eBook on Personal Finance

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INTRODUCTION

OBJECTIVE OF THIS WORK

We study to earn and once in a job, we struggle a lot to earn money. But unfortunately, many of us do not know how to manage this hard-earned money and channelize this money for various savings and instruments. This is because we never had a course on *personal finance* as part of our academic curriculum. Financial illiteracy is large among the masses. Not all are aware of:

- The available options for Savings / Investment
- Tax regimes and implication of different saving/investment options
- Various asset classes and
- Creating a financial plan that will take care of all their needs and prepare for retirement

This Financial illiteracy leads to many a wrong financial decision causing regrets in our later part of life - At a time, when we cannot change the impact of our past decisions. This knowledge helps to:

- Make your own financial decisions
- Evaluate the advice of financial advisors
- Instilling financial discipline

The situation, needs, capability, risk appetite, expected returns and financial targets are unique for every individual. A few examples below:

- Situation: A person may need to support his parents, dependent sibling and his family, whereas another would need to support only his family. One can save more than other. Thus, the saving capacity of these persons is different.
- Need: The financial needs of a person with one child and two children are different
- Capability: One person could earn 10 lakh/annum, and another could earn 30 lakh/annum. This differentiates what each can afford to save or invest. Thus, there would be difference in their financial targets needing a unique financial plan.
- Risk: A person could be in joint family with 4-5 dependents, whereas another would have both parents and in-laws could be well off. The risk appetite of both these persons are poles apart.

The saving/investment product should be chosen with these considerations. The above factors are interdependent for some individuals, thus making their financial planning more complex. Thus, the financial products/instruments available in the markets are NOT "One fit dress for all".

This work is intended to empower the readers with financial awareness, with the aim to:

- Create a financial plan aligning to your requirement

- Analyze and choose a financial product to achieve your financial plan
- Do the necessary course correction in mid-way of your investment journey

Armed with these insights, it is YOU who will be evaluating your situation, needs, analyze the viability of a financial product/instrument and park your money for attractive returns.

IT IS YOUR MONEY, YOUR BRAIN... YOUR GAIN 😉

This knowledge would not be a substitute for professional advice by financial planners. However, will help you get right the high-level concept of financial planning, bring financial discipline, understand different investment options available and the tax treatment for such investment options.

HOW ARE THE CONTENTS STRUCTURED IN THIS BOOK?

- Starts with a basic introduction to terms and concepts that are needed to understand the contents of this book
- How to analyze a financial product in hand?
  - There are many options, but not every product is a right fit for everyone.
  - It is not a one fit all.
  - This section aims to covers the different dimensions to analyze
- Asset allocation – A very important idea, but least understood and ignored by many
- Overview of different financial product available in the market – This purely in Indian context
- Preparing for milestones and calamities in life
- Tax Planning
- Insurance Planning
- Retirement Planning
- Investing in real estate, equities and gold
- Succession Planning – A most important and a completely ignored idea

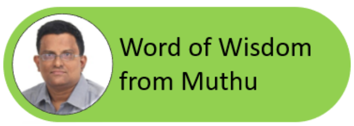
Apart from the above, there would be various sub-sections for further readings, FAQ, words of wisdom from Muthu and some action items. Below is a quick insight of what to expect from these subsections.

FURTHER READINGS

This section contains details of (1) Books, (2) YouTube Videos and (3) Websites, where additional details for further reading can be found. Readers are requested to explore these also to enlighten themselves. Such references are intended to share contents, which already have the best in the subject, without me repeating it.

FAQ

This section primarily covers some of the queries that was posed by followers in Twitter. These questions are put up under respective chapters.



Mr. Muthukrishnan is the founder of Wise Wealth Advisors. He tweets extensively on Personal Finance. I have included some of his tweets in relevant sections. Follow his tweets at @dmuthuk

Only talks or reading the book without any action is not a worthy exercise. It does not help… Acting on the information with concrete and actionable plans that fit your personal situation is what really helps. Towards this, the section aims to put actions.

Whatever you are today, are the results of the action you took in the past. Whatever action you take today based on these new insights will give you results (i.e. Achieving your financial goals) in distant future.

These actions are included after every chapter for you to reflect upon the learnings and connect personally with your situation. This may involve:

- Some activities that you would need to perform
- Think over your current situation and make relevant notes
- Alternatively, there could be some key take-away which you need to have in mind – Note it down immediately in a paper to think over it later
- Make a personal plan based on the learnings that would fit your reality of life

A few in Twitter had indicated that they wanted this book to provide an actionable plan. <u>Every individual's situation is unique, and a single book cannot address a single actionable plan that would fit all</u>. Personal Finance is NOT a "One fit for all" idea. The book can only show a path and direction. Readers need to work on these learnings and create a personalized plan that works for their reality. This section is aimed towards that objective.

After completing a chapter and before moving on to the next, spend time on this section, work on it and put down a "Actionable Plan" that works for you. Implementing these actions gives visible results or way to the next step.

TO THE BASICS

Personal finance is everything to do with managing your money and saving and investing. It broadly covers:

- Budgeting
- Loans
- Insurance Planning
- Investment Planning
- Retirement planning
- Tax planning and
- Estate planning

Personal finance is about meeting personal financial goals, both short-term (Children's education) and long term (Retirement planning). It depends to a great extent on your income, expenses, living requirements and individual goals and desires – and coming up with a plan to fulfill those needs within your financial constraints. But to make the most of your income and savings it important to become *financially literate* to identify good investment options and make savvy decisions in financial life.

UNDERSTANDING OF BASIC IDEAS

EARNINGS

All inflow of money to you is **earnings**, but money which is meant to be returned do not fall in this category. Earnings could come from:

- Work/profession in the form of a paycheck from your employer. It could take other forms like bonus, commissions, or tips.
- Other forms of income would be:
    - Rent from Property
    - Interest from Bank
    - Dividend from Shares & Mutual Funds
    - Capital gains from various assets
    - Profits from Business

EXPENSES

All outflow of money from you is **expenses**, but money that is shared with others, which is expected to be returned do not fall in this category.

- While income happens once a month in the form of salary, expenses happen daily.
- Also, our salaries are credited to single bank account, whereas expenses happen via multiple channels i.e. Cash, Net Banking, Credit card, PayTm etc.,

Tracking Expense

Tracking expenses is an important activity, which everyone must do. The primary intention of this exercise is to capture the monthly/yearly expense and not reduce expense. This data on expenses helps you to:

- Budget future expenses
- Create long term financial plan
- Plan retirement corpus based on estimated expense at the time of retirement

Tracking expense is not a one-time exercise. Do it regularly.

How to go about?

- Capture your expenses daily in excel – A sample format is shared below
- Use a 3 months data and arrive at an average expense per month

Date	Expense Details	Amount	Category*	Date	Month	Year

* The Category field tries to categorize the nature of expense. Some pointers are Food, Travel, Entertainment, Education, Internet/Phone, Building Maintenance and so on. There are no hard rules. Feel free to choose a few categories as applicable to you.

Word of Wisdom from Muthu

Income is for a limited period. Expenses are forever. Never forget this.

If you spend all you earn, you need to work till your last breath.

We earn for a limited period. We've to spend till the end. Remembering this would keep us financially wise.

High income or low expenses or usually a combination of both are the common traits of people who achieve financial independence by 40.

Don't aim for job security. It would never happen. Aim for financial security. It is in your control and you can make it happen.

If your income is not growing, it is actually decreasing. Don't forget inflation.

SAVINGS

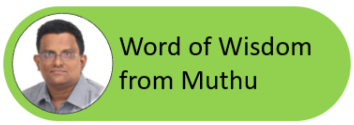
This is the money left out in our earning after covering all expenses

Earnings > Expenses = Savings

Rather than thinking about savings at the end of the month after all expenses, it is a wise and an agreed idea that part of the earnings must be first diverted towards savings. So, the equation becomes:

Expenses = Earnings – Savings

The savings, if invested wisely with discipline for years opens the door for *Financial Independence.*



If you find savings difficult in working years, imagine the difficulty you would face without income during retirement years.

Earn first. Save next. Invest. Then spend.

In personal finance, the margin of safety lies in high savings.

By savings, you're buying your future. By borrowing, you're selling your future.

Save money is the most boring advice. But this is the whole foundation on which everyone's financial life is built.

The percentage of income you are able to save is more important than the percentage of return you get. This is more true in the early part of your career.

High income does not lead to wealth. It is high savings.

Today's savings frees you tomorrow. Today's debt chains you tomorrow.

More than rate of returns, it is your savings rate which determine the final corpus.

Many say they would start saving when their income grows. If you don't save when income is small, you're unlikely to save when income grows.

DEBT

A person needs to go into debt, if their earnings cannot cover all our expenses

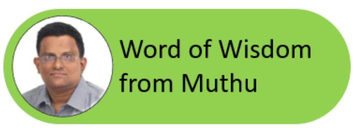
Expenses > Earnings = Debt

To manage this situation, one has will have to get into debt through:

- Loans
- Credit card
- Local borrowing from friends and relatives

There is a debate that there is a difference between good and bad debt. A quick look into both.

- Good debt: Borrowing made for investments, which give returns higher than the interest paid on the borrowing. But such options are mainly available in business and investments.
- Bad debt: Borrowing for our personal needs or desires (i.e. Buying a car, going on a vacation) or for buying depreciating assets (i.e. car) fall in this category.



Credit card is useful only for those who don’t need credit. For all others, it is the most expensive form of borrowing.

Best is spending yesterday’s income today and worst is spending tomorrow’s income today.

The first step to financial independence is to become debt free.

Interest clock never stop ticking; be it weekends, festivals, vacations or any other holidays. Be wise. Avoid debt

Debt is an expensive way to own depreciating stuff.

Borrowing money is borrowing our future.

Some of us believe that having loans gives a sense of commitment. Commitment needs to come from inside rather than due to external pressure. Debt is an expensive way to create commitment.

Those who don't have debt have more choices in life. Debt cripples our freedom.

The best financial advice is to avoid debt and save more.

If you're seeking financial independence, the top priority should be paying off debts.

IF YOU CAN POSTPONE YOUR DESIRES INSTEAD OF GETTING INTO DEBT, YOU'RE DESTINED TO ACHIEVE FINANCIAL INDEPENDENCE.

ZERO DEBT IS THE BIGGEST ASSET.

BAD IS LIVING FROM PAYCHECK TO PAYCHECK. WORSE IS BORROWING IN ANTICIPATION OF FUTURE PAYCHECKS.

INTEREST

It is cost of borrowing money. The borrower (deposit taking institutions like bank) pays interest to the lender or depositor an amount (i.e. interest) above repayment of the principal sum (i.e., the amount borrowed), at a particular rate. Interest can be calculated in two ways.

Simple Interest

- Formula: (P x N x R) / 100
- Simple interest has arithmetic growth (straight line)
- The real life equivalent, consider a 5-year investment where the interest is paid out every year

Compound Interest

- Formula: P x $\{1+R\}^n$
- Compound interest, the interest earned is left in the account along with the capital and we earn interest income on your interest earned
- Compound interest has geometric growth (rapid and every increasing)
- The real life equivalent, consider a 5-year investment where the interest is not paid out but added to the initial capital/previous year corpus.
- Interest is calculated every year on the new corpus, which has the interest of the previous year added

FINANCIAL PLANNING

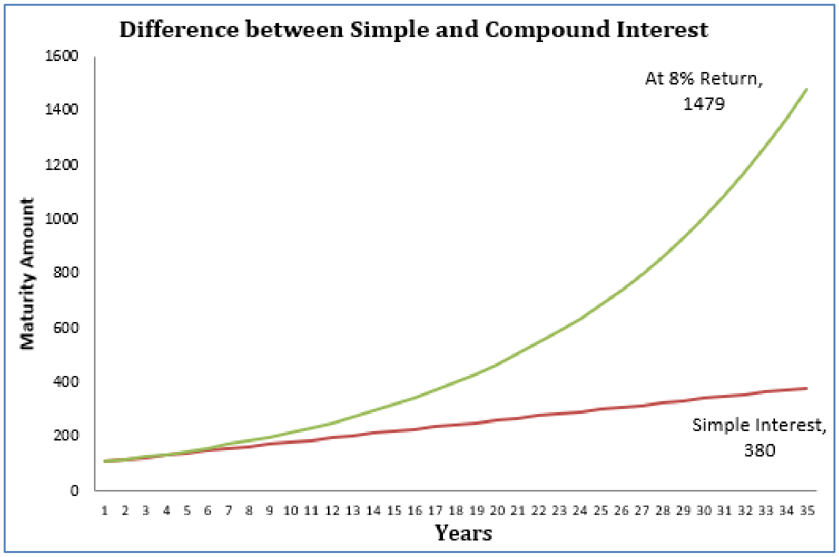
Financial planning helps you to ensure that you will have funds available to meet your present as well as future needs.

COMPOUNDING

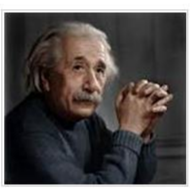
Compounding is a simple, but a very powerful concept in investment, which may ignore to implement in the beginning years of their earning cycle. The awareness of compounding and its power will help to create a golden nest.

- Put in its simple terms, the phrase compound interest means interest income on your interest income, resulting in your money growing at an ever-accelerating rate.
- Why powerful? Because compounding is similar to a multiplier effect, since the interest that is earned by the initial capital also earns an interest, the value of the investment grows at a

geometric (always increasing) rate rather than an arithmetic (straight-line) rate as shown in the below figure



QUOTES ON COMPOUNDING



Albert Einstein - 'Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it. (*Some dispute, that this quote was not by Einstein*)

Benjamin Franklin - '' tis the stone that will turn all your lead into gold Remember that money is of a prolific, generating nature. Money can beget money, and its offspring can beget more.''

Warren Buffet – He says that Compounding is the heart of his investment philosophy and refers it as "Joy of compounding"

Robert Kiyosaki – "The rich people use the power of compounding to their favor. The who abuse the power of compounding, would not become rich."

COMPARISON BETWEEN SIMPLE AND COMPOUND INTEREST

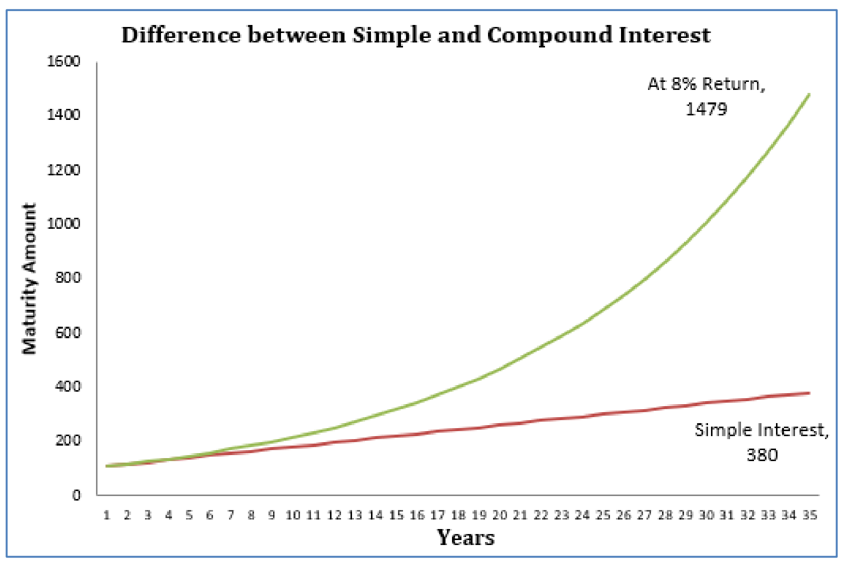
Let us see a numerical example, where ₹100 is invested in two different accounts. One carrying simple interest and another carrying compound interest. The interest rate for both the accounts is 8% and is deposited for a period of 35 years.

Number of years	Simple Interest	Compound Interest
1	108	108
2	116	117
3	124	126
4	132	136
5	140	147
6	148	159
7	156	171
8	164	185
9	172	200
10	180	216
11	188	233
12	196	252
13	204	272
14	212	294
15	220	317
16	228	343
17	236	370
18	244	400
19	252	432
20	260	466
21	268	503
22	276	544
23	284	587
24	292	634
25	300	685
26	308	740
27	316	799
28	324	863
29	332	932
30	340	1006
31	348	1087
32	356	1174
33	364	1268
34	372	1369
35	380	1479

In the simple interest account, you withdraw ₹8, the interest earned every year and leave the initial capital of ₹100. You with draw this ₹8 every year for the next 35 years. After 35 years… you would have got ₹280 as interest and your capital ₹100.

In the compound interest account, you do not with draw the interest. But leave both capital and interest intact for the next 35 years. After 35 years… you would have got ₹1349 as interest and your capital ₹100.

