

When you have some money left over from your paycheck, where should you park it? The answer depends on how easily and how quickly you may need to tap into the money.

Short-term savings are generally used for an emergency fund or for a specific purpose such as paying taxes or fixing the roof next year. In choosing where to put those short-term funds, look for two things: a safe investment with little risk of losing the money, and easy access to the money, preferably without withdrawal penalties.

If you have a longer time frame, such as several years or more, consider investments with more risk, but potentially higher rewards.

Savings Vehicles

For money you expect to need in the short term, you can choose among several savings vehicles—savings accounts, money market accounts, money market mutual funds, and certificates of deposit (CDs). With each type of account, the bank or financial

institution uses your money to make loans and earn interest, some of which is shared with you.

But not all short-term savings vehicles offer the same returns. Here are some factors that can affect the rate of return:

- Interest rate trends—in the late 1980’s, interest on savings accounts peaked at over 9 percent, but in 2006, the average rate was less than 1 percent.
- Vehicle you choose—a savings account usually earns much less than a Certificate of Deposit, for example.
- The amount of money you have or plan to keep in the account.
- Which bank or other financial institution you choose.

Here are the main features of each type:

	Savings Accounts	Money Market Accounts	Money Market Funds	CDs
Interest	A little, generally no more than 5 percent.	More than in a savings account.	More than in a savings or money market account. Because this is a mutual fund, return may be reduced by an “expense ratio” withheld for fund expenses.	More than with the other options. Rate varies depending on date you cash it in and the value of the CD.
Access	Easy to get to your money.	Easy to get to your money.	Easy to get to your money.	You commit to a time period, from one month to several years, and pay a penalty for early withdrawal.
Insured?	Yes, by the FDIC* for up to \$100,000 if opened through an insured bank.**	Yes, by the FDIC* for up to \$100,000 if opened through an insured bank.**	No, but in a properly managed fund you should have little or no risk of losing money.	Yes, by the FDIC* for up to \$100,000 if opened through an insured bank.**
Fees	May require a minimum account balance to avoid fees; or fee may be lower if account is linked to a checking account.	May require a minimum account balance to avoid fees.	May require a minimum account balance to avoid fees.	You may be charged a small fee at the time of purchase. You’ll pay a penalty if you withdraw your money early.

*FDIC: Federal Deposit Insurance Corporation

**If the money is in a retirement account, such as an IRA, 401(k), SEP or Simple, the FDIC insures up to \$250,000. However, because of the potential penalties and loss of appreciation, it is not recommended to use retirement accounts for short-term savings.

Pros and Cons

Safe investments like the ones described in the chart are a good idea if you are simply looking for a place to “park” your money for a little while. They’re easy to get into and out of, involve very little risk of losing money, and may be insured by the FDIC.

But there’s a big con: your money has little or no chance to grow much over time. If you’re earning

1 percent on a savings account and inflation is 3 percent a year, you’re losing purchasing power. For this reason, you should consider investments with higher rates of return for long-term investing, such as for retirement. Of course, with the opportunity for higher returns comes more risk of losing money. Here are the basic types of investments and their average returns over time:

Investment Type	What it is	Risk of Losing Money		Historical returns (1925-2002)
		Short Term	Long Term	
Cash	Savings vehicles	Low	High	3.8%
Bonds	A loan to a company or a government	Medium	Medium	5.4%
Stocks	Ownership of a piece (share) of a company	High	Low	10.2%

Compare these returns to the historical inflation rate—about 3.5 percent. In years of high inflation, savings vehicles aren’t able to outpace it.

This means that for money you won’t be using for

several years or more, especially for your retirement, you need to learn about and choose other types of investments.

Your To-Do List:

- Compare current interest rates** on savings accounts, CDs, and money market accounts at www.bankrate.com.
- Calculate the interest you’ll earn** on a CD at the same site, www.bankrate.com.
- Keep an eye on the current inflation rate** at www.inflationdata.com (scroll down the page to get to the table).
- Read about investment vehicles**, like stocks, bonds, and mutual funds by reading AARP’s Tip Sheets and online at www.aarp.org/finance.
- Find out if your bank is FDIC-insured** by calling 1-877-275-3342 or by using an online directory at www.fdic.gov/deposit.
- If you want to leave more than \$100,000 in an FDIC-insured account**, learn about strategies for insuring all of the money, www.fdic.gov/consumers/consumer/news/special/index.html.
- Use the calculator** in the Choose to Save website to figure out how much money you need to save every month to reach a specific savings goal, <http://partnersleadfusion.com/tools/choosetosave/savings03tools.fcs>.

This and other tip sheets provide general financial information; it is not meant to substitute for, or to supersede, professional or legal advice.

Special thanks to The Actuarial Foundation for their expertise on this project.

© AARP 2007.