THE COMPLETE GUIDE TO UNDERSTANDING MONEY

This is an Investor Education and Awareness initiative by PATEL Financial Services with association with Franklin Templeton Mutual Fund.

Our goal is to help you understand concepts related to savings & investing and understanding the basics of mutual funds and its benefits. And ultimately to guide you in planning your finances so that your life's goals can be achieved. We invite you to join us in this journey as we aim to make you more aware about ways of managing your money better with the help of mutual funds!

⊞ Module 1 - Basics of Investing

⊞ Module 2 - Understanding your financial needs

⊞ Module 3 - Evaluating Suitable Investment Avenues

⊞ Module 4 - Your Guide to Mutual Funds

⊞ Module 5 - Planning Your life goals

⊟ Life Goal 1 - Retirement Planning

1. **Calculating Your Retirement Corpus :**

   Many people often underestimate the amount of money that they need for a hassle free retirement. In just few years of their retirement, they realise that they will be running out of money. And the thought of the number of years that they may have to survive without any income is rather horrifying. So, in order that you do not land up in such a situation, it is necessary to calculate your retirement corpus carefully. In this session, we'll tell you how to go about calculating your retirement corpus. [Watch Video | Read Transcript]

2. **Managing Your Cash Flows :**

   Managing your cash flows wisely is imperative in the journey of building your retirement corpus. However, managing cash flows is a challenge for many individuals. Even after earning a decent income, many individuals struggle to maintain positive cash flows. So, in this session of money simplified we will help you understand how to handle your money better so as to save and invest a decent amount for your golden years of retirement. [Watch Video | Read Transcript]

3. **Evaluating Your Risk Profile** :

   In the world of investments, investors often make the mistake of misjudging their risk appetite. Many investors easily fall for financial instruments which may not be suitable for them or at times even invest in unregulated instruments. This is quite common in cases where investors get carried away by some extra ordinary gains made by their friends or relatives or on the basis of misleading advice. In such cases, it may happen that the returns on offer would look really attractive; but they may come with a level of risk you cannot afford to take. So, in this session of money simplified we will help you understand why is it critical to consider risk when we talk about investing and how you can evaluate your risk profile. [Watch Video | Read Transcript]

4. **Allocating Assets For Your Retirement Portfolio** :

   In an endeavour to live peaceful retired lives many of you may be investing in a host of investment avenues. But the question is: Are you allocating your hard earned money to the right asset classes? You see, asset allocation is an important ingredient in the endeavour to achieve your financial goals. It helps you to minimise risk in your portfolio and optimise the returns besides offering a host of other benefits which come along. In this session of money simplified, we will help you meaningfully chart your asset allocation which can help you achieve your ultimate goal of retirement effectively! [Watch Video | Read Transcript]

5. **Passing Assets To Your Loved Ones** :

   Have you ever thought what would happen to the wealth you created over years of hard work after you've left for heavenly abode? Have you ensured that your family is well-safeguarded? Dying intestate (i.e. without preparing a will) can lead to various complications and disagreements among your heirs. Hence, estate planning is vital. In this session of money simplified, we will introduce to the facets of estate planning and also the points you need to consider while writing a 'Will'. [Watch Video | Read Transcript]

6. **Retirement Planning at Various Life Stages** :

   Each one of us dream of living a comfortable and peaceful retirement. But realizing a peaceful retirement is a lengthy process. It takes deep planning and years of determination from the start of your career to help you manage your finances and life style during your retirement years. In this session of money simplified, we will tell you how you can give a good start to your retirement in order to live a self-sufficient and peaceful retired life. [Watch Video | Read Transcript]

⊞ LIFE GOAL 2 - TAX PLANNING

Session 1: Are You Saving OR Are You Investing

We are glad to have you with us for our First Session - **Are You Saving OR Are You Investing?**

Alright so now let's get started.

Many people often misconstrue savings with investments. But let us tell you that there is indeed a difference between the two.

Merely putting aside money under the mattress, or in a vault, bank locker or savings bank account after meeting your expenses and liabilities may not mean that money works for you.

In times where the inflation bug is eating into your earnings, you need to move a step forward and invest. More importantly, invest wisely!

By now many of you may have realized that there is indeed a difference between saving and investing. So let's delve a little deeper and understand the difference between the two...which can help us march forward in our journey of wealth creation.

Savings **Meaning:**

- **An act of putting aside money after defraying expenses and liabilities** (...therefore the unspent income results in savings)

Savings = Income - All expenses including obligations towards borrowed money

- **It's an act of economising**
- **In Personal Finance parlance:**

Savings refers to preservation of wealth for future use

The Right Approach to Increase Savings

- **Refrain from impulsive buying** (...It is imperative to stick to your immediate priority. Have a list while you go out shopping and be rational while making the list.)
- **Make a monthly budget** (...Ascertain your income... frame the budget in a way that allows you to save more.)
- **Economise on expenses** (...try to avoid those expenses which aren't necessary)
- **Avoid excessive borrowing / credit** (So while you may own and use a credit card, use it thoughtfully knowing your means - Remember: excessive credit can lead to a debt trap!)
- **Start saving at an early age** (...it always helps to plan for your future. Remember, you can always postpone your decision to buy your favourite gadget, but you should save for a rainy day.)
- **You may start small, but save regularly** (....Remember, your every bit of savings can help you attain financial freedom)

Conclusive remark on savings:

Now that we have seen the right approach to savings, the question is, can saving alone help you achieve your life's goals? - Which could be: buying your dream home, your dream car, your children's education, their marriage, your retirement; amongst a host of other ones.

Think about it.

Do you know, over the years, the money that you have saved - kept aside in your vault, bank locker, savings account, or under the mattress - may lose value as the inflation bug eats into your savings if it is not allowed to grow at a decent pace? Therefore, in order for it to grow, you need to put your 'money saved' to productive use - and make money work for you!

And what should you do to make money work for you?

Well, the answer lies in INVESTING!

INVESTING **Meaning:**

- **An act of laying out your 'money saved' for productive use with an expectation of <u>earning return more than inflation</u> to preserve purchasing power of money**

- **A process of making your 'money saved' work for you** (instead of simply stacking in your vault / bank locker or under the mattress)

Advantages of Investing

- **Can grow your savings**

- **Helps your money work for you since it is put to productive use**

- **Can help in countering inflation and maintain purchasing power of money** (You see, as <u>money tends to lose its value over time due to inflation</u> - which eats into your hard earned savings - you can counter the inflation bug by investing and maintain the purchasing power of money for your future)

- **You can achieve your <u>financial goals in life</u>** (...which could be...buying a dream home, a car, taking care of children's education needs, their marriage and <u>your retirement</u> amongst a host of others)

- **Helps wealth creation**

- **Provides a sense of financial security**

<u>*The Right Approach to Investing*</u>

- **<u>Understand your own risk tolerance</u>** (...if volatility makes you nervous then risky investments such as stocks and equity mutual funds may not be the ones for you. You then might as well invest in fixed income instruments instead, such as fixed deposits, <u>PPF</u>, etc.)

- **Ascertain the risk involved while investing** (...you see, <u>every asset class - equity, gold, debt and real estate</u> - has risk associated with it and therefore it is necessary to know about the same before investing your hard earned money)

- **Know your investment objective** (... It is important to know that there are various investment avenues which are meant to cater to respective investment objectives. So enough care should be taken while investing your hard earned money. Ideally each of your investments should match your investment objectives)

- **Consider your age** (...this can help you have the right investment instruments appropriate for your age)

- **Consider the time period before you need money** (...Remember: The longer you are away from the time you require your hard earned money, the more risk you can take, and hopefully even earn more by investing in risky asset classes.)

- **Do sufficient research** (...It is vital not to get carried away by exuberance and / or what your friends and family say. Instead, undertake solid fundamental research on respective investments, and please do not get caught up in hype....understand how the product works)

- **Evaluate cost of investing** (...Remember: gains can be easily eroded if you don't consider cost of investing and thus it is vital to keep an eye on terms and conditions associated with the investment avenue. Very often many indulge in trading in the stock market to make a quick buck without really understanding the associated costs they are <u>paying for regular trading or churning</u>)

- **Aim at investing in investment products that can help you earn more than inflation** (…if your investments manage to outpace inflation, it will help you achieve your financial goals smartly and efficiently)

- **Recognise the tax implication** (…this is important…after all, the objective is also to earn tax efficient returns. If you do not plan well, you may end up paying higher tax on your returns)

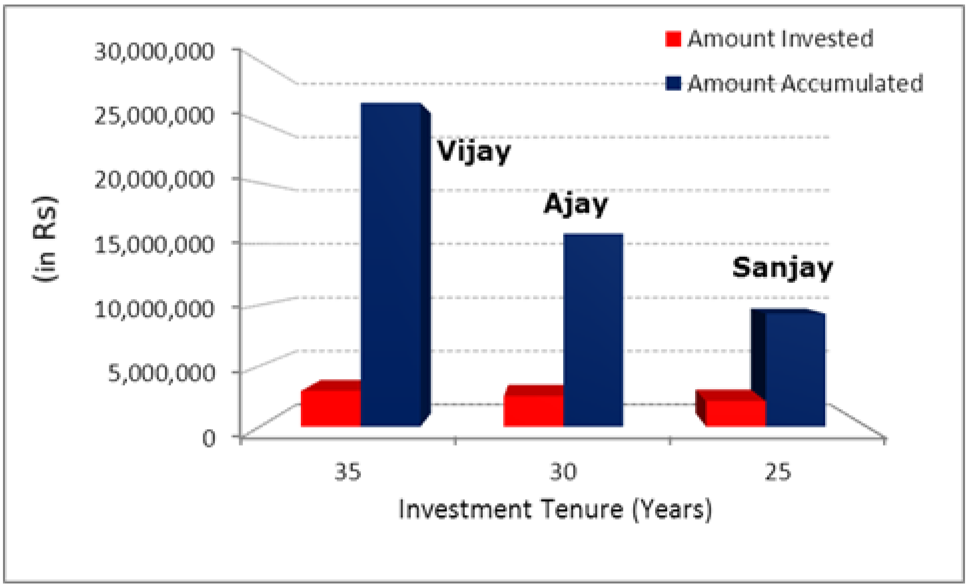
- **Always start early** (…as there are benefits of doing so. You can understand it well by taking a look at the following table and chart)

An Early Bird Gets A Bigger Pie

Let us take an example of 3 friends - Vijay, Ajay and Sanjay - All 3 had good jobs and wanted to retire at the age of 60. Vijay being the smarter of the lot, started planning for his retirement at the very initial stage, at 25, and invested Rs. 7,000 per month. Ajay realised the importance of planning for retirement once he was 30, while Sanjay could feel the guilt of being left out only when he was 35. See what they accumulated when they were on the verge of their retirement.

Particulars	**Vijay**	**Ajay**	**Sanjay**
Present age (years)	25	30	35
Retirement age (years)	60	60	60
Investment tenure (years)	35	30	25
Monthly investment (Rs.)	7,000	7,000	7,000
Returns per annum	10%	10%	10%
Sum accumulated (Rs)	2,65,76,466	1,58,23,415	92,87,834

Not only this, they also noticed a wide deviation in the proportion of growth they saw on their invested corpus. While Vijay's money grew around 9 times, Ajay's money grew 6 times and Sanjay saw a growth of just 4 times



Points to Remember for You to Save & Invest Wisely!

(Finally, to wrap-up this session of learning, here are some points one must keep in mind, now that you may have recognised why investing is imperative once you have saved)

To Save

- **Do not splurge all what you earn...SAVE!** (...Remember: It is important to economise on your expenses and save for a rainy day)
- **It is never too early to save** (...in fact, savings can help you feel financially secure and even sleep better at night)
- **Start small but maintain the regularity**

While Investing

- **Do not rush with investing** (...undertake thoughtful research by doing a holistic study)
- **Investing is a serious activity** (...in fact, it could be essentially boring, and not exciting)
- **Do not speculate** (...while it can be a thrilling experience, it can be killing as well if the tide turns against you. So it is best not to fall for excitement and exuberance)
- **Never use contingency funds to invest** (...Remember, they are put aside as part of your savings to meet your requirements on a rainy day)
- **Never invest from borrowed funds** (...except in the case of investing in real estate or your own business; but again, while investing therein don't go beyond your means)
- **Know your investment product** (...understand how it works and undertake research; recognise the risk-reward relationship the product offers)
- **Diversify** (...Remember, this can help you reduce your risk to your overall portfolio if you diversify wisely)

Some Important Ratios to Track Your Personal Finance

Savings to Income Ratio =	Total Annual Savings
	Total Annual Income

This ratio simply tells you what part of your income you are saving annually. Higher the ratio, the better it is, as it facilitates you to invest and lets your money work for you.

Total investment to Income Ratio =	Current Value of Total Investments
	Total Annual Income

This ratio helps you understand the current value of investments done as a ratio of current income.

At a younger age this ratio tends to be lower. However with time one needs to accumulate enough savings and invest to fulfil various financial goals in life.

Debt to Income Ratio =	Total Debt
	Total Annual Income

This ratio would help you evaluate the proportion of total debt as against the total annual income you earn.

Lower the ratio, the better it is.

Session 2: Time Value of Money & When to Start Investing

We are glad to have you with us for our Second Session - **Time Value of Money & When to Start Investing**

Alright so now let's get started.

The inflation bug as we learnt in our earlier learning session eats into our hard earned savings. So the value of our money reduces. Here in our today's learning session let's learn more about "Time Value of Money", which can help you manage your finances better. Here's an example.

Most of us vie to buy our dream home; so let's take the example of a house that you want to buy.

Have you ever thought...

The dream home...which was worth Rs 50 lac few years ago...costs Rs 1 crore today.

(The above example is hypothetical and for illustrative purposes only.)

Why?

Well, the answer lies in...

Time Value of Money

You see, as inflation, or simply put, the cost of living increases; it erodes the purchasing power of your hard earned money. Let's understand how it works and its impact.

Inflation ↑

Value of all Goods and Services ↑

Purchasing Power of Money ↑

Impact:- Today your Rs 500 note is worth less than what it was a few years ago

To make things simpler, let's take an example here.

Suppose you have won prize money in a contest and you have the option to receive Rs 1 lac today or after 1 year

What will you choose?

Well, rationally...

You will be at an advantage by taking (your prize money of) **Rs 1 lac today**

Why?

If you choose to take it after 1 year, you may be losing out on the interest that you may earn over the next 1 year...

Rs 1 lac invested today = 1.08 lac after 1 year
[100,000 X 8% = 108,000]

(Rate of interest of 8% is used for illustrative purpose only.)

Now let us see how to calculate time value of money. But before that, first, let us understand some basic concepts.

How to calculate Time Value of Money?

(Some basic concepts)

First, simple interest.

Simple Interest

Well, this is something we have all learnt in our school and college days and sometimes even put it to practice in our daily life. But just to brush-up...

Simple interest is the interest you earn only on your principal amount

Simple Interest: Principal X <u>Rate</u> X Number of Years
100

Let's use an example to understand it better.

What will be the simple interest on a 2 year deposit of Rs 10,000 offering interest @ 10% p.a.?

Simple Interest: 10,000 X 10% = Rs 1,000 p.a.

(Rate of interest of 10% is used for illustration purposes only)

The deposit of Rs 10,000 will yield Rs 1,000 p.a. for the next 2 years

So total interest you earn in 2 years' time is Rs 2,000

The next is compound interest, which again many of us may have heard or learnt about...and it's rather magical in the process of wealth creation. Just to brush-up...

Compound Interest

Compound interest is the interest you earn on both principal and interest

Compound Interest: Amount = Principal X (1+ Rate/100)^N
Compounded Interest = Amount - Principal

...Again let's take an example to understand it better.

What will be the compound interest on a 2 year deposit of Rs 10,000 @ 10% p.a.?

Amount: 10,000 (1 + 10%) 2 = Rs 12,100
Compound Interest: Rs 12,100 - Rs 10,000 = Rs 2,100

In 1st year you will earn interest on principal amount of Rs. 10,000 @ 10% i.e. Rs. 1,000

1st Year: 10,000 X 10% = Rs 1,000

In 2nd year you will earn interest on principal amount of Rs. 10,000 + interest you earned in the 1st year of Rs. 1,000; so you will earn interest of Rs. 1,100 on Rs. 11,000 @ 10%.

2nd Year: 11,000 X 10% = Rs 1,100

(Rate of interest of 10% is used for illustration purposes only)

So total interest you earn in 2 years' time is Rs 2,100

Now we can see that compound interest is more than simple interest by Rs 100

Moving a little forward from the basic concepts here are some very vital concepts in time value of money, which can help you on the path to wealth creation.

The first one...

Future Value

Inflation increases the cost of goods, year on year basis. So you may need to pay more in future.

Future Value = Present Value (1 + Inflation)^{N}

Let us understand this with the help of an example...

Say a packet of milk costs Rs 50 today and the inflation rate is 10%. So in this case, what will be the cost of the packet of milk after 1 year?

Well, if we use the formula which we just saw; you have the answer ... and the answer is Rs 55.

Future Value: 50 (1 + 10%) 1 = Rs 55

So you would be effectively paying Rs 5 more for the same packet of milk after a year due to the effect of 10% inflation rate.

(Inflation rate mentioned above is an assumption and for illustration purpose only)

The next important concept is...

Present Value

Real value of money in hand goes on decreasing because of inflation. So in future, your money needs to maintain pace with inflation.

Present Value = Future Value
(1 + Inflation)^{N}

Let us take this up with the help of an example...

Say, you have Rs 100 in your pocket today, but will the value of Rs 100 be the same 1 year hence assuming inflation rate of 10%?

Using the formula that we learnt in the previous slide - After 1 year Rs 100 note will be worth just Rs. 70.91 - in today's terms - assuming inflation rate of 10%.

$$\textbf{Present Value} = \frac{100}{(1 + 10\%)^1} = \textbf{Rs } 70.91$$

(Inflation rate mentioned above is an assumption and for illustration purpose only)

So inflation has clearly eroded the purchasing power of your hard earned money. And to catch-up with this erosion, one needs to invest wisely! While you want to invest wisely, knowing the real rate of return that you are earning on your investments would help you earn effectively.

Real Rate of Return

The Real Rate of Return you earn on your investment reduces due to inflation

Real Rate of Return = Rate of Return on Investment - Inflation

Take this case...

If the Rate of Return on your investment is 15% and inflation is 10%, then what will be your real rate of return?

With the help of the formula...

Real Rate of Return = 15% - 10% = 5%

(The rate of return and inflation rate mentioned above is for illustration purpose only)

So your Real Rate of Return is just 5%.

Many of you may have recognised that the answer to counter inflation is investing. But the question arises: when should you start investing?

When to Start Investing?

- **If you are already saving, then you are just one step away from starting your investment**
- **It is never early to start investing, but you can be late**
- **You should not wait for the right time to start investing**
- **Instead you may gradually start investing**
- **Starting early has its benefits!**

To understand the benefit of starting early, let's take the famous quote of Mr Albert Einstein, a renowned scientist. He said...

"Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it." - Albert Einstein

Power of Compounding

- **Earning interest on interest refers to Power of Compounding**
- **Longer your time horizon - Higher the effect of Power of Compounding**

Now to understand the effect of power of compounding, let's take a case study here...

Longer your time horizon - Higher the effect of

Power of Compounding

The table here indicates - what will be the value of one's saving at the age of 60, if someone would have started saving Rs. 1,000 p.m. at the age of say...

Rs 1,000 p.m. @ 10% p.a.	**Total Amount Saved (Rs)**	**Value at the Age of 60 (Rs)**
Starting Age		
25	420,000	3,828,277
30	360,000	2,279,325
35	300,000	1,337,870
40	240,000	765,697

...And what happens when one delays investing?

Impact of Delay

Let's take an example of 2 friends Ram & Shyam.

Particulars	**Ram**	**Shyam**
Starts investing at the age of	25	45
Monthly Savings (Rs)	5,000	15,000
Returns p.a. (Assumed)	12.00%	12.00%
Investment till the age of	55	55
Total Investment (Rs)	1,800,000	1,800,000
Accumulated amount at Age 55 (Rs)	17,649,569	3,485,086

Cost of Delay

To catch up with Ram, Shyam has two choices:

Earn on his investment	36.23%
OR Save per month	75,965

Before we wrap-up this session of learning, here are some points you must keep in mind while managing your finances - to recognise that the key lies in investing...and investing wisely.

Points to Remember.

- **Inflation decreases the value of money over time**
- **Prices of goods and services keep on increasing due to inflation** (…so you may have to spend more in the future)
- **Money received today is worth more than the same amount of money received after a few years**
- **In real terms, inflation also reduces the actual return you earn on your investment** (…so do not forget to consider it while investing)
- **Compound interest yields more return than simple interest** (...do not forget; the power of compounding is the eight wonder)
- (And…) **Longer your time horizon - Higher will be the effect of Power of Compounding**
- **You should not wait for the right time to start investing**
- **It is never early to start investing, but you can be late** (…So start early and gradually reap the benefits we just learnt)

Session 3: Checking your Financial Health

We are glad to have you with us for our Third Session - **Checking your Financial Health**

Alright so now let's get started.

To begin the session, let's start with an introduction to financial health

All of us want to live a healthy life, so we go to our doctors for regular checkups. But have you visited a Financial Doctor as well? While many of you may be surprised at this question, let us apprise you that like you undergo a health check, it is imperative to have a "Financial Health Check-up" as well, if you desire that your personal finances remain in the pink too.

So, here in our learning session today, let's learn how to check your Financial Health.

Checking your Financial Health

In order to check your financial health, you need to ask yourself a few questions related to your finances. So the 1st question that arises...

Are you aware about your cash flows?

i.e. Your cash inflows and outflows

If you are aware about your cash flows: Congratulations! You have got your 1st step right towards managing your finances, but if not, then you should immediately make a detailed chart of your income and expenses. It will enable you to know where you are spending your hard earned money and you may also come across some unnecessary expenses, which you could curtail to have better cash inflows.

Are your finances getting better or worse every year?

You see, as we all engage in an economic activity to make a living and have financial commitments to meet, we also need to assess if our personal finances are getting better or worse.

If your personal finances are getting...Better

You are getting financially healthy!

Congratulations! Your income is increasing at a higher rate than your expenses and you are getting financially healthy with each year that goes by.

But if your personal finances are getting...Worse

You should seriously start worrying... Why?

This is because your income is increasing at a lesser rate than your expenses and some day you may face a scenario where your income is insufficient to pay off all your expenses.

To avoid such a scenario you should either try to increase your income or reduce your expenses
Building Contingency Reserve

Can you pay for your regular expenses without having any income?...(In case you do not have a job for the next 6 months)

So...**it's Time you build a 'Contingency Reserve'**

You see, we all need to set aside some portion of our income to take care of the rainy days. And if you haven't done that, you could possibly face a financial crisis. So start building a Contingency Reserve of minimum 6 months of your regular expenses

So if your monthly expense is Rs 50,000/-

Your Contingency Reserve = Rs 50,000/- X 6* Months = Rs 3,00,000/-

(The figures used are for example purpose only. This is a recommended number. We would urge you to speak to your financial advisor to help you arrive at an appropriate number based on your risk profile.)

Know the extent of your liabilities...

Do you have any loan?

If you have a loan, you need to pay EMI on your loans and EMI is one of the major portions of your regular expenses...

If such EMI accounts for more than 40% of your monthly income then you are inviting financial risk...

If your monthly income is Rs 1,00,000/-

Ideally, Your EMI should not exceed 40%* of Rs 1,00,000/-, i.e. Rs 40,000/-

(The figures used are for example purpose only. This is a recommended number. We would urge you to speak to your financial advisor to help you arrive at an appropriate number based on your risk profile.)

What can lead to Financial Risks?

- **Increase in Interest Rates can increase* your EMI** (which will overstretch your monthly expenses)
- **High monthly expense will lead to low savings** (which may even have an impact on your commitment towards your financial goals)
- **If you choose to increase the loan tenure by keeping your EMI the same, you will have an extended repayment term** (and will have to carry your liabilities for some more years. And, maybe, postpone some of your financial goals)

…You see this is something for which you may not be financially ready…

So it is advisable that your expenses towards EMI should never be more than 35-40% of your monthly salary or income. Do not overburden yourself.

*In case you have opted for a floating rate loan

Is your investment portfolio well diversified?

Diversification can be done across many asset classes such as equity, debt, gold and real estate. It is one of the basic tenets of investing that helps you reduce the overall risk to your portfolio. Thus it is important that you diversify wisely.

Are you overexposed to Equities?

Equity as an asset class carries high risk. When you are young, your ability to take risk is high…

But as your age increases, your ability to take risk decreases. So consider your age.

A Basic Thumb Rule… Theoretically as a thumb rule you can invest 100 minus Your Age as a percentage into Equity and the rest can be in debt.

Investment in Equity (%) should be 100 - Your Age

For Example:

(If) **Your Age** (is) = **25 years**

Investment in Equity (%) = 100 - 25 = 75%

(The figures used are for example purpose only. These are recommended numbers. We would urge you to speak to your financial advisor to help you arrive at an appropriate number based on your risk profile)

Your Investment in Equity should be 100% - 25% i.e.75% and the rest 25% can be in debt and gold. As your age increases, and you approach your goals with more commitment, your risk taking ability reduces. So with each passing year you will need to gradually reduce your exposure to equities.

How do you invest?

Lump sum or via Systematic Investment Plan (SIP)

Investment habits can have a big impact on your returns especially in Equity...

As it is almost difficult for anyone to time the market correctly, it is advisable to invest via SIP rather than lump sum in Equity markets, as they offer you the advantage of rupee-cost averaging and compounding. Disciplined investment is good for your financial health.

Monitor your Investments

Do you monitor your investments regularly?

Investing whatever you save does not mean that you will be able to earn good returns; you also need to monitor your investments regularly.

If your investments are not in line with your asset allocation or are not performing well then you may have to do alterations to your investment portfolio as well

Do you have enough Life Insurance cover?

Life insurance cover protects the family financially in case of demise of the breadwinner of the family.

Your Life Insurance Requirement = Your Monthly Income X12 Months X10 times

You should at least have 10* times your annual income as a life insurance cover.

For example:

If your monthly income is Rs 1 Lac

Your Insurance Requirement = Rs 1,00,000 X 12 X 10 = Rs.1.2 crore

(The figures used are for example purpose only. These are recommended numbers. We would urge you to speak to your financial advisor to help you arrive at an appropriate number based on your risk profile.)

If you don't have the life insurance cover then you should immediately buy one and protect the financial future of your family. And we believe, the prudent way to buy a life insurance cover is through term plans; because the sole objective in insurance is to indemnify risk. Remember, not to club your investment and insurance needs together with "investment-cum-insurance plans". They may prove costly.

Have adequate Health Insurance cover

Do you have enough Health Insurance for you and your family?

Like life insurance it is imperative to have a health insurance cover as well.

Health insurance cover reimburses the hospitalisation bills in case the insured has to be hospitalised for any illness. So it's always better to take a health insurance cover at an early age because as age increases, the chances of being diagnosed with some disease increases and if that happens then it may be difficult to get an adequate health insurance cover.

Points to Remember

- **Know your cash flows and avoid making unnecessary expenses** (…stay within your means)
- **Create a contingency reserve of minimum 6 months and preferably 12 months** (…it will take care during emergencies)
- **EMI should not comprise more than 35-40% of your monthly income** (…else you may be overburdened with your liabilities and invite financial risk)
- **Diversify your investments** (…it will help reduce risk in your portfolio)
- **Invest via Systematic Investment Plan vis-a-vis lump sum investment in equity** (…SIPs can help inculcate discipline in your investments and keep you financially healthy)
- **Monitor your investments regularly** (…It is important to track your investments and take timely action)
- **Have an adequate life insurance cover to financially protect your family** (…your family will not have to face any financial difficulties in your absence)
- **Have an adequate health insurance cover for you and your family.**
- **Taking care of these small things with your finances can help keep you financially healthy**

Session 4: Building your Wealth with Wise Investing :

We are glad to have you with us for our Fourth Session - **Building your Wealth with Wise Investing**

Alright so now let's get started.

Many of us endeavour to create wealth for ourselves and give the best to our family. Through experience we can say that when everyone wants to make a fast buck, many people often indulge in rampant trading without recognising the risks; which we think can be hazardous to their wealth and health.

You may then wonder how one can create wealth!

Well, as it is said, "Rome wasn't built in a day". It takes a long time and prudence to create something blissful. While all of us desire to become wealthy by the day, it is important to note that wealth creation is a "journey"; involving process and prudence.

You see, in order to create wealth you need to put your money to use, and you can do this by "investing" - and more importantly investing wisely - taking into account a host of aspects which we shall learn in our session today. Remember, even if investing does not seem exciting...it should be taken seriously.

Now let's get serious and learn the various facets that you need to take into account in the journey of wealth creation with wise investing.

Wise Investing

- **Wise investing refers to a systematic process-and-prudence-driven approach** (...unlike investing in an ad-hoc manner where you put your money to use, but without much planning involved.)

- **It is not about timing the market and feeling the excitement** (...one cannot always get the market timing right. People who do get aroused by the excitement of timing the markets to make quick bucks, have higher chances of getting on the wrong foot)

- **Wise investing is about disciplined investing** (...it allows you sleep better at night and not worry about whether you've timed the markets well, to make a quick buck)

You see in order to invest wisely and create wealth; a host of facets need to be taken into account, such as...

Facets to be looked into for wise investing:

- **Investible surplus**
- **Investment objective**
- **Risk appetite and Risk Tolerance**
- **Asset Allocation**
- **Diversification**
- **Inflation**
- **Cost of investing**
- **Tracking & reviewing investments**
- **Selecting an unbiased advisor**

Let's understand each of these facets in a little more detail.

Investible surplus

- **It refers to the amount of money which you are left with after having defrayed all your expenses & liabilities** (...and also after having kept aside some money as contingency fund, to take care of rainy days)
- **It is imperative to take a good look at your finances to elevate your investible surplus**
- **Ideally, invest your money first and spend what you have left ?**(...this is a much better approach than doing the things other way round; but often people indulge in impulsive buying and then have very little money to invest for it to grow...think about it!)

Investment Objective

- **Investment objective refers to the purpose for which one is investing** (...while we all desire to create wealth, we also have to recognise whether preserving capital is also one of the objectives)
- (So can we say...) **Setting an investment objective simply means ascertaining why you would like to invest**
- **Knowing the investment objective also helps in <u>planning for your financial goals</u>** (...which could be buying a dream home, car, travelling abroad for leisure, children's education needs, their marriage and even one's retirement needs. But through experience we can say that very often investors stumble while defining investment objectives; this in turn brings in turbulence in their journey of wealth creation.)
- **It helps you choose suitable investment instruments for your portfolio** (...with a clear investment objective you can identify the investment instruments that are suitable for you and add them to your investment portfolio)

Risk Appetite and Risk Tolerance

- **<u>Risk Appetite</u> refers to one's willingness to take risk** (... depending upon one's age, past experience and knowledge)
- Risk Tolerance implies ability to actually take risk which is measured by:
    - **Income** (...this is an important determinant to gauge risk tolerance. So, if your income is high enough you will not mind taking higher risks while making investment decisions.)
    - **Expenses** (...you see, your outgoings also influence the risk which you can afford to take while investing. You may have a high income, but if your disposable income is petite, you could be refrained from taking high risk. Hence it is imperative for you to streamline unnecessary expenses, so as to keep your financial health in the pink.)
    - **Financial responsibility you are shouldering** (...which can take into account the number of dependents and whether your life goals (such as children's education and marriage needs)are to be planned for)
    - **Nearness to financial goals** (...you see, if you have planned for a financial goal, the time left to achieve the goals also determines the risk that you can prudently afford to take while investing. So if you are adequately away in terms of years from

meeting your financial goal, you can afford to expose your portfolio to higher risk which might enable you to create more wealth in the long term. But if your financial goal is drawing nearer, it would be more prudent for you to be a risk-averse investor to preclude wealth erosion.)

  - **Whether your <u>contingency fund</u> has been built** (...meaning have you already saved for a rainy day that can enable you to take risk)

  - **Whether you have <u>sufficient insurance coverage</u>** (...but mind you, while taking care of your insurance needs it is imperative to separate your insurance needs from investment needs; because buying an insurance cover is for indemnifying risk and not for investment purpose. While buying an insurance cover, you can look fora term plan.)

In order to build wealth wisely following the right asset allocation should not be missed.

<u>Asset Allocation</u>

- **Asset allocation essentially refers to investing your hard earned money in different asset classes such as equity, debt, gold and real estate prudently** (...which can enable you to balance your portfolio's risk and reward, keeping in mind)

- **Allocate your assets based on:**

  - Risk appetite and risk tolerance;
  - Financial goals; and
  - Investment horizon

Likewise diversification is important too...

<u>Diversification</u>

- **<u>Diversification</u> refers to spreading your investment in different baskets comprising various asset classes and investment instruments**

- **It is one of the basic tenets of investing**

- **Diversification helps to reduce the risk to your investment portfolio** (...and therefore most investment advisors harp on this word)

- (But...) **Diversification needs to be done wisely** (by...)

  - **Diversifying across asset classes** (...such as <u>equity, debt, gold and real estate</u>, since all assets don't move in the same direction.)

  - **Diversifying across investment avenues** (...thus, say, while your risk appetite allows you to invest into equities, you need to diversify well between stocks and mutual funds. Moreover, within stocks and mutual fund schemes too, there needs to be optimal diversification, to help you reduce risk as well as create wealth over a period of time.)

  - **Diversifying across issuer of securities** (...you see, while you are building your wealth it is vital to diversify across issuer of securities or else you will be provoking risk concentration to occur. There's no point favouring only one particular issuer as it could elevate risk in your investment portfolio. It is important to keep emotions at bay and invest rationally.)

- **Diversifying across countries** (…yes, today, with resident Indians being permitted to invest in assets and securities abroad, your scope for diversification has further widened. But it is important for you to be cognisant about the global economic scenario as well - and specifically the country where you are deploying your hard earned money.)

Inflation

- **Inflation refers to the rising cost of living** (…you see, as money tends to lose its value over time due to inflation - which eats into your hard earned savings - you can counter the inflation bug and maintain the purchasing power of money for your future, by investing wisely)

- **Investments should always yield positive inflation-adjusted returns** (…which in technical terms is also known as real rate of return that you earn on your investments)

Calculated as:

Inflation Adjusted Returns = Rate of Return on Investment - Rate of Inflation

Cost of investing

- **Cost of investing refers to expenses associated with investing and holding the investments in your portfolio** (…which could be in the form of fees, loads, demat account charges, bank locker charges (in case you are investing in physical gold) or any hidden charges levied by the issuer of respective investment instruments.)

- **Cost of investing should always be low** (…this will enable you to earn a better rate of return on your portfolio and prevent blunders like getting into high cost products.)

Tracking & reviewing investments

- **Tracking investments refers to monitoring your investments** (…regularly)

- **The frequency could be once a quarter** (…and need not be done everyday, if you have adopted prudence while investing.)

- **Reviewing refers to going a step forward and taking an action to make changes to investments held by you** (…with regular monitoring and review of your portfolio, you can timely know if and where you are going wrong, and if there needs to be a call to action. You can timely take corrective measures in case any of your investments are going off track.)

Selecting an Unbiased Advisor

- **An unbiased investment advisor can contribute immensely** (…to your journey of wealth creation)

- **Focus on knowing his attitude and rationalisation** (…you see, if your investment advisor is focusing on promoting products that earn him high commission and has not assessed the facets which we have just discussed with you; you could be in the wrong hands. He should be transparent and advise you with enough care and prudence as he would adopt while handling his own finances.)

- **Know his educational qualifications** (…ascertain whether your investment advisor has the requisite certifications from bona fide institutions. But merely relying on the certifications too isn't enough as one needs to delve a little deeper into the philosophy (attitude and rationalisation) and research process which he adopts while advising clients.)

- **Judge his infrastructure and value added services** (...this will help you gauge whether your investment advisor is able to service you better in the future.

Role of Discipline in Wise Investing

- **Discipline in investment is vital in wise investing** (...you should inculcate discipline in your investing. Adding discipline helps you invest regularly and may not let you deviate from your objective)

- Systematic Investment Plans (SIPs) can work for you (SIPs offered by mutual funds help you invest regularly)

- **SIPs enforce a disciplined approach towards investing**(...which is needed in the journey of wealth creation.)

- **Aids in maintaining regularity in investing** (...which is indeed needed to aid compounding of invested amount)

- **Disciplined investment via SIPs offer following benefits:** (...such as...)

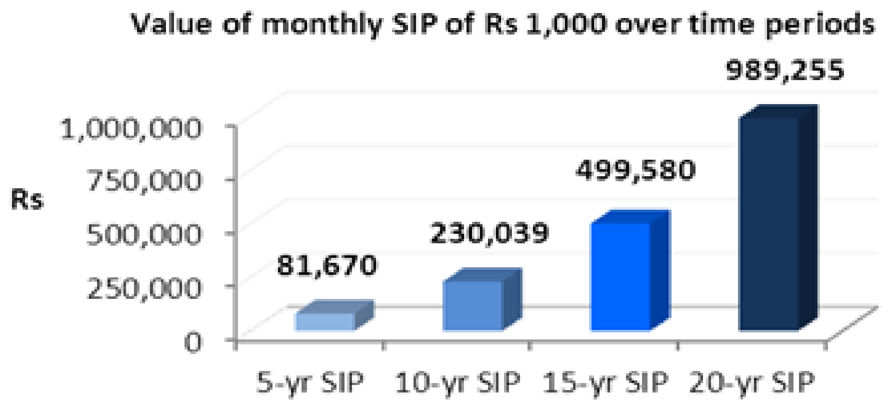
    - **Light on your wallet as it allows you to invest in small specified denominations regularly** (...instead of lump sum investing, which some might find heavy.)

    - **Makes market timing irrelevant** (...in fact it helps you manage the integral volatility of the markets better. You see, timing the markets, apart from requiring full time attention, also requires expertise in understanding economic cycles and market scenarios, which you may or may not possess.)

    - **Power of compounding** (...as mentioned earlier, since SIPs facilitate regular investing; it enables your invested money to compound well at a said rate of return.)

    - **Rupee cost averaging** (...meaning it allows you to buy more units when prices are low and, similarly, buy fewer units when prices are high. This infuses good discipline since it forces you to commit cash at market lows, when other investors around you may bewary and exiting the market. It also enables you to lower the average cost of your investments.)

    - **The longer you choose the SIP tenure the better it is** (...take a look at the chart here...)



The rate of return is assumed at 12% p.a. and is for illustration purpose only.

Preferably start early- because an early bird always gets a bigger pie!
Here take this example which we explained earlier in our 1st session as well.

Particulars	**Vijay**	**Ajay**	**Sanjay**
Present age (years)	25	30	35
Retirement age (years)	60	60	60
Investment tenure (years)	35	30	25
Monthly investment (Rs)	7,000	7,000	7,000
Returns per annum	10%	10%	10%
Sum accumulated (Rs)	2,65,76,466	1,58,23,415	92,87,834

Also, return per annum mentioned above is for illustration purpose only

Here Vijay, Ajay and Sanjay want to retire at the age of 60 years. Vijay being the smarter of the lot, started planning for his retirement at the very young age of 25 years and invested Rs 7,000 per month - Ajay realised the importance of planning for retirement once he was 30, while Sanjay started investing only when he was 35 - and you see what they accumulated when they were on the verge of their retirement.

Investment mistakes you should avoid!

So now that we have recognised what wise investing is all about, here are some common investment mistakes which you should clearly avoid!

- **Investing without a plan** (...Remember, wise investing is beyond a 3-step process of getting hold of an investment agent, filling up an application form and signing a cheque. Investing without a plan or an investment objective can be hazardous to your wealth. And mind you, segregating your financial goals into short-term, medium-term and long-term, will help you invest in a systematic way.)

- **Not Diversifying well** (...if you disregard this very basic tenet of investing, you could be in for trouble, as you are inviting more risk to your investment portfolio. While you may do well, during a run-up of a specific asset class, your portfolio may get battered during turbulence and downturn of the capital markets. Therefore it is vital that you don't put all your eggs in one basket.)

- **Ignoring related risk** (...you see, simply investing in an ad-hoc manner because the investment instruments are fetching higher returns or because your friends and families recommend, is not a prudent approach. It is imperative to recognise the risks which respective investment instruments carry and assess them in context to your risk appetite and risk tolerance.)

- **Getting married to your investments** (...This is a very common mistake which many people make. It is vital to be objective and review your portfolio at regular intervals to take corrective actions wherever required. Emotional attachment sometimes may not be good for your financial health.)

- **Timing the markets** (...While timing the markets is the mantra chanted by many and may sound exciting; it may not always create wealth for you. Remember a trader is only good until his last trade, as you don't know what the future has in store for you - good, bad or ugly. Let us apprise you that trading and timing the markets, can be hazardous to your wealth as well as health.)

Some Key Take Away Points!

- **Do not rush with investing** (...undertake thoughtful research by doing a holistic study)

- **Investing is a serious business** (...in fact it may seem boring and not exciting)

- **Have an investment objective in place** (...this will help you clearly define what you expect and thus identify the appropriate investment avenues)

- **Know your risk appetite and risk tolerance and then invest in suitable investment avenues**

- **Stick to your asset allocation** (...and timely rebalance if required)

- **Do not speculate or time markets** (...trading and timing the markets can be hazardous to your wealth as well as health)

- **Never use contingency funds to invest** (...Remember, they are put aside as part of your savings to take care during emergencies)

- **Do not rule out inflation factor while investing** (...after all the rate of return you earn on your investment has to outpace the inflation bug)

- **Never invest with borrowed funds** (...except in case of investing in real estate and business; but again while investing therein don't go beyond your means)

- **Know your investment product well** (...understand how it works and undertake research; recognise the risk-reward relationship the product offers and also the tax implications thereof)

- **Select an unbiased advisor** (...whom you can trust while investing your money)

- **Diversify** (...Remember, this can help you reduce your risk to your overall investments if you diversify wisely)

- **Track and review your investments** (...so as to take corrective measures wherever required)

Session 5: Identifying Your Financial Goals

We are glad to have you with us for our Fifth Session - **Identifying Your Financial Goals**

Alright so now let's get started.

As you may be aware, life expectancy of individuals has increased; which brings with it rise in medical and living costs during old age. Therefore, it is imperative to make provision for expenses wisely. All of us want to maintain our standard of living during our old age as well, but to do so we need to actually start thinking and planning for our retirement right from the beginning of our career when we are young.

This session aims to help you understand how you can identify and establish your financial goals.

***Goals* Meaning:**

- **Goals are something you want to achieve by putting in effort** (…So like in your school days you may have kept a goal of scoring high grades, get into the best college, pursue a bright career … by giving your best!)
- **So a goal is an end result that can be observed or measured and is expected to be achieved within a set timeframe** (…therefore you need to plan your goals well in advance)
- **Your goals need to be SMART**
    - **Specific** (…Your goal should be as specific and clear as possible.)
    - **Measurable** (…Your goal should be measurable and quantifiable so that you know when you can achieve it.)
    - **Attainable** (…Your goal should be attainable based on current facts and situations and not based on assumptions or conditions.)
    - **Realistic** (…You should choose a goal that is realistic, and which is not a distant fantasy.)
    - **Time bound** (…You should have a clear time frame in mind to achieve each of your goals planned.)

…Now that you have understood what we mean by goals, let us now learn about financial goals

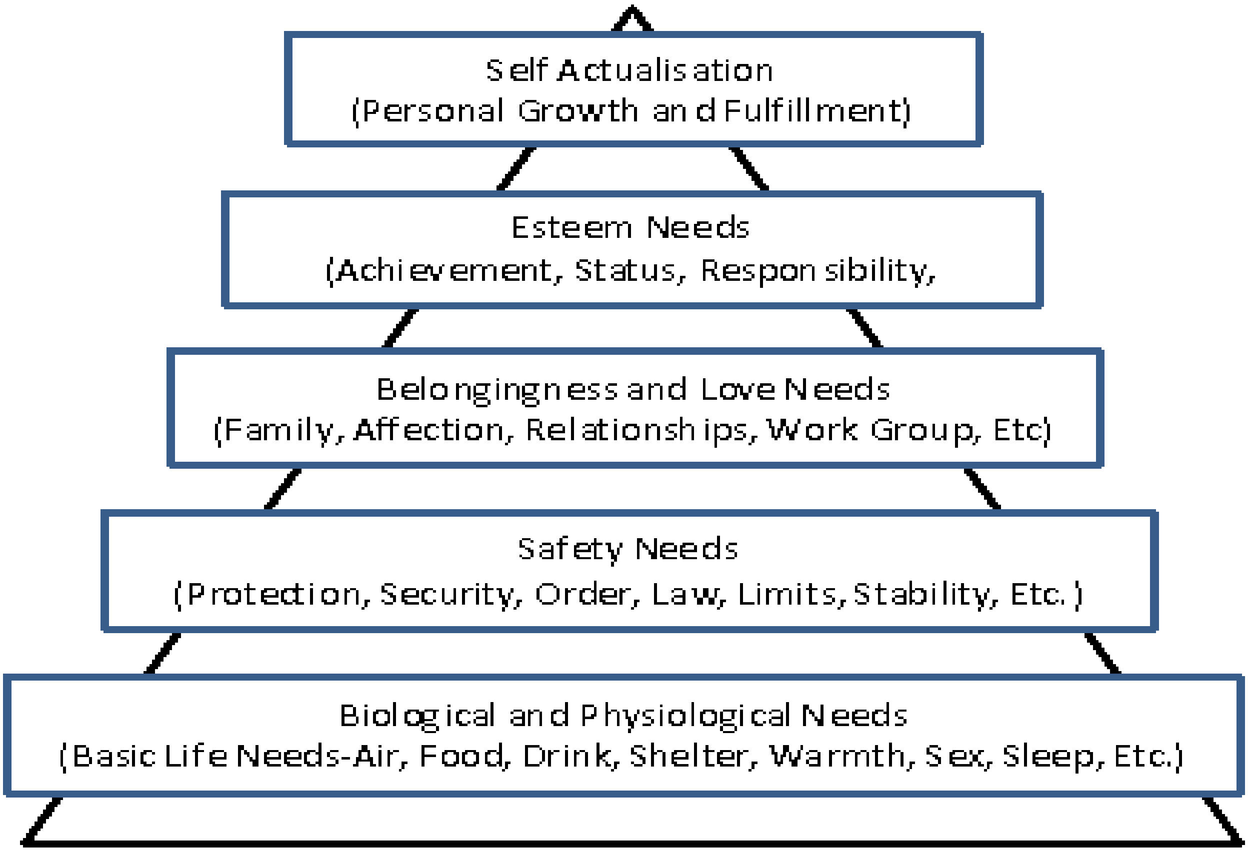
Understanding Financial Goals

- **Your financial goals are your personal goals with financial cost attached to them** (…And you see, they can be related to you, your family and the money you earn)
- **You can have various financial goals at various stages of your life** (…It can be during accumulation phase, transition phase or even vesting phase.)
- **You need to identify each of your financial goals and prioritise them** (…Achieving financial goals may not be an easy task and hence you may not be able achieve all your financial goals together. So you need to understand the significance of each goal and prioritise them appropriately.)

- **You need to provide and save for each of your financial goals** (...As each of your financial goals will have a financial cost attached to it, you will have to provide for and commit your savings towards achieving each of these goals from time to time.)
- (And mind you...) **You should not confuse financial goals with a financial wish** (...Many goals on your list may be wishes or mere fantasies. Like winning Rs 1 crore in a game show or buying a premium or luxury car in the next 1 year...)

You see, one needs to prioritise financial goals wisely...
How to prioritise your financial goals?

You have to consider your needs while listing and ensure the significance of each of your financial goals. And to do this, you should evidently understand your financial needs and obligations. Let's understand more on this with a simple and popular theory, which is...
Maslow's Hierarchy of Needs Theory



Maslow's Hierarchy of Needs is a popular theory in psychology proposed by Abraham Maslow in 1943, which you may have already heard of and read about in school. This theory describes the stages of movement in human need and motivation. Starting with the basic physiological needs like air, food and water; then safety and protection, moving towards belongingness and love; which once satisfied motivates you towards esteem and then self-actualisation needs like developing personal growth. In a similar way you ought to understand your financial needs and accordingly prioritise them based on your necessities.

So what is the...
Process for setting your financial goals

1. **Identify your goals** (...Based on your standard of living and your family. You need to identify your financial commitments & goals and write down each of them.)

2. **Prioritise your goals** (...Once you have listed down your financial goals, you should sequence them in order of importance...from most important to least important.)

3. **Understand the financial cost associated with each goal** (...You can roughly but rationally calculate the financial cost against each of your goals. This will help you understand if your identified goal is within or beyond your reach.)

4. **Set a timeline for each goal** (...You can put a target date against achieving each of your goals. Some may be short term, some medium, some long term. This will accordingly help you plan the money you will need over various time frames in order to achieve each of your goals.)

5. **Consider how much you can save each month** (...Here you need to determine how much money you can save each month to meet your goals. In case you are falling short of sufficient saving, then you may reconsider the least important goals. You see, it is also important to refrain from unnecessary spending, which can enable you to save more and thus achieve or move closer to achieving your financial goals.)

6. **Finalise your financial goals** (...Once you have considered each of your goals and the resources to meet them, you can finalise your financial goals.)

So what is the care to be taken while setting your financial goals...
Care to be taken while setting your financial goals

1. **Is your goal important** (...As we mentioned earlier, you should know how important is the goal which you have set. A less important goal, such as going on a tour to Europe over the next one year or buying a premium watch, should not be a priority, if you have another goal - a relatively more important one - such as a buying a house (to live in) or providing for higher education of your child.)

2. **Is it a goal or a wish** (...You see winning a lottery or Rs 1 crore from a game show can be your wish but not your financial goal. Likewise, you may wish to own a bungalow in a posh location, but you may not be able to attain it unless it is realistic, taking into account your present finances and assessing the scope for improvement in your financial situation.)

3. **Money you need to accomplish your goal** (...You need to consider the future value of your goal. i.e. if one of your long term goals is to send your child abroad after 15 years for higher education, which costs Rs 20 Lac at present; you need to account for inflation and accordingly calculate the money you will need after 15 years for this goal.)

4. **Do you have adequate resources to finance your goals on time** (...You see, you need to consider the options and resources you can use to create a corpus to achieve your goals. You need to keep a rational expectation for growth in your income or returns from your investments. You cannot assume 20% appreciation in your salary or income every year, or 30% p.a. returns from your equity investments each year.)

5. **Are you misjudging your timeline** (...Once you know your goals, you set a timeline for each goal. But you need to be flexible with your timelines when it comes to a few of your

less important or even important goals. Like you can always postpone your foreign vacation by 5 years, or, if needed, your retirement age from 50 years to 55 years.)

By establishing your financial goals, you can have something to work towards which can help keep you focused when it comes to your money. While financial goals may at times sound similar for different people, it may easily differ when we factor in the time and cost to each goal to be achieved. Based on your age and life stage, you can classify and set your goals as short term, medium term and long term to have a clear picture of what and when you want to achieve.

Here we can see few examples of financial goals set for someone who is young and has just started his career.

Short Term Goals (Less than 5 years)

- **Pay off your credit card debt** (...Very often the younger generation tends to easily get into the credit card debt trap due to excess spending habits, and repaying just the minimum amount due. So if you have mounted credit card debt, repaying the same should be your priority.)

- **Start saving and investing** (...To achieve your financial goals, you need to form a disciplined saving and investing habit. You should try to save a portion of your income every month and invest regularly to let it grow over time.)

- **Buy adequate life and medical insurance cover** (...As a priority, you need to secure yourself and your family against financial risk.)

- **Create a contingency fund for emergencies** (...To take care of any unforeseen event that may arise unexpectedly, you should set aside savings amounting to 6 to 12 months of your expenses.)

- **Provide for expenses towards your marriage** (...If you are planning to get married, do not forget that you will have to bear additional expenses as well.)

- **If already married, provide for your child's admission** (...If you have a child who is yet to go to school, you need to budget for getting admission in a decent school.)

Medium Term Goals (5 to 15 years)

- **Buying a house** (...If that's on your mind and intend to buy one after 5 years, you should set it as a medium term goal.)

- **Buying a car** (...Again, you need to shortlist your options wisely and set it as a medium term goal.)

- **Foreign Vacation** (...We all want time for leisure travel and vie to see international destinations; but plan for it well by setting it as medium term goal...which could be 5-10 years down the line. And if needed, be flexible and ready to postpone this goal, if any other goal set by you require priority.)

Long Term Goals (More than 15 years)

- **<u>Providing quality higher education to children</u>** (…With the cost of education increasing day by day; just imagine the education cost after 15 years. Yet you will always want your child to be well educated and thus will have to provide for accordingly.)

- **Getting your son / daughter married** (…You may be planning a lavish wedding ceremony for your son's or daughter's marriage; but be realistic - do not overstretch.)

- **<u>Planning for your retirement</u>** (…Your retirement is the most important goal among all, which you will have to take care of yourself. Planning well in advance may be helpful for you to maintain your standard of living even when you stop earning.)

- **Considering health care during your old age** (…During old age, you may have a major part of your monthly expense going towards medical expenses. And recognising the rising medication cost, you should make provisions wisely and should not ignore them from the list of financial goals.)

Once you have set your financial goals over various time frames, you need to periodically evaluate your progress towards achieving your goals. There can be conditions that may cause change in your financial goals.

Conditions that may cause change in your financial goals

- **<u>Marriage</u>** (…If you happen to set your financial goals before marriage; you may have to revisit them after your marriage. There might be a few important goals which you may have not considered before.)

- **Divorce** (…An event like divorce can lead to a bigger change in one's life, personally as well as financially.)

- **Birth of one or more children** (…If you have a new born child, congrats! But you may also have to now include some financial goals and provide for expenses related to your new born child.)

- **Death of a spouse** (…God forbid, but death of a spouse can hinder one's financial goals.)

- **Disability or illness** (…of self / parents / children / spouse can lead to a significant change in a financial commitment.)

- **Loss of employment** (…of self or spouse can impact your source of income and hence demand a change in your financial goals.)

- **Change in job** (…Moving from one job to another may have an impact on your financial commitment and lifestyle as well.)

- **Change in location** (…Moving from one location to another can also lead to a change in your lifestyle.)

So, with change in circumstances and needs, you will have to revisit the earlier goals and finalise them again.

We are hopeful that this session has given you an insight in identifying and prioritising your financial goals. Remember, it is you who would best understand your needs and decide your financial commitments.

Session 6: Introduction to various asset classes Equity, Debt, Gold

We are glad to have you with us for our Sixth Session - **Introduction to various asset classes Equity, Debt, Gold**

Alright so now let's get started.

Successful investing is not an easy task. Whenever you plan for your investments, you need to plan them well. Before investing your hard earned money, you need to be well aware about the instruments where you are investing your money. You need to prudently select the asset class for your investments, as each asset class carries their share of positives as well as negatives.

So through this session, we will take up three major asset classes Equity, Debt and Gold, which are popular amongst investors

But before that let us again understand - What is investing?

