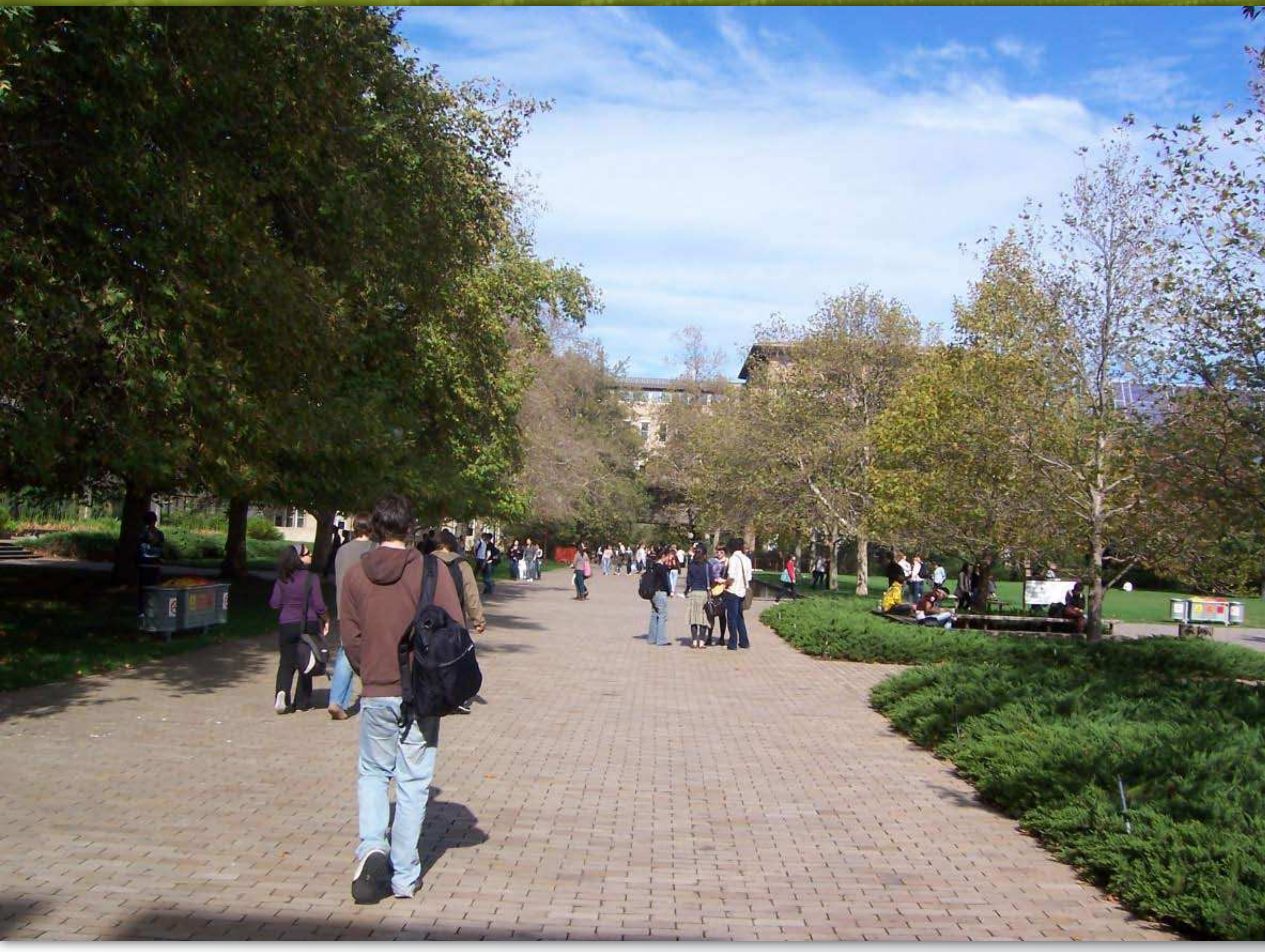
Securities and Exchange Board of India

LESSONS ON FINANCIAL PLANNING FOR YOUNG INVESTORS



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Key Learning Objectives:

After reading this booklet, you will be able to understand the following:

- Need for financial planning
- Need to plan at early age so that you can meet your needs in time
- Various investment avenues in the Indian financial market
- Precautions to be taken before making investments
- Investment strategies to achieve your financial goals
- How to begin investing?

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1. INTRODUCTION

Planning of finances is essential for each and every one, be it a school-going kid or a retired citizen. The more early you begin to manage your money the better it is. Let's suppose you choose not to plan and keep spending as and when you like and one day you wish to purchase a house but then you cannot as you hardly have any savings left. This is what happens when you don't plan and end up overspending.

We tend to overspend when we do not understand what we really need. We keep on spending to fulfill all our requirements and we lose count of how much we spent. One should understand the difference between your needs and wants. Things like daily lunch, dinner and house rent payments are our needs which we will have to incur. But things like play stations, videogames and movies are always an option and can be done without. If even we do want to splurge on our wants we can set aside some of our savings over a time period and can buy important needs like vehicles, house, higher education etc when we have accumulated savings. This is what planning is all about, to plan, save and help us achieve our financial goals.

When you start early you can always plan for your future financial goals and have the benefit of meeting them when you want to. This is because you have a longer time horizon to spread out your investments and manage your portfolio across time. Every school-going kid is taught from his childhood to count and save money for his future so that he can use them appropriately to finance his financial goals.

This tutorial on financial planning presents various aspects of financial planning for college students. Financial planning is very important for every individual. If people understand its significance at a younger age, achieving your future financial goals becomes more convenient as you can invest in different products to meet your needs.

2. FINANCIAL PLANNING

Financial Planning is important as it helps us meet our future goals. Every individual needs to understand the need to manage his or her finances. Let us look at an example to understand why.

The following excerpt is a conversation between a college student, Shantanu (17), who is pursuing his graduation in Finance, and his elder brother, Nikhil (35), who is working as a financial planner. The conversation gives an insight into planning and introduces the concept of financial planning.

SHANTANU: It is my best friend's birthday after a week. I wish to host a surprise party for him. I would like to invite our classmates for snacks. Could you please guide me?

NIKHIL: First of all, you need to plan the event and accordingly make the necessary arrangements.

SHANTANU: But why should I plan?

