

# The four USES of cash

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We know it's important to have cash available for our everyday spending needs as well as for the inevitable rainy day. However, many of us have never taken the time to understand how much we really need.

And while it may seem like a good problem to have, having too much of your savings sitting in cash can be an issue, especially when you're investing for long-term goals such as retirement. Ultimately, your cash strategy can be a key factor in your long-term financial success.

**To determine the role of cash in your financial life and how much you should have, we use the acronym USES:**

**U**

**Unexpected expenses and emergencies:** Cash used for situations such as a job loss, a home repair or an unplanned medical expense

**S**

**Specific short-term savings goal:** Cash dedicated for a goal that will occur within the next couple years, such as a wedding, vacation or home renovation

**E**

**Everyday spending:** Cash used to provide for your lifestyle, including day-to-day spending needs such as groceries, utilities, entertainment and your mortgage/debt payments

**S**

**Source of investment:** Cash used as an asset class and as a source of investment opportunities

The priority of these pieces may change depending on your goals and objectives. For example, younger individuals who have a regular paycheck may find that building an emergency fund for the unexpected may be the biggest opportunity. For retirees, the first goal may be to ensure you have enough for your everyday spending.

## Benefits of USES

By viewing your cash based on its USES, you can:

- Be confident you have enough cash on hand to meet your day-to-day living expenses as well as for the unexpected
- Determine the cash that can be used as a source of investment for your long-term goals
- Provide a cushion for your spending needs and emergencies to help avoid selling longer-term investments during a short-term market decline

## How much should you have?

Cash has benefits and trade-offs. It provides for your current spending needs and can serve as a cushion for the unexpected. On the other hand, cash generally earns a very low interest rate, which can make it a poor vehicle to achieve your long-term investment goals. Each stage of life is an opportunity for a new chapter that you get to write. So, it's important to have the appropriate amounts in each of the above categories.

As you'll see, our guidance for appropriate amounts of cash depends on whether you are still employed. Do you receive a regular paycheck, or does your income come from Social Security and investments? Since these situations are different, we provide different guidance for each where appropriate.

USES	Pre-retirees	Retirees
<b>U</b> Unexpected expenses & emergencies	Three to six months of total expenses	
<b>S</b> Specific short-term savings goal	Amount needed is based on your specific short-term savings goal(s)	
<b>E</b> Everyday spending	One to two months of total expenses (refreshed by your next paycheck)	12 months of total expenses, minus your annual income sources, such as Social Security, pensions and annuities
<b>S</b> Source of investment	0% – 5% of your investment portfolio	

# U

## Unexpected expenses and emergencies

### Description:

This includes cash for unexpected and necessary expenses, such as a home repair or an unplanned medical expense, or to cover your necessary expenses after a temporary loss of income, such as a job loss.

Establishing an emergency fund can help prevent the need to take on debt, invade your retirement accounts or sell long-term investments to meet a short-term cash need. Eliminating the need to sell long-term investments can be especially valuable during a short-term market decline, when these investments may be down in value. You may be better prepared to stick to your long-term investment strategy knowing you have cash set aside for the unexpected.

### Recommendation:

#### Save three to six months of total expenses

For most individuals (whether before or in retirement), having three to six months of total expenses in emergency savings is appropriate. The specific amount to target depends partly

on your risk of having unexpected expenses and, if working, your risk of a temporary loss in income. Consider, for example, the insurance coverage (health, home, auto, etc.) you have and how likely you are to use it, the amount of property you own that might need unexpected repairs, your job security or how many earners are in your household. In addition, think about how much you value the comfort of being able to weather extreme or multiple emergencies. The higher your risks and/or the more confidence you want, the closer to six months (or even longer) you should be.

#### Keep it in a separate, low-risk, easily accessible account

Keep your emergency fund in a separate account to mitigate any desire to use these funds for everyday spending or to fund other goals. It should be held in an easily accessible, principal-protected account. While avoiding investment risk, favor accounts that earn some interest. While outside credit sources can supplement your emergency cash, they should not be viewed as a replacement for it.

# S

## Specific short-term savings goal

### Description:

This includes cash earmarked for a specific purchase or goal in the next year or two, such as a car, vacation, wedding, etc. While this cash could be mixed in with your everyday cash, it is often separated (at least mentally), so you know what is targeted for this specific goal. Some people even have dedicated accounts — one for each goal.

