

# Starting your financial journey

## Balancing an emergency fund, retirement and debt

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Before the days of GPS, a local guide could point out milestones to watch for and set travelers on the right path. When you're starting your financial journey, you may find yourself in a similar situation. You know where you want to go, but you're not sure how to get there. This is where a map with clear milestones can help guide you.

### Your destination

To begin, it's important that you have a clear vision of where you're heading. When it comes to building a solid financial foundation, work toward:

- Having three to six months' worth of total expenses in savings to cover emergencies
- Saving enough to be on track for your retirement goal
- 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 setting milestones can help.

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

	Milestone 1	Milestone 2	Milestone 3
Emergency savings	\$500 to 1 month of total expenses	1.5–2 months of total expenses	3–6 months of total 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	Pay high-interest debt (>8%)	Debt-to-income (DTI) <35% with a mortgage or 20% without; pay down highest rate first	Consider paying off any debt that causes stress

Within each milestone, we recommend prioritizing each goal in the order listed: emergency savings first, then retirement savings and, finally, debt reduction. That said, you can choose a different approach that works better for you, such as saving for them equally or putting more money toward the one that most appeals to you.

## 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 car insurance and annual subscriptions. Also, look for opportunities to reduce or eliminate some expenses.
- 3 Make your debt as efficient as possible.** Understand how much and what kinds of debt you have. Consider ways to optimize your debt, such as refinancing or consolidation. Prioritize making all minimum payments and account for them in your budget, as fees and penalties can be costly and affect your credit.
- 4 Maintain basic forms of insurance** such as health, home, auto, disability and life.<sup>1</sup> This can help you weather unexpected events that could get you off track. 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** as a way to protect your loved ones should anything happen to you. For example, create a will, decide who'll make decisions on your behalf if you can't, and name guardians for your children.



## Milestone 1

Once your bags are packed, you'll want to build a foundation in each of the three goals. To make it easier, automate as much as you can. For example, divert part of your paycheck directly into an emergency savings or retirement account, and set up automatic payments for any debt.

- **Prioritize \$500 to a month's worth of total expenses in emergency savings.** 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 cash and cash equivalents that have low risk and are easily accessible.
- **Take advantage of any employer matches in a health savings account (HSA) and retirement plan.** Employer matches are a powerful savings tool, as they are essentially “free money” that can provide a tax benefit and potentially grow over time. Focus on getting any employer HSA match first since, in addition to helping you save for retirement, HSAs offer tax-free withdrawals when used for qualified health care expenses.<sup>2</sup> Then focus on getting any retirement plan match.
- **Pay down high-interest debt.** Debt with rates above 8%, such as credit cards, is likely to cost you more than what you can earn investing. Also, higher-interest debt tends to be revolving, which usually has a larger weight on your credit score. Because some interest, such as mortgage or student loan interest, may be tax-deductible, focus on debt with a high after-tax rate.

### Prioritizing your debt: Another approach

While we advise paying high-interest debt first, getting rid of small balances can be motivating.

If that's your case, you could prioritize small debts first (e.g., those with a few hundred or a couple thousand dollars), starting with those with a higher rate. Once smaller debts are paid off, tackle any remaining high-interest debt.

Note that while it can help build momentum, this approach could result in higher interest paid and your total debt being paid off later.

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

	Years to pay off	Interest cost
Making minimum payments	14	\$6,250
Paying \$100 extra per month	2	\$1,250

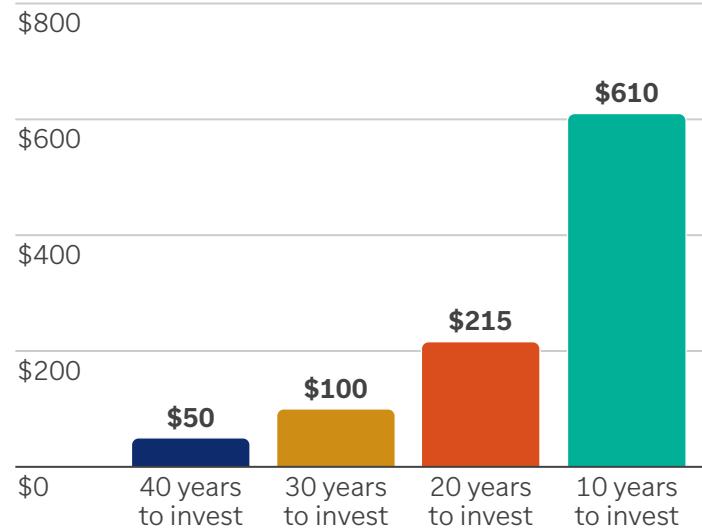
Source: Edward Jones estimates. Assumes interest rate of 20%. Minimum payments are the greater of \$25 or 1% of the balance, plus interest. Extra payment scenario assumes you hold the first month's total payment constant (minimum payment plus \$100). Values rounded to the nearest \$50.