NIKHIL: A plan will give you a detailed picture of your needs, resources and goals you wish to achieve. Without making a plan you would be unsure of completing the task at hand and could end up wasting the available resources. Suppose we don't plan for the birthday, then it is possible that all of your classmates may not be invited; the snacks may not be delivered in time and the birthday party may not turn out as good as you wanted it to be. But if we plan, we can make sure not to make any errors and we will be better equipped to handle any unusual situations.

SHANTANU: Oh! I had never thought of this before. Our Professor for Investments in the first session of financial planning was telling us about why we need to plan. What does financial planning mean?

NIKHIL: Financial Planning means to plan your finances. For this, it is important that one understands his financial needs or objectives and then plan how he can achieve these objectives or goals by making investments or by borrowing funds.

SHANTANU: Is this what your profession is all about?

NIKHIL: Yes, as a financial planner I assist investors to help plan their finances and manage their investments. We assist investors in choosing the right asset classes to park their funds so that they can achieve their personal financial needs in future.

SHANTANU: So how do I plan for the birthday party?

NIKHIL: Let's note down the things we have and things we need for the party. (Look at the following box items that Shantanu writes down as his brother asks him.)

NIKHIL: To start with, how many people would you be inviting for the party?

SHANTANU: I am planning to invite our entire class of 30 students.

NIKHIL: That's a big group of people. Have you collected any funds to arrange for the party?

SHANTANU: I have managed to collect Rs 6090 from my classmates.

NIKHIL: Now that we have an idea of how many guests are invited and the available funds we can plan the event accordingly. First of all, we should allocate our funds to the snacks and the birthday cake so that the funds are utilized well. Do you know the charges for the snacks?

SHANTANU: I have found out that party orders at the nearest fast food corner for 30 people would cost us close to Rs 3000.

PARTY PLANNING	
Guests (in nos.)	30
Funds (Rs)	6090
Snacks (Rs)	3000
Gifts (Rs)	2500
Balance (Rs)	590

NIKHIL: So this would cost us 50% of the funds collected. Do you wish to buy your friend a gift and give away souvenirs to the guests?

SHANTANU: Yes, but is it possible? I want to buy a play station for my friend on behalf of all of my classmates.

NIKHIL: It is possible provided you select gifts that are reasonable enough to fit in our budget. It is important to always make sure that you always have an idea of the funds available before making plans. A play station sounds good but it might cost us more than what we can spend right now. We might instead buy a gift that is more reasonable. You might gift some branded clothes that he might like.

SHANTANU: That would be a good idea. The nearest gift items store has all kinds of gifts at attractive prices from where we can get the souvenirs too. It might cost us around Rs 2500.

NIKHIL: This would leave us with Rs 590. Do you wish to have any extras like games?

SHANTANU: I think we should have games. We might use the rest of the funds for it and I can buy chocolates for all of us.

NIKHIL: Then I think we have made a plan for the party. Now all you need to do is place the snack order well in advance and buy the gifts a day before to avoid last minute hassles.

SHANTANU: Thank you so much. Now I am sure I will be able to arrange for the event.

NIKHIL: Always remember that whenever you need to carry out a task you always need to plan for it before.

EXERCISE:
Observe how Shantanu writes down the plan for the party. If he had not declared the amount of funds he had collected, planning for the event would have been tough. If Nikhil would not have asked him about this initially Shantanu could have ended up buying expensive gifts and would have no funds left for the snacks. Also note that Nikhil advises him to plan in advance so that he avoids making errors and last-minute rush.

You can plan your finances in the same way as Nikhil helped Shantanu plan for the party except that you need to be extremely careful about where we invest our money to make optimal usage of funds. Financial planning involves various aspects like goal identification, asset allocation, portfolio management, etc., which helps an investor to organize his finances. The following conversation between Shantanu and his brother Nikhil would help you get a better insight into financial planning.

Activity 1: Prepare your monthly budget by specifying your pocket money, monthly expenses and savings for the month. You can look at the above example where Shantanu prepares a plan for his friend's birthday party to make your monthly budget. You can use the following box shown below to list out your budget items.

YOUR MONTHLY BUDGET	
A: Income	
• Pocket money	
• Part-time assignment	
• Prize	
• Stipend	
• Cash gifts, if any	
B: Expenses	
• College fees	
• Party	
• Gift	
• EMI, if any	
• Lunch	
• Traveling Expenses	
• Others	
C: Balance (A-B)	

If your income is greater than your expenses, you are planning your finances adequately. However, if your balance is negative, you need to start planning your finances right away.

DID YOU KNOW?
IDEALLY YOUR SAVINGS SHOULD BE 20% OF YOUR TOTAL INCOME

PERSONAL BUDGET

Meanwhile, Shantanu has finished with the university level examinations in finance. After learning about the importance of financial planning Shantanu now wants to manage his finances well so that he can repay his loan and keep enough funds for his future needs. Shantanu approaches Nikhil for his advice.

Shantanu: Hello, Nikhil. This time my project was judged to be the best. Your insights really helped a lot. I wanted to ask you how I could plan my finances.

Nikhil: First of all, you should make a habit of preparing your monthly budget.

Shantanu: How can I do that?

Nikhil: A monthly budget is a detailed plan of your income, monthly expenses, future expenses and the balance income left with you. (Look at how you prepared the budget plan for the party earlier and try making new additions and changes to the budget plan as Nikhil guides Shantanu.)

Nikhil: First write your monthly income on the top. If you are not earning write down the monthly allowance you get as your pocket money to meet your expenses. Write down the items on which you are likely to spend money. Write an itemized detail of the money you spend through the month. Also, identify the unnecessary expenses you make through the month. In case you have any future plans to buy or sell assets keep a note of it. What's more important is you should maintain this record and keep writing details every day. One should be very honest too. It is important to declare the right income and expense figures as your future plan outcomes will depend on it.

Shantanu: I already feel that I can do it now. Is that all?

Nikhil: Not yet! Let me touch upon few more things in addition to what I had told you earlier before your exams. You should know your assets and liabilities. Asset is a resource that you own and can be easily converted to cash. Remember the money bag I spoke of earlier? The money bag is an asset as it has your monthly income and it can be easily converted to cash. Assets are resources, which you can use to pay off your debts. On the other hand, liability is an obligation to pay back. Your monthly bills and other expenses are all your liabilities, which you should pay up using your assets. Always structure your budget plan by writing your income under the head 'assets' and expenses under the head 'liabilities'.

