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**Emergency funds. The money must-have.**

Life becomes very stressful when budgets are tight and you're faced with unexpected and significant expenses. These may include car breakdowns, exorbitant vet bills, illness and even retrenchment.

These emergencies are very likely to happen at some point in time. They can be costly and need to be paid immediately. Yet they can be managed financially by setting up an emergency fund to use when the unanticipated happens, also providing some peace of mind in difficult circumstances.

Studies have shown that South Africans don't save enough for emergencies. This means that when funds are needed to cover an unexpected expense, people often use credit, making a financially bad situation worse as the capital as well as interest need to be repaid.

There are a few reasons why people don't save for emergencies. One is that they don't always believe that an unforeseen event will happen, nor do they know how much it will cost. The recent fires in the Knysna area are an extreme example. No one could predict with any degree of accuracy whether or when such a calamity could occur and how costly the damage could be.

Another reason is that emergency savings are not given priority. People tend to seek instant gratification and spend now rather than save for the unexpected. It is also easier to save for positive things that they know will happen like a holiday, a child's educational trip or retirement.

Insurance has an important role to play in financing emergencies, but does not replace the need for an emergency fund. Medical aid might not cover every expense, excesses apply to home or car insurance policies, warranties don't cover all vehicle parts and income protection insurance may only last for a limited time.

How much should you save for an emergency? Recommendations vary depending on the source of the advice. Financial advisers usually identify three to six months' expenses as a

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guide. This might seem like a lot of money, but when compared to the cost of a new car or home renovation, the amount is not that significant.

And where should you save? The cash in an emergency fund should be easily accessible and should earn a return that at least keeps up with inflation.

Banks offer a range of savings accounts that may suffice. With this option you should check if there is any notice period required to withdraw your funds, any possible penalties, or any minimum deposit period.

One of the favored options are money market unit trust funds. Their advantages are that they generally earn a higher rate of interest and funds can be accessed in 24 to 48 hours with no penalties. At the same time, they are low-risk investments, and interest can be reinvested, which helps the fund's value to keep pace with inflation.

Funds with a higher risk profile such as a bond fund or a low-equity multi-asset fund will generally earn a higher return than a money market fund. These funds could be selected for emergency items that experience above-inflation price increases such as medical expenses. It's important to keep in mind, however, that here is a risk of capital loss if you choose a higher risk fund, as these funds are more volatile than money market funds. In order to reduce the chance of losses, you should invest for longer term. In 2015, for example, the bond market had a -3.9% return for the year, yet bonds rarely record losses over longer three-year periods. Each unit trust fund has its own recommended investment period to help investors get the maximum benefit from that fund.

Keeping money in a low-risk fund does still carry a risk, which is the opportunity cost of having funds in a low-risk investment, which could be earning a higher return in a riskier investment.

Investors also need to keep their overall savings goal in mind. Emergency funds are not intended to be used for any purpose other than an emergency. This is the same as viewing retirement funds only for retirement. And very importantly, they need to be replenished if they are used.

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Emergencies are, by definition, unanticipated and usually bear negative connotations. Some people appear to handle emergencies better than others because they have more wealth. This isn't always true – they may simply have had an emergency fund in place. What's important is for you to be prepared, to save towards an emergency and to allocate that savings to appropriate investments.

Are you interested in investing for an emergency fund? Speak to a financial adviser or find out more about Prudential's funds by contacting our Client Services Team on 0860 105 775 or at query@prudential.co.za for more information.