Investing

As we mentioned even in our session 1, investing is...

- **An act of laying out the 'money saved' for productive use with an expectation of earning return higher than inflation to preserve purchasing power of money**
- **A process of making your 'money saved' work for you** (...instead of simply stacking in your vault / bank locker or even in your cupboard.)

In simple terms, by investing you purchase an asset with your money with an expectation of generating income or profit.

Assets are broadly classified as...

Physical Assets and Financial Assets

- **A Physical Asset is an asset which has value and can be touched, felt and used** (...An investor buying land, a house, a painting or gold can touch and feel them. Such assets are in the control of the buyer and can be put to use as per the choice of the buyer. But physical assets also carry a storage or maintenance cost.)
- **Financial Asset** (on the other hand...) **is an asset which is bought in the form of certificate, which entails the buyer for the benefits as a beneficial holder. But such entitlement cannot be touched or felt** (...Equity shares, bonds, debentures, fixed deposits, provident funds, mutual funds etc are some of the financial asset that investors normally invest in. The benefits derived from these assets depend on the performance of the underlying company or issuer.)

Historically in India, people have been more comfortable with physical assets, which have drawn a large portion of their wealth. As physical assets held by an investor do not benefit the economy, they are termed as unproductive assets. In order to help the economy grow and in turn benefit from the growth of the economy, people need to emphasise a portion of their investments towards financial assets.

Various Investment Avenues

- **Equities or Stocks** (…A most commonly thought of as a high risk - high return investment avenue.)
- **Debt or Bonds** (…People often construe debt markets to be safe, but it does carry risk, which we will tell you as we progress with the session.)
- **Fixed Deposits** (…One of the most popular investment avenue in India, which is considered to offer decent and fixed return. Here the risk is relatively less.)
- **Precious Metals** (…In India, precious metals like gold and silver have sentimental value attached to them. We usually buy them on auspicious occasions and consider them as security for unforeseen events.)
- **Commodities** (…As inflation keeps growing at a healthy pace, the prices of goods and services keep on increasing. In order to reap the benefit of increasing prices of goods, people now-a-days consider some exposure to commodities as well.)
- **Real Estate** (…The house you live in is meant to fulfil your basic need for shelter. Although it may appreciate over time, it shouldn't be purchased with an expectation of profit, because after all, the house you live in is a primary home for your own dwelling. In anticipation to make profits, some people buy multiple house, apartments, land etc to rent out or resell at a higher value in future, which form the part of their investments.)
- **Art** (…Some people consider valuable art objects like panting's etc. as a status symbol and some buy them with the intention of reselling them for a profit. Those who understand it, tend to spend huge money on art and consider them as an investment.)

While commodities and art may be classified as an investment avenue for informed investors, such investments carry a risk of physical depreciation /damage or perishable loss and also require storage costs that may cut into ensuing profits. On the other hand real estate investment carries complex and time consuming procedures. This in a way makes them unfriendly for new investors. So in this session, we will emphasise on relatively simple investment asset class like Equity, Debt and Gold.

Equity

- **Equity means Ownership** (…In simple terms, equity means ownership, everyone who holds equity in a company is a beneficial owner of the company, so can we say)
- **Equity holders are the owners of the company** (…Equity entitles you to become one of the several owners who are called the shareholders of the company and can participate in company's growth.)
- **Companies issue equity to raise capital** (…Which may be used to develop the business or repay existing debt etc.)

Advantages of Equity Investing

- **As an equity investor, you enjoy ownership in the company** (…Equity shares reflects partial ownership in the business of the company. As an equity shareholder you enjoy the rights of the owner, based on the level of stake you hold in the company. You also get opportunity to vote on important business decisions.)

- **Earnings in the form of profit sharing through dividends** (...After disbursing the preferred payments, profit making reputed companies share a part of their profit with the equity investors in the form of dividend.)

- **Returns in the form of capital appreciation** (...Over the longer term, shares are likely to produce capital gains through increases in share prices. As the shares of listed companies are traded on the exchange, the net worth of equity investors is influenced by the share price movement in the markets. If there is an appreciation in the share price, your opportunity of making gains from your equity investments increases.)

- **Ability to generate returns that are higher than inflation** (...Yes equity markets are exciting, dynamic and of course have the potential to provide high returns over the long term. Historically equities as an asset class, has outperformed other types of investments over long periods of time. Equities have proved their ability to generate returns higher than the rate of inflation in the long run. And hence they are generally considered as a crucial instrument while planning one's long term investment strategy.)

- **Limited liability** (...As equity has limited liability feature attached to it, as one of the many owners, you are personally not liable in case the company fails to meet its obligations. This means despite gaining from the benefits, you are personally not supposed to bear the losses. At the most what you can lose is the value of your investment.)

- **Tax Benefits** (...As per the current taxation laws, Equity investments carry favourable tax status. The dividend income is completely tax-free in the hands of shareholders. Even long-term capital gains you make by holding your equity investments for a period of more than 12 months are not taxable. Besides, short term capital gains are taxable @ 15% + applicable cess and surcharge.)

- **Liquidity** (...One feature listed equities offer is liquidity as compared to other investments like real estate where it may take time to liquidate your investments. You can sell your equity investments and get your money in 3 to 4 business days.)

- **Equity markets have a well regulated structure** (...Equity markets are well regulated by the regulator, thus protecting the interest of the investors. In India equity markets are regulated by SEBI (Securities and Exchange Board of India), who monitors and keeps control on any wrong doing that may hamper the investors)

- **Equity investing helps in economic development of the country** (...Equities play an important role in economic development as well. As an equity investor, you invest in the business of the company. The company can use this money in financing important projects, which creates employment. More employment leads to more consumption of goods and services offered by other companies, thus supporting projects of companies offering these goods and services. It also boosts the revenue collection of the government in the form of direct and indirect taxes, which if spent prudently leads to economic development)

But along with the advantages, there are some disadvantages to equity investing...

Disadvantages of Equity Investing

- **Equity does not guarantee return** (...Equities do not guarantee any return to the investors. The return on one's equity investment depends on the performance of the company. A well-managed company can do well and deliver for its investors, while a bad management can lead to failure and loss of capital to investors.)

- **Equity investments carry high risk** (...Equities are generally known as High Risk-High Return instruments. As the price of shares of a company can swiftly rise or fall, based on the news flows or sentiments prevailing in the equity markets. The investor is tied by the risk of capital depreciation if the market prices of stock move lower than his actual purchase price. However actual risk is accounted when the investor happens to book loss by selling the stock at lower price.)

- **Need proper skills to identify a good equity stock** (...It is not easy to identify a good equity or a stock for one's portfolio. Identifying the right stock require skills and ability to understand stocks on various parameters. You need to be more cautious. Proper analysis across qualitative and quantitative parameters and comparison with peers is a must while zeroing on a good stock.)

- **Needs regular monitoring** (...As an investor, you need to regularly monitor your equity investments and keep track of qualified news related to the company you have invested in. Such news has huge influence on the share price which decides the health of your investment portfolio.)

- **News flows impact equity markets** (...Human beings have tendency to get carried away with attractive money multiplying tips on stocks that they receive from friends or some stock brokers who put their interest first. But we think that you ought to be careful and not fell prey to such misleading tips or news. As we said, you need to be cautious and do proper analysis before investing in equities.)

Equity Investing is Suitable for

- **Investors with a certain level of risk taking ability** (...Equities being volatile by nature, carry risk to capital in the near term and hence may not be suitable for investors looking for safety of capital. Investors investing in equity should have the appetite for higher risk. You should do your risk profiling to gauge your risk appetite well before considering equity for your investment portfolio.)

- **Investors eyeing for high returns** (...Historically equities has been the asset class that has delivered better inflation adjusted returns for its investors in the long run. The quest for high returns attracts investors towards the equity markets. Though equities are known to be high return generating asset, they should not be considered as an instrument to double your money within 24 hours. Equity investing is not for gamblers.)

- **Investors having a long term investment horizon** (...Equity investment requires patience. If you start planning for your retirement at an early age, equity could potentially be an asset class you could consider. The earlier you plan the better it is, and equity can play a crucial role in getting close to achieving your long term financial goals.)

- **Investors ready to invest small but regularly** (...If you have a regular income and manage to save a portion of your income after providing for your contingencies and necessary expenses, you should not leave your money ideal in your bank savings account. You can plan regular investment based on your risk appetite and time horizon. Opting for a "Systematic Investment Plan", popularly referred to as SIPs, in an equity mutual fund is a good option for investors who want to follow disciplined investment approach. Such investments can help in gradually contributing towards long term wealth creation.)

How to Invest in Equities

Broadly you can invest in equities in two ways - Directly or indirectly. Let's see how...

- **Direct Investment**

  People, who wish to gain exposure from equity markets and have some expertise in choosing individual shares and can devote time for monitoring their portfolio, can buy equities directly. They can do so via...

- **Stock Exchanges through a Stock Broker** (…As equities trade on the exchange in the secondary markets, you can buy a stock directly from the exchange. You can approach your stock broker, who may buy on your behalf and get the stocks credited in your demat account.)

- **Initial Public Offerings (IPO)** (…When companies approach markets to raise capital they do it through a "Public Issue". The first time issue of shares by the company is termed as an "Initial Public Offering" more commonly known as an IPO. For this you can fill in the respective application form and wait for the allotment. The number of shares allotted to you will get credited to your Demat account.)

- **Indirect Investment**

  People who lack expertise of choosing individual shares and find it hard to devote time for monitoring their portfolio, can take the services of investment managers. Investment managers help investors indirectly hold exposure to equity markets. They can do this via...

  - **Mutual Funds** (…Equity schemes offered by <u>mutual Funds help investors take the benefit of equity investing</u>. Mutual funds are cost efficient instruments that carry the expertise of professional investing and managing money on behalf of investors. As mutual funds work on the concept of pooling in money, there are multiple investors, who jointly benefit from gains and losses. You can invest in mutual funds with as low as Rs 5,000/-)

  - **Portfolio Management Services (PMS)** (…<u>Portfolio Management Services are offered to investors</u>, under which the portfolio manager buys or sells stocks and creates a portfolio for the investors. The Portfolio manager charges a fee for this service. PMS services are regulated by SEBI and portfolio managers are required to comply with the regulations framed thereto. PMS are usually more expensive than mutual funds the minimum ticket size for investing through PMS is quite large.

Well, equity markets are a good choice for earning higher returns over the long run but do remember that high returns do entail high risks too. It means you need to put your invested capital at some risk and you cannot always expect preservation of capital.

And so to reduce the risk or to preserve your capital, you need an asset class which performs the function of preserving or protecting your capital from eroding or turning negative. It is not something new we are talking about, instead this is a traditional asset class which existed even much before equities became popular and exciting as an asset class.

Yes this brings us to our next asset class in today's session - Debt.

<u>Debt</u>

- **Debt means 'Loans'** (…In simple terms debt means loans. It is the money a lender lends to the borrower. In other words we can say that debt is an obligation or a commitment from the borrower to repay the money borrowed from the lender.)

- **Debt Investors lend money to issuers at a pre-decided coupon** (…In debt markets, the investors invest their money in the form of loan to the issuers, who are usually banks, company or government at a pre-decided coupon rate.)

- **On maturity the issuer returns the principal to the investor** (…When the bond matures on the due date, which usually ranges anywhere between 1 to 30 years, the issuer give the original investment or the principal amount back to the investor.)

Advantages of Debt Investing

- **Preservation of Principal** (…Debt markets as compared to equity markets are less prone to wild swings and volatility. Some conservative investors invest in debt markets for safety of principal and assume they are completely risk free. But the truth is, though debt markets are suitable for conservative investors, there are some risks attached to debt market investing, which we will cover in detail later.

  An investor can expect some safety of principal if he intends to hold the bond till maturity. As some bonds are riskier than others, the safety of principal depends on the credit profile of the issuer. You should check the ratings offered by the independent rating agencies to the issuer before investing in a debt market instrument.)

- **Regular flow of income in the form interest payments** (…As a debt investor you are entitled for regular flow of income in the form of interest payment by the issuer. Many investors buy bonds for the interest rate they offer. For example, a Rs 100,000 bond with a 8% p.a. interest rate pays Rs 8,000 in interest each year until the bond matures. The interest offered by instruments varies depending upon the credit ratings.)

- **Capital appreciation** (…Bonds trade in secondary market. Bond prices and interest rates have inverse relationship. Bond price rise when interest rates move down and vice versa. An investor can make money in debt markets by buying bonds when the interest rates are at a high and sell them when interest rates fall, thus making capital gains on the money invested. But do keep in mind that investing in bond for capital gains is much riskier than holding them till maturity.)

- **Reduce portfolio risk** (…As we said, holding bond till maturity is less risky than trading them for capital gains. You can earn regular flow of income by holding a highly rated bond till maturity. As debt markets are known to be relatively less volatile than equity markets, debt investing can help with diversification and stability to one's investment portfolio.)

- **Helps economic growth** (…India's debt market is one of the largest debt markets in Asia, and serves as a useful source for banking channels to meet their financial requirements. As issuers i.e. either banks, companies or government, raise capital in the form of borrowing from debt markets money raised for any productive activity helps in economic growth. While in equities such capital raising offers ownership, in debt markets such capital raising offers regular returns in the form of pre-decided interest rate. Even your bank fixed deposits are a kind of debt which offers you fixed interest rate; and the deposited money is used by the bank for lending to corporates and other individuals at higher interest rates.)

Disadvantages of Debt Investing

- **Low inflation adjusted returns** (…Historically debt markets have been less rewarding as compared to equity markets. As debt instruments are considered to be a "low risk-low return" investment, people prefer debt more for safety rather than capital appreciation. While on one hand you can expect getting assured returns, on the other hand these returns would be low.)

- **Issue with price discovery** (…As the retail debt market in India is not well developed, retail investors find it difficult to track the prevailing price of their debt holdings. For returns from their bond holdings, retail investors rely more on regular coupon payment, rather than looking for the prevailing market price of their holdings. Thanks to debt mutual funds, which help retail investors participate indirectly in bond markets, without worrying about prevailing market prices.)

- **<u>Interest rate risk</u>** (...As bond prices and interest rates are inversely related, bond prices fall when interest rates rise and vice versa. Debt markets quickly react to any policy action taken by the central bank (RBI). The expectations of interest rates lead to change in sentiments and impacts the market linked debt portfolio of investors. So while debt markets may be construed safe in terms of assured flow of income, they are not safe in terms of prevailing market price. To make your debt holdings safe, you need to hold them till maturity, but you may forego any opportunity of making intermediate capital gains. If you invest in debt markets considering it to be absolutely safe, do not forget that it may even surprise you in unfavourable conditions.)

- **Credit risk** (...Issuers in debt market have their credit worthiness, which is measured by the rating agencies. Before investing in any debt market instrument, you should check the credit rating assigned to the issuer. You should not fall for the high returns on offer. Issuers with low credit rating need to offer high interest rates to attract investors while issuers with high credit rating would offer low interest rate to the investors. Low credit rating means more chance of default, while high credit rating means less chance of default.)

<u>Debt Investing is Suitable for</u>

- **Conservative Investors** (...As debt markets are construed to be less volatile then equity markets, they are preferred by conservative investors looking for safety to capital. In fact your safety to capital depends on the kind of instrument you hold exposure to, your holding period, maturity profile etc.; you should select your debt investment based on your investment time horizon. Say if your time horizon is less than 3 months, you should not hold a longer maturity instrument, as it may be highly volatile in the near term.)

- **Investors looking for regular flow of income** (...Debt market helps in generating regular income as they offer exposure to income-generating instruments like Government Securities, Bonds, Non-Convertible Debentures, fixed deposits etc. As credible debt market instruments pay regular interests while keeping your principal intact, debt markets are ideal for investors looking for regular flow of income.)

- **Investors whose goal is approaching** (...When you have your goal approaching, preservation of capital becomes your priority. You would prefer to keep your money safe, so that you do not fall short of money to meet your commitment. Unlike equity markets which may be highly volatile in the short term, debt markets provide you with investment avenues to park your money even for a short span of time. Short term debt instruments or even liquid mutual funds are ideal category to park your very short term money, while keeping your principal relatively safe.)

<u>Avenues to Invest in Debt Markets</u>

Here are some common choices for you to invest debt markets...

- **Bank Fixed Deposits** (...Bank Fixed Deposits are most common debt market instrument in India. Bank FDs have been very common amongst investors as a traditional investment avenue for decades. As we said earlier your investment in bank fixed deposits is a kind of debt which offers you fixed interest rate along with some safety to capital. Fixed deposits upto Rs 1 lakh are covered under DICGC (Deposit Insurance and Credit Guarantee Corporation). The tenure of bank fixed deposits ranges from 7 days to 10 years.)

- **<u>Corporate Deposits</u>** (...Corporate deposits are nothing but fixed deposits offered by a company or an institution other than a bank. Over here, the interest rates vary depending upon the credit quality of the issuer. Independent rating agencies assess the credit quality of the company and assign the rating indicative of the risk involved in the investment. Thus, higher the credit rating lower is the interest rate offered and vice versa. However, sometimes companies raise money without securing a credit rating from independent rating agencies. In such cases companies often pay higher interest to attract investors.)

- **Corporate Bonds and Debentures** (…Corporate Bonds are issued by Public Sector Undertakings (PSUs) and private corporations as well, for a wide range of tenor normally, say for a period of 1 year to 15 years or even more. Don't forget corporate bonds may turn out to be risky. This riskiness depends on the issuing company's credit rating, the business into which the company is in, the sector in which the company operates and the prevailing market conditions. You need to consider the credit rating of a bond before zeroing on a bond or a debenture for your investment.)

- **Government Securities** (…G-Secs or Government of India dated Securities are units / debt papers is issued by the Government of India in lieu of their borrowings from the market. Government of India issues a certificate through the RBI acknowledging receipt of money in the form of debt, bearing an interest rate. Government Securities includes all Bonds, T-bills and instruments issued by the Central Government and State Government. These securities are normally referred to, as 'gilt-edged' as repayments of principal as well as interest are totally secured by sovereign guarantee.)

- **Small Saving Schemes offered by Government and Post Offices** (…The Government of India has framed various savings scheme to provide secured and attractive investment opportunity to the public, and use this as a resource for the development of the country. Even today the "Post office" is one of the largest savings institutions in the country and plays a vital role when it comes to savings. It offers various saving instruments to the public, which even provides numerous benefits to the investors. Some of the major instruments of post office schemes also offer tax exemption benefits to the investors.)

- **Public Provident Funds** (…Many of you might be aware of the term PPF. Public Provident Fund or PPF is used as a savings-cum-tax-saving instrument in India, as it used as a tool to save for one's retirement, especially for those who do not have any structured pension plan covering them. As per the current laws, you can invest a maximum of Rs 100,000 per year in PPF. PPF offers you a fixed interest rate every year, which helps your money grow on compounded basis each year. Many nationalised banks and now even some private sector banks are authorised to open PPF account for Individuals who are residents of India.)

- **Debt Mutual Funds** (…Today there is a plethora of investment options available under the category, which makes it difficult for you to choose from among multiple bank deposits, hundreds of corporate deposits, thousands of small saving schemes etc. As it is nearly impossible to invest money in multiple debt instruments, Debt mutual funds provide you the advantage of taking exposure to multiple fixed income instruments through a single investment product. Their primary objective is capital preservation and income generation. Your time horizon as well as your liquidity preference is of utmost importance while selecting the right debt mutual fund for you, as portfolio structure and maturity structures differ for various categories offered by debt mutual funds.)

Now that you may have obtained a better picture of investing in debt, let us take our next and popular asset class in today's session- Gold.

Gold

Gold is an asset class, which needs no introduction. We come across and even use this precious metal in our day to day life in some or the other form. But do you know why gold is a critical asset class when it comes to investing?

We will tell you why...

- **Gold is a Precious Metal** (…In true sense, gold is a precious metal, why?)

- **It carries "store of value"** (...Well, gold carries store of value. In contrast to other major asset class such as equities - which derive their value from the underlying businesses, or real estate - which could provide rental yields for you along with a potential for capital appreciation, or debt - which pays regular interest; gold possess no such distinctive characteristic(s). But having said that, let us apprise you that it is considered to be a store of value, as it enables you to combat the rising cost of living over the long-term and therefore also acts as a hedge against inflation. Historically gold has been a valuable and highly sought-after precious metal for making coins, jewellery and ornaments and is so precious that we even store gold in our vaults and lockers in the form of bullion, coins and bars.)

- **Gold is a vehicle to monetary exchange** (...Globally gold is widely used as a vehicle to monetary exchange and the money flowing in the global monetary system is in some way or the other attached to gold.)

How is Gold Put to Use?

Different people may have different reasons for buying gold. And here are a few reasons why people like to buy gold and some even put them to use.

- **Store of Value** (...As we just said, Gold is a long-lasting metal, which can last for ages. It being a precious metal has been used for exchange and has lasted as money for centuries)

- **Reserve Currency** (...Having store of value, the central banks and government of various nations aim to maintain gold reserves in order to secure their position. The central banks use these reserves as a guarantee to cash in their promises and pay their depositors and note holders.)

- **Hedge against economic pressures** (...Gold being a precious metal is also used as hedge against financial distress like inflation, deflation and currency devaluation. Due to frequent changes in the supply of money in the system, the value of currency can inflate or deflate. Hence holding gold can help one hedge such risk of devaluation of money which might be lying in their bank accounts and lockers.)

- **Industrial demand** (...Though not as high as silver, gold has some industrial and medical demand too.)

- **Jewellery / Ornaments** (...India is one of the largest consumers of gold. People in India have special fascination and emotion for gold. They buy gold especially in the form of jewellery on auspicious occasion like marriage, festivals and social events. Many Indians, like to pass on their gold to the next generation in the form of jewellery and ornaments.)

- **Investment** (...Purchase of gold jewellery may not always be termed as investment, as people hardly sell their physical gold jewellery to book profits when prices go up. Conventionally for investment purpose, people prefer to buy gold bar and coins in physical form.)

- **Portfolio Diversification** (...Gold is termed as a hedge against inflation as it has ability to take care of loss in purchasing power of money. In conditions where productive asset classes like equity, debt and real estate face the risk of losing value, due to fall in currency value, gold can come to rescue. Also if these productive asset classes are unable to adequately compensate individuals with inflation adjusted returns, then demand for precious metals like gold tends to increase. Hence it is recommended to hold a small portion of gold in one's investment portfolio, thereby diversifying risk across asset classes.)

- **Pledging for Emergency Needs**: (...Many banks and gold financing companies have started offering secured loans to individuals, who wish to pledge their gold at a reasonable interest rate, for a pre-specified tenure. The interest on such loans is lower as compared to personal loans. So, gold can be used for raising short-term finance for a nominal rate. Individuals with gold lying ideal in their locker can pledge their gold to meet their short term financial needs. Thus it is not necessary to sell your gold to raise money in case of emergency.)

How to invest in gold?

- **Conventional ways to invest in Gold**
    - Physical form - Jewellery / Coins / Bars (...Many investors prefer to invest in gold the conventional way. Yes you got it right - by purchasing gold in a physical form i.e. in the form of gold jewellery or coins or bars - As buying into the precious yellow metal is driven by emotions, many often prefer to invest in gold the conventional way, as they can touch, feel and see their gold holdings. While you can buy gold in the form of jewellery, coins or even bars from your jeweller; you can also buy gold coins and bars even from your bank.)

      But buying gold in physical form may have its disadvantage like high storage cost, quality issue, purchase at a premium price, resale at a price lower than the market price leading to low resale value etc. So to avoid these issues investors are gradually shifting towards unconventional ways to invest in gold.

- **Unconventional ways to invest in Gold**

  The unconventional way of buying gold facilitates you to invest in gold in a non-physical form i.e., either through paper form or even in non-paper form (which is electronic form), but they offer the advantages of investing in gold. Such investment options are:

    - **Gold Exchange Traded Funds (Gold ETFs)** (...ETFs are instruments, offered by mutual fund houses and are listed on a stock exchange. They represent ownership in an underlying security, commodity or asset. Hence, to put it simply, a Gold ETF is an instrument that represents an ownership of gold assets. When you buy a Gold ETF, you get a contract indicating your ownership in gold equivalent to the rupee amount of your investment. Gold ETFs are listed and traded on a stock exchange and you can buy or sell them on a real-time basis. But to own them, you need to open a demat account along with a share trading account with a broker.)

    - **Gold Funds** (...Gold funds are a relatively new breed of unconventional way to invest in gold. Gold funds are generally fund of fund schemes which invests their corpus into an underlying Gold ETF. These funds attempt to provide returns that closely correspond to the returns of gold as an asset class. Unlike Gold ETFs (where you hold units in your demat account); in gold funds you have an option to hold units in physical form as well. Moreover, gold funds apart from lump sum investing, offer the Systematic Investment Plan (SIP) mode, which is effective and convenient way of investing regularly in gold.)

      Holding gold in an unconventional form like Gold ETF's or units of a gold fund offers advantages like convenience, low storage cost, fair purchase and resale value, favourable tax implications amongst host of others.

Some Key Take Away Points

- **Equity**
    - **Equity means ownership** (...Equity entitles you with partial ownership in a company. And you can participate in company's growth.)

- **Equities help you earn through dividend as well as capital appreciation**
- **Equities have the potential to generate returns higher than inflation** (...Do not forget, for equities to generate returns higher than inflation, one needs to stay invested for the long term.)
- **Equity does not guarantee return** (...Equities do not guarantee any return to the investors. The return on one's equity investment depends on the performance of the company.)
- **Equity investments carry risk** (...While investing in equities; you may be tied by the risk of capital erosion.)
- **You can invest in equities in the direct form or through the indirect form** (...which we discussed earlier)

- **Debt**
  - **Debt offers preservation of capital** (...Being less volatile vis-à-vis equity, if invested prudently, debt can provide a level of safety to your capital.)
  - **Debt is ideal for generating regular flow of income** (...Debt offers pre-specified coupon payments which helps investors with regular flow of income.)
  - **Debt offers low inflation adjusted returns** (...You may find debt markets boring as it offers low returns, but do not forget that they may offer preservation of capital too.)
  - **There are some risk associated in debt markets** (...You cannot avoid interest rate risk and credit risk while investing in debt.)
  - **Bond Prices and Interest Rates are inversely related** (...When interest rate moves up, bond prices move down and vice versa.)
  - **Select your debt investment wisely** (...While investing in debt, you should consider your investment time horizon, and identify the debt instrument wisely.)

- **Gold**
  - **Gold is a precious metal and has a "store of value"**
  - **Gold is a good hedge against inflation** (...and it can come to your rescue during crisis.)
  - **You can hold gold in physical as well as non-physical form** (...You can choose to either buy gold bars and coins or hold it in your Demat account in the form of mutual fund units.)

Session 7: Ideal Asset Allocation

We are glad to have you with us for our Seventh Session - **Ideal Asset Allocation**

Alright so now let's get started.

All of us have some goals in mind such as buying a dream home, a car, travelling abroad for leisure, children's education, their marriage and even our own retirement needs. And to achieve them, we all endeavour to create wealth by investing in various assets classes as per our risk taking capability.

Some of us are conservative and want to invest only in fixed income instruments because of the fear of losing money, while some of us are aggressive and want to invest in risky asset classes to generate higher returns. But here it is vital to recognise that all asset classes do not move in the same direction at the same time. Therefore it becomes imperative for us to diversify our investments across various asset classes and invest according to our asset allocation.

So first let us understand, what is meant by Asset Allocation.

What is Asset Allocation?

- **<u>Asset allocation</u> is an investment strategy** (...It helps to define a road map for your investment portfolio, with appropriate diversification across asset classes.)

- **It helps to keep a balance between risk and return of any particular asset class** (...Asset allocation determines what amount of risk is being taken to earn a particular return.)

- **Asset allocation refers to <u>investing a certain percentage of your investible surplus in respective asset classes, such as equity, debt, gold and real estate</u>** (...You see, all the investments are considered separately and only a particular percentage is invested in each asset class on the basis of your risk taking capability.)

But the next question that arises is - How is Asset Allocation Determined?

So let us take a look at some key parameters that you should use while determining your asset allocation...

Parameters to Determine Asset Allocation

Asset Allocation can be determined on the basis of following factors:

- **Age**
- **Income**
- **Expenses**
- **Assets**
- **Liabilities**
- **Time Horizon**
- **Willingness to take Risk**

Let's take up each of them in more detail.

Age

- **Your age is one of the biggest factors in determining your asset allocation** (...When you are young you can take higher risk and invest into riskier assets such as equity.)

- **As your age increases your risk taking capability decreases** (...and you become risk averse)

Age	Risk Taking Capability	
25	High	↓
35		
45		
55	Low	

The table here shows that an individual who is of the age of 25 years has much higher risk taking capability than an individual whose age is 55 years. It happens because an individual at the age of 25 years has more time to recover from bad phase of riskier assets and therefore can afford to take higher risk. So if you have not yet started defining your asset allocation, then you should start immediately!

Income

- **Your income also determines your asset allocation**

- **High income = high risk tolerance** (…An individual who has high income and high expected growth rate in the future, can tolerate higher risks. He can invest more in riskier assets.)

Growth Rate in Income p.a.	Risk Taking Capability
25%	High
20%	
15%	
10%	
5%	
0%	Low

(This table is indicative, and for illustration purpose only)

In the table you can see that if you have an expected growth rate in your expenses as low as 5% as compared to an individual who has 20% expected growth rate, then your risk taking capability is much higher than the other individual.

Assets

- **The existing assets you hold in your investment portfolio is vital while determining your future asset allocation**

- **Consider the concentration level of each asset in your portfolio** (…Some individuals are too heavily invested in a particular asset class and forget to diversify their investments. Some believe that real estate is the best asset class to invest in as it gives them dual benefit of appreciation in value of the asset as well as rental income. But what they forget is, real estate is also an illiquid asset class which cannot be sold easily in case of emergencies.)

- (…You should) **Never put all your eggs in one basket** (…So proper asset allocation is necessary to diversify your investment portfolio well.)

Liabilities

- **Consider your loans and liabilities while determining your asset allocation** (…You see, your current liabilities can also affect your asset allocation. If you have big liabilities, then you have a huge burden to service them and that decreases your investible surplus and also your risk taking ability.)

- **High interest rate on your loans leads to burden on your cash flows** (...So, in case you owe a lot, then you need to invest in low risk asset class such as debt, because any increase in interest rate on your loans taken can affect your cash flows negatively.)

Liabilities	Risk Taking Capability	
Less	High	
35		
More	Low	

(This table is indicative, and for illustration purpose only)

The table here shows that the lesser your liabilities, the more risk you can afford to take and vice-versa.

Time Horizon

- **Consider your investment time horizon** (...Asset Allocation is also determined on the basis of Time horizon in which you wish to accumulate an amount for your future goal.)

- **Longer time horizon = High risk taking ability** (...Longer your time horizon higher the amount of risk you can afford to take.)

Time Horizon (Years)	Risk Taking Capability	
30	High	
20		
10		
5	Low	

(This table is indicative, and for illustration purpose only)

In the table you can see that when you have a time horizon of 30 years, you have a much higher risk taking capability, than if you have just 5 years of time horizon. Longer time horizon leads to increased risk taking capability and higher allocation towards riskier assets classes.

Willingness to take Risk

Your willingness to take risk determines what amount of return you should expect from your investments.

- **Are you ready to take high risk?** (...While investing ask yourself, are you willing to take high risk? If the answer is yes, you can look to have high allocation towards high return generating instrument like equity. If the answer is no, then you should identify and allocate assets for your portfolio prudently.)

- **High Risk = High Return** (...Do not forget, you may get rewarded for taking high risk, but there may be risk on your capital invested.)

- **Low Risk = Low Return** (...If you are not willing to take risk, you will have to compromise on your returns as well.)

Asset Class	Risk		Return	
Equity	High		High	
Real Estate				

Gold				
Debt	Low		Low	

(This table is indicative, and for illustration purpose only)

In the table you can clearly see that Equities have the highest return expectation but also carry with them the highest risk. Debt on the other hand, offers the lowest return expectation and thus the lowest risk.

So if you are willing to tolerate higher risk involved in Equities, then your allocation towards Equities will be higher and you can also expect to earn higher return over the long term. But if you cannot tolerate higher risk, then you would be better-off allocating a higher percentage towards debt, but at the same time it will also decrease your return expectation.

You see, <u>it is vital to define your risk tolerance</u> first and then determine which asset class you should be investing in.

How to determine an asset allocation?

(A Case Study...)

To help you better understand how an asset allocation is determined; let's take an example of 3 individuals who are at different stages of their life cycle.

Name	**Vijay**	**Ajay**	**Sanjay**
Age	30	45	60
Life Stage	Unmarried	Married with 2 Kids	Retired
Income	Medium	High	Low
Expenses	Medium	High	Low
Assets	Low	Medium	High
Liabilities	Medium	High	Low
Time Horizon	High	Medium	Low
Willingness towards Risk	High	Low	Medium
Overall Risk Appetite	High	Medium	Low

Vijay is a 30 year old unmarried individual, while Ajay is a 45 year old married person with 2 kids and Sanjay is a 60 year old retired individual.

Since Vijay is young and has just started earning a few years back, he has only a few assets but his time horizon is around 20-30 years, so his overall risk taking capability is high.

Ajay's income is high, but he also has dependents and liabilities. His time horizon is 10-15 years, so his overall risk taking capability is moderate.

Sanjay is retired and only his spouse is dependent on him. Since he does not have any income, he relies on his assets to take care of his day to day expenses. His time horizon is short and therefore his overall risk taking capability is low.

So what could be a suitable asset allocation for each of them...

Ideal Asset Allocation for Vijay	
Asset Class	**Allocation (%)**
Equity	80%
Debt	15%
Gold	5%

Well, in case of Vijay since his overall risk taking capability is high and he has a long term time horizon, his allocation towards Equity should be the highest and lowest towards Debt. So he can invest around 80% of his investible surplus in Equity, 15% in Debt and 5% in Gold. This allocation is expected to give him high returns, but at the same time, he will have an aggressive investment portfolio. He need not be too much worried about it though, as his time horizon is long term and his investment portfolio has a lot more time to recover from the short term down turn in the equity market.

Ideal Asset Allocation for Ajay	
Asset Class	**Allocation (%)**
Equity	65%
Debt	25%
Gold	10%

In case of Ajay since his overall risk taking capability is moderate and he has medium term time horizon, he can have a mix of equity and debt with slightly higher allocation towards equity. So he could invest about 65% of his investible surplus in Equity, 25% in Debt and 10% in Gold. This allocation is expected to give him sufficient returns to achieve his future goals, with a balanced investment portfolio.

Ideal Asset Allocation for Sanjay	
Asset Class	**Allocation (%)**
Equity	20%
Debt	75%
Gold	5%

In case of Sanjay since his overall risk taking capability is low and he has a short term time horizon, he needs preservation of capital. So Sanjay should have high allocation towards Debt, slight allocation towards Equity and lowest towards Gold. So he can invest around 20% of his investible surplus in Equity, 75% in Debt and 5% in Gold. This allocation will give him low returns from a low risk investment portfolio.

This portfolio would be ideal for him as his main objective is preservation of capital rather than growth on investments, since he is not earning and dependent upon his portfolio for his day to day expenses.)

So far we have learned what asset allocation is and how ideally determining it will benefit you to diversify your investment portfolio. But before we wrap-up this session of learning, here are some points you must keep in mind while managing your finances.

Points to Remember

- **<u>Invest early</u>** (…As we have learnt in our earlier learning session, it is the early bird who gets a bigger pie. Also, as your age increases your risk taking ability reduces. So start your investments early, so that you can take the benefit of a long term time horizon and possibly even be skewed toward equity for better wealth creation.)

- (Remember if you …) **Have higher future growth in Income, it increases your risk taking ability**

- **Keep a track of your expenses** (…Avoid any unnecessary expenses; because a penny saved is penny earned)

- **Diversify your assets** (…You should not be biased towards any particular asset class. Try to diversify your investments to reduce the overall investment risk on your portfolio.)

- **Avoid excessive loans** (…They can disturb your asset allocation pattern. So ensure that you are not taking too much burden of managing excessive loans.)

- **Longer your time horizon, greater will be your risk taking capability** (…So start early with your <u>investment and adopt prudence to live a blissful and prosperous life</u>.)

Session 8: Assessing your risk appetite

We are glad to have you with us for our Eighth Session - **Assessing your risk appetite**

Alright so now let's get started.

Many of us endeavour to create wealth for ourselves and give the best to our family. Through experience we can say that when everyone wants to make a fast buck, many people often indulge in rampant trading without recognising the risks; which we think can be hazardous to their wealth and health.

You may then wonder how one can create wealth!

Well, as it is said, "Rome wasn't built in a day". It takes a long time and prudence to create something blissful. While all of us desire to become wealthy by the day, it is important to note that <u>wealth creation is a "journey"; involving process and prudence</u>.

You see, in order to create wealth you need to put your money to use, and you can do this by "investing" - and more importantly investing wisely - taking into account a host of aspects which we shall learn in our session today. Remember, even if investing does not seem exciting...it should be taken seriously.

Now let's get serious and learn the various facets that you need to take into account in the journey of wealth creation with wise investing.

Wise Investing

- **Wise investing refers to a systematic process-and-prudence-driven approach** (…unlike investing in an ad-hoc manner where you put your money to use, but without much planning involved.)

- **<u>It is not about timing the market and feeling the excitement</u>** (…one cannot always get the market timing right. People who do get aroused by the excitement of timing the markets to make quick bucks, have higher chances of getting on the wrong foot)

- **Wise investing is about disciplined investing** (…it allows you sleep better at night and not worry about whether you've timed the markets well, to make a quick buck)

You see in order to invest wisely and create wealth; a host of facets need to be taken into account, such as...

Facets to be looked into for wise investing:

- **Investible surplus**
- **Investment objective**
- **Risk appetite and Risk Tolerance**
- **Asset Allocation**
- **Diversification**
- **Inflation**
- **Cost of investing**
- **Tracking & reviewing investments**
- **Selecting an unbiased advisor**

Let's understand each of these facets in a little more detail.

Investible surplus

- **It refers to the amount of money which you are left with after having defrayed all your expenses & liabilities** (...and also after having kept aside some money as contingency fund, to take care of rainy days)

- **It is imperative to take a good look at your finances to elevate your investible surplus**

- **Ideally, invest your money first and spend what you have left ?**(...this is a much better approach than doing the things other way round; but often people indulge in impulsive buying and then have very little money to invest for it to grow...think about it!)

Investment Objective

- **Investment objective refers to the purpose for which one is investing** (...while we all desire to create wealth, we also have to recognise whether preserving capital is also one of the objectives)

- (So can we say...) **Setting an investment objective simply means ascertaining why you would like to invest**

- **Knowing the investment objective also helps in planning for your financial goals** (...which could be buying a dream home, car, travelling abroad for leisure, children's education needs, their marriage and even one's retirement needs. But through experience we can say that very often investors stumble while defining investment objectives; this in turn brings in turbulence in their journey of wealth creation.)

- **It helps you choose suitable investment instruments for your portfolio** (...with a clear investment objective you can identify the investment instruments that are suitable for you and add them to your investment portfolio)

Risk Appetite and Risk Tolerance

- **Risk Appetite refers to one's willingness to take risk** (... depending upon one's age, past experience and knowledge)

- Risk Tolerance implies ability to actually take risk which is measured by:

- **Income** (...this is an important determinant to gauge risk tolerance. So, if your income is high enough you will not mind taking higher risks while making investment decisions.)

- **Expenses** (...you see, your outgoings also influence the risk which you can afford to take while investing. You may have a high income, but if your disposable income is petite, you could be refrained from taking high risk. Hence it is imperative for you to streamline unnecessary expenses, so as to keep your financial health in the pink.)

- **Financial responsibility you are shouldering** (...which can take into account the number of dependents and whether your life goals (such as children's education and marriage needs)are to be planned for)

- **Nearness to financial goals** (...you see, if you have planned for a financial goal, the time left to achieve the goals also determines the risk that you can prudently afford to take while investing. So if you are adequately away in terms of years from meeting your financial goal, you can afford to expose your portfolio to higher risk which might enable you to create more wealth in the long term. But if your financial goal is drawing nearer, it would be more prudent for you to be a risk-averse investor to preclude wealth erosion.)

- **Whether your <u>contingency fund</u> has been built** (...meaning have you already saved for a rainy day that can enable you to take risk)

- **Whether you have <u>sufficient insurance coverage</u>** (...but mind you, while taking care of your insurance needs it is imperative to separate your insurance needs from investment needs; because buying an insurance cover is for indemnifying risk and not for investment purpose. While buying an insurance cover, you can look fora term plan.)

In order to build wealth wisely following the right asset allocation should not be missed.

Asset Allocation

- **Asset allocation essentially refers to investing your hard earned money in different asset classes such as equity, debt, gold and real estate prudently** (...which can enable you to balance your portfolio's risk and reward, keeping in mind)

- **Allocate your assets based on:**

  - Risk appetite and risk tolerance;
  - Financial goals; and
  - Investment horizon

Likewise diversification is important too...

Diversification

- **<u>Diversification</u> refers to spreading your investment in different baskets comprising various asset classes and investment instruments**

- **It is one of the basic tenets of investing**

- **Diversification helps to reduce the risk to your investment portfolio** (...and therefore most investment advisors harp on this word)

- (But...) **Diversification needs to be done wisely** (by...)

- **Diversifying across asset classes** (...such as equity, debt, gold and real estate, since all assets don't move in the same direction.)
- **Diversifying across investment avenues** (...thus, say, while your risk appetite allows you to invest into equities, you need to diversify well between stocks and mutual funds. Moreover, within stocks and mutual fund schemes too, there needs to be optimal diversification, to help you reduce risk as well as create wealth over a period of time.)
- **Diversifying across issuer of securities** (...you see, while you are building your wealth it is vital to diversify across issuer of securities or else you will be provoking risk concentration to occur. There's no point favouring only one particular issuer as it could elevate risk in your investment portfolio. It is important to keep emotions at bay and invest rationally.)
- **Diversifying across countries** (...yes, today, with resident Indians being permitted to invest in assets and securities abroad, your scope for diversification has further widened. But it is important for you to be cognisant about the global economic scenario as well - and specifically the country where you are deploying your hard earned money.)

Inflation

- **Inflation refers to the rising cost of living** (...you see, as money tends to lose its value over time due to inflation - which eats into your hard earned savings - you can counter the inflation bug and maintain the purchasing power of money for your future, by investing wisely)
- **Investments should always yield positive inflation-adjusted returns** (...which in technical terms is also known as real rate of return that you earn on your investments)

Calculated as:

Inflation Adjusted Returns = Rate of Return on Investment - Rate of Inflation

Cost of investing

- **Cost of investing refers to expenses associated with investing and holding the investments in your portfolio** (...which could be in the form of fees, loads, demat account charges, bank locker charges (in case you are investing in physical gold) or any hidden charges levied by the issuer of respective investment instruments.)
- **Cost of investing should always be low** (...this will enable you to earn a better rate of return on your portfolio and prevent blunders like getting into high cost products.)

Tracking & reviewing investments

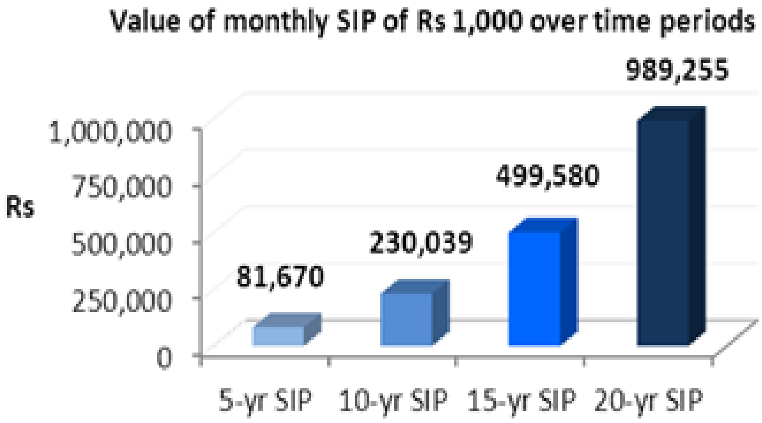
- **Tracking investments refers to monitoring your investments** (...regularly)
- **The frequency could be once a quarter** (...and need not be done everyday, if you have adopted prudence while investing.)
- **Reviewing refers to going a step forward and taking an action to make changes to investments held by you** (...with regular monitoring and review of your portfolio, you can timely know if and where you are going wrong, and if there needs to be a call to action. You can timely take corrective measures in case any of your investments are going off track.)

Selecting an Unbiased Advisor

- **An** **<u>unbiased investment advisor</u>** **can contribute immensely** (...to your journey of wealth creation)
- **Focus on knowing his attitude and rationalisation** (...you see, if your investment advisor is focusing on promoting products that earn him high commission and has not assessed the facets which we have just discussed with you; you could be in the wrong hands. He should be transparent and advise you with enough care and prudence as he would adopt while handling his own finances.)
- **Know his educational qualifications** (...ascertain whether your investment advisor has the requisite certifications from bona fide institutions. But merely relying on the certifications too isn't enough as one needs to delve a little deeper into the philosophy (attitude and rationalisation) and research process which he adopts while advising clients.)
- **Judge his infrastructure and value added services** (...this will help you gauge whether your investment advisor is able to service you better in the future.

Role of Discipline in Wise Investing

- **Discipline in investment is vital in wise investing** (...you should inculcate discipline in your investing. Adding discipline helps you invest regularly and may not let you deviate from your objective)
- <u>Systematic Investment Plans (SIPs)</u> can work for you (SIPs offered by mutual funds help you invest regularly)
- **SIPs enforce a disciplined approach towards investing**(...which is needed in the journey of wealth creation.)
- **Aids in maintaining regularity in investing** (...which is indeed needed to aid compounding of invested amount)
- **Disciplined investment via SIPs offer following benefits:** (...such as...)
    - **Light on your wallet as it allows you to invest in small specified denominations regularly** (...instead of lump sum investing, which some might find heavy.)
    - **Makes market timing irrelevant** (...in fact it helps you manage the integral volatility of the markets better. You see, timing the markets, apart from requiring full time attention, also requires expertise in understanding economic cycles and market scenarios, which you may or may not possess.)
    - **Power of compounding** (...as mentioned earlier, since SIPs facilitate regular investing; it enables your invested money to compound well at a said rate of return.)
    - **Rupee cost averaging** (...meaning it allows you to buy more units when prices are low and, similarly, buy fewer units when prices are high. This infuses good discipline since it forces you to commit cash at market lows, when other investors around you may bewary and exiting the market. It also enables you to lower the average cost of your investments.)
    - **The longer you choose the SIP tenure the better it is** (...take a look at the chart here...)



The rate of return is assumed at 12% p.a. and is for illustration purpose only.

Preferably start early- because an early bird always gets a bigger pie!
Here take this example which we explained earlier in our 1st session as well.

Particulars	**Vijay**	**Ajay**	**Sanjay**
Present age (years)	25	30	35
Retirement age (years)	60	60	60
Investment tenure (years)	35	30	25
Monthly investment (Rs)	7,000	7,000	7,000
Returns per annum	10%	10%	10%
Sum accumulated (Rs)	2,65,76,466	1,58,23,415	92,87,834

Here Vijay, Ajay and Sanjay want to retire at the age of 60 years. Vijay being the smarter of the lot, started planning for his retirement at the very young age of 25 years and invested Rs 7,000 per month - Ajay realised the importance of planning for retirement once he was 30, while Sanjay started investing only when he was 35 - and you see what they accumulated when they were on the verge of their retirement.

Investment mistakes you should avoid!

So now that we have recognised what wise investing is all about, here are some common investment mistakes which you should clearly avoid!

- **Investing without a plan** (...Remember, wise investing is beyond a 3-step process of getting hold of an investment agent, filling up an application form and signing a cheque. Investing without a plan or an investment objective can be hazardous to your wealth. And mind you, segregating your financial goals into short-term, medium-term and long-term, will help you invest in a systematic way.)

- **Not Diversifying well** (...if you disregard this very basic tenet of investing, you could be in for trouble, as you are inviting more risk to your investment portfolio. While you may do well, during a run-up of a specific asset class, your portfolio may get battered during turbulence and downturn of the capital markets. Therefore it is vital that you don't put all your eggs in one basket.)

- **Ignoring related risk** (...you see, simply investing in an ad-hoc manner because the investment instruments are fetching higher returns or because your friends and families recommend, is not a prudent approach. It is imperative to recognise the risks which respective investment instruments carry and assess them in context to your risk appetite and risk tolerance.)

- **Getting married to your investments** (...This is a very common mistake which many people make. It is vital to be objective and review your portfolio at regular intervals to take corrective actions wherever required. Emotional attachment sometimes may not be good for your financial health.)

- **Timing the markets** (...While timing the markets is the mantra chanted by many and may sound exciting; it may not always create wealth for you. Remember a trader is only good until his last trade, as you don't know what the future has in store for you - good, bad or ugly. Let us apprise you that trading and timing the markets, can be hazardous to your wealth as well as health.)

Some Key Take Away Points!

- **Do not rush with investing** (...undertake thoughtful research by doing a holistic study)

- **Investing is a serious business** (...in fact it may seem boring and not exciting)

- **Have an investment objective in place** (...this will help you clearly define what you expect and thus identify the appropriate investment avenues)

- **Know your risk appetite and risk tolerance and then invest in suitable investment avenues**

- **Stick to your asset allocation** (...and timely rebalance if required)

- **Do not speculate or time markets** (...trading and timing the markets can be hazardous to your wealth as well as health)

- **Never use contingency funds to invest** (...Remember, they are put aside as part of your savings to take care during emergencies)

- **Do not rule out inflation factor while investing** (...after all the rate of return you earn on your investment has to outpace the inflation bug)

- **Never invest with borrowed funds** (...except in case of investing in real estate and business; but again while investing therein don't go beyond your means)

- **Know your investment product well** (...understand how it works and undertake research; recognise the risk-reward relationship the product offers and also the tax implications thereof)

- **Select an unbiased advisor** (...whom you can trust while investing your money)

- **Diversify** (...Remember, this can help you reduce your risk to your overall investments if you diversify wisely)

- **Track and review your investments** (...so as to take corrective measures wherever required)

Session 9: Making Productive Investments

We are glad to have you with us for our Ninth Session - **Making Productive Investments**

Alright so now let's get started.

We strive hard all our life to make money so that we can fulfil our dreams and that of our family.

And in order to fulfil these dreams, we often invest the money we save. While that's a good habit and one should continue with it; the question is, "are you making productive investments?"

You see, investments need to be made prudently, so as to yield fruitful returns for you, or else your dreams could be farfetched and not turn into reality. While in one of our earlier sessions we introduced you to various asset classes - equity, debt and gold; in this session, we'll take you through how to make productive investments.

Let's first quickly brush-up through some important points we have already learnt in our earlier learning sessions.

What is Savings?

In simple terms savings means…

- **The money left with you after paying for all your expenses and liabilities** (…Therefore your unspent income results in your savings. To put it simply…)

Savings = Income - All expenses (including obligations towards borrowed money)

But the question is, can savings alone be sufficient to fulfil your dreams?

The answer is a very simple NO!

If saving was sufficient enough to fulfil your dreams, then there would have been no need to invest. Everyone would have kept their savings in their lockers. But the hard truth is that your savings will lose its value if you don't invest...and more importantly if you do not invest wisely!

So now let's have a look at what is investing...

What is investing?
Investing means...

- **Productively utilising your savings with an expectation of earning return over and above the rate of inflation.**

Investing is a...

- **A process of making your savings work for you** (…instead of simply stacking it in your vault or bank locker.)

Now we all know that you need to invest your savings, but the question arises, where?

Well, here are some of the investment avenues where you can invest your savings...

Some Well-known Investment Avenues

(Asset Class wise…)

1. **Equity** (…It simply entitles you to become one of the shareholders of the company, so you have a share in both company's profit and losses. Equity investing offers you an opportunity to earn income in the form of dividend distributed by the company or in the form of long term capital appreciation. But do not forget equity investing carries high risk as well.)

2. **Debt** (...The way you take a loan from a bank and pay interest on it, the same way the bank or any other financial institution borrows money from you and pays you interest. So the money you lend someone for earning an interest income is your investment in debt. Debt investing is safer than equities but it does carry some element of risk.)

3. **Gold** (...It is a precious metal and used not only to make gold ornaments but also to preserve value of money, as it is considered a hedge against inflation. The value of your investment in gold may change based on the prevailing market value of gold, but it does not offer you any regular flow of income.)

4. **Real Estate** (...Today, when we talk about real estate we not only talk about a house to live in (or primary home), but also approach it as an investment which can provide us price appreciation and / or rental yields.)

You see, knowing the asset class is as important as knowing which asset class suits your requirement the best. This is because all asset classes have their share of pros and cons, and hence it becomes imperative to know each of them on various traits, before investing your hard earned money.)

Key Points to Consider before Investing in...

(Equity, debt, gold and real estate...)

Traits	**Asset Classes**			
	Equity	**Debt**	**Gold**	**Real Estate**
Return	High [Capital Appreciation & Dividend Income]	Low [Interest Income]	Medium [Capital Appreciation]	Medium to High [Capital Appreciation & Rental Income]
Risk	High	Moderate To Low	Moderate	High
Liquidity	High	Medium	Medium	Low
Taxation*	STCG# - Taxable LTCG## - Non Taxable	Interest Income-Taxable	Capital gains-Taxable	Capital gains-Taxable Rental Income-Taxable
Suitability	For long term Investors having high risk appetite	For short term Investors having low risk appetite	For long term Investors having moderate risk appetite	For Long term Investors having high risk appetite

#: Short Term Capital Gain Tax
##: Long Term Capital Gain Tax
* As per current tax laws. Please consult you advisor for implications of the investment/participation in the aforesaid asset classes.

The table here compares the various parameters for each asset class we just talked about.

You see, while equity offers you opportunity to earn high returns, it comes with high risk. It offers you high liquidity and favourable tax status as well. Thus if you have high risk appetite with longer time horizon, then this asset class may be suitable for you.

While if you are conservative, then you might feel like investing only in debt as it has a low risk status. But do not ignore the other aspects of investing in debt - like taxation, liquidity etc. The interest income is taxable. Moreover, with low returns clocked by debt instruments, you may not be able to beat the inflation rate thereby eroding the purchasing power of your money.

Gold on the other hand has the ability to offer capital appreciation, but at times it may be risky.

Real estate should be considered primarily for your own dwelling and then for investment. Though it involves high cost and low liquidity, it offers you an opportunity to earn a second income in the form of rent.

So as we said earlier, you should make your investments prudently. If you are unable to beat the inflation rate, then you may end up eroding the purchasing power of your money.

Now you may be wondering how you will lose the value of your money; so to understand it better, let's take an example...

Can You Fulfil Your Desire?

Cost of your Favourite Car today = Rs. 5 lakh

Assuming Inflation @ 10% p.a.