IMPORTANCE OF FINANCIAL PLANNING

SHANTANU: I have been assigned a project on 'Financial Planning' and I am facing a few difficulties. Could you help me solve them?

NIKHIL: Sure. Do tell me your queries.

SHANTANU: My project has six segments. In the first segment, we need to introduce the concept of financial planning. Could you tell me what financial planning means?

NIKHIL: Financial planning means to plan your finances which help you identify your financial needs and objectives and then make investments accordingly to meet your requirements. Let me show you how financial planning takes place and the various steps of the process.

Steps Involved in the Financial Planning Process

Look at the following flow chart which Nikhil chalks out for Shantanu to help him understand the process of financial planning.

The five steps of the financial planning process are:

- Gathering your financial data - such as details on your income, debt level, commitments, etc.
- Identifying your goals
- Identifying any financial issues or gaps between where you are now financially and where you want to be.
- Preparing your financial plan - which will identify recommended investments and will address your attitude to risk
- Implementing your financial plan -reviewing and revising your plan - to ensure it stays up-to-date and relevant to the economic climate and your changing lifestyle

Step1: Gathering your financial data

NIKHIL: Financial planning constitutes these 5 basic steps. At the first step, you will need to list down your various sources of income. If you are an earning individual, your source of income could be your monthly pay, and if you are running a part-time business, then the income generated from that business would also add to your income. The source of income will vary across people. For you, it could be your pocket money, for an earning individual it will be his monthly pay, for a retired individual it could be his pension income or retirement plan returns. Once you know how much you get each month, you will know what you can afford to spend and how much you can invest. In other words, unless you know how much you have in your pocket, you can't venture out for shopping.

SHANTANU: Why is it important to manage our finances?

NIKHIL: If you manage your finances, you would be able to use your money better. If you don't, you would not be able to meet your needs. Let's say today is the first of the month. You have got your salary and you spend all the funds in your money bag on clothes and other accessories, then you would not have any money left to pay off your monthly bills and other payments through the month. Learning to save is essential or else you cannot meet your basic needs even though you earn a handsome pay.

SHANTANU: I really need to keep this in mind. What is the next step?

Step 2: Identify your financial goals

SHANTANU: It is said that one needs to identify his or her investment objective before he starts planning his finances. Is it true?

NIKHIL: Defining one's investment objective is vital before planning for finances. Your goals will tell you how you should manage your finances so that when you wish to meet your goals you have enough funds with you. You can then plan accordingly how much you need to save today for the future plans and how much returns you will receive on your investments to fulfill your future needs.

Your goals may be either short term, medium term or long term. Your short term goals could be say to pursue an MBA after a year, to purchase a two-wheeler etc. Short terms goals are defined to be met in up to three years. Medium term goals could be financing your marriage expenditure, to gift your parents a vacation package etc. These goals are defined as those needs which have to be met up to 5 years. Your long term goals could be to purchase a new house and these would have to be met after tenure of 5 years. You could further define the target date for each of these goals along with an approximate amount of funds you would require to meet these needs.

Step 3: Identifying any financial issues

NIKHIL: At this step you should also find out if you have any loans to be repaid. Someone might have monthly insurance premiums to be paid, retirement plan premiums, or a home loan. Determining your liabilities is extremely essential so that you do not overspend and end up defaulting on your EMI (equated monthly installments) payment. You should also know how much is your monthly expenditure; i.e., the money spent on food items, clothes, water, electricity and other amenities used so that you can allocate some of your funds to pay for it.

SHANTANU: So not only is the source of income important, but we should also know our liabilities too. Am I right?

NIKHIL: Absolutely. Let me make this simpler. Imagine you have a money bag and on the 1st of every month you get your monthly pay and the money bag gets filled. This money bag is your asset now and the monthly expenses like food bills, loan repayments, etc. become your liabilities. Money flowing into the bag will be your income and money flowing out of your bag will be your payments to others for the services you use. With time your liabilities would increase as you grow old. You would have to support your spouse, your kids and so on.

Step 4: Preparation of Financial Plan

NIKHIL: One should prepare their financial plan depending upon various factors like his income, risk taking ability, age group and investment objective.

SHANTANU: Oh! So this means that financial planning would differ for me and you as well?

NIKHIL: Yes. This is because the income for two individuals may not necessarily be the same and his personal needs could also be different and so on. A financial planner needs to note such differences and then accordingly suggest investment avenues for the investors. If he considers all the investors to be the same then an investor might not be able to meet his financial needs or objectives and the basic purpose of financial planning would not be met with. Suppose you approach me to help you manage your finances. I would first take a look at your income, which would be your pocket money. Since your income is much less than an earning individual the investment avenues that I would suggest you would be different from what I would suggest an individual who is currently working. You must understand that since your needs are different from others you need to make investments that would suit your profile. Many investors fail to understand this. Many individuals in the hope of making big profits invest most of their funds into below investment grade investments which offer high returns. One may profit if they perform well or else they may lose money. Every individual has a different risk appetite and needs to keep this in mind before he chooses which product to invest in.

SHANTANU: Could you please tell me about risk appetite?

Nikhil: Good question! Risk appetite is the risk taking ability of an investor. This varies from person to person. If I am a rich businessman and my monthly income ranges to lakhs of rupees, I might feel that losing a few thousand rupees would not be a matter of concern if I can make high returns. People who are rich or who have a high net worth are willing to invest aggressively unlike others. But if I am a middle class worker, then I might not be able to accept such huge losses. As a rich man, I can afford taking losses or in other words I am willing to take high risks. But as a middle class worker, I can't afford to take high risks. I might be able to take up losses in a few hundred rupees only. If I am a retired individual, my risk appetite would be different as I would need a regular income to support my personal needs like medical bills, health supplements, etc., which means that I would not be willing to take risks. Risk appetite is allotted to individuals on a scale from low to high. For a retired individual, the risk appetite would be low whereas for the businessman the risk appetite would be high. But for a middle class worker it would be moderate. There are various investment avenues like equity, debt, commodities, Forex, etc., each of which is termed as an asset class. You can choose to invest in any of these asset classes provided you understand that each of these asset classes differ from one another in terms of risks and returns. You should make investments depending upon your risk taking ability.