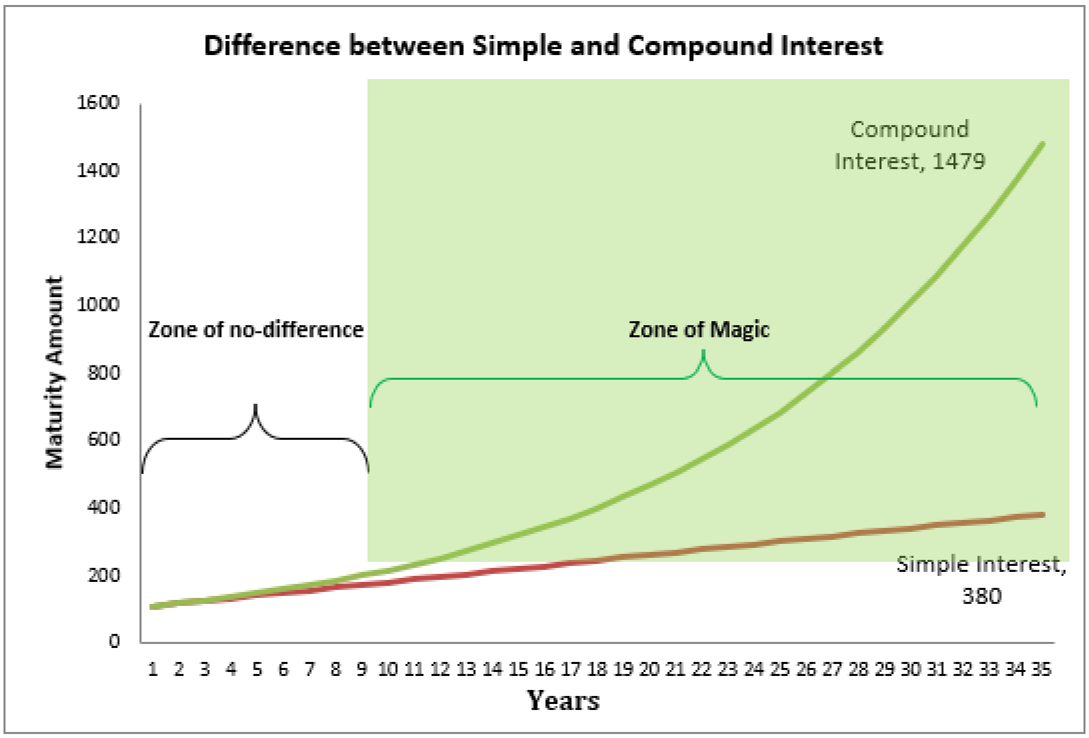
Shown on the left is the growth of the simple interest account and compound interest account after every year for the next 35 years. Below is the chart with the same data.



Simple interest has arithmetic growth (straight line) and Compound interest has geometric growth (rapid and every increasing).

COMPOUNDING TAKES TIME

The compounding does not provide immediate benefits. Phenomenal gains are not possible in the immediate term or staying invested for only 10 years. For the first 8-9 years, there is not much difference between a simple and compound interest. But from the 9th year starts the "Zone of Magic", where the money grows geometrically. See the chart below for the returns after 9 years. To realize the benefits of compounding one needs to remain invested for many years. The benefits of compounding are not seen over night. <u>It is very hard to make up the lost non-compounding years.</u>



Let us consider the case of Hari and Satyam.

- Hari invests ₹1,000 from his 25 years to 35 years and does not invest further. But allows the capital and interest in an account till his age of 60. So, his contribution is ₹10,000.
- Satyam prefers to enjoy life for a first few years… He starts investing ₹1,000 from his age of 35 till his age of 60. So, his contribution is ₹25,000.
- In both the cases, the rate of interest is 8%.

Hari's Account			Satyam's Account		
YEAR	Contribution	Interest and Capital after 35 years	YEAR	Contribution	Interest and Capital after 25 years
1	1000	13690	1	0	0
2	1000	12676	2	0	0
3	1000	11737	3	0	0
4	1000	10868	4	0	0
5	1000	10063	5	0	0
6	1000	9317	6	0	0
7	1000	8627	7	0	0
8	1000	7988	8	0	0
9	1000	7396	9	0	0
10	1000	6848	10	0	0
11	0	0	11	1000	6341
12	0	0	12	1000	5871
13	0	0	13	1000	5437
14	0	0	14	1000	5034
15	0	0	15	1000	4661
16	0	0	16	1000	4316
17	0	0	17	1000	3996
18	0	0	18	1000	3700
19	0	0	19	1000	3426
20	0	0	20	1000	3172
21	0	0	21	1000	2937
22	0	0	22	1000	2720
23	0	0	23	1000	2518
24	0	0	24	1000	2332
25	0	0	25	1000	2159
26	0	0	26	1000	1999
27	0	0	27	1000	1851
28	0	0	28	1000	1714
29	0	0	29	1000	1587
30	0	0	30	1000	1469
31	0	0	31	1000	1360
32	0	0	32	1000	1260
33	0	0	33	1000	1166
34	0	0	34	1000	1080
35	0	0	35	1000	1000
	10000	99211		25000	73106

The tabulation is slightly different from the earlier "₹100 for 35 years" example. There ₹100 invested in year 1 earns interest for 35 years.

But in this example, ₹1,000 is contributed every year 10 years by Hari. Whereas ₹1,000 is contributed for 25 years by Satyam.

The first year ₹1,000 earns interest for 35 years, the second year ₹1,000 earns interest for 34 years, the third year ₹1,000 earns interest for 33 years and so on.

The tabulation of the right reflects the calculation. In Hari's case the compounding is for 35 years and Satyam case it is for 25 years.

To Sum up these two cases…

Hari's contribution of ₹10,000 becomes close to ₹1,00,000 after 35 years. That is the invested amount becomes 10 folds.

Satyam's contribution of ₹25,000 becomes close to ₹73,000 after 25 years (25 because, he starts from 35 and invests till 60). The invested amount becomes nearly 3 folds.

Hari has a golden nest ☺

THREE FACTORS THAT DETERMINE OUR RETURNS IN COMPOUNDING

How to make full use of this power of compounding? The answer lies in the three variables of the compound interest formula $P \times \{1+R\}^n$

The three parameters are P-Principal, R-Rate or return and n-Number of years. Let us review these three variables in detail:

PRINCIPAL(P)

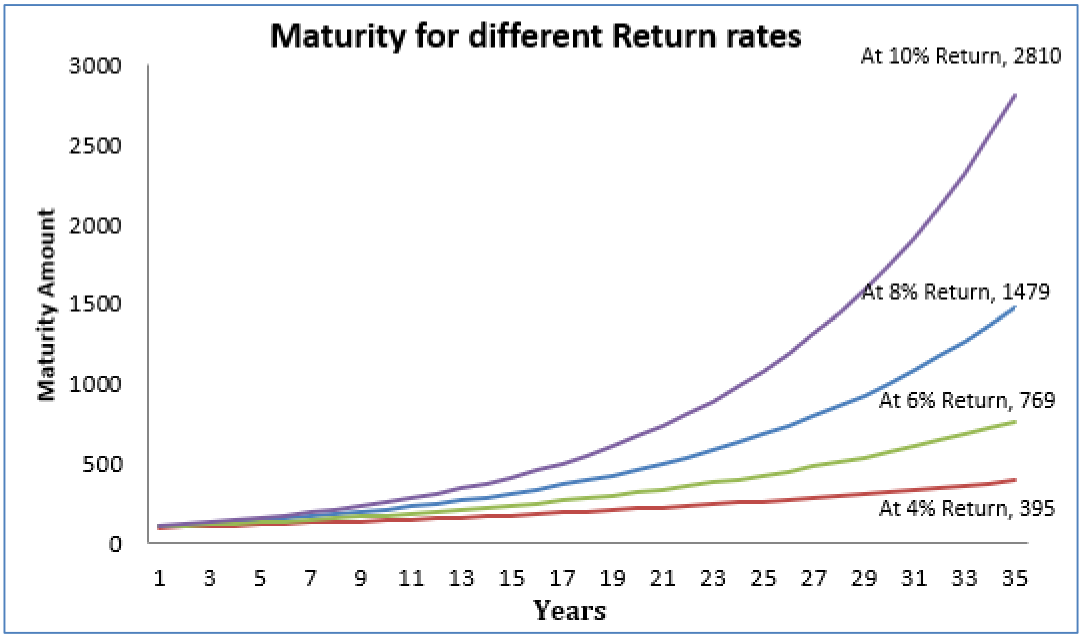
- This is the amount that you bring to the table for investment
- Higher the principal invested, higher the returns you get
- This factor is fully in investors hand, but the situation may not permit everyone to invest a huge, lump sum amount
- In such cases, instead of one-time lump sum investment an investor can go for a regular monthly, quarterly or yearly investment

RATE OF RETURN (R)

- The return that your investment earns for you
- The higher the rate of return, the maturity is <u>much greater</u>
- This factor is not fully in investor's hands and depends on the type of asset class chosen
- An investor needs to identify an investment option which give the BEST POST TAX RETURNS

Let us consider an example to see the impact of R on our investments.

- In the chart are shown the returns on ₹100 example invested for 35 years for 4 different return rates 4, 6, 8 and 10%
- The above return rates have only 2% difference with their succeeding values, but the final returns are having a wide progressive gap as shown below
  - ₹395 at 4% returns
  - ₹769 at 6% returns
  - ₹1479 at 8% returns
  - ₹2810 at 10% returns
- Double of 4% return rate is 8%, but the final return is nearly 3.74 times (1479 / 395 = 3.74)
- The mathematical reason for such variation is the reason that R and n share a geometric progression i.e. $\{1+R\}^n$



NUMBER OF YEARS (n)

- This is the number of years, you stay invested with the principal and interest in the investment
- This factor is in your control
- You decide and do your best to stay invested for the longest possible time. Let us go back to the same example of ₹100 invested for 35 years

Summing up the above three…In order to get the highest benefit:

- One must invest a huge amount (P)
- with a highest rate of interest possible (R) and
- Stay invested for the longest duration of time (n)

WHY WE DO NOT BENEFIT FROM THIS COMPOUNDING?

A question in your mind now would be… If it is so easy, why then everyone is not able to take benefit of this compounding

"*Procrastination is the natural assassin of opportunity. Every year you put off investing makes your ultimate retirement goals more difficult to achieve.*" - Unknown

It's human nature to procrastinate. You would have come across many such excuses below:

- "I will start saving from next year"
- "I don't have time to open a PPF — I'll do it later."
- "I will enjoy for a few years and then start savings"

- "I have started to earn now only, let me enjoy life for few years and then will think of savings later"

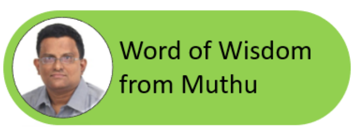
One must remember that the costs of delaying are enormous. Even one year makes a difference. The best way to ensure your future financial success is to start saving today. Even modest returns can generate real wealth given enough time and dedication.

The amount of capital you start with, is not nearly as important as getting started early. Starting early, does not mean that you sacrifice your initial years of enjoyment. You could start with the lowest possible amount. But starting early is more important.

Take Aways

- Compounding investment earnings can turn your small investments into a whopping sum after a period of time
- The best way to take advantage of compounding is to start saving and investing wisely as early as possible in an investment with the highest post tax returns
- **Be patient -** Do not touch the money
- Compounding only works, if you allow your investment to grow for many years
- Most of the magic of compounding returns comes at the very end

Compounding Creates a Snowball of Money. At First your returns may seem small, but if you're Patient, they'll become Enormous.



Compounding is your friend and inflation is your enemy.

Initial years of compounding are very boring. Despite slogging and saving, corpus would grow only slowly. Big wealth would seem to be a distant dream. The effect of compounding kicks off only after a decade and then it picks up momentum. Patience and persistence are the key.

The first crore is most difficult. Money is the seed of money. Once you reach certain threshold and as long as you don't do anything foolish, you start experiencing the joy of compounding.

Compounding work both ways. If you invest, it works for you. If you borrow, it works against you. The success lies in making compounding work for and not against you.

INFLATION

This factor is no way in our control, but still a brief idea of this is needed for every one of us to know what is happening to our savings and investments. Awareness of inflation is important to factor this aspect in our investment, financial and retirement planning. In simplest terms…

Inflation causes money to lose its buying power. It is the primary factor causing price rise.

WHAT IS INFLATION?

- Inflation is the general increase in price of goods and services over a period of time
- Over a period of time the value of money will go down
- Same amount of money will not be able to purchase as much as it would have earlier i.e. A month or year before
- Inflation reduces the purchasing power of money over time
- Inflation is invisible and eats up our savings and investment

EXAMPLE

Let us take an example for quick understanding of how inflation affects us. To make the case more realistic, I have considered post tax returns in this example

- Mr. Ajesh holds ₹100 and wishes to buy a dress material costing ₹100. But instead of buying now, he decides to buy it after 1 year.
- In this one year, he wants to earn some money from this ₹100. So, he put this money in a 1-year deposit scheme @8% interest and after 1 year gets ₹108 back.
- Ajesh is in the 20% tax bracket and hence pays ₹ 1.6 for the ₹ 8 interest earned. He now has ₹ 106.4 as his post-tax returns.
- Ajesh is happy as he now has a gain of ₹6.4, which he pockets and goes to shop to buy the same cloth material. To his surprise he finds that the same material now costs ₹109. So, he shells out his initial ₹100, interest ₹6.4 and additionally ₹2.6 from his savings pocket to get the cloth material.

Why the prices of cloth material increase in the above example? The price of the cloth material has increased by ₹9 in one year. This is because the inflation rate in the economy is 9% for this one year. This inflation rate has increased the cost of the cloth material and reduced Ajesh's buying power to the extent that he had shell to out additionally ₹2.6 from his savings.

HOW INFLATION IMPACTS A COMMONER?

Inflation impacts us in several ways

- It increases our cost of living and dents our saving capacity
- This is a more crucial factor in building the retirement corpus, as the expenses at the time of retirement would be significantly higher than what it is today due to inflation
- Also, over the retirement years (Life time post retirement), the income to cover the same level of expense increase (Does not remain constant) due to inflation

- This escalation in living cost during the retirement years due to inflation must be factored in the retirement corpus that is created to fund the expenses in retirement life

HOW INFLATION AFFECTS OUR EARNINGS AND INVESTMENTS

Let us see with examples as to what extend this inflation could play havoc in our *earnings and investments*:

- **Assume current monthly expenditure as ₹30K and aged 35. You would be retiring in 25 years from now. Then the monthly expenditure at your age of 60 would be…**
    - Approx. ₹1.25 Lakhs at an *inflation* rate of 6%
    - Approx. ₹2.05 Lakhs at an *inflation* rate of 8%
    - Approx. ₹3.25 Lakhs at an *inflation* rate of 10%

  These figures are arrived by using same compound interest formula P x $\{1+R\}^n$, where P is ₹30,000, R is 6 or 8 or 10% and n is 25 years. These levels of expenses are at a time, when you retire and have zero earnings ☺

- **One argument "Our salaries are also increasing…so we are protected"**
    - This is a rosy dream. Salaries don't increase at the rate at which the price of essential commodities increases
    - Taking a real-life example…there was an idly shop, where I and my friend regularly during our Bachelor life
        - I could get an idly for ₹2 in 2006. Today I pay ₹15 for the same Idly in the same shop.!
        - This is a 650%- or 7.5-times price increase in a span of 11 years. But my salary has not increased by 7.5 times in this same 11 years?
    - Mathematically, our salaries should increase atleast 1% above the average yearly inflation rate, just to protect our earnings from inflation.

TAKE AWAYS

- Inflation reduces the buying power, which is not visible.
- High inflation rate in the economy could wash our gains from savings/investments.
- Look for an investment options which gives a positive post tax inflation adjusted returns. Without which in the long run our buying power gets reduced.

FURTHER READINGS

Financial Rules of Thumb - https://www.youtube.com/watch?v=6DXs1CFT-Aw&t=57s by Ravichand

5 Asset Classes Explained – A simple guide for beginner Investors by *Jago Investor*

Health Care Inflation: Are Your Prepared for this Future Horror? by *Stable Investor*

Living Paycheck to Paycheck? Solution: Treat Savings as Monthly Bills by *Stable Investor*

The importance of Power of Compound interest and Early Investing by *Jago Investor*

Personal Finance eBook by NCERT

IT IS TIME FOR ACTIONS

Have you tracked your expenses in the past ___________________________?

How much is your monthly earnings __________________ and expenses __________________?

With the above data, how much can you save per month ________________________?

Do your expenses over shoot your income ___________? If Yes, how are you managing? (Credit card, Short term debt/Hand loan from friends)

____

____

Do you find yourself in situations where you need to go for short term borrowings from friends or credit cards to meet the month end expenses _____________ ? If Yes, it a red flag.

If the response to the above question is 'Yes'…List down where big money goes (or) what are the unwanted expenses that could be avoided? ____

DIMENSIONS OF A FINANCIAL PRODUCT

There are different dimensions with which an investment option must be analyzed. Those aspects are discussed in this section.

RETURNS

- Different financial products offer different rate of returns.
- The returns range from 3.5% for a SB account to 12-15 for Mutual Funds and much higher for stocks.
- Returns has been given the higher consideration, but there are other dimension to consider before making a decision.

