30-Day Mocha Money Challenge Article: Day 22

Dollar by Dollar

Follow your money through checking, savings, money market accounts and CDs.

We make a million decisions a day. Go to the gym or sleep in? Coffee or tea? Stairs or elevator? And the big one, what's for dinner? If stressing about takeout weren't enough, there are decisions to make about what to do with your money, too. You may find yourself thinking "checking account vs. savings account," "how is a CD different from a savings account" or "what type of savings account should I open?"

One way to simplify this decision is to break it down to the dollar level.

Let's compare 4 dollar bills as they make their way through 4 different types of accounts: a checking account, savings account, money market account and CD. With this dollar-level view, choosing which account is right for you will be one less decision to worry about.

Dollar #1: checking account
Let's start with the most flexible type of account, a checking account. When Dollar #1 goes into a checking account, it never gets comfortable or takes off its shoes because it needs to be ready to go at a moment's notice. A checking account is basically a house for your money to hang out in until you're ready to spend it. Dollar #1 will stay in this house until you write a check, use your debit card, get cash from an ATM or make an electronic payment.

The great thing about Dollar #1 is that it's flexible. Day or night, whenever you need it, you can use it. The trade-off for this flexibility is that Dollar #1 doesn't usually grow. Though some checking accounts can offer interest, most do not. So, while you can call on Dollar #1 whenever you need it, if you left it alone, it wouldn't grow any bigger.

Dollar #2: general savings account
A general savings account is a little less flexible than a checking account, but a little more profitable because it earns interest. Even though some checking accounts earn interest, it's more common for savings accounts to have interest rates. When Dollar #2 goes into a savings account, it unpacks its bags to stay for a while. As long as Dollar #2 stays put, it will grow, meaning it will make money (or interest), from the bank as a thank-you for hanging out. Let's say a savings account gains interest at an average rate of 1%. At the end of a year, Dollar #2 would now be Dollar #2 plus 1 cent, for a total of $1.01. That may not sound like much, but if it were $10,000, it would become $10,100. In other words, the more you save, the more you earn.

You can always get Dollar #2 out if you need it. However, unlike a checking account that allows you to spend anytime you want, you can typically only make 6 withdrawals a month from a savings account before encountering a fee.[1] Meaning Dollar #2 will grow over time but still remain accessible if you need it.

Dollar #3: money market account
When Dollar #3 goes into a money market account, it usually has a required number of roommates (additional dollars you put in). And, like a savings account, it can only leave the house a few times a month. In a money market account, Dollar #3 will grow faster than Dollars #1 and #2, but in order to do so, it has to stay in the house with a group of other dollars.

A money market account is a type of savings account that usually pays an even higher interest rate than a general savings account. Besides interest, the other main difference between a money market account vs. a savings account is that a money market account has a set amount of money that has to be in the account to earn a higher rate.[2] Additionally, you can only spend money from a money market account a few times a month, depending on your bank. The trade-off for keeping this higher balance in the bank is the higher interest rate that you earn.

Dollar #4: CD
Dollar #4 is going to a Certificate of Deposit (or CD). How is a CD different from a general savings account? A CD is a savings account that typically earns a higher interest rate because your money has to stay in the bank for a set amount of time that you get to choose—usually between 6 months and 5 years. Think of it like a contract. Typically, the longer the contract time, the higher the interest rate.[3]

Basically, Dollar #4 is promising the bank it won't leave the house for a while, and in exchange, the bank will reward Dollar #4 with a higher interest rate that you earn. If you need to take Dollar #4 out of the CD, you can, but you'll usually pay a penalty for breaking the contract.[4]

This means that Dollar #4 is going to grow the fastest but will be the least accessible. For money you can live without for the immediate future, a CD may be a solid option. If you want the benefits of a CD with more accessibility, look into a CD ladder as an alternative.

Let's do a quick recap
Dollar #1 went to a checking account and will grow the least but be the most accessible. Dollar #2 is in a general savings account where it will grow a little and still stay fairly accessible. Dollar #3 and its buddies are in a money market account. They will earn more interest than a general savings account but be less accessible with a higher minimum balance. Finally, Dollar #4 went off to live in a CD and will earn a high interest rate but has to stay put for a set amount of time based on a contract.

So, where should your dollar go? Only you can make that decision, of course. At the end of the day, it's all about determining the growth you'd like to see, the level of control and flexibility you feel comfortable with and your financial goals. Whether you choose a checking account, savings account, money market account or CD, now that you know the basics, you’ll be able to find the right place for your dollar.
