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MAKE THE RIGHT CHOICE

There are several strategies for investing in a mutual fund scheme. But pick the one that meets your investment objectives and matches with your risk appetite, finds out Sunil Kumar Singh.

If you don't want to risk your investments in the stock market by trading in equities directly, investing in a mutual fund could be a safer and indirect way to gain access into stocks. But did you know that you can deploy your money in mutual funds in more ways than one?

The most common way of investing in a mutual fund is to put money in one go or in lump sum amount, but this could turn out to be risky if market turns choppy. Another well-known investment strategy is systematic investment plan or SIP. But apart from such most familiar ways of investing in a mutual fund, there are other tried and tested ways too, which include, Systematic Transfer Plan (STP), Value Averaging Investment Plan (VIP), Systematic Withdrawal Plan (SWP) and Dividend Transfer Plan (DTP).

How rupee cost averaging works

Month	NAV (in Rs)	Amount invested (in Rs)	Units bought
1	20	1,000	50
2	10	1,000	100
3	12	1,000	83
4	15	1,000	66
5	11	1,000	90
Total		5,000	389

But what do these investment options actually mean and how to make the most of each investment strategy? In the following paragraphs, you'll find out the details of each investment strategy that would also help you to pick the best option tailored to your needs.

Systematic Investment Plan (SIP)

This is the perhaps the most popular way of investing in a fund. SIP is a simple investment strategy and helps disciplined investing over a period of time. Under SIP investors invest a fixed sum of money in a particular scheme at regular intervals, generally monthly. SIP is like climbing a tall building not in one go but step by step. Many

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fund houses allow SIP with as low amount as Rs 1000 on a monthly basis.Apart from disciplined investing, another great advantage of SIP is that it averages out your cost of investment and hence reduces your risk. For instance, you invest Rs 1,000 in fund on a monthly basis whose current NAV is Rs 20. That means, at the end of one month you've bought 50 units of the fund. In the second month, you invest again Rs 1,000 but the NAV of the fund has gone down to Rs 10. That means you end up buying 100 units of the fund in the second month.

Hence, at the end of two months you've invested Rs 2,000 and accumulated 100+50 = 150 units, with the total value of your investment amounting to Rs 1,500. However, suppose you had put in a lump sum amount of 2,000 in the first month, the total value of your investment at the end of two months would be only Rs 1,000, i.e net loss of Rs 1,000. This is called the magic of rupee cost averaging that reduces risk and generates superior returns. As illustrated in the Table (see *page 56*), you can end up owning 389 units of the fund through SIP as against just 250 had you invested Rs 5,000 in lump sum in the first month.

"This is the most popular choice for a salaried individual or any person who saves money regularly," says Harsh Vardhan Dawar, Director, Wealth Cafe Financial Advisors, Mumbai. SIP is a very good investment option for small investors who cannot contribute a large sum for their life goals. However, the greatest disadvantage of SIP is that it doesn't work well in unidirectional market.

As Jitendra P.S. Solanki, Certified Financial Planner & Founder, JS Financial Advisors, Delhi says, "An SIP works very effectively in volatile markets like equities but may not be fruitful in markets which are moving in one direction like constant rising or falling."

Systematic Transfer Plan (STP)

While in SIP one invests a fixed amount regularly, under STP an investor invests a lump sum amount in one scheme and regularly transfers a pre-defined amount into another scheme. Generally, on a specified date of a month one can transfer a fixed amount or capital appreciation from one mutual fund scheme to another of his/her choice. Many fund houses give a choice between switching a fixed sum or only the appreciation on your investments. STP is basically for those investors who want to get the best of both worlds, i.e. secure money while investing in a debt fund or fixed income scheme while at the same time earn steady return from investing in equity funds, or vice versa.

