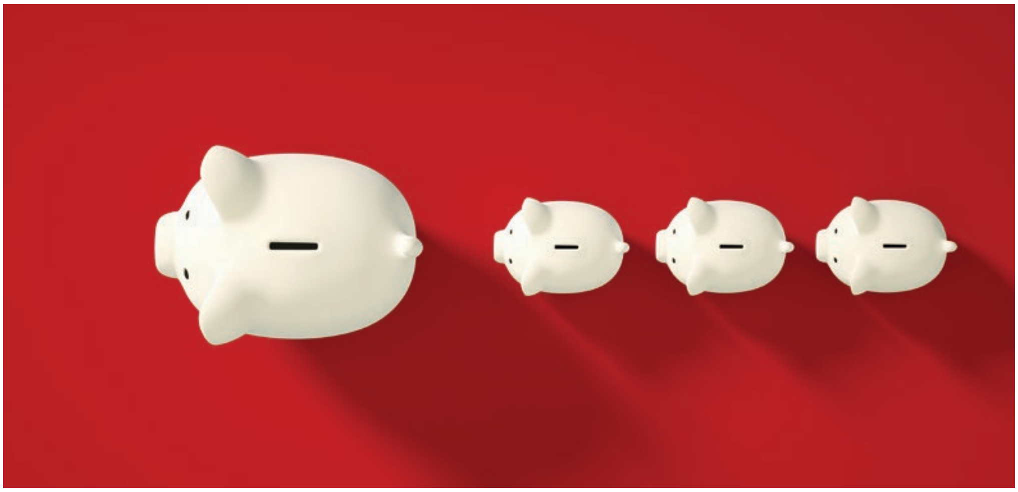

Editor's Note: This is the first piece in a new series of Financial Wellness articles tailored for military personnel. Shad and Rob have written several articles for The Bulletin *in the past, mainly focused on TSP best practices and estate planning. With positive feedback from our readers and requests for additional topics, we are producing a series of articles relating to military Financial Wellness. We hope you find them helpful.*

Most people have heard the advice to always keep some cash on hand for unexpected expenses. This pot of money is often referred to as an "emergency fund" or "rainy day fund" and true to its name, the purpose of this money is to provide assistance during a time of financial hardship. What most people do not know is how large their emergency fund should be and where it should be kept in order to optimize its earning potential. After working with thousands of servicemembers and civilians, we have compiled some "Emergency Fund Best Practices" in this article to assist with this foundational element of prudent personal financial planning.

With incredibly reliable employment and steady paychecks, do military members really need to keep an emergency fund?

This is one of the most common questions we hear, and it is a very valid question. The short answer is an emphatic YES; every person should have an emergency fund. For folks who are relatively new to the Service, it may seem that your military paycheck appears in your checking account without fail twice per month. For those of us who have been in the Service a decade or two can recall periods of government shutdown, continuing resolution, and even times as recent as 2019 when Coast Guard members did not receive their paychecks as expected. While generally reliable, receiving your military pay on-time is no longer a guarantee. There are many more reasons an emergency fund is needed for members of the military, including the obligation to pay off a government travel card for TDY or PCS expenses while awaiting travel claim settlement. And while a CGMA loan may be available in times of financial hardship, it is more responsible to be self-reliant.

How large should an emergency fund be?

While the need can vary per person, typically 3-6 months of fixed expenses is appropriate. We suggest looking at your budget and identifying your fixed expenses, or items you will still have to pay for even if your income were paused. Typically, these include housing, utilities, groceries, gas, insurance, pet expenses, etc. Take this sum and multiply by three or six to arrive at a ballpark number for your emergency fund. More specifically, if you have two incomes in your household, you can lean closer towards the three-month mark. (Two incomes meaning each spouse works, or only one spouse works but has two sources of income.) Compare the calculated number with how much cash on hand makes you feel comfortable and safe. We've seen folks who prefer a much larger emergency fund because it truly helps them sleep more soundly. Remember that money is simply a tool and one of its purposes is to make you feel secure. Here are some additional questions to help determine the amount of cash you may need on hand:

Do you have a spouse and children who depend solely on your income? Or, are you young, single, and could you move back in with your parents if you lost your job or were separated from the service?

Do you own a home and have a mortgage payment you have to make? Or, are you in a month-to-month lease and could you leave your housing with little financial obligation to your landlord?

Do you own a rental property, and might you be forced to cover expenses if your property goes vacant or your tenants don't pay rent?

How steady is your employment? Are you an entrepreneur or independent contractor who has unsteady income? Is your employment "at-will" and could you be let go tomorrow if your company had to downsize?

Where should I keep my emergency fund?

We talk to so many people who have their rainy-day money sitting in their savings account or primary checking account. There are two major downsides to doing this:

- Your money is commingled with your everyday spending funds
- Your money isn't working hard for you. At best, a savings account at one of the top 5 banks is paying 0.05%.

This is why we encourage you to open a high yield savings account, which as of time of publication in June 2022, pay about 0.90%. While 0.90% is still far less than the current inflation rate of 8%, it's significantly better than what Chase, Wells Fargo, Bank of America, and military-affiliated banks pay in their savings and checking accounts.

