Twitter Thread by Abhay | Money Wisdom ■



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How to Build a Emergency Fund.

Emergency Fund 101

A Thread ■

Inspiration -- @FI_InvestIndia

What is an emergency fund?

An emergency fund is a bank account with money set aside to pay for large, unexpected expenses, such as:

- Unforeseen medical expenses.

- Home-appliance repair or replacement.

- Major car fixes.

- Unemployment.

Importance of an emergency fund

Life is full of unexpected situations – good and bad.

Hence, apart from other things, you need to be prepared for it financially.

While you can plan for some foreseeable expenses, an emergency fund can help you manage all unplanned expenses efficiently.

The current pandemic is an example of one such unplanned expense.

People with an emergency fund are in a much better position to manage this lockdown than those who don’t.

During financially difficult times, an emergency fund can help you stay afloat without having to rely on credit cards or loans.

If you already have loans that you are paying off, then an emergency fund can help you avoid borrowing more.

How Much Emergency Fund Do You Need?

Every individual has different financial needs.

Each individual has a unique combination of lifestyle, dependents, income, and unavoidable expenses.

Hence, the figure will be different for all.

Before calculating the amount of the emergency fund you need, it is important to calculate the minimum amount you need to get through the unavoidable monthly expenses.

This should include house rent, loan installments, utility bills, etc.

Ensure that you don’t include avoidable expenses that movies, travel, etc. in this amount.

Once you know your monthly expense, try to create a cash fund that can help you survive three-six months without any income.

Given the current situation, most people will agree that six months of basic living expenses stashed as an emergency fund is a must at all times to manage exigencies efficiently.

Where Should You Keep Your Emergency Fund?

Once you have finalized the amount of the emergency fund you need to build and start working towards saving it, it is important to find a good place to keep it.

A savings account is a logical choice since it offers liquidity that is highly important during a crisis.

You can look for a savings account offering a high rate of interest with no minimum balance requirements or heavy fees.

However, another important aspect of an emergency fund is that you will not need it regularly.

Hence, rather than accepting the returns offered by a savings account, you can consider investing a part of this fund in an instrument that offers high liquidity and returns better than savings accounts.

Some mutual funds offer easy liquidity and better returns than savings accounts while keeping risks minimal.

These are liquid funds.

By investing a sizable part of the emergency fund in these schemes, liquidity is ensured since you can redeem within a couple of days.

Average returns on liquid funds hover around the 6-8% mark.

Another important aspect of an emergency fund is building it.

Let’s say that your basic living expenses are Rs.40,000.

Therefore, you will need to save between Rs.2-2.5 lakh as your emergency fund.

Considering the increasing costs of living, this can take time.

You can reach this goal faster by using a debt mutual fund.

With low risks and an opportunity to earn good returns, these funds can help you create the corpus in a shorter period.

You can consider starting a systematic investment plan (SIP) and automate your savings and investments.

You can also invest your annual bonus in these funds to reach the target sooner.

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