Invest right

- SIP reduces risk when you play the market trend
- It works equally well for buying as well as selling decisions
- STP enables an investor to invest a lump sum amount in one scheme and transfer a pre-defined amount into another scheme
- SWP is suited for those who want to receive regular income at regular intervals
- Under VIP the amount invested varies according to market conditions and a mathematical formula is used to calculate the amount of investment
- Under DTP you can invest the dividends received from your income/liquid schemes into equity and hybrid schemes

STP is also considered to be a good way of gaining a gradual exposure into equities or of gradually reducing exposure over a period of time. This scheme too entails benefits of rupee cost averaging.

"For a business person who earns in lump sums, STP is the best option. Since markets are volatile in the short run, and it's impossible to time the markets to perfection, an investor must opt for STP. Lump sums can be invested in a liquid scheme and instructions can be given to the mutual fund AMC to transfer regular amounts to an equity scheme. This helps even out the volatilities just like the SIP option," says Dawar.

However, this strategy too has its share of demerits. As Solanki says, "If there is any exit load in debt scheme and your capital gains from debt investments are high, you will end up paying capital gains tax which is higher in debt."

Systematic Withdrawal Plan (SWP)

Contrary to SIP, under SWP you can take your money out of a fund according to a regular schedule that you instruct the fund house. SWP is considered to be a convenient way to draw down one's holdings over a period of time.

SWP is suited for those who want to receive regular income at regular intervals. For instance, if you need monthly or quarterly income, through SWP you can withdraw either a fixed sum per month or quarter, or the capital appreciation of your investment in the fund.

However, it's better to read the rules and regulations of the fund house regarding SWP as many fund houses have stipulated a minimum account balance in order to start the SWP facility.

The strategy is highly beneficial to retirees who have the need of regular income, maintains Solanki.

However, he adds, this strategy can be a drawback if you choose to withdraw a fixed sum as the company will withdraw from your

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capital investment if there is less gains. Thus, relying on this option for your income needs can be painful as the regular withdrawal may vary as per the market performance.

Value Averaging Investment Plan (VIP)

It's much similar to SIP. However, the only difference is that while under SIP you invest a fixed amount of money; under VIP the amount invested varies according to market conditions. A mathematical formula is used to calculate the amount of investment.

"Pioneered by Benchmark Mutual Fund (Now taken over by Goldman Sachs), VIP differs in the fact that while in SIP the monthly investment is a fixed amount, in VIP the monthly investment varies. The beauty of VIP lies in how the monthly amount to be invested is decided. VIP works on the concept that one must invest more when the markets are low and invest less when the markets are high," maintains Dawar.

In other words, instead of investing a fixed sum, you invest more when markets are low and less when markets are high.

Adds Solanki, "It's a very good strategy and has all probabilities of generating higher return than SIPs. However, sometimes the investors can face difficulty in managing the cash flows as the amount of investment is variable. Also, if the markets are moving in one direction VIP can end up giving less return than SIPs."

Dividend Transfer Plan (DTP)

If you want to invest in equities and at the same time maintain majority of your investments in fixed income schemes, DTP is right for you. Simply speaking, under DTP you can invest the dividends received from your income/liquid schemes into equity and hybrid schemes.

Dawar says, "[DTP is] an innovative option for the risk averse investors. One has two choices under this. If you have invested in an Equity scheme, you can decide to transfer dividend declared by the equity schemes to a debt fund. This ensures that your profits are protected and transferred to a safer avenue. Conversely, if you have invested your money in a debt scheme, you can transfer dividends declared by the debt Fund to an equity scheme. This way your capital is protected and you returns are invested in equities in a bid to earn higher returns."

However, one limitation is that the frequency of transfer is dependent on the dividends declared by the scheme in which the investment has been made.

Is one better than the other?

Here comes the crucial question: Is one investment strategy superior to the other/s?

No, maintain experts, since all these strategies are used by people with different risk appetite and according to their financial situation.

"No strategy is superior to other. It depends on your risk appetite and your goals from the investment you want to achieve. Also, these strategies are applied at different stages of your life cycle. SIP, STP or lump sum is more advisable when you are accumulating for your goals while SWP is effective only when your need is regular income or booking profits at fixed intervals," advises Solanki.