Cost of your Favourite Car after 1 year = Rs. 5.50 lakh

(Inflation @ 10% p.a. is used for illustrative purposes only)

Say your desire is to own the latest model of a car, which costs Rs 5 Lakh today. But you decide to wait for 1 year and then purchase it. Mind you, if inflation grows at the rate of 10% p.a., the cost of the car you dreamt of owning may move up to Rs 5.50 lakh. So to fulfil your desire of owning this car, you need to have Rs 5.50 lakh after 1 year.

Your Investment in a Fixed Deposit for 1 year = Rs. 5 lakh

Expected Rate of Interest = 8% p.a.

Maturity Value of Fixed Deposit after 1 year = Rs. 5.40 lakh

(Rate of interest of 8% is used for illustrative purposes only)

Say you have a saving of Rs 5 Lakh. Now since you are planning to buy your favourite car next year, you choose to invest your savings of Rs 5 lakh in a bank fixed deposit earning interest at the rate of 8% p.a.

But at maturity - a year later - your money in the fixed deposit will have grown to just Rs 5.40 lakh while the cost of your favourite car will be Rs. 5.50 lakh in that year. So you may end up with a deficit of Rs. 10,000... and not to forget, after paying the applicable taxes on your interest income, the money in your hand will reduce further.

It means the car which you could have bought today, may be worth more than the amount you may have after 1 year... In simple words, if you do not make productive investments, the value of your money or we can even say the purchasing power of your money will decrease with time.

Now let us move a little further...

How to Achieve Long Term Financial Goals?

Asset Allocation (...Asset Allocation is a very important strategy when it comes to well thought out Investing. Investing with a prudent asset allocation will help you appropriately plan your finances and make sure that you earn the desired result after investing a certain percentage of your money in each asset class.)

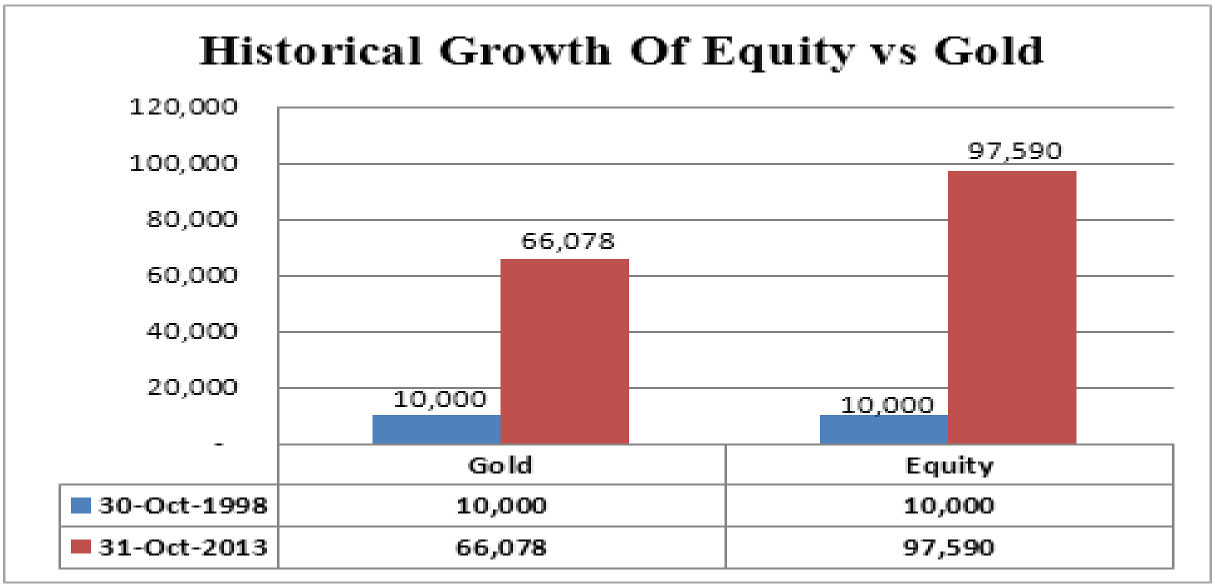
Diversification (...By diversifying your investment, you will choose to invest not only in 1 type of asset class, but different asset classes and even different types of instruments within a particular asset class. Diversification will effectively help you reduce the risk on your overall investment portfolio.)

Power of Compounding (...For your money to multiply manifold, you need to invest for longer periods. The higher the returns and longer the time horizon, the higher will be the compounded growth of your investment.)

To understand productive investment better, let us see the historical growth of two popular asset classes equity and gold.

Now let's see how equity and gold have performed over a period of 15 years to have an idea of which asset class performs the best in the long run.

Investing Wisely Helps!



Note1: The value of equity investment is derived from the performance of S&P BSE Sensex - TRI,
Note2: While the value of gold investment is derived from the performance of Gold-London AM (INR)
Past performance may or may not be sustained in the future.

The graph here shows that if you had invested Rs. 10,000 each in Equity and Gold on 30-Oct-1998, then the value of your investments in gold and equity would have been Rs. 66,078 and Rs. 97,590 respectively as on 31-Oct-2013...

It means that over a period of 15 years your returns in Gold would have grown at the compounded annual growth rate of around 13% while your investment in equity would have grown at the compounded annual growth rate of around 16%. So your investment in equity would have outperformed gold by around 3% p.a.

Not all asset classes have the potential to deliver inflation beating returns in the long run. So in order to make productive investment, you need to choose your asset class wisely. Or else you may not be able to even beat the rate of inflation and loose the purchasing power of your money, thus missing out on some of your important financial goals.

So What do we Understand?

Equity - One of the Best Asset Class in the Long run Even though you might see some ups

and downs in equity in the short run; over the long run it tends to outperform all other asset classes. You can earn income via dividends as well as capital appreciation.
In the long run, equity helps you earn a return better than the inflation rate, which means your money should actually grow at a better pace rather than depreciate.

Debt - Preferred Asset Class in the Short run
Debt might not be able to give you high returns and may not have the potential to beat the rate of inflation; but it may make sure that your principal amount is protected against market volatility (on the condition that you hold it till maturity). It offers you a regular flow of income but at lower rates. So if you are looking to park your safe money for a shorter time period, then debt will be an ideal asset class.

Gold - An Asset Class to Preserve the Value of Money
Gold is considered as a hedge against inflation and will help you preserve the value of your hard earned money. It may not help you with a regular flow of income.

Real Estate - An Asset Class to serve your Basic Needs first
If you plan to buy a self-occupied house then anytime is a good time, as purchasing a home is more an emotional need rather than an investment. You should not consider real estate as a preferred investment asset class unless it fulfils your own basic need for shelter. It is best to ignore your self-occupied house as your investment. The other property that you hold may however be considered for regular flow of rental incomes or capital gains.

Finally before we wrap up today's learning session, here are some points you must keep in mind to make productive use of your investments...

Points to Remember

- **Just investing your savings is not enough. You should invest wisely!** (…As inflation will reduce the purchasing power of your money, you should be making productive investments, which can counter inflation better and create wealth for you to meet your long term financial goals.)
- **Know the pros and cons of the asset class before investing** (…Merely investing in an ad-hoc manner, may not be good for your long-term financial well-being.)
- **Less risky assets may not be able to beat the inflation rate** (…So to earn positive real rate of return, asset allocation and diversification is necessary.)
- **Equity has potential to generate high returns in the long term** (…Please note that, even though equity will show some volatility in the short term, in the long term it may counter the inflation rate and potentially give you a better positive real rate of return.)
- **Debt is suitable in the short term** (…Invest in safe debt instruments if you are investing for the short term and safety of principal is your main priority. Do not forget, not all debt investments are safe.)
- **Gold is considered a hedge against inflation** (…It will preserve the value of your hard earned money, but may not offer you any flow of income.)
- **Real Estate should fulfil your basic needs first** (…Consider real estate for investment only after having one to meet your basic need like shelter.)

Session 10: Introduction to Mutual Funds, its benefits and Regulatory structure

We are glad to have you with us for our Tenth Session - **Introduction to Mutual Funds, its benefits and Regulatory structure**

Alright so now let's get started.

Many investors at times are absolutely fascinated about investing in mutual funds. But, in our opinion mere fascination is not enough. Investing wisely and with the right insight, helps one make the right investment decision. If you do not have the right perspective, mutual fund investing could be a challenge. If you are not cautious, then you could easily go down the wrong path, reaching an unwanted destination.

Hence, it is imperative that you understand the various aspects about mutual fund investments. And from this session we start guiding you on various aspects that you should know when it comes to mutual fund investing.

So let's start with understanding the term called...

Mutual Funds

A mutual fund is a legal vehicle that enables a collective group of individuals to:

- (Create various...) **Pools of Investment** (...by pooling their surplus money and collectively invest in stocks, bonds and other securities for a common investment objective.)

- **Each Pool of money is called a Mutual Fund Scheme** (...which may have different investment objectives based on investors' need and preference.)

- **Mutual funds assist in Earning Income or Building Wealth** (...This is a primary investment objective which is achieved by participating in opportunities available in various securities and markets.)

- **Utilise the Knowledge and Experience of a Professional Fund Management Team** (...A capacity that individual investors may not possess.)

- **Benefit from the Economies of Scale** (...As facilitated by large size of the pool; which otherwise may not be available to you as an investor on an individual basis.)

So investing in a mutual fund is like an investment made by a collective group of individuals, who may have a lesser amount of money at their disposal, than say a group of friends put together.

So, to simply put, a mutual fund is the money pooled in by a large number of investors and offers an opportunity to invest in a diversified and professionally managed basket of securities at a relatively lower cost.)

Why Should You Invest in Mutual Funds?

- (They are...) **Easy to Understand** (...If you are aware of the broader asset class where mutual funds invest your money, you could easily understand your mutual fund scheme.)

- (They enable you...) **To Earn Income or Build Wealth** (...Mutual funds are a simple tool, that can help you easily allocate your money across various asset classes such as Equity, Debt or Gold; based on your objective or planned allocation. Mutual funds offer various avenues to invest in such as regular income generating debt instruments, or build wealth through investing in equity instruments.)

- (They...) **Offer Choice of Various Categories of Schemes** (...under each asset class, to suit your investment objective and varying needs for various financial goals.)

- (Help you...) **Access to Ready Investment Portfolio and Past Track Record** (...As mutual funds invest in and build a portfolio of securities, you as an investor can know where your money is invested. The past performance track record of the mutual fund scheme can help you judge and compare the mutual fund scheme vis-à-vis its benchmark index and peers, before investing.)

- **For Regular and Disciplined Investing** (...Systematic Investment Plan (SIP) offered by Mutual Funds facilitates investing regularly. Via SIPs you can commit a portion of your 'money saved', every month or quarter, towards your financial goals. It inculcates financial discipline and may even help you in long term wealth creation.)

- **Help You Render Service of Investment Professionals** (...It is worth mentioning that through Mutual Funds you can easily render the services of investment professionals at a relatively low cost, irrespective of the size of your investment portfolio. As many of you may not be well-equipped to closely track the developments in the markets and draw its impact on your portfolio holdings; the professional fund manager will do the same for you.)

What do you get as a Mutual Fund Investor?

- **Status of a Unit holder in the Scheme** (...When the investor invests money in a mutual fund scheme, in return, he receives "Units" of the scheme. You as a mutual fund investor will hold units of the respective mutual fund schemes. The number of units held by you basically represents the fraction of the fund that you hold, based on your investment amount.)

- **Unit Certificates or Statements of Accounts** (...As a mutual fund unit holder, you receive unit certificates or statements of accounts confirming your title in the respective mutual fund scheme. You can store it as a proof of your investment and refer to it for details like folio no., balance units, holding status etc. for future transactions.)

- **Share in Gains or Loss in Value of the Mutual Fund Scheme** (...Any increase or decrease in market price of the underlying instruments impacts the asset value of your mutual fund scheme and so the value of your mutual fund investments. The post expense profits due to appreciation in value or loss due to depreciation in value is passed on to the unit holders in the proportion of the number of units held by each investor.)

So what are the...

Benefits of Investing in Mutual Funds

- **Diversification** (...By putting your money into just a few stocks, you can subject yourself to considerable risk. Any major decline in a single stock can have an adverse impact on your investments, damaging the returns of your portfolio.

  A mutual fund, by investing in several stocks, tries to overcome the risk of investing in just 3-4 stocks. By holding, say 25 to 30 stocks, the mutual fund avoids the danger of one rotten apple spoiling the whole portfolio. A diversified portfolio of a mutual fund may fall to a lesser extent, even if a few stocks fall dramatically. Also, a mutual fund's NAV may certainly drop; but mutual funds tend to not fall as freely or as easily as stocks.)

- **Professional Management** (...Active portfolio management requires not only sound investment sense, but also considerable time and skill. By investing in a mutual fund, you as an investor do not have to track the prospects and potential of the companies in the mutual fund portfolio. This is already being done for you, by skilled professionals appointed by the mutual fund houses. These are the professionals whose job is to continuously research and monitor these companies, and take appropriate measures for the benefit of the investors.)

- **Lower Entry Level** (...There are very few quality stocks today that investors can buy with Rs 5,000 in hand. This is especially true when valuations are expensive. Sometimes, with as much as Rs 5,000 you can buy stocks of just a single company. In the case of mutual funds, the minimum investment amount required is as low as Rs 500. This is especially encouraging for investors who start small and at the same time take exposure to the fund's portfolio of 25-30 stocks.)

- **Economies of Scale** (...By buying a handful of stocks, the stock investors lose out on economies of scale. This directly impacts the profitability of their portfolio. If you as an investor buy or sell actively in stocks, it may impact your profitability. On the other hand, in case of mutual funds, frequent voluminous purchases/sales results in proportionately lower trading costs than individuals, thus translating into relatively better investment performance.)

- **Flexible and Innovative Plans for Investors** (...Mutual Funds offer various innovative plans like Systematic Investment Plans (SIPs), Systematic Transfer Plans (STPs), Systematic Withdrawal Plans (SWPs), Asset Allocation Plans, Trigger plans etc. As these plans can help you systematically invest or withdraw funds according to your needs and convenience, they can be effective as a tool for you to efficiently manage your portfolio from a financial planning perspective too.)

- **Liquidity** (...The best feature your investments can offer is the access to your money when you need it the most. Mutual funds can offer the much required liquidity while investing. In case of an open-ended fund, you can buy/sell at that day's NAV by simply approaching the fund house directly, or by approaching your mutual fund distributor, or even by transacting online - and you can get your money back generally within 3-4 working days.)

- **Transparency** (...You may not be always comfortable when it comes to handing over your money to someone else. You need to know what is happening with your money.

  In the case of Mutual Funds, your money is handed over to investment professionals, whose job is to keep track of developments in the markets and look out for the best opportunities for you. Moreover the monthly factsheets published by mutual funds can help you keep regular track and know the facts about the scheme in which you have invested. It provides you the holding details of the scheme in which you have invested your money, % of exposure in top ten companies, the ratings of debt instrument in your portfolio, fund managers' name, performance data etc. Apart from this, the NAVs are disclosed by fund houses may help you know the current value of your investments.)

- **Well Regulated Structure** (...All Mutual Funds are registered and monitored by the regulatory body, SEBI. Mutual Funds have to function as per the regulations designed to protect the interests of investors. So you need not worry much about your investment in mutual funds being in safe hands.)

So on account of the advantages which mutual funds offer, they have emerged as an immensely popular investment avenue, especially for retail investors, and for investors looking to build wealth over time.

Now let us see, what is the...

Regulatory Structure of Mutual Funds in India

- **Securities and Exchange Board of India (SEBI) is the Regulatory Authority** (...for the Indian Mutual fund industry.)

- **SEBI aims to Protect the Interest of Investors** (…and in order to do so, SEBI has consistently introduced several regulatory measures.)

- **It has framed SEBI (Mutual Funds) Regulations, 1996** (…which is the principal regulation for the Mutual fund industry in India.

As the regulator of the Indian capital market, SEBI had framed its first mutual fund regulations in 1993. In these guidelines SEBI expressed the need for creating a compliance mechanism for the functioning of the mutual fund industry. These regulations were revised and enlarged subsequently in 1996.)

SEBI (Mutual Funds) Regulations, 1996

To understand the legal structure of mutual funds in India, let us take a look at how the SEBI (Mutual Funds) Regulations, 1996 has defined mutual funds:

SEBI (Mutual Funds) Regulations, 1996 defines "mutual fund" as:

"Mutual fund" means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments or real estate assets. - *Source: Sebi.gov.in*

So what are the…

Key Features of a Mutual Fund as per its

Defined Structure

- **Mutual Fund is established in the form of a Trust**

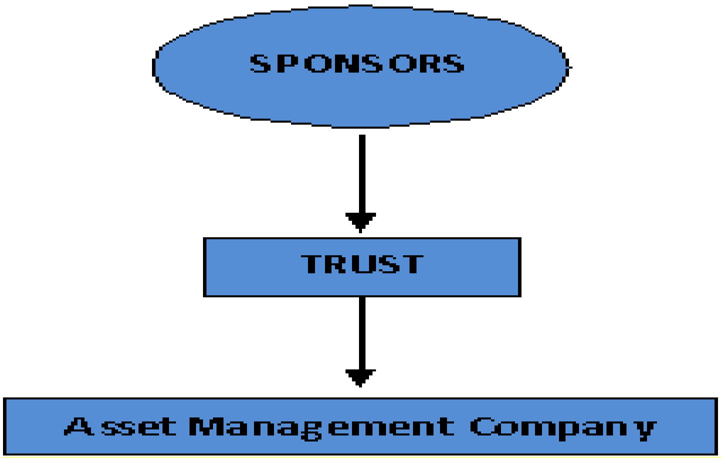
- **Mutual Funds Raise Money through Sale of Units to the Public** (…or a section of the public under one or more schemes.)

- **Mutual Fund Schemes can Invest in Various Securities** (…They can invest in various securities like equity, debt, money market instruments and gold or gold related instruments as well as real estate assets.)

Now let's learn what are the…

Key Constituents of a Mutual Fund

When we talk about the constituents of a mutual fund, the Indian mutual fund industry follows a 3-tier structure as shown here:



Let's understand each of these in detail:

- **Sponsors**
  Sponsors are the individuals or entity who initiates the process of formation of a mutual fund. For registration of a mutual fund, the Sponsor approaches SEBI. Not everyone can start a mutual fund. SEBI grants permission to start a mutual fund only to a person of integrity, having sound track record and reputation, having significant experience in the financial sector, a certain minimum net worth etc. Sponsors are the main people behind the mutual fund formation.

- **Trust**
  Once SEBI is satisfied with the credentials and eligibility of the proposed Sponsors, the Sponsors then establish a Trust under the Indian Trusts Act, 1882. Trustees are the individuals/entity authorized to act on behalf of the Trust. Contracts are entered into in the name of the Trustees. Once the Trust is created, it is registered with SEBI, after which, this Trust is known as the mutual fund. Trustees have a significant role in ensuring that the mutual fund complies with all the regulations and protects the interest of the investors.

- **Asset Management Company (AMC)**
  The Trustees then appoint the AMC, which is established as a legal entity, to manage the investor's (unit holder's) money. The AMC handles the day to day operations and money management. In return for this money management on behalf of the mutual fund, the AMC is paid a fee for the services provided. This fee is borne by the investors and is deducted from the money being managed. Also in all its investment decisions, AMCs are required to exercise due diligence and care.

Before we move ahead, let us tell you about an important body in the mutual fund industry.

Association of Mutual Funds in India (AMFI)

- (AMFI is...) **An Industry Body Created to Promote the Interest of Mutual Funds in India**

- **All AMCs in India are Members of AMFI**

- (Its role is to...) **Maintain High Professional and Ethical Standard** (...in all areas of operations of the mutual fund industry.)

- (To maintain ethical standards...) **AMFI has set up 'AMFI Code of Ethics'** (...which is to be followed by all AMCs.)

- (AMFI has also set...) **AMFI Guidelines & Norms for Intermediaries (AGNI)** (...which are the guidelines and norms for the mutual fund distributors.)

- (So…) **AMFI Recommends and Promotes Best Business Practices and Code of Conduct** (…which need to be followed by members and entities engaged in the mutual fund activity in India.)
- **AMFI Interacts with SEBI and Represents the Indian Mutual Fund Industry** (…to SEBI, Government, RBI and other bodies on all matters pertaining to the Indian mutual fund industry.)

Also there are some…

Other Service Providers in Mutual Fund Industry

- **Custodian** (…Custodian is an entity appointed by the mutual fund to hold the custody of the assets of a mutual fund scheme. The custodian needs to accept and give delivery of securities for every purchase and sale transaction by a mutual fund scheme.)
- **Registrar and Transfer Agent (RTA)** (…RTA is an entity registered with SEBI, and is appointed by the AMCs for handling the documentation and maintaining the records of the mutual fund investors. While many AMCs appoint RTA to handle transactions, some AMCs handle this activity in-house.)
- **Auditors** (…The accounts of mutual fund schemes need to be regularly audited by independent auditors. As per guidelines, the auditors appointed for audit of the scheme accounts need to be different from the auditor of the AMC.)
- **Fund Accountants** (…AMCs need to publish the Net Asset Value (NAV) of all mutual fund schemes on a regular basis. This role of calculating the NAV of all mutual fund schemes is performed by the fund accountants.)
- **Mutual Fund Distributors** (…AMFI registered Mutual Fund Distributors play a role in selling suitable mutual fund schemes to the investors. To be eligible for distribution activity, Mutual fund distributors need to pass the prescribed certification test and get registered with AMFI.)
- **Collection Bankers** (…AMCs appoint collection bankers for accepting application forms for the schemes.)

So far we have learned about mutual fund and its benefits, its constituents and the regulatory framework set for the mutual fund industry, which is aimed for the protection of investor interest. Now let us quickly wrap-up this session by reviewing some important points about mutual funds, that you must keep in mind)

Points to Remember

- **Mutual funds are established in the form of a Trust**
- **Mutual funds are collective investment vehicles** (…They mobilize money from investors and invest in various securities and asset classes.)
- **Mutual funds assist investors in earning income and building their wealth** (…by investing in various asset classes like equity, debt, gold etc.)
- (…Based on the invested money) **Mutual fund investors get a proportionate share in a mutual fund scheme and are called unit holders**
- **Any Profit or Loss made by a mutual fund scheme is proportionately shared by the unit holders**

- **Mutual funds offer several benefits** (…like Diversification, Economies of Scale, Professional Management, Transparency, Liquidity etc.)

- **SEBI is the regulatory authority for the Indian mutual fund industry**

- **SEBI aims to protect the interest of investors** (…and has framed the principal regulation for the mutual fund industry in India.)

- **Sponsors are the individuals or entity who initiate the process of formation of a mutual fund**

- **Trustees of the mutual fund appoint the AMC** (…to handle the day to day operations and money management.)

- **AMFI is an Industry Body created to promote the interest of the Mutual Fund Industry** (…The role of AMFI is to maintain high professional and ethical standard in all areas of operations of the mutual fund industry)

Session 11: Some Myths About Mutual Funds

We are glad to have you with us for our Eleventh Session - **Some Myths About Mutual Funds**

Alright so now let's get started.

In one of our earlier learning sessions we learnt that mutual funds are an effective engine to route your investments in the securities market. <u>They (mutual funds) offer several advantages over direct stock picking</u>; such as… diversification, professional fund management, lower expenses, economies of scale, liquidity, etc. But despite all of this, very often we see investors surrounded by myths about investing in mutual funds.

In a world filled with information, we do recognise that many of us develop our own set of beliefs and judgements. But it is vital to recognise, whether we are living in plain truth or delusions.

In this session of Money Simplified, we would like to clarify some of the common myths on investing in mutual funds and endeavour to make you more informed, so that you can take prudent investment decisions.

You see, our experience shows that, the myths which many investors have about investing in mutual funds can be classified into 2 parts:

- Myths based on Incorrect Beliefs
- Myths based on Incorrect Facts

So let's understand each of them in detail…

Myths based on Incorrect Beliefs

1. **Mutual Funds Lack the Excitement**
   Myth Clarified: The excitement can be done away with for long-term wealth creation through mutual funds.

   (…This is the common discourse that, which many have about investing in mutual funds. They say, they are dull and boring. Well, mutual funds may lack the excitement of the stock market, but it's the kind of excitement that investors can do without for the long-term health of their wealth. Mutual funds may not give an impetus to the investor's portfolio, in a bull run, like some 'exciting' stocks do. But you may be cushioned better, during the downside in the markets.)

2. **Mutual funds are too Diversified**
   Myth Clarified: In fact diversification helps to reduces risk, while a concentrated portfolio elevates risk.

   (…Many investors believe that a stock portfolio of 8 to 10 stocks will generate a more attractive return than a mutual fund - which may hold more number of stocks. Many may argue that seasoned investors successfully manage a small portfolio over a long period of time. But, not too many investors can claim to have investment discipline, insight and experience. You see, a concentrated portfolio adds risk, while a well-diversified portfolio, mitigates risk.)

3. **Mutual funds are Expensive**
   Myth Clarified: In fact they reduce your cost of investing

   (…Mutual funds on an average charge 2.25% to 2.50% of the daily net assets as a recurring expense which go towards meeting expenses like brokerage costs, custodial costs, fund management cost, etc. But some of these expenses are incurred by you as stock investor as well. In fact if you are frequently churning your stock portfolio; as an investor you are eventually paying much more.)

Myths based on Incorrect Facts

1. **A Mutual Fund Scheme Invests in the Same Stocks as its Benchmark Index**
   Myth Clarified: The benchmark index only serves the stated purpose i.e. benchmarking returns. It offers investors the opportunity to evaluate the fund's performance. It need not always construe that an actively managed mutual fund scheme would invest in stocks that form a part of the benchmark index.

   (…A number of investors believe that a mutual fund always invests in the same stocks that constitute its benchmark index. For example, if the S&P BSE Sensex is the benchmark index for a fund, then it is expected to invest in the same 30 stocks that form the S&P BSE Sensex. This is true only in the case of index funds i.e. passively-managed funds that attempt to mirror the performance of a chosen index. In all other cases, i.e. in actively managed funds, the fund manager is free to invest in stocks from within or outside the benchmark index.)

2. **Mutual Funds Invest up to 35% in Debt**
   Myth Clarified: While such an allocation may form a part of the investment mandate of equity mutual funds, they may not use the mandate in a stricter sense to invest in debt

   (…In other words, the intention is to be a 'true blue' equity fund that is almost entirely invested in equity instruments at all times. They usually invest a diminutive portion in debt and / or hold cash; but not always to the tune of 35%, with the intention of curbing losses in a falling equity market. So clearly, benefiting from investment opportunities in the debt markets by being invested therein at all times, is not the intent.)

3. **Funds with more Stars/Higher Rankings Provided by Independent Third Party Agencies make better Buys**
   Myth Clarified: At best, rankings and ratings can serve as starting points for identifying a broader set of "investment-worthy" funds; but they are not the end to picking winning mutual funds.

   (…Fund rankings and ratings have gained popularity over the years. A higher ranking/rating is construed as a sign of the fund being a good investment avenue. Often many investors pick mutual fund schemes for their portfolio based on rankings and ratings assigned to them.

   But sadly, what investors fail to realise is that often rankings/ratings are based on the past performance of the funds. Most ratings do not provide adequate weightage to the qualitative aspects of analysing mutual funds such as portfolio characteristics, fund expenses, proportion of AUM actually performing, fund manager's experience and number of schemes managed by them, investment processes & systems, amongst others.

Secondly, rankings/ratings are known to change over a period of time, in line with a change in the fund's performance. You see, fund rankings/ratings operate on the rationale that one-size-fits-all. They fail to reveal who should invest in the fund, based on risk appetite and risk tolerance.)

4. **Once the Fund House Makes the Grade, so do all its Funds**
Myth Clarified: Just because a fund house makes the grade, it doesn't necessarily mean that all its funds are worth investing in.

(...Here the proverb, "One swallow does not make a summer" is appropriate.

Investors often make the mistake of confusing the fund for its fund house i.e. they assume that simply because a mutual fund scheme belongs to a renowned fund house, it's worth investing in. Such an investment approach is far from correct. It is not uncommon to find mutual fund schemes that have either lost focus on account of persistent change in positioning or have fallen out of favour within the fund house itself, on account of their lacklustre investment themes. So, you as an investor should not be under this notion while investing in a mutual fund schemes.)

In addition to the myths we just spoke about, we will now tell you about some common myths that investors have about SIP investing.

Some Common Myths about SIP

As you may know, apart from investing in a lump sum manner, mutual funds also offer a facility to invest systematically by enrolling for a Systematic Investment Plan. There are investors, who see to have some misconceptions about investing in mutual funds via the SIP mode. For example:

1. **Only Small Investors go in for SIPs**
Myth Clarified: Please note that SIP stands for Systematic Investment Plan (SIP) and not Small Investors Plan. They infuse a disciplined investment habit of investing regularly and provide you the benefit of compounding along with rupee-cost averaging.

(... The fact is, they infuse a regular saving habit that most of us may have followed while we maintained a piggy bank; where we all saved some money every day or week or month to build a corpus at the end of a particular period, but with a market-linked rate of return earned over it, it may help you achieve your financial goals. Moreover, they provide the benefit of compounding along with rupee-cost averaging.)

2. **Rupee Cost Averaging can be done in a Stock itself - then Why SIP?**
Myth Clarified: SIP experimented on single scrip, can expose you to more volatility unlike SIP in a mutual fund scheme which reduces the risk, due to diversification provided by mutual funds.

(...As per the market capitalisation bias followed by a mutual fund scheme, you can also strategically structure your portfolio depending upon your risk appetite. Similarly, you can structure your portfolio on the basis of the market caps (viz. large cap, mid cap, multi-cap, flexi-cap etc.) or style of investing (viz. value, growth or blend style) followed by the mutual fund scheme. Thus SIP mode of investing in mutual fund schemes can provide you with diversification across style and market caps, and thus offers better rupee-cost averaging. . But it should be noted that rupee-cost averaging neither ensures you profits nor protects you from making a loss in declining markets.)

3. **SIP Mutual Fund Schemes are different from Lump sum Mutual Fund Schemes**
   Myth Clarified: The fact is SIP is just the mode of investing. There are no special mutual fund schemes for SIP investments.

   (…All you need to do is select mutual fund schemes prudently for your portfolio, which may help you with better returns in the long run.)

4. **Lump sum Investments cannot be done in a Mutual Fund Scheme, where a SIP account exists**
   Myth Clarified: (…As mentioned earlier) SIP is just the mode of investing. Hence investing a lump sum amount to a mutual fund scheme where your SIP exists is possible.

   (…So say, you have an SIP instalment of Rs 1,000 per month going on in a mutual fund scheme and suddenly if you have a surplus of say Rs 50,000; then you can invest this lump sum amount to your on-going SIP account.)

5. **I'll be Penalised if I Miss one or two SIP dates**
   Myth Clarified: Since an ECS mandate is usually signed, the question of missing SIP dates doesn't arise. Also on the SIP date if you do not have sufficient funds in your bank account, you aren't penalised by the AMC; you will simply miss that SIP instalment, but your account will remain active.

   (…So it's not like the EMI on your loan, where you miss an instalment, and you are penalised.)

6. **Markets are at a Low to Start a SIP**
   Myth Clarified: Lower level markets can in fact be the right time to start an SIP and gain from future upside. Buying "low" is better than buying "high".

   (…You see, when the markets start correcting you would be accumulating more number of units, with every fall in the NAV, thus enabling you to lower your average purchase cost. And, when the markets surge once again (post the correction), you would gain, as the yield may work to be higher than the lump sum money invested at higher level. Remember, SIPs help you to manage the swings of the markets better. Therefore, don't unnecessarily try to time the markets, as it is not always possible.)

7. **In case of SIP in Tax Saving Mutual Fund Schemes, Entire Money can be Withdrawn after 3 Years**
   Myth Clarified: The fact is, your every instalment of SIP should have completed the lock-in tenure of 3 years for you to be in a position to withdraw.

   (…Very often, investors have this myth while they invest in tax saving mutual fund schemes. But as said, your every instalment of SIP should have completed the lock-in tenure. So say if you put in Rs 5,000 through SIP in the month of November 2013, the lock-in period for only 1 instalment (i.e. of November 2013) will get over or free in November 2016.)

Now that we have seen various myths about investing in mutual funds, here are some points to remember before we end our today's learning session today.

Points to Remember

- **Excitement is not good for one's investment portfolio in the long run** (…Yes, mutual funds do lack the excitement of investing in stocks, but it's the kind of excitement that you as investors can do without for your long-term wealth and health.)

- **Diversification benefit offered by mutual fund investing helps you reduce risk**

- **<u>Actively managed mutual fund schemes</u> do not necessarily invest in the same stocks as its benchmark index** (…The benchmark index only serves the stated purpose i.e. benchmarking in case of actively managed mutual funds. It offers investors the opportunity to evaluate the fund's performance.)

- **Never invest in mutual fund schemes solely on the basis of star rating / ranking** (…Star ratings / rankings can serve as a starting point, but they aren't the end to picking winning mutual fund schemes. You see, fund rankings/ratings fail to reveal who should invest in the mutual fund scheme, based on risk appetite and risk tolerance.)

- **Never invest only on the basis of fund house** (…Investors often make the mistake of confusing the mutual fund scheme for the fund house i.e. they assume that simply because a mutual fund scheme belongs to a renowned fund house, it's worth investing in. But this isn't the prudent approach to select winning mutual fund schemes.)

- **SIPs infuse regular investing habit**

- **SIPs offer the benefit of rupee-cost averaging and compounding** (…which helps you manage market volatility better as compared to stocks)

- **Mutual fund schemes for SIP investment are the same as those for lump sum investments** (…There aren't any separate mutual fund schemes for SIP investing)

- **There is no penalty for missing an SIP instalment**

- **SIP in a tax saving mutual fund scheme has a lock-in tenure for each instalment**

Session 12: Understanding Mutual Fund Offer Document and KIM

We are glad to have you with us for our Twelfth Session – **Understanding Mutual Fund Offer Document and KIM**

Alright so now let's get started...

Many investors often invest in mutual funds being convinced by the sales pitch of mutual fund distributors / agents / relationship managers. But are these sale pitches making you overlook – probably in excitement – some of the important facets for you to <u>take the right investment decision in congruence to your risk profile</u>?

You see, simply getting swayed by tall claims in pursuit of getting wealthier, is not the right approach to investing. You ought to take enough responsibility, and be cognisant while investing in mutual funds, so as <u>to make a wise investment decision</u>. Just as you compare the features of a gadget or the latest smart phone you wish to buy, it is imperative for you while investing in mutual funds as well, to read the Statement of Additional Information (SAI), Scheme Information Document (SID) or at least the Key Information Memorandum (KIM) before you invest your hard earned money in pursuit of earning returns and becoming wealthy.

We often read what interests us. It may be a magazine, a novel, or it may be just newspapers. But when it comes to investing, it becomes imperative to adopt the art of reading portions of the SID (Scheme Information Document) or KIM (Key Information Memorandum) that are important and will help you make an appropriate investment decision

This session of our learning initiative does exactly that; by educating you on important areas or portions of the SID which you should focus on and understand well, before investing your hard earning money in a particular scheme.

So let us understand each of these areas or portions of the SID in detail; but before that let's understand what is meant by mutual fund offer document.

Mutual Fund Offer Document

Meaning: Offer document or a prospectus from a mutual fund house is a document offering its scheme(s)to the public for investing. Offer document consists of two parts i.e. Statement of Additional Information (SAI) and Scheme Information Document (SID).

- (While...) SAI contains all statutory information of the Mutual Fund house
- SID carries important information about the scheme(s) such as their investment objective, asset allocation pattern, investment strategies, risk involved, benchmark indices for respective scheme(s), who will manage the scheme(s) and fees & expenses; amongst a host of others for making an informed investment decision.

Both SID and SAI are prepared in the format prescribed by SEBI and submitted to SEBI. The content of the document needs to flow in the sequence prescribed in the format. In addition the mutual fund is permitted to add any disclosure which it feels is material for the investor.

What to read in a Scheme's Information Document

- **Investment Objective** (...You see, every mutual fund scheme has an 'investment objective' and it is important to know the same before investing your hard earned money. The investment objective explains the aim behind launching a particular mutual fund scheme and how it will be attained. Apart from this, most importantly it clears the doubt created in the minds of the investors due to the scheme names they sometimes carry. For example, 'Monthly Income Plans (MIPs)' do not guarantee monthly income, as also 'Capital Protection Oriented Funds' do not guarantee protection to capital. Similarly a 'High Interest Fund' does not guarantee high interest income. Such ambiguities are clearly answered by the mutual fund scheme's 'Investment Objective' – and therefore it is imperative for you to read it well; because the investment objective of the scheme could be far different than the ones suiting your requirements.

- **Asset Allocation** (... This section of the information document indicates how a particular mutual fund scheme will allocate its assets under management to the respective asset classes (such as equity, debt and gold) under normal market conditions. The asset allocation pattern indicates the allocation of the mutual fund scheme to various asset classes, and typically there is no fixed percentage that is mandated to invest in the respective asset classes. Instead, a range is provided indicating the minimum and maximum exposure to the respective asset classes. For example a range of 65% to 90% for equity asset class, will indicated that the respective mutual fund scheme will allocate a minimum of 65% and a maximum of 90% of the total assets in equities.

  From the asset allocation you can judge whether the mutual fund scheme is equity oriented, debt oriented, commodity oriented, or is a hybrid scheme – having a mandate to invest in different asset class. Thus this would give you as an investor a sense, whether the respective mutual fund scheme can be an appropriate fit for you, depending upon your requirements.)

- (Once you know the asset allocation and determine the orientation of a mutual fund scheme (i.e. equity, debt, commodity or hybrid) the next section to focus on is the...) Investment Instruments the scheme would invest in (...You see, within an asset class, there are numerous investment avenues. Thus say, as permitted by your risk appetite if you choose to invest in an equity oriented fund; it becomes imperative to assess which investment instruments the mutual fund scheme would invest in. For example while investing in equities, if the scheme aims to have a high exposure towards riskier instruments such as derivatives, it could weigh on the final returns generated by the mutual fund scheme. However, if a mutual fund scheme takes exposure to derivative instruments purely for hedging their positions then it may not turn out to be of very high risk to investors.)

- (Also...) **The Investment Strategy** (...that the fund would follow in its pursuit of achieving its investment objectives, is vital to know before investing in a mutual fund scheme. The investment strategy explains the approach the mutual fund scheme would adopt while selecting the instruments (equity, debt or gold) for investment. The investment strategy reflects the processes and systems followed by the fund house as a whole. Such process driven mutual fund schemes are better off, as opposed to those that do not follow a clear strategy and depend solely upon the fund managers' ability to pick investment instruments for the portfolio.)

- **Benchmark of the scheme** (...You see, it is vital to know how a particular mutual fund scheme benchmarks its performance. Essentially, a benchmark is selected so that the suitable constituents of the same are structured in the portfolio of the respective mutual fund scheme as well.)

- **Risk factors associated with the respective mutual fund scheme** (...By now you may be aware that investing in mutual funds carries inherent risk of investing in capital markets. Risk as you may be aware, hampers the value of your investment in the mutual fund scheme. So you should be aware of the risk involved and evaluate whether you are willing to take risks. Broadly the risks involved in mutual fund investing are..)

  - **Liquidity Risk** (...It indicates the risk stemming from a lack of marketability of the investments held by a mutual fund scheme in its portfolio. Simply put, it impacts the buying and selling of securities impeding the liquidity criteria of the portfolio. Thus it is imperative to evaluate the investment mandate of a mutual fund scheme as to what market capitalisation bias it would follow. Usually stocks of large sized companies are more liquid than their smaller counter parts – especially the small cap ones.)

  - **Default Risk** (...This risk is more relevant to the debt holdings of a mutual fund scheme, and it emanates from debt securities offered by companies unable to make their payments on debt obligations (in terms of interest payment and repayment of principal amount). Here it becomes imperative to assess the quality of instruments - as conferred by the ratings – that they hold in their portfolio. A highly rated debt portfolio is construed to be less risky than the one which has lower ratings.)

  - **Settlement Risk** (...This risk occurs on account of failure of one party to deliver the terms of the contract with the other party at the time of the settlement. So a settlement risk can be infused at the time of settlement on account of default and any timing differences in settlement between the two parties.)

  - **Interest Rate Risk** (...You see, the changes in the interest rate scenario may also have a bearing on the schemes Net Asset Value (NAV), especially if it is a debt mutual fund scheme. Generally the prices of debt instruments increase as interest rates decline and decrease as interest rates rise. They have an inverse relationship. Indian debt and Government securities markets can be volatile leading to the possibility of price movements, up or down in fixed income securities and thereby to possible movements in the NAV. So for you as an investor, it is imperative to be cognizant about the interest rate cycles you are investing with and select the right mutual scheme(s) for you to earn fruitful returns on your investments.)

  - **Re-investment risk** (...Every investment in a debt portfolio is exposed to re-investment risk. In case of debt securities, the interest rates prevailing at the time of maturity date and / or on the coupon date may differ from the original coupon the debt instrument offers. Consequentially the proceeds may get invested at lower rates, due to which there's a re-investment risk. So one needs to be aware of this risk, while investing in debt mutual fund schemes.)

Apart from the standard risk which we just learnt of, there are other scheme specific risks such as...

- **Economic Risk**
- **Currency Risk**
- **Political Risk**

…that the respective mutual fund scheme may have a direct or indirect exposure to.

For instance, in an offshore mutual fund scheme (which invests your money in assets abroad); your investments are always exposed to the respective country risks – both political and economic risks. In case of sector specific or thematic mutual fund schemes (which invest in a particular sector or a theme), the particular mutual fund scheme will be exposed to the developments taking place in that sector. Say for instance a mutual fund scheme pertaining to the banking sector will be exposed to the interest rate risks along with the standard risks mentioned above.

Hence, it is essential to know the standard risks as well as scheme specific risks which you may be exposed too, before investing your hard earned money.

- **Who will manage the scheme** (…Even if the mutual fund scheme which you wish to invests in, comes from the stable of a well-established fund house and has proper investment processes and systems in place, it is essential for you to know the fund manager managing your investments in that particular scheme. The fund manager's expertise is vital for the overall performance of the scheme in the long run. The Fund manager's experience, his or her track record, qualifications, etc. are some of the qualities you should be aware of. These details are highlighted in the scheme's information document. An experienced fund manager can enable creating alpha in the case of an actively managed mutual fund schemes.)

- **Past Performance** (…In case you are investing in an existing mutual fund scheme, the information document of the respective schemes would also contain details about their past performances over various time frames. Past performance can be guidance while making an investment decision, but should not be sorely relied upon, as past performance cannot be an indication of future performance. While evaluating a mutual fund scheme, it is imperative to look at performance over longer time frames and not get lured by short-term performance, if any. Also it is vital to assess whether the track record clocked by the respective mutual fund schemes meets the investment objective laid out.)

- **Fees & Expenses charged by the fund** (…It is noteworthy that your net returns from a particular scheme is directly proportional to the fees and expenses charged by the fund house. As the mutual fund house has the objective of making money for you, as for itself, it levies charges in the form of exit loads, switching charges and fund management fees amongst others. The charges and fees are deducted from the respective scheme's NAV and thus you should ideally look for a mutual fund scheme which has a lower fees and expense ratio.

- **Investment Options** (…Please note that a mutual fund scheme offers its prospective investors various options for investing. The broader investment options available under a mutual fund scheme are Growth and Dividend – and under the Dividend option you have two sub-options namely, the Dividend Pay-out option and Dividend Re-investment Option. At the outset you have different modes of investing, namely: lump sum Investment as well as SIP (Systematic Investment Plan) and STP (Systematic Transfer Plans) which help you benefit from rupee-cost averaging and compounding. You should opt for an option which suits your need and also the mode that is effective for you to create wealth in the long run.)

- **Judge the credibility** (…While reading the aforementioned aspects can help you judge a mutual fund scheme, to judge the credibility of the mutual fund house you must read 2 things in the offer document.
    - **Investor Grievance** (…You see, every fund has to disclose the status of investor grievances in the Statement of Additional Information. The mutual fund house has to reveal the number of queries and complaints received towards a particular scheme and the complaints addressed. This information shows investors, how proactive and responsive a fund can be towards investor grievances.)
    - **Penalties & pending litigation** (…Likewise every fund has to disclose the penalty imposed on the mutual fund house or the fund sponsor for any economic offence or violation of any securities laws in the SID. Also they have to disclose any pending litigation or proceedings towards the Mutual fund, fund house, trustees, associated companies, or the directors of the mutual fund house.

  So, reading such aspects in the offer document will help you judge the credibility of the fund house you are contemplating to invest your hard earned money.)

Key Information Memorandum

Meaning: The Key Information Memorandum (also known as KIM) is the abridged form of the scheme information document serving the cause of investors by mentioning the key sections of the offer document.

It is noteworthy that the Securities and Exchange Board of India (SEBI) has pronounced a standard format for disclosures in this document, and it serves the interest of you investors; because most of the relevant information – which we just talked about – is mentioned in the KIM. More over KIM needs to be updated at least once a year. As per SEBI regulations, every application form needs to be accompanied by the KIM.

Contents of the Key Information Memorandum

- (…KIM carries the) **Details of the Mutual Fund and AMC** (…like the name of the mutual fund, its Trustees and the AMC)
- **Scheme Details** (…such as the name of the scheme, its investment objective, issue date, inception date, risk profile of the scheme, benchmark index, Fund managers name etc.)
- **Minimum Investment Details**
- **Plans and Options offered by the Scheme**
- (If it is an existing scheme then…) **Performance of the Scheme** (…vis-à-vis its benchmark index over last 1 year, 3 years, 5 years and since inception)
- **Loads and Recurring Expenses**
- **Contact details of the Registrar and Transfer Agent (RTA)** (…who would process your transaction and take up investor grievances)
- **<u>Comparison of existing schemes</u>**

So here are some key takeaway points from today's session...
Some Key Takeaway Points!

- **The offer document can be a friend and guide to enlighten you as an investor** (...Provided you read it well focusing on aspects which we just learnt about.)
- (So,) **Do not rush with investing** (...Ascertain the risk factors associated with the respective mutual fund scheme, investment objective, asset allocation that the fund would follow, investment instruments it would invest in, investment strategy the fund will follow, against which index the fund would benchmark its performance, who will manage the mutual fund scheme, past performance (if it is an existing fund), investment options available for you to invest in and judge the credibility.)
- **If you find reading the offer document voluminous, at least lay your hands on the KIM and read it well** (...This will help you to an extent.)
- (And last, but not the least...) **Get rid of the ignorance and be a responsible investor** (...This is because while ignorance is bliss, that may not be true in the world of personal finance and investing. Also it may not yield you much in your journey to wealth creation.)

Session 13: Technicalities you should know about Mutual Funds

We are glad to have you with us for our Thirteenth Session – **Technicalities you should know about Mutual Funds**

Alright so now let's get started...

In our previous session we told you about an important topic that helped you know more about the mutual fund offer document and KIM, which you need to go through to understand various elements of your mutual fund. But there are many technicalities which you should know while investing your money in mutual funds. Understanding these small but essential points may ease your entire process of investing in mutual funds.

So let us start with... Process of Investing in a Mutual Fund

Though investing in a mutual fund is a simple task, many investors find it cumbersome due to the lack of knowledge about process and documentation involved. So how should one go about investing in mutual funds?

- **Refer Key Information Memorandum (KIM) to know your fund details** (...As we had mentioned in our previous session, you should go through the details of the mutual fund scheme before making your investment decision. Referring to KIM of the mutual fund scheme may help you know various features of the scheme and help you invest with confidence.)
- **Fill a Mutual Fund Application form** (...Once you have made your decision to invest, you need to get the right application form and fill it completely by mentioning all the necessary details carefully, so that in future you do not find the need to rectify the error and avoid rejection of the application.)
- **Get your KYC done and attach a Copy of Your KYC and PAN Card** (...Copy of the KYC and PAN card are important documents required when investing in mutual funds. If you do not have a KYC, you should get it done immediately. Your application may not be accepted without proper KYC. You should fill the correct details in the right KYC form and attach the copies of the requisite documents like proof of identity, proof of address, PAN card and Photograph. Once you submit the KYC form to the relevant point of acceptance, along with the original documents for over-the-counter verification, you will get the KYC acknowledgement followed by a copy of your KYC. As KYC is a onetime process, you can

attach the copy of your KYC with application forms for your future investment in mutual funds.)

- **You can approach a Mutual Fund Distributor or Invest through your Broker using your Demat A/c** (...You see, if you the lack time to carry out the process of a mutual fund transaction on your own, you can approach an AMFI Registered mutual fund distributor who can help you complete the process of investment. In case you have a Demat A/c, you can approach your existing stock broker for buying units of mutual funds in your Demat A/c. All you need to do is register with your existing stock broker by filling up the requisite forms. Do not forget that the distributor or broker may charge you a fee to carry out the transactions in mutual funds.)

- **You can even Invest through Online Mode** (...If you are tech savvy, then you can choose to invest through the online mode. You can register and buy mutual funds through distributors, broking companies and fund houses offering online services. All you need is a one-time registration through the respective websites of the companies. With online mode, you can easily access and keep track of all your mutual funds.)

- **Submit Application Form to official Point of Acceptance (POA)** (...Your process of investment in a mutual fund will be complete once your application form is submitted to the official point of acceptance. While many mutual funds appoint Registrar and Transfer Agents (RTAs) to collect and process mutual fund application forms, some fund houses carry this activity in house. If you are investing directly without taking the help of a distributor, then you need to make a note of the official point of acceptance for the respective mutual funds while submitting your investment form.)

- **Collect Acknowledgement Slip** (...Once you submit your application form, the acknowledgement slip will be time stamped and handed over to you. The stamp on the acknowledgment slip reflects the time when you submitted your application form.)

Though filling a mutual fund application form is simple, first time investors may often find it cumbersome. So, here's the ...

Care You Should Take While Filling a Mutual Fund Application Form

- **Check Transaction Charges** (...When taking the service of an AMFI registered mutual fund distributor, you may need to write a separate cheque to pay him a fee based on the quality of service and advice rendered to you. For carrying out an investment transaction, there might be a transaction charge in case your investment amount is Rs. 10,000 or more and your distributor has opted in to receive transaction charges. These charges may be deductible from your investment amount and payable to the distributor, while the units will be issued only against the balance amount invested. You need to take care of this point while filling your application form.)

- **Fill correct personal details** (...Your personal details like your Name and PAN Number along with details of all the joint holders should be filled in correctly. You also need to mention your Status as an individual or HUF etc. as applicable to you, and mention the correct permanent address along with mailing address for all future communication.)

- **If investing in the name of Minor** (...In case you are investing in the name of your child, who is a minor, then you would be investing as a guardian. For investment in the name of a minor you need to mention date of birth of the minor and attach the child's birth certificate, your relationship with the minor, though not compulsory you can even attach the copy of the PAN card of the minor if available, fill the correct bank details of the minor or self where you need the dividend proceeds, if the minor does not have a bank account then you need to provide a third party declaration.)

- **Mode of Holding** (...You see, you need to correctly opt for the mode of holding of the investments, as this will decide who all are required to sign for all future transactions in the scheme. You need to decide and mention whether you wish to invest as a single holder or joint holder, or you want to opt in for Either or Survivor i.e. either of the unit holders can sign for future transactions.)

- **Mention the Correct Scheme Name and Plan** (....Any discrepancy in the scheme name may lead to confusion and even rejection of the application form. Also mention whether you want to invest in the schemes 'Direct Plan' or 'Regular Plan.' Please note that 'Direct Plans' are more cost effective than 'Regular Plans'.)

- **Choose the Right Options** (...Once you have mentioned the scheme name, you need to choose the right scheme option such as Growth, Dividend Payout or Dividend Reinvestment based on your investment objective. If you are looking for long term growth, then you should choose Growth option; while Dividend payout option may help you with intermediate cash flows. However, please consider taxation implication also while deciding on the options.)

- (You should...) **Mention Correct Bank Account Details** (...Ideally the bank account where you need your dividends and redemption proceeds to be credited. Mutual funds also offer you an option to provide details of multiple bank accounts, but you should clearly state the preferred bank account for proceeds from future transactions.)

- **Details of ECS Mandate or Post Dated Cheques for SIPs** (...If you have opted for SIP, you need to mention details of your bank account in the ECS mandate with proper dates for starting and ending SIP. In case you opt for SIP via post-dated cheques, then mention the details of the cheques with cheque numbers and dates in the SIP form. This will also help you maintain proper track of your SIPs.)

- **Mention Mode of Payment of Redemption and Dividend proceeds** (...As a unit holder, you can receive redemption/ dividend proceeds directly into your mentioned bank account via Direct credit/ NEFT/ECS facility. However if you wish to receive the redemption / dividend proceeds (if any) by way of a cheque or demand draft instead of direct credit into your bank account, then you need to mention accordingly.)

- **Appoint a Nominee** (...You should pro-actively nominate any person as a nominee for all your investments. This will help your family get your money in case of any unforeseen event.)

What You Get After Investing in Mutual Fund

- **Folio Number** (...Once your application form is accepted and processed, an exclusive folio number will be created for your investment with the mutual fund, which you can use for all your future communications and transactions with the fund house. Under a single folio you can invest in multiple schemes from the same fund house. Every new fund house will create a new folio for you. You should avoid having multiple folios from the same fund house, as a single folio helps easily track all your investments with the fund house.)

- **Allotment of Units** (...Mutual funds create and allot you units of the respective schemes against the money invested by you. The value of a single unit will be equivalent to the NAV of the scheme. The composite value of all the units will help you arrive at the valuation of your investment in the scheme.)

- **Statement of Account** (...Post investment, mutual funds issue a statement of account for your investment in the scheme. The statement reflects your details provided in the application form, along with the number of units you hold, the current valuation of your investment and the transactions executed. As statement of accounts is even available in the online mode, you can easily get a copy of a duplicate or updated account statement directly in your mail box and get a hard copy on request.)

Things to Consider While Transacting in a Mutual Fund Scheme

Buying or Selling units of a mutual fund scheme are the most crucial transactions you do with a mutual fund... So what are the things you should consider while carrying these crucial transaction in a mutual fund scheme...

While Buying

- **Fresh Purchase or Additional Purchase in a Mutual Fund Scheme** (...You can invest in mutual funds not only for fresh investment, but you can also choose to make additional investment in a scheme you already hold in your portfolio. While as a fresh investor you need to fill the long application form, you can just use a transaction slip (which may be attached in your account statement) for additional purchase in the scheme.)

- **Lump sum or SIP in a Mutual Fund scheme** (...You can either invest all your money together as a lump sum investment in a scheme, or choose to gradually invest in a scheme via the SIP mode. So, you need to accordingly select the right form.)

- **You can pay through Cheque / DD / ECS** (...Mutual funds provide you the convenience to pay as per your preference via cheque / DD or ECS. However mutual funds do not accept investment in cash above Rs 20,000 per investor, per mutual fund, per financial year.)

- **Submit Investment form to POA before Cut-off Time** (...Your mutual fund application form should reach the official Point of Acceptance on time and your investment in the scheme should happen before the cut-off time. Barring liquid schemes all other categories of mutual funds have a cut-off time of 3:00 pm. Submitting after the cut-off time means your investment will be carried to the next business day and may result in delay of investment by a day.)