RISK

- Risk: exposure to hazard or danger
- In investment decisions, risk is the different between the expected returns and the actual returns earned
- If the returns in an investment is unchanged over time, then there is no risk – But there is no such investment option in the real world
- The causes of risk depend on the use for which the investment proceeds are put and the factors affecting it
- Some risk can be managed strategically – Diversification
- Other risks have to be managed tactically – Asset Allocation

INFLATION RISK

- This is the risk that the money received on an investment may be worth less when adjusted for inflation
- Inflation risk is also known as purchasing power risk
- Inflation risk is common in fixed return instruments like bond, debentures and deposits, where the interest there is period interest payment followed by return of capital on maturity
- Practical example
    - A fixed deposit has an interest rate of 8%
    - At 7% inflation rate the real return is just 1%
    - At 9% inflation rate the real return is negative

DEFAULT RISK

- Default risk or credit risk refers to the risk that the borrowers will not be able to honour the commitment to pay the interest and/or principal as scheduled
- Debt instruments are prone to default risk

LIQUIDITY RISK

- Liquidity or marketability refers to easy with which an investment can be sold or brought in the market
- Liquidity risk implies that the
  - Investors may not be able to sell their investment when desired or
  - Sell the investment below intrinsic value or
  - There is a high transaction cost
- All the above reduce the realizable value of investment
- Some investments come with a lock-in period during which the investors cannot exit the investments

BUSINESS RISK

- This is a risk inherit to the operations of the company
- This is primarily linked with investments in stocks

EXCHANGE RATE RISK

- This happens due to changes in exchange rate of domestic currency relative to foreign currency
- This risk occurs when a domestic investor invests in foreign assets or when foreign investor invests in domestic assets

MARKET RISK

- Loss in investment value due to adverse movement in price of the asset in the market
- The price of asset responds to information that affects the intrinsic value of the asset
- This risk affects investments where the transactions happen at current prices like equity, gold, real estate among others
- Investments in fixed deposits are not marketable and the investor gets pre-defined amount on maturity and hence do not carry market risk

---

Risks or Returns cannot be discussed in isolation. They are related with the following four possibilities:

- High risk, Low return
- High risk, High return
- Low risk, High return
- Low risk, Low return

Of the above the below two combination are not possible:

- High risk, Low return: Such an investment is not possible. Even if possible, no one would prefer such a combination!

- Low risk, High return: If this option was possible, every investor would put their money in these investments.

The other two options (i.e. High risk, High return/Low risk, Low return) are realistic and applicable to most investment options available in the market.

Based on objectives and risk profiles, investors are classified as conservative, moderate and aggressive investor. Their characteristics are:

Investor Profile	Conservative	Moderate	Aggressive
Investing Horizon	Short & Medium term	Long term	Long term
Risk Tolerance	Unwilling to take risk	Moderate	High
Objective	Income	Growth and Income	Growth
Investments	Income oriented assets		Growth oriented assets

LIQUIDITY

"Velocity of money"

How fast the investment can be closed, and we get the cash on hand to meet some of our urgent requirement?

- Fixed deposits can be liquidated as cash in 1 days.
- An investment in PPF cannot liquidated. Though premature withdrawal is allowed in specific cases, it takes time to get the money.

VOLATILITY

The extent to which the expected returns could fluctuate.

- Returns from fixed deposits are not volatile. The amount indicated in the FD receipt will be available at the time of maturity less TDS (if any).
- Returns from stocks are volatile. Even the invested capital could see depreciation based on market conditions. At times the changes are very fast.

TAX TREATMENT

Different investment options have different tax treatments and exemptions

- Bank deposits are subject to TDS
- Interest from bank deposits is taxable, while that of PPF is tax free
- Investment in PPF has exemption benefits under Section 80C, where as a fixed deposit does not carry that benefit

COMPOUNDING

How long or how many years of compounding effect does an investment option offer? Longer the better. Looking at the compounding options of a few investments:

- ELSS – 3 Years lock-in
- PPF – 15 years lock-in
- EPF – 20 to 25 years depending on the number of years of employee's service
- SSA – 21 years

It is not only the option provided by the investment, but even the investor's ability to stay invested for long duration.

EXAMPLE OF ANALYZING AN INVESTMENT OPTION WITH VARIOUS DIMENSIONS

Let us see two examples analyzing an investment with the various dimensions i.e. Returns, risk, liquidity, volatility, tax treatment, compounding and factor inflation.

CASE – 1

Details of Case

Investment option	Fixed Deposit	Option choose by investor
Sum Invested	₹100	The amount that investor can invest
Return Rate / Interests offered	7%	Fixed by bank – Not in investor's hand
Current Tax Slab	30%	Fixed by IT – Not in investor's hand
Period of deposit	1 Year	Choice of investor based on his need
Inflation Rate	5%	Not in investor's hand

All figures are assumed to explain the case

Analysis Approach

Returns	• Amount Invested: ₹100 • The amount returned at the time of maturity: ₹107 • Interest earned: ₹7 • Pay 30% of the interest towards tax: ₹7 x 30% = ₹2.1 • The amount post tax: ₹107 – ₹2.1 = ₹104.9 • Post tax returns = 4.9%, arrived by % of Rs.4.9 post tax returns on a initial investment of ₹100 • The buying power ₹100 after 1-year factoring 5% inflation rate = ₹104.9 – ₹5 = ₹99.9 This can be expressed visually as a chart as shown in Figure 1 below.
Risk	Low in the case of Fixed Deposits

Liquidity	The Fixed Deposit can be closed and converted to cash, in as less as 1 day. There would be some penalties levied by the bank post for premature withdrawal
Volatility	Less, the amount indicated in the fixed deposit receipt will be provided at the time of maturity less any TDS
Tax Treatment	Interest is taxable and no exemption benefits under Section 80C
Compounding	• Fixed deposits carry maturity range of even 10 years, which gives a good option for compounding. • However, seeing the buying power of ₹100 invested to deteriorate to ₹99.9 after one year, it is not a wise idea to invested in this fixed deposit for long periods of times. • Because such long-term investments lead to capital deterioration.

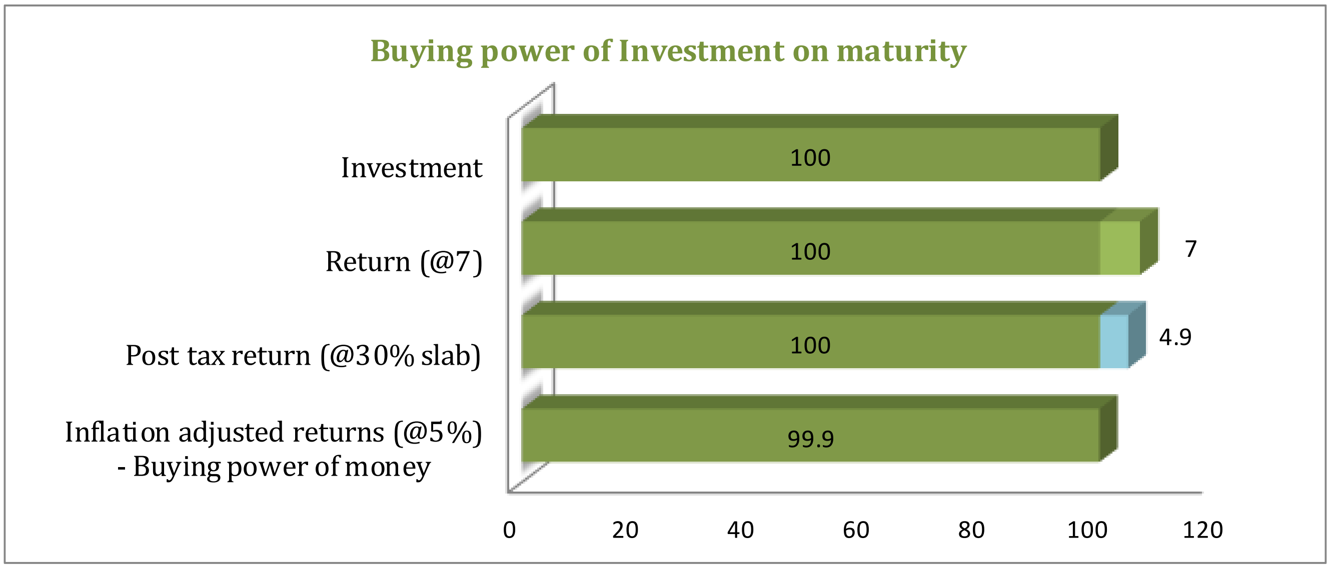


Figure 1

CASE - 2

Details of Case

Investment option	PPF	Option chosen by the investor
Sum Invested	₹100	The amount that investor can invest
Return Rate / Interests offered	8%	Fixed by bank – Not in investor's hand
Current Tax Slab	-	No tax as PPF is EEE
Period of deposit	15 Year	Fixed by policy – Not in investor's hand
Inflation Rate	5%	Not in investor's hand

All figures are assumed to explain the case

Analysis Approach

Returns	• Amount Invested: ₹100 • The amount returned at the time of maturity: ₹108 • Interest earned: ₹8 • No Tax on interest or at the time of withdrawal as PPF comes in EEE regime • The amount post tax: ₹108 • Post tax returns = 8%, (as there is no tax) • The buying power ₹100 after 1-year factoring 5% inflation rate = ₹108 – ₹5 = ₹103 This can be expressed visually as a chart as shown in Figure 2 below.
Risk	Low, as it is a government security
Liquidity	Less, as premature closure and withdrawal are allowed only in some special conditions, which again takes time to liquidate
Volatility	Less, the interest rate is as fixed by government, and may fluctuate by a few point percentage over a year
Tax Treatment	Interest is tax free and qualifies exemption benefits under Section 80C
Compounding	• This option proves 15 Years compounding with taxation benefits at the time of investment and no tax on interest or maturity amount. • The buying power of ₹100 invested is ₹103 after one year, which is comparatively good in comparison with other similar investment options. • Given the above two aspects, this option is good as an investment to meet long term goals like children education or building a retirement corpus.

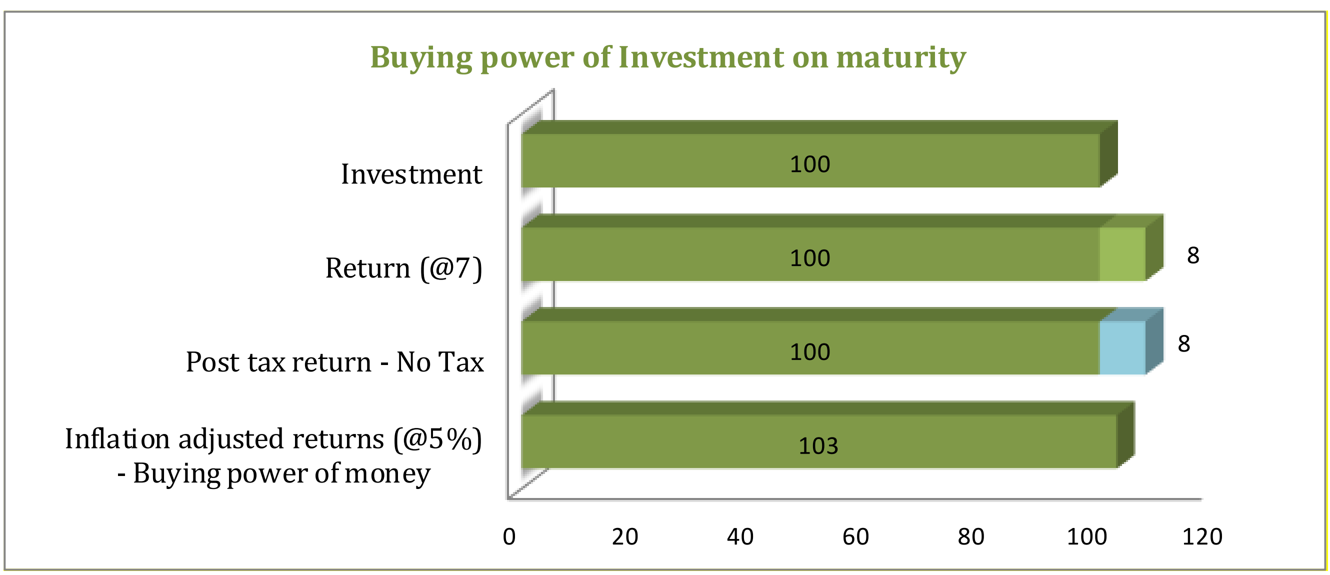


Figure 2

IT IS TIME FOR ACTIONS

Analyze your different investments with the above framework and try to estimate the buying power of money at the time of maturity

ASSET ALLOCATION

This is an important aspect of Personal Finance, which is least understood and not accorded the required importance. We will discuss a few ideas of asset allocation in this section.

ASSET CLASS

It is a group of securities/investment products that has similar characteristics, behaves similarly in the market, and is subject to the same laws and regulations. The five main asset classes are:

- Fixed Income
    - Deposits
    - Bonds
- Shares
    - Mutual Funds
    - Equities
- Gold
- Real Estate

ASSET CLASS DIVERSIFICATION

- Each asset class is expected to reflect different risk and return investment characteristics and perform differently in any given market environment.
- Investors interested in maximizing return often do so by reducing portfolio risk through asset class diversification.
- Asset allocation is an investment strategy that helps to balance risk versus reward by adjusting the percentage of each assets in an investment portfolio

ASSET ALLOCATION AND REBALANCING STRATEGIES

STRATEGIC ASSET ALLOCATION – SAA

- Asset allocation that is built purely on the needs and preference of an individual over a long term is Strategic Asset Allocation (SAA)
- SAA is a long-term strategy, where the choice of the asset class is based on the short and long term financial goal of the investor
- The goal is to achieve targeted returns with risk levels acceptable to the investor
- The proportional asset allocation to each asset class is aligned with investor objectives and constraints and is rebalanced to the asset allocation that determined to meet the desired goals
- SAA needs rebalancing of assets classes, if the needs and goals of the investor changes

Example

- The SAA based on the individual preference and goals: Equity 40% and Debt 60%
- In the current year equities have done well and the portfolio represent equity and debt 50% each

- The portfolio is rebalanced by selling 10% of equity and investing it in debt to maintain the equity as 40% and debt as 60%

Limitations of this strategy

- There is no change in allocation of asset class based on the market movements, because there is no active call of which asset class is going to out-perform or under-perform
- These portfolios underperform during bull markets in certain asset, when it would systematically move the investments from winning assets to a losing asset class to maintain a fixed ratio between two (or different) asset classes

TACTICAL ASSET ALLOCATION – TAA

- Strategic allocation is need based, but tactical asset allocation is view based bringing the element of market timing into asset allocation decision
- Different asset classes perform well at different times - Time to time, returns deviate long term returns and thus providing opportunities for value to be added by tactical shifts in asset allocation
- Tactical Asset Allocation: aims to rebalance the portfolio with a view of relative performance of asset classes and may actively manage the risk and return, with the objective of outperforming SAA
- TAA involves active portfolio management with the aim adding value through short term adjustments of rebalancing the asset allocation based on relative asset class performance

Example

- SAA:
  - Debt 60% and Equity 40%
  - Expected performance: Debt 9% and Equity 18%
  - Expected market view: Equity to perform better than debt
- TAA:
  - Debt 30% and Equity 70% (Move 30% from Equity to Debt)
  - Returns from original portfolio (Strategic allotment) = (60 x 9%) + (40 x 18%) = 12.6%
  - Returns from Tactical Asset Allocation = (30 x 9%) + (70 x 18%) = 15.3%
  - Difference in portfolio returns due to TAA = 15.3% - 12.6% = 2.7%

Limitations of this strategy

- There is no formula to market timing, asset class performance varies dynamically and not always feasible to practise TAA successfully
- If the call is wrong (Markets crash against expected) the tactical asset allocation comes under stress

DYNAMIC ASSET ALLOCATION – DAA

- Tactical rebalancing can add or reduce value to the portfolio, depending on whether the call on asset class performance is right or wrong
- In such situations, mechanical triggers based on which changes to asset allocation can be made is becoming popular
- Dynamic Asset Allocation (DAA) works based on predefined model portfolio which does the mechanical rebalancing between asset classes
- There are several mathematical models proposed and used in DAA
- The main objective of these models is to create a mechanical system that triggers asset allocation and rebalancing
- In this allocation the assets classes are not a fixed percentage, but varies depending on the performance of chosen asset class variables
- Rebalancing may happen periodically on happening of an event like (1) Proportion of an asset class in the portfolio (2) Market going beyond specified limits

Example

- Change in asset allocation on achieving a certain target return
- Mutual funds rebalancing to debt at a chosen level of market index

FACTORING RISK AND RETURNS IN ASSET ALLOCATION

- One common sense approach for looking at the risk and return preferences of investors is to look at the life cycle of an investor
    - An individual patterns of earning, spending, saving and risk acceptance depend on life cycle change
    - Young investors are willing to (1) seek growth from investments, (2) take a long-term view and (3) willing to take risk
    - Senior investors look for (1) Income from investment, (2) limited investment horizon and (3) unwilling to take risk
- Another approach to understand risk preferences is to consider where the individual stands in the need hierarchy
    - Individual first need to take care of basic survival needs, followed by contingency needs and finally seek investments or speculative returns
    - The return requirement and the ability to take risk depend on the stage the investor is in

It Is Time For Actions

Have you taken a structured approach towards Asset allocation as above? ____________________

If the answer to above is 'No', list out how to allocate your assets in line with your life goals and risk appetite ____
____

Are you monitoring your asset allocation on a periodic basis? _____________

OVERVIEW OF DIFFERENT A FINANCIAL PRODUCT

There are many investment products in the market, each with different risk and return pattern, that suits different goals and life needs of different category of investors. A few of the most common products are discussed in this section.

Mutual Funds, Stocks and Insurance are not discussed here, but in separate chapters.

