

## Saving for Short-Term Financial Goals

Most of us know we need to save for our future goals. Buying a home, providing an education for our children and investing for a secure retirement are the most common long-term savings goals. But what about next year's vacation, remodeling or refurbishing your house, or buying a second car? You can always just say "charge it." That is how Americans have amassed billions of dollars in credit card debt. Instead, why not try a new approach? With a little encouragement and guidance, you can begin saving for these short-term needs today.

### Getting Started

The first step in any investment strategy is to develop goals. And the first "must have" goal is to ensure that you have adequate reserve funds to cover emergencies or even temporary unemployment. Many financial planners suggest that you have three months' salary available in savings for the unexpected.

Next, take a look at your spending needs over the coming 12 to 24 months. How much did you spend on your last vacation? How is the car running? By planning ahead for large expenditures, you can prevent anxiety and save on finance charges. Once you have determined how much you need—and when you will need it—you are ready to begin matching your goals to the investment options available to you.

It sounds easy, but if you are like most people, you may lack the discipline to save. Some banks and most credit unions offer a variety of special-purpose savings plans designed to help. Vacation and Christmas Clubs use coupon books that provide a schedule for reluctant savers. If your bank does not offer special savings plans, you can take the lead by setting up your own automatic transfers from your checking account to your savings account.

The idea is to make savings a habit and to treat your monthly (or weekly) savings deposits as a fixed expense—like a rent or mortgage payment—not just an afterthought once the bills have been paid.

### Key Investment Criteria

Whether your goals are long term or short term, you should look at three investment factors before choosing a savings or investment vehicle: liquidity, safety and return.

**Liquidity**—When can you get your money? If your savings are meant to pay for next year's vacation, real estate is probably not a good investment. But even certificates of deposit (CDs) may be too restrictive.<sup>1</sup> Be sure you understand what it might cost to turn your investment into cash. Are there penalties for early withdrawal? When you are using a time deposit, make sure the investment's maturity matches your needs.

**Safety**—As a general rule, return is proportional to risk. Just as liquidity concerns would rule out short-term investments in real estate, safety factors would rule out short-term investments in stocks or bonds.<sup>2</sup> It is not that these investments are inherently unsafe, but that the volatility (or fluctuation in the value) of these investments often makes them unsuitable for short-term investing.

**Return**—Short-term investors are restricted by safety and liquidity. You should, therefore, be realistic about how much you can expect to earn. Still, there are many investment choices available. While some investments require a minimum amount, others do not. Generally speaking, the more you have, the more you can earn. Even if you don't have the \$500 for a CD, you can still save \$50 a week until you do. Keep in mind that your final return will be reduced by any fees or taxes you incur.

### Savings Vehicles

**Savings Accounts**—Given their convenience, availability and relative safety, banks are often the first choice for savers.

Accounts at FDIC-insured banks are protected to \$250,000 per depositor, per insured bank, for each account ownership category.<sup>3</sup>

Additional explanation provided on FDIC.gov states the following:

“The FDIC insures deposits that a person holds in one insured bank separately from any deposits that the person owns in another separately chartered insured bank. For example, if a person has a certificate of deposit at Bank A and has a certificate of deposit at Bank B, the accounts would each be insured separately up to \$250,000. Funds deposited in separate branches of the same insured bank are not separately insured.

“The FDIC provides separate insurance coverage for funds depositors may have in different categories of legal ownership. The FDIC refers to these different categories as 'ownership categories.' This means that a bank customer who has multiple accounts may qualify for more than \$250,000 in insurance coverage if the customer's funds are deposited in different ownership categories and the requirements for each ownership category are met.”<sup>3</sup>

Shop around for rates and fees, keeping in mind that banks will usually waive monthly fees if you maintain a minimum balance. Most banks will link your savings and checking accounts, making regular transfers between the two accounts much easier.

**Money Market Deposit Accounts**—These accounts generally pay a higher rate than passbook savings accounts, but the rate typically fluctuates with market conditions. You may also get the advantage of limited check writing.

**Time Deposits**—CDs are available with terms ranging from 7 days to 30 years. CDs are FDIC insured and offer a fixed rate of return if held to maturity. A fixed-rate CD may or may not be an advantage. The time to lock in is

when rates are at their peak. Since it is difficult to know when rates have peaked, you can stagger maturities to limit your interest rate risk (the likelihood that rates will rise or fall). By purchasing CDs with a variety of maturities, you can reinvest principal from maturing CDs if rates go up, while longer-term CDs will continue earning higher returns should rates fall.

**Relationship Accounts**—Many banks reward their best customers with relationship accounts. By consolidating your deposits and loans with one bank, you can often minimize fees, earn higher rates or get free services. Check with your bank to see if this option would benefit you.

## U.S. Treasury and Other Money Market Securities

U.S. Treasury bills (T-bills) are generally issued in 13- and 26-week maturities with a \$1,000 minimum investment. You can also purchase T-bills with shorter maturity rates directly through banks and brokers. T-bills are sold at a discount, which means that the interest is paid to you when the bill matures. An added bonus is that interest earnings on T-bills are exempt from most state and local taxes. However, earnings may be subject to the alternative minimum tax (AMT).

In addition to Treasury securities, a wide variety of short-term commercial securities are available. The yields will be higher than T-bills due to the increased risk. Unlike bank money market deposit accounts, these investments pay a fixed rate of return.

<sup>1</sup>CDs are FDIC insured and offer a fixed rate of return if held to maturity.

<sup>2</sup>Investing in stocks involves risks, including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. Government bonds and Treasury bills are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

<sup>3</sup>Source: FDIC.gov, “FDIC Insurance Coverage Basics,” updated December 31, 2012.

---

*This article was prepared by S&P Capital IQ Financial Communications and is not intended to provide specific investment, tax or legal advice or recommendations for any individual. Please consult me, a qualified tax or legal advisor if you have any questions.*

*Because of the possibility of human or mechanical error by S&P Capital IQ Financial Communications or its sources, neither S&P Capital IQ Financial Communications nor its sources guarantees the accuracy, adequacy, completeness, or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. In no event shall S&P Capital IQ Financial Communications be liable for any indirect, special, or consequential damages in connection with subscribers' or others' use of the content.*