Three milestones on the road to financial stability

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Before the days of GPS, lost travelers knew the value of asking a local for directions. A local guide could point out milestones to watch for and set them on the right path.

You may find yourself in a similar situation with your financial strategy. You know what you want to achieve, but you're not sure how to get there.

Edward Jones recommends:

- Having three to six months' worth of total expenses in savings to cover emergencies
- Saving enough for your unique retirement needs
- Being free of burdensome debt

Each of these may seem challenging, and trying to accomplish all of them at once may have you feeling lost. This is where a map with clear milestones can help guide you.

Here are the milestones to work toward as you build stability and flexibility in your financial life.

	Milestone 1: Building a foundation	Milestone 2: Gaining stability	Milestone 3: Optimal state
	Review budgeting, insurance, debt efficiency and estate		
Emergency savings	$500 to 1 month of expenses	1.5 – 2 months of expenses	3 – 6 months of expenses
Investing for retirement	Employer match (HSA then retirement)	10% – 15% gross income (including employer match)	The amount necessary to get on track for your retirement goal
Debt reduction	High nondeductible interest (>8%)	DTI <35% with a mortgage or 20% without, pay down highest after-tax rate first	Consider paying off any debt that causes stress

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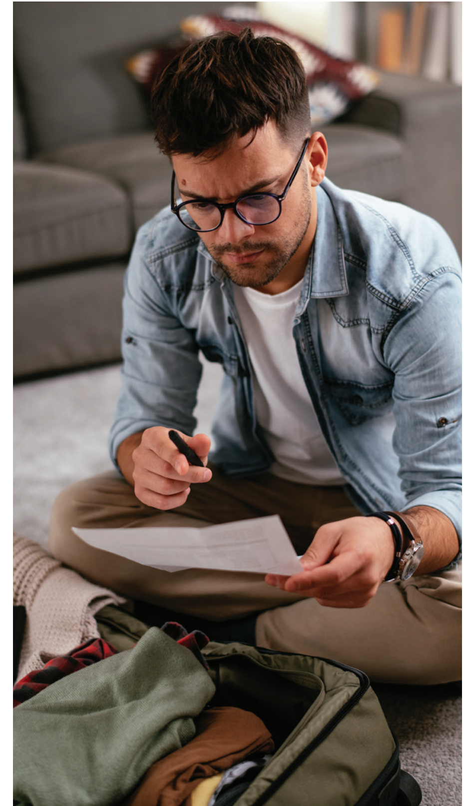
Know before you go

When preparing for a road trip, you might do a few tasks ahead of time to help ensure the trip goes smoothly. For your financial journey, the following can help make the trip a little easier:



1. **Enlist a trusted guide.** Your financial advisor can help you define your goals (where you want to go) and how to achieve them (how to get there) based on your unique needs and circumstances.

2. **Build a budget to help you know how much you have available to save.** Make sure you account for expenses that don't occur on a regular basis, such as your car insurance and taxes. Also, look for opportunities to reduce or eliminate some expenses.

3. **Make your debt as efficient as possible.** Start by understanding how much and what kinds of debt you have. Consider ways to lower your interest rate, such as refinancing. Be cautious when trading unsecured debt (credit cards) for secured debt (a home equity loan) because if you're unable to pay in the future, you may be jeopardizing your home. Prioritize making all minimum payments, and account for them in your budget. Late fees and penalties can be costly hurdles to overcome.

4. **Maintain basic forms of insurance** such as health, home, auto, disability and life.[1] Term life insurance can help insure your future income and provide resources to pay off debts should something happen to you. This could be especially important if you are the primary income earner or have dependents. Periodically review your coverage, especially after a life event such as buying a new home or the birth of a child.

5. **Understand your employer benefits.** These can be instrumental in helping you achieve your goals.

6. **Begin planning for your estate** by outlining key priorities and objectives, such as asset transfer, incapacity protection and guardianship for minor children and dependents.

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Milestone 1: Building a base

Now that your bags are packed, you'll want to build a foundation in each of the three goals. While we recommend prioritizing each goal in the order shown below, you can tackle them one at time, save for them equally or put more money toward the one that most appeals to you.