## Milestone 2

Now you're building on the momentum you gained in Milestone 1. Again, prioritize each goal in order, and automate where you can.

- **Save one and a half to two months' worth of total expenses in emergency savings.** This amount can help you cover a larger unexpected expense or a longer period of lost income, or weather multiple smaller events at once.
- **Save 10% to 15% of your gross income (including any employer match) in retirement accounts.** You're already receiving your employer match, but many people would benefit from saving more. When it comes to retirement savings, time is your ally. Even increasing your savings by small amounts can provide big benefits over time. Start with what you can, and pledge a portion of any future raises, bonuses and tax returns toward your retirement savings.
- **Check your debt-to-income (DTI) ratio.** Your DTI ratio is your total monthly debt payments divided by your gross monthly income. The higher this ratio is, the higher the percentage of income you're using to pay off debt. With a high DTI ratio, you may have trouble securing loans for big purchases such as a home or car, or you could be subject to higher interest rates. If you're paying a mortgage, aim toward a DTI ratio of 35% or less. Without a mortgage, strive for 20% or less. Focus on paying down the debt with the highest after-tax interest rate first.

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



Source: Edward Jones estimates. Assumes a 6% constant rate of return. This hypothetical example is for illustrative purposes only and does not reflect the performance of a specific investment. Values rounded to the nearest \$5.

Just like long trips can have detours, life can be full of the unexpected. Throughout your journey, you may find yourself back in an earlier milestone for one or more goals, and that's OK. You can retrace those steps knowing you've navigated those roads before.

## Milestone 3

You're now in the home stretch. Once you achieve Milestone 3, you'll have a fully funded emergency fund, be on track for retirement, and be free of stressful debt.

- **Save three to six months' worth of total expenses in emergency savings.** This amount can help you withstand longer periods of unemployment or multiple larger expenses. It can also provide flexibility to do the things you want to do, such as 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. Work with your financial advisor to determine how much you should save to realize your retirement goal.
- **Think about your attitude toward debt.** At this point, your debt should be at a more manageable level. But if there's any debt that still causes you stress, you could consider paying it down. Paying off your loans will save you in interest charges — but be aware that you may do so at the expense of investing for your future.

### Example: Pay down debt vs. invest

Extra \$250 per month: Pay down 30-year, \$300,000 loan or invest

	Loan with a 4% interest rate		Loan with a 7% interest rate	
	Pay down debt	Invest at 6%	Pay down debt	Invest at 6%
Interest paid	(\$156,000)	(\$216,000)	(\$283,000)	(\$419,000)
Return on investment (after 30 years)	\$37,000	\$161,000	\$66,000	\$161,000
Net impact	(\$119,000)	(\$55,000)	(\$217,000)	(\$258,000)

Source: Edward Jones estimates. Assumes that you either (i) make extra debt payments of \$250 until the loan is paid off and, afterward, you invest an amount equal to the debt payments plus the \$250 for the remaining term of the loan or (ii) you don't make extra debt payments and invest \$250 a month for 30 years. The rate of return is 6% per year and the loan interest rate is either 4% or 7% per year. This hypothetical example is for illustrative purposes only and does not reflect the performance of a specific investment. Values rounded to the nearest \$1,000.

### The road ahead

When your destination appears on the horizon, excitement sets in. Take time to look around and be proud of how far you've come. Not only have you built financial stability, but you're also achieving financial flexibility to do the things you want to do. Whichever road you choose next, your financial advisor will be there to help you at every turn.

### To learn more, ask your financial advisor for our reports:

- *Building an emergency fund: Your questions answered*
- *Preparing for retirement*
- *Paying down debt: What you need to know*

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