Similarly, he adds, if you have surplus to invest then lump sum investment is always advisable while for small investors where regular investing is the only option SIP or VIP is highly effective. Hence, one has to look at his/her requirement based on current financial situation and then adopt a strategy which can help in reaching the desired goals.

> "VIP works on the concept that one must invest more when the markets are low and invest less when the markets are high."
>
> -Harsh Vardhan Dawar, Director, Wealth Cafe Financial Advisors, Mumbai

Regulating investment advisors will benefit industry: Sebi

The proposed regulation of investment advisors will benefit the industry once enforced, a senior Sebi official has said. "Once the regulation of investment advisors comes into effect, the industry will benefit," Sebi Deputy General Manager Maninder Cheema said while addressing a seminar on 'Future of career in financial planning,' organised by the Financial Planning Standards Board.

In a move aimed at addressing conflicts of interest in distribution of financial products, the Sebi had issued a concept paper to regulate investment advisors last September. The capital markets regulator intends to keep a check on investment advisors through the self-regulatory organisation (SRO) route. The proposed regulatory framework is on the activity of providing investment advisory services in general, not limited to securities, insurance and pension funds. Addressing the meeting, Reserve Bank General Manager DG Kale said, "While the regulators take care of three 'I's (instruments, infrastructure and investors) the fourth 'I' (individuals) needs to be addressed by professional financial planning bodies such as the FPSB promoting CFP certification...."

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LITTLE MONEY, BIG BENEFITS

Have you recently been rewarded with a bonus from your employer or have received a lump sum amount from redemption of a mutual fund scheme? Don't just misspend this money frivolously. Instead, invest it wisely to create wealth in the long run.

Sunil Kumar Singh

Recently a piece of news broke out that the IT services firm Cognizant has doled out a 200 per cent bonus to its top performers for second year in a row, while the average bonus payout for its employees stood at more than 150 per cent.

A windfall - you would say - for the employees of the company! Of course it is, but there're many times when a working executive receives a surprise lump sum amount in the form of bonus like the one illustrated above, or lump sum from a money-back life insurance policy, maturity amount of a life insurance policy, redemption amount from a mutual fund scheme, proceeds from a sale of property, etc. Many of them, however, tend to just fritter away this money on a dine-out at a lavish restaurant or on expensive attire or on a piece of jewelry.

But how many of them have ever cared to invest this lump sum amount in a systematic manner instead of just spending thoughtlessly? How many of them follow the simple principle of wealth creation that says the journey to a corpus starts from small steps?

Perhaps very few. So let's see the various prudent ways you could invest this money for capital gains over time depending on risk-return trade off.

Improve your finances

- Before investing in any instrument, be sure about your risk tolerance
- Tailor your investment goals with age and time needed to achieve them
- If you're not sure about your goals, park the money in a liquid instrument
- Investing directly in equities could be a risky proposition if you lack expertise
- Go for equity funds if you've a long term view

Decide your goals

The first step to put this money to the best possible use is to identify your investment goals, recommend experts. "If you've been following a goal-based financial planning, then it's easier for you to allocate this money as per your risk appetite. However, if you don't have a targeted plan, it's a good idea to frame or review it now. Or else you would end up squandering this money," maintains Jitendra PS Solanki, Certified Financial Planner & Founder, JS Financial Advisors, Delhi. The second factor to consider is your time horizon.

"You must identify what's the time you need to achieve your financial goals," Solanki adds. However, if you haven't set any goal or are not clear about your objectives, it's better to park this money in a stable instrument like bank FD or savings account or in a liquid instrument such as liquid mutual fund till you review your objectives.

However, investing in FDs won't make sense if the interest income earned by you is more than Rs 10,000 annually because in that case it would come under taxable income as per the income tax rules. Hence analyze your options carefully.

