

The savings waterfall: How to prioritize your investing

Blog

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In the first edition of [our "Learning out Loud \(LOL\)" podcast](#), we discussed the first steps that you should take when it comes to investing—for example, how to build a budget, how to choose your investment strategy, and how to think about the difference between the short- and long-term time horizons.

In these types of conversations, our friends and family members often tell us that they are confused about all the different investment account types, and aren't sure where they should be putting their hard-earned savings.

In the waterfall chart below, we attempt to tackle the complexities of this decision into a general order of priorities.

The first priority is to build your emergency fund. We recommend setting aside resources to meet 6–12 months of your spending needs. This will help you pay for unexpected expenses, and also help protect against the risk of temporary unemployment.

After that, we've identified the investment vehicles with the greatest impact based on after-tax return potential. The obvious starting point is allocating to your 401(k) to take advantage of your company's match (if there is one), since this is like getting an immediate 100% return (in a tax-advantaged account) on the matched dollars. As you make and save more money, you will be able to allocate your savings further down the waterfall.

This rule of thumb won't work for everyone, and there are important factors to consider, such as [whether to choose a high-deductible healthcare plan to gain access to a Health Savings Account \(HSA\)](#), or [whether to invest through a traditional or Roth IRA or 401\(k\)](#). You may also need to skip some steps—for example, if you aren't contributing to a 529.

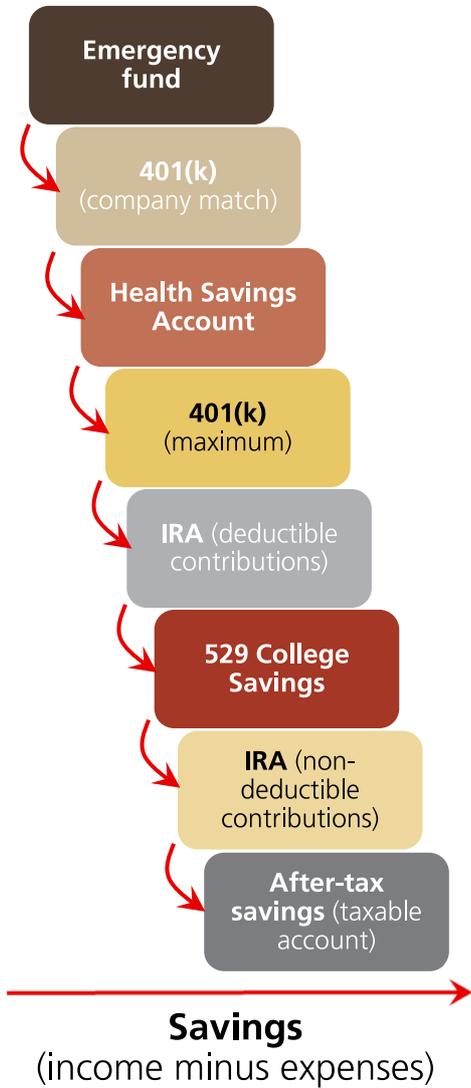
Resources like the [2020 Retirement Guide](#), which includes contribution limits and other details, can help you find the right strategy, but it's also

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vital that you review this with your financial advisor to make sure you're accounting for your family's unique circumstances.

Doing this once—and then setting up direct deposits and payroll elections so that your paychecks are put to work automatically in the background—can pay immense dividends (pun intended) over time. This is the good type of "habit-forming" behavior: automating good decisions and raising the barriers to making bad decisions.

Figure 1 - The "savings waterfall"



Source: UBS. For illustration purposes.

Appendix

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