- **Collect Acknowledgement Slip** (...On submission of the application form, the acknowledgement slip will be time stamped and handed over to you. It is a proof that you have submitted your application form.)

While Selling

In case you need money and decide to sell your investment in a mutual fund scheme, you need to consider these points...

- **Check Folio Number and Scheme Name** (...You see, your folio number helps keep a track of your investment and is required to be mentioned for all your future transactions in the scheme. You need to correctly mention the folio number and the scheme name on the transaction slip. Any error in the folio number or scheme name may lead to rejection of your redemption form and cause unnecessary delay in getting your money.)

- **Mention the No. of Units or Amount you wish to Redeem** (...You can either withdraw a fixed number of units or all units from the scheme or else choose to withdraw a particular amount from the scheme. So you can withdraw fully or partially based on your requirement.)

- **Signature of the Unit Holders should be as per the Mode of Holding** (...Your redemption form may be rejected if there is no proper signature or mismatch in signature as per the mode of holding. In case you are a single holder, your signature will suffice; as a joint holder all the unit holders need to sign the redemption form; while the sales transaction in a folio with either or survivor option may be processed with the signature of any one of the unit holders.)

- **Check Bank Details for Payment of Sales Proceeds** (…As you will get your sales proceeds via cheque or direct credit to your bank account, you should be clearly aware of where your money will be credited. In case there is any discrepancy in bank details, you should get it rectified before you submit your redemption request.)

- **Submit Redemption form to the POA before Cut off Time** (…Once you are sure that all the details are proper, you should submit your redemption form to the official Point of Acceptance before the cut off time.)

- **Collect Acknowledgement Slip** (…Your redemption form will be acknowledged with a time stamp on the acknowledgement slip, confirming the receipt of your redemption request.)

How to keep a Track of Your Mutual Fund Scheme

(Once you are invested in a mutual fund, you need to keep a proper track of your mutual fund scheme. So here's what you should look for in order to keep a proper track of your mutual fund scheme.)

- <u>**Refer Monthly Fact sheets**</u> (…Mutual Fund houses publish a monthly report card called Fund Fact Sheets reflecting various facts about your mutual fund. Apart from the investment objective of the scheme, fact sheets can update you with the latest status of your mutual fund scheme like its performance comparison vis-à-vis its benchmark, updated portfolio details like top stock holdings and sector holdings, fund manager details, expenses and load factor etc. You can easily find a copy of these fact sheets on the website of the respective mutual funds. You can <u>refer to these monthly fact sheets for your first hand analysis and make crucial notes</u> of your mutual fund scheme.)

- **Track Fund Manager details** (…Fact sheets reflect the name of the fund managers and the time spent managing the scheme. Some fund houses also mention the experience of the fund manager. This point in the fact sheet may help you know about the individual who is managing your money.)

- **Check Holdings in Schemes Investment Portfolio** (…As fact sheets reflect the holdings in the schemes investment portfolio, you can make a note of where your money is invested. It may help you form a view on the investment strategy of the fund manager.)

- **Check Funds performance** (…Your mutual fund schemes performance may reflect whether you are able to make money by staying invested in the scheme. You can <u>compare your schemes performance vis-à-vis its benchmark and its comparable category peers</u>. You should ideally ignore the short term performance and give more weightage to long term performance of the scheme as it reflects fund managers ability to deliver consistent performance in the long run.)

- (You should also…) **Refer Quantitative Indicators** (…such as funds standard deviation, its Sharpe ratio, portfolio turnover ratio, expense ratio etc. The standard deviation and Sharpe ratio reflects the risk reward relationship of the scheme. <u>Portfolio turnover reflects the level of churning in the portfolio</u>, while the expense ratio reflects the cost associated with the scheme.

  If you are invested in a debt mutual fund scheme, then you should also refer to indicators like average maturity, modified duration and YTM of the portfolio. Credit quality of the portfolio may be an added indicator to judge your scheme.)

- <u>**Consider Fund NAV for Your Portfolio Valuation**</u> (…As we mentioned earlier, NAV reflects the value of each unit of your mutual fund scheme. NAV can help you derive the composite value of all the units held by you and arrive at the valuation of your investment in the scheme. The change in NAV since the time you invested in the scheme may reflect the potential gain or loss you have on your investment in each unit of the scheme.)

- **Refer Exit Load Period** (...You need to also consider the exit load in case you are planning to exit your investment from a mutual fund scheme, many equity schemes carry an exit load for holding period of upto 1 year. Exiting before the end of the exit period may be an added cost on your investment.)

- **Fund Expenses can be Crucial** (...The expenses of your mutual fund is indirectly borne by you. Higher expenses may eat a portion of your returns. You should judge if your scheme is able to deliver against the level of expenses it is levying.)

So here are some key takeaway points from today's session...

Some Key Take Aways...

- **Key Information Memorandum (KIM) can help you know your scheme better**

- **You need to get your KYC done** (...Copy of the KYC is an important document required to invest in mutual funds.)

- **Mention correct Scheme Name, Plan and Options of the scheme you wish to Invest in** (...Any discrepancy in the scheme name or plan may lead to confusion and even rejection of the application form.)

- **You should mention your Bank Account details correctly**

- **(You should pro-actively)** Nominate any person as a Nominee for all Your Investments.

- **An exclusive Folio Number will be created for your Investment with the Mutual Fund** (...which you can use for all your future communications and transactions with the fund house.)

- **Post Investment, Mutual Funds allot Units and Issue a Statement of Account** (...for your investment in the scheme)

- (You need to...) **Submit Investment or Redemption form to POA before Cut-off Time** (...because submitting after the cut-off time means your transaction will be carried to the next business day.)

- **Monthly Fact Sheets published by Mutual Fund houses reflect the latest details about your Mutual Fund Scheme**

- (You should...) **Compare Your Schemes Performance vis-à-vis its Benchmark Index and its Comparable Category Peers**

- **NAV reflects the Value of each Unit of your Mutual Fund Scheme**

- (As fund houses levy exit load...) **Exiting before the end of Exit Period may be an Added Cost on Your Investment**

- **The Expenses Incurred by the Mutual Fund Schemes are Indirectly borne by the Investors**

Session 14: Various Investment options offered by Mutual Funds

We are glad to have you with us for our Fourteenth Session – **Various Investment options offered by Mutual Funds.**

Alright so now let's get started with our learning session today and let us see the various categories of mutual fund schemes available and the investment options they offer for investing your hard earned money.

The world of financial innovation and exuberance has introduced many of us to numerous exotic financial products. Mutual funds too, over the years have become innovative in their offering; and today investors have so many options that they often seem either confused or completely swayed by the exuberance. You see, while numerous categories for investing may be good; you need to recognise what each of them aim for, and whether they suit your risk profile and investment objective. And this session of our learning initiative does exactly that by educating you on various categories of mutual fund schemes and the available investment options.

So let's first take a quick view at the typical classification of mutual fund schemes and then understand each of them in detail.

Typical classification of mutual funds

Basis	**Type of funds/schemes**					
	1	**2**	**3**	**4**	**5**	**6**
A. Tenor	Open Ended	Close Ended	-	-	-	
B. Asset Class	Equity	Debt/Income	Hybrid	Real Assets	-	-
C. Investment Philosophy	Diversified Equity	Sector	Index Funds	Exchange Traded Funds (ETFs)	Fund of Funds (FOF)	Fixed Maturity Plans (FMPs)
D. Geographic Regions	Country/Regions	Offshore	-	-	-	-

The table here exhibits classification of a mutual fund scheme on the basis of Tenor, Asset Class, Investment Philosophy and Geographic Regions. You see this broader classification makes way for various categories of mutual funds that we shall learn of now in detail.

A. **Mutual Fund Schemes by Tenor**

   (As you may know, 'tenor' refers to the 'time'). **Mutual funds can be classified on the basis of time as under:**

   - **Open-ended funds:**

      - **These funds are available for fresh subscription and redemption all throughout the year**

      - (So…) **Investors have the flexibility to buy or sell any part of their investment at any time, at the prevailing price (i.e. NAV)**

      - **These funds do not have a fixed tenor** (…So their existence is perpetual until they are wound-up or merged with any other mutual fund scheme)

      - **The unit capital of an open-ended mutual fund scheme keeps varying**

- (But it should be noted that...) **An open-ended mutual fund scheme is not obliged to keep on selling new units at all times** (...If the management thinks that it cannot manage a large-sized fund optimally, it can stop accepting fresh subscription requests from investors.)

- (However...) **An open-ended mutual fund scheme can repurchase the units at all times**

- **Such funds are susceptible to the worry of regular and sudden redemptions**

o **Close-ended funds:**

- **They are available for subscription during a specified period** (...So they are unlike the open-ended ones)

- **<u>Buying into a close-ended mutual fund scheme</u> after its NFO period is not possible**

- (This is because...) **They have a time period until which investors' money is locked-in**

- (However...) **The units of a close-ended mutual fund scheme may trade at a premium or discount to the NAV** (...depending upon investors' expectations of the scheme's future performance and prospects.)

- (Due to the lock-in period...) **Close-ended funds are not prone to regular and sudden redemptions**

B. **Mutual Fund Schemes by Asset Classes**

In one of our earlier learning sessions we introduced you to asset classes such as <u>equity, debt, gold and real estates</u>. Mutual funds provide you with an opportunity to invest in such asset classes by investing in funds from their stable; so let's learn about such funds.

o **Equity Funds:**

- (As the name suggests, these funds...) **Invest in equity as an asset class, in shares / stocks, rights, warrants, and other equity related instruments**

- (They may as per their investment mandate...) **Invest in the respective market capitalisation segments** (...such as large cap, mid cap or small cap or even hold a mandate to invest across market capitalisation and adopt a flexible approach)

- (They may...) **Invest in growth stocks, <u>value style</u> or dividend-yielding stocks depending on the investment objective** (...and this in turn sets the nature of the schemes.)

- (Thus on the basis of the nature of stocks it holds in the portfolio...) **Equity Funds may follow a growth style, value style or a combination of both – called as blend style of investing** (...which we will learn in brief as we progress with our learning session today.)

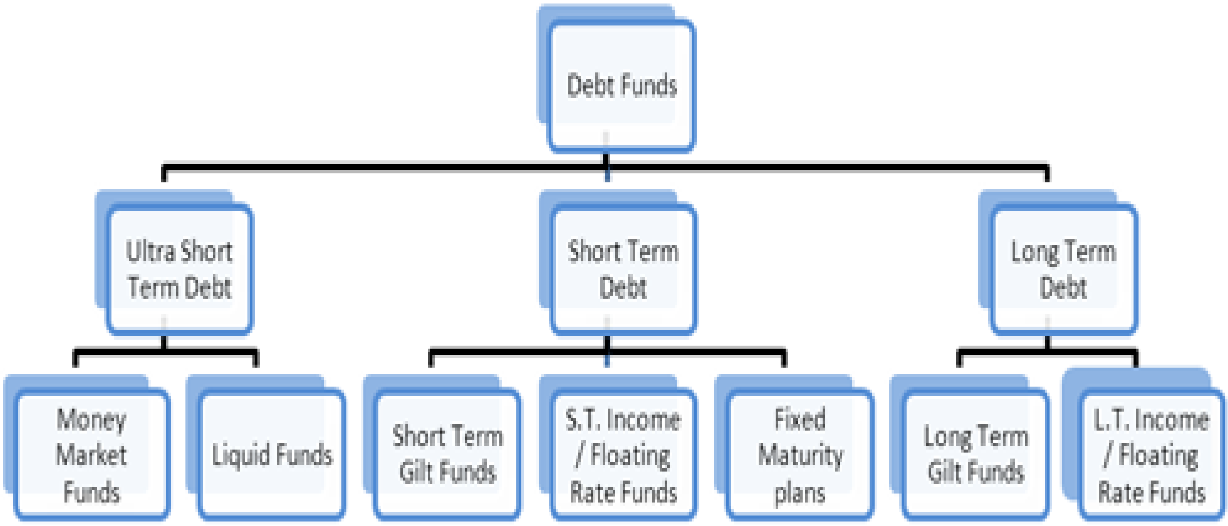
Suitability => Equity funds are suitable for investors with an appetite and tolerance for high risk and want to earn better <u>real rate of return</u> (i.e. inflation-adjusted returns) in the long run and who invest with an objective of meeting their long-term financial goals.

- **Debt Funds or Income Funds:**

  - (These funds ...) **<u>Invest in debt</u> and instruments such as Certificate of deposits, corporate bonds, debentures, fixed deposits of banks, commercial papers, Treasury Bills, inter-bank term money and money market instruments** (...amongst others.)

  - **Debt funds are divided into two sub-categories i.e. short-term and long-term on the basis of the maturity profile of the papers they hold** (...And then there are some which may invest dynamically across maturities.)

    Debt Funds are of various types (...as depicted by the chart here)



Type of Fund	Invests in...
Liquid Funds	Mainly invest in very short term money market instruments with maturity up to 91 days. Also invest in call money
Ultra Short Term Debt Funds	Portfolio comprises a mix of certificate of deposits, commercial paper, call money and other money market instruments with slightly higher maturity than the instruments held in liquid funds
Floating Rate Funds	Typically invest in short-term instruments offering flexible interest rates i.e. whose interest rate reflects the prevailing interest rate in the country
Short-term Income Funds	Have exposure to short-term bonds, deposits and NCDs. May also invest in T-bills and Government securities with maturity of less than 3 years
Fixed Maturity Plans	Provide exposure to bonds, NCDs and money market instruments that have maturity profile in line with the horizon of the scheme the Fixed Maturity Plan (FMP).
Dynamic Bond / Flexi-Debt Funds	Such funds invest in short-term as well as long-term bonds and NCDs. They may also invest in Government securities with maturity of up to 5 years
Long-term Income Funds	Invest in bonds and debentures with maturity of more than 5 years. Can also invest in Government securities with maturity profile of 5 to 10 years.

Gilt Funds or G-sec Funds	Invest only in securities issued by the Central and/or State Government.

Suitability => Debt funds are suitable for investors who are rather risk averse and do not mind compromising on real rate of returns (i.e. inflation-adjusted returns) they would earn in the long run, and generally have near or short-term financial goals. But while doing that care should be taken to select from various categories of debt mutual fund schemes.

- **Hybrid Funds:**

  - (As the name suggests, these funds ...) **Invest in multiple asset classes which could hold equity instruments, debt instruments and even gold.**
  - **They are mandated to allocate a certain portion of their AUM in the respective asset classes**
  - **Depending upon their dominant exposure to equity or debt they are classified as equity-oriented hybrid funds and debt-oriented hybrid funds**
  - **Balanced Fund is an example of equity-oriented hybrid fund**
  - **While Monthly Income Plans (MIPs) and capital protection funds are examples of debt-oriented hybrid funds**

  Suitability => (Thus...) Hybrid funds can be suitable for investors who want to tactically allocate their assets; but the selection therein should be done as per their risk appetite and tolerance (...in order to hold an appropriate fund in the portfolio.)

- **Real Asset Funds:**

  - (These funds...) **Invest in physical assets such as gold and real estate**
  - **Gold Exchange Traded Funds (ETFs) and Real Estate Investment Trusts (REITs) fall within the category of real asset funds**

Suitability => Those who wish to invest in other asset classes and diversify their portfolio by assuming high risk thereto, can invest in Real Asset Funds.

C. **Mutual Fund Schemes by Investment Philosophy**

- **Diversified Equity Funds:**

  - (These funds...) **Are primarily equity funds investing across various sectors and market capitalisation**
  - (They...) **Invest in equity & equity related instruments following the basic tenet of investing, i.e. diversification** (...But care should be taken to select them wisely.)

You see within the diversified equity funds, there is an array of schemes on the basis of the style of investing and the market capitalisation they follow; so let's learn about it...

- **Value style: Value investing refers to buying stocks whose market value is severely deviated from their fair intrinsic value.** (…Unlike market value, which is readily quoted, intrinsic value is not available easily and has to be estimated by conducting thorough fundamental analysis by studying various ratios such as Price-to-Book Value, (P/B), Price-Earnings (P/E), Dividend Yield, Price to Sales; amongst a host of others.)

  Value investing also revolves around a set of investment principles which are:

  - **Companies should have sound management**
  - **Earning capacity of the companies** (…Which can be judged by brand equity, Earnings per Share (EPS) growth rate, amongst others.)
  - **Consistency in returns**
  - **Prudent approach to debt financing** (…Which can be judged by paying attention to capital gearing ratio, debt-service coverage ratio, interest service ratio, financial leverage, amongst a host of others.)
  - **Buying at the right price** (…which can provide enough margin of safety.)
  - **Long-term investment approach**

    Suitability => Value style funds are suitable for those who give due weightage to the tenets of value investing that we just learnt of.

- **Growth style: - <u>Growth style of investing</u> focuses on the following factors for stock picking:**

  - **Companies that deliver above-average earnings** (…and have with them a strong competitive position and opportunities galore for further growth, thus enabling them to pursue the growth path.)
  - **Companies that have higher PE (Price-to-Earning) multiple** (…but at the same time make them appear inexpensive when looked at the future growth potential it has to offer.)
  - **Companies with lower dividend yields** (…through which, instead of declaring dividend from the earning, the company uses the accruals for facilitating growth for the company.)

    But following the aforesaid distinctive principles, growth investing also follows some of the value investing principles while selecting companies.

    Hence, even the legendary value investor - Mr Warren Buffett too stated that there's no theoretical difference between value investing and growth investing. He said "Growth and Value Investing are joined at the hip". And hence recognising that, later Mr Peter Lynch pioneered the concept of GARP (Growth at Reasonable Prices) investing wherein he mentions that one should look at consistent earnings' growth that are above the market level but at the same time avoid companies with high valuations while following growth investing.

    Suitability => Growth style funds are suitable for those who are willing to assume high risk in their endeavour to create wealth at an accelerated pace.

- **Blend style:** - (…As mentioned earlier…Blend style of investing follows…) **a combination of value and growth style of investing while picking stocks for the portfolio.** (…Hence it depicts the traits of both, but to what extent the fund manager follows each of them, remains his prerogative.)

Suitability => Blend style funds are suitable for those who wish to follow the tenets of value investing, but at the same time would like to assume a little more risk and accelerate the pace of wealth creation.

Now apart from the typical or the more commonly known styles of investing…that we just learnt of…a mutual fund scheme could also have the mandate to follow the…

- **Opportunities style: -** Opportunities style funds (as the name suggests) invest in stocks of companies across market cap segments (large cap, mid cap, small cap) and across sectors. They hold a flexible investment mandate due to which these funds stand a better chance to benefit from attractive investment opportunities in various market segments. However in practice, this depends mainly on the fund manager's expertise in identifying and tapping promising investment opportunities well before others.

  Suitability => These funds are suitable for those who wish to take advantage of opportunities across sectors and market capitalisation optimally, but by assuming a little higher risk as against a typical diversified equity fund.

Now apart from following a particular style of investing, mutual funds can also offer schemes that are mandated to invest a predominant portion of their assets towards the respective market capitalisation segments. So let's learn about such funds...

- **<u>Large cap mutual fund schemes</u>: -** These funds are usually mandated to invest a predominant portion of their assets in large cap companies which stand at the uppermost layer of the market capitalisation pyramid. (…Some traits about large caps are:)

  - **Companies with well-established businesses and stable revenues**
  - **They have a high market share**
  - **Usually are well-researched**
  - **Their performance is more predictable** (…than the highly volatile mid caps)
  - **They have the ability to weather the unfavourable economic conditions better**
  - (Hence...) **These companies generally command a premium over the mid and small cap companies**

    Suitability => Large cap funds are an indispensable part of the equity portfolio, irrespective of the risk appetite of the equity investor. (…So even if you have a large appetite for risk, you must include in your portfolio some petite composition of large cap funds along with mid and small cap funds showing a dominant portion).

- **<u>Mid cap mutual fund schemes</u>: -** These funds are usually mandated to invest a predominant portion into mid cap companies which fall below the large caps but above the smaller companies in the market capitalisation pyramid. (…Some traits about mid cap companies are:)

  - **They are well-established but have the potential to grow as they are yet in the growth stage of their life cycle**

- **They are leaner in size** (...as compared to large caps) **but have the ability to accelerate returns on investments**

- **They are often less researched** (...and hence, more often, available at a discount to the large caps)

- **They are more volatile** (...and not as stable as compared to large caps) **as they tend to show fluctuations in profits and at times struggle to sustain when the going gets tough** (...And for this reason investment in midcaps is considered risky; but it could be well rewarding over the long-term.)

Suitability => Mid cap funds are suitable for those who are willing to assume high risk in their endeavour to clock alluring returns. (...This is because, while mid caps show a tendency to do well during the upside of the market, they also tend to plunge (and some plunge rather violently) during the downside of equity markets. Hence although one could invest as permitted by risk appetite, it is imperative to stay invested for the long-term to strike a better risk-return trade-off.)

- **<u>Small cap mutual fund schemes</u>: -** These funds – also known as micro cap funds - are usually mandated to invest a predominant portion into small cap companies which fall below the market capitalisation of mid cap companies. So they are at the bottom of the market capitalisation pyramid. Some traits about small cap companies are:

  - **These companies are often under-owned** (...As very few investors have the heart to invest in under-researched smaller companies.)

  - **They are leaner in size as compared to mid caps**

  - **The volume of transactions** (on the stock exchange) **and liquidity in small caps is low** (...It is noteworthy that low volumes create a great price impact when sudden buying or selling shock occur.)

  - **Thus investing in small cap carries very high risk**

  - (But...) **They have the potential to generate super-normal returns**

  Suitability => Small cap funds are suitable for those who are willing to assume very high risk in their endeavour to clock super-normal returns. (...Small caps, as learnt, often have fewer transactions on the exchange and low liquidity, and thus that instils volatility in them when sudden buying and selling occurs. Hence, although one could invest as permitted by risk appetite, it is imperative to stay invested for the long-term to strike a better risk-return trade-off.)

- **<u>Multi cap mutual fund schemes</u>: -** These funds are facilitated by their mandate to invest across market capitalisation, i.e. large caps, mid caps and small caps. Thus by doing so they spread their risk across market capitalisation and even capture investment opportunities across segments (...depending upon the market scenario therein. Moreover, they are not confined to one particular style of investing; which allows them to follow a value, growth or blend style of investing.)

  Suitability => Multi cap funds are appropriate if you are willing and / or want to take exposure across market capitalisation to tap opportunities, and at the same time want to diversify risk.

- **<u>Flexi cap mutual fund schemes</u>: -** These funds, as enabled by their mandate, aim to optimise exposure to every market capitalisation segment depending on its attractiveness. (...In other words, a flexi cap fund can work as a large cap fund if the fund manager expects a better performance from large caps, and it may serve as a mid & small cap fund if the fund manager turns bullish on mid-sized companies. Moreover, some funds go one step ahead and switch between asset classes such as debt and equity with the flexibility to go 100% on either sides.)

Suitability => Flexi cap funds work as all-weather funds for the portfolio and are appropriate for those who wish to optimally capitalise on the available opportunities within market capitalisation and even asset classes vide a flexible investment mandate.

- **Sector / Thematic Funds:**
  - (These funds…) **Focus to invest in a particular sector**
  - (Thus…) **A dominant portion of the fund's assets is invested in the respective sectors** (…which could be FMCG, power, IT, media & entertainment, banking & financial services, etc.)
  - **Thematic funds are a variation to sector funds and have a slightly broader mandate for investing by following a theme**
  - **Thematic funds could invest in themes such as infrastructure, consumption, etc.** (…which invest in such stocks that comprise a theme.)

Suitability => Investors who are willing to take very high risk and are adequately diversified but yet wish to follow their conviction of investing in sectors / themes may consider such funds.

- **Index Funds:**
  - (These funds…) **Are aligned to the respective benchmark indices**
  - **The portfolio of such funds replicates the composition in terms of allocation or weightage of the chosen index**
  - **These funds nearly mirror the performance of the designated benchmark index**
  - (Thus…) **<u>Index funds are passively managed</u>** (…as against diversified equity funds, sector funds and hybrid equity funds which are actively managed.)
  - **They carry with them low expense ratio, relatively low portfolio turnover ratio and thus a low risk** (…as compared to actively managed mutual funds.)

Suitability => Index funds can be considered by those who are naïve to mutual fund investing as they generally command low risk amongst the equity funds. So, if you are relatively risk averse but yet want to take exposure to equities and mirror the performance of the benchmark index, then you may invest in such funds.

- **Exchange Traded Funds (ETFs):**
  - (These funds…) **Are traded on the exchange** (…and therefore called Exchange Traded Funds or ETFs.)
  - **They can be bought or sold on the stock exchange on a real time basis** (…through your registered stock broker.)
  - **The AMC may not offer sale and re-purchase of units** (…As in the case of other open-ended funds, where NAV is declared.)

- **ETFs are traded on the respective stock exchanges and are benchmarked to their respective indices**

- (Today...) **ETFs are available for pre-specified equity indices and also those which mirror the price of gold**

- **Most ETFs are passively managed**

Suitability => ETFs are suitable again for naïve investors looking for lower cost, convenience of investing and who are relatively risk averse, but yet want to take exposure to equities and mirror the performance of the benchmark index.

- **Fund of Funds (FoFs):**

  - **FoFs invest their money in other funds of the same mutual fund house or other mutual fund houses** (...So, it is unlike the other mutual fund schemes which invest in stocks and debt instruments directly for portfolio construction.)

  - **FoFs could have a mandate to invest in funds focusing on investing in various asset classes and markets / regions**

  - (Thus FoFs...) **Provide an opportunity to create a diversified portfolio of various mutual fund schemes; whereby one can avail of the benefit of: diversification by fund manager and investment style** (...followed by funds in the portfolio.)

  - **FoFs may help in diversification across types and investment style** (...by investing in a single fund)

  - **Relieves you from the process of selecting the right mutual fund schemes** (...since the FoF fund manager takes care of that.)

  - **Reduces hassles such as multiplicity of transactions, filling forms, maintaining multiple account statements and tracking multiple mutual schemes** (...usually experienced while investing directly in regular mutual fund schemes.)

  - (But...) **FoFs may have a high expense ratio** (...as compared to a regular mutual fund scheme.)

Suitability => FoFs are suitable for small and new investors willing to build a portfolio of mutual funds but lack resources and skills to research and select the right funds. Also for those who want to eliminate the hassle of maintaining and tracking their investment in multiple schemes, but are ready to bear high expense ratio.

- **Fixed Maturity Plans (FMPs):**

  - **FMPs are close-ended schemes with fixed tenure that cease to exist thereafter**

  - (Being close-ended...) **FMPs are listed on the stock exchange**

  - **They invest in debt & money market instruments of similar maturity as the stated maturity of the plan** (...Which means a 90 day FMP will invest in debt & money market instruments that mature within 90 days like 3-month Certificate of Deposits (CDs), 3-month Commercial Papers (CPs), etc.)

  - (Unlike bank FDs...) **The maturity amount in case of FMPs is not fixed**

- **There is no default guarantee or insurance** (...as in the case of bank FDs that comes with a DICGC guarantee or insurance up to a sum of 1 lakh per bank.)

- (Also unlike bank FDs where investors have an option to prematurely exit...) **FMPs do not provide investors with an option to exit**

- (However...) **Exiting prematurely is permissible through a sell transaction on the stock exchange**

Suitability => FMPs are suitable to those who wish to clock better post-tax returns as against bank or corporate FDs; but who are willing to take slightly high risk since the maturity proceeds are not guaranteed.

D. **Mutual Fund Schemes by Geographic Regions:**

- **Country or Region Specific Funds:**

  - (These funds...) **Invest in securities (equities and / or debt) of a specific country or region or economic groupings, viz. developing & emerging economies and developed economies**

  - **The underlying belief is that the chosen country or region is expected to deliver superior performance** (...Which in turn be favourable for securities of that country.)

  - **Such funds have an exposure to currency risk, interest rate risk, macroeconomic risk, regulatory risk and geopolitical risk**

  - (But...) **They can facilitate geographical diversification**

Suitability => <u>Country or region specific funds</u> can be suitable if one is adequately diversified within the domestic portfolio, and is looking for further diversification across countries or regions; but is willing to bear high risk emanating from such an investment. Moreover, care should be taken while selecting such funds.

- **Offshore Funds:**

  - (These funds...) **Are domiciled outside the home country where the mutual fund house is registered**

  - **They are usually established in countries which provide a significant tax advantage for foreign investors** (...Some popular countries for offshore investments are Isle of Man, the Bahamas, Bermuda and the Cayman Islands.)

  - (Thus...) **They ought to comply with the regulations of the country where they are registered**

  - **<u>Offshore funds</u> mobilise money from investors for the purpose of investment outside their home country**

  - **Offshore funds invest in listed equities and debt securities**

  - **They facilitate geographical diversification**

  - (Nonetheless...) **Investors in offshore funds are exposed to regulatory risk, geopolitical risk, macroeconomic risk and currency risk**

Suitability => Before investing in offshore funds, one should have a fair diversification within the domestic portfolio, and then if risk appetite permits, may invest in offshore funds for geographical diversification. (…But utmost care should be taken while selecting offshore funds, and one should avoid those which have a mandate to take an acute country-specific exposure.)

Now, having learnt the classification and the various types of mutual fund schemes therein, let's learn about the various options that mutual fund houses provide investors with: such as dividend, growth and bonus.

Options Available For Investing In Mutual Funds

- **Dividend Option:**

  This option facilitates investors to book profits in the form of dividend and provides further sub-options:

  - **Dividend Payout: -** This option proposes to timely pay distributable surplus / profits to investors in the form of dividends either through cheques or ECS credits, thereby facilitating them to book profits.

    Suitability => This option can be selected by those who are in need of cash flows during the investment horizon and may not have regular flow of income.

  - **Dividend Re-investment :-** (Under this option instead of paying dividend cheques or providing ECS credits...) The dividend amount declared by a mutual fund scheme, goes in to buy additional units of the same scheme (where one is invested). So it keeps re-investing the dividend proceeds in the same scheme.

    Suitability ? This option is suitable for investors who are not in need for cash flows in the form of dividend during the investment horizon; but instead would prefer to add additional units to the same scheme (where they are invested via the dividend declared for the scheme.)

    It should be noted that selecting the dividend option in no way makes it mandatory for the fund house to declare dividends. It is solely subject to the performance of the respective mutual fund scheme, availability of distributable surplus and discretion of the Trustees.

  - **Growth Option:**

    This option facilitates compounded growth in value of your mutual fund scheme, subject to the investment bets taken by the fund manager.

    Suitability => This option is suitable for those investors who are not in need for cash flows in the form of dividend during the investment horizon; but would instead prefer to invest their hard earned money for compounding their wealth.

  - **Bonus Option:**

    Under the bonus option investors are not paid regular dividends. Instead they continue to receive bonus units in accordance to a ratio declared by the fund house. (…Very few mutual fund houses have this option.)

    Suitability => This option is suitable to those who wish to add units to their investments as per the ratio of bonus declared.

Overall while selecting between the options that we discussed, one should align them well in accordance to what the financial plan calls for, so as to achieve the life goals being addressed by the financial plan.

Today while investing in mutual fund schemes, investors can opt for either the direct plan or the standard plan. So, let's learn what they mean...

Direct Plan vs. Standard Plan

- **Direct Plan:**
    - (Opting for this plan...) **Facilitates investors to invest directly in the mutual fund scheme offered by the fund house**
    - (So here...) **Investor can bypass the distributor channels**
    - **Direct plan has a lower expense ratio** (as against the standard plan)
    - (So...) **Investors can save a good deal of money and thus may fetch better returns**

  Suitability => Savvy investors who use the online platform and don't mind investing in mutual funds using e-route may be better off opting for direct plans. Likewise those who take independent advice on mutual funds from a mutual fund research company can also consider investing through direct plans.

- **Standard / Regular Plan:**
    - (By opting for this plan...) **Investors go through the distribution channel, whereby the investments are done through mutual fund distributors / agents / relationship manager / advisor**
    - **Servicing issues are taken care of by the mutual fund distributor / agent / relationship manager / advisor**
    - **Standard plan commands a high expense ratio**
    - (Thus eventually...) **Returns fetched under standard plan could be a little lower** (...as against a direct plan)

  Suitability => Investors who are looking for convenience, getting service, not having access to mutual fund research and therefore do not mind paying a higher expense ratio and compromising on the returns a bit, can opt for the standard plan.

Some Key Takeaway Points!

- **Care should be taken while selecting mutual fund schemes** (...so as to have the appropriate ones that can meet your financial goals.)
- **Have funds from the respective categories of mutual fund schemes as per your investment objectives**
- **Equity funds carry high risk** (...And therefore are suitable if you have an appetite and tolerance for high risk and want to earn better real rate of return.)

- **Equity funds are suitable if you have a long-term investment horizon and wish to clock better real returns**
- **Debt funds are suitable if you are risk averse and do not mind compromising on real rate of returns**
- **Tactical allocation can be facilitated by hybrid funds**
- **Sector / thematic funds carry very high risk**
- (While...) **Diversified equity funds expose you to lower risk** (...by following the basic tenet of investing i.e. diversification.)
- **FoFs provide an opportunity to create a diversified portfolio of various mutual funds schemes by investing in a single fund**
- **Country or region specific funds and Offshore funds facilitate geographical diversification but expose you to regulatory, geopolitical risk, macroeconomic risk and currency risk**
- **Selection between dividend, growth and bonus option should be done carefully in alignment to your financial plan**
- **Opting for Direct Plan helps to clock better returns (...as compared to Standard Plan) due to relatively low expense ratio charged**

Session 15: Modes of Investing in Mutual Funds

We are glad to have you with us for our Fifteen Session - **Modes of Investing in Mutual Funds.**

So let us now begin with our learning session today.

[Introduction on the subject]

In our previous learning session, we learnt about various investment options that you can look at while investing in mutual funds. But do you know, mutual funds offer various modes of investing that are designed to fulfil your various needs? Yes. Even if you are new to mutual funds, it is not necessary to have a big amount for you to start investing in mutual funds. You can start your mutual fund investments with a small amount and keep on investing regularly till it steadily grows to a decent amount that may help you meet your financial goals in the future. Let us take them one by one and see how you can invest in mutual funds at your convenience. Moreover we will also tell you about some features that mutual funds offer that you can use to withdraw your investments as per your needs.

Popular Modes of Investing in Mutual Funds

While mutual funds offer various modes of investing, one should preferably consider his or her convenience while investing in mutual funds. Some of the key modes of investment offered by mutual funds are:

- **Lump Sum or One Time Investment** (...If you have a big sum of say Rs 1 lakh in your bank account and are looking to invest it in mutual funds at one go, then you can consider investing via lump sum mode. But beware! Investing all your money at one point, may call for market risk. And so to reduce this risk, there is an option called...)
- **Systematic Investment Plan (SIP)** (...SIP can help you invest your money gradually every month or quarter. Where you can instruct the mutual fund to buy units of the scheme in your folio, by debiting a fixed amount from your bank account every month or quarter. But do not forget, that the balance money lying in your bank's savings account may

continue to earn a lower rate of return. So what can be a better option, to increase returns on your money lying idle? Well, mutual funds offer an opportunity to invest regularly while providing an opportunity to earn better returns on your idle money, through…)

- **Systematic Transfer Plan (STP)** (…STP is a mode of investing, where you initially park your entire Rs 1 lakh in a less risky category of mutual fund such as a liquid scheme, and then systematically transfer money on a regular basis from the liquid scheme to an equity fund or any other mutual fund scheme of the same fund house. So, while you are able to invest your money on a regular basis, the liquid scheme provides you an opportunity to earn returns better than your bank's saving account.)

(Let us run you through this in more detail ...)

Lump Sum or One Time Investment

- **Lump Sum Mode helps Invest all your Investible surplus at one go** (…Even if you have a large corpus to invest, you can invest all your money in a mutual fund through a single transaction. But as we mentioned earlier…)
- **Lump Sum Investment attracts market risk** (…so you need to be careful. You should invest in lump sum only if you have an appetite for higher risk as chances are high that, you may see your investments in the negative for some time. Ideally while investing in lump sum, you should have a longer time horizon. Or, on a cautious note, if you have a short term horizon, then you should invest your lump sum money in less risky options like liquid funds.)
- **LumpSum Investment can be rewarding only if the long term trend of the economy is positive** (…you see, the impact of near term market volatility may fade over time.)
- (…So we can say that lump-sum investment is…) **More suitable if you are ready to take High Risk in anticipation of High Return** (…or are willing to compromise on the returns by parking your entire surplus in Low Risk option such as liquid funds)
- (Also as there is a single transaction, ...) **You can make your Investment via a Single Cheque** (…You need not write multiple cheques or fill any additional forms. So if you have say Rs 1 Lakh to invest, you can make a lump-sum investment by writing a single cheque of Rs 1 Lakh in favour of the mutual fund scheme and submit it along with the application form.)

(The other mode of investing is popularly known as SIP…)

Systematic Investment Plan (SIP)

- **SIP is a disciplined Mode of Investment** (…SIP helps develop disciplined investment strategy by spreading your investments over a certain time period. Through SIP you can invest a fixed sum of money on a regular basis, in a mutual fund scheme.)
- **You can start SIP with a lower investment amount** (…You see, if you make a one-time investment you may need a minimum amount of Rs. 5,000/-, but opting for the SIP mode you can start with an amount as low as Rs. 500/- per month.)
- **(So…)SIP can help you steadily build a corpus over time** (…With the power of compounding SIPs can be a smart financial planning tool that may help you create wealth in the long run.)
- **SIPs provide you the benefit of Rupee Cost Averaging** (…Through SIP, you invest a fixed amount every month, irrespective of the market movements. As the investment happens on a regular basis, you get an opportunity to invest at various market levels. So

when the markets fall, you buy more units with the same amount; while if the market trends higher, you buy less units and simultaneously the value of your existing units grow. So in the long run your cost of buying is averaged out and your Average Cost per Unit may work out to be lesser than the Average Price per Unit.)

- **You can start your SIP with a One-Time Instruction** (...Along with a cheque for the first transaction, you need to fill a one-time instruction form called SIP Instruction form through ECS/Direct Debit, which needs to be submitted only once. Post activation of your SIP instruction, the money can be deducted on a regular basis from your bank account and invested in the respective mutual fund scheme.)

Now let's take an example to see how SIP works...
...Suppose you have Rs 1.2 Lakh in your bank account, you may easily split your investment over a period of 12 months and invest Rs 10,000 per month in the mutual fund scheme through SIP...

SIP vs.Lump-Sum

Month	**S&P BSE Sensex**	**Systematic Investment Plan**			**Lump-Sum**		
		Investment Amt. (Rs)	**Units**	**Market Value (Rs)**	**Investment Amt. (Rs)**	**Units**	**Market Value (Rs)**
15-Jan-2013	19,987	10,000	0.50	10,000	120,000	6.00	120,000
15-Feb-2013	19,468	10,000	0.51	19,740	-	-	116,886
15-Mar-2013	19,428	10,000	0.51	29,699	-	-	116,642
15-Apr-2013	18,358	10,000	0.54	38,064	-	-	110,219
15-May-2013	20,213	10,000	0.49	51,911	-	-	121,358
17-Jun-2013	19,326	10,000	0.52	59,632	-	-	116,032
15-Jul-2013	20,034	10,000	0.50	71,819	-	-	120,286
16-Aug-2013	18,598	10,000	0.54	76,670	-	-	111,663
16-Sep-2013	19,742	10,000	0.51	91,387	-	-	118,533
15-Oct-2013	20,548	10,000	0.49	105,114	-	-	123,367
18-Nov-2013	20,851	10,000	0.48	116,665	-	-	125,187
16-Dec-2013	20,660	10,000	0.48	125,595	-	-	124,039
15-Jan-2014	21,289	**120,000**	**6.08**	**129,425**	**120,000**	**6.00**	**127,821**
Returns (XIRR)				**14.80%**			**6.52%**

Say if this was a scenario in the beginning of C.Y. 2013 and, as can be seen in the table, if you invested this money in equities or in S&P BSE Sensex over a period of 12 months in C.Y. 2013; then with the same amount of money, the investments via SIP would have helped you accumulate more number of units than your lump sum investment. We can see that the value of your one-time investment of Rs 1,20,000 was in the negative for a while due to the downside market movement, while simultaneously SIPs helped you accumulate more units. As a result your investment via SIP would have delivered returns better than the lump sum investment. However this is just an example of how SIPs can help you benefit even from market volatility. It is not necessary that SIPs outperform lump sum investment every time; but they do help you with disciplined investment and rupee cost averaging that help you steadily create wealth in the long run.

(The next mode of investing that we would like to explain is...)

Systematic Transfer Plan (STP)

(Though less popular, STP is an advanced version of SIP, which functions with a similar objective... so let's see what makes STP different from SIP...)

- **STP helps in gradually investing a large corpus in a selected asset class** (...Like SIPs, STPs help you invest gradually in a selected asset class like equities. But unlike SIP, in STP the investor initially invests in less risky liquid funds that may offer better returns, and over time gradually or systematically transfer a certain amount from the scheme to another scheme which may be an equity fund from the same fund house.)

- (So can we say...) **STP is a relatively safer investment method than lump sum investment and may prove to be a higher yielding method than SIP investment** (...As all your money is not invested directly in risky asset class, STP may turn out to be a relatively safe investment strategy. Moreover, it also provides you with an opportunity to put the idle money in your bank's savings account

- (So if used sensibly...) **<u>STPs can be a smart financial planning tool</u>** (...that can help you utilise your corpus towards meeting your long term financial goals.)

- **STPs provide you with the benefit of Rupee Cost Averaging** (...Like SIPs, STPs too help you invest on a regular basis at various market levels. So when the markets fall, you buy more units with the same amount; while if the market trends higher, you buy less units and simultaneously the value of your existing units grow.

- **You can start your STP with a Single Mandate** (...So as an investor, you need to give a single mandate to the fund house to periodically and systematically transfer a certain amount from one scheme to another. While you need to draw the cheque in favour of the initial scheme, you should mention, in the STP application form, the name of the secondary scheme where you wish to transfer the money, along with the amount and period. The fund house will process the transactions as per your instructions.)

Now let's see how STP works...
If you wish to invest Rs 1.2 Lakh lying in your bank account, but without putting all your money directly to market risk, you may opt for STP. Through STP, the entire Rs 1.2 Lakh can be invested in a low risk liquid scheme of the mutual fund house of whose equity scheme you wish to invest in.

Month	Opening Balance in Liquid Fund (Rs)	Transfer to Equity Fund (Rs)	Closing Balance in Liquid Fund (Rs)	Return from Liquid Fund @ 7% p.a. (Rs)	Return from Equity Fund @ 12% p.a. (Rs)	Final Value of each Transfer (Rs)	Total Value of Investment (Rs)
1	120,000	10,000	110,000	642	1,268	11,268	-
2	110,642	10,000	100,642	587	1,157	11,157	-
3	101,229	10,000	91,229	532	1,046	11,046	-
4	91,761	10,000	81,761	477	937	10,937	-
5	82,238	10,000	72,238	421	829	10,829	-
6	72,659	10,000	62,659	366	721	10,721	-
7	63,025	10,000	53,025	309	615	10,615	-
8	53,334	10,000	43,334	253	510	10,510	-
9	43,587	10,000	33,587	196	406	10,406	-
10	33,783	10,000	23,783	139	303	10,303	-

11	23,922	10,000	13,922	81	201	10,201	-
12	14,003	10,000	4,003	23	100	10,100	-
Total		**120,000**	**-**	**4,026**	**8,093**	**128,093**	**132,119**

So here in the table, we can see that Rs 1.2 Lakh invested in a liquid fund is gradually transferred to an equity fund over a12 month period. At the end of 12 months, the Rs 1,20,000 transferred to the equity fund which we assume to have grown @ 12% p.a. would appreciate to Rs 1,28,093; while the liquid fund if it is able to yield 7% p.a. may provide a gain of Rs 4,026. So through STP you can gradually transfer a fixed amount each month from a liquid fund to an equity fund at various market levels and over time create a portfolio of equity mutual funds without putting all your money at risk at one point of time.

It is noteworthy that the Indian mutual fund industry has never stopped itself from trying or innovating strategies that can fulfil your needs as an investor, may it be while investing your money or withdrawing it to meet your financial goals. So let us now shed some light on a few of the other techniques introduced by some mutual funds that may be effective while managing your finances...

Value Averaging Investment Plan (VIP)

(Value-averaging Investment Plan is a relatively new method of investing in equity markets through a mutual fund. While in SIP the monthly investment is a fixed amount, in VIP the monthly investment varies which is calculated as per the targeted performance.)

- (So based on the market movement...) **VIP aims to Invest More when the Markets are Low and Invest Less when the Markets are High** (...Therefore unlike SIP the amount invested each month is not fixed, but varies with market fluctuations.)

- **A target investment amount that has to be achieved monthly, needs to beset** (...Based on the target, the value of subsequent investments will be derived from the difference between the target and the actual value of the investment.)

- (Through a flexible investment strategy ...) **VIP helps one to lower the Cost of Purchase of Units more effectively than SIP** (...as the investor can take benefit of bearish phases in the market and even enjoy the benefit of power of compounding.)

- (As the investment amount may keep varying on month on month basis...) **VIP may be suitable for Investors who are ready to invest different amounts each month**

- **Only a few mutual fund houses offer this facility to Investors**

SIP vs. VIP in S&P BSE Sensex

Month	**S&P BSE Sensex**	**Systematic Investment Plan**			**Value Averaging Investment Plan**			
		Investment Amt. (Rs)	**Units**	**Market Value (Rs)**	**Opening Balance (Rs)**	**Investment Amt. (Rs)**	**Units**	**Market Value (Rs)**
15-Jan-2013	19,987	10,000	0.50	10,000	-	10,000	0.50	10,000
15-Feb-2013	19,468	10,000	0.51	19,740	9,740	10,260	0.53	20,000
15-Mar-2013	19,428	10,000	0.51	29,699	19,958	10,042	0.52	30,000
15-Apr-2013	18,358	10,000	0.54	38,064	28,348	11,652	0.63	40,000

15-May-2013	20,213	10,000	0.49	51,911	44,042	5,958	0.29	50,000
17-Jun-2013	19,326	10,000	0.52	59,632	47,806	12,194	0.63	60,000
15-Jul-2013	20,034	10,000	0.50	71,819	62,200	7,800	0.39	70,000
16-Aug-2013	18,598	10,000	0.54	76,670	64,982	15,018	0.81	80,000
16-Sep-2013	19,742	10,000	0.51	91,387	84,922	5,078	0.26	90,000
15-Oct-2013	20,548	10,000	0.49	105,114	93,670	6,330	0.31	100,000
18-Nov-2013	20,851	10,000	0.48	116,665	101,475	8,525	0.41	110,000
16-Dec-2013	20,660	10,000	0.48	125,595	108,991	11,009	0.53	120,000
15-Jan-2014	21,289	**120,000**	**6.08**	**129,425**	**-**	**113,865**	**5.81**	**123,659**
Gain/Loss	-	-	-	**9,425**	-	-	-	**9,794**
Returns (XIRR)				**14.80%**	-	-	-	**15.79%**

Let's take an example of VIP and see how it works. Say you, as an investor, want to invest Rs 10,000 a month for a certain period of time in C.Y. 2013. If you start with Rs 10,000 in January 2013, and at the end of the first month, as we see, the market discounts, and the value of your investment becomes Rs 9,740. So now you need to invest Rs 10,260 (20,000-9,740), to make the investment worth Rs 20,000 (over a period of 2 months). Likewise, at the beginning of the 5thmonth in May 2013, if the value of your investment is Rs 44,042, then you need to invest Rs 5,958 (50,000 -44,042) only to make the amount reach the target amount of Rs 50,000in 5 months. So at the end of 12 months you would have invested Rs 120,000 by adjusting the market returns, but the actual money that is debited from your bank account is Rs 113,865. And if we compare the gains on total investment, then we can see that VIP has managed to offer slightly better returns than SIP. But do not forget that here the comparison between SIP and VIP is made for the same underlying investment or scheme and the outcome may be otherwise in actual terms for different schemes, based on their performances.)

(The other similar concept is...)

Value Averaging Transfer Plan (VTP)

(Value-averaging transfer plan works on a similar concept while flexibly transferring money from one scheme to another based on the set target...)

- **VTP is similar to VIP in terms of the concept of investment** (...The difference here is that instead of a bank account, the money is transferred from a liquid fund to the selected equity fund)

- **Like VIP, VTP too helps one Invest by Flexibly Transferring More Money in the scheme when the Markets are Low and Less Money when the Markets are High**

- **The targeted amount and returns of the scheme are considered for arriving at the amount of subsequent transfers** (...from Liquid Fund to Equity Fund)

- **VTP may not be suitable for novice investors** (...They should instead consider investing via STP if in the early stage of investing.)

(The next concept is...)

Dividend Transfer Plan (DTP)

- **Dividend Transfer Plan as a concept works similar to Dividend Reinvestment Plan** (…but with a difference in structure.)
- **Through DTP one can choose to reinvest the Dividend Income either from a Debt Scheme to an Equity Scheme or from an Equity Scheme to a Debt Scheme** (…The idea is to move dividend income to a different asset class.)
- (So through DTP…)**The reinvestment of the Dividend Income can be done in another scheme but from the same fund house** (…Unlike dividend reinvestment where the dividend amount gets reinvested in the same scheme, through DTP the investor can instruct the fund house to reinvest the dividend amount in another scheme of his choice, as and when declared.)

(Another less popular but useful concept is...)

Systematic Withdrawal Plan (SWP)

(Systematic Withdrawal Plan is a smart way to plan for your future needs by withdrawing amounts systematically ...)

- **SWP helps Systematically Withdraw an amount of money from the invested mutual fund scheme on a regular basis** (…at pre-determined intervals) to meet the ongoing expenses of the investor (…It can be an effective tool to manage one's regular expenses during retirement phase.)
- **The money withdrawn through SWP can be credited to the bank account of the investor** (…as per the instruction of the investor)
- **SWP offers Fixed Withdrawal as well as Appreciation Withdrawal facility** (…Through fixed withdrawal, you as an Investor can specify the amount you wish to withdraw from your investment on a monthly or quarterly basis, while under Appreciation Withdrawal you can withdraw the appreciated amount on a monthly or quarterly basis.)
- SWP can help manage regular expenses without keeping the savings idle (…If you withdraw all your investment at one point then the withdrawn money may lie idle in your bank's savings account. But through SWP your money can keep on earning better returns by remaining invested, while you can meet your regular expenses.)

Some Key Takeaway Points!

- **Lump Sum Investment attracts market risk and can be rewarding if the long term trend of the economy is positive** (…and so it is suitable for investors who are ready to take High Risk for High Return)
- **Systematic Investment Plan or SIP helps develop disciplined investment strategy** (…and so it can be an effective financial planning tool.)
- (Even with small investments…) **SIPs can help you steadily build wealth over time**
- (Moreover…) **SIPs provide you with the benefit of Rupee Cost Averaging and Compounding**

- **Systematic Transfer Plan** (…which helps transfer a certain amount from one scheme to another…) is a relatively safer investment method than Lump Sum investment and higher yielding method than SIP investment

- **Value Averaging Investment Plan helps investors invest more when the markets are low and invest less when the markets are high** (…which helps lower the cost of purchase of units more effectively than SIP)

- (Like Value Averaging Investment Plan …) **Value Averaging Transfer Plantoo helps one Invest by flexibly transferring more money from one scheme to another when the markets are low and less money when the markets are high**

- **Dividend Transfer Plan can help reinvest the Dividend Income**(…earned by the investor) **from one scheme to another scheme** (…of the same fund house)

- **Systematic Withdrawal Plan (SWP)helps systematically withdraw a fixed amount of money from the scheme (on a regular basis)to meet the ongoing expenses of the investor** (…without keeping the savings idle)

Session 16: Analysing Risk Return and Performance of Mutual Funds

We are glad to have you with us for our Sixteen Session - **Analysing Risk Return and Performance of Mutual Funds.**

Alright so now let's get started with our learning session today and let us understand the various parameters that can help you analyse risk and evaluate the performance of mutual funds.

Evaluating Risk-Return is the primary step towards investing in mutual funds. You see, as other investment avenues carry risk, even mutual funds carry risk while they endeavour to create wealth for their investors in the long run. Hence you should choose mutual funds based on your risk tolerance level and return expectations. In today's session we will tell you how you can balance your risk and return with appropriate tools and data available, while you invest in mutual funds. Also while identifying and finalising the right mutual funds for your portfolio, you should make sure that they match your risk tolerance level and return expectation.

So what are some of the major…

Risks Associated With Mutual Funds

- **Market Risk** - Mutual Fund investments are subject to market risk, as the underlying investments where mutual funds invest - such as stocks and bonds - show uncertain movement. Do not forget the prices of these underlying instruments are driven by market sentiment and over a time period it may lead to volatility in the performance of the funds.

- **Industry Risk** - Any negative news / development in a particular industry may lead to a fall in stock prices for that particular industry, and therefore may impact the valuation of funds with a concentration towards such an industry.

- **Country Risk** - Country specific risk may have an impact on financial markets. This can be due to economic factors such as inflationary pressure, sovereign risk - i.e. default by government, etc; or even political events such as general elections, administrative functioning, policy decisions; or even natural disasters such as earthquake, flood, etc. All these may have a high impact on the performance of funds focusing towards any such country.

- **Currency Risk** - A swift upside or downside movement in currency may impact one's investment in offshore instruments. An Indian investor investing in a U.S. focused fund may earn high return in a scenario where the Indian Rupee suffers a huge depreciation against the U.S. dollar and vice versa.

- **Interest Rate Risk** - Interest rates and bond prices are inversely related. Any upside movement in interest rates may lead to downside movement in bond prices and thus impact its portfolio valuation, especially debt portfolio and debt mutual funds. However the impact of this risk may fade over time.

- **Credit Risk** - Also known as default risk arises when a bond issuer fails to meet his obligation of timely interest payment or principal repayment.

- **Principal Risk** - Any near term volatility or swift fall in prices of underlying instruments may lead to depreciation in fund value to levels even lower than the original investment. This may cause principal risk for investors.

- **Fund Manager Risk** - Fund manager risk can be experienced when the fund manager fails to execute the fund's investment strategy or meet its investment objective. Also a frequent change in fund managers may lead to such risk. However process driven fund houses are well placed to avoid such risk for its investors.

So you see, it is imperative for investors to identify mutual funds that can help them meet their investment objectives at the desired risk level. And mind you, gauging risk in a mutual fund scheme only on the basis of the NAV of the fund reports may not be a holistic assessment. It is noteworthy that, in a rising market, it is not altogether difficult to clock higher growth if the fund manager is willing to take higher risk. We have seen this on several occasions in the past - during the tech rally of 1999 and early 2000, as well as several mid cap rallies of the past.

So, assessing the past returns clocked by the mutual fund in isolation will be inaccurate, because they do not give you any indication of the level of risk you have been exposed to as an investor.

So here are the...