To make it easier, automate as much as you can. For example, you can divert part of your paycheck directly into an emergency savings account or retirement account and set up automatic payments for any debt.

- **Prioritize $500 to a month's worth of expenses in emergency savings.** Unexpected expenses and dips in income are common, and small disruptions can happen frequently. This amount can help you cover minor repairs or a few days of missed work without taking on new debt. Consider keeping your emergency savings in an account separate from your everyday spending, so you know what is set aside for emergencies.
- **Take advantage of any employer matches in a health savings account (HSA) and retirement plan.** If your employer's plan provides a match, this can give you an immediate return on your contributions, in addition to a tax benefit and potential market appreciation. HSAs can help you save for retirement, and they also offer tax-free withdrawals when used for qualified health care expenses.[2] For this reason, focus on getting any employer HSA match first and then any retirement plan match. Since an employer match is such a powerful tool for saving, and you can't recoup lost years, prioritize this next.
- **Pay down high-interest, nondeductible debt.** Some types of debt, such as mortgages and some student loans, allow you to deduct the interest paid from your taxable income. This tax benefit lowers the overall cost of the debt, making it less advantageous to pay off. However, high-interest, nondeductible debt, such as credit cards, is likely to cost you more in interest than you can expect to earn on your investments. You're better off paying down this debt first.

Benefits of extra payments on a $5,000 credit card balance

	Years to pay off	Interest cost	Total cost
Making minimum payments	15	$5,487	$10,487
Pay $100 extra per month	3.33	$1,100	$6,100

Minimum payment based on standard minimum payment formula (the greater of $25 and 1% of balance, plus interest). Extra payment scenario assumes you hold the first month's payment constant (minimum payment plus $100). Interest based on national average as of the time of writing (17.5%).

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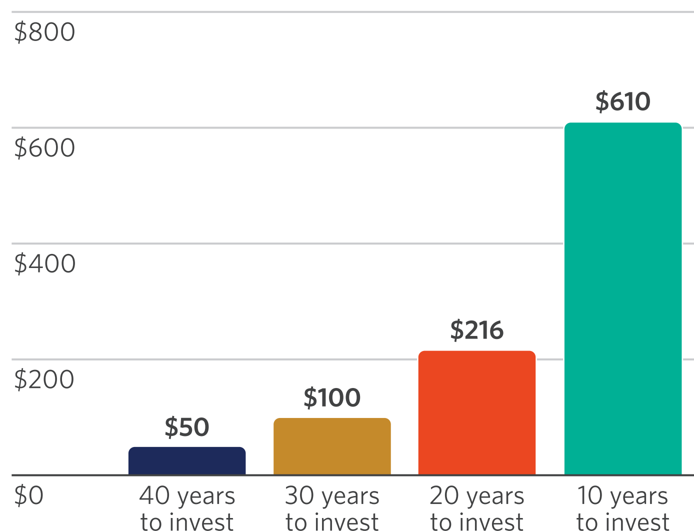
Milestone 2: Gaining stability

Now you're building on the momentum you gained in Milestone 1. Again, prioritize each goal in order, and automate where you can. While you should continually manage your budget, keep your debt as efficient as possible and ensure you have adequate insurance.[1] Milestone 2 provides a good opportunity to reflect on these.

- **Save 1½ to two months' worth of expenses in emergency savings.** Not only will this help you cover larger, unexpected expenses or longer periods of lost income, it can also help you weather multiple events. Given the security this amount of emergency savings can provide, you may be tempted to prioritize it over an employer match or paying down high-interest debt. But don't forget what you'd be giving up by skipping the steps in Milestone 1.
- **Save 10% to 15% of your gross income (including any employer match) in retirement accounts.** You're already receiving your employer match, but what if you could add to that total? When it comes to retirement savings, time is your ally. Saving even smaller amounts can provide big benefits over time. Start with what you can, and pledge a portion of any future raises toward your retirement savings. Bonuses and tax returns can also help boost your retirement savings.
- **Check your debt-to-income (DTI) ratio.** Your DTI ratio can be a predictor of your financial health. The higher the number, the higher the percentage of income being used to pay off debt. If you have a higher DTI ratio, you may have trouble securing loans for big purchases such as a home, or you may be forced to accept higher interest rates on those loans.