TRADITIONAL SAVING PRODUCTS

BANK DEPOSIT

- Govt. banks, PSU and reputed private banks carry zero risk
- Some risk associated with less reputed private banks
- Interest rates are not much volatile. May change by 0.5% once in six months when RBI makes some policy changes
- High liquidity: Matured proceedings are credited to your savings account in one day
- Premature closure of deposits may carry penalty based on the individual bank policy
- Fixed Deposits are suitable channel for lumps one-time investment
- Recurring Deposits are suitable channel for monthly savings, where a fixed amount is channelized to the deposit account every month

COMPANY DEPOSITS

- Company Fixed Deposit (corporate FD) is a term deposit which is held over fixed period at fixed rates of interest
- Company Fixed Deposits are offered by Financial and Non-Banking financial companies (NBFCs)
- The maturities of various company fixed deposits can range from a few months to a few years

BONDS

CORPORATE BONDS

- Corporate bonds are debt instruments issued by private companies and PSU
- They are issued with a tenure of 2 – 15 years though the 5 year and 7 year are more popular
- Most corporate bonds are issued to institutional investors like mutual funds, insurance companies and provident funds through private placement of securities
- Company may also raise money from public by issuing bonds to retail investors
- Bonds issued by non-government issuers come under the regulatory purview of SEBI
- They need to be compulsorily credit rated and issued in demat form
- The coupon rate depends on the tenure and credit rating of the bond
    - Bonds with highest rating (AAA) have highest level of safety and pay lower rate of interest
    - Bonds with lowest rating (BBB) have a high credit and default risk (Do they pay a higher interest rate due to this?)

- All public issue of bonds must be mandatorily listed in the stock exchange

INFRASTRUCTURE BONDS

- Government announces from time to time, infrastructure bonds which carry tax benefits under section 80C
- Bonds issued by the below companies eligible for such deduction
  - Industrial Development Bank of India (IDBI)
  - India Infrastructure Finance Company Limited (IIFCL)
  - National Bank for Agricultural and Rural Development (NABARD)
- The bonds are structured by these institutions as interest paying bonds or zero-coupon bonds or any other structure, they prefer
- The terms of issue i.e. tenor, interest rates and minimum investment could differ across bond while the lock in period (3 or 5 years) is common
- During this lock in period the bonds cannot be transferred or pledged
- These bonds are compulsorily credit rated and issued in demat form
- Interest from bonds is taxable

INFLATION INDEXED BONDS

- These are government securities issued by RBI to provide inflation protected returns
- These bonds have fixed real coupon rate which is applied on inflation adjusted principal on each interest date
- On maturity, higher of the face value and inflation adjusted principal is paid out
  - The inflation adjustment to the principal is done by multiplying it with the *index ratio* (need more details on this)
  - The *index ratio* is calculated by dividing the reference ratio on settlement date by reference ratio on date of issue of security
  - The Wholesale Price Index (WPI) is the inflation number that is used for calculating the *index ratio*
- Thus, both the coupon income and principal are protected against inflation

POST OFFICE SCHEMES

There are several savings schemes run by the India posts. Below are the schemes.

- Savings Account
- Recurring Deposit Account
- Time Deposit Account
- Monthly Income Scheme (MIS) Account
- Public Provident Fund (PPF) Account
- National Savings Certificates (NSC)
- Senior Citizen Savings Scheme (SCSS) Account

- Sukanya Samriddhi Accounts

Complete details of all schemes can be found from the below link. The link has individual links to each of the above schemes.

https://www.indiapost.gov.in/Financial/pages/content/post-office-saving-schemes.aspx

POST OFFICE TIME DEPOSIT

- This is like fixed deposit of banks
- Scheme details
  - Tenure: 1, 2, 3 and 5 Years
  - Minimum deposit: ₹200
  - Maximum amount: no limit
- The deposit can be made individually or jointly by a maximum of two holders
- The interest rate is subjected to changes as declared every quarter, compounded on a quarterly basis and subject to tax
- The five year term deposit is eligible for Tax benefit as in section 80C of IT Act

POST OFFICE RECURRING DEPOSIT

- This account can be opened by individuals or jointly by a maximum of two people and hold the account jointly or either-or survivor basis
- An individual can hold any number of RD account singly or jointly
- Scheme details
  - Minimum deposit: ₹10 per month and in multiples of ₹5
  - Maximum amount: no limit
- The interest payable on a quarterly compounded basis and subject to tax
- The maturity amount with interest is paid at the end of the term
- Deposit have to be made regularly on a monthly basis, and penalties are applicable in case of non-payment of instalment
- An account can be closed by post office if deposit is not made for 4 month and the condition is not rectified by paying penalty
- Deposit can be made in advance and there is a nominal rebate in such cases
- The account can be closed after three years and in cases of such premature closure of accounts, only the savings bank interest rate is applicable
- One withdrawal is allowed after the deposit has been in operation for atleast one year and 12 monthly deposit have been made
- Interest as applicable will be applied to such withdrawal and the repayment can be lump sum or instalments

POST OFFICE MONTHLY INCOME SCHEME

- This scheme is intended to provide monthly income to the depositors

- Scheme details
    - Tenure: 5 Years (Reduced from 6 years, w.e.f December 1, 2011)
    - Minimum amount: ₹1,500
    - Maximum amount: ₹4.5 Lakhs if held in an individual account / ₹9 Lakhs if held as a joint account
    - A depositor can have multiple accounts, but the aggregate amount should not cross the maximum limits
    - Deposit can be made in cash or cheque or DD
- The interest rate is declared every quarter and paid out on a monthly basis with no bonus on maturity (There was earlier a bonus of 5% payable on maturity, which was withdrawn w.e.f. December 1, 2011)
- Nomination facility is available and can be made at the time of application or subsequently
- Premature closure allowed after 1 year of opening the account and the encashment rules for accounts closed:
    - between 1 – 3 years, 2% of the deposited amount is deducted as penalty
    - after 3 years, 1% of the deposited amount is deducted as penalty
    - The bonus applicable for deposits made before December 1, 2011 is also forfeited in case of premature closure

SENIOR CITIZENS SAVING SCHEME (SCSS)

- Scheme eligibility
    - This scheme is applicable to senior citizen of age 60 years or above on the date of opening the account
    - The age limit can be reduced to 55 years, if the individual is retired by superannuation or VRS or special VRS and the account is opened within one month of receipt of retiral benefits
    - Retired defence personal, excluding civilian defence employees, shall be eligible irrespective of age limit
    - This account can be opened jointly with spouse, however the age restriction applies to the first holder only
    - NRI, HUF, PIO are not eligible to open this account
- Scheme details
    - Tenure: 5 Years, but can be extended once for 3 years, if applied within 1 year of its maturity
    - Maximum amount: 15 Lakhs, however for individuals applying to this scheme before completion of 60 years the amount is restricted to actual retiral benefits or 15 Lakhs, whichever is less.
    - An investor can have multiple accounts subject to the condition that the amount in all account at any point of time does not exceed 15 Lakhs
    - Deposit can be made in cash (if deposit is less than 1 Lakh) or cheque or DD

- The interest rate applicable to the scheme is announced on a quarterly basis
- Benefit of section 80C is available to the instrument but interest is fully taxable
- Premature closure is allowed after one year of opening subject to the following encashment rates for different closure periods
    - 1 – 2 Years: 1.5% of the deposit will be deducted
    - After 2 years: 1% of the deposit will be deducted
    - No deduction is made, if the account is closed due to the death of the account holder

SUKANYA SAMRIDDHI ACCOUNTS

KEY HIGHLIGHTS

Dimension of financial product	Details
Objective	This scheme launched for the benefit of **minor girl children**.
Scheme details	Investment Amount/Limits Min: ₹1,000/Year, Max: ₹1,50,000/Year Tenure: 21 years from the date of opening the account Risk: Low, Government security
Interest / Compounding	The interest rate is notified by the government on a quarterly basis. Interest is calculated and compounded on a yearly basis.
Liquidity	Very less. ○ If the girl child gets married before completion of 21 years, then the account is closed ○ Partial withdrawal is allowed after the account holder attains 18 years of age, to the extent of 50% of the balance in the preceding financial year
Taxation Details	Tax Regime – EEE / Carries the benefits of Section 80C of IT Act TDS – Not applicable Tax Implication - EEE, no tax to be paid at any stage.

OTHER ASPECTS OF SSA

- The account can be opened in the name of the girl child by natural or legal guardian
- Only one account can be opened for one girl child and a guardian and open a maximum of two accounts for two different girl children
- The age of the child cannot be more than 10 at the time of opening the account

NATIONAL SAVINGS CERTIFICATE (NSC)

KEY HIGHLIGHTS

Dimension of financial product	Details
Objective	This scheme launched for the benefit of **minor girl children**.
Scheme details	<u>Investment Amount/Limits</u> Min: ₹1,000/Year, Max: ₹1,50,000/Year (The certificates are available in denomination of ₹100, 500, 1000, 5000 and 10000) <u>Tenure:</u> • 5 Years (NSC VIII issue amended as of December 1, 2011) • 10 Years (NSC IX issue effective December 1, 2011) has been discontinued <u>Risk:</u> Low, Government security
Interest / Compounding	Interest is compounded on an annual basis, accumulated and paid on maturity
Liquidity	Very less.
Taxation Details	• Contribution to NSC VIII is eligible for deduction under section 80C of the Income Tax Act 1961 • Accrued interest is taxable; however it is deemed to be reinvested and therefore *the interest* becomes eligible for Section 80C benefits • There is no TDS at the time of redeeming the certificate value

WHO CAN/CANNOT INVEST IN NSC?

- Individuals can buy these certificates on their account or in the account of minors
- NRI, HUF, Companies, Trusts, Societies are not permitted to invest in NSC
- A resident becoming an NRI during after the purchase of certificate can continue to hold the certificate till maturity, but the amount cannot be repatriated
- Joint holding is allowed and can be joined held by 2 individuals on joint basis or either-or survivor basis

One important caution for an NSC investment is that we need to note the number in the NSC certificate and also retain copies of the certificate. Reason: If at the time of maturity the original certificates are not traceable, then this minimum information would be very handy.

Proper book keeping of the NSC certificates, maintaining copies of certificates and the serial number mentioned in the certificates. This would help in case of situation arising of missing originals.

This is important because the highest NSC denomination is ₹10,000 and for an investment of 1 Lakh for a year, one would have 10 such certificates for a year. If the 1 Lakh investment is continued for 5 years, then an investor is likely to have 50 certificates.!

KISAN VIKAS PATRA

- KVPs can be purchased by an adult or two adults for a minor
- NRI, HUF and other entities are not eligible to invest in KVP
- It can be purchased from postal department or bank through payment of cash, cheque and DD
- Scheme details
  - The KVP are available in the denomination of 1000, 5000, 10000 and 50000
  - Minimum deposit: ₹1,000
  - Maximum amount: no limit
  - Tenure: 118 months (As per the 2014 amendment of the scheme)
- The effective rate of interest is announced on a quarterly basis
- The facility of nomination, joint holding is available, and the certificate can be transferred from one person to another and also from post office to another by endorsement and delivery
- KVP can be prematurely encashed after a period of 2.5 years
- There is no tax incentive for investment in KVP and the interest is taxable on accrual basis

RETIRAL BENEFIT PRODUCTS

EMPLOYEE PROVIDENT FUND (EPF)

KEY HIGHLIGHTS

Dimension of financial product	Details
Objective	The Employee Provident Fund is a retirement benefit scheme that is available to salaried employees. Under this scheme, 12% is deducted from the employee's salary and contributed towards the fund.
Scheme details	Investment Amount/Limits - Employer contributes (12% of the Basic – ₹1250) to the EPF fund - Employee contribute 12% of the Basic pay to the EPF fund Where this ₹1250 of employer contribution go? This amount ₹1250 is towards to Employee Pension Scheme (EPS) Tenure: Service period of the employee Risk: Low, Government security
Interest / Compounding	The interest rate is notified by the government on a yearly basis. The interest is compounded every year on "Average Monthly Balance". Refer "COMPOUNDING DETAILS"

	One of the best instruments where the power of compounding can be put to work for a long period of 30-35 years.
Liquidity	Very less. Premature withdrawal is difficult. Refer "PREMATURE WITHDRAWAL" below for more details
Taxation Details	Tax Regime – EEE / Carries the benefits of Section 80C of IT Act TDS – Not applicable Tax Implication - EEE, no tax to be paid at any stage. However, tax needs to be paid, if the amount is withdrawn or account closed before rendering 5 years of continuous service.

COMPOUNDING DETAILS

EPF interest is <u>yearly compounding</u> by using the method of "**Average Monthly Balance**" calculation method. This means the balance in EPF account on 1st of every month is used for calculation of interest. However, this interest accrued is not added to the balance of previous month. Instead the interest is calculated every month and the total of 12 months interest is added to the EPF account at the end of the year.

PREMATURE WITHDRAWAL & CLOSURE

Premature Withdrawal

EPF is a very powerful tool to build a sizeable retirement corpus utilizing the power of compounding. The purpose goes waste, if the money is withdrawn frequently. Hence the provision in EPF allow employees to withdraw money only for a few genuine requirements as listed below.

- Marriage of self, sibling or children
- Education expense of self or children
- Medical expense of self, spouse, children and parents
- Purchase of a plot/flat or house
- Construction of a flat or house
- Renovation of existing house

The employee needs to fulfill certain criteria and submit some documents to withdraw money for the above requirements. Also, there would be limits for the amount that is withdrawn. These details would be provided by the employer. Hence one needs to approach their employer to know the criteria, documentation requirements and limits of withdrawal. The processing may take some time (say 1 week) before getting the cash. Withdrawal is not so easy and quick.

Premature Closure

The EPF is a not a savings bank type of account, where money can be easily withdrawn or account closed. **Premature closure has tax implications.** The income-Tax act outlines that PF withdrawals by employees after completing five years of contributions is only tax free. However there an exception, if the employee has not rendered continuous service of five years, but the service is terminated by reason of the employee's ill health or discontinuance of the employer's business, then the amount will be tax-exempt.

If the PF is withdrawn before 5 years of subscription, the employer/employee contribution and interest are subject to below deductions/Taxations.

- The employer's contribution to PF along with the interest accrual thereon closure of EPF is taxed as under the heads "salary" for that financial year.
- Interest on the employee's contribution is taxable under the heads "other income" for that financial year.

VOLUNTARY PROVIDENT FUND (VPF)

KEY HIGHLIGHTS

In EPF, employee and employer contribute 12% of basic each. The employee has an option to increase his contribution over and above the 12%. He could provide an additional contribution of 20% or 30%. However, employer would **not** be matching this additional contribution. The employer contribution continues to be only 12% in any case.

This investment option where the employee contributes additional amount to EPF is the Voluntary Provident Fund (VPF). Every financial aspect of the VPF is the same as EPF. No separate account is needed, these contributions are made to existing EPF account. The additional contribution by the employee qualifies for Tax exemption under section 80C. However, the ceiling of such exemption would ₹1.5 Lakh.

Since the maturity/interest are tax free (as part of EEE) and compounding has a long play, this is a good tool for building long term retirement corpus.

How to invest in VPF?

- To invest in VPF, check with your payrolls and give a suitable declaration for this additional PF contribution at the beginning of the year
- Once declaration is given, it cannot be changed at the later part of the financial year
- This declaration is applicable for only ONE year

Thus, by deciding at the beginning of the financial year and contributing additional % of income as VPF, one investor can easily avail tax exemption upto ₹1.5 Lakh without need for investment in any additional tax saving instruments.

VPF being in EEE regime and offers years of compounding is a good option to utilize the full limits of ₹1.5L for investors who are risk averse to try tax saving options like ELSS.

PUBLIC PROVIDENT FUND (PPF)

KEY HIGHLIGHTS

- PPF refers to Public Provident Fund Account and is a Long-Term Debt Scheme of the Govt. of India on which regular interest is paid.
- This is a very closely mirrored product of EPF and VPF with slight differences.
- Any Individual in India (whether Salaried or Self-Employed or any other category) can invest in this scheme and can earn a handsome tax-free return on the same which is usually higher than the return offered by banks on fixed deposits. This is primarily because of the tax rebate available in the EEE tax regime.

Dimension of financial product	Details
Scheme details	<u>Investment Amount/Limits:</u> Min: ₹500/Year, Max: ₹1,50,000/Year <u>Tenure:</u> Refer "TENURE OF THE SCHEME" for details <u>Risk:</u> Low, Government security
Interest / Compounding	The interest rate is notified by the government on a quarterly basis. The interest is compounded every year on "Average Monthly Balance". Refer "COMPOUNDING DETAILS" for details One of the best instruments where the power of compounding can be put to work for a long period of 30-35 years.
Liquidity	Very less. Premature withdrawal is difficult. Refer "PREMATURE WITHDRAWAL" below for more details
Taxation Details	Tax Regime – EEE / Carries the benefits of Section 80C of IT Act TDS – Not applicable Tax Implication - EEE, no tax to be paid at any stage.

INTEREST CALCULATION

- In one line - "PPF interest is calculated monthly on the lowest balance between the end of the 5th day and last day of month, however the total interest in the year is added back to PPF only at the year-end."

- The interest is not compounded monthly. The interest earned every month will add to our account only at the end of the year. Thus, the interest is compounded yearly.

MAXIMIZING YOUR RETURNs FROM PPF

- Since interest for the month is calculated on the lowest amount from the 5th to the last of the month, any deposit to our PPF account should be done before 5th of the month.
- From the above, it can be understood that a lumpsum amount of 1.5 lakh invested before April 5 (First month of the financial year) will carry maximum benefit, since interest is calculated for 1.5 lakh (i.e. the lowest balance) every month. However, this being ideal and difficult for many individuals to deposit such a lump sum amount.