Indicators for Measuring Mutual Fund Risk

- **Standard Deviation (SD) - is the measure of risk taken by, or volatility borne by, the mutual fund** Mathematically speaking, SD tells us how much the values have deviated from the mean (average) of the values. SD measures by how much the investor could diverge from the average return either upwards or downwards. It highlights the element of risk associated with the fund and is calculated by using historical NAVs of the scheme. Higher SD indicates that the scheme carries high risk for investors. So if 2 schemes have generated identical returns, then you should choose the scheme with the lower SD, as it has managed to deliver returns at relatively lower risk.

- **Beta - is a measure of the volatility of the scheme in comparison to the market indices** Beta shows the extent to which the return of the scheme is impacted by market factors. Say a scheme's beta of 1.0 vis-à-vis the benchmark index like CNX Nifty will indicate that the scheme's risk is in line with the Nifty index, and will move in tandem with the index. A beta of less than 1.0 will indicate that the scheme is less volatile than the benchmark index; while beta of more than 1.0 will indicate that the scheme is more volatile than the benchmark index.)

- **R-Squared - It measures the correlation between the scheme's beta and its benchmark index and ranges between 0 and 1.** ...While 0 represents no correlation, 1 represents full correlation. A fund with low R-Squared means the fund will not give returns similar to its benchmark index, while R-Squared of an index fund (replicating a particular index) would be around 1 and may give returns in line with the benchmark index.

- **Duration - It measures a bond's sensitivity to changes in interest rates** In simple terms, duration shows the change in value of fixed income instrument that will result from a 1% change in interest rate. Longer the duration of a bond, higher the sensitivity and vice versa. The sensitivity of a debt mutual fund scheme to interest rate changes can be determined from its average duration. It can help you measure the level of interest rate risk you are exposed to, by holding the fund. If you have a low risk appetite, debt funds with higher duration may not be suitable for you.

  You see, below the historical returns of a mutual fund scheme, it is usually stated that, "past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments". This disclaimer is explicitly stated, whenever fund houses mention the past performance of a scheme. A reason why past performance is not entirely representative of a mutual fund's 'good showing' is because: it does not take into consideration the performance of its peers. It is possible that a fund has performed reasonably well (across relevant parameters) by itself, but hasn't quite made the mark when compared to its peers. So let us now take a look at the parameters that may help you compare the returns and performance of a mutual fund scheme with its comparable peer group, and help you assess whether or not you should invest in it.

Calculating Mutual Fund Returns

- **Absolute Returns - are the simple returns** ...i.e. the returns that an asset achieves, from the day of its purchase to the day of its sale, regardless of how much time has elapsed in between. This measure looks at the appreciation or depreciation that an asset - usually a stock or a mutual fund - achieves over the given period of time. Mathematically it is calculated as under:

$$\frac{\textbf{(End Value - Initial Value)}}{\textbf{Initial Value}} \text{ X } 100$$

- Generally returns for a period less than 1 year are expressed in an absolute form.

- **Annualised Return - shows the average annual return on investment over a period of time** ...It means if you earn an absolute return of 100% over a period of 5 years, then your annual return would be 20%. i.e. 100/5. Annualised return may not exactly indicate the annual growth you get on your investment.

  And hence you should consider...

- **Compounded Annual Growth Rate - CAGR can show you the year-on-year growth rate of your investment over a period of time** ...It can give you a better idea about the past performance of any investment. While selecting a mutual fund scheme one should look for and compare the scheme based on long term performance. The long term growth of a mutual fund scheme vis-à-vis its peers over a longer time period of say 3 years or 5 years, should be calculated in terms of CAGR.

  Mathematically CAGR is calculated as:

$$CAGR = \left(\frac{\text{Ending Value}}{\text{Beginning Value}}\right)^{\left(\frac{1}{\text{\# of years}}\right)} - 1$$

For calculating CAGR you need to consider your fund's end value, your initial investment value and the number of years of your holding.

- **Dividend Payout and Distribution of Bonus** - ...Not the least, while considering the return of a mutual fund scheme over a particular time frame, you should also account for all the Dividends and Bonus that have been distributed by the scheme in that time period. This point is relevant for investors looking to invest in a Dividend option of the scheme, as here it is imperative to calculate dividend-adjusted returns and / or bonus-adjusted returns.

Calculation of Returns

	Value (Rs)	**Absolute Return (%)**	**Annualised Return (%)**	**CAGR (%)**
Year 0	1,00,000	-	-	-
Year 1	1,10,000	10.0	10.0	10.0
Year 2	1,20,000	20.0	10.0	9.5
Year 3	1,30,000	30.0	10.0	9.1
Year 4	1,40,000	40.0	10.0	8.8
Year 5	1,50,000	50.0	10.0	8.4

The table shows the return calculation on an investment amount of Rs 1,00,000 over a period of five years. We can see that absolute returns keep on increasing with an increase in value. And even if the annualised returns for all the five years are the same i.e. 10%, the CAGR reduces gradually. So, different methods of return calculation can project different returns. Before falling in for any investment option showing you high returns, you need to check whether the returns are calculated in absolute terms or annualised or CAGR. You should always compare returns by applying the same method of calculation.

Making your investment decision by considering only historical returns and dividends in a mutual fund scheme can be risky. As we mentioned earlier, as an investor you need to also evaluate the risk involved in a mutual fund scheme before investing. But evaluating the investment option on any one of the two, i.e. risk or return on a stand-alone basis, will not be a prudent assessment. Hence before making any investment, the mutual fund scheme must be evaluated based on the risk-return criterion.

Indicators for Measuring Mutual Fund Performance based on Risk Return Parameters

- **Sharpe Ratio - A measure developed to calculate risk-adjusted returns** Sharpe Ratio measures how much return you can expect over and above a certain risk-free rate (for example, the bank deposit rate), for every unit of risk (i.e. Standard Deviation) of the scheme. Statistically, the Sharpe Ratio is the difference between the annualised return and the risk-free return divided by the Standard Deviation during a specified period.

Sharpe Ratio =	**(Portfolio Return - Risk Free Return)**
	Standard Deviation of the Portfolio

- Higher the magnitude of the Sharpe Ratio, higher would be the performance rating of the scheme. So if 2 schemes have delivered similar returns, you should choose the one with the higher Sharpe Ratio, as it has shown its ability to deliver better risk adjusted returns.

- **Treynor Ratio - It measures risk-adjusted return based on systematic risk** It is similar to the Sharpe ratio, with the difference being that the Treynor ratio uses Beta as the measurement of volatility, while the Sharpe ratio uses Standard Deviation.

Treynor Ratio =	**(Portfolio Return - Risk Free Return)**
	Beta of the Portfolio

- A scheme with a higher Treynor Ratio should be preferred as it indicates the scheme has excess return per unit of systematic risk or Beta.

- **Jensen's Alpha - Represents the difference between actual returns of the scheme vis-à-vis the expected returns of the scheme, over a period of time** A positive alpha means the fund manager has managed to generate returns in addition to the benchmark index, while a negative alpha means the fund manager has generated returns lower than its benchmark. So we can also say, Alpha indicates the ability of the fund manager to generate additional returns for investors.

Some Key Takeaway Points!

- (As...) **Mutual Funds Carry Risk** (...you should choose mutual funds based on your risk tolerance level and return expectations.)
- **Interest rates and bond prices are inversely related** (...Any upside movement in interest rates may lead to downside movement in bond prices and vice versa)
- **Process driven fund houses are well placed to avoid fund manager risk for their investors**
- **Standard Deviation measures the risk taken by the mutual fund scheme**
- (While...) **Beta shows the extent to which the return of the scheme is impacted by market factors**
- **Longer the duration, higher will be the sensitivity of the bond**
- (Do not forget...) **Compounded Annual Growth Rate (CAGR) is a better method to calculate long term growth of a mutual fund scheme**
- (You should...) **Always compare returns by applying the same method of calculation**
- **Sharpe Ratio is an important Ratio to measure risk-adjusted returns** (...of a mutual fund scheme)
- (While...) **Treynor Ratio measures risk-adjusted return based on systematic risk**
- (So...) **A scheme with a higher Sharpe Ratio or a higher Treynor Ratio should be preferred for investment**
- **Alpha indicates the ability of the fund manager to generate additional returns for investors**

Session 17: How to Select Mutual Funds

We are glad to have you with us for our Seventeenth Session - **How to Select Mutual Funds**

Alright so now let's get started with our learning session today and see how to select mutual funds prudently.

With a plethora of mutual fund schemes within each category - thanks to frequent New Fund Offers (NFOs) - the task of picking the right mutual fund can be rather mind boggling. It often creates a dilemma in the minds of the investors, as to how they should rightly select and invest in winning mutual funds.

While there is information galore to address this issue, we think that "information overload" could actually confuse investors and make the task of selecting mutual funds tougher rather than easier. Many investors also do feel that 'any' mutual fund can help them achieve their desired goals. But, let us apprise you that each mutual fund scheme is unique and caters to a certain risk profile and investment objective. Selecting mutual funds involves a rigorous process, where both quantitative and qualitative parameters are considered, as it is imperative to have consistent performers in your portfolio; those that can stand by you in sickness and health.

So, in this session of money simplified let us see the vital aspects, which you as an investor must study rigorously, in order to select winning mutual fund schemes for your portfolio.

Factors to consider while selecting mutual fund schemes

- **Performance** (...You see, past performance of a fund is important in analysing a mutual fund. But, remember that past performance is not everything, as it may or may not be sustained in the future. It is important to take a note of the following :
    - **Returns** (...Yes, returns are obviously one of the important parameters that one must look at while evaluating a fund. But remember, although it is one of the most important, it is not the only parameter. Many investors simply invest in a fund because it has given higher returns. In our opinion, such an approach for making investments is incomplete. In addition to the returns, one also needs to look at the risk parameters that explain how much risk the fund has undertaken to clock higher returns.)
    - **Risk** (...Risk in case of mutual funds is measured by Standard Deviation (SD) and signifies the degree of risk the fund has exposed its investors to. It is vital to check the risk a mutual fund scheme has exposed its investors to in order to have funds which fit in line with your risk profile as an investor. For example, if two funds have delivered similar returns, then a prudent investor will invest in the fund that has taken lesser risk i.e. the fund that has a lower SD.)
    - (You also need to check the...) **Risk-adjusted returns** (...clocked by a mutual fund scheme. This is measured by the Sharpe Ratio (SR). It signifies how much return a fund has delivered vis-à-vis the risk taken. In fact this ratio also tells us whether the high returns of a fund are attributed to good investment decisions, or to higher risk. Higher the Sharpe Ratio better is the fund's performance.

- **<u>Compare fund's performance</u>** (…This is because a fund's performance in isolation does not indicate anything. It is crucial to compare the fund with its benchmark index and its peers, so as to deduce a meaningful inference. And while comparing, one must take care so as to not compare apples with oranges.)

- (Also note the…) **Time period** (…on the basis of which you are judging the performance. It is imperative to have a long-term horizon (of at least 3-5 years) <u>if you wish to invest in equity oriented funds</u>. Besides, it is equally important to <u>evaluate how a fund has performed</u> over different market cycles (especially during the downturn). During a rally it is easy for a fund to deliver above-average returns; but the true measure of its performance is when it posts higher returns than its benchmark and peers during the downturn. So, choose a fund like you choose a spouse - one that will stand by you in sickness and in health.)

- (Then also check the…) **Portfolio Characteristics** (…where you need to evaluate aspects such as…

  - **Portfolio concentration** (…This parameter reveals the over-exposure of a mutual fund to a particular company or a sector. Funds that have a high concentration in particular stocks or sectors tend to be very risky and volatile. Hence, investors should invest in these funds only if they have a high <u>risk appetite</u>. Ideally, a well-diversified fund should hold no more than 50% of its assets in its top-10 stock holdings.)

  - **Liquidity of the portfolio** (…It is also vital to take note of how liquid a mutual fund scheme's portfolio is, by taking a look at the quality of equity instruments and debt papers held by the fund. Liquidity reveals the ease with which the portfolio - equity and debt - can be converted into cash. Hence, higher liquidity is always preferable.)

  - **<u>Portfolio turnover ratio</u>** (…This is also a parameter which you should look at. This parameter measures the frequency with which investment instruments in the portfolio are bought and sold. It also depicts whether the fund manager of the respective fund holds his portfolio with conviction towards the long-term fundamental portrayed by the security, or does he indulge in mere momentum playing. Higher the turnover rate, higher may be the churning, which may lead to excess volatility. The fund might not be able to compensate the investors adequately for the higher risk taken. So remember to invest in mutual fund schemes with a low portfolio turnover ratio if you want lower volatility.)

  - **Average Maturity, Modified Duration, Yield To Maturity** (…These parameters are important while evaluating debt mutual funds.

    The average maturity refers to weighted average time until all securities in a debt portfolio of a mutual fund mature. Lower the average maturity; the better it is in terms of the interest rate risk and lower volatility.

    Modified Duration (MD), reflects the responsiveness of the debt securities' price when the interest rate scenario changes. It is based on the inverse relationship between the price of the bond and interest rates. By taking this parameter into consideration, the volatility of the debt portfolio can be revealed.

YTM refers to the expected rate of return anticipated on a debt portfolio, if all instruments in the portfolio are held till maturity. It is also commonly referred to as the yield on the debt portfolio.)

- (Other parameters that may be crucial in identifying winning mutual funds are...) **Fund management team** (...You see, while the trustees assign the job of managing investors' money to the Asset Management Company (AMC), a check over the experience of the fund management team may ensure that you are giving your hard earned money to competent and deserving hands. It is imperative that the team managing investors' hard earned money has considerable experience in dealing with market ups and downs. Here it is vital to check the **fund manager's experience and performance**, because he is the one who manages your money.

  The true test of the fund manager lies during the bear phase. This is because the respective mutual fund schemes managed by the star fund manager must display limited downside risk during the turbulence of the equity markets, thereby attempting to protect wealth erosion. And indeed if the fund manager has delivered a luring performance, then you got to ponder over the question of what should you do if the fund manager leaves the organisation. While this may sound a bit too much of long- term thinking, in our opinion it is imperative in case where the mutual fund house is not process and system driven, whereby the fund manager has been given the leeway to manage a mutual fund scheme based on his individual conviction and fund management traits.

  While you are forming a view of the fund management team, you should also see...)

  - **Number of schemes the fund manager is managing** (...It is noteworthy that in the race to garner more AUM, many mutual fund houses frequently launch too many schemes. This results in the fund manager being overburdened with managing multiple schemes, which could result in lower efficiency of the fund manager on focusing on the need of his investors. So a fund manager ideally should not solely manage more than 4 to 5 schemes, as any number beyond this would reflect increasing pressure on the fund manager, which may result in reducing efficiency and replicating the portfolio, which consequently may defeat the unique mandate of each scheme managed by him.)

- (Then you also need to look at the...) **Cost of investing** (...where you need to evaluate the expense ratio and exit load...)

  - **Expense Ratio** (...You see, like any other organisation, a mutual fund house also incurs annual expenses such as administrative costs, management fees, etc. to run its business. Expense Ratio is the percentage of assets that go towards these expenses. Every time the fund manager churns his portfolio, he pays a brokerage fee; which is ultimately borne by the investors in the form of expense ratio. So remember to invest in a fund having low expense ratio and stay invested in it for a longer duration.)

  - **Exit load** (...Likewise, you should also be checking the exit load that respective mutual fund schemes would charge. An exit load is levied when you sell your units of a mutual fund within a particular tenure. Most funds charge the investor if the units are sold within a year from the date of purchase. As exit load is a fraction of the NAV, it eats into your investment value. Thus it is imperative that you invest in a fund with a low exit load, and more importantly stay invested for the long-term.)

Points to Consider while Investing with a Fund House

(Now apart from the factor which we just learnt of, here are some broader points for you to know while investing with a fund house.)

- **Fund sponsor with integrity** (...As you have learnt in one of our earlier learning session that, sponsors are individuals or entities who initiate the process of forming a mutual fund. While SEBI would grant permission to start a mutual fund only to a person of integrity, with significant experience in the financial sector and a certain minimum net worth; it imperative for you to be satisfied (by your own judgement) on these aspects.)

- **Judge the credibility** (...In order to judge the credibility of a mutual fund house, you must read two things in the offer or information document, which are:

    - **Investor grievances** (...You see, every fund has to disclose the status of investor grievances in the statement of additional information /offer document / prospectus of the fund. The mutual fund house has to reveal the number of queries and complaints received towards a particular scheme and the complaints addressed. This information shows investors, how proactive and responsive a fund can be towards investor grievances.)

    - **Penalties & pending litigation** (...Likewise every fund has to disclose the penalty imposed on the mutual fund house or the fund sponsor for any economic offence or violation of any securities' laws. Also they have to disclose any pending litigation or proceedings towards the mutual fund, fund house, trustees, associated companies, or the directors of the mutual fund house.)

- (Then you must also check the broader...) **Investment philosophy, processes and systems followed at the fund house** (...It is noteworthy that, processes and systems followed at respective fund houses, have a major impact on individual mutual fund scheme's performance. Thus, it is important for you as an investor to delve a little deeper in understanding these aspects before entrusting your hard earned money to respective fund houses, in mutual fund schemes managed by them.)

- **Investment style** (...is also what you must watch out for. Generally, every mutual fund house has a forte in a particular fund management style i.e. value, growth, opportunities, etc. Thus it is vital to assess the same, in order to see what suits your need.)

(So before we end our learning session today, here are some key takeaway points...)

Some Key Takeaway Points!

- **Care should be taken while selecting mutual fund schemes** (...so as to have the appropriate ones that can help you meet your financial goals.)

- (Remember...) **Each mutual fund scheme is unique and caters to a certain risk profile and investment objective**

- (Therefore...) **Have mutual fund schemes from the respective categories as per your investment objectives**

- **Both quantitative and qualitative parameters should be considered for selecting mutual funds** (…as it is imperative to have consistent performers in your portfolio)

- **Analysing past performance is important, but is not everything**

- **Returns is one of the parameters to assess mutual fund scheme, but not the only parameter**

- **Risk parameters should be gauged by assessing the standard deviation** (…If two mutual fund schemes within a category have delivered similar returns, then as a prudent investor you should invest in the fund that has taken lesser risk i.e. the fund that has a lower standard deviation.)

- (Risk taken should commensurate with the returns generated by the mutual fund scheme; so...) **check the Sharpe Ratio** (…Higher the Sharpe Ratio better is the fund's performance.)

- **Compare mutual fund schemes prudently with its peers and benchmark** (…because a fund's performance in isolation does not indicate anything.)

- **Performance of a mutual fund scheme should be judged over a longer time horizon** (…of at least 3 to 5 years)

- **Evaluate mutual fund schemes over bull and bear phases of the markets**

- **Check the portfolio characteristics**, (…wherein see: portfolio concentration, liquidity of the portfolio, portfolio turnover ratio, average maturity, modified duration and YTM)

- **Know the fund management team well** (…wherein assess the expertise of fund managers by taking a view of number years of experience in fund management and educational qualifications.)

- **Ascertain the cost of investing** (…by checking the expense ratio and exit load levied by the mutual fund scheme)

- (Also...) **Ascertain the taxation aspect of a mutual fund scheme** (…before investing)

- **Do not rely heavily on star ratings** (…for picking mutual fund schemes. Do your own home work and select those that fit your requirement. You see, most star ratings are on the principle of "one size fits all"; which is not the case in reality.)

Session 18: Model Portfolios based on Risk Appetite and Time Horizon

We are glad to have you with us for our Eighteenth Session - Model Portfolios based on Risk Appetite and Time Horizon.

Alright so now let's get started with our learning session today and see how you should build an optimal mutual fund portfolio based on your risk appetite and time horizon.

In our previous lecture, we told you how to select winning mutual funds. Once you have done so, the next step would be to build an optimal mutual fund portfolio that can help you achieve your investment objective over a longer time period. But identifying right funds and building a mutual fund portfolio may not be a simple task. With over thousands of mutual funds available today, the task can become herculean and complex, as there may be funds that may not be doing what they say, and hence may not be suitable for your portfolio. So you need to be careful.

In today's session we will tell you about how to go about building a mutual fund portfolio. And more importantly we will tell you about how to structure a mutual fund portfolio based on your risk appetite and time horizon.

So let us first understand the...

Process of Building a Mutual Fund Portfolio

While there is no standard rule to this, we can broadly divide the process of building a mutual fund portfolio into two steps. The first step involves eliminating mutual fund schemes and the second step involves selecting mutual fund schemes for the portfolio.

- **Process of elimination** (...As you need to be cautious while picking mutual funds for your portfolio, the process of elimination is important while building your portfolio. You should clearly know what kind of mutual fund schemes may suit you. So that you can have the right funds in your portfolio and know what kind of funds you should avoid. Moreover, you should question the existence of every mutual fund in your portfolio, so that you are left only with the funds that suit your profile. Now while eliminating mutual funds, one has to keep in mind the following points...

  - **Define your filtration criteria:** (...Filtration plays an important role while selecting funds for your portfolio. As you may be looking for funds that have shown a consistent track record in the long run, you may not like to add funds that have no track record or less track records to show. Hence you can have an initial criterion like, funds that have not completed a 3-Yr track record. With this you will be automatically left with those that have at least a 3-Yr track record.)

  - (You should clearly define and...) **Refrain from investing in schemes not suitable for you** (...If you have a low risk appetite, then you can <u>refrain from investing in sector/thematic mutual funds</u>, as such schemes have a tendency to plunge more during the downturn. It is best to opt for mutual fund schemes with a broad investment mandate, championed by well-diversified equity funds. Eliminating all sector/thematic funds, would leave you with just the well-diversified ones.)

  - **Limit the number of funds in your portfolio:** (...It's important for you to guard yourself against over-diversification. Hence you should limit the number of funds in your portfolio. Do not forget, your fund manager is already taking care of diversification and hence there is little point in diversifying something that is already diversified.)

  - **Avoid duplication:** (...If there are two or more mutual funds that seem to be doing the same thing in terms of mandate or style, then you have to ensure that you are left with just the best in that category and eliminate the rest. <u>Do a peer comparison</u>.)

  - **Eliminate inconsistent performers:** (...Finally, evaluate fund's performance over a long-term (say 3-5 years) and over various market cycles. This will enable you to understand whether the equity fund under review has stood the test of time. Many momentum funds may do reasonably well during a swift market rally in the short term, leading investors to believe they are well-managed funds. But do not forget, if the markets had not appreciated sharply, the fund may have been one of the dismal performers over this period. It takes a bear phase to separate the men from the boys. Eliminating such funds may help you shortlist consistent performers.)

- **Process of selection** - (...Once the elimination process is performed by the investors diligently enough, the second step will come naturally. For instance, if you have ignored all the sector/thematic funds, that leaves you with just the well-diversified ones. Likewise, if you eliminate all funds that have not completed a 3-Yr track record, you are automatically left with those that have a minimum 3-Yr track record. So while selecting mutual funds for your portfolio, you must keep the following points in mind...)

- **Select across market caps:** (...Investors should have a mix of both large cap as well as mid cap funds, since both have their inherent strengths. When both are well-selected, they can reward the investor handsomely over the long-term. The proportion of investments in large cap funds will depend upon the risk appetite of the investor. For example, a 25-year old person would have a higher allocation towards mid cap funds, when compared to large cap funds. Similarly, it also pays to invest in an equity fund that can invest in both large caps and mid caps depending on the opportunity; these funds are commonly referred to as opportunities or flexi cap funds.)

- **Select across investment style:** (...Investors should go for both - well-managed growth style and value style equity funds. This will help capitalise on opportunities across the board. Growth funds invest in well-managed companies that are likely to show high growth going forward. Whereas, value style funds invest in well-managed companies that are undervalued temporarily, but have the potential to achieve their fair value in the future.)

- **Select across asset class:** (...Investing in a mix of equity and debt or a hybrid fund can help bring in stability to the portfolio on account of the provision in the investment mandate for investment in debt. But while deciding on the allocation between equity and debt, it is vital to judge your risk appetite, and follow a prudent approach.)

  To top it all, your selection process must purely be based on research and analysis. Your agent, neighbours and colleagues are welcome to air their views, but remember at the end of the day it's your own hard earned money.

Once you are aware about the process of picking mutual funds to build a portfolio, the next step would be building an ideal mutual fund portfolio that can meet your investment objectives.

So let's see what can be different...

Approaches to Building a Mutual Fund Portfolio

- **Building Portfolio based on Risk Appetite** *(...Defining your risk appetite plays an integral role in building an ideal mutual funds' portfolio. You can define your risk appetite as ...)*

  - **Aggressive Risk Appetite** (...Investors who have a penchant for making high returns by taking high risk can be termed as aggressive. Such investors can include high growth funds in their portfolio that can generate high returns in the future.)

  - (Investors with...) **Moderate Risk Appetite** (...may look for decent return, but at the same time would not like to take high risk. Such investors need to balance their portfolio well between growth and stability.)

  - **Conservative Risk Appetite** (...Some investors may not like to take risk with their money and hence prefer stability over growth. If you have a conservative risk appetite, then you should look for stable funds that have the ability to limit downside risk during uncertain market conditions.)

% of portfolio based on Risk Appetite			
Market Cap / Style	**Aggressive**	**Moderate**	**Conservative**
Large-cap Funds	20%	30%	40%

Mid-cap Funds	30%	10%	-
Multi-cap Funds	10%	20%	20%
Flexi-caps / Opportunities	30%	20%	-
Balanced Funds	-	20%	40%
Sector / Thematic Funds	10%	-	-
Portfolio Total	**100%**	**100%**	**100%**

- The table here shows how you can allocate your portfolio to various categories of mutual funds based on your risk appetite. So while an aggressive investor can have high exposure to mid-caps and such high growth funds, a conservative investor should have high exposure to large caps and balanced kind of funds that are known to be more stable. And as you can see a Moderate risk investor can have a mix of aggressive and stable funds in his portfolio. Based on your risk appetite, you should define an allocation to various categories of mutual funds that may be suitable for you and then pick the best funds based on your parameters under each category for your portfolio.

- **Building Portfolio based on Strategy** (…You can optimise your portfolio by having a proper strategy. You should clearly know the purpose of each holding in your portfolio. So accordingly you can classify the components of your portfolio into…)

% of portfolio based on Strategy - Risk wise			
Market Cap / Style	**Aggressive**	**Moderate**	**Conservative**
Core	**50%**	**60%**	**80%**
Large-cap Funds	20%	30%	40%
Mid-cap Funds	20%	-	-
Multi-cap Funds	10%	20%	10%
Balanced Funds	-	10%	30%
Satellite	**50%**	**40%**	**20%**
Mid-cap Funds	10%	10%	-
Multi-cap Funds	-	-	10%
Flexi-caps / Opportunities	30%	20%	-
Balanced Funds	-	10%	10%
Sector / Thematic Funds	10%	-	-
Portfolio Total	**100%**	**100%**	**100%**

  - **Core Holdings** (…The key and stable holdings in your portfolio that you intend to preserve in your portfolio irrespective of market conditions are your core holdings. The core holdings in your portfolio can help you steadily grow your wealth in the long run and may help you meet your extreme long term goals.)

  - (While the…) **Satellite Holdings** (…in your portfolio are like toppings that can add a flavour of extra-ordinary returns to your portfolio. These can be high risk-high return kind of funds that you may add to your portfolio for additional returns. But while doing so, you need to be ready to bear the excess volatility that it may bring to your portfolio. Moreover you may need to keep a close track of such holdings and take timely measures during unfavourable conditions.)

- The portfolio table shown here is an example of a Strategic portfolio. You see, the proportion of core and satellite holdings in your portfolio may vary based on your risk appetite. So a conservative investor would prefer stability over growth and hence would hold more of core holdings as they bring stability to the portfolio while having a low penchant for extra-ordinary returns. On the other hand an aggressive investor would be ready to take high risk for high growth and maintain a relatively high exposure to satellite holdings that can bring him extra-ordinary gains. And as we said earlier, investors with moderate risk appetite would maintain a decent balance between stability and growth as per their risk tolerance.

- **Building Portfolio based on Asset Allocation** (...Diversification is key to the success of an investment portfolio. You should have proper diversification across asset class.)

    - (Based on your risk appetite you need to...) **Define a Standard Allocation across asset class (i.e. equity, debt and gold)** (...While aggressive investors may have high allocation towards equities, a conservative investor should prefer relatively higher diversification to other asset class, mainly debt investments that can help maintain stability to the portfolio. Do not forget, you may need to review and change your standard allocation as you progress in your age and nearness to financial goals.)

% of portfolio based on Asset Allocation - Risk wise			
Market Cap / Style	**Aggressive**	**Moderate**	**Conservative**
Equity	**80%**	**60%**	**30%**
Large-cap Funds	20%	30%	40%
Mid-cap Funds	30%	10%	-
Multi-cap Funds	10%	20%	20%
Flexi-caps / Opportunities	30%	20%	-
Balanced Funds	-	20%	40%
Sector / Thematic Funds	10%	-	-
Debt	**10%**	**25%**	**50%**
Long Term Income Funds	40%	30%	20%
Short Term Income Funds	40%	40%	40%
Money Market / Liquid Funds	20%	30%	40%
Gold ETFs / Funds	**10%**	**15%**	**20%**
Portfolio Total	**100%**	**100%**	**100%**

    - (Moreover, you need to...) **Regularly monitor and keep a proper track of your allocation** (...As your allocation to each asset class may vary over a period of time. You should review the allocation of your portfolio every 6 to 12 months, especially if there is a swift rally in any of the asset class. This will help keep your portfolio under control and you can take timely measures.)

    - **Timely Rebalance your Asset Allocation** (...Moreover you need to make sure that the allocation to each asset class in your portfolio is not deviating from the standard allocation you have set for your portfolio. And if it does, then you need to timely rebalance your asset allocation. So if your allocation to equity, debt and gold has moved from your standard allocation of 60:20:20 to 70:15:15, then you can book the additional 10% growth in equities and shift it to debt and gold, in order for the allocation to once again reach 60:20:20)

- The table here shows how a mutual fund portfolio can be structured based on asset allocation. As you can see, the portfolio is spread across equity, debt and gold based on one's risk appetite. So if you are an aggressive investor, you may consider equity as a catalyst for wealth creation whereby you hold 80% allocation in equity, and just 10% allocation each for debt and gold. On the other hand, if you are a moderate and / or a conservative investor, you would prefer a higher level of stability. So in such a case you may hold lower exposure to equity and high exposure towards debt and gold. So the allocation for moderate and conservative investors can be 65:25:15 and 30:50:20 respectively across equity, debt and gold. Further, under each asset class you can define the allocation to various styles and categories of mutual funds that can cater to your investment needs.

- **Building Portfolio based on Time Horizon** (…Considering your time horizon is a must while building your portfolio. You cannot put your money in risky assets if you need it in the next 3 to 6 months or even 12 months. You should ideally reduce your allocation to risky assets if you are nearing your goal and / or have low time horizon.)

    - (So accordingly if you have...) **Short time horizon** - (…you need to have…) **High exposure to a low risk asset class**

    - (On the other hand if you have…) **Medium Time Horizon** - (…you can have…) **Balanced exposure across asset class**

    - (Besides, if you have…) **Long time horizon** - (…You can have…) **High exposure to risky asset class**

% of portfolio based on Time Horizon				
Market Cap / Style	**Less than 3 Mths**	**3 to 12 Mths**	**1 Yr to 3 Yrs**	**Above 3 Yrs**
Equity	**0%**	**0%**	**0% to 10%**	**80%**
Equity Mutual Funds	-	-	Allocate across category based on your risk appetite	
Debt	**100%**	**100%**	**80% to 100%**	**0% to 20%**
Long Term Income Funds	-	-	50%	60%
Short Term Income Funds	-	50%	50%	40%
Money Market / Liquid Funds	100%	50%	-	-
Gold ETFs / Funds	**0%**	**0%**	**0% to 10%**	**10% to 20%**
Portfolio Total	**100%**	**100%**	**100%**	**100%**

- As you can see in the table - investors having a shorter time horizon, i.e. less than 12 months should hold no exposure to equity and gold, while the entire exposure can be in fixed income assets. But you need to be careful, not all income funds are safe and so you need to be selective. And investors who have medium to longer investment time horizon can increase their exposure towards equities and risky asset class, with some exposure towards gold. So once you have defined your investment time horizon, you can allocate your portfolio to the right category of mutual funds.

Key Takeaway Points!

- (You should...) **Follow a proper elimination and filtration process while building your mutual fund portfolio**
- (You should...) **Limit the number of funds in your portfolio**
- (Make sure that you...) **Spread your portfolio across investment styles and market caps** (...according to your risk appetite)
- (So...) **Build your portfolio based on your risk appetite**
- **As an aggressive investor you can look for high growth funds**
- **As a conservative investor you would prefer stability and should hold stable funds** (...in your portfolio)
- (While...) **As an investor with Moderate risk appetite you should maintain a fair balance between growth and stability**
- (You should...) **Define a standard allocation across asset class and timely <u>rebalance your portfolio</u>** (...if it deviates from your standard allocation)
- (Moreover...) **Your time horizon is a must while building your portfolio**

Session 19: Tax Planning with Mutual Funds

We are glad to have you with us for our Nineteenth Session - Tax Planning with Mutual Funds.

So let us now begin with our learning session today.

All of us engage in an economic activity and work hard to make a living. But as we do that, it becomes imperative for us to work a little harder and smarter, to <u>save our taxes the legitimate way</u>, so that it can help us make our dreams come true. While there are a host of provisions under the Income Tax Act, 1961 and numerous investment avenues, in our learning session today, we'll take you through how you could use mutual funds in your tax planning exercise and the aspects you <u>must consider while investing</u>, so as to save tax through this investment instrument the prudent way.

So let's understand the special category of schemes that mutual funds offer, in order to save tax.

Equity Linked Saving Schemes (ELSS)

- (This is...) **A category in mutual funds that offers tax saving benefits to investors** (...It is popularly also known as tax saving mutual funds)
- (They...) **Are <u>diversified equity funds</u>** (...as they invest a dominant portion of their assets in equities across market capitalisation segments and sectors)
- (A distinguishing feature about them is that...) **ELSS are subject to a compulsory lock-in period of 3 years**
- **Most ELSS allow a minimum investment of** (...as low as...) **Rs 500, while there is no upper limit**
- (Like any other equity mutual fund scheme...) **ELSS allow you to invest either in lump sum or through <u>Systematic Investment Plan (SIP)</u>** (...which is a mode of investing)

- **Investment in ELSS is possible irrespective of income earned by the individual or whether he's old or new to investing in equity markets**

And what's the Tax Benefit...

- (Investment in ELSS...) **Makes an investor eligible for a tax deduction under section 80C of the Income Tax Act, 1961; subject to a maximum limit of Rs 1 lakh per annum**
- (Moreover at the end of the lock-in period and at exit if there is any gain - it is classified as Long Term Capital Gains as per the current tax provisions...) **Being an equity scheme, Investors need not pay any Tax on the Long Term Capital Gains in ELSS**

Then there are...

RGESS Mutual Funds

- **Rajiv Gandhi Equity Saving Scheme (RGESS) is a tax saving avenue introduced by the Central Government in the Union Budget 2012-13**
- **Mutual funds too are eligible to launch mutual fund schemes investing in instruments as enunciated for RGESS** (...It is noteworthy that RGESS is targeted towards attracting the new retail investors into equity markets)
- (Thus...) **Only first time equity investors** (...who do not have a demat account, or have one but not made any transactions in equities till the date of notification of RGESS i.e. November 23, 2012...) **can claim tax benefit under RGESS**
- (Moreover...) **RGESS is available to those whose gross annual income is less than or equal to Rs 12 lakh**
- **In case of mutual funds, the units of RGESS eligible Exchange Traded Funds (ETFs) and mutual fund schemes** (which are traded and listed on the exchange) **can be considered for investing in RGESS and to avail a tax benefit**
- (Also... Apart from RGESS mutual fund schemes, the...) **Other securities eligible for investing in RGESS and to avail a tax benefit are:**
    - **Top 100 stocks listed under S&P BSE-100 and CNX-100**
    - **Stocks of Maharatna, Navaratna and Miniratna Public Sector Undertakings (PSUs)** (... including their Follow-on Public Offers (FPOs))
    - **IPOs of PSUs with Government stake not less than 51%, with revenue of Rs 4,000 crore in the last three years**

      So by investing predominantly in large cap and PSU domain, RGESS attempts to provide a relatively safer avenue in equity investing and ensure liquidity. Moreover, in order to make it convenient to identify the eligible stocks and mutual funds the stock exchanges have to furnish a list of RGESS eligible stocks / ETFs / MF schemes on their website. Also, whenever there is any change in the said list, the revised list will also be forwarded to the depositories at monthly intervals, while mutual fund houses shall communicate the list of RGESS eligible MF schemes / ETFs to the stock exchanges.
- **The maximum investment permissible under RGESS is Rs 50,000**
- **The money invested in RGESS mutual funds** (...and even the other eligible instruments for RGESS...) **is subject to an overall lock-in period of 3 years**

- (It is noteworthy that...) **The scheme has a fixed lock-in period of 1 year, on the expiry of which one can sell / pledge / hypothecate one's securities** (But...) **Withdrawal of money before 3 years is not possible**
- (However...) **Investors are allowed to churn their portfolio during the flexible lock-in period** (i.e. after the completion of the fixed lock-in period of 1 year)
- (Further...) **In case the investor fails to comply with any condition specified in RGESS, the benefits availed there under are withdrawn and the investor is liable for tax payment**

You see, while there are a host of instruments for investing in RGESS and to avail a tax benefit, investing in RGESS eligible ETFs and / or schemes offered by mutual funds, can aid first time retail investors because mutual funds provide the expertise of professional fund management. Otherwise, first time retail investors may find difficulty in identifying the right stocks and the valuations at which they should include them in their portfolio. By routing their money through mutual funds, they can be confident that their money will be used more efficiently in identifying the right stocks at right valuations through a process driven investment strategy.

And what's the Tax Benefit...

- (The investment amount makes an investor eligible for...) A tax deduction under section 80CCG of the Income Tax Act, 1961 to the tune of 50% of the amount invested for investments of up to Rs 50,000 only

But before you invest your hard earned money in ELSS and / or RGESS in your endeavour to save tax, here are a few important aspects that you should consider...

Things to consider before investing in ELSS and RGESS mutual funds

- **Your Age** (...As we have learnt in our earlier learning sessions, your age determines your asset allocation. Usually at a younger age the ability to take risk is high and vice-versa. Thus for prudent tax planning too, if you are young, you should allocate more towards market-linked tax saving instruments such as ELSS and RGESS, and less if you are much older. If you are young, the investment horizon would be fairly long, which in turn would enable you to make more aggressive investments and create wealth over the long-term to meet your financial goals.)
- (Then comes...) **Your Income** (...If your income is high, your willingness to take risk is generally high. This thus can facilitate you to skew your portfolio more towards equity related instruments such as ELSS and RGESS, in the endeavour to save tax. But if your income is not high enough, then tax planning the assured return way - by investing in instruments such as Public Provident Fund (PPF), National Savings Certificates (NSCs), 5 Yr Bank Fixed Deposits, etc - would be appropriate.)
- (Likewise...) **Your Expenses & Liabilities** (...should also be considered. If one is shouldering more expenses and have obligations to meet, then investing in ELSS and RGESS which offer market-linked returns may not be suitable. But if one has well-controlled expenses and liabilities, which result in higher investible surplus, market-linked tax saving instruments can be explored.)
- (Also...) **Your Financial Goals** (...If you have financial goals set in your life such as buying your dream home, a car, planning for your children's education, their marriage, your retirement, etc.; the same too could have an influence on your tax planning and investment in tax saving instruments. So, say for example your goal is to retire from work 5 years from now, then your tax saving investment portfolio should also be less skewed towards market-linked tax saving instruments such as ELSS and RGESS, as you are quite near your goal and your regular income will stop soon.

But if you are many years away from your financial goal, you should ideally have maximum allocation to market linked tax saving instruments such as ELSS and RGESS, and less towards those tax saving instruments which provide you low assured returns.)

- (And then comes...) **<u>Your Risk Appetite</u>** (...It refers to an individual's willingness to take risk on the basis of an assessment of various facets such as age, income, expenses & liabilities and financial goals that we just learnt of. So, say if your risk appetite is categorised as high, you can skew the tax saving portfolio more towards market-linked tax saving investment instruments such as ELSS. But if your risk appetite is relatively low, your tax saving investment portfolio should ideally be skewed towards instruments which offer you assured returns. And if you are a moderate risk taker, you can take a mix of 60:40 into market-linked tax saving instruments and assured returned tax saving instruments respectively.)

  So to summarise what we just learnt: if your age permits i.e. if you are young, income is high, expenses & liabilities are low and therefore willingness to take risk is high along with your financial goals being far away; you may look at ELSS and RGESS to avail a tax benefit under section 80C and 80CCG respectively of the Income Tax Act, 1961.

Now before we end our learning session today, here are some points you need to remember...

Points to Remember...

- **<u>Effective tax planning</u> is possible if options available under mutual fund investing are well-explored and one has invested smartly**

- **ELSS funds are subject to a compulsory lock-in period of 3 years**

- **Investing in ELSS offers tax benefits under section 80C of the Income Tax Act, subject to a maximum limit of Rs 1 lakh** (...However it should be noted that one can always invest more than Rs 1 lakh in ELSS, but the tax benefit would be restricted only to a sum of Rs 1 lakh.)

- **RGESS eligible ETFs and mutual fund schemes** (...and the other securities eligible for RGESS...) **provide tax benefit to first time retail investors**

- **RGESS benefit is available to those whose gross annual income is less than or equal to Rs 10 lakh**

- **The maximum Investment permissible under RGESS is Rs 50,000**

- **Investment in RGESS mutual funds** (...and the other securities eligible for RGESS...) **is subject to an overall lock-in period of 3 years and a fixed lock-in period of 1 year**

- **Investment in RGESS mutual funds** (...and the other securities eligible for RGESS...) **offers a tax deduction under 80CCG of the Income Tax Act, 1961 to the tune of 50% of the amount invested**

- (And last but not the least...) **While investing in market-linked tax saving instruments it is vital to consider age, income, expenses & liabilities, financial goals, etc.**

- (...and assessing all these) **Judge your risk appetite and thereafter invest in ELSS and RGESS mutual funds**

Session 20: Understanding Tax Implications on Mutual Funds

We are glad to have you with us for our Twentieth Session - Understanding Tax Implications on Mutual Funds

So let us now begin with our learning session today.

In our previous session we told you how you can avail of tax saving benefits by investing in mutual funds. But do you know, the gains you make from your investments in mutual funds may be taxable?

So whenever you select any form of investment, make sure that you are well versed with the taxation part of it too. Knowing the tax implication will help you understand the net returns (after adjusting for tax) you will enjoy on your investments.

So, let us see what are the tax implications of investing in mutual funds. But before that, let us see what are the...

Factors determining tax status of mutual funds

- (First you need to know the...) **Type of Mutual Fund** (...you are investing in; whether it qualifies under equity mutual fund or debt mutual fund)
  - **Equity Funds** (...You see, any fund holding over 65% of its assets in equity shares in domestic companies qualifies as an equity oriented fund from a taxation perspective.)
  - **Non-Equity Funds** (...are those that hold less than 65% of their portfolio in equities and equity related instruments. They can be debt funds, debt oriented hybrid funds or liquid and money market mutual funds)
- **Type of Income** (...In mutual funds, you may earn income in the form of dividends and /or capital gains.)
  - **Dividends** (...While investing in mutual funds, if you have opted for the dividend option and are in receipt of dividend income from the mutual fund scheme(s), it is tax free in your hands as an investor.)
  - **Capital Gains** (...It is the profit that you make from your investment in a mutual fund scheme)
- (But the...) **Period of holding and Capital Gains** (...are important to determine the capital gain tax on your mutual funds. So your capital gains could be either long term capital gain or short term capital gain.)
  - **Long Term Capital Gain** (...In mutual funds, any holding over a period of 1 year is considered as long term. So if you make a gain on your investment in a mutual fund scheme that you have held for over 1 year, it will be classified as Long Term Capital Gain)
  - **Short Term Capital Gain** (...If your holding in a mutual fund scheme is less than 1 year i.e. if you withdraw your investment in a mutual fund scheme before 1 year, after making a profit, then the profit will be considered as Short Term Capital Gain)
- **Tax Status** (...your tax status is also important to determine the tax implication on your investment in a mutual fund.)
  - (So you may be investing as a...) **Resident Individual** (...or...) **Hindu Undivided Family (HUF)**
  - **Partnership Firm / Association of Person (AoP) / Body of Individual (BoI)** (...whether incorporated or not)
  - (Or you may be investing as a...) **Domestic Company**

- (...<u>In case your residential status is...) NRI</u> (...then your residential status may have an impact on the tax implication of your mutual fund investment. And we'll explain to you how.)

Tax Implication on Equity Mutual Fund Investments...

Type of unit holder	**Distribution Tax**
	FY 2014-15
Resident Individual/HUF	NIL
Resident Partnership Firms/AOP/BOI	NIL
Domestic Companies	NIL
NRIs	NIL

- (In case you have opted for the dividend option while investing in an equity oriented mutual fund, it is noteworthy that the...) **Dividend received from an equity oriented scheme is exempt from tax** (...as dividend income is tax free in the hands of the investor.)

- (Moreover there is...) **No dividend distribution tax borne by the mutual fund house on the dividend distributed by them in case of equity mutual funds**

For Capital Gains on Equity Mutual Funds			
	Short Term Capital Gains Tax (Period < 1 Year)	**Long Term Capital Gains Tax (Period > 1 Year)**	**TDS**
	FY 2016-17	**FY 2016-17**	**FY 2016-17**
Resident Individual / HUF	15%	Nil	Nil
Domestic Companies / Partnership Firms / AOP / BOI	15%	Nil	Nil
NRIs	15%	Nil	STCG - 15% ^ LTCG - Nil ^

^ Plus applicable surcharge and secondary and higher education cess. Securities Transaction Tax (STT) @ 0.025% on redemptions / switch over

- (As you could see that...) **There is no Long Term Capital Gains Tax on equity mutual fund schemes** (...So, by investing in equity mutual fund schemes for the long-term i.e. for a period of more than 12 months, you will not be liable to pay any long term capital gains tax.)

- (But in case if you've booked profits in the short-term i.e. within a period of less than 12 months, you'll be liable to pay...) **Short Term Capital Gains Tax on equity oriented mutual funds @ 15%**

- **Securities Transaction Tax (STT) @ 0.025%** (...will be deducted on equity funds at the time of redemption i.e. sale of units or switch to the other schemes)

Apart from this, a Surcharge @10% is levied in case you are an individual investor or an HUF, whose income exceeds Rs 1 crore.

Also Surcharge @ 5% is levied for domestic corporate unit holders whose income exceeds Rs 1 crore, but is less than 10 crore. In case where the income exceeds 10 crore, a surcharge is levied @ 10%.)

Tax Implication on Debt Mutual Fund Investments...

	Dividend Income	**Dividend Distribution Tax - Liquid / Money Market / Debt Schemes**	**Dividend Distribution Tax - Infrastructure Debt Funds**
	FY 2016-17	**FY 2016-17**	**FY 2016-17**
Resident Individual / HUF	Tax free	28.84 % (25% + 12% surcharge + 3% education cess)	28.84 % (25% + 12% surcharge + 3% education cess)
Domestic Companies / Partnership Firms / AOP / BOI	Tax free	34.608 % (30% + 12% surcharge + 3% education cess)	34.608 % (30% + 12% surcharge + 3% education cess)
NRIs	Tax free	28.84 % (25% + 12% surcharge + 3% education cess)	5.768 % (5% + 12% surcharge + 3% education cess)

- (As seen here in the table...) **Dividend income received is exempt from tax, in case of <u>debt mutual fund schemes</u> as well**

- (But there's a...) **Dividend Distribution Tax** (...that...) **is deducted by debt mutual fund schemes while they distribute dividends** (...It is @ 25% plus 10% surcharge and 3% cess for individuals, and 30% plus 10% surcharge and 3% cess for corporates.)

For Capital Gains Tax on Non-Equity / Debt Mutual Funds			
	Short Term Capital Gains Tax (Period < 3 Year)	**Long Term Capital Gains Tax (Period > 3 Year)**	**TDS**
	FY 2016-17	**FY 2016-17**	**FY 2016-17**
Resident Individual / HUF	As per Tax Slab	20% with Indexation	Nil
Domestic Companies / Partnership Firms / AOP / BOI	30%		Nil
NRIs	As per Tax Slab		STCG - 30% ^ LTCG - 20% (if listed) ^ (After Providing for Indexation)

^ Plus applicable surcharge and secondary and higher education cess.

- (Here in this table you can see that...) **Long Term Capital Gains on debt mutual fund schemes are taxable @ 10% without indexation or 20% with indexation, whichever is lower**

- (And in case if you book profits in the short-term i.e. within a period of less than 12 months, you'll be liable to pay...) **Short Term Capital Gains Tax on Debt mutual funds @ 30% or as per your tax slab**
- (And in case you are an NRI, then you should note that...) **Tax Deduction at Source (TDS) on capital gains will take place for NRIs** (...after providing indexation benefit if applicable)

Now before we end our learning session today, here are some points you need to remember...

Points to Remember...

- **Mutual fund schemes holding at least 65% of its assets in equity shares in domestic companies , enjoy equity oriented tax status**
- (While...) **Mutual fund schemes holding less than 65% of its assets in equities are classified as non-equity scheme** (...from a taxation angle)
- **Profits from schemes held for more than 1 year, attract Long Term Capital Gains Tax**
- **Profits earned from schemes held for less than 1 year, is liable for Short Term Capital Gains Tax**
- **There is no Long Term Capital Gains Tax on equity oriented mutual fund schemes**
- **Long Term Capital Gains on debt mutual fund schemes is taxable @ 10% without Indexation and 20% with Indexation** (...whichever is lower)
- **Dividend Distribution Tax is deducted by the fund house** (...at applicable rates...) **while distributing dividend income on debt mutual fund schemes**
- (Last but not the least...) **TDS is applicable only on gains made by NRIs**

Session 21: Mutual Funds vs Fixed Deposits

We are glad to have you with us for our Twenty First Session - **Mutual Funds vs. Fixed Deposits**

So let us now begin with our learning session today.

Many of you may be quite familiar with this traditional investment instrument that is considered safe and caters to the needs of a large category of investors in India, even today. Being a financial instrument provided by banks in India, it offers returns better than the regular savings account and hence enjoys an edge when it comes to earning better returns on one's savings. Yes, we are talking about 'Fixed Deposits'.

It usually ends up in a long debate when it comes to comparing fixed deposits with other investment avenues like mutual funds. In our learning session today, we'll try to present a clear and unbiased comparison which may help you choose a suitable investment avenue (i.e. Mutual Funds or Fixed Deposits) to meet your financial goals.

So, let us see which of these are more advantageous - mutual funds or fixed deposits. But first, let us take a look at what are...

Fixed Deposits

- (Fixed Deposits are…) **A Traditional Financial Instrument offered by Banks**
- **Fixed Deposits Provide Rate of Interest Higher than Regular Savings Account** (…Banks compensate you for committing your money with them for a longer time period)
- (They…) **Offer Fixed Rate of Interest for a pre-specified Tenure** (…So you will continue to enjoy the same interest rate throughout the tenure. Such interest rates may vary from bank to bank, ranging from 4% to 10% or sometimes even higher. Generally, the longer the term of deposit, the higher would be the rate of interest offered by the bank)
- **Fixed Deposits come with a pre-defined Maturity Period** (…You can fix your money at a higher rate, right from 7 days to as long as 10 years)
- (But there is a restriction on withdrawal of the money before maturity…) **Banks may Charge a Penalty for Premature Withdrawal** (…Say, you invested in a FD offering interest @ 9% p.a. for 5 years; but due to some emergency you need to withdraw the money after 3 years. In this case, the bank will pay you interest applicable for 3 years of your investment tenure, leaving you with a lower interest rate of, say, 7%. So you would lose 2% on returns and maybe an additional 1% in the form of penalty for premature withdrawal)
- **Fixed Deposits are considered to be Safe Investments** (…as they are covered by the Deposit Insurance and Credit Guarantee Corporation (DICGC). However, DICGC guarantees an amount of up to Rs 1,00,000 per depositor per bank - for both principal and interest. It is noteworthy that deposits kept in different branches of a bank are aggregated for the purpose of insurance cover and a maximum amount of up to rupees one lakh is paid to the depositor.)
- (Apart from Fixed Deposits…) **Banks** (…in India…) **also offer Recurring Deposits and Flexi Fixed Deposits** (…to investors)

While in our past sessions we told you all about investing in mutual funds and how it is beneficial for you. Here we have compared mutual funds and fixed deposits on various parameters.

Mutual Funds vs. Fixed Deposits

Parameters	**Mutual Funds**	**Fixed Deposits**
Rate of Returns	No Assured Returns	Fixed Returns
Inflation Adjusted Returns	Potential for High Inflation-adjusted Returns	Usually Low Inflation-adjusted Returns
Risk	Medium to High Risk	Low Risk
Liquidity	Liquid	Medium to Low Liquidity
Premature Withdrawal	Allowed with Exit Load	Allowed with Penalty
Cost of Investment	Management Cost	No Cost
Tax Status#	Favourable Tax Status	As Per Tax Slab

Taxation details are as per existing tax laws. The nature of tax will depend based on the individuals tax status and nature of investments

- In terms of **Rate of Returns**: while the interest rate offered on fixed deposits are pre-specified and fixed for the entire tenure, the returns on mutual funds may vary based on the market movement. While mutual funds offer you the benefit of market-linked returns, they have the potential to earn high returns in the form of capital appreciation during positive market conditions. On the other hand, fixed deposits would continue to offer you the same interest rates even if markets turned negative or positive. So usually mutual funds outscore fixed deposits during positive market conditions, and underscore fixed deposits during negative market conditions.

- We all know that inflation eats a major chunk of our savings in terms of loss in the value of money. So you need to keep pace with inflation. Your investments would be worthy only if they are able to offer you decent **Inflation-adjusted returns**. Assume you have invested in a Fixed Deposit offering interest @ 9% p.a. while the rate of inflation is 8%; your inflation-adjusted return would be only 1%. It is quite obvious that you would like to look beyond this rate. Mutual funds have the ability to offer you better inflation-adjusted returns. But do not forget, they come with a relatively higher risk.

- So what is the **risk** associated with these instruments? While bank fixed deposits are known for low risk, mutual funds carry market risk which is higher than fixed deposits. So you should consider your risk appetite while opting between bank's fixed deposits and mutual funds. Also, recognise that High Return comes with High Risk.

- In terms of **liquidity**: Fixed deposits come with a fixed tenure and offer medium to low liquidity option until you complete the entire tenure of the deposit. On the other hand most mutual funds do offer liquidity to its investors but with certain conditions.

- As we mentioned earlier, you may need to pay a penalty for **premature withdrawal** of your fixed deposits, where you would lose out a portion of your expected return. On the other hand, most mutual funds offer you high liquidity, once the minimum holding period is complete. In case you happen to withdraw immediately after your investment (usually within a period of 1 year), then you may have to pay an exit load which is usually around 1%. Exit load conditions may vary from one fund to another. So you should be aware about the exit clause of the mutual funds you are investing in.

