Retirement Hacks

Which comes first – emergency savings or your retirement goals?

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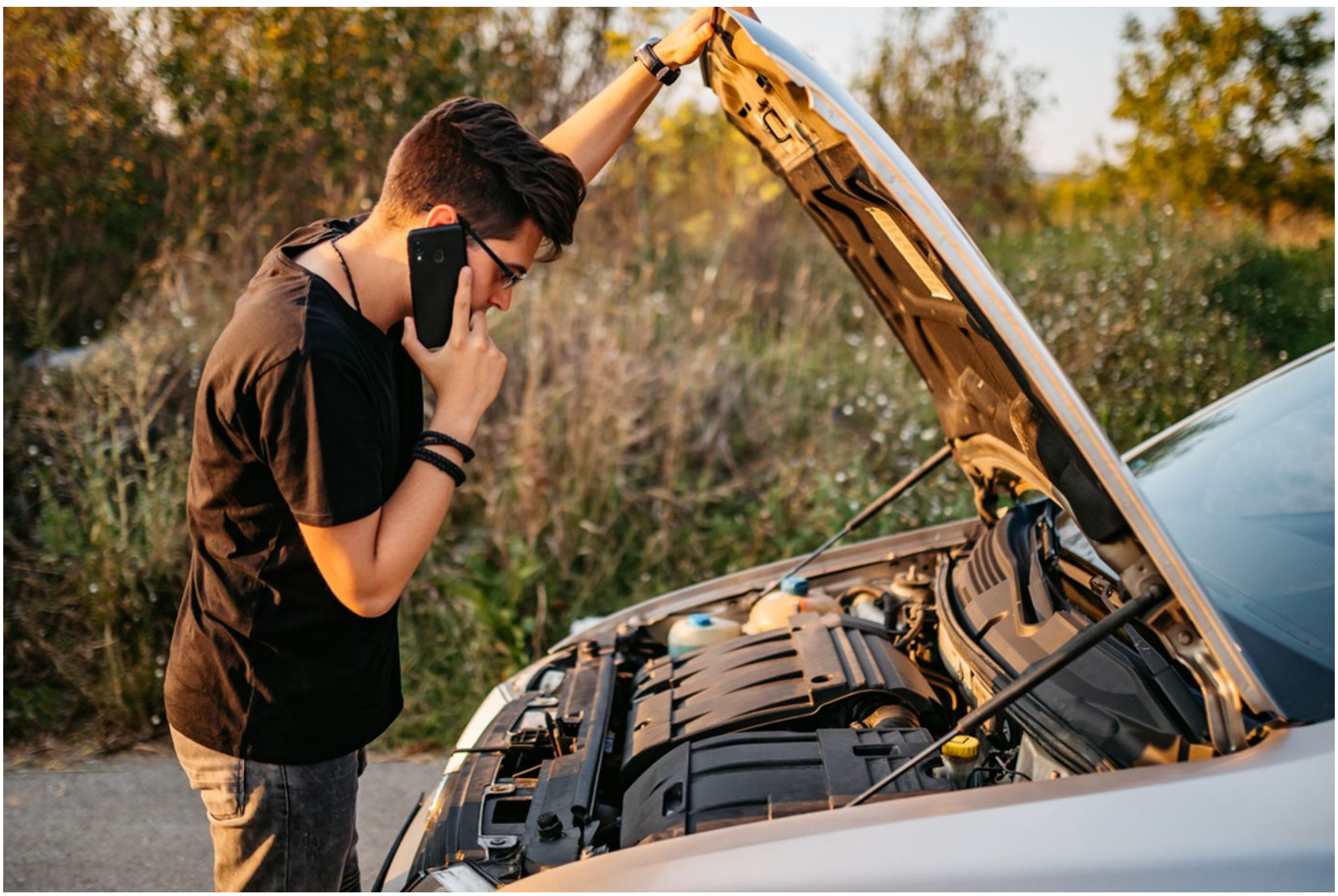
A retirement plan will help you in the future, but only if you're able to pay for the unexpected today



Any emergency can mess up a person's current finances, and their retirement plans as well. GETTY IMAGES

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One single emergency can derail a retirement, which is why it should take precedence when saving – at least temporarily.

Not everyone has an emergency savings account, or if they do, there isn't enough to cover one or more challenges. But these accounts can have a huge impact on current and future finances. Savers can use these funds when something unexpected and unfortunate comes up, instead of tapping into their retirement accounts, which could result in taxes and penalties.

Retirement Tip of the Week: Focus on bulking up your emergency savings before contributing more to your retirement accounts. That money can save you on tax bills and lost returns should an emergency arise.

"Focusing on the emergency account is much more important," said Nicholas Bunio, a certified financial planner. "That should be goal No. 1."

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Advisers typically suggest having three to six months' worth of monthly expenses in an easily accessible emergency savings account, depending on a few factors. The rule of thumb states a single individual or a couple with one income should have six months' of expenses saved, while a household with both spouses working, or a single individual with multiple sources of income, might be OK having closer to three months' of expenses put away. Some people feel more comfortable with significantly more than those guidelines, such as up to a year's equivalent to expenses.

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The standard rule is to have that account established before moving on to retirement savings and other goals, said Nick Covyeau, a certified financial planner and owner of Swell Financial.

Congress also has an eye on helping Americans build emergency savings accounts. In Secure 2.0, a retirement-focused law passed in December, legislators included a provision that will allow employers to offer an emergency savings account within defined-contribution plans, so that workers are able to save for the unexpected through payroll deductions.

Savers should be aware of other workplace benefits they may get with their retirement accounts, such as employer matches to their contributions in a 401(k). “I hate to see an employer match go to waste and so I prefer to have clients, once they reach $5,000 in savings, start contributing to their 401(k) and finish up their emergency savings,” Covyeau said. “Once the emergency savings is fully funded, they can easily redirect their monthly savings into their 401(k). The key is building the muscle of saving regularly and consistently.”

Have a question about your own retirement concerns? Check out MarketWatch’s column “Help Me Retire”

Some savers may want to take advantage of those benefits before completing their emergency accounts, in which case, they’ll need to strike a balance.

One strategy is having $2,000 or $3,000 in an emergency savings account and then beginning to contribute to a retirement plan, said Kevin Brady, a certified financial planner and vice president of Wealthspire Advisors. “Once that small ‘starter’ emergency plan is in place, you should contribute to a work retirement plan up to the full employer match, assuming there is a match,” he said. “The employer match is part of your compensation so to not get the full match is to leave money on the table,” even if the retirement plan costs are high or investment options subpar.

Some workers may want to plump their emergency savings more these days, given fears of a recession and layoffs looming. “I also think you need more in emergency savings depending on what sector you’re in,” said Catherine Valega, a certified financial planner at Green Bee Advisory. “If you do get laid off, it is nice to have some time and flexibility to decide what you’d like to do next – versus having to panic and take the first job thrown at you.”