High yield savings accounts can be opened (and maintained with no monthly fees) at a myriad of reputable online banks including Discover Savings, Marcus by Goldman Sachs, Capital One 360, Ally, American Express, Vio Bank, and several other institutions. Some of the aforementioned banks run promotions frequently and will give you a $200 bonus for opening a new account and depositing $15k-$25k. These accounts can literally be set up online in fewer than ten minutes and you can link your primary checking or savings account and transfer money electronically using their app or website. Rob personally uses Marcus, Discover Savings, and Capital One 360 Performance Savings and is pleased with them all. You can set up free sub-accounts too, and label them with their specific purpose. Each bank tends to offer a specific feature too: Marcus offers free same-day wire transfers to other accounts in your name, Ally has a "buckets" feature that allows you to save for multiple goals in one account, Capital One has "cafes" in major metropolitan areas which can be helpful while working on the road. Wherever you decide to keep your emergency fund, ensure it is liquid (meaning accessible within a few days without the potential of losing principal.) An emergency fund should not be invested in the stock or bond market, nor placed in crypto holdings.

How can these banks offer rates 50-85 times better than Chase, Wells Fargo, and Bank of America?

Two main reasons. First, most of these banks are internet-only, meaning they do not have to maintain brick and mortar branches and they can save on real estate costs, leasing, utilities, staffing, etc. Second, many of these banks use their high yield savings accounts as "loss-leaders," hoping consumers will later sign up for higher-margin products such as wealth management, a mortgage, or personal loan. However, we encourage you to select the best product at each company, you are of course under no obligation to use one institution for all your financial needs.

How much of a difference does this make for me?

Say for example you keep a $30,000 emergency fund. If your money is held at Chase Savings, which pays 0.01% interest, you would earn $3 per year. (Simple interest, ignoring compounding: 30,000 x 0.0001). If instead you held it at Marcus which currently pays 0.90% interest, you would earn $270 per year (30,000 x 0.009). If interest rates continue to rise, the benefit would of course be greater.

Other common questions and notes about emergency funds:

You can expect the interest rate to fluctuate every few months depending on economic conditions and the actions of the Federal Reserve. There is no need to switch banks if you see the rate 0.05% or 0.10% higher elsewhere. The above-mentioned banks all tend to stay competitive with one another and adjust rates in tandem.

Typically, a hard pull on your credit report will not be done when opening a high yield savings account, as one would be done when opening a new credit card. The bank account application will still ask for your SSN to comply with government regulations and tax reporting requirements.

Unfortunately, there are no specific military benefits or perks with any of the major high yield savings account providers, as there are with credit cards. However, we've found that many servicemembers gravitate towards an American Express high yield savings account if they already have a Platinum card, to benefit from one consolidated login.

If your new high yield savings account generates greater than $10 in interest in a year, expect to receive a 1099-INT tax form. Some banks forgo paper mailings and require you to log in and download it from their website. Any interest earned is taxable per IRS regulations and we suggest you consult with a tax professional if you have questions.

Are there any downsides to using a high yield savings account? There aren't many, but perhaps one drawback is that without physical locations, you have to rely on the bank's app, website, and customer service for any issues. But with the shift to online banking these days most readers are probably comfortable calling in if needed.

There is no compounding advantage for keeping all your cash in one account. For example, $30,000 in one account will earn the same sum of interest as $10,000 in three separate accounts. So feel free to nickname your accounts and save for specific purposes in multiple accounts. We've seen some people have a vacation, downpayment, new car, or other named account.

Do USAA and NFCU offer high yield savings accounts? Unfortunately, no, they do not. NFCU does offer an interest-bearing checking account called "Flagship Checking" and USAA offers a "Performance First Savings Account," however, neither of these come close to matching the current high yield savings rate.

Are CD's similar to or better than a high yield savings account? A Certificate of Deposit (CD) is a totally different product than a high yield savings account. With a CD, you lock up your money for a fixed period of time and agree to receive a specific interest rate. Your money is not liquid (readily accessible) until the CD matures. A high yield savings account can be tapped anytime without penalty and the interest rate can fluctuate at any time in either direction. Note that NFCU does offer a terrific introductory CD called a "Special Easy Start Certificate," which is currently paying 3% for 12 months, although unfortunately the limit one can deposit is only $3,000.

With inflation high and high yield savings rate still relatively low, another consideration is I-Bonds. Offered by the U.S. Treasury and only available at treasurydirect.gov, I-Bonds are currently paying a whopping 9.62%! These are limited to $10,000 per taxpayer per calendar year and there is no liquidity at all within the first year. We would place I-Bonds in a separate bucket of funds as your emergency fund and would not recommend putting your emergency fund into I-Bonds due to the inability to access that money when you may need it. Some folks create an "I-Bond ladder" and after 5 years, have more liquidity.

When creating a comprehensive financial plan, financial professionals generally try to minimize the amount of cash on hand due to the fact that cash in your account is losing to inflation. But it is important to keep some on hand for specific goals in the near future, or for emergencies. We like to say, "Cash is like toilet paper during Covid. Have some available, but no need to hoard it." And just like an emergency generator or aft-steering, you don't need an emergency fund until you do. At that point, you are very glad you have it.

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