- **Cost of investment / expenses**: There is a cost associated with your investment in mutual funds and it depends on the category of mutual fund you are investing in. While a liquid fund may have a low expense of up to 1% p.a., debt mutual funds may have anywhere between 0.5% p.a. to 2.25% p.a., and the expense of equity mutual funds may be up to 3% p.a. This expense is adjusted in your returns. So the returns yielded are post expenses. On the other hand, bank fixed deposits offer an advantage on this parameter, as they do not levy any expense on the depositor. And you get the entire rate of interest promised by the bank.

- **Tax Status** is an important aspect which should be considered while choosing between mutual funds and fixed deposits. You would agree that you will like to make high post-tax returns from your investment. In our previous session we told you about the tax implications on your mutual fund investment. The tax status of mutual funds is based on their category. While you need not pay any long term capital gain tax on your investment in equity mutual funds, the short term gain is taxable @ 15%. On the other hand your gains from long term investment in debt mutual funds (i.e. over a period of 1 year) is taxable @ 20% with indexation and 10% without indexation (whichever is lower); while your short term capital gain from debt and liquid mutual funds is taxable as per your tax slab. As far as fixed deposits are concerned, irrespective of the tenure, the interest which you earn thereon is taxable as per your income tax slab. So, as per the current tax laws mutual funds are quite tax friendly, provided you have held on for more than a year and you are in the highest tax slab.

The illustration here can help you understand the comparison better…

Mutual Funds vs. Fixed Deposits

	Fixed Deposits	Debt Mutual Fund	Equity Mutual Fund
Investment Amount	100,000	100,000	100,000
Return (% p.a.)	9.0%	9.0%	9.0%
Holding Period	3 Year	3 Year	3 Year
Fund Value	1,29,500	1,29,500	1,29,500
Inflation	7.5%	7.5%	7.5%
Indexed Investment Amount	-	1,24,230	-
Taxable Income	29,500	5,270	-
Tax Paid (as applicable) – 20 %	5,900	1,054	-
Post Tax Returns	23,600	28,446	29,500
Post Tax Returns (%)	7.86 %	9.482%	9.83 %

- But you should choose your investment avenue wisely. Judge your risk appetite and investment time horizon well and understand your return expectation (which should be rational), before zeroing in on the type of investment avenue.

Now before we end our learning session today, here are some points you need to remember…

Points to Remember…

- **Fixed Deposits are traditionally a safe investment instrument that provide Rate of Interest higher than Regular Savings Account**
- **Fixed Deposits are covered by the Deposit Insurance and Credit Guarantee Corporation** (…or DICGC…), **which guarantees an amount of up to Rs 1,00,000 per depositor per bank**
- **The Rate of Interest on fixed deposits is fixed for a pre-specified Tenure** (…FDs would continue to offer same interest rates irrespective of market conditions.)
- **Compared to bank fixed deposits, mutual funds have the ability to offer better inflation-adjusted returns** (… to its investors. The returns on mutual funds are linked to market movement.)
- **Fixed deposits are suitable for investors with low risk appetite**
- (…While…) **Mutual funds** (…being subject to market risk…) **are suitable for investors having relatively higher risk appetite**
- (While fixed deposits are less liquid…) **Premature Withdrawal of fixed deposit may be allowed with a penalty** (…which may harm expected returns)
- **Early redemption from mutual funds may be subject to exit load** (…which in most cases is applicable for holding of less than 1 year)
- (In terms of cost…) **Fixed deposits are placed better than Mutual Funds**
- (While…) **Mutual funds enjoy favourable tax status as compared to fixed deposits** (…which means better post-tax returns for mutual fund investors)

- (So you should...) **Consider your risk appetite, investment time horizon and your return expectation** (...along with other parameters...) **while choosing between fixed deposits and mutual funds**

Session 22: How to Smartly Invest in Gold?

We are glad to have you with us for our Twenty-second Session - **How to Smartly Invest in Gold?**

So let us now begin with our learning session today.

In contrast to other major asset classes, such as equities - which derive their value from the underlying businesses; or real estate - which could provide rental yields for you along with the potential for capital appreciation; or debt - which pays regular interest; gold possesses no such distinctive characteristic(s). But yet gold has always occupied centre stage in the evolution and development of the monetary system. This is because, gold is considered as a store of value due to its ability to counter inflation over the long run and act as a hedge during uncertain times. You see, gold as an asset class usually has a negative correlation with other asset classes and therefore can be of help in defence and act as a useful portfolio diversifier. Thus as an investor you must hold some portion of gold in the investment portfolio.

Mind you, there are a host of ways you could hold gold, but in this session we will tell you about the smart way of investing in gold. But before we do that, let's first understand why gold commands such importance.

Importance of Gold

- (As mentioned earlier, gold has a...) **Store of value** (...because it's a long-lasting precious metal, used for exchange for over centuries. Moreover, as Governments in the developed economies have resorted to printing more money, which in turn reduces its value; gold has become bold, commanding a better value.)

- (Recognising the store of value, gold acts as a...) **Reserve Currency** (...because central banks and Governments of various nations maintain gold reserves in order to secure their position during uncertain times. The central banks use these reserves as a guarantee to cash in their promises and pay their depositors and note holders.)

- (Also, it is a...) **Hedge against economic pressures** (...such as inflation, deflation, current devaluations, fiscal strains, etc.; because of its tendency to be defensive and do well or remain bold during such times.)

- (Further, it can be used for...) **Pledging during emergency purpose** (...Many banks and gold financing companies have started offering secured loans to individuals, who wish to pledge their gold at a reasonable interest rate, for a pre-specified tenure.)

- (Likewise, gold can also enable...) **Portfolio Diversification** (...due to a negative correlation being usually depicted with other asset classes.)

Apart from what we just explained, gold also has some industrial demand too, since it is used in thermal and electrical conductors and also has medical utility. Similarly, there's demand for the precious yellow metal to make jewellery / ornaments. People in India have a special fascination and emotional attachment with gold and often buy them on auspicious occasions like marriage, festivals and social events. Moreover, many Indians like to hand down their gold to the next generation in the form of jewellery and ornaments. For investment purpose, conventionally, many people prefer to buy gold bars and coins in the physical form.

But here in this session we would like to defy the rationale of buying gold in the physical form and explain the smart way of holding this precious yellow metal, which in turn could yield you better returns.

Perils of investing in physical gold

If you are a hard-core believer of investing in physical gold, the only advantages that it can offer you are "touch, feel and see" along with the choice of converting the gold coins and bars collected by you into jewellery at some point in time. However this fascination of investing in gold in the physical form has some disadvantages. Like...

- **High holding cost** (…You see, holding gold in a physical form comes at a high holding cost. It refers to the cost of holding a security. Hence, the locker rent that one pays for stacking gold in the bank locker constitutes the holding cost.)

- **Quality** (…Unless the gold that you buy is from a reliable source or is 'hallmarked', the quality of the same is always under question. It often happens that when you buy a certain amount of gold (either coins or bars or jewellery) from a jeweller and sell it years later to another, the quality of gold is questioned, thereby possibly resulting in loss of its true value.)

- (It may also happen that the jeweller or the bank may sell gold at a...) **Premium** (...to the market price - which usually ranges from 5% - 10% inclusive of making charges in the case of jewellers, and up to 15% in the case of banks. So in that sense, the pricing of gold varies depending on the vendor and it is ultimately you who are at loss since you are acquiring gold at a higher price.)

- **Re-sale value** (…As explained earlier…while selling your physical gold, you must have encountered some horrendous experiences of your gold merchant telling you "this is not 100% pure - it has some mixing", thus questioning the quality of the gold held by you. Moreover, if the quality of the gold held by you is of the finest purity or 'hallmarked', then while converting gold into jewellery, making charges are deducted. And as far as banks are concerned they will refuse to buy-back your gold as they are not allowed to do so due to RBI regulation.)

- **Tax** (…If you are a gold bug then you would also be taxed by wealth tax on the value of the physical gold held by you. Also, you attract the provisions of the Income Tax Act, depending upon on how you have sold your gold holdings.)

Now having known the demerits of investing in physical gold - which may have made you jittery - let us move a step ahead and discover a better or a smarter way of investing in gold that is the unconventional way.

The first one under that is...

Gold Exchange Traded Funds (Gold ETFs)

Before we explain Gold Exchange Traded Fund, let's first understand what is meant by Exchange Traded Funds (ETFs). ETFs are mutual fund schemes that are listed and traded on a stock exchange. They represent ownership in an underlying security, commodity or asset. Hence given that background...

- **Gold ETF is an instrument representing ownership of gold asset** (…Gold is held on your behalf by an appointed custodian for the ETF.)

- **They are open-ended funds that track prices of gold** (…and each unit of gold in the fund that you buy is approximately equivalent to 1 gram of gold. Some funds even offer units equivalent to ½ gram of gold.)

- **Gold ETFs are traded on the stock exchange** (...and hence can be bought like stocks on a real-time basis)
- (But...) **To own units of gold ETFs you need to have a demat account along with a share trading account**
- (When you buy gold ETF, you get...) **A contract indicating your ownership of gold** (...equivalent to the rupee amount of your investment. You never get to see or receive delivery of the gold you own. So, now one may ask - what's the advantage if I can't touch, feel and see the precious yellow metal.)

Well, Gold ETFs offer a host of benefits...

Advantages of investing in Gold ETFs

- **Convenience** (...In the absence of physical delivery they are easy to hold. Being traded on the stock exchange they can be easily bought and sold at the market value. Moreover, you do not have to worry about the storage and security aspects that are typically associated with investing in physical gold.)
- **Low cost** (...Being in the non-physical form, it reduces your holding cost, in the form of locker rent, which otherwise you would have defrayed for holding gold in a physical form. The only cost that you will be incurring here is the cost of maintaining a demat account and a trading account with a broker, and the nominal brokerage for each transaction.)
- **Quality** (...You do not have to worry about the quality of the gold that you own; because as per the Securities and Exchange Board of India (SEBI) regulations, the purity of underlying gold in GETFs should be 0.995 fineness and above.)
- **No premium** (...Unlike physical gold where many of you may have encountered the horrendous experience of the gold vendor charging a premium; transacting in Gold ETFs is at the prevailing market price.)
- **Resale value** (...As mentioned earlier, since gold ETFs are traded on the exchange they can be easily sold in the secondary market on a real-time basis, i.e. at the prevailing market price during the trading hours of the exchange. This is convenient and precludes you from encountering horrifying experiences, which you otherwise face while selling physical gold where the jeweller doubts the quality of gold held by you - and therefore pays you a less price, while in the case of jewellery deducts making charges that are added while buying gold. And as far as banks are concerned, they refuse to buy back gold (due to RBI regulation).)
- **Taxation** (...Holding gold ETFs does not attract wealth tax. From an income tax point of view, the tax implications of gold ETFs and debt mutual funds as per the existing tax structure are the same. Short-term capital gains are taxed as per your income tax slab, while the long term capital gain, if any, is liable to long-term capital gains tax at 20% (after allowing for indexation benefit) or 10% (without indexation benefit), whichever is less.)

The second unconventional way to invest in gold is through...

Gold Funds

- **Gold funds are Fund of Fund schemes which invest their corpus into an underlying Gold ETF**

- **They benchmark their performance against the prices of physical gold** (…Hence by doing so, they attempt to provide returns that closely correspond to the returns of its underlying Gold ETFs.)
- (So…) **Gold funds are passively managed**
- (And one need not have a demat account to own gold funds since...) **Units of gold funds** (i.e. your holdings in gold) **are allotted in a paper form which are reflected in the <u>mutual fund account statement</u>**
- (However...) **Annual expenses charged by Gold funds may be comparatively higher than what are charged for Gold ETFs** (…but yet lower as against the cost of owning gold in the physical form.)
- **The cost includes fund management cost along with the cost of Gold ETFs**
- **Gold funds, along with lump sum investing, also offer investors the <u>Systematic Investment Plan (SIP)</u> mode** (…which is an effective and convenient way of investing regularly in gold.)

Advantages of investing in Gold Funds

Being fund of fund schemes with Gold ETFs as the underlying scheme, Gold funds have most of the advantages offered by Gold ETFs, but with the additional benefits of...

- **Added convenience** (...One need not necessarily have a demat account to invest in gold via Gold funds; as units of Gold funds are allotted in a paper form which are reflected in the mutual fund account statement.)
- (Since holding a demat account is not necessary, it further…) **Reduces holding cost as one does not have to incur charges such as:**
    - **Annual maintenance charge for holding a demat account**
    - **Delivery brokerage charges**
    - **Transaction charges (while investing in demat mode)**
- **Liquidity is not restrained by the fund** (…as you can subscribe and redeem units on all business days directly from the AMC at the prevailing NAV and not have to depend on the liquidity on the exchange as in the case of Gold ETFs)

  Through the SIP mode of investing it also provides investors with advantages such as:

- **Discipline while investing**
- **Rupee-cost averaging**
- **Compounding**

As far as tax implications are concerned, they are just as in the case of Gold ETFs which we explained earlier.

Points to evaluate while exploring the smart ways of investing in gold …

- **Percentage of gold holdings** (...Ideally while investing, gold ETFs should hold significant portion of the portfolio in gold, and a gold fund in gold ETF; - and not hold much cash, or else the impact may be seen on performance.)

- (For this purpose one should see the...) **Tracking error** (...It would help you evaluate how much the Gold ETF has deviated from returns generated by the benchmark, due to the Gold ETF's holding in gold and cash respectively.)

- (Then you must see the...) **Expense ratio** (...This is because gold ETF with a lower expense ratio would translate into relatively higher returns.)

- (If you want to invest in Gold funds being appealed by the added benefits they offer, you should see the...) **<u>Performance Track Record</u> of Gold ETF to judge how much returns you can expect** (...This is because, as learnt earlier, the returns of a Gold fund would closely correspond to that of its underlying Gold ETF.)

Now before we end our learning session today, here are some points you need to remember...

Points to Remember...

- **Gold is a store of value** (Recognising the store of value, central banks across the world have maintained gold reserve in order to secure their position during uncertain times.)

- *(So...)* **Gold is also used as reserve currency**

- **Gold acts as a hedge during uncertainties**

- *(Thus...)* **Gold can be an effective Portfolio diversifier**

- *(But...)* **Avoid investing in gold in the physical form**

- **Investing in physical gold carries with it high holding cost**

- (Moreover...) **You also tend to pay more than the market price due to the premium charged by jewellers and banks**

- (Also...) **If the physical gold that you've bought is not from a reliable source then its quality can come under question**

- **Gold ETF and Gold fund are unconventional and smart ways of investing in gold**

- **Gold ETFs are listed on the stock exchange**

- **(While...) Gold funds are open-ended Fund of Fund schemes**

- **Both Gold ETF and Gold funds benchmark their performance against the prices of physical gold**

- **By buying into Gold ETFs and Gold funds you represent ownership of gold asset (...but your holdings are either in demat or paper form)**

- **Gold ETFs and Gold funds are convenient ways to invest in gold**

- (Moreover...) **The cost of investing in them is low and quality is not questionable**

- (Also...) **Transacting in Gold ETF is at the prevailing market price, while in the case of mutual funds it is at the prevailing NAV** (...So there's no question of paying a premium or fetching less at the time of sale.)

- **Gold funds offer you the option to invest via the SIP mode** (...which is not available in the case of gold ETFs.)

- (And last but not the least...) **While investing in gold the smart way, you should evaluate: percentage of gold holdings, tracking error, expense ratio and the performance track record**

Session 23: How to select your Advisor

We are glad to have you with us for our Twenty-third Session - **How to select your Advisor**

So let us now begin with our learning session today.

So far in our learning sessions of money simplified we've learnt about how to put your savings to productive use through investments. We introduced you to various asset classes - equity, debt, gold - and also told you how go about allocating your assets depending upon your risk profile, investment horizon and financial goals. We also explained how mutual funds work, the ways of investing in them and selecting winning mutual funds the prudent way.

In our learning session today, we will tell you about the care you should take while selecting an investment or a mutual fund advisor.

You might have come across several investment advisors or mutual fund distributors who operate actually as agents.

It is noteworthy that the Association of Mutual Funds in India (AMFI) has made the Know Your Distributor (KYD) certificate mandatory for mutual advisors, which enables you to check the credentials of the mutual fund advisor whom you are dealing with. Here are some valuable aspects which you should look into, to select an independent and an unbiased investment and / or mutual fund advisor.

Aspects to evaluate while selecting an Advisor

- **Seek References** (...It becomes imperative to judge and possibly check his client testimonials through some references.)

- (Then you should also check the...) **Advisor's qualification** (You see, SEBI makes it mandatory for individuals engaging in mutual fund advisory service to have an advisor's certification issued by the National Institute of Securities Management (NISM). Likewise in the case of insurance agents, it is mandatory for them to have passed the IRDA examination and completed the requisite number of hours of training. Apart from these certifications, it would be an added advantage if the advisor holds a post-graduate or a professional degree in finance / investments; which may facilitate you to get better qualified advice. But that's not enough. It is vital to look at the philosophy by which he / she operates.

- (You should also assess the...) **Infrastructure and value added services** (Judge whether he has the right infrastructure set up, in order to provide a proficient and prudent advice and service on a continuous basis. Remember, after having done your investments they need monitoring and tracking on a regular basis. Therefore as a value addition, your investment or mutual fund advisor should ideally provide you with various tools and calculators for online tracking of your investments. Moreover, he/she should persistently advise you on your portfolio in accordance to the change in market conditions and financial goals.)

- **After sale support** (…should not be ignored. As there could be several reasons for which you may need to seek support, such as changing the bank mandate for your investments, obtaining account statements, submitting redemption requests, switch request, a timely review of the portfolio and action to be taken thereon, etc. So there should be proper accountability. Likewise in the case of insurance, you need after sale support at the time of premium payment and claim. So, an advisor who is easily accessible would generally make sense.)

- (And finally you also need to check the...) **Track record of the advice** (...If an advisor can provide you this, you can judge his credibility. The data if provided by the investment advisor can be cross verified with some of his clients as a reference check. This exercise may help you not only understand the advisor's performance track record, but also recognise whether he does provide prompt and reliable after sales service, or he is merely a bluff master.

As an investor you should not be swayed by tall claims regarding the performance of some of the schemes. This leads to many investors getting swayed in their pursuit of getting wealthier. But what they fail to recognise is, what the outlook for the future is and most importantly, whether the investment product is meant for them.

Here's why you should adopt caution while selecting your advisor.

Why adopt caution while selecting an Advisor

- (Agents / distributors / relationship managers (RMs) are...) **Responsible for offering you appropriate advice** (…taking into account your investment objective and risk profile.)

- **Be led by advice that keeps you as the focal point, rather than a product** (Question suitability relative to your needs rather than past performance. Question this suitability more so, when it is a new fund launch, whether it is really required and whether an existing investment option with a good track record can provide the same.)

Now before we end our learning session today, here are some points you need to remember…

Points to Remember...

- **Choose your investment advisor after proper due diligence**

- **Do not get swayed by tall claims made by an investment advisor** (…about himself or about any product. Verify and know the facts.)

- **AMFI has made the Know Your Distributor certificate mandatory for mutual advisors** (...which can enable you to check the credentials of the mutual fund advisor)

- (But...) **Evaluate the attitude / rationalisation of the advisor**
- (Then, also ...) **Check your advisor's qualifications**

- (You should also...) **Assess the Infrastructure and value added services** (...provided by your advisor)

- **Evaluate whether he can provide you with sufficient after sale support**

- **Ask for a track record of his advice**
- **Ask your investment advisor questions that are relevant in the context of your risk appetite, investment objectives and time horizon**
- (And last but not the least...) **Do your own due diligence, do not simply be led by brands or influential individuals for investment advice**

⊟ **Module 5 - Planning Your life goals**

Session 24: Life Goal 1 - Planning for Contingencies

We are glad to have you with us for our twenty-fourth session - (let's talk about the) **1st Life Goal** - (which is) **Planning for Contingencies**

Alright, so now let's get started...

Prudent Planning is the first step in achieving any objective in life. Planning not only makes your job easy, but also gives you a sense of direction to achieve your objective. However you have to adopt prudence while planning and more so when you are dealing with your finances.

Planning for your contingency fund is an important aspect for a smooth financial journey.

So in this session we'll explain the first and most important step in financial planning i.e. Planning for Contingencies.

First let's understand...

What is Contingency Planning?

- (It is...) **Planning for rainy days**
- (By...) **Keeping aside money for any unknown and uncertain event** (...that may occur but is not likely or intended, such as medical emergencies, loss of job or any other eventuality for which you haven't planned for)
- (If not taken care of...) **Such events may derail one's finances and lead to a financial crisis** (...and hence you need to plan well in advance)
- (Planning and providing for such unforeseen events in advance means... you are in the...) **Process of building a Contingency Reserve**

Such a contingency reserve may help you tide over unexpected situations that may drain your finances and may not be covered under any other means.

Now you may ask...

How much Contingency Reserve should be maintained?

Minimum: 6 months of expenses and Maximum: 24 months of expenses
[Maintain a sufficient amount in your contingency reserve]

Well, you should maintain a minimum of 6 months of expenses as contingency reserve and a maximum of 24 months. This will enable you to cover expenses in case a contingent event does occur. So while keeping money aside as a contingency reserve, you ought to prudently ascertain your expenses, for contingency planning to be effective. This is because if you under-allocate, you are not being effective in such a contingency planning exercise.

You see, maintaining less than 6 months will mean that you do not have a sufficient amount to deal with emergencies and maintaining more than 2 years will mean that you have extra cash, on which you are losing out on <u>investment opportunities</u>. Thus you should always maintain a reasonable amount of contingency reserve by accounting for your expenses wisely.

What kind of expenses should be covered in Contingency Planning?

While creating a contingency reserve you should take into account all such expenses that are rather unavoidable. You can consider your...

- **Household Expenses** (...which are towards your basic needs and utilities)
- **Lifestyle Expenses** (...where you may control a few of such expenses)
- **Medical Expenses** (...as they are unavoidable)
- **<u>Travel Expenses</u>**
- **EMI on loans** (...where you should remember that it is not advisable to default on your loans)
- **<u>Children Education Expenses</u>** (...which are a priority)
- (And...) **Any other Unavoidable Expenses**

You see, of these expenses some are unavoidable expenses which are to be paid even if there is loss of income, or no income.

Let's take an example to understand better...

Contingency Planning: Example 1

Mr Shah is a government employee and has a very stable career. His monthly expenses are:

Household = Rs 25,000;

Lifestyle = Rs 10,000;

Medical = Rs 5,000;

Children School Fees = Rs 2,500;

EMI = Rs 12,500.

(So here let's understand...) **How many months of contingency reserve should he maintain and what should be the amount of his contingency reserve?**

Mr Shah should maintain:

At least 6 Months of Contingency Reserve
Amount of Contingency Reserve = Rs 3,30,000 (i.e. 6 months x Total Monthly Expense of Rs 55,000)

Since Mr Shah has a very stable career and his job is quite secured being a government employee. 6 months of contingency reserve should be sufficient to take care of his emergencies. Thus as a multiplication of the expenses which he is incurring, the amount of his contingency reserve will be Rs 3,30,000.

Now let's take an example of another individual Mr Tiwari...

Contingency Planning: Example 2

Mr Tiwari is an IT consultant and his career is highly dependent on India's economy. In a booming economy his income doubles while in a weak economy, it is vulnerable. **His monthly expenses are:**

Household = Rs 10,000;

Lifestyle = Rs 5,000;

Medical = Rs 15,000; and

Travel = Rs 10,000

(So here let's understand...) **How many months of contingency reserve should he maintain and what should be the amount of his contingency reserve?**

Mr Tiwari should maintain:

2 Years of Contingency Reserve
Amount of Contingency Reserve = Rs 9,60,000 (i.e. 24 months x Total Monthly Expense of Rs 40,000)
(The name and figures used in this example are for illustration purpose only)

Since Mr Tiwari's income is highly uncertain and can also lead to low income in the case of a weak economy, he requires to maintain 24 months of contingency reserve. Thus as a multiplication of the expenses which he is incurring, the amount of his contingency reserve will be Rs 9,60,000.

Options to maintain your Contingency Reserve

Contingency funds are meant for emergencies. So returns are secondary, and therefore one should make a sensible decision while building a contingency reserve. You see, in case of any urgency, money should be available for use within 24 to 48 hours. Accordingly there are various options which you may consider for keeping money aside, for your contingency needs. Some of the prominent options are...

- **Cash in Bank** (...You can maintain a small portion of your contingency reserve in a savings bank account for liquidity, which can be accessed any time. But as it is next to having some money in your wallet, it may hardly earn for you. Do not forget, the longer the money lies idle, the more is the loss in value. Hence you can limit the amount of contingency money kept in your savings account.)

- **Bank Fixed Deposit**

- **Sweep in Account**

- **Flexi Deposit**

  (For a safe and better return, you can keep some money in a bank fixed deposit or sweep in account or have a flexi deposit with your bank. If possible, you should link it to your savings bank account to withdraw it in an emergency. But withdrawing such money prematurely may attract penalty, or in some cases you may even lose a portion of your interest earned, based on your bank's policies.)

- **Money Market Mutual Funds** (…As many people fear losing money, they do not invest, or invest such contingency money only in options like FDs which can attract penalty on premature withdrawals. Many people in India are still unaware of various investment options suitable for very short term investments like: liquid and money market funds, which have the potential to earn returns more than interest on a savings bank account.)

Let us now dwell a little deeper and understand - How you can maintain your contingency reserve through mutual funds...

Maintaining your Contingency Reserve through Mutual Funds

While mutual funds offer you various investment options targeted towards various investment objectives, there are some categories of mutual funds that invest in instruments of very short duration and are suitable for maintaining one's contingency reserve…

- **Liquid or Money Market Funds** (…These funds can be considered in order to park a portion of one's contingency fund with a shorter time horizon of less than 90 days. As most liquid funds do not have any exit load, one can exit any day, without any penalty. On withdrawal, the redemption proceeds are usually credited to your bank account within 1-10 days.)

- **Liquid Plus or Ultra Short Term Debt Funds** (…These are funds that invest in instruments with higher durations as compared to the liquid funds. As the duration is slightly higher, the risk is slightly higher as well; but they have the potential to yield returns higher than those clocked by liquid funds. While most of these funds do not carry exit load, there are some ultra-short term debt funds that have an exit load period of 7 to 30 days. Hence the money that may not be required within 3 to 6 months can be kept in these funds.)

- **Floating Rate Funds** (…They aim to generate returns in line with the prevailing interest rates and are suitable to hedge your corpus against interest rate risk. While these funds carry less interest rate risk, they are meant for investments with a time horizon of around 6 to 12 months.)

- **Short Term Debt Funds** (…There may be times when you may not be using a portion of your money for long, say the next 12 to 24 months. Money meant to take care of your medical emergencies etc., can be kept aside for a slightly longer duration. Short Term Debt funds invest in instruments with duration of around 1 to 2 years and hence can be considered where the investment horizon is of around 1 to 2 years. Do not forget, many short term debt funds may attract an exit load if withdrawn within 6 to 12 months. So you need to plan accordingly.)

Points to Remember...

- **Contingency Reserve helps you pay for unexpected expenses**

- (So…) **Create a Contingency Reserve for a minimum 6 months of expenses and up to 24 months of your expenses** (…based on the level of your income)

- (As…) **Contingency funds are primarily meant for emergencies, the returns should be secondary** (…you should make a sensible decision while maintaining your contingency reserve)

- (It would be prudent to...) **Diversify your contingency funds across suitable options**

- **Planning for contingencies should be considered as an important life goal**

Session 25: Life Goal 2 - Planning for Child's Education and Marriage

We are glad to have you with us for our twenty-fifth session - **Life Goal 2 - Planning for Child's Education and Marriage**

As a parent, you want to give your child the best of everything. Be it the child's education, lifestyle and even a grand marriage. But as you may be aware, the cost of everything is going up. So are you saving enough and planning wisely to give your little bundle of joy what you've been dreaming of and what he or she deserves? Well if not, you better get started right away!

This session of money simplified brings you a refreshed approach for planning your child's future - be it his / her education and / or marriage needs. So in this session we are going to handhold you and explain how with prudent and effective planning, your dream of providing the best (but within your means) to your child can indeed come true.

So, let's get started...

Defining Goals

Well, the first step in the planning process is defining your financial goals. So while planning for your child's future is a broader objective, you need to define it further as to what you intend to plan for - child's education or marriage needs.

Let's take the first one...

- **Child's Education** (...Here you need to further be clear about which stage of their education you want to plan for...)

    - **Graduation**
    - **Post-Graduation**

    As Nelson Mandela said, "Education is the most powerful weapon which you can use to change the world"; so as parents you want to give the best quality education (but within your means to the child). Today's generation, as you may already be aware, is very smart. Their inquisitive acumen makes them fast learners. There is a spirit of competitiveness amongst today's children and a vigour to achieve the pinnacle of success, whether in studies or at the work place. But, to follow one's dream and make it into a career can be a very costly affair...and as parents you need to be ready for that. Depending upon the aspirations and acumen of the child, whether to be a doctor, lawyer, engineer or a finance professional; you need to plan well. And remember that no matter how old your child is, it is never too early to start planning for your child's education.

    Likewise, while planning for your Child's Marriage you as a parent, in consultation with your child, need to be clear whether the wedding would be simple or done with much pomp and style.

- **Child's Marriage**

    - **Simple**
    - **Lavish**

    As a parent you want your child's wedding to be one of the most memorable occasions filled with fun, happiness and music. But you need to be within your means as well while planning your child's wedding as the cost associated with it should not create a sour memory.

    You see, there was a time when a wedding was only an auspicious day for the holy union of two families which was done at a decent and rational cost. But today, weddings have also become an occasion to display one's social stature and monetary wealth. Some people believe that if they do not spend liberally on their child's wedding, it will become difficult for them to face society. And in the bargain, they drain out most of their financial resources or even take loans, putting their retirement needs at stake.

It is noteworthy that some things which are a necessity to a few could also be a luxury to others. It is for you to decide what are your "need to have" things and what things can be "easily avoided". Having a practical approach to all wedding related expenses is necessary as that will enable you and your family to live a stress-free financial life. Again remember: the earlier you start saving and investing for your child's wedding, the lesser you will need to set aside per month to achieve your objective.

The next step in the planning process is to determine the age of your child at the time of the occurrence or goal realisation.

Age of Child at the time of Goal

Child's Graduation - 18 years

Child's Post Graduation - 21 years

Child's Marriage - 25 years

Generally we have seen investors envisaging the requirement of funds for their child's graduation needs at 18 years of his / her age. Assuming the child will take 3 years to complete his or her graduation, they want to plan for a 2 year post-graduation course at 21 years and finally want their child to get married by 26-27 years.

So in this process you see, it is imperative to recognise the number of years remaining until the goal, which is calculated as...

Number of years remaining towards Goal

Number of years remaining towards Goal = Child's Age at Goal - Child's Current Age
Example:

Child's Current Age = 5 years

Child's Graduation Age = 18 years

Number of years remaining towards Goal = 18 - 5 ? 13 years

Say your child's current age is 5 years and you require money for his graduation when his age is 18 years; you have 13 years remaining until the goal.

Therefore the current age of your child and his / her age at the time when the financial goal realises, will define the number of years remaining towards the goal. It will determine whether your child's financial goal is short term, medium term or long term.

Then the next step is to determine the...

Amount Required in Today's Terms for the Goal

Child's Graduation = Rs 5 lakhs to 15 lakhs

Child's Post-Graduation = Rs 10 lakhs to 25 lakhs

Child's Marriage = No limit

You see, it is imperative to recognise this; because on the basis of this, the value you require in the future, i.e. at the time of the goal, is determined.

Over the years, while dealing with clients we have observed that graduation costs in today's terms are estimated somewhere around Rs 5-15 lakhs, while post-graduation costs around Rs 10-25 lakhs and in the case of a child's marriage needs, either the amount is not thought of precisely or a limit to the same is not stated.

But as inflation tends to erode the purchasing power of your money, you will need to consider the present value while estimating the future value, i.e. at a time when the goal is likely to occur or realise.

Future Value of Child's Education and Marriage Cost

Inflation for Graduation / Post-Graduation = 10% to 15% per annum
Increase in Marriage Cost = 8% to 12% per annum

While planning for a child's education needs an inflation factor of 10-15% p.a. will be fair to assume taking into account the pace at which education fees are on the rise. On the other hand for a child's marriage needs, an inflation factor of 8-12% p.a. would be fair to assume. You see, accounting for inflation factor while calculating the future value of the goal will help you arrive at a more realistic value for meeting your child's future needs.

	Current Cost	**Years to Goal**	**Inflation**	**Future Value**
Graduation	5,00,000	13	10%	17,26,136
Post-Graduation	10,00,000	16	10%	45,94,973
Marriage	20,00,000	20	8%	93,21,914
Total	**35,00,000**			**1,56,43,023**

Here is an indicative calculation of the future value of a child's education and marriage. Considering inflation on education @ 10% and @ 8% for marriage, in 13 years' time the cost of graduation would increase from 5 Lakh to 17 Lakh and the post-graduation cost of Rs 10 Lakh would increase to around Rs 46 Lakh in 16 years' time. Similarly over 20 years, Rs 20 Lakh budgeted for a child's marriage would inflate to Rs 93 Lakh if inflation on marriage is assumed @ 8%.

Then you also need to...

Prioritise Your Goals

- **Low**
- **Medium**
- **High**
- **Very High**

We understand that all the financial goals pertaining to your child's future needs are extremely important. But in the journey and process of achieving you need to prioritise your financial goals; because for all practical reasons they may not be achieved at one time, nor would the occurrence of the same be at one time. Therefore you need to decide which goal is most important for you and for which goal you can compromise on with respective to time and amount. Hence in order to do this, you need to categorise all the goals pertaining to your child's future needs into low, medium, high and very high categories. This will help streamline your finances and prudently plan your child's future.

After having recognised your priorities for the goal, you need to…allocate your investments or assets towards each goal. Do not forget to have the right asset allocation while you invest…

Asset Allocation As Per Years to Goal

Time Horizon	Equity	Debt	Gold
0-3 years	10%	85%	5%
3-5 years	40%	55%	5%
5-8 years	55%	35%	10%
8-10 years	70%	20%	10%
More than 10 years	80%	10%	10%

You see, any fresh investments you make towards your child's future needs - be it education or marriage - require to have a prudent asset allocation. Depending upon the time horizon for your child's future needs you can decide the kind of asset allocation you should maintain by referring to the above table.

In the table you can see that if you have a longer time horizon for your child's future, the higher will be your allocation towards Equity. But when the time horizon is less or you are just a few years away (about 3 years) when you require the money for the goal; your allocation should be skewed towards Debt.

Therefore to reap the benefit of a longer time horizon, which facilitates you to invest in equities; start planning for your child's future needs now to earn a bigger pie for his / her financial goals.

You should also...

Allocate Your Existing Assets towards the Goal

Goal	Time Horizon	Equity Shares/ Equity Mutual Funds	Fixed Deposits/ Debt Mutual Funds	Gold / Gold ETFs
Child's Graduation	3 Years	10%	85%	5%
Child's Post Graduation	6 Years	55%	35%	10%
Child’s Marriage	10 Years	80%	10%	10%

Being in the earning and asset accumulation phase, you as a parent might have accumulated some assets over the years. Now these need to be mapped towards your child's future goals - be it his / her education and / or marriage. So remember, the major portion of your debt investments such as Debt Mutual Funds, Bank FDs, etc. can be mapped towards a near-term goal like child's graduation, provided you are a few years away (about 3 years) when you require the money for the goal.

A major portion of your existing equity investments such as Equity Mutual Funds and Equity Shares can be mapped towards goals which are farther away such as a child's post-graduation, and marriage needs, where the time horizon for realisation is over 3 years. You can simultaneously maintain some allocation towards debt mutual funds and gold ETFs.

You can also keep aside your existing investment in Physical Gold and Gold Mutual Funds for your child's marriage. If you have a higher time horizon, and as you need to keep pace with inflation, based on your risk appetite you can invest a major portion of your assets in equities through equity mutual funds.

Once you have decided the asset allocation, you need to know how much amount you need to invest. An Investment can either be made one time in a lump sum, or monthly or yearly. You see, calculating the required investment will give you an idea whether all your child's goals are within your reach or you need extra effort to achieve the goals.

Mutual Funds Category across Asset Class

Risk Appetite	Equity	Debt	Gold	Time Horizon
Low	Balanced Fund	Liquid / Money Market Fund		**Short**
		Floating Rate Fund		
	Large Cap	Income - Short Term	Gold Fund	
Moderate		Income - Long Term		**Medium**
	Multi / Flexi Cap		Gold ETF	
		Gilt Fund		
High	Mid and Small Cap	Monthly Income Plan		**Long**

You see, we have in the past sessions, told you about various categories of mutual funds that have specific investment objectives and are designed to cater to various investment needs and hold different levels of risk-reward relationship. Once you are aware of the amount to be invested towards achieving your respective goals and the kind of asset allocation, you need to judge your risk appetite and consider your investment time horizon before investing in mutual funds. Longer your time horizon, higher the risk you can take. Based on your risk appetite and investment time horizon, you can decide the kind of mutual fund schemes suitable for you, where you can invest and get started towards achieving your child's future goals. You can choose the scheme category on the level of risk you can take. You need to decide if you want to create a risky or a risk averse portfolio.

Points to Remember...

- **Define your Child's Goal carefully**
- **Determine the Child's Age at which you want to plan for the respective goals** (...such as graduation, post-graduation and marriage)
- **Determine the Amount required for the goal** (...Be rational! Do not overestimate or underestimate, as it may derail your plans)
- **Consider the Inflation rate** (...as it will push up the cost of your goal in the future)
- **Determine the Asset Allocation required for each goal** (...as it will make your portfolio healthy and help it sustain volatility seen in any of the asset class)
- **Calculate the investment amount required to achieve the goal** (...you need to get this right as this is a kind of seed capital which would grow towards achieving your future goals)

- **Start Investing in suitable investment options like Mutual Funds to reap benefits** (…as they cater to various investing needs)

Session 26: Life Goal 3 - How to Plan your Retirement

We are glad to have you with us for our twenty-sixth session - Life Goal 3 - How to Plan your Retirement

Alright so let's get started…

Many of us work hard all our lives to earn more, so as to give a better lifestyle to our families and provide for their financial goals. But it often happens that planning for one of the most important goals - which is retirement - is ignored or simply delayed.

You see, if you wish to enjoy the standard of living that you are enjoying at present even during retirement, you cannot ignore planning for retirement or put it off to another day. The more you ignore or delay, the more difficult it becomes to counter the inflation bug later.

Noel Whittaker (an eminent financial wizard who has authored several books) has rightly said, "Life is full of uncertainties. Future investment earnings and interest and inflation rates are not known to anybody. However, I can guarantee you one thing… those who put an investment program in place will have a lot more money when they come to retire than those who never get around to it."

So taking cognisance of these words of wisdom, in this session of money simplified we'll guide you to the path of rich retirement. We will tell you the ways to meet your dream of comfortable retirement and all the measures you should take while planning a hassle free retirement.

First, you need to ask yourself some important questions…

Questions you need to ask yourself while planning for your retirement

When you are jotting down important questions that need to be answered honestly, involve your family. You see, involving your family, especially your spouse is vital while you plan your retirement; because together, you can have better clarity on how and when you want to retire.

In order to live a comfortable or a blissful retired life, here's a list of questions you both should introspect while planning for the golden years. First…

Let's take the first one…

- **When do I want to retire?**
  While you decide on this, you need to be realistic. You cannot merely set an ambitious target to retire early. It is imperative to take into account the financial responsibilities you are shouldering and the financial goals that you need to fulfil for your family, such as - buying a dream home (but within your means), children's education, their marriage, etc. …and then see what you own at present and can build in future to achieve these goals. This will help you recognise the gap between reality and your dreams.

- **How long will I live?**
  As you may be aware, the average life expectancy of people in India has increased to 70-75 years of age. This table can serve as a useful reference…

Average Life Expectancy in India (Age wise)			
Age	**Life Expectancy**	**Age**	**Life Expectancy**
5	69.7	55	75.4

10	70.1	60	76.7
15	70.3	65	78.5
20	70.7	70	80.7
25	71.2	75	83.7
30	71.7	80	86.8
35	72.2	85	90.3
40	72.8	90	93.9
45	73.5	95	97.8
50	74.3	100	102.0

- While that's good, you have to take into account the fact that old age and health issues go hand in hand. And with the kind of stress and challenging conditions that we are witnessing around us today, we often see people being a victim of some or the other health related problems as early as in their 40s, which impact their lives. Do not forget, you may need to service your retirement for many years and that too with low or no income.

- **What is my monthly basic expenditure?**
  You see, calculating your present monthly basic expenditure is the key to predicting the future corpus you'll require when you retire. This is because; during your golden years of retirement you must have a sufficient corpus which can at least maintain the standard of living that you enjoy at present.

  Say, currently if your monthly basic household expenditure is around Rs 1 lakh, you should also consider other additional expenses that you may incur every month: on medicines, fuel, phone bills, life style, entertainment, etc. This will help you gauge your retirement needs well. And do not forget to account for inflation, because, as it has an effect of eroding the value of money...the sum of Rs 1 lakh which you are defraying at present, may be insufficient in the future.

  Through experience we can say that, often, since inflation is not accounted optimally, many individuals encounter a challenge during their golden years.

  So, on that note you need to ask yourself...

- **What will be my cost of expenditure in the future?**
  To answer this, take an optimal rate of inflation. Since 1957, Inflation in India has grown at an average of around 7.5%, while over the past 10 years inflation has grown at an average of around 8.8%.

If Inflation grows @ 8% p.a.		
	Current	**After 25 Years**
Monthly Expenditure (INR)	1,00,000	6,84,848
Value of Money (INR)	1,00,000	14,600

- So, if inflation has to grow at say 8% p.a. the sum of Rs 1 lakh which you are expending monthly today, may turn to Rs 6.85 lakh after 25 years. Or in other terms, the value of Rs 1 lakh kept in your safe would be just around Rs 14,600.

- **Do I have enough contingency corpus?**
  Taking inputs from one of our earlier sessions of Money Simplified on Planning for Contingencies, you also need to examine this very carefully. You see, **one cannot avoid**

an uncertainty, which may knock on your door without informing you. Thus you have to **be well-prepared to manage it. Keeping aside 6 to 24 months of your monthly expenditure** (including your EMIs) is always **advisable to build a contingency reserve.**

- **How much should I provide for my health care and medical needs?**
  As you may be aware, with growing age your medical needs may also increase; so you need to account for this while planning for your retirement. Here as well, you have to consider inflation, which in healthcare has been around 10%.

If inflation on Medical grows @ 10% p.a.		
	Current	**After 25 Years**
Annual Expenditure (INR)	1,00,000	10,83,471

- So, say you are spending Rs 1 lakh annually today on medical needs and an average rise in healthcare inflation is 10%; then after 25 years, you'll require a sum of Rs 10.83 lakh for annual medical needs...and that may increase with your age as well.

- **What do I own and owe?**

	Assets	**Liabilities**
Self-Occupied House	N.A.	N.A.
Second House	✓	
Housing Loan		✓
Stocks / Mutual Funds	✓	
Fixed Deposits / Bonds / PPF	✓	
Credit Card Dues		✓
Gold Bars / Jewellery	✓	
Borrowings from Friends		✓
Ancestral Property / Land	✓	

- In the retirement planning process it is vital to take cognisance of your assets and liabilities. While assets are what you own, liabilities are what you owe; which you need to repay before you retire to live a stress-free retirement. Therefore, list the assets and liabilities down. All your investment in shares, mutual funds, bonds, fixed deposits, gold, ornaments, ancestral properties, land, etc. are your assets, provided you do not have any loan or encumbrances against them. Remember, you should not consider your self-occupied house as an asset, since it's your primary home - a house where you are living with your family. The second house of course can be considered as an asset, provided it is free from encumbrances. You should classify which of these assets you would keep for your retirement and which of these you would pass on to your heirs. And as far as liabilities are concerned, of course, since you may not want to pass them on, you should make sure that all your liabilities are repaid as soon as possible.

- **Can I generate cash inflows during retirement?**
  You see, while **you may have invested in physical and financial assets**, you have to **assess which of them can generate cash inflows** for you during retirement. For instance, the second house that you own and have not passed on to your legal heirs can be one vital medium through which you can generate yield through rental income. Likewise, if you have invested in PPF (Public Provident Fund) or may have even contributed to EPF (Employees Provident Fund) during your working years as a salaried

individual, you can expect to get some cash flows in the form of annuity or pension during retirement. Also if you are in receipt of gratuity or investible surplus in the form of bonus, you should deploy such money in safe investment instruments that can provide decent appreciation over time and generate regular cash flows during your retirement.

- **What do I desire to do during retirement?**
  Many a time most individuals after having retired wish to travel and see places across the world at least once a year. But mind you, this can be an added expenditure and thus if you wish to do so, you have to plan it well. As inflation erodes the value of money, the cost of travel is also bound to go up.

If inflation on Vacation grows @ 10% p.a.		
	Current	**After 20 Years**
Annual Expenditure (INR)	1,00,000	6,72,750

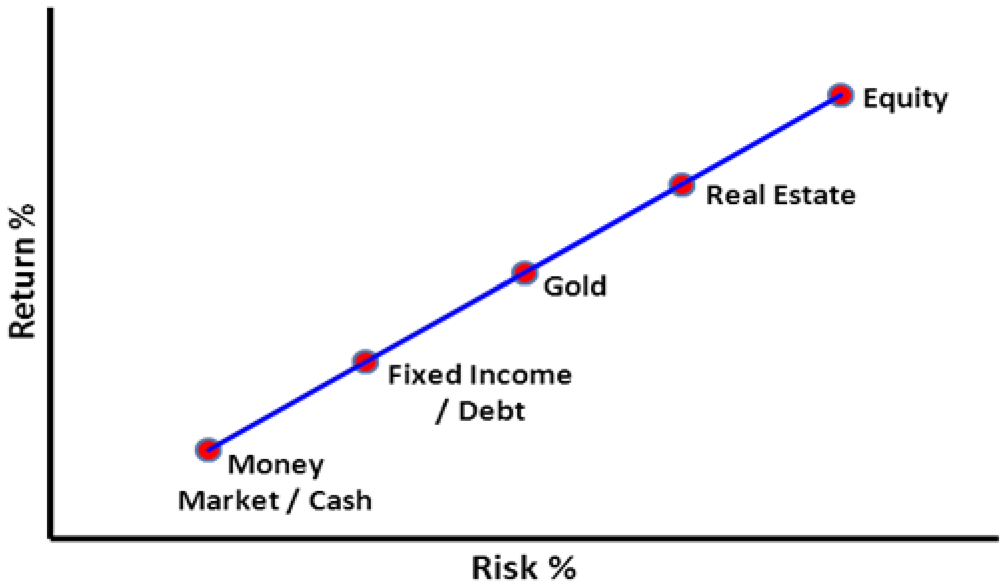
- So, say a sum of Rs 1 lakh that you expend today on your travel for leisure, is expected to grow to Rs 6.73 lakh if inflation on vacation grows @ 10%.

After having asked yourself relevant questions to plan your retirement prudently, you have to also list down which investment instruments would be suitable for you in accordance to your risk profile.

Suitability of Asset Classes

Here you have to recognise the <u>risk-return trade of every asset class</u> and assess if it fits into your risk profile. And while expecting returns from asset classes you need to be realistic. You cannot expect equities to deliver 30% growth every year, or you cannot always expect to make a huge gain like your neighbour did from his investment in real estate. So, here is a chart that can be of help...

Risk Return Trade off



Risk-Return Trade Off = Potential of returns correlated with the risk of respective asset classes. The potential of a return rises with the rise in the level of risk.

Looking at the chart, you can figure out that an asset class like equities has High Risk-High Return characteristic and debt is known to be a Low Risk-Low Return generating asset class.

But before you invest, take into account the following points...

- (As mentioned earlier…) **Relate each asset class to <u>your own risk appetite</u> and investment time horizon.** (You see, although you may have a high risk appetite, you should not invest in risky asset classes if you are just a few years (i.e. 2 or 3 years) away from your financial goal.)

- (While you may maximise your return by taking maximum risk…) **Do not forget to <u>allocate your assets</u> to minimise the level of risk for a certain level of return expectation**

- (As allocation across asset classes is the best strategy to diversify your risk, you should…) **Maintain a fair level of diversification while you invest**

Building a Retirement Corpus

1. **Start Early** (The key to accumulating your retirement corpus is to start early. You see, if you procrastinate on the implementation of your retirement planning exercise, the lesser will be the corpus you will be able to build. Remember: The early bird gets a bigger pie.)

2. (If you are not in a position to save and commit to your retirement planning exercise…) **Do not hesitate to cut on unnecessary expenses** (…such as weekly entertainment, leisurely vacations, etc. You see, cutting down on such expenses may help you invest more and reach closer to your targeted corpus for retirement.)

3. **Create an ideal investment portfolio** (…Taking the learning from our previous sessions of Money Simplified, consider your risk profile to suitably allocate assets. You see, some assets like equities have the ability to offer you a decent inflation-adjusted return; while fixed income instruments can offer you safety. Likewise, gold can be a store of value and act as insurance for your portfolio. <u>Mutual funds offer you various investment options</u> across asset classes and can help you build a well-diversified retirement portfolio. But mind you, while investing, do a thorough risk assessment, considering your age and the time horizon you have before you retire. Once you have invested, a frequent review of your portfolio is necessary to timely re-balance if need be.)

4. **Invest Regularly** (To achieve the targeted corpus for your retirement, it is vital to invest regularly in prudently selected investment avenues. Moreover, if you are in the prime phase of your earning life cycle and in receipt of annual bonuses; or have windfall income, or even otherwise ... such funds can go towards planning for your retirement needs.)

5. (And last but not the least…) **When you are already retired, look for regular cash inflows** (You see, post retirement, you might not have any other source of income.

    - **Liquidity will be the key concern for you**. (So, you would have to rely only on your investments to help you manage your expenses during retired life.)

    - (Remember, during such times…) **It may not be very wise to hold high exposure into equities** (...due to the high risk involved. You should not be holding more that 25-30% portfolio in equity as an asset class.)

    - (On the other hand…) **You should be invested in instruments offering a regular interest** (...of annually say 8.0 - 9.5%. Therefore you could consider small saving schemes like Post Office Monthly Income Schemes, Senior Citizen Savings Scheme and Bank Fixed Deposits, etc. that can help you generate regular cash inflows. You see, they can act as a safe source to generate regular income from your portfolio. Moreover you can systematically withdraw your money from mutual funds to take care of your regular investments.

⊟ Life Goal 1 - Retirement Planning

Calculating Your Retirement Corpus

We are glad to have you with us for our 1st session of the Retirement Planning Series - Calculating Your Retirement Corpus

Alright so let's get started...

Many people often underestimate the amount of money that they need for a hassle free retirement. In just few years of their retirement, they realise that they will be running out of money. And the thought of the number of years that they may have to survive without any income is rather horrifying.

So, in order that you do not land up in such a situation, it is necessary to calculate your retirement corpus carefully.

Therefore, in this session of money simplified we'll tell you how to go about calculating your retirement corpus.

But before you start calculating your retirement corpus, you should be clear about where you stand today and where you wish to be tomorrow realistically. So here are...

8 Things You Should Consider
While Calculating Your Retirement Corpus

Years left to your retirement:
You should consider the number of years left for your retirement. This is the only time that you have in your hand to earn and see cash flowing in... that can help build your retirement corpus. Moreover the power of compounding works out to be a boon for those who start early. But for those who have started late or have few years to go, need to plan cautiously.

1. **Your Life Expectancy:**
   You need to consider and provide for the number of years you expect to live post retirement. The average life expectancy in India has grown steadily over the years because of advancement in medical science. To be on the safer side one must plan for 20-30 years post retirement.

2. **Your monthly basic expenditure:**
   Apart from your current monthly basic house hold expenditure, you should also consider other additional expenses that you incur every month towards your life style like your phone bills, fuel expenses, shopping, entertainment, medical expenses etc., which you would continue to incur even during your retirement.

3. **Inflation growth rate:**
   Do not forget to arrive at inflation adjusted expenses. As you know, Inflation decreases the purchasing power of your money. And to maintain your current life style and secure the purchasing power of your money, you need to compete with this monster called inflation. While your basic household expenses can be assumed to grow @ 7% to 8%, the cost of your other expenses such as medical bills, children education, etc. may grow at a comparatively higher pace.

4. **Your contingency needs:**
   An uncertainty may knock your door without informing you. So you need to pro-actively provide for contingencies like medical, hospitalisation, loss of job etc., which may derail your finances. Setting aside money for such contingencies may help you handle your finances for few months, and give you some time to settle.

5. **Estimate the value of your assets:**
   Assets are something that can grow in value and which you can liquidate in case of emergencies or during your retirement. You might have already built some assets for your security and if you are young, you might be planning to build more in future, before you retire. All your investment in shares, mutual funds, bonds, fixed deposits, gold, ornaments, ancestral properties, land etc. are your assets. You should estimate the future value of your assets and how you would like to use them during your retirement.

6. **Recognise your liabilities:**
   Some of you might be having liabilities, which you should repay before your retirement. You should not get into a situation where you need to keep on paying your liabilities even during your retirement. The housing loan that you took to buy your house is a liability or any credit card dues and personal loans are your liabilities that you need to repay well before your retirement.

7. **Provide for your key life goals:**
   You should provide for all your financial goals like buying your dream home, your children's higher education, their wedding etc. You can keep aside a portion of your investments you own at present to achieve these goals. This will help you recognise the gap between your dreams and reality.

Here are the...

Steps to Calculating Your Retirement Corpus

Estimate your basic household expenditure:
Once you have planned the year in which you wish to retire and know the number of years left to your retirement; you can estimate your total expenditure towards basic household needs during your golden years. While calculating your household expenditure, do not forget to account for inflation which may grow at a decent pace and have an effect of reducing the purchasing power of your money.

Your Current Age	45 Years
Retirement Age	60 Years
Life Expectancy	80 Years
Current Monthly basic household expenditure	Rs 50,000/-
Inflation (pre and post retirement) assumed to be	@ 8% p.a.
Monthly basic expenditure @ age 60 years would cost	**Rs 1,58,608/-**

- So if your current age is say 45 years and you plan to retire at the age of 60, and assuming your life expectancy is 80 years; you need to provide for 20 years post retirement. If your monthly basic household expenditure is around Rs 50,000/- then assuming pre and post retirement inflation @ 8%, your monthly basic expenditure would cost you around Rs 1.59 lacs when you retire at the age of 60. Do not forget while this expenditure would increase @ 8% every year, you need to provide for this expenditure for a period of full 20 years.

- **Estimate your Medical expenses:**
  With growing age your medical needs might increase, so you need to account this well while calculating the corpus needed for your retirement.