Step 5: Implementing your financial plan

NIKHIL: After preparing your financial plan you need to review and revise your plan to stay up-to-date and relevant to the economic climate and your changing lifestyle.

SHANTANU: Is this what is meant by portfolio management?

NIKHIL: Yes. The entire collection of investments you make is termed as the portfolio. Suppose you have Rs 1000 and you invest 50% in equity and the rest in debt securities. Your entire investment would be your portfolio which has a value of Rs 1000 currently. This value might increase or decrease depending upon the market movements, which will bring a change in the value of the securities you hold. Nowadays investors use various portfolio management services to help them manage their investments. Every asset is different from the other in terms of risk and returns.

Every step in the process of financial planning is equally important. Most of the investors declare their income, risk tolerance levels and also make investments but neglect monitoring their investments. If you do not watch over your investments, even if it had been making gains it may become a loss making investment. Thus there is a need to periodically review your portfolio and make changes in the portfolio as the situation demands. Suppose the equity investments have not performed well for the last quarter and you hold up to 70% of your portfolio in the shares of these companies, then you cannot continue holding the same portfolio. You might have to shift your funds to other asset classes that are less risky like bonds till the markets recover.

3. SMART GOALS

A critical first step in managing your finances is to be able to setup SMART financial objectives. Your goals have to be S (specific), M (measurable, motivated), R (realistic, resource-based), and T (time-bound, can be monitored). Many people make the mistake of setting general goals which, more often than not, will not materialize.

Objectives	Goals	Incorrect Approach	Right Approach
Specific	You need to know exactly what you want and when	I need money to pay my college fees in a year's time	I will save the money of Rs. 50,000 to pay my fees at college
Measurable	Your goal should be measurable so that you know when you can achieve it	I will pay off my debts to my friends	In the next six months, I will return Rs 3000 to my two friends for lending me their money.
Attainable	Your goals should be reasonable i.e. within your reach	I will save money.	I will save Rs. 2,000 each month by cutting down on eating out and partying.
Realistic	Your goals need to be based on resources and tasks that you can reasonably accomplish.	If I save money I will be rich.	If I save regularly, need not borrow more money, I can pay off my debts by next year and will have enough savings till I begin to earn.
Time-bound	Goals with timelines allow you to track your progress and encourage you to keep going until you reach your goal	I will save money for my vehicle	I will save Rs.10000 a year for the next 2 years for my vehicle.

4. HOW TO ACHIEVE YOUR GOALS?

NIKHIL: Now that you know the different aspects of financial planning let us chalk out few goals of yours and how you can go about achieving them. Tell me what are your goals for the future?

SHANTANU: Yes. I would first like to finance my education and then a two wheeler.

NIKHIL: You should write your goals depending upon when you want to achieve them this will help you categorize them.

Table 1: Goals for Mr. Shantanu *Age: 21 Years*

Goals	Goal Type	Name	Target Date	Amount(Lakh)
Education	Short term	Self	2011	05.00
Two-wheeler	Medium term	Self	2014	00.50
Vacation	Medium term	Parents	2016	1.00
Marriage	Long term	Self	2018	10.00
House	Long term	Self	2020	60.00

Once you do this you should plan your investments accordingly.

Goal	Goal Type	Target Date	Action plan required
Education	Short term	2012	Finance your fees partly from your parents funds and partly by taking loan
Two-wheeler	Medium term	2015	By 2013 it is expected you would begin to earn money. So you can save 10 thousand every year so in three years you can have enough funds to buy a vehicle
Vacation	Medium term	2018	Also keeping in mind this goal you can make suitable investments like equity and mutual funds to earn sufficient returns to fund the vacation for your parents provided you plan well in advance
Marriage	Long term	2020	Make investments in equities, debt and mutual funds which will give you sufficient returns to cover your expenses
House	Long term	2022	You can make investments in Fixed deposits which will help you to lock away funds for this goal, however as this would not be enough you should look at other options as well

5. RISK V/S RETURNS

Every individual has their own risk taking capacity. Your risk-return profile is your level of risk tolerance. If you invest in a high risk business like a start up firm your risk would be high. There are three types of risk return profiles which you can fall under depending upon your source of funds and the investments you choose to make. They are:

1. Conservative i.e. you take minimal risks ensuring your funds are secure. You prefer investing in post office deposit schemes, bank fixed deposits, government bonds
2. Moderate i.e. you are willing to take some risks and prefer investing in mutual fund schemes
3. Aggressive i.e. you are willing to take high risks and prefer investing in equity, commodities markets and you may even be speculating for returns.

There is an important investment principle which says the level of your returns depends on the level of risk you take. While you stay invested it is crucial you take necessary measures to manage your risk. Once you invest in any asset class you should monitor your investments and keep yourself updated about various market happenings to avoid any pitfalls. Always check the potential risks when quoted returns are unusually high.

6. THE POWER OF COMPOUNDING

Time is an influential factor when it comes to investments. Your returns depend upon the time you enter and exit. Compounding is a concept which when followed with dedication gives great rewards. However, it rewards better when savings are compounded over longer horizons. Compounding, in short, basically means earning interest on previously earned interest. Let us look at an example:

If you set aside a sum of say Rs 5,000 every month from the age of 25, at a return interest rate of 10%, in 60 years you will have with you funds worth about Rs 1 crore (Rs 10 million) and more. However, if you start at 40 with the same amount and return rate of interest, the retirement fund will amount to only around Rs 33 lakh (Rs 3.3 million).
Consider you invest Rs 100 for a period of 5 years.

Year	Amount (at 10% fixed rate of interest)	Floating rate of interest	Amount (terms of floating rate)
1	110	10%	110
2	121	9%	119.9
3	133.1	12%	133.50
4	146.41	10%	146.8508
5	161.05	9%	160.06

Notice here that the Rs 100 that you had invested will fetch you Rs 161.05 in 5 years in terms of fixed interest rate and similar results in terms of floating rate as well. Thus in 5 years you stand a chance of making around 60% return!!!

Thus compounding is a tool that helps you make phenomenal growth in your investments over a period of time. Thus the more time you have, the more money you are capable of making and this is exactly why financial planning is so very important.

