Millennials And Financial Trade-Offs: Where To Put Your 'Extra' Savings To Work

In the early months of the Covid-19 pandemic, back in April 2020, to be specific, the overall personal savings rate in the U.S. reached 33.7%, a record high. For many people, job concerns and economic uncertainty forced this change in habits. But even those who remain financially stable have become cautious with their money, not knowing what the near-term future holds.

In the months and years ahead, the most fortunate among us may have unusually large balances in our everyday bank savings account. And some of the people struggling financially right now may aim to continue saving at a relatively high rate. These would both be positive developments, as extra cash on hand provides security and flexibility. But, at some point, a large savings account balance begins to open the door to unintended long-term consequences that are not helpful.

The potential risk particularly applies to Millennials. At their current stage of life, this generation often has multiple, competing financial responsibilities and goals.

Money that sits for an extended period in a low-yield savings account can have opportunity costs. First, the funds may lose value due to inflation. Young adults working to catch up on retirement savings may miss out on crucial stock market returns. And those with high-interest debt could end up paying more in interest than if they had devoted large sums to repayment.

It's not always easy to decide where or in what amounts to allocate your funds. For Millennials planning for how they eventually may use their hard-earned savings, let's review some common financial trade-offs that this group faces:

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  - Student loan and other debt repayments
  - Saving for retirement
  - Buying a home

- Saving for their children's college
- Ensuring sufficient emergency funds

Student Loans and Other Debt

Young adults may first direct their attention to education debt. In many cases, this is where your first automated payment after rent goes, even if you're only covering the minimum amount required each month.

Financial responsibility aside, an obligation to make a credit card payment or repay a student loan balance can feel more immediately important than some future opportunity. While long-term financial goals—such as retirement—are essential, they are less likely to be top of mind.

Student loans, in particular, may weigh more heavily on Millennials than other debt. The high loan balances that many graduates carry can feel insurmountable. They may worry that student loans will define much of their adult lives.

The current student loan repayment process can create paralysis for higher and lower earners alike. Numerous forgiveness and refinancing options may make higher earners wonder whether putting more money toward student loans is a mistake. Meanwhile, lower earners on an income-driven repayment plan may want to put more savings toward their loans. But they may conclude that any extra contributions will make only a small dent in the total balance.

Paying It Off

In many cases, the key to surviving—and eventually repaying—student loans has a strong psychological component to it. Many Millennials may rely on some combination of income-driven repayment and forgiveness to pay off this debt. Repayment typically is a long process, though, which requires patience.

A select group of graduates with higher incomes and fewer competing priorities may have an opportunity to pay off their balances faster. For everyone else, it's critical to focus on the aspects of your budget you can control.

Retirement Savings

If existing debt strikes young adults as acute pain, retirement savings may seem like a luxury that can wait for brighter days. Even before the pandemic, many young adults struggled to prioritize saving money for a distant time later in life, especially given the tradeoffs they face today.

In its most recent Better Money Habits Millennial Report, Bank of America found that one in four Millennials has $100,000 or more saved toward retirement. If, however, as large institutions such as Fidelity Investments recommend, a person wants to have saved two times their annual income by age 35, and three times their annual income by age 40, it's clear that Millennial savers still have a way to go.

The 401(k) plan employer match that some companies provide has encouraged employees to contribute at least enough to their retirement accounts to collect that benefit. And yet these same employer-sponsored retirement plans have dramatically shifted the retirement savings burden onto workers, compared to what employers offered prior generations. Even young adults understand the financial shortfall they're likely to face at an older age if they fail to contribute to available retirement plans across the decades.

After Millennials achieve their employer's 401(k) match, their financial concerns may shift elsewhere. At that point, a down payment, a child's college education or an emergency fund could feel like a more valuable use of limited resources. When compared to funding a future retirement of unknown duration and needs, other goals may feel both more finite and more attainable.

Committing to Save

Young adults can catch up on saving for retirement through being consistent and recognizing new opportunities to save.

For example, one or two annual increases to your retirement contribution rate can make a significant long-term difference without causing immediate financial pain. Likewise, diverting part of a raise or bonus to individual retirement account—whether a traditional IRA or a Roth IRA—can help you get back on track, thanks to the longer time horizon that's still available.