Current Medical expenses - Annual	Rs 60,000/-

Inflation on medical expenses assumed to be	@ 8% p.a.
Annual medical expenses @ age 60 years would cost	**Rs 1,90,330/-**

- (The above table is for illustration purpose only and all annual growth rate mentioned above is on assumption basis)

- If you consider your annual medical expenditure to be around Rs 60,000/- at present, and say the average rise in inflation on medical is 8% p.a., then after 15 years (@age 60 years), you may need to spend around Rs 1.90 lacs on your annual medical cost... and it might keep on rising as your age progresses.

- **Estimate the value of your current investments:**
Being in your earning years, some of you might have been regular investors and have already created some assets in the form of property, stocks, bonds etc. The future valuation and cash inflows that you can generate from such assets should be well considered while calculating your retirement corpus.

Current Value of your investments	Rs 50,00,000/-
Expected returns on investment, until retirement age	@ 12% p.a.
Expected returns on your investments post retirement	@ 10% p.a.
Value of your investments on your retirement	**Rs 2.74 Crore**

- (The above table is for illustration purpose only and all annual growth rate mentioned above is on assumption basis)
-

Being an earning individual, you might have taken some risk and invested in high yielding assets which have the ability to grow at the pace of 10% to 12% p.a. on average. Say if the current value of your investment portfolio is Rs 50 Lacs, considering a growth of 12% p.a. during your pre-retirement years, it can be expected to be around Rs 2.74 crore at the age of 60.

Now once you retire, you may no longer have that earning which will allow you to take high risk. So you may need to shift your investment to relatively low risk instruments, which may instead offer you lower growth but high safety. In such scenario, the expected returns on your investments post retirement can be assumed to be lower at say 10% p.a.

- **Calculate the deficit:**
It might happen that your investments might be insufficient to service your post retirement expenses.

Corpus needed to maintain your current life style for 20 years (post retirement) (A)	Rs 3.45 Crore
Value of your investments on your retirement (B)	Rs 2.74 Crore
Deficit (A-B)	**Rs 0.71 Crore**

- (The above table is for illustration purpose only and all annual growth rate mentioned above is on assumption basis)

- * Assuming a monthly expenditure of Rs 158,608/- and annual medical expenses of Rs 190,330/- for 20 years post retirement (subject to inflation @8% p.a.). Also considering that your balance retirement corpus post expenses is assumed to grow by 10% p.a. With these levels of expenses post retirement you need a corpus of around Rs 3.45 crore to maintain your current life style for 20 years post retirement.

  Once you have calculated your total annual expenditure and the money or corpus you need to maintain your current life style for 20 years (post retirement), you can arrive at the short fall. So say if you need a corpus of around Rs 3.45 Crore to maintain your current life style post retirement for 20 years, and considering the expected value of your current investments to be around Rs 2.74 crore at the age of 60; you would need an additional Rs 71 Lacs to maintain your current life style during your retirement.

- **How much you need to invest:**
  Your retirement might not be easy if you fail to build your retirement corpus which is required to maintain your life style post retirement. Your retirement plan should not be in deficit. To make up for the deficit, you need to commit more money during your earning years. So you need to calculate how much do you need to invest (possibly in high yielding asset) each month or each year, during your earning years, to make up for the deficit.

Corpus needed to maintain your current life style for 20 years (post retirement) (A)	Rs 3.45 Crore
Value of your investments on your retirement (B)	Rs 2.74 Crore
Deficit (A-B)	Rs 0.71 Crore
Expected returns on investment, until retirement age	@ 12% p.a.
Fresh Annual Investment required per annum	**Rs 1.70 Lacs**

- (The above table is for illustration purpose only and all annual growth rate mentioned above is on assumption basis)
- Considering that you are 45, you have just 15 years left for your retirement. While you are still earning, over the next 15 years, you need to invest around Rs 1.70 Lacs each year in a portfolio of asset classes which is assumed to grow @12% p.a. to make up for your deficit of Rs 71 Lacs.

Calculating Your Retirement Corpus

Your Current Age	45 Years
Retirement Age	60 Years
Life Expectancy	80 Years
Current Monthly basic household expenditure	Rs 50,000/-
Inflation (pre and post retirement) assumed to be	@ 8% p.a.
Monthly basic expenditure @ age 60 years would cost	**Rs 1,58,608/-**

Medical expenses - Annual	Rs 60,000/-
Inflation on medical expenses assumed to be	@ 8% p.a.
Annual medical expenses @ age 60 years would cost	**Rs 1,90,330/-**
Value of your current investments	Rs 50,00,000/-
Expected returns on investment, until retirement age	@ 12% p.a.
Expected returns on your investments post retirement	@ 10% p.a.
Corpus needed to maintain your current life style for 20 years (post retirement) (A)	**Rs 3.45 Crore**
Value of your investments on your retirement @ age 60 years (B)	**Rs 2.74 Crore**
Deficit (A-B)	**Rs 0.71 Crore**
Fresh Annual Investment required per annum @ 12% returns to meet deficit	**Rs 1.70 Lacs**

(The above table is for illustration purpose only and all annual growth rate mentioned above is on assumption basis)

So you see, timely calculating your retirement corpus and estimating the future value of your current investments as well as any deficit may help you prepare a roadmap for building your retirement corpus.

As we see in this example, to maintain your current life style where your monthly basic household expenditure is Rs 50,000/- and expecting inflation @8%, your monthly basic expenditure would cost around Rs 1.59 Lacs @ age 60 years, while your annual medical expenses post retirement may be around Rs 1.90 Lacs (which would further grow @ 8% p.a.).

Thus to cover your expenditure and to maintain your lifestyle for entire 20 years of your retirement life, you would need around Rs 3.45 Crore. Considering that your current investments have the potential to grow @ 12% p.a. it would be valued at around Rs 2.74 Crore when you are 60. But to cover your deficit of Rs 71 Lacs, you need to invest around Rs 1.7 Lacs each year in a portfolio of asset classes which could be expected to grow @ 12% p.a. in future. So be prudent while calculating your retirement corpus. As it is the primary step to build a proper road map for your key life goal i.e. your Retirement.

Managing Your Cash Flows

[Retirement Planning Series] Session 2: Managing Your Cash Flows
We are glad to have you with us for our 2nd Session on Retirement Planning - Managing Your Cash Flows

Alright so let's get started...

Managing your cash flows wisely is imperative in the journey of building your retirement corpus. You might have heard the saying 'A penny saved is a penny earned'. It is therefore important to keep track of your income and expenses so that you do not deviate from your objective of saving enough for your future.

Managing cash flows is a challenge for many individuals. Even after earning a decent income, many individuals struggle to maintain positive cash flows. A key reason being their desire to own things that are clearly outside their means. It is therefore important to draw the line between what is affordable and what is not and keep personal finances under control. Remember, if you are not living within your means, you may possibly get into a debt trap. For that, you need to learn and distinguish between needs and desires so as to be able to comfortably manage your finances or cash flows better.

So, in this session of money simplified we will help you understand how to handle your money better so as to save and invest a decent amount for your golden years of retirement.

To begin with, here are 4 broad facets you should consider and the care you should take while managing your cash flows.

4 Facets You Should Consider
While Managing Your Cash Flows

Know Your Cash Inflows

- **Know Your Cash Outflows**
- **Inclusions in Your Cash Flow or Budget Exercise**
- **Rational Thinking and Proper Planning**

Let's talk about each of them in detail...

1. Know Your Cash Inflows

i. If you are a salaried individual:

You should **Consider your Net Take Home pay** (i.e. net salary that you get in hand) as your income for the purpose of cash inflows and not the CTC (i.e. Cost to Company or gross salary) which is subject to statutory deduction and taxes. The reason for doing so is that you cannot use the money that you do not get in your hand.

Calculating Net Income from Your Salary	
Gross Annual Salary	10,00,000
Statutory Deductions	1,00,000
Net Take Home	**9,00,000**
Monthly Take Home	**75,000**

(The figures in the above table are for illustration purpose only)

ii . If you have income from business and profession:

There may be some limitations in estimating your future income from business and profession as it may vary based on business conditions. In such cases you should **find a way to get expected income from your business**. While you do so, please ascertain whether it reflects a trend to give a clear picture. For example, taking an average of your past income may be helpful to judge the trend.

Calculating Income from your Business	
Financial Year	**Net Income (Rs.)**
2014-15	10,00,000
2013-14	9,00,000

2012-13	8,00,000
Total	**27,00,000**
Annual Average	**9,00,000**
Monthly Average	**75,000**

(The figures in the above table are for illustration purpose only) In this example, we have assumed that over the past 3 years, the total income drawn from business (for personal use) is Rs 27 lakh. So it gives an annual average of Rs 9 lakh and monthly average of Rs 75,000. If conditions remain the same, the future income from business / profession may reflect a similar trend going forward.

iii. Windfall Gains / Bonus:

While calculating your cash inflows, you should not ignore such incomes as they can be utilised by you to meet some more needs. **Windfall Gains / Bonus may be helpful in paying off a part of your debt, or fulfilling some key needs that may otherwise be expensive.** You should prepare a list of commitments that can be fulfilled from such onetime inflows. For example, if you are on the verge of retirement, you should calculate the estimated gratuity that you would receive from your employer on retirement.

iv. Dividend and Interest income:

You may also be earning dividend and interest income by the virtue of the investments made in stocks, mutual funds, fixed deposits, small saving schemes, etc. So, you should account for such income as well while managing cash flows and see how they can be efficiently used. They may help you **pay some of your monthly utility bills**, or if you do not need them in the near future, you may **club all such income to re-invest them at a rate higher than your savings bank account.**

v. Rental Income:

If you have a property in which you do not reside, you can **let-out the same to fetch a rental income**. Rental income is an important source of earning for retired individuals and including such income while managing your cash flows may help you plan your finances better.

vi. Other Incomes:

If you have hobbies and interest, you should think of monetising them. If you are able to do so, then it may be used to improve your life style. Do not forget that such incomes may or may not be regular and **should not be used to finance regular expenses.** Nonetheless they can act as an extra stream of earning when you retire.

Now let's discuss the other side of managing cash flows i.e. Cash Outflows

2. Know Your Cash Outflows

You should be disciplined and systematic when it comes to managing your cash outflows. Spending carefully, while meeting your basic and important needs is the key to balance your cash flows. So, you need to live within your means. Here are things you should consider while handling cash outflows…

i. Prioritise your needs:

You may have various needs. The best is to prioritise needs. Moreover, **you need to differentiate between needs and wants...**

- Your monthly groceries, your utility bills, travelling allowances, fees for children's education, EMIs, insurance premium etc., are your basic and compulsive expenses
- Your clothing and lifestyle are your essentials
- Dining at a 5 star hotel or buying an expensive gadget or the latest smartphone may be classified as a less important need. Similarly, buying a luxury car or that duplex in a posh location may be a mere desire or a want.

Thus it is important to classify your needs into 'must have' and 'good to have' and accordingly prioritise the same. The rest could be wants or desires.

ii. Compare your needs with income:

If you are falling short of meeting your needs, then postpone the ones that are less important to the next year.

Comparing your needs with your income			
Estimated Yearly Income (Rs.)		**Estimated Yearly Expenses (Rs.)**	
Salary	12,00,000	Basic Needs	4,50,000
Dividend	40,000	Essentials	2,00,000
Interest	60,000	EMIs	4,20,000
		Regular Investments	2,00,000
		Less important needs	1,00,000
Total Income	**13,00,000**	**Total Expenses**	**13,70,000**

(The figures in the above table are for illustration purpose only) If your comparison table shows a similar deficit, where your expenses are exceeding your income; then postponing some of your less important needs to subsequent years would be helpful. You would comfortably get closer to meeting your important needs. So don't overspend and try to economise.

iii. Know your spending habits:

You should ideally **list your expenses to know your spending habits**. This would help you to ascertain where you are overspending and **do away with superfluous expenditure**. If you want to go for discounted offers, don't over indulge in them and get swayed. In fact, you may end up buying more than you need. Pre-decide the frequency of dining out so that your expenses are within limit. While buying groceries check for loyalty discounts and other offers.

iv. Set a limit on your expenses:

This will help you in **not going overboard under any expense head.**

Setting Limit on Your Expenses			
(In Rs.)	**Limit**	**Monthly**	**Annual**
Income	-	1,00,000	1,200,000
Basic	35%	35,000	4,20,000

Essentials	10%	10,000	1,20,000
EMIs	30%	30,000	3,60,000
Regular Investments	20%	20,000	2,40,000
Less Important	5%	5,000	60,000

(The figures in the above table are for illustration purpose only) An exercise as depicted in the table here would be helpful to stay within your means. Setting a limit on each head of expense may help you keep your overall expenses under control, thus keeping your net cash flow positive.

v. Set a target for your monthly investments:

The way to create corpus for your golden years is to **save and invest effectively**. Hence provisions for investments should also be a part of your annual budget. You should **inculcate a systematic investment approach and allocate a portion of your income** to the same - say 20% of your annual income towards your savings and investments.

vi. Build up a contingency reserve:

A contingency fund helps manage any sudden outflows without hampering your regular planned expenses. You should always keep aside 1 to 2 years of your regular expenses or 6 to 12 months of your income as a contingency fund. This may help you take care of few months of expenses during times of crisis.

Apart from what we just talked about, here are some important aspects to take into consideration in your cash flow or budget exercise.

3. Inclusions in Your
Cash Flow or Budget Exercise

i. **Remember to track irregular cash outflows:**
This is something which many tend to miss out. Household maintenance, vehicle maintenance, donations, birthday /anniversary gifts or such other expenses tend to be missed out while planning cash flows. So, include them to be more realistic!

ii. **Remember to discuss your Budget Exercise with your family:**
If you are spending as a family, you can also learn to save as a family. Keep your spouse and kids involved in the path of achieving your life goals, and also celebrate achievement of key goals with your family (but of course being within your means). **Involving your family members will facilitate an integrated and well-co-ordinated approach.**

iii. **Track and review your cash flows:**
You should ideally do this at least once a month. Many people are under the impression that they are done once they plan expenses based on their income. But that may not be the case as you need to review your cash flows with the changing environment.

4. Rational Thinking and Proper Planning

i. Remember, managing your cash flows prudently is means to an end
ii. Rational thinking is imperative to manage your cash inflows and outflows
iii. Prudent goal planning would help you to lead a peaceful retirement
iv. Adopt financial discipline while investing for your retirement and other financial goals
v. If need be, take professional guidance to set your finances right

Evaluating Your Risk Profile

We are glad to have you with us for our 3rd Session on Retirement Planning - Evaluating Your Risk Profile

Alright so let's get started...

In the world of investments, investors often make the mistake of misjudging their risk appetite. Many investors easily fall for financial instruments which may not be suitable for them or at times even invest in unregulated instruments. This is quite common in cases where investors get carried away by some extra ordinary gains made by their friends or relatives or on the basis of misleading advice.

In such cases, it may happen that the returns on offer would look really attractive; but they may come with a level of risk you cannot afford to take. After all, it is your hard earned money and you should invest it prudently.

So, in this session of money simplified we will help you understand why is it critical to consider risk when we talk about investing and how you can evaluate your risk profile.

Why is it critical to consider risk?

1. Any discussion about **investing is incomplete unless it underlines the risk along with the potential return.**

2. Very often we all want to earn high returns on our investments. But **high returns come at a price**. Remember, there are no 'free lunches'!

3. As earning high returns also calls for taking high risk, **not all are comfortable taking high risk**. Thus before you consider any investment product which claims to offer you high returns, it is critical to assess the risk associated with such in1vestment products in conjunction with your own risk taking ability.

4. Although you may understand what we mean by 'Risk', you must also know that **there is a difference between your 'Risk Appetite' and your 'Risk Tolerance level'.**

Risk Appetite vs. Risk Tolerance

While 'risk appetite' refers to willingness of an individual to take risk, 'risk tolerance' implies the ability of an individual to tolerate the level of downside risk.

Determinants of Risk

Risk Appetite	Risk Tolerance
1. Your current age At a younger age you have the advantage of time and may have willingness to take high risk.	**1. Your current financial situation** You can assess your current financial situation by considering factors like your income, expenses, assets, liabilities and financial responsibilities that you are shouldering. A favourable current financial situation may help increase your risk tolerance level.
2. Your past experiences with your investments Going by your past experience, if you have earned substantially higher returns in the past, you may have the heart to take more risk.	**2. Your contingency funds** Your savings for a rainy day can enable you to take risk. If you have failed to maintain adequate funds for your contingency needs, your risk tolerance level could be low, as you are not financially ready to manage any contingent events.
3. Your Knowledge A thorough knowledge about something increases your awareness. Becoming aware about good and bad effects completely, may help you analyse risk better.	**3. Nearness to your financial goals** The time left to achieve your goals also determines the risk that you can prudently afford to take while investing. If your financial goals are far away, you can afford to have a higher risk tolerance level. But if your financial goal is near, then your risk tolerance level is usually low.
	4. Insurance Coverage Life being uncertain, you would not want to pass on any financial burden to your loved ones. If you do not have an optimal life insurance cover, your risk tolerance level would be low.

Risk Profile

Risk Profile = Risk Appetite + Risk Tolerance

As you can make out from this equation; your risk profile is a combination of your risk appetite and risk tolerance level which helps in prudent risk assessment.

Once you have identified your risk appetite and risk tolerance levels well, you would be nearly close to assessing your risk profile.

So, it is a combination of your risk appetite and your risk tolerance that you need to consider before you take any major investment decision.

Categories of Risk Profile

Based on your risk profile, you as an investor can be broadly classified as…

- **Risk Seeker or Aggressive:** If your risk profile is high, you are an aggressive investor and may be willing to take high risk.

- **Risk Neutral or Moderate:** If your risk profile is between medium to high, you would be moderate on your risk. You may be looking to earn decent return at a relatively lower risk.

- **Risk Averse or Conservative:** If your risk profile is between low to medium you are a conservative investor and risk averse in nature. You may not be comfortable in taking risk.

Risk profiles can be further fine-tuned to include five instead of three categories, viz., Aggressive, Moderately Aggressive, Moderate, Moderately Conservative and Conservative.

Indicative Portfolio Allocations
(Based on Your Risk Profile)

Risk Profile	Equity	Debt	Gold
Aggressive	65-85%	5-20%	10-15%
Moderate	40-60%	35-50%	5-10%
Conservative	10-25%	70-80%	5-10%

Equity / Gold must have a minimum horizon of 5 years and their higher values may be chosen for very long term goals. One must follow a glide path or de-risk his portfolio to debt as goal nears.

The aforesaid portfolios are for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.

Here is an Indicative Portfolio Allocation, for investors having different kinds of risk profile.

For an investor with an aggressive risk appetite, allocation to equities would be relatively higher for goals which are very long term in nature.

For a moderate risk appetite, allocation to equities will be slightly lower than that of an aggressive investor. Such investors should balance their portfolio between equities offering growth and debt to cushion the downside risk.

If you are a conservative investor and are risk averse, seeing a loss in your portfolio is most likely going to make you uncomfortable. So, you need to prioritize the protection of your capital. Depending on your age and investment time horizon, a major portion of your investments would be in debt.

Points to Remember

While there is information galore on investment avenues, **you ought to adopt caution.**

- **Ensure that you are taking a wise investment decision** which suits your needs and risk profile.
- There is **no point in being carried away by an investment opportunity which has been hyped** even though it may be really worth it. And **do not indulge in in something that does not suit your risk profile or you do not understand.**
- You should **be cautious of investment opportunities which harp on returns and do not emphasise on the risk involved.**
- As a matter of fact **in the absence of information related to risk, information isn't just incomplete, it may be downright misleading!**

Allocating Assets For Your Retirement Portfolio

We are glad to have you with us for our 4th Session on Retirement Planning - Allocating Assets For Your Retirement Portfolio

Alright so let's get started...

In an endeavour to live peaceful retired lives many of you may be investing in a host of investment avenues. But the question is: Are you allocating your hard earned money to the right asset classes? You see, asset allocation is an important ingredient in the endeavour to achieve your financial goals. It helps you to minimise risk in your portfolio and optimise the returns besides offering a host of other benefits which come along.

While benefits of diversification have been talked about widely for its merits, it quite often has been incorrectly or incompletely followed by many investors. If your asset allocation has gone awry, there is a high chance you may not be on the right track in your retirement journey and you may be left with a suboptimal corpus during your golden years.

So, in this session of money simplified, we will help you meaningfully chart your asset allocation which would help you achieve your ultimate goal of retirement effectively!

The Importance of Asset Allocation for Your Retirement

1. One cannot ignore the risk which comes with an investment idea; no matter how luring or promising it sounds. You need to **balance your risk-reward** keeping in mind your age, your income & expenses, assets & liabilities, risk profile, and your investment time horizon.

2. Prudent asset allocation can **help you diversify your investible surplus meant to <u>plan your retirement</u> wisely** across asset classes like equity, debt, gold, or even holding cash equivalents for that matter.

3. Having exposure to more than one asset class optimally can work in your favour, because **<u>different asset classes</u> react differently to the same set of factors in play and hence are subject to varying levels of risk.**

4. Asset allocation **reduces dependency on a single asset class.**

5. Can **help you manage your liquidity needs better** during retirement.

6. (And thus…) Asset allocation **can set the right investment strategy.**

<u>*6 Key Benefits of Asset Allocation*</u>

Benefit #1: Minimises your portfolio risk

- If the retirement portfolio is well-diversified into various asset classes such as equity, debt, gold, or even cash equivalents risk can be reduced.

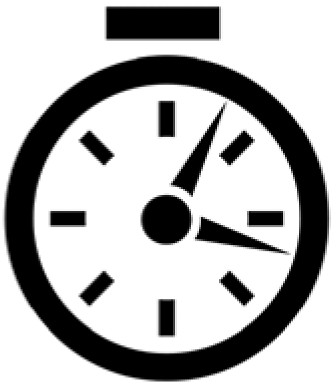
- A prudent asset allocation helps you protect from market ups and downs.

Benefit #2: Optimises your portfolio returns

- Through asset allocation, you can ensure that you do not invest in an ad-hoc manner, or else your retirement goal may not be achieved.

- It helps you place a rational return expectation.

Benefit #3: Helps align your investments as per your time horizon



- Along with the risk profile which is an essential facet while investing, the time left until your retirement is considered. This helps to draw a prudent asset allocation for your retirement portfolio.

  As a ground rule remember that if you are left with a sufficient or long time for your retirement (say more than 10 years), a predominant portion of your investible surplus can be parked in equities. On the contrary, when the time left until retirement is quite short (less than 5 years); it is best to avoid investing in equities and instead prefer investing in fixed income instruments. If you are left with medium term horizon (i.e. 5 to 10 years) you could maintain a healthy balance between equities and fixed income.

- However, as time passes you need to review your asset allocation…and that should be done based on your age, change in financial circumstances, windfall gains, unexpected losses, besides change in outlook for a particular asset class. This helps you align your retirement portfolio wisely.

Benefit #4: Makes market timing almost irrelevant

- A prudent asset allocation plan is charted taking into account your risk profile, your financial goals and your investment time horizon amongst a host of others; which makes timing the market almost irrelevant for you. This thus ensures that there's no digression from the financial plan charted for your long term financial wellbeing.

Benefit #5: Helps maintain adequate liquidity

- Liquidity is also one of the vital factors while making investment decision. Sufficient liquidity helps you address your retirement needs.

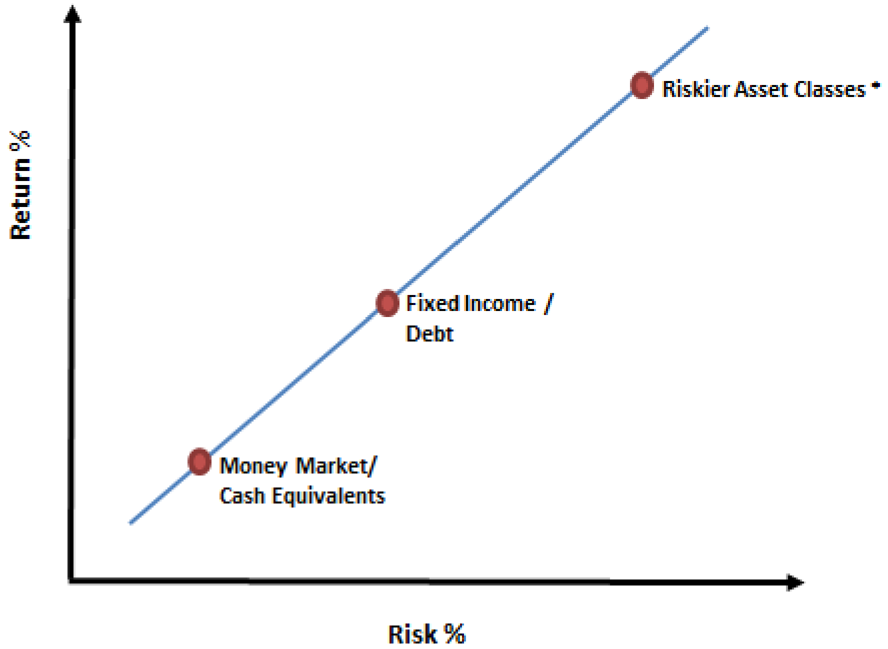
Benefit #6: Minimises your tax outgo

- A high incidence of taxation can he avoided if investment planning for your retirement is done well through tax-saving instruments or right asset class mix which facilitates minimisation of taxes.

But understanding which asset classes are suitable is not easy...

You need to...

- **Understand risk-return trade-off of every asset class.**



The aforesaid chart is for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.

As you can see, money market / cash equivalent / fixed income and debt instruments carry lower risk and thus generate lower returns vis-à-vis high risk asset classes like equities that have the potential to generate higher returns. The return potential of asset classes in your portfolio will be subject to the risk you are willing to take.

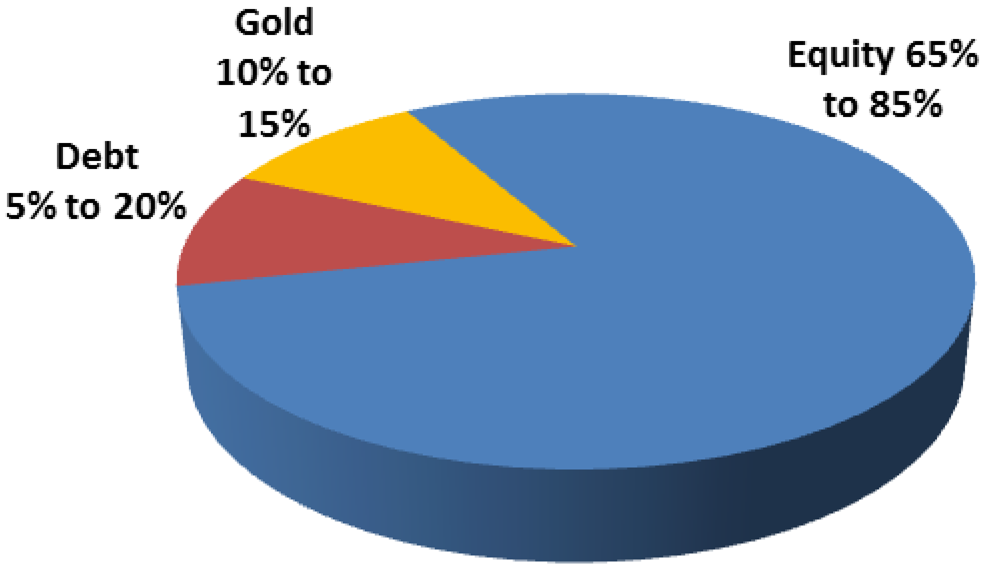
- Moreover, you should **keep your return expectations realistic.**
- You should **calculate the required annual growth rate to build a respectable corpus** for your retirement.
- And while you do so, **account for inflation wisely.**

Defining Your Asset Allocation

Well, this is a daunting task. But one of the best ways to do it is by recognising the age bracket you happen to be placed under.

- **For Individuals between 25 to 35 Years having Time Horizon of 25 to 35 Years**

Life Stage - Accumulation Phase (Portfolio Type - Aggressive)

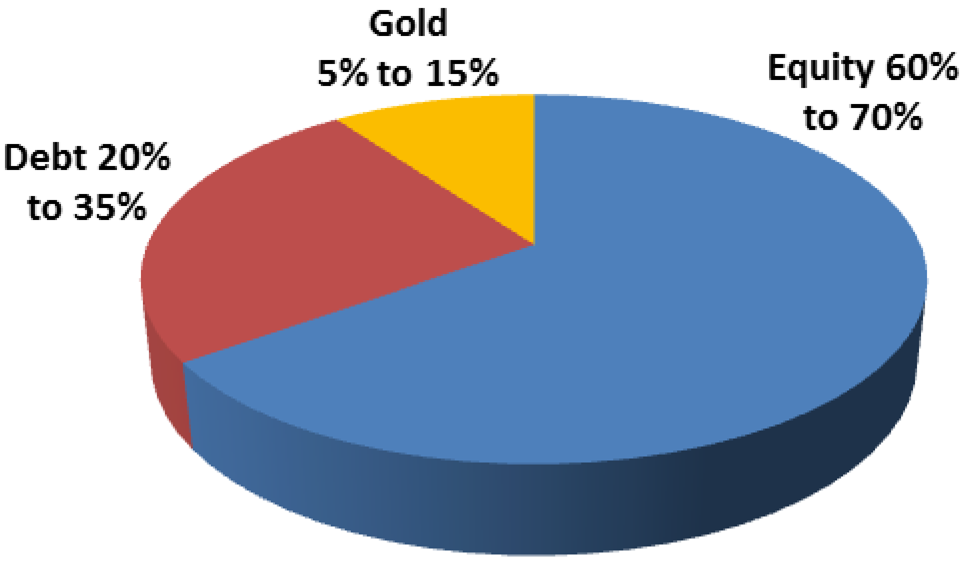


The aforesaid portfolio is for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.

As an individual if you happen to be in this age bracket, **you are in the accumulation phase of your life.** Hence you may be looking for wealth creation in the long run since you have sufficient time before you hang your boots. Apart from retirement, you may also have financial goals in the interim such as: buying a dream home, car, getting married and even save to begin a family and eventually plan for your child's future needs. So, given such a scenario you would need to prioritise each of your financial goals. Nevertheless, with a sufficient time horizon until your retirement, you can afford to take a higher risk with your retirement savings. Therefore there's scope to **position your portfolio aggressively by allocating 65%-85% of your portfolio in equities and around 5%-20% in debt.** Based on your preference you may also hold around to 10% to 15% exposure to gold to diversify further.

- **For Individuals between 35 to 45 Years having Time Horizon of 15 to 25 Years**

  Life Stage - Mid-asset Accumulation Phase (Portfolio Type - Moderately Aggressive)



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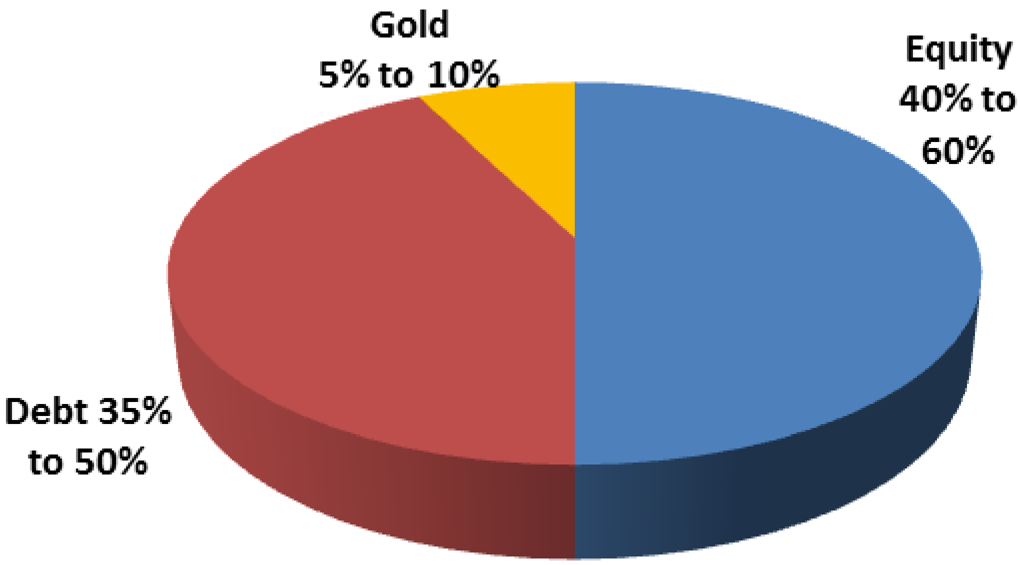
If you are in this age group, **you are in the mid-asset accumulation phase of life.** You may be planning to buy a house, a car and invest for your child's education. You need to plan your income well and stream line it towards achieving your goals and life style. With a time horizon of around 15 to 25 years on your side, you can take a relatively higher risk to grow your retirement portfolio. Hence your **portfolio can be positioned in the moderately aggressive risk profile by allocating 60%-70% in equity, 20%-35% in debt and holding 5%-15% in gold.**

- **For Individuals between 45 to 55 Years having Time Horizon of 5 to 15 Years**

  Life Stage - Protection Phase (Portfolio Type - Moderate)

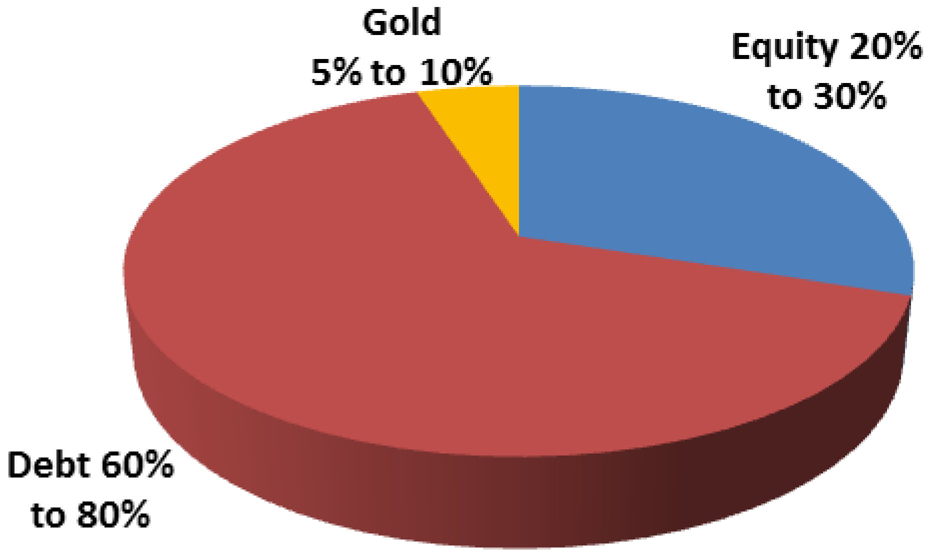


(Source: PersonalFN Research) The aforesaid portfolio is for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.

If you are in this age group, **you are in the protection phase of your life cycle.** In this age bracket, you may still have life goals to fulfil such as child's higher education, their marriage or even moving into a big house you've dreamt of. Hence this is a phase when you need to streamline your finances - both inflows as well as outflows. You see, you need to keep aside sufficient funds for your retirement portfolio; because there is a possibility that you may fall short on the corpus for retirement. But since you have a time horizon of 5-15 years you can afford to take some amount of risk rather than being too conservative. Hence your **portfolio can be positioned moderately by allocating 40%-60% towards equity, 35%-50% towards debt and about 5%-10% in gold to hedge the portfolio.**

- **For Individuals between 55 to 60 Years having Time Horizon of less than 5 Years**

Approaching Retirement - Portfolio Type - Moderately Conservative

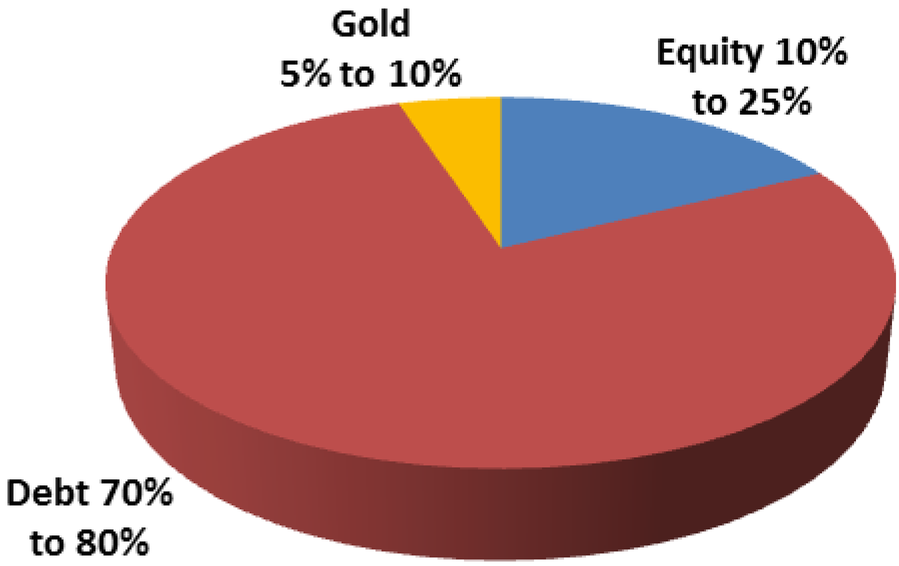


(Source: PersonalFN Research) The aforesaid portfolio is for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.

If you are in this age group, **you are on the verge of retirement**. These are your few final years before you hang your boots. **Soon, your regular source of income would stop**. Hence you ought to be conservative while investing your hard earned money. It would be not be advisable to have a high exposure towards equity. You should **position your portfolio as 20%-30% in equity, 60%-80% in debt and 5%-10% in gold as a hedge.**

- **For Individuals Above 60 Years - Already Retired**

Life Stage - Distribution Phase (Portfolio Type - Conservative)



(Source: PersonalFN Research) The aforesaid portfolio is for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.

If you are 60 years and above, **in all likely chances you may be retired**. You have completed the conservation and protection phase of your life and have **entered the distribution phase**. By now **you have limited income or even no regular income** and thus at this stage one dips into his savings and reserves that has been built over the years. Hence while you invest to take care of your retirement needs, your portfolio needs to be positioned conservatively. **Around 70% to 80% of your portfolio should be inclined towards fixed income generating instruments** to generate post tax returns of at least 7% to 8% p.a. assuming annual inflation expectation is @ 7%; some portion, say **10%-25% of your portfolio can be in equities** with a long term investment horizon of at least 5 years **and about 5%-10% in gold as a hedge in your portfolio.**

Do not forget to rebalance your portfolio

In this exercise of asset allocation, a need to rebalance the portfolio may arise.

- **Rebalancing refers to re-aligning or adjusting the holding in your portfolio.** You should rebalance your portfolio as your age progresses or change in risk appetite - led by various circumstances, nearness to financial goals or even when the outlook for a particular asset class alters significantly.

- **It helps you to book profits** (sell high) **in an outperforming asset class and/or buy more of an underperforming asset class** (i.e. 'value buy').

- Hence you should **review your portfolio on a regular basis**, say on a yearly basis, to check the need for realignment. This is because the allocation to an asset class may drift significantly away from the initial allocation due to appreciation or depreciation in its own value or appreciation or depreciation in the value of other asset classes.

- Rebalancing would **help you manage the risk** to your portfolio and smooth out your portfolio returns.

Lastly, before we end this session here are some...

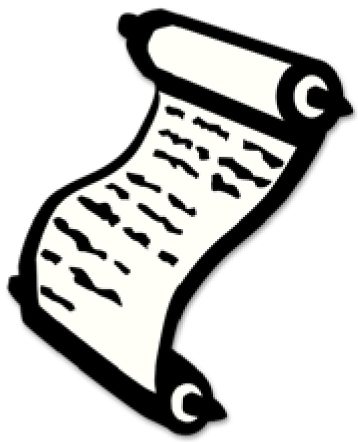
Points to Remember

- Don't just invest in an ad-hoc manner for you retirement. **Invest by prudently charting an asset allocation most appropriate for you.**

- **While drawing your asset allocation consider**
    - **Age;**
    - **Income & Expenses;**
    - **Asset & Liabilities;**
    - **Risk appetite; and**
    - **Time horizon**
- **Asset allocation is an important ingredient to achieve your ultimate financial goal of a peaceful retirement**
    - **It reduces dependency on a single asset class**
    - **will help you minimise risk and optimise returns of your retirement portfolio**
    - **makes market timing almost irrelevant**
    - It will **help you maintain adequate liquidity in your retirement portfolio**
    - It **sets forth the right investment strategy**
    - But ensure that you **review your retirement portfolio and if need be, rebalance it appropriately**

Passing Assets To Your Loved Ones

We are glad to have you with us for our 5th Session on Retirement Planning - 'Passing Assets To Your Loved Ones'.



Alright so let's get started...

Benjamin Franklin, a renowned polymath, who was a leading author, political theorist, civic activist, statesman and diplomat, once said, "...in this world nothing can be said to be certain, except death and taxes." And interestingly many of us despite being aware of this inevitable fact, often avoid thinking about it, or defer estate planning to another day. But have you ever thought what would happen to the wealth you created over years of hard work after your demise? Have you ensured that your family is well-safeguarded?

You see, dying intestate (i.e. without preparing a will) can lead to various complications and disagreements among your heirs.

Hence, here is where estate planning comes into picture. Through years of experience we can say that there exists a wrong notion among people that estate planning is meant only for the wealthy or needs to be done after you've retired. But the fact is that it is essential for everybody in today's world.

In this session of money simplified, we will introduce you to the facets of estate planning and also the points you need to consider while writing a 'Will'.

Why Estate Planning?

1. Estate planning refers to **passing down assets / investments from one generation to another**

2. **Many people become incapacitated in their old age or sometimes even as young adults.** An incapacitated person is an individual who is incapable of taking care of his own self and provide for his basic needs due to some mental or physical condition which he suffers from. Preparing for such contingencies is also a part of estate planning.

3. And **estate planning is essential for all** regardless of the economic strata and size of the portfolio.

4. **You don't need to wait till you own plenty of assets / investments or till your retirement for estate planning.** Life is quite unpredictable and hence you should begin at preferably in the mid-asset accumulation phase i.e. between 35 to 45 Years or latest in the protection phase of your life cycle when you are between 45 to 55 Years. Estate planning is one of the most essential aspects of our lives and should not be put off until it's too late. It is advisable to prepare your will early, once you have certainty about your asset and legal heirs to whom you would like to pass on your wealth.

5. **It is a dynamic process which needs to be reviewed at regular intervals** to absorb any changes, which might happen in our lives or in the laws of the country. If required, you may even need to revise your will if there is substantial change in the circumstances that existed at the time of preparation of the earlier will.

Here are some…

Benefits of Estate Planning

1. **Estate planning ensures that your physical assets and investments, are inherited by the people to whom you want them to be transferred to after your demise.** The law might not take into account your personal relationships or preferences while distributing your assets if you die intestate (i.e. dying without a Will). Without proper planning, it is possible that the law disposes your estate even among distant relatives who might not be your first choice of beneficiaries.

2. **Estate planning can also help pass accolades bestowed on you to a specific individual.** Say, you are a defence personnel and wish to give your war medal, which has some sentimental value to your younger daughter who has interest in war history; this is possible through prudent estate planning. But in the absence of proper estate planning, it may or may not be granted to the person of your choice.

3. **Prevents financial, emotional and legal grief to your loved ones**

4. It also **avoids complications, disagreement, bitterness and drift in the family**

5. **Estate planning** might also **help the beneficiary reduce tax outgo on account of inheritance** if done prudently. For instance, instead of passing on assets after your

death, you might gift them to your loved ones while you are alive. If left to the prevailing intestacy rules, there is a chance that a higher amount of tax may be applicable on your property and other assets. You can also make separate arrangements for tax payments. For example, you can provide for tax liabilities separately from your residuary estate, if you don't want to reduce the inheritance value of assets by way of taxes.

We believe that for all these reasons and in order to avoid being the reason of agony for your loved ones, you must start estate planning early and consider it as a part of your retirement planning exercise.

Few Myths About Estate Planning Debunked...

Myth#1: Estate planning is meant only for the wealthy
Fact: It is essential for everyone irrespective of the quantum of wealth one owns.

Myth#2: Estate Planning should be thought of only after retirement
Fact: Life is quite unpredictable and hence **the earlier you think through and plan, the better it is.** As mentioned earlier, you need to begin preferably in the mid-asset accumulation phase, when you are between 35 to 45 Years or latest in the protection phase of your life cycle, when you are between 45 to 55 Years.

Myth#3: My legal heirs will handle it maturely
Fact: Well, we wish that they do. **But unfortunately often many disputes happen over money in today's world.**

Myth# 4: I have registered my nominee(s) in respect of my Mutual Fund units so they will automatically get ownership of these units.
Fact: The nominee(s) registered under the nomination facility provided by a Mutual Fund does not necessarily acquire any title or beneficial interest in the Units. The nominee(s) receives the Units only as an agent/ trustee for the legal heirs or legatees. The Mutual Fund is not bound to transmit the Units in favour of the nominee in the event of any dispute in relation to the nominee's entitlement to the Units.

Myth#5: I don't need to seek legal opinion
Fact: While it is not necessary, **it would be prudent to reach out to your lawyer to ensure that estate planning is done legitimately** considering the nitty-gritties involved.

Ways to Carry Out Estate Planning...

Broadly there are two ways...

1. **You can transfer your assets to your beneficiaries by creating a Trust:** This might enable you to decide how and when your beneficiaries must receive their inheritance. Creating a Trust is largely useful in the case where your spouse and minor children are unable to manage their finances on their own. But overseeing the Trust well is also a critical aspect.

2. **By Drafting a Will:** Ideally a Trust should be complimented by a Will as it is the cornerstone of all estate plans. Writing a Will appropriately will benefit you as a testator making a valid Will and will provide an enhanced understanding of your current financial strength and an opportunity to improve upon it in your remaining life span.

Here are...

Points to Note While Writing a Will

A Will should be free from coercion, fraud and undue influence.

- **Do use the title 'Last Will And Testament Of (state your name here)'** to make it clear that the document is your Will.

- **State your full name, current address, and the fact that you are of sound mental health and under no duress from any one to make the Will.** It is necessary to bring in clarity that the Will is prepared in complete sense.

- Even though it is not necessary, it is advisable to **state the name of the executor** i.e. the person who will carry through the principles of the Will. You can name your spouse or the main beneficiary. If you are nominating an outside person to be the executor of your Will, you must ask their permission first. If you have minor children, you must also indicate a guardian for them in your absence.

- **A Will should be Simple, Precise and Clear,** otherwise there may be problems for the legal heirs. It is always better to take the advice of a trusted advocate when writing your Will.

- **A Will must always be dated.** A Will without date is not maintainable. If more than one Will is made then the one having the latest date will nullify all other Wills.

- **Each page of the Will should be serially numbered and signed by the Testator that is you and the Witnesses.** This is to prevent the Will being substituted, replaced, or pages being inserted by people intending to commit fraud. At the end of the Will you (the Testator) should indicate the total number of pages in the Will. Corrections if any should be countersigned.

- **It is possible to make changes or minor alterations in a Will** before it is registered. After the registration of the will, if at all there are any changes re-registration would be required. In case there are too many or major changes, it will be better to make an entirely new Will and register the same.

- **It is not compulsory for one to register a Will** with the Registering Authority, but in case any property or asset is given to any charitable organization; then registration should be done. In order to avoid frauds and tampering, it is always preferable to get it registered. If you wish to register your Will then it can be done with the registrar/sub-registrar by paying a nominal registration fee. This also requires you to be personally present at the registrar's office along with the witnesses. Also, it is better if the witnesses signing your Will are not the immediate beneficiaries of your estate or wealth. They could be 2 people who are trustworthy and reliable. Also, it would be wise to inform the executor and your family members about the whereabouts of your Will in order to avoid confusion later.

- **A Will should be kept at a secure location** in order to avoid any misuse or fraud.

- **Will can be typed or handwritten.** A stamp paper is not necessary to prepare a Will. You can write a Will on a simple plain paper.

Lastly, before we end this session here are some...

Points to Remember

- **Dying intestate can lead to various complications and disagreements among your heirs, hence estate planning is critical** while you retire.
- **Estate planning is essential for everyone irrespective of the amount of wealth one owns** and not only for those who are wealthy and retired.
- **Estate planning is a dynamic process**, so it needs to be reviewed.
- **It potentially ensures that your assets are passed on to your loved ones and they are protected.**

- But you need to **carry out estate planning prudently by creating a Trust and / or drafting a Will.**
- **Will should -**
    - **Be dated and kept simple, precise and clear**
    - **Be free from coercion, fraud and undue influence**
    - **Ideally state the name of the executor**
    - **Use the title 'Last Will And Testament Of (state your name here)'**
- And last but not the least, **your mutual fund investments should have proper nominations** and ensure that requisite documents are timely furnished to the AMC for transmission.

[The content in this video transcript is for general information purpose only. The financial institution/ intermediary processing the transmission claim basis the Will of the deceased investor may have different policies and procedures to ensure that the claim is processed to the actual legal heir(s) of the deceased investor and may ask for additional documents from the legal heirs in this regard.]

Retirement Planning at Various Life Stages

We are glad to have you with us for our 6th Session (of the Retirement Planning Series) on 'Retirement Planning at Various Life Stages'.

Alright so let's get started...

Each one of us dream of <u>living a comfortable and peaceful retirement</u>. But realizing a peaceful retirement is a lengthy process. It takes deep planning and years of determination from the start of your career to help you manage your finances and life style during your retirement years.

In this session of money simplified, we will tell you how you can give a good start to your retirement in order to live a self-sufficient and peaceful retired life.

Why Retirement Planning?

- You would agree that **retirement is an important phase in each one's life**

- Since you cannot avoid it, **retirement planning is imperative to remain financially independent, secure and to maintain a healthy and comfortable standard of living during this phase** where you may not be having regular flow of income

- **Timely planning for retirement is very important so that funds are sufficient till your demise.** This includes taking care of day-to-day expenses as well as any medical emergencies that may arise as your age progresses

Here's how you should go about Planning Your Retirement at Various Stages of Your Life...

25-35 years left to your retirement...

- You are probably in the **age group of 25-35 years**

- Which means you are in the **accumulation phase of your life...**You are young and have another 25-35 years of working life before you retire

- **You should look for wealth creation in the long run** since you have sufficient time before you hang your boots

- Apart from retirement, **you may also have other <u>financial goals</u> in the interim** such as: buying a home, car, getting married and even save to begin a family and eventually start planning for your child's future needs. Given such a scenario, you would need to prioritise each of your financial goals

- You need to **form a habit of living within your means** and give yourself a cushion so that you don't fall into the trap of excessive credit and unreasonable expenses

- You should **insure your life adequately** through a decent Term insurance plan

- **Buy medical insurance** if you are still single, or a family floater if you are married and have children

- Nevertheless, with sufficient time until your retirement, you can afford to take a higher risk with your retirement savings. So there is scope to **position your portfolio aggressively by allocating 65%-85% of your portfolio in equities and around 5%-20% in debt**

- Based on your preference, **you may also hold around 10% to 15% exposure to gold** to further diversify your portfolio

[The portfolio allocations mentioned are for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.]

• You may **save through monthly SIPs in mutual funds to have a disciplined approach to investment.** You may open a PPF account or invest in debt mutual funds for the fixed income portfolio

• Any salary hike or tax refund or **dividend and interest income can be ad-hoc investments** which can be utilized for your intermediate goals

• The earlier you start saving and investing, the greater would be the value of your retirement portfolio due to the power of compounding. You may even be able to retire earlier

15-25 years left to your retirement...

- You are probably in the **age group of 35-45 years**

- Which means you are in the **mid-asset accumulation phase of your life**
- **You may be planning to buy a house or** may have already bought one or **invest for <u>your child's education</u>.**
- **If you own a home, make sure you pay off your loan before you near your retirement.** You should ensure that the term of your loan does not exceed 20 years at any point of time or else you may find it difficult to pay off your loan before retirement
- Also, **buy a medical insurance, preferably a family floater** to protect the health of your family
- Moreover you should **have adequate life insurance to cover all your liabilities or about 10x of your annual income.** This will act as a provision to financially safeguard your family in case of uncertainty
- You need to **plan your investments well and stream line it towards achieving your financial goals.** You should also talk to your spouse and make sure your retirement goal is compatible
- While you should diversify your investments and maturity dates to optimize returns and account for risk; with a time horizon of around 15 to 25 years on your side, you can take a relatively higher risk to grow your retirement portfolio. Hence, **your portfolio may be positioned in the moderately aggressive risk profile in the initial years**

- **You can allocate 60%-70% of your portfolio in equity, 20%-35% in debt and hold around 5%-15% in gold**

[The portfolio allocations mentioned are for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.]

- You may **continue with your monthly SIP in mutual funds**
- **Continue contributing towards PPF and extend it for another 5 years if the maturity date is nearing** even if your employer is already deducting your monthly contribution towards EPF. All your contributions towards fixed income generating instruments would turn into a key pension stream during your retirement

5-15 years left to your retirement...

- You are probably in the **age group of 45-55 years**
- Which means you are in the **protection phase of your life**
- In this age bracket **you may still have some life goals to fulfil such as your child's higher education, marriage or even moving into a bigger house**
- If you have accumulated enough wealth, **you may even plan to retire early or travel to your dream destination**; but ensure that your other dreams do not hamper your retirement plans

- This is a phase when **you need to streamline your finances - both inflows as well as outflows**
- **Start maintaining sufficient contingency funds and have adequate medical insurance** for yourself and your family. There should not be any slip-up on your finances
- Moreover you need to **keep aside sufficient funds for your retirement portfolio** because there is a possibility that you may fall short on your retirement corpus, since you started late
- **Recalculate your required retirement corpus** by using a retirement calculator. If you are falling short, you need to increase your monthly investments as far as possible, or else increase the return potential of your portfolio by having greater exposure towards potentially high returns generating instruments

- But you also got to **ensure that you are balancing your portfolio wisely.**
- Since you have a time horizon of 5-15 years, **you may afford to take some amount of risk rather than being too conservative**
- Hence **your portfolio can be positioned moderately by allocating 40%-60% of your portfolio towards equity, 35%-50% towards debt and about 5%-10% in gold** as a hedge for your portfolio

[The portfolio allocations mentioned are for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.]

- **While you continue investing in equity mutual funds, you should also have reasonable exposure towards debt mutual funds**. Also, do not forget to extend your PPF account for the next 5 years, if it is about to mature

- **Check with your employer on pension benefits or post-retirement benefits they provide** such as Gratuity, Leave encashment, Superannuation, Pension, etc. Consider them in your retirement plan

- Check if **early retirement would have an effect on your pension plan**. Calculate the impact! Moreover, have complete knowledge about your pension related investments and social security plans, so that you can take timely actions, when necessary

Less than 5 years left to your retirement…

- You are probably in the **age group of 55-60 years**

- Which means **you are on the verge of retirement**

- **You may have accomplished almost all your other financial goals.** You have your own mortgage free house to live in comfortably, your children are well settled, and you have perhaps travelled to your dream destinations

- **You are into your final years before you hang your boots** and soon, your regular source of income would stop

- Hence, **you ought to be conservative while investing your hard earned money**

- It would not be advisable to have high exposure towards equity as you are nearing retirement. **You need to start cutting your equity exposure considerably and start shifting your portfolio towards lower risk fixed income investments**

- At this stage **you should position your portfolio as 20%-30% in equity, 60%-80% in debt and 5%-10% in gold** as a hedge

  [The portfolio allocations mentioned are for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.]