Recurring deposits and SIPs can help you on this front, ease in payment of this regular investment amount through a direct debit facility or post-dated cheque can help you execute your compounding strategy.

7. INFLATION EFFECTS ON INVESTMENTS

Inflation is rise in prices for goods and services. As the prices rise, lesser number of people can buy them. Let's say the rate of petrol changes from Rs 40 to Rs 45, with no change in quality. Then the price difference indicates inflation.

If you are earning returns of 10% over your investment of Rs 5000 which is Rs. 500 after a year and the inflation rate is 11% then you will end up giving your returns due to high inflation rates. Hence always ensure your returns are above the inflation rates. You should also understand the time value of money.

Time Value of Money

SHANTANU: Yes. I know about the time value of money. I remember our Investment Professor telling us about this. He gave us an assignment to help us understand this. He asked us to find out the value of things in our house, which we use the most, and to list down their price or value today and their value 5 years back. We found out that when we compared their values, their value today was much higher.

NIKHIL: This is because of the time value of money. As time passes you will realize that if 10 years back you could afford to purchase a full lunch for Rs 10, today you might afford to get few pieces of vegetables only. This means that the value of a thousand rupee note would be higher today than after five years. If you invest Rs 1000 today, at 5% per annum, then after a year you would receive Rs 1050. Thus Rs 1000 received today is equivalent to Rs 1050 received after a year. In order to protect one's money from losing its value people invest their money. Now I guess you understand your rationale for investing in stock markets was wrong. What you also need to know is that borrowing and spending is not that easy. When you borrow you take up a liability that is you agree to repay and the amount you repay is the original amount you had borrowed along with an interest payment, which is levied upon the amount you borrow.

Activity 2: List down the various items you often use and write down their value today and its value 10 years back. Compare the two values and observe how the value of money has changed over time.

TIME VALUE OF MONEY			
Commodity	Price then (2001-02)	Price now (2009-10)	% increase in inflation
Sugar (1kg)	16.00	40.00	150.00%
Cooking Oil (5 liters)	290.00	500.00	72.41%
Gold (10 grams)	4474.00	17138.00	283.06%
Silver (1 kg)	7868.00	28345.00	260.26%
Rice (1 kg)	14.00	35.00	150.00%
Wheat (1 kg)	10.00	30.00	200.00%
Petrol (1 liter)	33.46	48.83	45.94%
Diesel (1 liter)	19.88	36.74	84.81%

Source: For bullion prices – RBI, the prices of other commodities are approximate prices from web sources

Example 2: Now if you want to buy a house after 20 years the amount of saving and investment required to be made every month at various rates of return to build up corpus of various amounts will be;

Corpus required / Interest rate	50,00,000	60,00,000	70,00,000	80,00,000	90,00,000	10,00,000
6%	10,973.44	13,168.12	15,362.81	17,557.50	19,752.19	21,946.87
8%	8,731.18	10,477.42	12,223.66	13,969.89	15,716.13	17,462.37
10%	6,906.20	8,287.44	9,668.69	11,049.93	12,431.17	13,812.41
12%	5,435.63	6,522.75	7,609.88	8,697.00	9,784.13	10,871.25
15%	3,767.69	4,521.23	5,274.76	6,028.30	6,781.84	7,535.38

Example 2: Suppose your parents are to retire and you want to build up a corpus for their retirement then how much of corpus is required at their retirement to get continuous flow of cash for their monthly expense requirement at 7% rate of return and 5% inflation rate?

Monthly expenses / years to retire	10,000	12,000	15,000	18,000	20,000	25,000
5	5,73,081.76	6,87,698.12	8,59,622.64	10,31,547.17	11,46,163.53	14,32,704.41
10	10,94,691.47	13,13,629.77	16,42,037.21	19,70,444.65	21,89,382.95	27,36,728.68
15	15,69,452.16	18,83,342.59	23,54,178.24	28,25,013.89	31,38,904.32	39,23,630.40
20	20,01,571.62	24,01,885.95	30,02,357.43	36,02,828.92	40,03,143.24	50,03,929.05
25	23,94,879.74	28,73,855.68	35,92,319.61	43,10,783.53	47,89,759.47	59,87,199.34

Example 3: Monthly investment you require to build your corpus___________

Assumption: You can take interest rate as per your risk profile.

For calculation purpose, amount that you have to invest regularly to build the corpus of Rs.10 lakhs. If your requirement is 20 lakhs, then multiply the monthly investment amount by

Assumption: You can take interest rate as per your risk profile.

Interest rate / No of year	6%	8%	10%	12%	15%
5	14,321.72	13,621.38	12,958.11	12,329.91	11,449.24
10	6,125.04	5,516.23	4,963.82	4,463.57	3,802.02
15	3,468.51	2,943.09	2,489.91	2,101.14	1,622.41
20	2,194.69	1,746.24	1,381.24	1,087.13	753.54
25	1,471.50	1,093.09	804.40	587.47	362.77
30	1,021.18	705.41	480.93	324.57	177.56

What are the measures I can take to minimize my risk?

Diversification

SHANTANU: Why do I need to invest in various asset classes? Rather if I invest in just one I don't have to maintain a huge portfolio. Also, managing just one asset class sounds a lot easier. I can also save on the portfolio manager's fees too.

NIKHIL: Well, when it comes to investments one should remember that investing in various asset classes has its own advantage. When you distribute your investment across various asset classes, your risk is balanced out across the portfolio. Let me give you an example.
(Look at how Nikhil explains diversification in the following steps.)

Asset Allocation	
Funds	Rs 10, 000
Investments - Stocks	Rs 3500
Bonds	Rs 3500
Bullion	Rs 3000

NIKHIL: Suppose the amount available with you for investing is Rs 10, 000. You make investments in various assets. You invest Rs 3500 each in equity (which are shares or stock of a company) and bonds which may be government securities or corporate bonds. The rest of the funds are allocated to commodities, let's say gold or silver, which is termed as bullion in commodity markets. Now, say the company's shares in which you have invested have not performed well then there is a possibility that you may lose money on the capital invested in these shares. However, since you have invested in other asset classes the decrease in value of any one asset will be balanced by the gain in other asset classes. This is the benefit of diversification. Diversification thus reduces the risk of the portfolio. If two asset classes are correlated, it implies that when one asset class does not perform well the other asset also loses value depending upon the extent to which they are correlated. If they are positively correlated the direction of movement would be the same but if they are negatively correlated they would move in opposite directions. Investors park their funds in different asset classes with a motive to even out the losses in one asset with the gains in other asset classes. One should always analyze the fundamentals of the company before investing in its products. If one wishes to invest in equity markets, he or she may choose to do so by investing in blue chip companies which have good fundamentals rather than investing in companies whose business you do not understand.