TENURE OF THE SCHEME

The account matures after expiry of 15 years from the end of the financial year in which the account was opened.

- On completion of the term of 15 years, the account can be closed or continued with or without contribution for a further block of 5 years. <u>The rules for contribution to the extended account remain the same.</u>
    - Without contribution: Your PPF account is active and the amount continues to earn interest for another 5 years. You need not contribute for this additional 5 year period.
    - With contribution: You continue contributing to your PPF account upto 1.5 Lakh/year for this additional 5 year period.
- Once an account is continued without contribution for more than a year, the option cannot then be changed

Extension of PPF account would be a very ideal option. Do we stay with contribution or without contribution for these extra 5 years does not matter much. But these additional 5 years, give you a great compounding effect. <u>This extension of 5 years can be done any number of times</u> i.e. Extend another 5 years after 20 years.

<u>Example:</u> Let us say Kannan starts PPF account at the age of 30 and at 45 reaches the closure period. He is most likely not to have any major commitment at this point of time. He child's education or marriage would be another long way after 5-10 years. His retirement is another 15 years down the line. So, he could just extend his PPF for additional 5 year with or without contribution. After 20 years, he could make up his mind and extend for another 5 years, based on situation at his age of 50. The returns would be phenomenal as seen in the below table.

Case 1

No Extension - PPF closed in 15 years.		
YEAR	Contribution	Interest and Capital
1	150,000	475,825
2	150,000	440,579
3	150,000	407,944
4	150,000	377,726
5	150,000	349,746
6	150,000	323,839
7	150,000	299,851
8	150,000	277,640
9	150,000	257,074
10	150,000	238,031
11	150,000	220,399
12	150,000	204,073
13	150,000	188,957
14	150,000	174,960
15	150,000	162,000
	2,250,000	**4,398,642**
	Times	**1.95**

Case 2

Extend to 20 Years - No Contribution		
YEAR	Contribution	Interest and Capital
1	150,000	699,144
2	150,000	647,355
3	150,000	599,403
4	150,000	555,003
5	150,000	513,891
6	150,000	475,825
7	150,000	440,579
8	150,000	407,944
9	150,000	377,726
10	150,000	349,746
11	150,000	323,839
12	150,000	299,851
13	150,000	277,640
14	150,000	257,074
15	150,000	238,031
16	-	-
17	-	-
18	-	-
19	-	-
20	-	-
	2,250,000	**6,463,049**
	Times	**2.87**

Case 3

Extend to 20 Years - with Contribution		
YEAR	Contribution	Interest and Capital
1	150,000	699,144
2	150,000	647,355
3	150,000	599,403
4	150,000	555,003
5	150,000	513,891
6	150,000	475,825
7	150,000	440,579
8	150,000	407,944
9	150,000	377,726
10	150,000	349,746
11	150,000	323,839
12	150,000	299,851
13	150,000	277,640
14	150,000	257,074
15	150,000	238,031
16	150,000	220,399
17	150,000	204,073
18	150,000	188,957
19	150,000	174,960
20	150,000	162,000
	3,000,000	**7,413,438**
		2.47

OTHER ASPECTS OF PPF

- Non-Resident Indians (NRI's) are not allowed to invest in PPF. However, if someone opens a PPF while they were resident of India but subsequently becomes an NRI, he shall be allowed to continue investing in his account.
- Investors are requested to note that each individual is eligible for only 1 PPF Account per person. If an Individual is detected with having more than 1 Account (except when on behalf of minor), then the 2nd Account would be closed, and the entire amount invested shall be refunded. Only the principal amount will be refunded, and the interest thereon will be forfeited.
- PPF can only be opened in individual's name and not as a joint account. However, a nominee can be appointed for the PPF. On the death of the account holder, the nominees cannot make any additional contribution on the death of the deceased.

EMPLOYEE PENSION SCHEME (EPS)

Not many are aware of such deductions or features of this scheme. A contribution of ₹1250 of the employer's PF contribution goes to. Much clarity is not known and much details not available in internet about this scheme. Available information available is presented below.

- This scheme is a statutory requirement, where employer's contribution of PF is used to pay for EPS
- Contribution to EPS from the employer contribution of PF
    - Till August 2014, ₹6500 per year / ₹541 per month
    - From September 2014, ₹15,000 per year / ₹1,250 per month.
- One can find this in their pay slip, where ₹541 was paid to EPS account upto August 2014 and ₹1,250 paid to EPS account from September 2014
- Details of pension
    - Lifelong pension is available to the member and upon his death members of the family are entitled for the pension
    - The actual amount depends on the number of years of contribution made
    - The maximum pension per month is ₹3,250
    - An employee can start receiving the pension under EPS only after rendering a minimum service of 10 years and attaining the age of 58/50 years
    - No pension is payable before the age of 50 years
    - Early pension can be claimed after 50 years but before the age of 58 years
        - But it is subject to discounting factor @ 4% for every year falling short of 58 years
        - In case of death / disablement, the above restrictions don't apply
- **No pensioner can receive more than one EPF Pension.**

More details about this scheme can be found from the article at
https://www.bankbazaar.com/saving-schemes/guide-to-understanding-the-employee-pension-scheme.html

GRATUITY

Gratuity is given by the employer to his/her employee for the services rendered by him during the period of employment. It is usually paid at the time of retirement, but it can be paid before provided certain conditions are met.

The gratuity amount depends upon the tenure of service and last drawn salary. It is calculated according to this formula:

Last drawn salary (basic salary plus dearness allowance) X number of completed years of service X 15/26

According to this formula, the time period of over six months or more is considered as one year.

This means if you have completed five years and seven months of service, the number of years would be considered as six years for calculation of gratuity benefit.

On the other hand, if the service period is five years and five months, for gratuity calculation it will be considered five years.

An employer can however give higher gratuity than the amount under the prescribed formula.

ATAL PENSION YOJNA

This is a pension scheme and not an investment. Salient details below.

- The minimum age for joining this scheme is 18 and maximum age is 40.
- Enrolled members would have to pay monthly premium as part of the scheme.
- The monthly premium amount is a factor of age of the subscriber and the amount of pension that is needed in future.
    - Age of Subscriber: Lower the age, higher the premium amount. i.e. A 35 year old individual pays more than a 25 year old person for the same pension amount.
    - Amount of pension: More the pension amount needed, higher the premium. The subscriber has an option to choose a scheme with the future monthly pension. The future monthly pension amount ranges are ₹1000, 2000, 3000, 4000 and 5000.
    - The representation of monthly contribution for various age groups and pension amount is tabulated below.

Indicative Monthly Contribution Chart

Age of Entry	Monthly pension of Rs 1000.	Monthly pension of Rs2000	Monthly pension of Rs3000	Monthly pension of Rs4000	Monthly pension of Rs5000 .
18	42	84	126	168	210
20	50	100	150	198	248
25	76	151	226	301	376
30	116	231	347	462	577
35	181	362	543	722	902
40	291	582	873	1164	1454

- The scheme can be easily opened in any of the PSU banks like SBI, Canara bank etc. All you need is that one needs to have a savings account in that bank.
- Exit of scheme before the age of 60 is not possible. After the age of 60, the member gets the pension as per his/her scheme. Post the death of the subscriber, the spouse gets the pension. Upon death of both, the pension corpus is given to the nominee.

The corpus would be given to the nominees after the death of subscriber and their spouse. This corpus amount in the case of ₹5,000 pension scheme is ₹8.5 Lakhs. i.e. The nominee gets 8.5 Lakhs, after the demise of the subscriber and spouse.

TIP:
If one can open two accounts… one in their name and other in their spouse, then they will get pension of ₹10,000 per month (5000+5000).

More details of this scheme can be had from https://www.npscra.nsdl.co.in/scheme-details.php

FURTHER READINGS

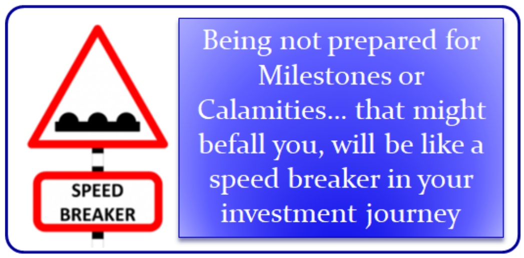
How to use PPF to save Rs 1 Crore – Be PPF Crorepati by *Stable Investor*

PPF Interest Rate History & What You Should Really Know by *Stable Investor*

Everything you need to know about PPF and EPF by *Jago Investor*

THE KNOWNS AND THE UNKNOWNS

- Everyone wants to become wealthy and make lot of plans for investments in a variety of investment options i.e. Stocks, Real Estate, Mutual Fund, Gold etc.
- Toward this we do spend time to find which investment gives best returns, which one is less risky, which has great potential and so on…
- But before all this, one must spend time and put a few thoughts on **Milestones*** (The Knowns) that come up in life and **Calamities** (The Unknowns) that they might face in their investment journey.
- Not planning for these **two** events will throw your investment journey out of track and at times may even mess it up



* A few life milestones are listed below:

- Settling any dues/loan taken by us or our parents.
- Buying a house and a car
- Repair/Upgrade existing property
- Plan for marriage of self
- Expenses in children's marriage
- Expenses associated with marriage of brothers/sisters
- Children's educational
- Our own expenses associated with career enhancements
- Any unforeseen medical expenses of self or dependents
- Regular household expenses
- Life's entertainment like vacation, parties, holidaying, birthdays, festivals, get together, family functions etc.
- Retirement expenses
- Plan for early retirement

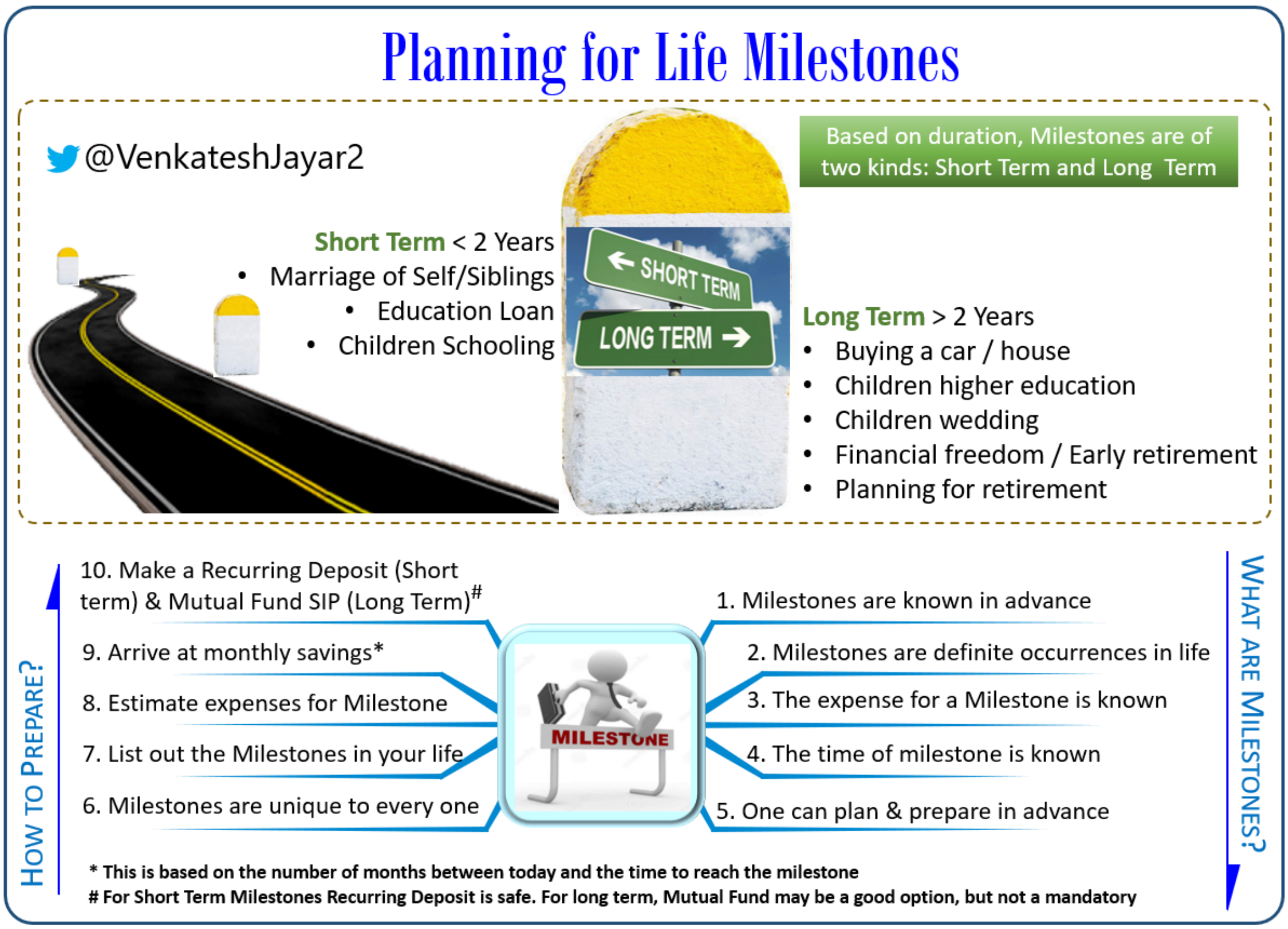
MILESTONE

- These are known in advance and definite occurrence in our life
- E.g. Your marriage, children education, buying a car or a house
- There are milestones in your/dependents life that must be fulfilled

Note: Planning for milestones in life is also referenced as "Goal Based Planning"

WHAT SHOULD AN INDIVIDUAL BE PREPARED FOR MILESTONES?

- List out the milestones in your life with specific dates/month
  - Long term (>2 years)
  - Short term (< 2 years)
- This should include the expectations of your dependents as well
- Calculate the indicative expenses for the milestones
- Based on the time span, decide on the amount and save regularly every month
- You will have the necessary corpus by the time you reach the milestone
- Balance both your short- and long-term milestones in this plan
- Re-visit your milestone document/list every two years and re-align based on the "then circumstance/reality"



CALAMITY

- These are unforeseen circumstances and uncertain.
- It might or might not happen.
- E.g. Loss of job, unforeseen medical expenses of self or family members or loss in business. At the extreme, it could be loss of one life.

- These have a hard impact on our investment journey and milestones! At times, these could be even life changing.

Note: Planning for calamities is also referenced as "Preparing for rainy days"

WHAT SHOULD AN INDIVIDUAL BE PREPARED FOR CALAMITIES?

- List out the risks that you see could come across in your life
- Involve your dependents in this discussion
- Have a mitigation action or plan in the form of savings for each of the risks, in case the event occurs
- Re-visit this every 2-3 years and re-align based on new information and "then circumstance" and risks in life.

MITIGATION FOR SOME COMMON EXPECTED CALAMITIES

Calamity	Mitigation
Loss of Job / unemployed, Recession or Depression	Create an emergency fund, which is a fixed deposit equating to your 3-month expenses. Never touch this for any other expense.
Loss/Damage to property	Property insurance is gaining grounds in India. Explore them.
Sickness of self and dependents	There exists option of medical insurance provided by companies. But opt for a health insurance with a family cover in your individual capacity.
No money post retirement	Be part of social security schemes i.e. PPF and pension schemes i.e. Atal Pension Yogna.
Loss of life	• This is the ultimate and need a strong backing with a huge amount reaching our dependents hands. This can be done by means of Term Insurance. These give a cover of 1 Crore for an amount of 30-40K/year. • Create a 'Will' with details of "Who gets what/how much?" [This helps quicker and easier disbursal of claims by the concerned authorities] • Create a knowledge sharing document and pass on to family at regular intervals (Refer next slide) • Wherever possible create joint accounts with spouse or parents • For existing accounts, add the details of nominee Refer more details of "Succession Planning"

TWO IMPORTANT CALAMITIES

There are two important calamities that can befall anyone at any time. One must be mentally and financially prepared to face such situations. They are:

- Loss of Job
- Hospitalization

A well-prepared financial plan can help not only you but your beloved ones to survive emotionally and financially as well. We will discuss more of these two calamities and how to mitigate them.

It is time to ask a lot of questions and find answers to the same. It is not only about arranging money for these situations, but also keeping ourselves and our families prepared for this situation.

LOSS OF JOB

In current times the threat of losing the job looms large on many of us. A loss of job not only renders the individual jobless, worthless (a feeling till you get another job), but throws life completely out of gear. Ask these questions to yourself…

- How does your family survive the shock?
- Have you catered financially to take of children's education, health needs and daily living needs?
- Are you prepared financially to survive few months without pay?
- What are your options to generate revenues when your steady source of income is lost?
- Are your savings adequate to cushion the loss of job?
- Do you have any alternate source of income?
- Have you developed any additional skills that can help you in getting a new job or money?

Below tabulation address the (1) other preparations and (2) money needs.

Other preparations	• Keep the family informed of a possibility of losing a job in today's job market. Explain them the availability of a buffer from your end to meet this situation. • The buffer amount to cater the education needs, health, rent and other daily living needs for THREE TO FOUR MONTHS should be available. • How to arrive at this buffer? Calculate all the expenses that you currently do for a month and arrive at a figure. Observe this pattern for 2-3 months. Tracking of expenses that we discussed earlier will be very handy for this exercise. • This could give a tentative monthly expense. You need to have 4 times this amount as buffer to manage your expenses for 3-4 months.