### Recommendation:

Your financial needs are personal, so work with your financial advisor to identify how much cash you should have for your short-term goals.

For goals taking place in the next year or two, you may want to keep your savings in cash. If so, as with your emergency savings, favor accounts that earn some interest. This could be a savings account, money market or short-term CD. If you are more comfortable taking on investment risk or have three to five years before your goal, you can consider investing your savings, favoring fixed-income investments.

For more guidance, review our report “Short-term goals: Enjoying your journey along the way.”

# E

## Everyday spending

### Description:

This is the cash used to pay your day-to-day expenses.

To find out how much is enough, it's important to start with a word that makes some of us cringe — “budget.” But budgets don't have to be intimidating. In fact, they can help you see where you spend your cash, which could help:

- Potentially highlight areas where you could reduce your spending
- Determine how much you may have available to invest for your long-term goals

### Recommendation:

#### Pre-retirees — One to two months of total expenses

For pre-retirees, your everyday cash is replenished every couple of weeks by your paycheck. Therefore, having one to two months of total expenses in cash provides for your ongoing spending needs. Anything above and beyond your expenses (and your emergency cash) can be directed to your investment accounts.

Your everyday cash should be held in an easily accessible, principal-protected account, such as a checking account.

#### Retirees — 12 months of total expenses, minus your annual income sources, such as Social Security, pensions and annuities

We believe it's important for retirees to have about a year's worth of expenses covered. You can start by adding up any income you expect from outside sources such as Social Security, annuities or a pension. Any expected expenses not covered by these outside sources of income should be held in cash. For example, if you have annual expenses of \$60,000 and receive \$20,000 from Social Security and \$10,000 from a fixed annuity, you should have \$30,000 in a cash management vehicle.

Retirees should keep one to two months of expenses in an easily accessible, principal-protected account, such as a checking account. For cash amounts above that, you may consider favoring accounts that earn more interest (although they should still be easily accessible and principal-protected), such as a savings account or short-term CD.



# S

## Source of investment

### Description:

Cash can play a role as part of a well-diversified investment portfolio. This role is typically one of the following:

- A strategic cash allocation as part of your portfolio's asset allocation — cash can be viewed as a distinct asset class. It tends to behave differently from other asset classes, such as stocks and bonds, and therefore, can provide diversification benefits.
- A temporary allocation to cash targeted for future investment — you may have cash you have recently deposited in your investment account, or from an investment that has matured, that you are targeting for reinvestment.

### Recommendation:

#### Strategic allocation

Based on our outlook for interest rates, the markets and the economy, we recommend about 0%–5% of your overall investment portfolio in cash. This recommendation may be adjusted as our long-term outlook changes.

#### Temporary allocation

This is temporary cash, so it should be invested based on a schedule you have established with your financial advisor.

You may wonder when the right time is to invest. In our view, the best time to invest is when you have the money available. One way to take timing (as well as emotions) out of the investing decision is through dollar-cost averaging (DCA). Just like diversifying the investments you have, you can diversify when you invest. With DCA, you buy the same dollar amount at set intervals

(bi-weekly, monthly, etc.). It can help smooth out the price you pay for your investments and help maintain discipline in your investing decisions.<sup>1</sup>

### Using cash wisely

Cash has many USES, whether it is providing for an unexpected event, a short-term savings goal, your everyday expenses or even a source of investment. By ensuring you have each of these areas covered, you can better focus on your longer-term goals, including preparing for retirement and paying for education. Schedule some time with your financial advisor to review your USES of cash.

### The risk of not investing

Some people hold too much in cash, viewing it as a safe haven against the risk of a market decline.

But cash is not risk-free. There are also risks of not investing. If this cash is designated for long-term goals such as retirement or education, you may face an even bigger risk than a short-term decline. In fact, the biggest risk you face isn't a temporary pullback in the market — it's the possibility of not reaching your long-term goals.

If you have your cash needs covered as outlined in the USES framework, then it is important to focus on the growth necessary to help achieve your long-term investment goals.

<sup>1</sup> Dollar-cost averaging does not ensure a profit or protect against loss. Investors should consider their willingness to keep investing when share prices are declining.

The information in this report is intended as educational only and should not be interpreted as specific investment advice. Investors should make investment decisions based on their unique investment objectives and financial situation.