Asset Allocation

Every asset class has its own risks and returns. Equity investments are considered to be risky investments as they might lead to erosion of entire capital invested, whereas government bonds are considered to be risk free as you are confident that the government will not default on its interest payments. When it comes to choosing what investments would suit you, a financial planner will tell you about various asset classes and will help you allocate your funds appropriately. This is termed as asset allocation. In other words, now you would begin implementing your financial plan. Asset allocation is a technique for investing your money into various asset classes. Your planning consultant will suggest assets that would suit you according to your income and risk appetite. If your risk appetite is high, he would suggest risky assets, but if your risk appetite is low, then he would suggest less risky assets. While allocating your funds to various assets, it is important to see that you distribute your funds across various assets to benefit from diversification.

8. SAVINGS V/S INVESTMENTS

Savings mean the funds you keep aside in safe custody like bank saving accounts. While investing on the other hand means to purchase various financial instruments which will pay you a return on some future date. The difference between savings and investment is that savings is simply idle cash while investments help your funds to grow over a period of time. We can meet our short term needs with our savings but to meet our long term goals we need to make investments. Savings help to protect our principal while investments help us earn returns over our investments

9. LOANS V/S INVESTMENTS

People always are confused whether they should avail a loan or build investments to achieve their financial goal. Both of the options are different and should be availed appropriately. The following points are worth remembering:

- It purely depends on your financial strength and other factors.
- Credit card debts and personal loans are very costly
- If you have a loan with a low interest rate and tax benefits as in the case of home loans, it is advantageous to go for a loan. If you have an investment plan where you can make good return, and then you may opt for investment.
- You have to be sure that the investment is not risky and will not affect your family if you lose the money. For example, you are investing huge sums in share market, instead of closing the existing debts, that is too much risk.

Basics & Dangers of Credit Cards

SHANTANU: I was thinking of getting a credit card? Should I?

NIKHIL: People of your age fancy credit cards, they feel that having a credit card is like a status symbol because it gives them the ease of payment at any time but what they forget is the bill they need to pay later.

Disadvantages

1. Credit cards come with a lot of additional charges like interest rates, service charges etc. in exchange for the credit offered by them. People forget to read these terms before purchasing a credit card.
2. Credit cards often tempt people to spend more even if they do not have money today as they have the comfort of paying back later.
3. People tend to purchase more credit cards so as to extend their income and later end up piling huge sums of debt.

Advantages

1. Credit cards offer a number of gifts like cash back, holiday vouchers and other coupons on making purchases through using credit cards.
2. Credit cards offer the benefit of traveling without cash.
3. Credit cards offer cash in advance and hence are easier to use.

It is advised that one should learn to save and manage their funds wisely. Always try to cut back on your spending and rethink before you buy any items other than your basic needs. People at your age are very keen on electronic gadgets and wish to spend on the latest in town. But what you do not realize is these gadgets cost quite a lot on your pockets, squeezing your bank accounts to an extent that you would not be able to pay up for your education.

SHANTANU: I remember even I need to pay back my educational loan after I complete my graduation. I had completely forgotten about this.

NIKHIL: I am glad you told me about your loan before you registered for a credit card. If you already have debt to repay why should you go for more debt? It will not help your financial position. You should instead make investments that will help you repay the loan and also support your needs for the future.

10. INVESTMENT VEHICLES

Indian markets offer a number of financial instruments like equities, debt, mutual funds, currencies and commodities in addition to other structured products. However their choice should be appropriate for the investor depending upon his or her risk profile and other investment horizon.

For younger age group individuals since the investment horizon is long one can invest in products which offer capital appreciation or growth on investments. One should always check that he or she has allocated funds to spend on his or her immediate needs before investing.

Equity Products:
These are company sponsored instruments like shares or stocks of the company's capital. These instruments offer the investor with shareholder rights where in investors can participate in the annual general meeting and have the right to vote. These products earn returns depending upon the profits made by the company from its operations. The returns may thus fluctuate depending upon the profitability of the company business. These products offer a number of benefits like Investors should understand the company business very well before investing. One can choose to invest in these instruments when they have a longer investment horizon.

Mutual Funds:
A mutual fund is generally a professionally managed pool of money from a group of Investors. These products may range from asset class specific portfolio or a mixed group of asset classes. But the choice of scheme or plan should depend upon your investment objective. Investing in mutual funds helps in diversifying your portfolio and thus reduces the risk in your portfolio. These products are considered to be ideal for beginners who lack the necessary expertise to manage their funds.

Structure wise there are two types of mutual funds – Open ended and closed ended.

OPEN ENDED SCHEME sells and repurchases units at all times. When fund sells, investor buys and when the investor redeems, the fund repurchases the units. Buying or redeeming is at a price based on the NAV (Net Asset Value).

CLOSED ENDED SCHEME, after the offer closes, investors are not allowed to buy or redeem units from the fund. Closed end funds are listed on stock exchanges to enable investors to buy or sell units.

