Set up an emergency fund

If your emergency fund doesn't contain three months' worth of living expenses, you could be in trouble.

By Mary Rowland

Ever turn on "Wall Street Week" or CNBC and hear a guest talking about disability insurance or writing a will? Probably not. Investing, the glamour girl of personal finance, is usually what takes center stage on money talk shows and magazine covers.

The real money horror stories, though, are not about people who forgot to invest, but about those who failed to protect their assets. Investing is critical to achieving your life's goals. But before you can invest, you've got to build a base to protect what you have.

That means you need health insurance to pay medical bills if you have an accident or become ill, you need disability insurance to protect your income if you cannot work, and your dependents need you to carry life insurance. Finally, before you can invest, you need a cash safety net or an emergency fund.

Saving for emergencies

Your emergency fund should contain three months' worth of living expenses. The amount does not have to equal three months' worth of your salary, but only what you need to pay the rent or mortgage, repay debt, buy food and make the car payment. While you're at it, you should also set up a basic record-keeping system using a personal finance program like Microsoft Money.

Emergency money must be accessible. Of course, therein lies a danger. If you're not disciplined, you can easily tap into it for impulse purchases, like weekend vacation trips and new ski equipment. This money, however, should exist for medical bills, brakes for the car, a spell of unemployment and the like. If there's talk of layoffs at work, increase the amount you put into it. When you must use money from this fund, make repaying it your top priority.

Put your emergency money in a highly liquid account, such as a saving account or money market account (which pays higher interest rates).

No maintenance fees

Wherever you open an emergency fund, persuade your banker to eliminate any account maintenance fees, which can run as high as $100 a year or more. In most cases, you can automatically eliminate these fees by maintaining a minimum balance. Look for a bank or credit union that uses an average daily balance method for computing this rather than a minimum daily balance. The latter will charge a fee if your account falls below the minimum on just one day. You can also avoid a fee by linking a checking account to a savings account or an interest-bearing checking account.

Putting the cushion in a smart place

Once you have built up a three-month cushion, you can also consider putting a portion of it into a certificate of deposit, or CD, to earn a higher interest rate. The longer the term of the CD, the higher the rate. But if you lock up your money for too long, you've defeated the purpose of easy access.

Once you've got your emergency fund in place, then you're ready to invest.