Money needs	• If current monthly expense is Rs. 25,000, then the buffer amount needed is 25,000 x 4 = 1 Lakh liquid cash. • However, this need not be held as cash, but as short term Fixed deposit for 3 months. • This Fixed deposit can be renewed every 3 months. • The amount dispensed as final settlement by the current employer would also be handy along with the buffer.

HOSPITALISATION

Hospitalization seems to be a certainty in today's uncertain times!!! Hospitalization is not only life threatening, but costly in terms of finances. Some treatment very easily could cost 1-2 lakhs. We enjoy some protection in the form of Medical cover provided by our employers. But remember, some ailments are NOT COVERED by insurance companies. about dependents?

Ask these questions to yourself…

- Have you planned for such an eventuality?
- Do you have adequate medical cover?
- Are your family members aware of the details of medical cover?
- Have you planned your finances to cater for such an eventuality?
- Do they know which hospital, which doctor which insurer to refer to?
- Is your Emergency contact list updated?
- One must ponder and plan over these issues.

Below tabulation address the (1) other preparations and (2) money needs.

Other preparations	• Much financial planning is not needed, as most of them are covered adequately through medical insurance cover provided by employers. • However, some aspects that needs to be considered are...Preparing the list of emergency contacts like friends, hospital, doctor, ambulance, insurance SPOC/Help desk etc. This needs to be made as hard copy and should be available with our immediate family members and friends. In an emergency every minute counts.! • This apart hospital need <u>copies</u> of a Govt. ID proof, company ID card and insurance card at the time of hospitalization. These also need to be available with our family and friends.
Money needs	• Even if there is medical coverage, it is needed to have ₹10,000 in our SB account for immediate dispense through ATM.

	• This amount would help for Ambulance expense, or first aid or other lifesaving medicines or injections that would need to be administered in priority prior to hospitalization and before insurance desk is informed.

CREATING AN EMERGENCY FUND

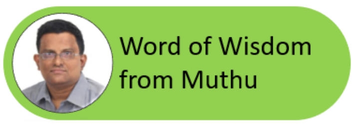
The below four steps could be a good guideline.

Activity	Details
Calculate your total monthly expenses	• This step is important and should not get this one wrong. • When calculating expenses, it is necessary to calculate your family's expenses and not just your own. • This should include everything from expenditure related to food, rent, loan repayments (EMIs), transportation (fuel) costs, monthly insurance premiums, monthly investments (SIPs in mutual funds), medicines, dress, telephone bills, electricity & water bills to more discrete expenditures like eating outs, gifts, festivals etc. • This would give a figure of how much money you need to manage a month's expense.
Decide how much you would like to save	• This totally depends on your level of comfort. • There are different opinions about how much money you should put in an emergency fund: 3 months, 6 months or 12 months worth of expenditures. • It's your emergency fund and only opinion which matters is yours. I would prefer 4 months. • Ask yourself how much you would need to feel secure and make that your target for emergency fund.
Determine how much you can save regularly	• Emergency funds aren't built in a day. • It takes time and regular savings on your part. • Analyze your finances and determine how much you can afford to put towards your emergency fund every month. • Even a small amount will do as when you start saving.
Savings/RD account	• Once you have decided how much you need to put in your emergency fund, it is time to decide where to keep your money. • One major requirement of emergency funds is liquidity. • <u>This means that you cannot park your money in mutual funds, stock markets, gold or other illiquid assets.</u> • Best option would be to open a Savings Account/RD. • Better to have an account exclusively for this emergency fund. Otherwise, you would be tempted to dig into your emergency fund account for non-emergency requirements.

- Though savings account don't offer much returns, it is important to understand that what they do offer is 'liquidity'.
- Some banks offer close to 6-7% on Savings Account, which is quite decent considering the liquidity these savings account offers.

DON'T FOCUS ON RETURNS ON THIS EMERGENCY FUND

The amount is accumulated for emergency, *the liquidity and safety of amount is very important*. Since the emergency corpus (4-month expenses + 10,000 in Savings account) is for emergency one should not focus on interest or growth. However, go for short term FD, which offer good interest. Check with your various bank accounts for their interest rates and do online FD for that period. Keep re-investing the interest and capital as well.



DON'T USE YOUR EMERGENCY FUND FOR NON EMERGENCIES. THIS WOULD DEFEAT THE VERY PURPOSE OF HAVING ONE. EMERGENCIES CAN HAPPEN ANYTIME. BE ALWAYS READY.

WHEN YOU'VE EMERGENCY FUND, YOU WOULD BE LESS AFRAID OF YOUR BOSS. THE FOCUS WOULD BE ON BETTER OUTPUT THAN TRYING TO PLEASE HIM. THIS WOULD BENEFIT YOU, THE ORGANISATION AND EVEN THE BOSS. WIN-WIN FOR ALL.

TAKE AWAYS

	Milestones	Calamities
Nature	• Milestones are definite and sure to occur. • One will have an idea of when the milestone would occur and what expenses could be incurred. • Unique to every person	• These are indefinite and unsure incidents as to when they will happen. • It might or might not happen. Sometimes it would be impossible to figure out the outcome. • Generic to a great extend but unique to the extend, that a person sees a specific risk coming up in his life.
Time Span	• Milestones are *short term* and *long term*. • Those which you need to fulfill in a span of 2 years could be short term and above it is long term.	• They can also have a temporary or permanent impact. • The incidents can have a long or a short-term impact

What should you do?	• Plan and prepare in advance. • One must list out their short/long term milestones, estimate the expenses, and consciously save money for it.	• Impossible to plan but can have risk mitigation actions in place. • But one can surely identify a few possible calamities. • Have a safety net. **Always have a Plan B.**

FURTHER READINGS

https://stableinvestor.com/2017/01/financial-planning-goal-based-investing.html

IT IS TIME FOR ACTIONS

Work a Plan for yourself. List out the:

- Planning for milestones
  - Identify your both short and long term plan.
  - Timeline, Duration and amount you may have to spend.
  - How much you must save per month to catch up with the required amount.
- Mitigating calamities
  - Create emergency fund to cover 2- or 3-month expenses based on your comfort
  - No money at time of retirement - Savings in social security schemes like PPF or pension plan
  - Loss of their own life
    - Knowledge sharing documents
    - Wherever possible, have a joint account with parents or spouse.
    - A simple 'Will'
    - Nomination details updated for all your bank accounts / insurance policies etc.

Below are a few pointers to help to arrive at the possible Milestones and Calamities that you would need to consider.

Milestones	Calamities
<u>Short Term</u> ➢ Marriage of self, brother or sister ➢ Settling parents' loan or Education Loans ➢ Children's schooling <u>Long Term</u> ➢ Buying a car or a Bike ➢ Buying a house ➢ Children's higher education	➢ Loss of Job ➢ Hospitalization of Self or dependents ➢ Loss in business ➢ Loss of property by natural calamity or theft ➢ Global depression as it happened in 1929 or a recession that happened in 2008 ➢ At the extreme, it could be loss of ONEs life.

<u>Note:</u> What is long term for a person, may be short term for another.

SAMPLE LIST OF MILESTONES AND CALAMITIES

Below is a sample of Milestones and Unforeseen Circumstances identified by my friend who is oversees.

Milestones	Unforeseen Circumstance
1) Travel to India – 5K Pounds 2) Parents travel to UK – 5K Pounds 3) Driving license for wife 4) Purchase of new car	1. A recession period without job for 6 months – 18000 pounds 2. A deep depression as in 1929, where people could be jobless for 3-4 years. 3. Partial disability (caused by accident or sickness) there by rendering a person jobless. 4. Loss of residential property by natural calamity 5. Unforeseen medical exigency for self or dependents (i.e. spouse, children, parents etc.) 6. No money post retirement 7. The last and the most important…. The unfortunate DEATH of the himself.

TAX PLANNING

- Tax is the life blood for the Government.
- This tax amount is needed for Government spending and various welfare schemes.
- We earn money from our profession which are our main source of income.
- We pay income tax based on our Tax slab and get the balance as net payment (also called as Take home) in our banks.
- This money is spent/saved
- However, our spending and savings are also taxed

We WILL NOT be discussing the taxation in depth, but only to the extend needed for our financial decisions. When we do a saving or investment, people generally consider two dimensions (1) risk and (2) return. Taxation is additional dimension to be considered. Many investors ignorantly ignore the Taxation aspect. By ignoring this aspect people make a costly mistake leading to wealth erosion. To avoid this one needs to understand:

1. Tax slabs,
2. Various Tax exemptions and
3. Stages in Taxation / Tax Regimes

TAX SLABS

Government offers a general exemption from tax to its citizens. The exemption varies depending on the age group and the amount earned by a person. This provision by the Government reduces the taxable income of a person.

The tax slab for various categories can be checked from the below link:

https://www.incometaxindia.gov.in/pages/charts-and-tables.aspx

TAX EXEMPTIONS

Tax slabs, which we discussed in our previous mail is a general exemption applicable to all without any condition (except for slab for different age groups and income levels as in above table). But Tax exemptions are condition based. When the conditions or eligibility criteria are met by the individual, the exemption is provided.

Examples for tax exemptions are

- EMIs for home loan
- Premium paid on life/medical insurance or
- Donations to approved charitable organizations

There are limits on these exemptions that can be claimed. Some exemptions may need an eligibility criterion to be fulfilled. These exemptions are grouped under various sub-sections of section 80, which we will discuss shortly.

The ideology behind such exemptions is not to tax the expenses on…

- Basic human needs like shelter (home) i.e. home loans, education (education loans), travel to visit families in native (LTA)
- Medical expenditure,
- Support for social causes (E.g. donations to orphanages, temples etc.)
- Support for Government welfare schemes (Prime Minister Drought Relief Fund)
- Support for national calamity (Earthquake, Tsunami etc.)

TAX REGIMES

To well understand the taxation regimes, one needs to understand the different stages in a savings/investment.

THREE STAGES OF TAXATION

When one saves/invests in any financial instrument then there are 3 stages:

1. Investment/Contribution stage: when one invests
2. Accumulation/Accrual stage: when one gets benefit (earns interest) on investment.
3. Withdrawal/Maturity stage: when one withdraws the whole or part of your investment with benefit i.e. interest or accrued interest

Example: Suppose you invest ₹100 in a financial instrument for 15 years at the rate of 8% interest.

- At stage one, you make an investment say of ₹100. – **Investment/Contribution stage**
- At stage two, this investment gathers a return say ₹8 of interest that is not paid out but accumulated in YOUR ACCOUNT taking the value to ₹108 at the end of one year. – **Accumulation/Accrual stage**
- At stage three, you withdraw from the product say after 15 years you get back ₹317 as the initial investment earns 8 per cent each year at a compound rate. – **Withdrawal/Maturity stage**
-

You could be taxed in any one or more of the above stages, depending on the investment product. Let's explore these stages in detail.

Stages in investment cycle	Details

Investment / Contribution Stage	• In this stage one makes the investment, so no tax is levied at this stage • But one can save tax, if invested in some Tax Saving instruments • Given the importance of savings, the Government from time-to-time provides various incentives (in the form of tax exemptions) for promoting savings • **In India, the saving behavior of the people is largely motivated by the tax incentives or benefits attached to any saving instrument** • Tax saving **Section 80C identifies various financial instruments qualifying for saving to a maximum of Rs. 1.5 Lakh.** This 1.5 Lakh is deductible from one's income for the purpose of calculating tax • This means that the income gets reduced by this investment amount (up to Rs. 1.5 Lakh), and one ends up paying no tax on it at all for this 1.5 Lakh
Accumulation Stage / Accrual stage	• This is the time when you earn benefits from your investment account. • For example, if you saved in the fixed deposit, you get interest on the amount invested or if you invested in stocks you get the dividend on your stocks. • This can be taxed or not depending on which financial product you have saved or invested?
Withdrawal / Maturity Stage	• This is the stage, when one withdraws the invested amount along with the benefits such as interest. • For example, when fixed deposit gets mature you get the full amount with interest. • This can be taxed or not depending on which financial product you have saved or invested?

TYPES OF TAXATION REGIMES

We all would have come across the terms EEE, EET, ETE etc., as some point in time. These are the different tax regimes and we will understand this in detail along with its importance.

The three parts (i.e. EET) of the Acronym indicate three stages of investment

1. Investment/Contribution stage,
2. Accumulation/Accrual stage and
3. Withdrawal /Maturity stage

The letter **E** stands for **E**xempt from Tax and **T** for **T**axable.

- E is used when the investment qualifies for tax exempt

- T is used when the investment is taxed
- The various valid combinations of taxed and exemptions are EEE, TEE, ETE, EET, TET, TTE

Examples
- EEE would stand for exempt from Tax in investment stage, Exempt from Tax in Accumulation stage and exempt from Tax in withdrawal stage.
- TEE would stand for no Tax exemption in investment stage, Exempt from Tax in Accumulation stage and exempt from Tax in withdrawal stage.

TAX SAVING OPTIONS

The details of different tax saving investments and expenses that are exempt from tax is discussed below.

Section 80C: allows expenses and investments to be deducted from total income to the extend of lower of 100% Rs.1.5 Lakhs or actuals. It covers,

- Insurance premium paid for self, spouse or child in case of individual / members in case of HUF
- Payment towards deferred annuity contract for life of self, spouse or child
- Contribution towards (1) statutory provident fund, (2) recognized provident fund or (3) super annuation fund
- Contribution toward Public Provident Fund, 1968
- Fixed deposit for a tenure of 5 years, notified for this purpose from a scheduled commercial bank
- Contribution to NSC (VIII)
- Contribution to Sukanya Samriddhi Account
- Contribution to units of Equity Linked Saving Schemes (ELSS) notified by the Central Government
- Contribution to Pension funds run by Mutual Funds u/s 10(23D)
- Subscription to deposit schemes run by National Housing Board (NHB) / Contribution to pension fund run by NHB notified by Central Government
- Cost toward the purchase or construction of a residential house (Including repayment of loans to Government, LIC, bank and employer and also the stamp, registration fees and such other costs needed to transfer the property to their name)
    - The income from such property is taxable and shown under “Income from house property”
- Subscription to notified bonds of NABARD
- Accounts under Senior Citizens Savings Scheme, 2004
- Five year term deposit under Post Office Time Deposit Rules, 1981

Tuition fees (Excluding development fees and donations) to educational institution in India for the purpose of full-time education of two children of the individual are also exempt from tax

80CCC: Premium paid for annuity scheme to LIC and other Insurance companies within the over all limit of 1.5 Lakh

80CCD: Payment to pension scheme within the overall limit of ₹1.5 Lakh

<u>Other sections</u>

- 80CCD(2): Deduction of contribution by the employer towards NPS account of the employee to the limit of (10% of Basic+DA), which is separate and above the limits of 1.5 Lakh
- 80CCG: Rajiv Gandhi Equity Savings Scheme (RGESS), 2012 – For the first-time retail investors in eligible securities to the extend of 50% of Rs.50,000
- 80D: Premium paid towards Health Insurance within the limits prescribed in this section (Refer to the link for details of the limits https://www.bankbazaar.com/tax/section-80d.html)
- 80DD: Expense towards maintenance of disabled persons to the extent of ₹80,000 – 1,25,000 depending on the severity of the disability
- 80DDG: Medical expenses for very senior citizens to the extent of ₹80,000 for senior citizens and ₹40,000 for others
- 80E: Interest towards education loan – applicable from assessment year relevant to previous year in which the interest for paid for a subsequent seven years
- 80G: Deduction upto a limit for contributions to charitable organisations
- 80U: Deduction for disabilities (75,000 for normal disability and 1,50,000 for severe disability)
- 80TTA: Deduction of interest earned from Savings Bank account upto a limit of ₹10,000

FAQ

How to benefit Hindu Undivided Family (HUF) Structure for taxation purpose?

- HUF is an Indian structure where the assets belonging to a family is managed centrally
- To begin with HUF must have an ancestral property or income that is attributable to HUF and not to an individual
- Other assets including investments can then be obtained using the fund at its disposal
- What is a HUF
    - HUF according to Hindu law is a family consisting of all individuals from the same lineage from a single person including wife and unmarried daughters
    - The Karta of the HUF is a senior male member, who may transfer this to another male member
    - In a HUF (1) Male members are called as co-parceners and (2) Female members are called as members

- For the purpose of taxation, HUF is treated as individual investor, provided it has three co-parceners
- The income of HUF must accrue from its own assets
- Any income arising out of transfer of assets by a member or co-parcener and is clubbed with the income of the respective individual and taxed as such
- This will not be treated as income of the HUF

Should I pay Tax for interest received from Fixed or Recurring deposit?
Yes. The interest received from fixed deposit is added as Additional income section of your taxable income and tax paid according to your slab. E.g. A person in the 20% slab, has to pay 20% of the interest earned as Tax.

Once the annual interest paid on deposits crosses ₹10,000 banks deduct 10% of the interest amount and pay it as tax. This is called as TDS.

In the example below ₹12,000 made as fixed deposit, 296 is interest earned and 29.6 is the interest amount recovered by bank and paid to government.

INTEREST CREDIT 50300012833337	3304220131215577	15/12/13		296.00
TAX RECOVERED 50300012833337	3304220131215577	15/12/13	29.60	
PRIN AND INT AUTO_REDEEM 50300012833337	3304220131215580	15/12/13		12,000.00

End of the year, banks would provide you report of the tax recovered from your interest. This is very much similar to Form 12 and 16 provided by your employer.