Insurance products:
Insurance is more a safety option than an option to invest. We buy insurance to protect ourselves from unforeseen events like death, accidents, theft of valuables etc. Some of the common insurance plans are:

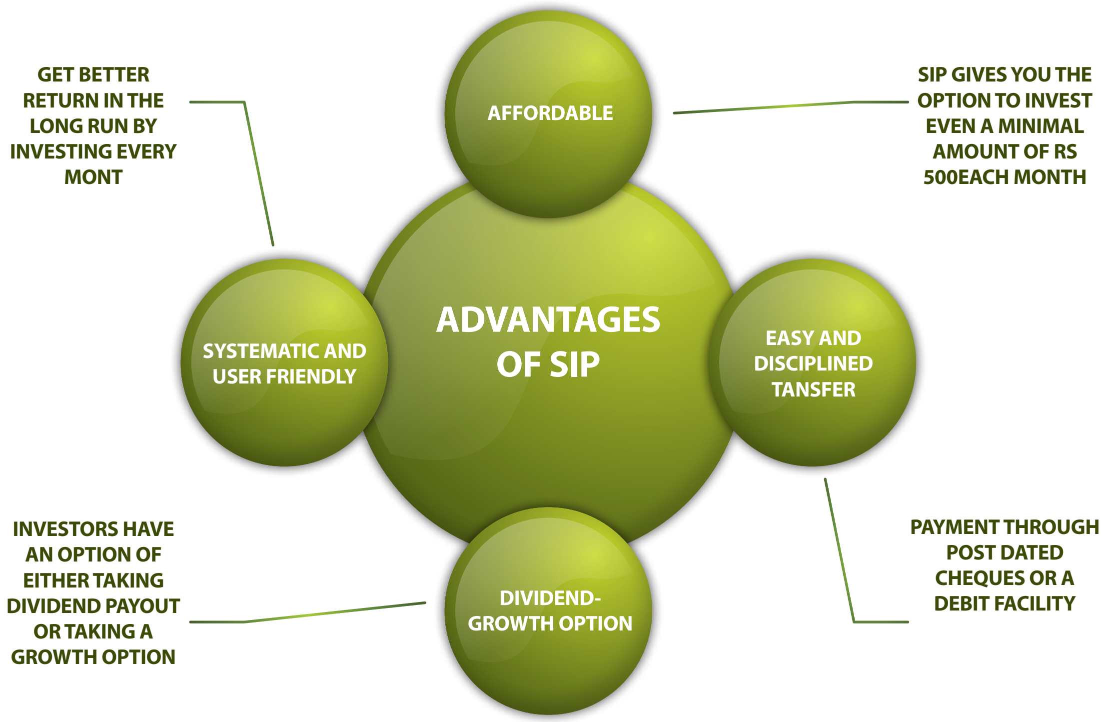
- Unit Linked Insurance Plans
- Term / Term with Return of Premium Plans
- Health Insurance
- Personal Accident Insurance
- Insurance cover for your Home / Car
- Insurance cover to protect your family from liabilities
- Travel insurance

The value of the cover that you opt for should depend on your need for protection. Life insurance helps your dependent family members to cover daily expenditure in case of any sad demise. Medical insurance covers your hospitalization expenses in case of any critical illnesses. Within this category, products may have different payout structures and limits for various heads of expenditure. The hospitalization coverage may be reimbursement based plans or fixed benefit plans. These plans aim to cover the more frequent medical expenses.

11. INVESTMENT STRATEGIES

SYSTEMATIC INVESTMENT PLANS:

Starting early is the key to financial planning; today you don't necessarily need to inherit wealth from family to get wealthy. SIP or systematic investment plans are an excellent means by which you can start investing small, fixed sums of money at regular intervals, (commonly 1 month) most



SIPs start at minimal Rs 500 a month, affordable to a beginner like you.

THE CONCEPT OF RUPEE COST AVERAGING:

SIP uses the concept of rupee cost averaging. Let me illustrate this with the help of an example:

Month	January	February	March	April
A: Amount invested (Rs per month)	500	500	500	500
B: NAV	5	10	15	12
C: No. of units (A/B)	100	50	33.33	41.06

Rs 500 invested in January would fetch you 100 units compared to just 41 units in the month of April. Thus by investing the same amount of Rs 500 every month, you buy more units when the market is down and buy fewer units when the market is up. Thus lowering your average cost per unit. SIP acts as an excellent means by which you can save time and efforts in tracking the stock market movements.

DID YOU KNOW?
A ONE TIME INVESTMENT CARRIES MORE RISK THAN A SIP.

12. HOW NOT TO LOSE MONEY?

Updating oneself with the current happenings is a must for every investor as he will then be aware of various events in the financial markets. In addition to this, there are various matters that need to be looked into to keep a check on your portfolio. If you do not then you will end up losing all your returns

You should make a habit of analyzing your investments, valuing your investments and rebalancing your portfolio.

If you are investing in mutual funds, you can keep a watch on the daily NAV (Net asset value) of the particular fund just like you watch the daily stock prices. You should also be aware of various financial ratios like profit margins, solvency ratios and liquidity ratios, which give you an idea of how the said company is in terms of profitability of its projects, share value and other factors. If you are investing in bonds you should be aware of the bond's maturity, the rate of interest and other elements of the bond. If you are aware that the company has earlier defaulted on its interest payments on its borrowings, then it is better not to invest in securities of that firm. It is always safer to have a good know-how on valuation techniques like ratio analysis and investment pay-off.

You should keep an eye on how the value of your investments changes depending upon fluctuations in the markets, economic issues and other factors.

You can analyze your investments by looking at financial statements of the companies, see how they have performed in the past and if you expect that the company will perform well in future, then you can think of investing in that company. You should try to familiarize yourself with the financial statements of the company to understand how the company utilizes its finances. You should be wary of the publicity gimmicks that a company would put up to impress the masses. You should develop a knack to read through what the company writes up on its performance as a part of the results declared. Every investment you make is crucial hence you should monitor it from the time you invest into the investment product till the time you receive your proceeds from the investment. The time period from the beginning of the investment, that is when you pay out from your funds to buy an asset, till the time you receive your proceeds from the sale of the asset is termed as the Investment Life Cycle. Every investor should monitor his investments from the time of entry till the time of exit. Throughout the time horizon you stay invested you should maintain a check on your investments. The time horizon varies across investors. Some may enter and exit trades within few minutes, hours or within a day while some stay invested for years. But it is always advised that investors should remain invested for a longer time horizon to benefit from an investment. The longer you stay invested you attract less taxes also. But many do not do that in the hope of making quick profits.

Tax Planning

Every individual should know about the tax implications on his or her investments. Every individual is charged income tax but the charges vary depending upon under which tax bracket he falls.