It's also important to avoid the temptation to tap retirement savings to fund more immediate financial needs. The Transamerica Center for Retirement Studies found, in May 2020, that Millennials were more likely than other generations to borrow or withdraw money from their retirement plan accounts.

Housing Down Payments

Having savings left over after paying down student loan debt and contributing to a retirement account can feel like a victory. You may be content with letting that extra amount sit in a high-yield savings account—a relative term in the current low interest rate environment. For those at a particular stage in life, these remaining savings may be the start of a down payment on a home.

But the new complexities of buying a house often raise many questions: Is it too soon to buy? Will we even stay in our high-cost city? Do we need to put 20% down, or can we get away with doing less? This uncertainty often means that the least stressful way to save for a house is to label that extra money in the bank as "general savings."

Any young adult who keeps their down payment funds available for other uses takes a prudent initial approach. But, at some point, life may force you to decide whether to tap into those funds for a different goal. The decision of whether to redirect a potential down payment is complicated by the subjective elements that can accompany homeownership, such as how much you will value owning a home and how much these new circumstances will impact your life.

Deciding Whether to Buy

Homeownership regularly gets credit for building equity and eliminating rent payments. But using your money for that purpose invites many hidden costs (such as maintenance and repairs) and can push back the time line for other vital savings goals.

Ongoing conversations with a thoughtful lender can help to clarify what your mortgage options may look like. They also can give you clarity on what your new monthly payments would be. Yet, only you can decide whether to forgo additional student loans, retirement or college savings contributions to purchase a home.

College Savings Accounts

Without the incentive of earning a match, college fund contributions seem to get off the ground more slowly than retirement accounts. Yet, college savings can exert a stronger emotional pull on parents than their own retirement. Parents may assume they'll have to spend the money regardless and want to spare their children from having student debt.

The barriers to effectively saving for college, though, can feel very similar to the obstacles of retirement. It's not only a matter of having the desire to save but also knowing how much to contribute and where to invest the funds.

Saving for College

Most Millennials with young kids aren't able to contribute large sums to a college savings account, such as a 529 plan. As a result, they don't face much initial risk of overfunding the account. Indeed, anything you can save in a low-cost fund that aligns with college's timing is worthwhile. But the calculation can change as the account grows and more information about the child's college needs becomes available.

We know with certainty that we'll need to be able to support ourselves financially later in life. Plus, there are multiple options available both for attending and paying for college. Given this dynamic, many parents may need to consider proceeding conservatively with college savings until they feel more confident about their own retirement trajectory.

Emergency Funds

You may intuitively know that you need some money available for unexpected expenses. Yet, this savings goal may have fallen lower on your priority list. And even if you're interested in building an emergency fund, you may not know how much to save.

For years, experts have suggested having three to six months of expenses saved for a rainy day. But the specific costs and time range you choose to fund can make a big difference. As with retirement, when a recommendation feels out of reach, many people procrastinate or neglect the goal.

The Covid-19 pandemic has shown many more people what an unexpected—and extended—financial emergency looks like. As a result, young adults have become more likely to pay attention to this savings goal.

Building an Emergency Fund

Building an emergency fund with small, incremental contributions is a sustainable, effective strategy to get the fund to an appropriate size. The ultimate goal is less important when you're focused on one month at a time. After all, an emergency fund is never truly "complete." Instead, the decisions change.

As the months of expenses saved increase, each household can determine when it makes sense to shift their contributions elsewhere—either to a higher-returning account they can still access or to a different financial goal entirely.

Embracing Trade-Offs to Avoid Paralysis

While having excess savings on hand can be an excellent problem to have, the potential uses for savings account funds can feel overwhelming. Ultimately, though, you can feel good about the financial progress you're making if you're consistently increasing your liquid net worth—the cash you can access quickly, minus your short-term liabilities. After all, savings account funds can cover multiple goals at once or various goals over different periods. These goals will create conflicts and force trade-offs, but they don't need to paralyze you with uncertainty, fear and regret.

Instead, focus first on hitting specific minimum benchmarks with each goal that you're pursuing. Then understand where additional allocations could help to reduce or eliminate high costs that you're currently incurring. From there, how you use your extra savings ultimately may come down to what you value most for your life.

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