In the above example, bank has paid 10% tax. If the person falls in 30% tax slab, then he/she has to declare in self assessment and pay the remaining 20% (In this case 59.2) tax, at the time of tax filing in the year end.

My fixed deposit is for 3 years. I receive the interest amount at the end of 3 years. When do I pay Tax? At the end of three years when I receive the interest?
No, The tax for interest has to be paid every year. The depositor may get the interest as cash only after three years, but the interest amount is accumulated in his account. Hence the depositor has to pay Tax on interest accumulated for that year. This is based on the concept of accrual, i.e. accrual of interest to your account. Below is the simple accounting definition of accrual concept.

> "Financial statements are prepared under the Accruals Concept of accounting which requires that income and expense must be recognized in the accounting periods to which they relate rather than on cash basis. Transactions are recorded when they occur and not when the related payments are received or made."

Let us consider an over simplified example. I make an Rs.100 deposit for 3 years. I earn 8% simple interest and, I would receive ₹24 after three years. However, Rs.8 is accrued to my account every year. If I fall in 30% slab, I have to pay Rs.2.4 (30% of 8 is 2.4) every year as tax.

A point for extension… The real post tax returns in the above case are 5.6%, though the investor receives 8% interest from bank.

FURTHER READINGS

Done Your Tax Planning? But what about Financial (Investment) Planning? By *Stable Investor*

Section 80C and How Salaried Young Indians can Save Tax & Grow Rich? By *Stable Investor*

RETIREMENT PLANNING

Imagine all that you could do after retirement!

- Travel to all the places that you have been dreaming about
- Spend more quality time with the family, children and grandchildren
- Pursue your favorite hobby full time
- Write the book that you wanted to

In brief, you can live the life you want to, the way you want to. You decide what you want to do with your time with no pressures of undergoing a daily grind to work.

But however, this is the green side of the story. But one should understand that retirement mean no more fixed salary or business income. **Income stops but not the expenses.**

Before you retire, you must ensure that you can pay for the regular expenses, or costs of starting something of your own without having to resort to any loans or any financial dependence on friends/family/relatives.

So, if one earns and saves till retirement, his/her retirement would be a pleasant experience. So, on a bird eye view, it looks that the solution is easy and is at sight. "Earn for Retirement" is the motto. BUT UNFORTUNATELY, IT IS NOT SO. Retirement is like reading appendix portion of a big book, which has several main chapters before that. Retirement is at the last phase and there are several mile stones (the main chapters.!) that one come across before that. A few significant ones being are discussed under the topic Milestones

Only after crossing all these milestones does one enter the retirement phase. So, most of our earnings would be channelized for these commitments and retirement corpus is not significant enough to live a life we want.

WHY THINK SO MUCH ABOUT THIS.? MY PARENTS TOO RETIRED, THEY GOT PF MONEY AND ALSO MANAGING THROUGH PENSION. I CAN ALSO LIVE THE SAME WAY.? **True.** However there exists some challenge and differences in the times out parents lived, and we live today.

CHALLENGE	DETAILS
Job Guarantee	• When our parents where working, the used to retire only at 60 and mostly they would have served one or utmost 2 companies in their entire career. • However, in our case, with many working in Private firms and MNCs, there is no concrete guarantee for service till 60. • Another dimension for this safety/guarantee can be seen from the fact that as employees, our parents were more protected by Trade unions. • However, for the present generation working in IT companies, there is no such back up. • People working Govt. and PSU could be an exception (May be for now!)
Rapid pace of technology advancement	• New technology being introduced rapidly which phase out of existing technology is a threat to sustained employability. • We constantly learn, update our skills to keep in pace and retain our employability. • If not, then working upto 60 may be a question.
Dilution of PF corpus	• The PF amount was not touched by our parents and got a big kitty at the time of retirements. • However, in present scenario due to frequent switches of companies this money if often redeemed (or taken as loan for some emergencies). • Hence the disciplined approach of building a retirement corpus through PF, is lesser in our case.
High cost of Medical expense	• Health/Medical related expenses have been spiraling in this past few years and worst can be expected in this sector i.e. Consultation fee for a fever could be Rs. 1000. • We may not get medicines/tablets less than Rs.200 or so. • This is not the general price rise, but the peculiar pattern in which Health/Medical related expenses have been spiraling • To enjoy retired life, apart from Wealth, Health is also needed, and a significant portion of retirement corpus would be spent on this.

The last point on Medical expense co-relates to another aspect for retirement. Because of the medical attention you receive, your life expectancy goes up and you live longer ☺. So, you need sufficient money to help you lead a decent life for this longer life expectation!

Say you live up to 90 years… i.e. 30 years post retirement. So, you would need a financial package to support the needs of you and your spouse till around that time.!

PRODUCTS FOR RETIREMENT PLANNING

The following products are ideal for retirement:

- Corpus from EPF
- Pension from EPS
- Public Provident Fund
- National Pension Scheme
- Annuity schemes run by Mutual Funds and Insurance companies
- Atal Pension Yojna
- Senior Citizens Savings Schemes – Provide regular monthly interest, when the corpus received from EPF or PPF is channelized to these accounts

Most of the above options are discussed in earlier chapters under section RETIRAL BENEFIT PRODUCTS

IT IS TIME FOR ACTIONS

- Do you have a rough idea of what your expenses would be when you enter retirement life?

[Tip – Use the data from our earlier exercise to Track Expenses. Use the annual expenses and add a inflation rate of 7-8%. Use these values in compounding formula with 'n', as number of years for you to enter the retirement phase. E.g. If you are aged 40, then you have another 20 years to enter into retirement. In this case use n = 20]

- Do you have plans in place to create a corpus that will give monthly income sufficient to meet your post retiral expenses?

- Do you have a health insurance?

INSURANCE PLANNING

Nothing is certain in life. We all face this risk of an accident or fire or disability or even a sudden demise. Such incidents not only affect us but also our dependents. Insurance is a tool to mitigate these risks. Insurance is a wonderful risk management tool in personal finance. It is a must for everyone. The key mistake in approaching insurance products is:

- Insurance is seen as an investment
- Insurance is seen as a tax saving tool

Insurance is just a risk mitigation tool

"Most surveys show that the common man, the kind of people that we are surrounded with, buys very less of term insurance and lot more ULIPs and endowment policies. The reason is that the insurance companies incentivize heavily the sale of all products except the term insurance. In many cases, the commission to the insurance agent is as high as 40% of the first few premiums. The agents push the insurance that earn them the highest commissions" – S G Raja Sekharan in his book HOW TO GET RICH AND RETIRE EARLY

An individual need only term insurance, which is very useful to them. All other policies are useful to brokers and the insurance company!

INSURANCE FOR TAX SAVING

- Insurance plans have traditionally been a very popular tax saving tool considered by many people
- This is a very famous product which creates buzz in every investors mind when deciding for tax savings
- A vast majority of insurance related products are sold in the quarter from January to March
- This is the time, when the tax planning for the financial year ends

- Tax saving is the provision provided by the Government to reduce the cost of insurance for the policy holder.
- However, taking insurance policy to avail tax exemption it NOT a way to save taxes.
- If tax savings is the objective, then there are other products like VPF/PPF.

Insurance product are not a suitable product for tax saving or investments. Insurance products are neither savings nor investments.

WHAT ALL INSURANCE DOES A INDIVIDUAL NEED

Insurance products are purely risk management contracts between the policy holder and the insurance company. An individual need are the following 4 insurance products:

1. Term Insurance
2. Motor Insurance – Needed by regulations
3. Health Insurance
4. Property Insurance

Never mix investments and insurance. Insurance policy must be availed only for risk management.

Before deciding to take a policy, one need to ponder these **two** questions in depth.

1. Do you need an Insurance?
2. If needed, what is the amount of insurance that is to be insured?

Let us see these two questions in detail.

Do you need insurance?

Insurance products are not "One fit for all" type. A good study of self is needed from the part of the policy holder to actually decide, if he / family needs a policy. To illustrate an example, consider three different persons X, Y and Z and their respective situations

Person X	• No Loan, • Has an own house • His wife is earning a good salary • He is the only son and his wife the only daughter for her parents • Parents and In-laws are well off • Has inherited some ancestral property which gives some rent • Has savings and assets to take care of immediate and the life goals for the next few years
Person Y	• Has a home loan for 25 Lakhs

	• Wife is earning a good salary • The person has a brother and his wife has a sister. Parents and In-laws are well off. • Some minimum savings available only for an emergency.
Person Z	• Has a home loan for 30 Lakhs • Wife is home maker • Parents and In-laws are dependent on his income. • His younger brother is studying and sister entering wedlock in a year. • All money goes to settle loans, brother's education and dependent parents. No sufficient reserves even for an emergency.

Below are the few take away from the above cases, which will help one to make a decision, if policy is needed or not…

- Person X does not need any insurance.
  - In the unfortunate absence of Person X, Wife earning can still take care
  - No loans and no dependent parents or brothers/sisters
  - Being single children to their parents, they are likely to inherit the property of their parents after their life time
  - Sufficient cash for immediate and a few life term goals
- Person Y and Z definitely need insurance. However, the amount needed for insurance would be significantly different for these two cases.
  - Person Y and Z have loans, which is a biggest liability. The immediate family head (Wife or parents) need to settle his liability in an unfortunate absence of Person Y / Z.
  - Person Z has dependent parent, brother who is studying and sister waiting to get married. In the unfortunate absence of Person Z, the whole family dreams would be shattered.

However, the amount needed for insurance would be significantly different for Person Y and Z. How to arrive at the amount of insurance required for Person Y and Z? This is related to second question.

What is the amount of insurance that is to be insured?

Many simply insure for a 2-5 Lakhs without a rationale behind and purely for tax benefits. This will not help the dependents in an unfortunate absence. There should be a rationale in arriving at the insured amount. This purely depends on the individual's situation. Below are the questions that need to be answered to arrive at the sum to be insured.

- What does your monthly house hold expenses? (Here is where tracking of monthly expenses that was discussed in previous, comes handy)
- Do you have any loans? What is the total value of the loan amount?

Add this entire amount to get the insurance amount? Let us see walk through an example. Consider the case of a person having a loan of 30 Lakhs and a monthly expense is Rs.20000. With this data, let us estimate his "Sum needed for Insurance".

- **<u>Monthly house hold expenses</u>** of ₹20,000 corresponds to a yearly figure of 2.4 Lakhs.
    - Add a multiplication factor of 1.5, which gives this figure as 3.6 Lakhs.
    - Hopefully you should have got a question of why I multiply with 1.5? This is considering the below two factors
        1. Act as a cushion for future changes in spending pattern (i.e. College fees of children).
        2. Inflation effects: The Monthly house hold expense could gradually increase to ₹30,000 over the years, due to the rising price.
    - Is this 3.6 Lakhs the needed amount for insurance? <u>No</u>. This 3.6 Lakhs is needed for the family members for **every year**, in the event of an unfortunate absence of the person running the show.
    - The family should get 3.6 Lakhs every year. Who will give you this money every year? The option is the family should get this amount as interest every year from a bank deposit. ☺
    - To get 3.6 Lakhs every year, an amount of **₹45 Lakhs** is needed in a fixed deposit account. At an 8% interest rate, the family gets ₹3.6 Lakhs every year.
- **<u>Loan:</u>** The person has a loan of **Rs.30 Lakhs.**
    - The spouse would need to settle the EMI for this loan or repay the entire loan of ₹30 Lakhs.
    - Settling the entire loan of ₹30 Lakhs is an advisable option as in the absence of income, paying an EMI with interest leads to wealth erosion.

The sum needed for insurance is 75 Lakhs (i.e. 45 + 30). In the unfortunate absence of the person, his family members get around 75 Lakhs from the insurance company. From this amount, they repay the loan of 30 Lakhs and invest the balance 45 Lakhs in a fixed deposit scheme with a monthly interest option. This FD at 8% pays out an interest of ₹30,000/Month, which is much above the current expense of ₹20,000/Month.

One might think that 75 Lakhs is a huge amount and would need lot of premium. TRUE. But this is the purpose of insurance and should be approached this way. Go for a Term Insurance that would provide coverage for 75 Lakhs. The amount of premium for this amount largely depends on age of the insurer.

The above calculation is just a crude calculation to show the approach. This be streamlined better by reducing the amount that the family could receive from employer as PF/Gratuity etc.

COMMISSION ON INSURANCE PRODUCTS

The topic is slightly related to your decision on insurance products. Agents get commission for selling insurance products. They get commission for the full policy term. With the highest commission paid out the first year. These commissions are paid from the premium paid by the policy holder.

Refer the below link for details of the commission to agents for different products for different policy terms.

http://www.basunivesh.com/2013/03/29/do-you-know-your-life-insurance-agents-commission/

A product that is good for an insurance agent/distributor might not be necessary good for the policy holder, as there would be bias to push product that offer them incentives.

FURTHER READINGS

"How to Get Rich and Retire Early" by *S. G. Raja Sekharan*
Chapter 18-21: Investing through Insurance

How Much Term Insurance I Have, and Why by *Safal Niveshak*

Insurance requirements change with Age & Tax Benefits on Life Insurance by *Stable Investor*

Confused with Different Types of Term Plans? Here is How to choose the Right Term Plan by *Stable Investor*

Is a Rs 50 lakh or 1 Crore Life Insurance Enough? by *Stable Investor*

Answers to 20 Important Questions about Term Life Insurance by *Stable Investor*

Till what Age should you take Life Insurance? by *Stable Investor*

Insurance is not Investment. Don't Mix the Two! by *Stable Investor*

https://www.jagoinvestor.com/2019/03/life-insurance-claim-process.html by *Jago Investor*

It Is Time For Actions

- Review the amount of term insurance cover you have
- Identify how much term cover would be needed for your dependents based on your financial plan
- Do you have a health insurance cover for yourself and family?

INVESTMENT IN REAL ESTATE

The term investing in "Real Estate" makes people imagine of unimaginable riches ☺

But that is not the Real-ity always ☹

Investing in real estate could widely involve one or more the below activities:

- Buying a land or property (residential or commercial) and selling at a higher price, thereby making capital gains
- Buying a property (residential or commercial) and let it for rent by which one can get a steady stream of income
- Buying a property (commercial or office) and leasing it to someone for a lump sum amount

Investment in Real estate has constraints and may not be a right fit for many of our personality as investor.

Constraints

Ticket Size	• Unlike other investment opportunities, investment in Real estate cannot be done with little money like ₹10,000 or ₹20,000 • In shares or deposit, you can do with as low as possible that you can afford • But in real estate you easily need a few lakhs to pay advance and block a land or property • You then need lump sum money to finalize the dealing. This many of us cannot afford
Bank Loan	• There is some time element is involved in sanctioning loans • Lot of formalities and not all property don't qualify for a bank loan • Because of this time element in taking a loan, once cannot quickly grab investment opportunities that come across
Authenticity of Ownership	• The original owner of the property is not accurately known many times despite proper verification • The document many a times are in native language and need translation support • The document what you have for verification itself might turn out to be a forged one • Sometimes, the purchase leads to legal hassles which cost more in terms of time, money and mental peace

Is Real Estate Investing a Right Fit for all?

- As an investor, we really have some personal traits for investing in real estate
- Investing in real estate may not suit every one's personality
- None of the above-mentioned constraints mentioned above are intended to create a fear psychosis about this investment, but for consideration before taking up this investment

- Some would have a personality fit, skill sets, negotiation capabilities, network (Brokers, lawyers etc.) required for this investment; they surely can do this successfully
- If you see that this is a style of investment that will suit your personality, go-ahead and succeed

FAQ

Buying land / flat / individual house... Is it saving or investment?

It can be both saving and Investment. This is how it goes…

- Buying land now and building house in future for your own occupation – Not an investment
- Buying a flat / individual house for your own occupation – Not an investment
- Already you have a house and then buy another Flat / individual house for Rent – Investing for Additional income
- Already you have a house and then buy another Flat / individual house for selling at a higher price and make quick profits – Investing for capital gains
- Already you have a house and then buy land for selling at a higher price and make quick profits – Investing for capital gains

From the above cases one can see that saving comes first. i.e. Getting a house for you/family occupation first. Then comes investment i.e. an additional house for Rent/Sale at profits.

FURTHER READINGS

"How to Get Rich and Retire Early" by *S. G. Raja Sekharan*
Chapter 24-28: Investing through Real Estate

INVESTMENT IN EQUITIES

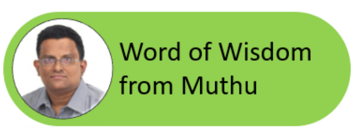
THROUGH STOCKS

The Discussion Below Is On Long Term Investing In Stocks And Does Not Refer To Trading And Speculation, Which Are Carried Out For Quick Profits.

Investing in equities means buying stock of companies. As owners of stock in a company, you own a part of a company. If the company is profitable, its management may pay out a part of it as dividends, to all shareholders (Including yourself). If the company performs well, the price of the stock increases and the shareholder gains through capital appreciation. On the contrary if the company does not perform well the share price decreases and invest loses due to capital depreciation. Much has been written and discussed on how to invest in equities. Everyone has an opinion. There is no right or wrong approach.

The vastness of the idea in stock investment does not lend to be covered in a book meant for personal finance. There is huge resource of materials available in the internet for investors wishing to understand about stock investing. I have shared many good available references and books in the "Further Reading" heading at the end of this section.

However, if investor feel that their ticket size is small to spend time directly into stocks, they can choose the Mutual Fund route to invest in equities



We have investing span of two or three decades but behave like we have two or three years.