To calculate your DTI ratio, **divide your monthly debt payments by your gross monthly income.** If you're paying a mortgage, try to keep your DTI ratio at 35% or less. (Without a mortgage, strive for 20% or less.) To lower your DTI ratio, start paying down the debt with the highest after-tax interest rate.

Give yourself time: Monthly savings required to reach $100K



Source: Edward Jones. For illustrative purposes only. Assumes a 6% constant rate of return.

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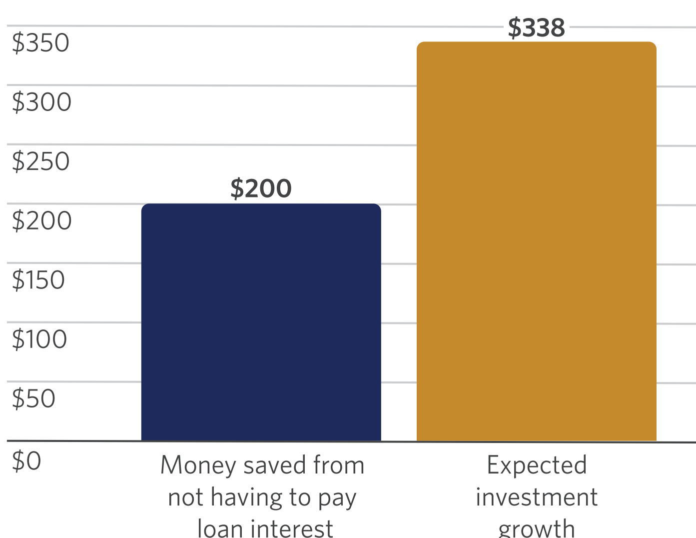
Milestone 3: Optimal state

With Milestone 2 in the rearview mirror, you're now in the home stretch. But just as a road trip can have a detour, life can be full of the unexpected. You may find yourself back in an earlier milestone for one or more goals, and that's OK. You can spend from your HSA or emergency savings with confidence knowing it's there for exactly that purpose. If that expense moves you back to an earlier milestone, you can go forward knowing you've navigated these roads before.

- **Save three to six months' worth of expenses in emergency savings.** This amount can help you withstand longer periods of unemployment or multiple larger expenses without having to dip into your retirement savings or take on new debt. It can also provide flexibility to do the things you want to do, such as taking a sabbatical, switching careers or taking time off to care for a loved one.
- **Stay on track for your retirement goal.** Your vision of retirement is unique, and so is your path to get there. In this milestone, the focus is on ensuring you're saving enough to realize your retirement goal. Your financial advisor can help you adjust as necessary.
- **Think about your attitude toward debt.** After completing Milestone 2, your debt should be at a more manageable level. If your balances still cause you stress, you could consider paying them down. Paying off your loans will save you in interest charges — but you may need to do so at the expense of investing for your future. As this chart shows, it's possible the expected return on your investments could outpace what you owe in interest. While you'll want to be comfortable with your amount of debt, this may come at the expense of achieving other goals.

Investing vs. paying low-interest debt



Source: Edward Jones. Assumes paying off a $1,000 loan at 4% interest versus investing $1,000 at a 6% constant return. Illustration is over a five-year period and is for example only.

The road ahead

At the end of the trip, there's a moment when your destination appears on the horizon and excitement sets in. Take time to look around and be proud of how far you've come in your journey. Not only have you built financial stability, but you're also achieving financial flexibility to do the things you want to do, such as paying for a child's or grandchild's education, contributing to a cause you're passionate about or saving for a major purchase. Whichever road you choose next, your financial advisor will be there to help you at every turn.

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[2] Edward Jones, its employees and financial advisors cannot provide tax advice. You should consult your qualified tax advisor regarding your situation.

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