How Much Money Should You Save for Emergencies?

Description

It has been over three months since Canadians have been in a lockdown driven by the COVID-19 pandemic. During this period, many lost their jobs, and many took pay cuts. The Canadian Revenue Agency (CRA) controlled the emergency by providing the Canada Emergency Response Benefit (CERB) to individuals who lost their jobs. The pandemic has reiterated the need to have sufficient savings for an emergency, as the CRA will not come to rescue you every time. The question is, how much money you should save for an emergency?

Emergency fund

There is no hard and fast rule on the amount of money you need for an emergency. There are many types of emergencies, such as job loss, a medical emergency, or a contingency expense. While the cost of the other two emergencies is challenging to estimate, it is easy to calculate the cost of the first emergency.

An emergency fund should at least cover your and your dependents' six-month living expense. If your one-month living expense is $3,000, you should have at least $18,000 in your emergency fund. The CRA paid out $2,000 per month in CERB payment to individuals who lost their jobs. The CERB amount shows that an average household should have at least $12,000 in an emergency fund.

Three things you need to know while building your emergency fund

While building an emergency fund, you should keep three things in mind. Firstly, the fund should be liquid; you should be able to withdraw from it anytime. Secondly, it should be a low-risk fund, as you don't want to end up losing money during an emergency like the pandemic. Lastly, you should give time for your emergency fund to grow.

The government encourages Canadians to inculcate a savings habit. In 2009, it started the Tax-Free

Savings Account (TFSA), in which you can invest $5,000-$6,000 of your after-tax income every year. The money you earn from these investments would be exempt from taxes, thereby enhancing your returns. The TFSA is ideal for high-growth and high-dividend stocks that have the potential to double your money in five to seven years. The TFSA allows you to withdraw your money anytime, giving you the liquidity required for emergencies. Where should you invest your money using your TFSA?

The stock market has a higher risk than bonds, but it also offers better returns. You can reduce your risk by diversifying your investment. An ETF

Saving for the next recession

One ETF that meets the above criteria of high liquidity, lower risk, and stable long-term returns is the **iShares S&P/TSX 60 Index ETF** (TSX:XIU). The ETF gives you exposure to the top 60 stocks trading on the Toronto Stock Exchange. It has an average trading volume of six million. S&P Dow Jones quarterly reviews the TSX 60 Index and replaces poorly performing stocks with well-performing stocks. As the XIU tracks the TSX 60 Index, your investments are protected from poor performers.

If you had invested $10,000 10 years back, your money would have increased to $18,000 by now. If you had invested the same amount in the same ETF five years back, your money would have grown to $12,400. The longer you stay invested, the higher the return. It is not too late to invest in the XIU ETF. It is trading 14.7% below its 52-week high of $27.05.

Foolish takeaway

Your investment will not start giving you returns immediately. Building an emergency fund needs discipline, consistency, and informed decision-making. If you invest your emergency fund in one or two stocks, your money could either grow exponentially or decline. You should avoid such a risk when building an emergency fund. The XIU ETF will limit your downside while giving you better returns than bonds.

CATEGORY

1. Coronavirus
2. Dividend Stocks
3. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:XIU (iShares S&P/TSX 60 Index ETF)

PARTNER-FEEDS

1. Business Insider
2. Koyfin

3. Msn
4. Newscred
5. Sharewise
6. Yahoo CA

Category

1. Coronavirus
2. Dividend Stocks
3. Investing

Tags

1. Editor's Choice

Date
2025/08/22
Date Created
2020/06/29
Author
pujatayal