- While you may **continue investing in equity mutual funds** to match the above mentioned allocation, you should **increase your exposure towards debt mutual funds** and other traditional fixed income instruments

- **Your <u>contingency corpus</u> can be parked in liquid funds** so that they may earn better returns than a savings bank account, and yet can be withdrawn in case of emergencies

- Also **make sure that you have paid off your loans by now.** If not, pay off all your loans before retirement. You cannot afford to enter your retirement phase with liabilities to settle

- And most importantly, **continue paying premium towards your medical insurance** since it may be difficult to get insurance at this age, due to health ailments, if any. So the best way is to pay your premiums regularly and continue.

- If you do not have medical insurance, **maintain a separate fund to take care of your medical needs**

Already retired…

- **Probably you have completed 60 years** and the conservation and protection phase of your life; which means you have entered the distribution phase of your life

- By now you have limited income or no regular income and hence **you need to dip into your savings and reserves** that you have built over the years. Your savings and reserves would include the wealth accumulated in your PPF account, EPF account, Superannuation account, Fixed deposits, Small Saving Schemes, Mutual Funds, Gold ETFs etc.

- At this stage **your portfolio needs to be positioned conservatively** so that your investments can take care of your retirement needs

- **Around 70% to 80% of your portfolio should be inclined towards fixed income generating instruments** ...and aim for reasonably good inflation adjusted post tax returns

- Some portion, say **10%-25% of your portfolio may still be in equities** with a long term investment horizon of over 5 years and about 5%-10% in gold as a hedge in your portfolio

  [The portfolio allocations mentioned are for illustration purposes only and should not be construed as investment strategies / investment advice. Investors should consult their investment advisor and construct their portfolios based on their risk appetite, time horizon, investment goals, etc.]

- **Your goal should be to create a stream of cash flows to take care of your basic expenses.** For this you need to calculate the money you need each month and which portion of your investment portfolio they can come from. For example, the interest and dividend income you receive on your investments can help you settle your utility bills and some day to day expenses.

- Moreover, you should calculate and fix a monthly withdrawal amount which can be withdrawn initially from your low risk investments, while letting your other investments grow and earn in the later years. **Systematic Withdrawal Plans (SWP) offered by mutual funds is also a good option to create a cash inflow stream post retirement.**

- **The money you receive from Gratuity and Leave encashment from your employer on retirement can be invested in short term debt mutual funds** to enable you to receive a regular income stream. You can start withdrawing from these instruments after 3 years or as and when you need money. However, ensure that the instruments where you invest this money offer sufficient liquidity.

- **Do not stop paying premium towards your medical insurance** as you need it the most during your retirement. Some insurance companies provide health cover until the age of 70. Or else maintain a separate contingency fund to take care of your medical needs

- **Your contingency money maintained in liquid funds can take care of any other emergencies.**

You see retirement planning is an on-going and life long process. It takes decades of commitment in order to enjoy the rewards during your golden years. The earlier you start the better it is.

So, as you aim to build a decent corpus for your retirement, you can follow the above guidelines and march forward in the journey to achieve a peaceful retirement.

6.

⊟ **Life Goal 2 - Tax Planning**

1. **Reducing Tax Liability by using Deductions under Chapter VIA**

   Many people often underestimate the amount of money that they need for a hassle free retirement. In just few years of their retirement, they realise that they will be running out of money. And the thought of the number of years that they may have to survive without any income is rather horrifying. So, in order that you do not land up in such a situation, it is necessary to calculate your retirement corpus carefully. In this session, we'll tell you how to go about calculating your retirement corpus. [Watch Video | Read Transcript]

Reducing Tax Liability by Using Deductions under Chapter VIA

Session 1: Reducing Tax Liability By Using

Deductions Under Chapter VIA

We are glad to have you with us for our 1st Session on Tax Planning – (…and that is…) 'Reducing tax liability by using deductions under Chapter VIA of Income-tax Act, 1961

Alright so let's get started…

All of us engage in some economic activity and earn an income to make a living. Based on the quantum of income, we, as citizens of this country have a constitutional duty to abide by i.e. pay taxes and contribute to the nation building efforts of the Government. Nevertheless, it is equally important to save tax, to the extent possible, through prudent tax planning. Remember the proverb, "A penny saved is a penny earned".

In this session of Money Simplified, we will tell you how to reduce your tax liability optimally by using deductions under Chapter VIA of the Income Tax Act, 1961.

So, let's begin with our today's session on…

Reducing tax liability by using Deductions under Chapter VIA

The process of tax planning begins with computation of your Gross Total Income (GTI)…

- **Gross Total Income (GTI) is the total income earned by an individual before availing any Deductions under the Income Tax Act, 1961**
- This includes **income from various sources** like:
  - **Salary**
  - **House property**
  - **Profits and gains from business & profession**
  - **Capital gains (short term and long term)** and

- **Income from other sources**

  This helps you assess where you stand in terms of total income earned during a financial year.

- **It is vital to know your GTI to undertake tax planning exercise prudently** ...so that you can plan by using the relevant provisions of theIncome Tax Act to avail applicable deductions to GTI

- After having computed GTI, the next step is to compute your Net Taxable Income (or NTI)... **Net Taxable Income (NTI) is the amount obtained after subtracting various Deductions under Chapter VIA** (which contains deductions under Section 80C to 80U of the Income Tax Act) **from GTI**.

Snapshot of deductions available under
Section 80C to 80U of the Income Tax Act, 1961

Section	**Quick Description of Deduction**
80C	Key investment instruments eligible for deduction under this Section upto a maximum limit of Rs 1. 5 lakh include – Equity Linked Savings Scheme (ELSS), Public Provident Fund (PPF), EPF (Employee Provident Fund), NSC (National Saving Certificate), Senior Citizen Savings Scheme (SCSS), 5-year tax saving bank fixed deposits, 5-year Post Office Time Deposit (POTD) , premium paid for life insurance plans, housing loan principal repayment, etc.
80CCC	Contribution to Pension Fund of Life Insurance Corporation or any other insurer referred in section 10(23AAB). The deduction limit is upto Rs.1.5 lakh aggregated across section 80C, 80CCC, 80CCD.
80CCD	Contribution to Pension Scheme (National Pension System) notified by the Central Government. The deduction limit is upto Rs.1.5 lakh aggregated across section 80C, 80CCC, 80CCD. Additional deduction of up to Rs.50,000 is allowed for contribution towards NPS which is over and above the limit of Rs 1.5 lakh under section 80CCD(1B).
80CCG	Rajiv Gandhi Equity Savings Scheme (RGESS)
80D	Premium paid for medical insurance
80DD	Maintenance including medical treatment of a handicapped dependent who is a person with disability
80DDB	Expenditure incurred in respect of medical treatment
80E	Interest on loan taken for pursuing higher education
80G	Donations to certain funds and charitable institutions
80GG	Rent paid in respect of property occupied for residential use
80GGA	Certain donations for scientific research or rural development
80GGC	Contribution made to any political parties or electoral trust
80TTA	Deduction in respect of interest earned on savings bank deposits
80U	Person suffering from specified disability(s)

Note: The list is not exhaustive, but only indicative

Availing / accounting for these deductions help you reduce your taxable income and thus your tax liability (...which in turn can also help achieve your long term financial goals).

Let's focus on the most popular Section 80C which encourages one to invest and save tax effectively...

Schemes	**Interest Rate**	**Tenure**	**Min – Max Investment**	**Premature Withdrawal**	**Current Tax on returns**
Tax planning with market-linked instruments					
Equity Linked Savings Scheme **(ELSS)**	Market-Linked Returns	Ongoing; Lock-in-period: 3 years	Varies from scheme to scheme. Can range from Rs 500 - No upper Limit	Withdrawal allowed post lock-in	Dividend & Capital gains are tax free
Unit Linked Insurance Plans (ULIPs) [80C & 10(10D)]	Market-Linked Returns	10 - 20 years; Lock-in-period: 5 years	Premium varies from scheme to scheme	Yes	Capital gains post lock-in are tax free
National Pension System (NPS)	Market-Linked Returns	30-35 years	Rs.500 per month or Rs 6,000 per annum, no upper limit	Yes	Capital gains taxed on withdrawal
Tax planning the "assured return" way					
Public Provident Fund	8.10% p.a.	15 years^	Rs 500 - Rs 1. 5 lakh	Yes*	Interest income is tax free
National Savings Certificate	5 yr : 8.10% p.a.	5 years	Rs 100 - No upper Limit	No	Interest accruedis taxed everyyear as per one's income-tax slab
Bank Deposits	7.70% p.a.#	5 years	No upper Limit	No	
Post Office Time Deposit	5-Yr: 7.70% p.a.	5 years	Rs 200 - No upper Limit	Yes*	
Senior Citizens Savings Schemes	8.60% p.a.	5 years	Rs 1,000 - Rs 15 lakh	Yes*	
Non-ULIP Insurance Plans	Sum Assured Only(i.e.	5-40 years	Premium depends upon the	Varies from policy to policy	Redemption amount is tax free

	Insurance Cover)		insurance cover			

* Partial withdrawals allowed subject to conditions; ^can be extended in tranches of 5 years; #The interest rate mentioned here is that of SBI Tax Saving Scheme.

The Section 80C offers you a host of popular investment instruments mentioned here, which are market linked as well as fixed income investment instruments.

Investing in any or all instruments under Section 80C qualifies for a maximum deduction of Rs 1.5 lakh p.a.

Tax Saving through Mutual Funds

- **Equity linked Savings Scheme (Section 80C)**

  - Most ELSS are diversified equity funds with a **lock in period of 3 years.**
  - **An Individual/HUF is entitled to deduction** from Gross total income for investments in ELSS upto Rs 1.5 lakh u/s 80 C of the Income Tax Act 1961.
  - **You can invest in ELSS with as little as Rs 500 and can invest via SIP** (Systematic Investment Plan) **mode or Lump sum** (depending upon what suits you, but every SIP instalment would be subject to a lock-in period of 3 years).
  - ELSS should not be looked upon as a 3-year product because of the lock-in; but more as **a product to reach long-term goals** which are generally more than 5 years away.

- **Rajiv Gandhi Equity Savings Scheme (Section 80CCG)**

  - Rajiv Gandhi Equity Savings Scheme (or RGESS) was **introduced in the Finance Act, 2012, under Section 80CCG** provides for deduction for investment in RGESS
  - The **Deduction** under RGESS scheme **will be available to new retail investors who comply with the conditions of the scheme and whose gross total income for the financial year in which the investment is made under RGESS is less than Rs 12 lakh**
  - Sec 80CCG defines **'New retail investor' interalia shall mean any resident Individual who has not opened a demat account**
  - The **maximum Investment permissible for claiming deduction** under RGESS is **Rs 50,000**
  - The investor would get **a 50% deduction of the amount invested** from the taxable income for that year u/s 80CCG. The benefit is in addition to deduction available u/s Sec 80C
  - **Investments** are to be **made directly in eligible listed equity or Follow on Public offer of such listed equity or into units of mutual funds and ETFs**
  - The total lock-in period for investments under the RGESS would be divided into '**fixed lock-in period' and 'flexible lock-in period'**

- **The initial period of lock in** shall be **known as Fixed Lock-in Period** which shall commence from the date of purchase of such securities in the relevant financial year and end on the 31st day of March of the year immediately following the relevant financial year. The new retail investor shall not be permitted to sell, pledge or hypothecate any eligible security during this fixed lock-in period

- **The period of two years beginning immediately after the end of the fixed lock-in period shall be called the flexible lock-in period**. Upon completion of the fixed lock-in period, new retail investors would be allowed to trade in the eligible securities. Investors would, however, be required to maintain their level of investment during the next two years (i.e. the flexible lock-in period) at the amount for which they have claimed income tax benefit or at the value of the portfolio before initiating a sale transaction, whichever is less, for at least 270 days in each of these 2 years. Such investment value shall exclude the value of investment which is under the fixed lock-in period. **Learning by example:**

Particulars	**Amount (in Rs)**
Investments in RGESS (New retail investor)	50,000^
Investments in ELSS	1,00,000
Eligible Deductions under Chapter VIA	1,50,000
ELSS u/s 80C	1,00,000
RGESS u/s 80CCG (50% of Rs 50,000)	25,000
Total deduction that can be availed	1,25,000

So say you have invested a sum of Rs 1,00,000 and Rs 50,000 in ELSS and RGESS respectively; for deduction under chapter VIA of the Income Tax Act, you can avail Rs 1,00,000 deduction under Section 80C for investments in ELSS, while for RGESS it would 50% of the amount invested i.e. Rs 25,000 under Section 80CCG. Thus the total deduction one can avail will be Rs.1,25,000.

Computing Tax Payable

After having effectively saved tax using Section 80C to Section 80U, compute your tax liability.

- **Tax liability is computed based on your income tax slab**

  The income- tax rates for Individuals and HUFs for FY 2014-15 is depicted here:

Net Taxable Income (in Rs)	**Rate**
Upto Rs 2,50,000 [for Individual (including NRIs / PIOs and HUFs)	Nil
Upto Rs 3,00,000 (for resident senior citizens 60 years and above but below 80)	
Upto Rs 5,00,000 (for resident super senior citizens aged 80 and above)	
Rs 2,50,001 to Rs 5,00,000 #	10%
Rs 5,00,001 to Rs 10,00,000 ##	20%
Above Rs 10,00,000	30%

- #For resident senior citizens of 60 years of age and above but below 80 years of age, the slab is between Rs.300,001 to Rs 5,00,000 taxable @ 10%
  ## For resident super senior citizens aged above 80 years, the second slab is between Rs 500,001 to Rs 10,00,000 taxable @ 20%

  Note: 1) Additional surcharge @ 12% will be levied if the total income during the financial year exceeds Rs 1 crore
  2) Education cess @ 2% + Secondary and higher education cess @ 1% – i.e. total of 3% as cess is applicable on computed tax liability (Income tax plus surcharge, if applicable) source:*Personal*FN Research)

- For Individual (including NRIs / PIOs) and HUFs – net taxable income upto a sum of Rs.2,50,000 is exempt from tax. NTI between Rs.2,50,001 and Rs.5,00,000 is subject to tax @ 10%, between Rs.5,00,001 and Rs.10,00,000 @ 20% and above Rs.10,00,000 @ 30%. For resident senior citizens (i.e. 60 years and above but below 80), the basic exemption limit is Rs.3,00,000. Hence for them, income between Rs.3,00,001 to Rs.5,00,000 is taxable @ 10%, between Rs.5,00,001 to Rs.10,00,000 @ 20% and above Rs.10,00,000 @ 30%. For resident super senior citizens (i.e. those aged 80 and above) the basic exemption limit is Rs.5,00,000. Hence income over Rs.5,00,000 but upto Rs.10,00,000 is taxable @ 20%, while above Rs.10,00,001 @ 30%.

- **Also if your total income during the financial year exceeds Rs.1 crore, an additional surcharge @ 12% would be levied**. This is in addition to the 3% cess that is paid on the total income-tax.

- Apart from the tax rate, you would have to **pay an education cess @ 2% + Secondary and higher education cess @ 1% – a total of 3% as cess on your computed tax liability (Income tax plus surcharge, if applicable)**.

- **For individuals whose NTI is below Rs 5 lakh a Tax Credit or Special Rebate of Rs 2,000 is available (u/s 87A)**, but the rebate **is limited to the extent of your tax liability or Rs 2,000, whichever is less**. Thus if your tax liability is say Rs 1,500, you will get a tax credit of only Rs 1,500 under Section 87A and no tax will be payable.

  while filing your income-tax returns. .

What you should do to reduce your tax liability

- **Avail exemptions and deductions available under the respective heads of income**

- **Invest in tax saving instruments under Section 80C of the Income Tax Act to avail a maximum deduction of Rs 1.5 lakh**

- **Optimise your tax deductions further by effectively using other deductions available under Chapter VIA**...think beyond the provisions of Section 80C

- **Try to compliment investment planning with tax planning**. Consider your age, income, expenses, assets & liabilities, risk appetite and financial goals, to prudently select investment instrument in this exercise. You may seek the help of your independent financial advisor / financial planner or tax consultant for the same. For example, you may choose ELSS for their potential to provide higher inflation-adjusted returns over the long run though they are relatively riskier vis-à-vis traditional tax saving products offering assured returns.

Remember, tax planning as an exercise is not just limited to filing returns and paying taxes. It is a process whereby your larger financial plan needs to be taken into consideration after accounting for host of factors. So in the last quarter of the financial year, ensure you're taking the right steps on tax planning.

2. **Tax Planning Options for Aggressive Investors** (Released on 19-Feb-2016)
   All of us engage in some economic activity and earn an income to make a living. Based on the quantum of income, we, as citizens of this country have a constitutional duty to abide by i.e. pay taxes and contribute to the nation building efforts of the Government. Nevertheless, it is equally important to save tax, to the extent possible, through prudent tax planning. Remember the proverb, "A penny saved is a penny earned". In this session of Money Simplified, we will tell you how to reduce your tax liability optimally by using deductions under Chapter VIA of the Income Tax Act, 1961. [Watch Video | Read Transcript]

Tax Planning Options for Aggressive Investors

[Tax Planning Series]

Session 2: Tax Planning Options For Aggressive Investors

We are glad to have you with us for our 2nd Session on Tax Planning – and that is 'Tax Planning Options for Aggressive Investors'

Alright so let's get started...

Often many individuals wait till the eleventh hour to do their tax planning. Feeling the heat to do tax planning as the financial year draws to a close, they buy any and every tax saving investment product, without really recognising what's the most appropriate for them. In the bargain, this leads to mere 'tax saving' rather than 'tax planning'.

Under "tax planning" one's larger financial plan after accounting for one's age, financial goals, ability to take risk and investment horizon are considered. Hence, it is vital to complement tax planning with investment planning so that financial goals can be achieved holistically.

In this session of Money Simplified, we will explain how aggressive investors or risk takers can go about doing their tax planning.

Tax Planning Options for Aggressive Investors

So, let's begin with our today's session and first let's understand who can be classified as an aggressive investor or a risk taker.

Typical Traits of an aggressive investor

Typically young;

- Has a high source of income;
- Has created or is in the process of creating considerable assets ;
- Is willing to accept the risk of short term losses to create long term wealth
- Has limited liabilities
- Is not supporting many dependents ;and
- Most financial goals are far away

Tax saving investment avenues for aggressive investors

If you match traits of an aggressive investor or one who can afford to take risk, market-linked tax saving investment instruments would be suitable for you.

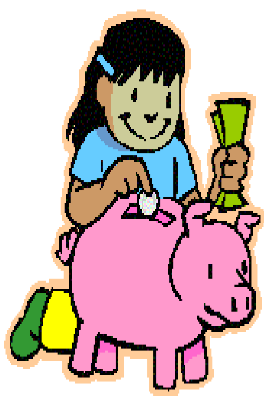
Market-linked tax saving instruments invest in the capital markets and offer a variable rate of return. The returns aren't fixed.

Let's discuss the market-linked tax saving instruments; which you may consider...

- **Equity Linked Saving Schemes (ELSS)**

  Also known as tax saving mutual fund schemes, are by far popular amongst individual investors and HUFs, who intend to create wealth through higher inflation-adjusted returns. A distinguishing feature about them are:

  - Comes with a lock-in period (of 3 years)
  - Minimum investment of Rs 500 can be made with no upper limit



- Both lumpsum and SIP mode available for investing (If SIP mode is opted for benefit of compounding and rupee-cost averaging , each unit will need to complete the lock-in period)
- Withdrawals are allowed post lock-in; and
- Dividend and capital gains are tax-free
- The amount invested in ELSS qualifies for deduction u/s. 80C (of Income Tax Act, 1961) upto a sum of Rs 1.50 lakh p.a.

While selecting Equity Linked Savings Scheme (ELSS), you may give importance to those which have completed at least 5 years of track record and are from mutual fund houses that follow strong investment policies and processes. Don't get lured just by returns, because there's more to evaluating a mutual fund scheme than just returns. Pay attention to risk taken to generate the returns, portfolio turnover, expense ratio and other portfolio characteristics.

- **Unit-Linked Insurance Plans (ULIPs)**

- Equity oriented plans – These is a market linked investment instrument offered by insurance companies
- They have a lock-in period of 5 years
- Capital gains post lock-in are tax free
- Minimum investment of Rs10,000 is required

But ideally insurance and investment needs should be dealt separately via term insurance and mutual funds respectively, to ensure optimum insurance coverage.

The premium paid for ULIPs qualifies for a deduction u/s. 80C (of Income Tax Act, 1961) subject to the maximum eligible amount of Rs 1.50 lakh p.a. Also, at maturity the amount received (by you or your beneficiary) is exempt from tax u/s. 10(10D) of the Income Tax Act, subject to specified conditions.

- **National Pension System (NPS)**

One can voluntarily contribute/invest in National Pension System (NPS) through various intermediaries so as to build a retirement kitty.

There are two accounts – Tier-I and Tier-II

Tier-I Account:

o In this account, minimum investment is Rs 500 per contribution and Rs 6,000 a year

o Minimum 1 contribution in a year is required

o Premature withdrawal is not permitted before you attain 60 years of age. If one retires before 60 years, then 80% of the amount accumulated has to be utilised by you to buy a life time annuity.

o After 60 years, 40% of the amount accumulated has to be utilised to buy a life time annuity.

<u>Tier-II Account:</u>

- For opening this account, minimum investment is Rs 1,000 per annum
- Minimum 1 contribution in a year is required subject to minimum contribution of Rs 250. If you open an account in the last quarter of the financial year, you will have to contribute only once in that financial year.
- You will be required to maintain a minimum balance of Rs 2,000 at the end of the financial year. Moreover, in order to have Tier-II account, you first need to have a Tier-I account. Tier-II account is a voluntary account and withdrawals will be permitted under this account, without any limits.

- Even if you hold both the NPS account, only the Tier-I account are eligible for tax benefits.
- As an investor you have two investment choices: Active or Auto.
- Under the Active option you have a choice to decide the asset allocation to equity (E), Credit risk bearing fixed income instruments (C) and Government bonds (G). As an aggressive investor, you should ideally be investing in equity. But the maximum allocation to equity is capped at 50%, which is a limitation for someone who is young and can afford to take risk.

o If you opt for Auto choice, money will be invested in these asset classes in accordance with the predetermined asset allocation and age.

o Non-Resident Indians (NRIs) can also participate in NPS

If you are a salaried individual, deduction upto Rs 1.50 lakh can be claimed u/s. 80CCD(1).

An additional deduction can be claimed u/s. 80CCD(2) if there is any contribution made by the employer but only upto 10% of their salary (for this purpose, salary construes, Basic Salary plus Dearness Allowance)

In the Union Budget 2015-16, the Government inserted a new sub section 80CCD(1B) in section 80CCD which provides additional deduction of Rs 50,000 for contribution made by Individual assessee under NPS.

In case of NPS, capital gains are taxed on withdrawal

While NPS enables investors to plan for their retirement needs, it may not be able to meet all retirement needs. Hence holistic retirement planning would be needed.

- **Rajiv Gandhi Equity Savings Scheme**

Rajiv Gandhi Equity Savings Scheme (or RGESS) was introduced in the Finance Act, 2012, under Section 80CCG provides for deduction for investment in RGESS

- One can avail a Deduction under RGESS scheme provided you are new retail investors who comply with the conditions of the scheme and whose gross total income for the financial year in which the investment is made under RGESS is less than Rs 12 lakh. New retail investor' interalia shall mean any resident Individual who has not opened a demat account

- The maximum Investment permissible for claiming deduction under RGESS is Rs 50,000

- As an investor you would get a 50% deduction of the amount invested from the taxable income for that year u/s 80CCG. The benefit is in addition to deduction available u/s Sec 80C

- Investments are to be made directly in eligible listed equity or Follow on Public offer of such listed equity or into units of mutual funds and ETFs

- The total lock-in period for investments under the RGESS would be divided into 'fixed lock-in period' and 'flexible lock-in period'. The initial period of lock in shall be known as Fixed Lock-in Period, which shall commence from the date of purchase of such securities in the relevant financial year and end on the 31st day of March of the year immediately following the relevant financial year. A new retail investor shall not be permitted to sell, pledge or hypothecate any eligible security during this fixed lock-in period. The period of two years beginning immediately after the end of the fixed lock-in period shall be called the flexible lock-in period. Upon completion of the fixed lock-in period, new retail investors would be allowed to trade in the eligible securities. Investors would, however, be required to maintain their level of investment during the next two years (i.e. the flexible lock-in period) at the amount for which they have claimed income tax benefit or at the value of the portfolio before initiating a sale transaction, whichever is less, for at least 270 days in each of these 2 years. Such investment value shall exclude the value of investment which is under the fixed lock-in period.

Here's a snapshot of the market-linked tax saving instruments which we discussed...

Market-linked tax saving instruments for aggressive investors: A snapshot

Schemes	Tenure / Lock-in	Min – Max Investment	Premature Withdrawal	Current Tax on returns
Equity Linked Savings Scheme (ELSS)	No limit on tenure, Lock-in-period: 3 years	Varies from scheme to scheme. Can range from Rs 500 - No upper Limit	Withdrawal allowed post lock-in	Dividend & Capital gains are tax free
Unit Linked Insurance Plans (ULIPs) – Equity oriented plans	Tenure: 10 - 20 years;Lock-in-period: 5 years	Premium varies from scheme to scheme	Yes	Capital gains post lock-in are tax free
National Pension System (NPS) – *Active Choice, Option' E'*	Tenure: 30-35 years (for Tier-I a/c); Lock-in till 60 years^	Rs.500 per month or Rs 6,000 per annum, no upper limit	Yes, *but allowed only in Tier-II a/c*	Capital gains taxed on withdrawal
Rajiv Gandhi Equity Savings Scheme (RGESS)	No limit on tenure, Fixed lock-in periodFlexible lock-in period	No limit on the maximum investment (but maximum Investment permissible for claiming deduction u/s. 80CCG is Rs 50,000	Yes*	Capital gains post lock-in are tax free

*permitted only during the 'flexible lock-in period subject to specified conditions
^ If one retires before 60 years, then 80% of the accumulated amount must be utilised to buy life time annuity

Here are the final...

Points to remember...

- Don't wait till the eleventh hour to do your tax planning as by doing so you'll buy any and every tax saving investment product
- Market-linked investment products which clock a variable rate of return are suitable only if you are a risk taker / aggressive investor

- You can start investing in ELSS with as little as Rs 500
- ULIPs offered by insurance companies look at both insurance and investment but ideally consider separating insurance and investment needs through mutual funds and term insurance
- Even if you hold both the NPS accounts, only the Tier-I account are eligible for tax benefits
- Only new retail investors whose gross total income in a financial year is less than Rs 12 lakh can invest in RGESS
- Complement tax planning and investment planning

3. **Tax Planning Options for Conservative Investors:** (Released on 07-April-2016) Feeling the heat to do tax planning as the financial year draws to a close, many individuals buy any and every tax saving investment product, without really recognizing what's the most appropriate for them. In this session of Money Simplified, we'll focus on helping conservative or risk-averse individuals to plan their taxes the assured return way. If you are averse to taking risk for variety of reasons, this session is for you. [Watch Video | Read Transcript]

Tax Planning Options for Conservative Investors

[Tax Planning Series]

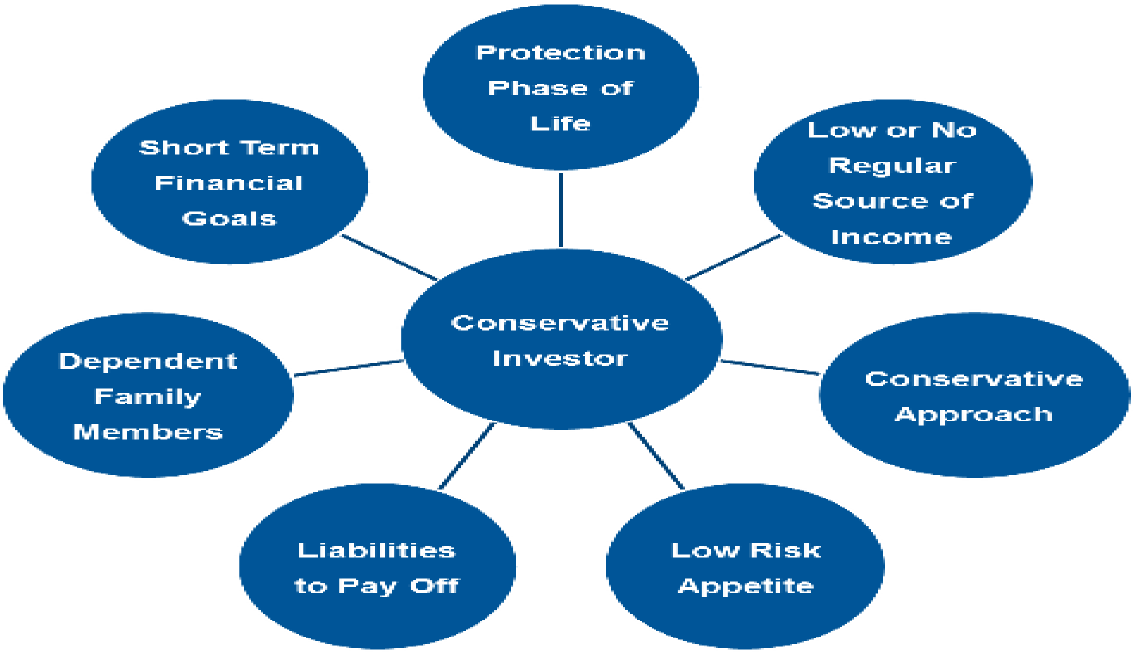
Session 3: Tax Planning Options For Conservative Investors

We are glad to have you with us for our 3rd Session on Tax Planning – and that is 'Tax Planning Options for Conservative Investors'

In the last session of money simplified we took you through tax saving options for aggressive investors or risk takers. But if you are averse to taking risk for variety of reasons, this session is for you. Here we'll focus on helping conservative or risk-averse individuals to plan their taxes wisely.

So, let's begin with our session today and first let's understand who can be classified as a conservative investor or one who's averse to taking risk.

Typical Traits of a conservative investor



- Typically he/she is in the conservation and protection phase of life – on the verge of retirement or already retired;
- Very soon would be waving a goodbye to his regular source of income or already has;
- May have created considerable assets, but now has a conservative approach;
- Has a low risk appetite in the process of wealth creation;
- Has liabilities to pay off;
- Has dependent family members and therefore responsibilities to shoulder; and
- Vital financial goals are to be met in the short term

Tax saving investment avenues for conservative investors

So, if you match traits of a conservative investor or one who is averse to taking risk, tax saving investment instruments offering assured returns would be a suitable choice for tax planning.

Let's discuss the tax saving investment instruments you may consider in this category...

 Non-Unit Linked Insurance Plans or Traditional Insurance Plans

Broadly they are of two types: **"pure term life insurance plans" and "insurance-cum-investment plans".**

 Pure term life insurance plans provide pure life protection and do not include any embedded investments. They offer a high insurance cover at relatively lower premiums vis-à-vis traditional insurance plans.

 Insurance-cum- investment plans on the other hand, club insurance and investments. For the same premium, the insurance coverage is far lesser than pure term insurance plans. Such insurance plans include: endowment plans, money back plans, pension plans etc. Ideally, you should separate insurance and investment.

The insurance premium you pay – irrespective of the insurance plan – is eligible for a deduction u/s. 80C of the Income Tax Act, 1961 upto a limit of Rs 1.50 lakh. However, one must not buy insurance plans with the objective of tax saving, it should be purely to cover risk to life.

- **Public Provident Fund (PPF)**

PPF scheme is a statutory scheme of the Central Government of India.

To participate in this scheme, open a PPF account at your nearest post office or public sector (nationalized) bank.

The PPF account has an expiry of 15 years from the end of the year in which the initial investment (subscription) to the account is made.

You can invest in the account ranging from a minimum of Rs 500 to a maximum of Rs 150,000 in a financial year. You have the convenience of investing either lump sum or in instalments not exceeding 12 in a financial year. However, it is not necessary to place a deposit every month and the amount can be in multiples of Rs 5, subject to the minimum (Rs 500) and maximum (Rs 1,50,000) investment limits.

Investing in PPF offers a tax-free interest @ 8.1% p.a.[1] You can withdraw from the PPF account only on completion of 6 years from the end of the year in which initial investment (subscription) to the account is made. However, your withdrawal will be restricted to 50% of the amount that stood to the credit of your account at the end of the 4th year immediately preceding the year of withdrawal or at the end of the preceding year, whichever is lower. When you complete the term of 15 years, the entire amount standing to the credit of the PPF account can be withdrawn together with the interest accrued till the last day of the month, preceding the month in which application for withdrawal is made.

After the term of 15 years is over, you may even renew your account within one year of maturity for another period of 5 years without having the compulsion of putting any further deposits in case of extension.

- The withdrawal in case of extended accounts is permissible once in every financial year. But the total withdrawal should not exceed 60% of the balance accumulated to the account at the commencement of the extension period (of 5 years).

- The contribution made to the PPF account qualifies for a deduction u/s. 80C (of Income Tax Act, 1961) subject to the maximum eligible limit of Rs 1.50 lakh p.a. Also, the maturity amount received (by you or your beneficiary) is currently exempt from tax.

[1] Applicable from April 01, 2016 to June 30, 2016

- **National Savings Certificate (NSC)**

NSC is also a scheme floated by the Government of India.

- You can invest in this scheme, through your nearest post office (as the scheme is available only with Indian Post).
- The certificate has a tenure of 5 years and can be made in your own name either singly, or jointly (by two adults), or even for minor through a guardian.
- A 5-year NSC carries a prefixed interest rate @ 8.1%p.a.[2] compounded half-yearly, thus giving you an effective interest rate of 8.26% p.a. The interest income will accrue annually and will be reinvested further in the scheme till maturity or until the date of premature withdrawals.
- However, interest income earned on NSC is taxable in the year in which it accrues.
- The minimum amount which you can invest is Rs 100, with no maximum limit. However, Section 80C tax benefit can be claimed only for an investment upto Rs.1.5 lakh. Any investment exceeding this limit will not be eligible for the tax benefit.
- Premature withdrawals are permitted only in specific circumstances such as death of the holder.

The amount invested in NSC along with the accrued interest of the relevant financial year is eligible for tax deduction u/s. 80C of the Income Tax Act, 1961 upto a maximum limit of Rs 1.50 lakh p.a.

In case if you have no other income apart from interest income, in order to avoid Tax Deduction at Source (TDS), you can submit a declaration in Form 15-G (if you are a general or non-senior citizen) or Form 15-H (if you are a senior citizen) to the post office.

[2] Applicable from April 01, 2016 to June 30, 2016

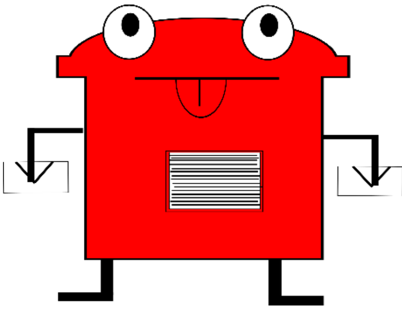
5-Year Tax Saving Bank Deposits

- Banks offer 5-Year Tax Saving Bank Deposits.
- They come with a lock-in period of 5 years. So premature withdrawals are not allowed.
- The prefixed rate of interest offered varies from bank to bank.
- The interest earned is taxable.
- Banks offer 5-Year Tax Saving Bank Deposits.
- The minimum amount you can invest is Rs 100 but the maximum allowed is Rs 1.50 lakh in a year.

The amount invested is eligible for a deduction u/s. 80C of the Income Tax Act, 1961 upto a maximum limit of Rs 1.50 lakh p.a. In case if you have no other income apart from interest income, in order to avoid Tax Deduction at Source (TDS), you can submit a declaration in Form 15-G (if you are a general or non-senior citizen) or Form 15-H (if you are a senior citizen) to the bank(s).

5-Year Post Office Time Deposits (POTD)

As the name goes, this time deposit is offered by India Post. So, if you are considering saving tax by investing in this scheme, approach your nearest post office.



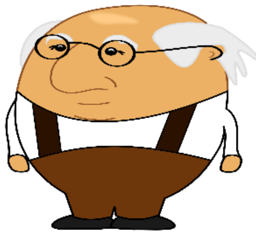
- 5-Year POTD can be opened either singly, or jointly (by two adults), or even in the name of a minor (through guardian).
- The minimum investment can be as little as Rs 200, and there's no upper limit…but the investment amount over Rs 1.50 lakh will not be eligible for any tax benefit.
- 5-Year POTDs earn interest @ 7.9% p.a.[3] (compounded quarterly) but paid annually, thereby giving you an effective interest rate of 8.14% p.a.
- The interest earned on POTD is taxable.
- You are permitted to withdraw prematurely, but only after 1 year from the date of deposit. However the interest earned in such case shall be 1% lower than the rate specified for a 5-Year period deposit.

The amount invested in POTD is eligible for a deduction u/s. 80C of the Income Tax Act, 1961 upto a maximum limit of Rs 1.50 lakh p.a.

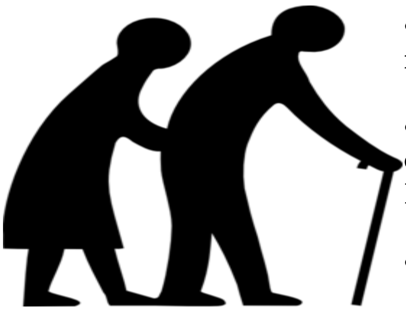
[3] Applicable from April 01, 2016 to June 30, 2016

Senior Citizens Savings Scheme (SCSS)

SCSS is an effort made by the Government of India for the empowerment and financial security of senior citizens.



- So, if you are aged 60 years and above, you are eligible to invest.
- Moreover, if you have attained 55 years of age and have retired under a voluntary retirement scheme; then too you are eligible to invest.
- You are required to open a SCSS account (which can be opened singly or jointly with your spouse) to enjoy the benefits of the scheme. The account can be opened at your nearest post office or any nationalised bank.



- You can start by investing as little as Rs 1,000, but the maximum allowed is Rs 15 lakh.
- SCSS offers an interest rate @ 8.60% p.a.[4] payable on a quarterly basis (i.e. on March 31, June 30, September 30 and December 31) every year from the date of deposit.
- However, the interest earned by you is taxable.
- SCSS has a maturity period of 5 years.
- After maturity you can extend your SCSS account for a period of 3 years but within 1 year from the maturity by giving an application in the prescribed format.
- Premature withdrawals too are permitted but only after 1 year from the date of opening the account. If you withdraw between 1 and 2 years, 1.5% of the deposit will be deducted. And in case if you withdraw after 2 years, 1% of the deposit is deducted. But in case of accounts which are extended after maturity, the accounts can be closed any time after expiry of one year of extension without any deduction.

Investments upto Rs 1.50 lakh in SCSS are entitled for a deduction under Section 80C.

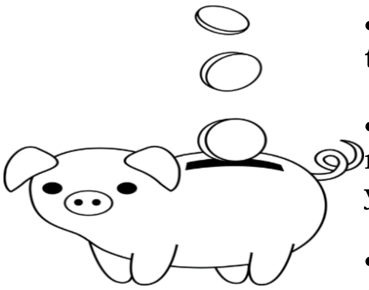
If you have no other income apart from interest income, then in order to avoid Tax Deduction at Source (TDS), you can submit a declaration in Form 15-G (if you are general or non-senior citizens) or Form 15-H (if you are a senior citizen) to the post office or bank as the case may be.

[4] Applicable from April 01, 2016 to June 30, 2016

Pension Funds

Pension funds offered by mutual funds can not only be used for tax planning, but also as an effective instrument to plan for a peaceful retired life.

- Most Pension funds typically allocate a predominant portion of their assets in debt and the rest in equity. Conservative investors may avoid any pension fund with a predominant equity component.
- However, pension funds do carry some element of risk vis-à-vis assured returns products owing to their market linked nature.



- They have a higher potential for wealth creation over the long run than assured returns products owing to the equity component.
- At the vesting age, you may choose to withdraw fixed amounts at a regular frequency through Systematic Withdrawal Plans (SWPs) to meet your retirement cash flows.
- Being a debt-oriented scheme, they are subject to long term capital gains tax (LTCG) post indexation benefits.

The amount invested in pension funds qualifies for deduction under Section 80C of the Income-Tax Act, 1961 subject to a maximum limit of Rs 1.50 lakh p.a.

Here's a snapshot of the assured returns tax saving instruments, if you are averse to taking risk as an investor …

Tax planning options for risk-averse investors: A snapshot

Schemes	Current Returns	Tenure	Min – Max Investment	Premature Withdrawal	Current Tax on returns
Public Provident Fund	8.1% p.a.	15 years^	Rs 500 - Rs 1. 5 lakh	Yes*	Interest income is tax free
National Savings Certificate	8.1% p.a. for 5 yr deposit (compounded half-yearly)	5 years	Rs 100 - No upper Limit	No	Interest accrued is taxed every year as per one's income-tax slab
Tax Saving Bank Deposits	Varies from bank-to-bank For SBI: 7.00% p.a.	5 years	Rs 100 - Rs 1.5 lakh	No	

Post Office Time Deposit	5-Yr: 7.9% p.a.;(compounded quarterly & paid annually	5 years	Rs 200 - No upper Limit	Yes*	
Senior Citizens Savings Schemes	8.6% p.a. (payable quarterly)	5 years	Rs 1,000 - Rs 15 lakh	Yes*	
Non-ULIP Insurance Plans / Traditional insurance plans	Sum Assured Only (i.e. Insurance Cover)	5-40 years	Premium depends upon the insurance cover	Varies from policy to policy	Redemption amount is tax free
Pension Funds	Variable	These funds have a 3-5 year lock-in period in some cases and an exit load till one attains 58-60 years of age. One can decide type of regular pay-outs post the exit load period	Rs 500 – No upper limit	Yes (subject to applicability of exit load, if any)	Long Term Capital Gains

All information is as of March 2016, Interest rates applicable
from April 01, 2016 to June 30, 2016 (except for SBI Tax Saving Deposit)
* Partial withdrawals allowed subject to conditions; ^can be extended in tranches of 5 years

Here are the final...

Points to remember...

- Tax planning is a year-long exercise.
- Complement tax planning and investment planning.

- If you are conservative or risk-averse individual, consider investment avenues across market-linked and assured returns products.

- Avoid buying insurance just to save tax. Ideally keep your investment and insurance needs separate.

- Public Provident Fund (PPF) proceeds are tax free on maturity.

- Interest earned on National Savings Certificate (NSC) is chargeable to tax in the year in which it accrues

- If you are aged 60 years and above, you may consider investing in Senior Citizen Savings Scheme. Likewise, if you have attained 55 years of age and have retired under a voluntary retirement scheme.

- If you looking at serving two objectives – planning for retirement and tax saving – you may consider debt oriented pension plans offered by mutual funds. They have a higher wealth creation potential owing to their equity component.

4. **Tax Planning through Mutual Funds:** (Released on 29-April-2016)
   Many of you may not be aware that some mutual funds are eligible to provide tax saving benefits too, thus helping you save huge amount on your taxes every year. In this session of Money Simplified, we will tell you about the features of such mutual funds and the conditions under which you can avail tax saving benefits by investing in these funds.

Tax Planning Through Mutual Funds

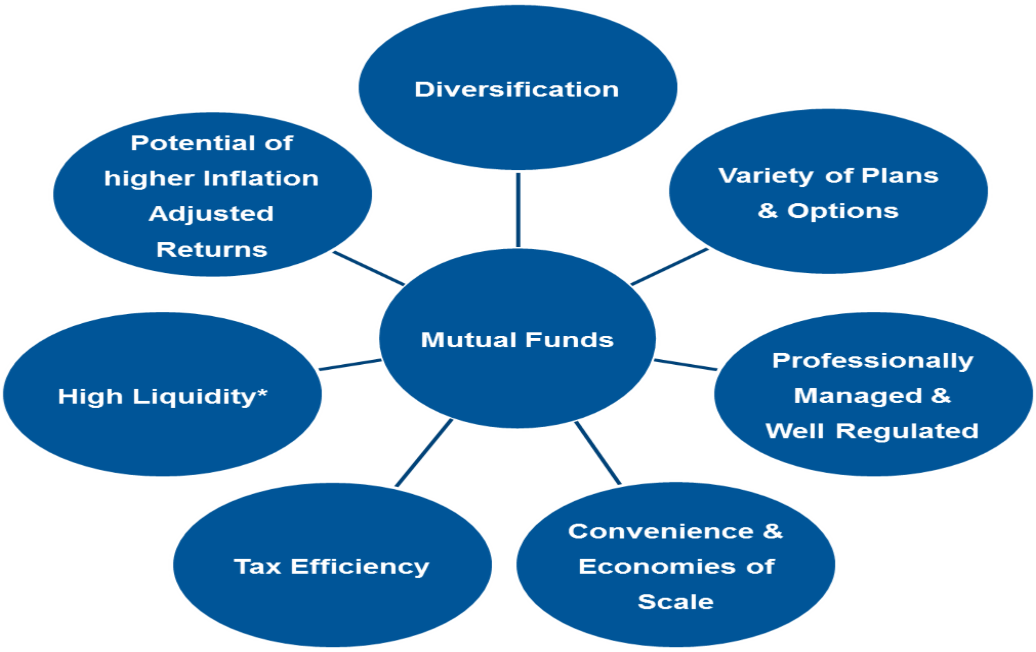
[Tax Planning Series]

Session 4: Tax Planning through Mutual Funds

We are glad to have you with us for our 4th Session on Tax Planning and that is...

Tax Planning Through Mutual Funds

In the last few sessions of money simplified we took you through tax saving investment options under Section 80C of the Income-tax Act, 1961 and how aggressive as well as conservative investors can go about tax planning. Moving forward, in this session of the tax planning series, we'll elucidate how you could undertake tax planning with mutual funds.



As you may know mutual funds -

- Offer diversification across asset classes;
- Offer variety of plans & options;
- Are professionally managed and well regulated;
- Offer low minimum investment, convenience of SIPs (i.e. Systematic Investment Plans) and economies of scale
- Offer Tax Efficiencies
- Offer high liquidity (for open ended funds) and
- Offer the potential to earn higher inflation adjusted returns

So, if selected wisely they potentially reward you well for the risk taken. Moreover, tax planning is also possible through mutual funds.

Here are types of mutual fund schemes you can consider for tax planning...

Mutual fund schemes for tax planning

So, if you match traits of a conservative investor or one who is averse to taking risk, tax saving investment instruments offering assured returns would be a suitable choice for tax planning.

Let's discuss the tax saving investment instruments you may consider in this category...

 Equity Linked Saving Schemes (ELSS)
These are also known as tax saving mutual fund schemes. Distinguishing features about them are:

 Come with a lock-in period (of 3 years)

 Minimum investment of Rs 500 can be made with no upper limit

 Both lump sum and SIP mode available for investing (For SIP mode, each unit will need to complete the lock-in period)

 Withdrawals are allowed post lock-in; and

 Dividends and capital gains are tax-free

 The amount invested in ELSS qualifies for deduction u/s. 80C (of Income Tax Act, 1961) upto a sum of Rs 1.50 lakh p.a.

If you have a higher risk appetite (i.e. you're an aggressive investor), ELSS funds may be a predominant portion of your tax saving portfolio. But don't invest in ELSS blindly or just by past performance; because it may or may not be sustained in the future. Look at the risk taken to generate the returns, portfolio turnover, expense ratio and other portfolio characteristics. Also while selecting, you may give importance to those which have completed at least 5 years of track record and are from mutual fund houses that follow strong investment policies and processes.

Also while you consider ELSS for tax planning don't approach it as a 3-year product because of the lock-in period; but more as a product to achieve long-term goals which are generally more than 5 years away.

 Rajiv Gandhi Equity Savings Scheme (RGESS)

This scheme was introduced in the Finance Act, 2012, under Section 80CCG that provides for deduction for investment in RGESS.

- But only new retail investors who comply with the conditions of the scheme and whose gross total income for the financial year in which the investment is made under RGESS is less than Rs 12 lakh can avail a deduction by investing in RGESS. New retail investor interalia shall mean any resident Individual who has not opened a demat account or who has opened a demat account but has not made any transactions in the equity segment or the derivative segment

maximum investment permissible for claiming tax deduction under RGESS is Rs 50,000

- As an investor you would get a 50% deduction of the amount invested from the taxable income for that year u/s 80CCG. The benefit is in addition to <u>deduction available u/s Sec 80C</u>

- First time equity investors can invest into units of mutual funds and ETFs under RGESS.

- RGESS also includes eligible listed equity or Follow on Public offer of such listed equity.

- First time equity investors can invest into units of mutual funds and ETFs under RGESS.

- The total lock-in period for investments under the RGESS would be divided into 'fixed lock-in period' and 'flexible lock-in period'. The initial period of lock in shall be known as Fixed Lock-in Period, which shall commence from the date of purchase of such securities in the relevant financial year and end on the 31st day of March of the year immediately following the relevant financial year. A new retail investor shall not be permitted to sell, pledge or hypothecate any eligible security during this fixed lock-in period. The period of two years beginning immediately after the end of the fixed lock-in period shall be called the flexible lock-in period. Upon completion of the fixed lock-in period, new retail investors would be allowed to trade in the eligible securities. Investors would, however, be required to maintain their level of investment during the next two years (i.e. the flexible lock-in period) at the amount for which they have claimed income tax benefit or at the value of the portfolio before initiating a sale transaction, whichever is less, for at least 270 days in each of these 2 years. Such investment value shall exclude the value of investment which is under the fixed lock-in period.

If you have a high risk appetite (i.e. you're an aggressive investor) but new to investing in equity, you may consider RGESS for your tax saving portfolio.

Pension Funds

Those who are moderately conservative can consider pension funds.

- Debt oriented Pension funds typically allocate a predominant portion of their assets in debt and the rest in equity.

- They have a higher potential for wealth creation over the long run than assured returns products owing to the equity component.

- However, pension funds do carry some element of risk vis-à-vis assured returns products owing to their market linked nature.

- The amount invested in pension funds qualifies for a deduction under Section 80C (of Income Tax Act, 1961) upto a sum of Rs 1.50 lakh p.a.

- All debt-oriented pension funds are subject to long term capital gains tax (LTCG) (post indexation benefits)

Pension funds can be an effective tool to plan one's retirement. At the vesting age i.e. after you retire, you may choose to withdraw fixed amounts at a regular frequency through Systematic Withdrawal Plans (SWPs) to meet your retirement cash flow needs.

Learning by example:

Computation of Tax Liability of new retail investor (2016-17)		
Gross Total Income (a)	**Tax Rate**	**1,100,000**
Investments done in FY2016-17		
RGESS		50,000
ELSS		100,000
Pension Funds		25,000
Eligible for deduction u/s. 80C (b) (ELSS & Pension Funds)		**125,000**
Eligible for deduction u/s. 80CCG (c) (50% of RGESS investment)		**25,000**
Net Taxable Income (in Rs) (a) – (b) – (c).		**950,000**
Upto 2,50,000	Nil	
Rs 2,50,001 to Rs 500,000	10%	25,000
Rs 500,001 to Rs 10,00,000	20%	90,000
Rs 10,00,001 & above	30%	-
Tax payable (in Rs)		**115,000**
Education Cess	3%	3,450
Total Tax Liability (in Rs)		**118,450**

Now let's say you are a new retail investor and your Gross Total Income is Rs11.00 lakh and you have invested a sum of Rs 1,00,000 in ELSS, Rs 50,000 RGESS and Rs 25,000 pension funds. For deduction under chapter VIA of the Income Tax Act, you can avail Rs 1,25,000 deduction under Section 80C for investments in ELSS and pension funds (put together), while for RGESS: 50% of the amount invested i.e. Rs 25,000 under Section 80CCG. Therefore the total deduction you can avail will be Rs 1,50,000.

This will help you reduce your Net Taxable Income (or NTI) to Rs 9.50 lakh and so will the tax liability to Rs 1.18 lakh as per this table.

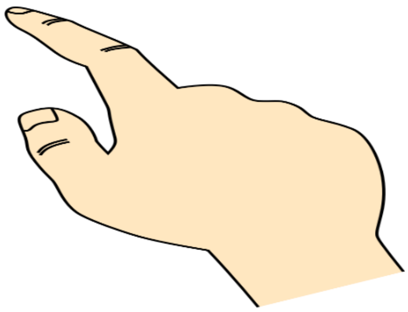
Other aspects of tax planning through mutual funds…

- Besides holding ELSS, RGESS and pension funds, one should be cognizant of the holding period while holding other mutual fund schemes.
- Holding period has impact on Short Term Capital Gains (STCG) tax and Long Term Capital Gains (LTCG) tax.
- Having said that, if the exit from a mutual fund scheme becomes necessary owing to consistent underperformance or any other negative reason, you may give priority to redemption to cut further losses rather than calculating tax impact.

We will discuss the tax implications of investing in mutual funds in our ensuing lecture.

Points to Remember…

- While you endeavour to achieve your long-term financial goals, mutual funds can also help you in tax planning
- But select your mutual fund schemes prudently
- While ELSS has a lock-in period of 3 years don't approach it as a 3-year product but more as a product to achieve long-term goals
- RGESS is available only to new retail investors whose gross total income in a financial year is less than Rs 12 lakh
- Maximum investment permissible for claiming deduction under RGESS is Rs 50,000. You can get a 50% deduction u/s. 80CCG of the amount invested
- ELSS and RGESS are suitable for investors with a higher risk appetite or those classified as aggressive investors
- Debt oriented Pension funds are suitable for moderately conservative investors. Nevertheless they carry some risk as a predominant portion of their assets are invested in debt and the rest in equity.



- Pension funds can be an effective tool to plan one's retirement
- Be cognizant of the holding period while investing in mutual funds to avoid tax implications

- If the exit from a mutual fund scheme becomes necessary owing to consistent underperformance or any other negative reason, priority may be given to redemption to cut further losses rather than calculating tax impact.

So, complement tax planning and investment planning

5. **Tax Implications on Mutual Funds:**
   Before making your investment decision you need to be aware of the tax implication you would have on your investments…be it into mutual funds or any other investment avenue. In this session of Money Simplified, we will tell you about the latest tax implications that you would have on the gains or dividend income earned on your investments in mutual funds

6. **Investment Strategy to Boost Your Tax Saving:**
   You would have various life goals which you need to plan and attain at each stage of his life. Moreover your commitment at each stage of your life would have significant impact on your appetite for risk and therefore the return expectation. In this session of Money Simplified, we will help you understand how you can better allocate assets within the entire gamut of tax saving instruments, based on your age and risk profile

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