How Much Cash Should I Have on Hand?

Financial / Personal Finances / How Much Cash Should I Have on Hand?

Stashing cash in an emergency fund is a prudent way to avoid having to pull money out of less liquid investments at inopportune times. But how much should you have in your emergency fund? *Bottom Line Personal* asked James Holtzman, CFP, how much cash and cash equivalents are appropriate…

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Three-to-six months of expenses is a reasonable emergency fund for most households.

When people worry about potential financial emergencies, they tend to picture big, unexpected costs that could arise—but the most daunting out-of-the-blue financial challenge that many people actually will face is not a new cost…it is the sudden lack of income due to a lost job. That makes it sensible to measure the size of your emergency funds in terms of months of expenses rather than as a flat dollar figure. **US Bureau of Labor** unemployment statistics provide some sense of how many months of expenses might be needed—the median length of unemployment is between two and three months…and nearly 80% of periods of unemployment are shorter than six months.

"Expenses" means necessities

Three-to-six months' worth of expenses doesn't mean you need to set aside enough cash to cover *all* of your current bills for a quarter or half a year. The figure to use is the amount you pay for necessities, such as your mortgage/rent, insurance policy premiums, utilities, groceries and auto payments. There's no need to include any costs that you could quickly eliminate during tough times.

Your job security and insurance affect your emergency fund requirements

If you have a secure job *and* good insurance, it might be reasonable to land toward the low end of that three-to-six-month range. Disability insurance is especially important here—even people who have extremely secure jobs could lose their income if physical issues prevent them from working. Review your disability coverage to see how long you would have to wait for this coverage to kick in if needed. Other types of insurance matter, too—while unemployment is a major cause of big, unexpected financial problems, poorly covered medical and/or home-repair bills can be extremely expensive as well.

Some people should have *more* than six months of expenses set aside

If you work in a sector known for career instability or extended hiring downturns…or if you suspect that you would need to retrain for a new career if you lost your current job…and/or if you're risk-averse by nature, aim for six to nine months of emergency funds instead. Even 12 months isn't necessarily excessive.

Stash your emergency funds in a money-market fund

Money-market funds currently pay interest rates upward of 4%, which makes setting money aside more palatable than it was a few years ago when money-market funds paid barely any interest at all. CDs are less appropriate for emergency fund assets—they generally impose significant penalties if money is removed before the CD's term ends. If you have a high-deductible health insurance plan, money saved in a **Health Savings Account (HSA)** can be considered part of your emergency fund, though there could be penalties and tax implications if HSA money is used to pay for a non-health-related emergency.

Related: If you're wondering whether it's worth having money in hand in a more literal sense—that is, keeping actual folding currency in your home—there's little harm in having a small amount, but this isn't the wise way to hold significant sums. Not only could currency be lost if your home was robbed or burned down, it doesn't earn the 4%-plus interest rates that money-market funds currently provide.

A home equity line of credit (HELOC) can serve as an emergency fund adjunct

Having access to a HELOC offers another source of money you could tap in an emergency. But HELOCs charge variable interest rates, so this could be a more-expensive-than-expected way to access money if rates rise. Borrowing against home equity also can increase the risk of losing the home. *Similar*: A personal line of credit or a securities-based line of credit could theoretically serve this emergency-money role as well, but their interest rates can be steep.

Creating an emergency fund should be considered *a* top priority…but not necessarily *the* top priority

As important as it is to put money into an emergency fund, doing so should not crowd out all other financial priorities. *Higher-priority examples:* **Paying off high-interest rate credit card debt**…making contributions to a 401(k) that will be matched by an employer. But if you currently have no emergency fund or a severely underfunded emergency fund, get into the habit of putting money into one. Perhaps arrange to have a modest amount to be automatically transferred from a checking account into a money-market fund each month, then slowly increase the size of this monthly transfer.