



Here's Why a Big Emergency Fund Is a Terrible, Terrible Idea

Description

If there's anything the COVID-19 pandemic taught us, it's this: everyone should have at least three to six months' worth of emergency savings stored in a safe, accessible account.

Three to six months is a good rule of thumb, but, believe or not, some households have amassed more than six months' worth of expenses — some have even saved nine months', 12 months', a year-and-a-half worth of expenses. Can an emergency fund ever be *too* big?

Can an emergency fund be too big?

Yes. In some circumstances, an emergency fund can be overfunded. In general, if your emergency fund is larger than six months, and you agree with the following statements, your emergency fund is probably way too big:

- You're healthy
- You're single or you're married but don't have dependents
- Your debt-to-income ratio is low
- You're not living paycheck to paycheck
- Your job is stable
- Even if you *were* to lose your job, you could find one easily

Of course, if you *don't* agree with these statements — if your job isn't stable, if you have dependents, or if you live in a city with a high cost of living — then you might need a bigger emergency fund. The keyword there is *might*. As I'll explain below, big emergency funds aren't always beneficial, as they can steal your money's growing power.

Why big emergency funds aren't always wise

Perhaps the number one reason to avoid large emergency funds (that is, bigger than six months' worth of expenses) is the slow-growing power that emergency funds have.

I'm assuming here that you've stored your emergency in a safe, accessible place, such as a savings account. Traditional wisdom says emergency funds should be extremely liquid, meaning you could access your money at a moment's notice. But storing *too* much money in savings accounts with meagre interest rates can be severely disadvantageous to you.

For one, inflation will slowly deplete your savings of their spending power. No savings account — not even high-interest accounts — can outpace Canada's inflation rate. With inflation as high as it is, not even GICs or bonds can outpace it (those are *not* good places to store an emergency, by the way).

Secondly, storing money in a savings account means missing out on the immense returns of more lucrative investments, like stocks, funds, and cryptocurrency. Even safe stocks, like blue chips or large caps, can help your money grow at a faster rate than a savings account.

How much should you have in your emergency fund?

In general, three to six months' worth of expenses are enough to cover most emergencies. Of course, every household will be different, but unless you fear losing your job, or you're a single-income household, you don't need to overstuff your savings account.

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