

A NOTE ON INVESTING

Dear Sir/Madam,

In general, Investment is for **three** purposes.

The **first (1)** is for parking funds or keeping some funds aside to meet emergencies.

The **second (2)** is to earn regular returns. This is an area where most people make mistakes. When you are of an age where you can actively work and earn money, your earnings, whether from employment, profession or business, constitute your regular income. It would be most unwise to place your savings in further regular returns avenues such as bank fixed deposits, which offer returns that very often fail to provide a positive real rate of return, i.e., return after inflation and tax.

The **third (3)** purpose for which we invest is growth, or to build wealth. During your active working life, a major portion of your savings should go into growth avenues of investment. History has shown that equity, real estate and your own small business are the only three avenues of investment that have consistently beaten inflation and delivered genuine, wealth-enhancing returns over periods of 10 years or more.

Business of course, is not for everyone. But all individuals can invest in both stocks and real estate after obtaining some essential knowledge about these avenues. The right approach would be to invest using strategies such as **highly conservative systematic plans of mutual funds**.

We believe in objective-oriented investing and try to convey this to our clients. We encourage them to think of all their investments as falling into one of three categories - an emergency fund, a retirement fund, and a general investment fund. Here we make a few suggestions about these vitally important categories under which all personal investment must fall.

Emergency Fund:

It would be prudent for every family to establish an emergency fund equal to one year's normal living expenses, rounded off to the next higher Rs 1 lakh. For example, if normal living expenses of the family are Rs 40,000/- per month, the emergency fund must be Rs 5 lakhs.

We would advise building the emergency fund in a liquid/ultra short term mutual fund. Once the emergency fund is built up, monthly capital appreciation transfers must be registered to a diversified equity index fund.

The principal portion of the emergency fund remains intact. Only the income is transferred to an equity fund on a monthly basis. The amounts in the debt and equity fund together will constitute the emergency fund.

The emergency fund can be built up in a lump sum or via a systematic investment plan (SIP), depending upon individual circumstances. One emergency fund is sufficient for a family. Depending upon individual circumstances, one or more members of the family may build up the emergency fund.

Retirement Funding:

The purpose of a retirement fund is to provide for the comfortable living expenses of the individual and the spouse of the individual from the date of retirement to the end of life of the survivor among them.

A good thumb rule to ascertain how much should be set aside for retirement is at least ten per cent of net income for each earning member of the family. Net income means income after deductions and taxes. Each earning member must set up his/her own and separate retirement fund.

Anyone having ten years or more for retirement, and choosing the systematic investment route, can build up the retirement fund almost entirely in equity. Equity investment for retirement can be by investing in **equity index mutual funds** route through (SIPs) or (STPs).

Just as an emergency fund should not be touched except in an emergency, the money in a retirement fund must never be withdrawn, unless it is for funding expenses in retirement. The only exception is if the life of a family member is threatened and emergency funds and insurance are insufficient to take care of the expenses involved.

General Investment Fund:

After the emergency fund is set up, you will do well to establish a (GIF). Briefly, a GIF is designed to meet lump sum non-normal, non-emergency and non-retirement fund contribution outflows that crop up during a person's active working life.

Examples of GIF needs are vehicle purchases, marriages and other social and religious functions, family vacations, children's education, down payment on a real estate purchase, renovation charity, and family support.

When in doubt about which investments to choose for a GIF, maintain a 50:50 balance between debt and equity. Once you embark upon setting up a GIF, try to make the first withdrawal from this category of your investments only 5 years later.

Regards,

Lalith

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