However when it comes to investments you can get a tax rebate.
Section 80C of the Income Tax Act allows you to get a rebate up to a limit of Rs. 1, 00, 000 which is irrespective of under which tax bracket you are. This covers investments like –

- Provident Fund
- Public Provident Fund
- Life insurance premium
- Pension plans
- Equity Linked Saving Schemes of mutual funds
- Infrastructure bonds
- National Savings Certificate

Section 80D of the Income Tax Act also allows you to get a rebate over premium payments of medical insurance plans. This is over and out of the Rs 1 lakh limit offered by Section 80C. 80D provides a deduction up to Rs 30,000. For senior citizens, the deduction up to Rs. 20,000 is allowable. This deduction is available for premium paid on medical insurance for oneself, spouse, parents and children. It is also applicable to the cheques paid by proprietor firms. This act also exempts home loan payments. For self occupied properties, interest paid on a housing loan up to Rs 150,000 per year is exempt from tax. However, this is only applicable for a residence constructed within three financial years after the loan is taken and also the loan if taken after April 1, 1999.

13. HOW TO BEGIN INVESTING?

One can begin investing by fulfilling the following steps:-

1. Investor must have the following documents
   - Personal Identification Proof – PAN Card, Passport Copy, Driving License copy
   - Address proof – Utility bills – Telephone bills, Electricity bills
2. Investor should approach an intermediary which may be a broker, relationship manager etc.
3. Investor is then required to fill up the KYC (Know your client) form and should furnish the necessary details. In addition, he would have to fill the broker-client agreement.
4. Investors then need to open a demat account and a clearing bank account. For this, he or she would have to furnish his or her bank account details.

Once these steps are completed an investor can begin trading in financial markets.
In case of any disputes, investors can approach the following authorities –

No.	Asset Class	First authority to approach	If not solved
1	Shares/Securities	Company/ stock Exchange (if exchange based trading)	SEBI/MCA
2	Corporate Debt	Company/ stock Exchange (if exchange based trading)	RBI/ MOF
3	Commodities	Stock Exchange	FMC
4	Forex	Stock Exchange	RBI
5	Insurance	Company	IRDA
6	Mutual Funds	AMC / Stock Exchange (if exchange based trading)	SEBI
7	NBFC	Concerned NBFC	RBI
8	Listing /delisting /takeover /buyback	Company	SEBI
9	Merger/Amalgamation	Company	MCA
10	In case of government debt		RBI

Where,

SEBI	-	Securities & Exchange Board of India
MCA	-	Ministry of Corporate Affairs
RBI	-	Reserve bank of India
MOF	-	Ministry of Finance
FMC	-	Forward Markets Commission
IRDA	-	Insurance Regulatory and Development Authority

14. SUMMARY

- Know the importance of financial planning.
- Set financial short and long term goals
- Prepare an investment plan and monitor your progress.
- Invest for income and try to allow for your income to rise with inflation.
- Differentiate between needs and wants
- Adjust your living standards if your after-tax income will not be able to meet your expenses.
- Plan how to manage all your financial resources together
- Stay informed about issues that may affect your investments like inflation, taxes etc.
- Keep track of how your investments are doing, changing needs for income, how financial markets and products are changing, and how income might help you achieve your goals.

15. SELF ASSESSMENT

1) As a rule of thumb approach, there is a method of calculating how long it will take for your investments to double. Consider your latest return on investments. Let me help you with a few.

Investments	Expected Rate of return (A)	Rule 72 [(A/ 72)x 100 =no of years]
Stocks		
Bonds		
Mutual funds		
Fixed deposits		

Thus through this approach we get an approximate estimate of how long it will take your investments to double.

2) Write down the goals and aspirations you wish to fulfill and how you plan on getting there. This activity is designed to help to realize how important financial planning really is and whether what you are doing will help you get there or not!

S.No	Goals	Years from now	How will you get there?	Which financial instruments would you use?
1	Buying a car			
2	Buying a house			
3	Marriage			
4	Starting a family			
5	Children's education			
6	World tour			
7				
8				
9				
10				

If you have left some of these spaces blank or feel confused as to what you should be doing to fulfill your dreams, then you need to properly start financial planning with your financial planner.

3) Given below is a small questionnaire designed to help you understand what sort of investor you are.

1. What is your major investment objective?
   a. High return
   b. Moderate return
   c. Liquidity
   d. Low risk
   e. Safety

2. How would you allocate your funds?

Allocation of funds (Options)	Stocks %	Mutual Funds %	Real Estate %	Debt up to %	Fixed Deposits up to %
I	100	0	0	0	0
II	70	10-20	10-20	05	2
III	50	15-25	10-20	10	5
IV	30	20-25	10-20	20	10
V	10	20-30	10-20	25	20

3. What is your investment horizon?
   a. 3 to 6 months
   b. 6 months to 1 year
   c. 1 year to 3 years
   d. 3 years to 5 years
   e. > 5 years

4. What are your expectations on return from investments?
   a. 50 to 100%
   b. 40 to 50%
   c. 20 to 40%
   d. 10 to 20%
   e. 5 to 10%

5. What type of investor do you consider yourself?
   a. High risk taker
   b. Opportunistic risk taker
   c. Moderate risk taker
   d. Low risk taker
   e. I don't like taking any risk

Scoring:
It's now time for results!!!

Each of the options carry a score, 'a' being the highest risk and 'e' carrying lowest risk.

Scores	Results
5 - 10	Highest risk takers
10 - 15	High risk takers
15 - 20	Moderate risk takers
20 - 25	Lowest risk takers

NOTE: In question 2, you may try out a number of portfolio combinations. Look at the following combinations which will give you an idea of how you can allocate investments based on your risks and investment horizon.

Asset class	% of Investments			
Stocks	70	50	30	10
Mutual Funds	15	20	23	30
Real Estate	10	15	17	20
Debt	3	10	20	25
Fixed Deposits	2	5	10	15
TOTAL	100	100	100	100

Observe how your allocations will change depending upon your risks. The above combinations are used for illustrative purposes.

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Securities and Exchange Board of India

For future financial education programs on any of the following modules;
1. School Children
2. College Students
3. Middle Income groups
4. Executives
5. Retirement Planning
6. Home Makers
7. Self Help groups

OR

Any of the following topics on securities markets namely;
1. How to read an offer document
2. How to invest in the primary market through stock exchanges.
3. How to trade in securities/guide to investors.
4. D-mat account and depositories.
5. Mutual funds-do's and Dont's
6. Collective investment schemes- Do's and dont's
7. Buy back of shares, delisting of securities,
8. Takeover regulations
9. Investor grievances-how to resolve it

Please write to SEBI at: feprogram@sebi.gov.in

Or

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