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50/15/5: An easy trick for saving and spending

It isn't about managing every penny. Track your money using 3 categories.

Fidelity Viewpoints

Key takeaways

> Consider allocating no more than 50% of take-home pay to essential expenses.
>
> Try to save 15% of pretax income (including any employer contributions) for retirement.
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> Save for the unexpected by keeping 5% of take-home pay in short-term savings for unplanned expenses.

Budget. Does anyone like that word? How about this instead—the 50/15/5 rule? It's our simple guideline for saving and spending: Aim to allocate no more than 50% of take-home pay to essential expenses, save 15% of pretax income for retirement savings, and keep 5% of take-home pay for short-term savings. (Your situation may be different, but you can use our framework as a starting point.)

Why 50/15/5? We analyzed hundreds of scenarios in order to create a saving and spending guideline that can help people save enough to retire. Our research found that by sticking to this guideline, there is a good chance of maintaining financial stability now and keeping your current lifestyle in retirement. To see where you stand on our 50/15/5 rule, use our Savings and spending check-up.

Feedback

Essential expenses: 50%

Some expenses simply aren't optional—you need to eat and you need a place to live. Consider allocating no more than 50% of take-home pay to "must-have" expenses, such as:

- Housing—mortgage, rent, property tax, utilities (electricity, etc.), homeowners/renters insurance, and condo/home association fees
- Food—groceries only; do not include takeout or restaurant meals, unless you really consider them essential, i.e., you never cook and always eat out
- Health care—health insurance premiums (unless they are made via payroll deduction) and out-of-pocket expenses (e.g., prescriptions, co-payments)
- Transportation—car loan/lease, gas, car insurance, parking, tolls, maintenance, and commuter fares
- Child care—day care, tuition, and fees
- Debt payments and other obligations—credit card payments, student loan payments, child support, alimony, and life insurance

Keep it below 50%: Just because some expenses are essential doesn't mean they're not flexible. Small changes can add up, such as turning the heat down a few degrees in the winter (and turning your AC up a few degrees in the summer), buying—and stocking up on—groceries when they are on sale, and bringing lunch to work. Also consider driving a more affordable car, carpooling, or taking public transportation. Consider a high-deductible health plan (HDHP), with a health savings account (HSA) to reduce health care costs and get a tax break. If you need to significantly reduce your living expenses, consider a less expensive home or apartment. There are many other ways you can save. Take a look at which essential expenses are most important, and which ones you may be able to cut back on.

Retirement savings: 15%

It's important to save for your future—no matter how young or old you are. Why? Pension plans are rare. Social Security probably won't provide all the money a person needs to live the life they want in retirement. In fact, we estimate that about 45% of retirement income will need to come from savings. That's why we suggest people consider saving 15% of pretax household income for retirement. That includes their contributions and any matching or profit sharing contributions from an employer. Starting early, saving consistently, and investing wisely is important, as is saving in tax-advantaged retirement savings accounts such as a 401(k)s, 403(b)s, or IRAs.

How to get to 15%: If contributing that amount right now is not possible, check to see if your employer has a program that automatically increases contributions annually until a goal is met. Another strategy is to start by contributing at least enough to meet an employer match, and then if you get a raise or annual bonus, add all or part of these funds to your workplace savings plan or individual retirement account until you have reached the annual contribution limit.

Short-term savings: 5%

Everyone can benefit from having emergency savings. An emergency, like an illness or job loss, is bad enough, but not being prepared financially can only make things worse. You can start with setting aside $1,000. Then a good practice is to gradually build up savings to cover 3 to 6 months of essential expenses. Think of emergency savings contributions as a regular bill every month, until there is enough built up.

While emergency savings are meant for more significant events, like job loss, we also suggest saving a percentage of your pay to cover smaller unplanned expenses. Who hasn't been invited to a wedding—or several? Cracked the screen on a smartphone? Gotten a flat tire? In addition to those, there are certain categories of expenses which are often overlooked; for example, maintenance and repairs of cars, field trips for kids, copays for doctor's visits, Christmas gifts, and Halloween costumes, to name a few. Setting aside 5% of monthly take-home pay can help with these "one-off" expenses. It's good practice to have some money set aside for random expenses so you won't be tempted to tap into your emergency savings or pay for one of these things by adding to an existing credit card balance. Over time, these balances can be hard to pay off. However, if you pay the entire credit card balance every month and get points or cash back for purchases, using a credit card for one-off expenses may make sense.

How to get to 5%: Having this money automatically taken out of a paycheck and deposited in a separate account just for short-term savings can help a person reach this goal.

What next?

Our guidelines are intended to serve as a starting point. It is important to evaluate your situation and adjust these guidelines as necessary. If you're close to the 50/15/5 target spending and saving amounts, good job. And for those staying within the guidelines, any remaining income is theirs to save or spend as they would like. Some ideas: First, pay down high-interest debt. For other goals, like paying for a child's college or wedding, you could use the remaining income to save for them. And finally, for those who want to retire early or haven't been saving diligently, putting it toward retirement savings may make sense.

The good news is that it isn't about micromanaging every penny. Analyzing current spending and saving based on our 3 categories can give you control—and confidence. Most everyone's financial situation will change over time. A new job, marriage, children, and other life events may change cash flow. It's a good idea to revisit spending and saving regularly, particularly after any major life events.