Long term investing has no serious competition. It works well because of the same. Human nature being what it is, this is expected to continue.

Find one company you can hold for 10+ years
Use your savings in the year to buy that one stock
Find next company in the second year
Repeat the process
Do it year after year
Over a period, you would have built a great portfolio.

Picking right companies is overrated. Avoiding wrong companies is underrated.

FURTHER READINGS

"How to Get Rich and Retire Early" by *S. G. Raja Sekharan*

- Chapter 11: Investing through equities
- Chapter 12: Identifying Well Managed Consumer Monopolies
- Chapter 13: Calculating the Right Price to Invest in the Stock

Readings in my Investment Journey by Venkatesh Jayaraman. This covers various resources that helped me in Stock Investing.

THROUGH MUTUAL FUNDS

Like in stocks, there are plenty of academic material to understand Mutual Funds. In order not to make repetition of available good materials, I include those contents in the "Further Reading" heading at the end of this section.

A properly chosen Mutual Funds do give better returns than traditional bank deposits. This is ideal for investors who do not have time to learn and spend time in stock investing.

EQUITY LINKED SAVING SCHEME (ELSS)

- These are investment in Mutual funds. Every mutual fund has a Tax saving product.
- They have lock in period of 3 years. The investor can continue invested in the product for few more years or month of his/her choice after the 3 year period.

Dimension of financial product	Details
Objective	Tax savings and investment in equities
Scheme details	Investment Amount/Limits Min: ₹500/Year, Max: No limit. However only 1.5 Lakh qualify for Tax exemption. Tenure: 3 years lockin period Risk: Market related risk
Interest / Compounding	Not applicable
Liquidity	Very less, 3 year lock in period
Taxation Details	Tax Regime • EEE, if the capital gains at the end of 3 years is less than 1 Lakh • EET, if the capital gains at the end of 3 years is more than 1 Lakh Carries the benefits of Section 80C of IT Act / TDS – Not applicable

"How to Get Rich and Retire Early" by *S. G. Raja Sekharan*

- Chapter 14: Why Invest Through Mutual Funds?
- Chapter 15: Types of Mutual Funds
- Chapter 16: Evaluation Mutual Funds – Which Mutual Fund to Invest?
- Chapter 17: How to Get Rich by Investing in MFs?

SIP Vs Lump sum – Which is better in Mutual Funds Investing? by *Stable Investor*

Guide to Mutual Fund Taxation by *Clear Tax*

How to Identify Winning Mutual Funds (Free E-Book) by *Safal Niveshak*

Understand all the basics of Mutual funds by *Jago Investor*

4 Common myths about Mutual funds by *Jago Investor*

Advantages and Disadvantages of Mutual Funds by *Jago Investor*

Types of mutual funds - Which every investor should know before investing by *Jago Investor*

INVESTING IN GOLD

Gold is an important investment instrument that everyone should have in their portfolio. As with any other investment instruments many aspects of this investment are wrongly understood or wrongly marketed. The general notion which most of the people have are:

- Investing in gold jewels will help in rainy days
- Gold prices always rise and thus benefitting the investors
- Gold acts as a hedge against inflation – Means, by investing in gold you are protected against inflation.

All the above are nothing just myths or selling points by some finance advisors. But the below are fact, that everyone needs to realize.

- Gold has strange price movements. It does not keep on rising. In this one year, there has been down turn from ₹3,000/gm to around ₹2500/gm currently.
- Whether gold is an investment or not depends on the form of gold that is purchased. Purchase of gold jewels is NOT AN INVESTMENT.
- In case of a dollar or Euro, when the value depreciates, the corresponding Govt. or reserve bank steps in to action and avoid the depreciation of their currency. But Gold is not owned by any country or any standards or governing body. So, in case of value of Gold diving down, there is no one who will interfere to protect its downfall.
- Gold is a commodity. The price of which depends on the demand and supply gap.

GOLD JEWELLERY

Making Charges

When jewelry is made, the jeweler charges a hefty making charge. It can range from ₹150 per gram to ₹200 per gram. Let's say that the making charge is ₹200 per gram. On a gold price around ₹3,000 per gram, it is a whopping 6.7%! This means the actual investment of Rs.100 in gold is only for getting gold worth ₹93.3.

Liquidation Charges

To realize profit on any investment, you have to sell what you bought. Let's consider the time when you want to liquidate your gold holding by selling it. If it is in the form of jewelry, you would have to forego another fraction of the value in the form of "melting charges" or "melting losses". And this is around 5% of the value. So, your ₹92 now ends up as ₹87.

Authenticity

When bought as jewelry, gold is bought from regular jewelers. This means that you rely purely on the expertise (and honesty!) of the jeweler as far as the quality of gold is concerned. Unless Hallmark gold is used, there is no certification backing the purity of the gold. And this means that you can get a rude shock on purity, when you want to liquidate your gold jewelry.

Storage and Safekeeping

Once you but the jewelry, you have to worry about its storage and its continued safekeeping. This means that you either keep it at home (or remain worried all the time), or rent a safe deposit locker, and pay yearly maintenance fee for it.

GOLD COINS

These are better option than jewelry, but not the best option for investing in gold. There are two sources from which gold coins can be purchased and each has their pros and cons.

Banks and Post Offices

Gold coins are available from Banks and Post offices. These banks source their gold from the most authentic sources. You can trust the purity, and the weight. Banks also give a certificate of purity with the gold that they sell. But all these come with a higher price tag…

- The price that banks charge for gold is usually some premium % higher than the market rate. This increase in the cost of acquisition means reduced profit when you sell it!
- Most important, banks don't repurchase the gold coins from you when you decide to sell. You need to go the market to see it at the prevailing market rates. You also do not get the premium % that you paid to the bank at the time of buying the coins.
- The storage and safety of the coins is your responsibility.
- The banks also charge 2-3% additional charge when selling the coins to you. It is the die/cast charge, equivalent to the making charges involved in jewelry.

For buying pure and certified gold from banks, these are the associated costs.

Jewelry Shops

Gold coins are available from jewelry shops. The two main advantages of buying from jeweler when compared to banks are

1. One need not pay 10-15% as charged by banks. The coins can be purchased from the jeweler at market rates with a small percentage for the die/cast charges.
2. Jewelers do buy back their own coins, which they sold in the past at the prevailing market price. They do not discount much (or sometime, they don't apply any discount).

But the drawback lies in…

- There is no guarantee of the purity of the gold and depends on the reputation of the jeweler.
- If the same coin is sold to a different jeweler, the price may be steeply discounted even to the extent of 15% of prevailing market price.

GOLD EXCHANGE TRADED FUNDS

The GETF are mostly handled by Mutual fund companies. They collect money from investors, to invest in physical gold on their behalf. Gold ETFs buy gold from very reliable sources and take care of its safekeeping. In return, they issue you units of the ETF, each unit representing roughly 1 gram of gold. These units are traded on the stock market and can be bought and sold like ordinary shares.

The NAV of these units fluctuates based on their demand and supply, and usually mirrors the price movement of physical gold. The charges regarding the storage, insurance and safekeeping of physical gold purchased on your behalf are added to the NAV of the units.

Advantages of Gold Exchange Traded Fund (Gold ETF)

Ease: If you want to invest in gold, you just purchase the units of the ETF. The Gold ETF does all the hard work of finding reliable sellers, buying from them, storing the gold and its safekeeping. And if you want to sell, no need to go to the market to a jeweler – just sell the units like ordinary shares on the stock exchange.

Safety: Since gold is not physically held by you, you don't have to worry about its safekeeping! The fund house takes care of the storage, insurance and safekeeping. There are no physical certificates to worry about either – it is all electronic. That's a big relief.

Quality: If you are buying physical gold, your first concern would be to be sure about the quality of gold. With ETFs, there are no such worries - the ETFs buy only from the most reliable sellers, and so the investor need not worry about Quality!

Small Investments: With Gold ETFs, you can invest in as less as 1 gram of gold. Some fund houses offer options of investing even in 0.1 gram of gold

Liquidity: If you want to sell physical gold, you would need to go to the few jewelers available in your area and would have to settle for the best price offered by one of them. Gold ETFs are traded in an open market in a transparent manner, and they have ample liquidity. This means that you get a price that is very close to the actual prevailing price of physical gold.

What would one need to buy GETF? A Demat account, through which you can purchase and sell these GETFs.

SOVEREIGN GOLD BOND SCHEME, 2015

- This was launched with the intention to provide alternate ways for investors to take exposure in gold as an investment
- This is a government scheme denominated in grams of gold
- The bond is issued with a denomination of 1 gram of gold and in denominations thereof

- The tenure of investment is 8 years
- Investors buy the bonds by paying cash and after tenure the maturity proceeds are paid in cash
- The units of gold brought by the investor and represented by the bonds is protected
- The value of bond will reflect the price of gold
- On maturity the value of the bond may be higher or lower depending on the price of gold
- The bonds carry an interest of 2.75% on the initial investment and will be credited semi-annually to the account of bond holder
- Investors can apply for the bond when the issue of each tranche is open
- RBI will provide information about the issue based on previous week's price of gold
- The bonds are available for investment to individuals, HUF, trusts and others
- Investors can apply for these bonds (1) online through the website of listed scheduled commercial banks or (2) physically through designated post office and banks
- The bonds can be held in physical or demat form
- The bond is tradable on stock exchanges
- The bonds have a lock in period of 5 years – Early redemption is possible only after 5th year from date of issue
- Minimum investment is 1 gram and maximum of 500 grams per year for eligible investors
- Interest will be taxed as per prevailing laws and capital gains will be taxed similar to that of physical gold

FURTHER READINGS

"How to Get Rich and Retire Early" by *S. G. Raja Sekharan*

- Chapter 22-23: Investing through Gold

SUCCESSION PLANNING

Though discussed lastly it is not so. This should be most important activity, once we start our investing journey.

This is a mandatory activity, whether you are 28 or 82

All of us spend a huge portion of our life in earning money, sacrifice many a happiness (and even basic needs in our life) to save money and invest them to earn a higher return. But that is not the end of it...There is a knot missing in this loop.

Why Succession Planning?

- We must leave a legacy...A legacy for our hard-earned wealth.
- A clear Succession Planning and some measures that will support the dependents in case of the unfortunate departure of the person running the show.
- Many would not even have given a thought about this in their lifetimes.

What is Succession Planning?

- This topic is not something one feels comfortable to read or even think about. But it is a must. Think about the contents of this section and take the necessary ACTIONS.
- Succession Planning is not about only creating/writing a 'Will'. It is much beyond and a person needs to put some thoughts and have a proper planning.
- Succession Planning is for any one irrespective of the age group they belong to. Whether 28 or 82, one must think about succession planning.

Options for Succession Planning

There are three widely used options to help in Succession Planning (1) Nomination, (2) Joint Holding and (3) Will

> Note: There are few other options like Power of Attorney, Family Settlement and Mutation which are not discussed in this eBook.

NOMINATION

- Nomination is the right given to a person of an investment product to appoint another person to receive the money in case of unfortunate ___
- Only individuals can nominate
- Non-individuals like trust, Karta of HUL, Corporate bodes, Power of attorneys cannot nominate
- Who can be nominees?
    - Another individual, trust or company etc.

  - Minor – But a guardian has to be named
  - NRI – Subject to repatriation rules
  - Any number of nominees can be made with percentage identified for each nominee
- The nomination can be made when the investment is made or subsequently any time after it
- The nominees can be changed any number of times.
- Nomination is a simple way to discharge the payments in the event of death of investor.
- Indian succession laws do not Nominee as a legatee
- A 'Will' supersedes a nomination

WILL

Dying Intestate - A person dying without making a 'Will' is said to have died 'intestate'. In such cases their property is inherited by their heirs in accordance to the succession law applicable to them. There are three succession laws:

1. Hindu Succession Act, 1956 – Applicable to Hindus, Jains, Buddhist and Sikhs
2. Indian Succession Act, 1925 – Applicable to Christians, Jews and Parsis
3. Mohammedan Personal Laws – Governs inheritance of Muslims

What is a Will? "*means the legal declaration of the intention of a testator with respect to his property [which he desires to be carried into effect after his death.*" Definition according to Indian succession Act 1925.

There are three parties to a 'Will':

1) Testator
- The person who makes the Will
- The will comes into force only after the death of the testator

2) Legatee
- The person named in the Will
- Receives a portion of the deceased person's Estate

3) Executor
- The person named in the Will to administer the deceased person's Estate.

Additional Details about Will

- Essential features of a Will
  - A Testator can write what he owns and can be transferred legally
  - A 'Will' can be modified any number of times
  - Such changes to 'Will' is called as 'Codicils'
  - Testator can revoke (Meaning: Cancel or Annul) a Will any time before his death
  - A person must be fit to write a 'Will', minors and mentally unsound cannot make a Will

- Will must be written and signed in the presence of two witness. There are some exceptions like people in armed forces can create an oral Will
- Contents of a Will
    - Name, address of the testator and a statement that they are making the Will voluntarily
    - Clearly identify the beneficiaries as the property that is being bequeathed
    - Identify an executor
    - Signed by the testator and attested two witnesses
    - The witnesses must sign in the presence of each other
    - There should be no ambiguity of the contents and the intend must be brought out clearly
    - A statement that the current will revokes all previous bequests of any kind
    - To avoid any disputes there should be only one single copy of latest Will should be in existence
    - Residual statement to the effect that any unnamed property in the Will to go to a identified beneficiary
- Registering a Will
    - This is not mandatory, however a good practice
    - A registered Will cannot be tampered with, stolen/lost, mutilated or destroyed
    - A registered will not be viewed without the written permission of the testator

JOINT HOLDING

- Gives easy access to specific members of the family like spouse, children.
- Join holding means that the property is held by jointly by more than one person and access subject to mode of operation
- Joint holding is applicable to all asset classes, however there could be some differences in procedural aspects like:
    - Number of joint holders
    - Mode of operations
    - Kind of transactions that needs consent of joint holders
- Usually the First holder is the registered holder of the asset having access to information and benefits of the asset
- The joint holders subject to the terms of holding access the asset after the death of First holder
- Different modes of operations:
    - Jointly – approval of all transactions by every joint holder
    - Either of survivor
    - Anyone
    - Survivor basis
- In case of dispute between the legal heirs, joint holding is superseded by applicable succession laws.

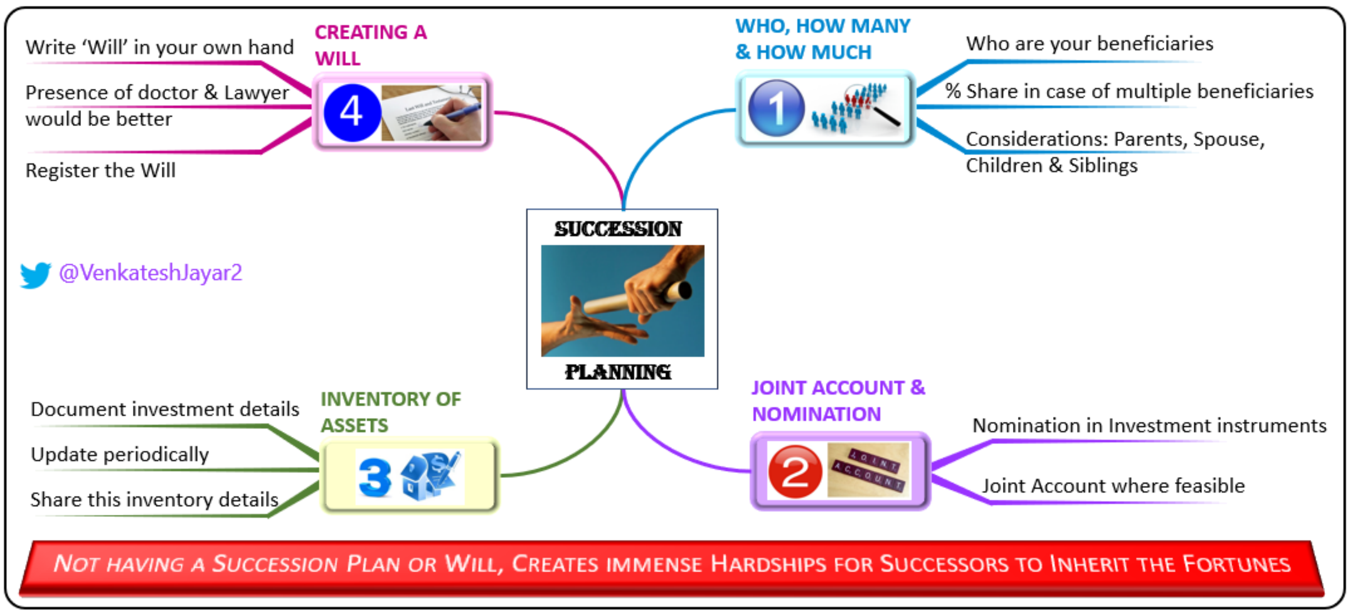
Digital Inheritance

There were requests in Twitter to cover this topic. However, this is a new topic for me and need to explore more and need discussion with experts. This will be covered in the next version of this document.

FURTHER READINGS

Importance of will and some essential points to be considered while making a will by Jago Investor

SUMMARY



IT IS TIME FOR ACTIONS

- Have you filled nomination details in all your investment instruments?
- Make a inventory of assets and update it on a quarterly or half yearly basis
- Do consider creating and registering a 'Will'