Aim to beat inflation

"The basic purpose of investing is to generate returns that can beat inflation and help in meeting your financial objectives," maintains Solanki. Therefore, he says, if you have a clear-cut objective and have a time horizon of say 5 to 6 years, you can take exposure to equity funds - ranging from diversified equity funds to balanced funds - depending on your risk appetite. If you've a time horizon of more than 5 years, equities are always a good asset class to invest for generating an inflation-beating return.

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Adds Radhey Sharma, Chief Financial Planner, TheWealthWisher Financial Planners, "For a person who has high risk appetite, he can park the money in diversified equity mutual funds if the money can be used for long term goals. In equities, there are direct stocks and then there are sector and thematic mutual funds as well to invest in but the small retail investor is better off with diversified equity mutual funds."

However, experts maintain, investing directly in equities could be a risky proposition for a retail investor. As Sharma advises, for a low to moderate risk appetite person, equities should be avoided. Investing in equities not only requires high capital to invest but good expertise too. With the same amount, he/she can buy a mutual fund scheme where not only his/her money is diversified but it also gives a relatively stable return as his/her money is managed by a professional fund manager, Solanki advises.

Get exposure to gilt funds

If you've a high risk appetite, you can also look for investing this lump sum amount in gilt funds or income funds, apart from equity funds.

Gilt funds, as the name suggests, invest in government securities while income funds take exposure in corporate bonds too. This means the NAV of such funds are not static and rise or fall as the prices of the underlying instrument moves. The price of these instruments tends to decrease when interest rates are rising and increase when interest rates start falling. Therefore in the current market conditions, when interest rates are widely expected to fall, going for gilt funds or income funds makes a good investment option as they would generate higher returns in the next couple of years. However, as Solanki cautions, since these funds are highly volatile one should invest money in these funds only when he/she has high risk appetite. Adds Sharma, the usual suspects - fixed deposits, recurring deposits and other small saving schemes (NSC, KVP etc) - are always there but the investor has to keep in mind the lock-in period of his investments should be opted with any of these.

7 steps to invest lump sum money

According to K Ramalingam, Director and Chief Financial Planner, Holistic Investment Planners, Chennai, there are seven ways the lump sum money received by an executive can be deployed.

- Repaying any high cost debt
- Tax saving investments to be made for the current year or the subsequent year
- Planning for unexpected events: This includes creating emergency reserve to the tune of 3 to 6 months of expenses; taking adequate health insurance for self and dependents; taking adequate life insurance cover with an online term insurance policy; and protecting our properties with a general insurance policy that covers fire, natural perils, terrorism, etc
- Once you have deployed the money for the above points and if you still have some more money left out, then you may consider investing in debt funds and equity funds. To invest in equity funds you need to follow the Systematic Transfer Plan strategy
- If you are ready to take more risk and you need your money back only after 5 years or later, then you can provide more allocation to equity funds. You may choose the allocation such as 70:30 (equity: debt)
- If you are not comfortable in taking more risk then you need to provide less allocation to equity funds. You may choose the allocation such as 30:70 (equity: debt)
- In any case you should not invest in equity funds if your time frame is less than 5 years, he advises.

Go for MIPs

While equity funds, gilt funds and income funds are for high risk appetite investors, those with low-to-moderate risk appetite can park this money in MIPs or Monthly Income Plans. MIPs are suited to an investor with a low to moderate risk appetite, as these funds invest in debt instruments with some equity exposure which varies in each scheme with some going up to 20-25 per cent. "The basic purpose of MIPs is to earn steady income with debt exposure and at the same time it tries to generate a good return through equity investments. Some of the schemes' performance makes it a good bet for moderate-risk investors. In the past these funds have been able to generate 11-13 per cent decent returns for investors," Solanki says. Hence, while investing the surplus you receive midway it's important to analyze your financial objectives as this makes it easy to select an asset class which will supplement your other investments in meeting your goals, he adds. One thing which needs to remember is that it's difficult to achieve long term goals without asset classes like equities because inflation eats out most of the returns, jeopardizing the net earnings you are making from your investments, he maintains.