The Definitive Guide to

Financial Planning

Personal FN

December, 2010

Prologue

Dear friend,

If you are reading this guide – then Congratulations!

You already understand that Financial Planning can help you get your financial life in order. You want to take a planned approach to achieving financial success and not depend on chance alone.

But building a Financial Plan for yourself can seem confusing – not only are you too close to the project since it involves your own finances, but also it is a complex process which takes into account a number of pieces of your personal financial information – like a large puzzle where each piece is your own financial data and requirements.

These puzzle pieces include:

- ✓ Your Assets
- ✓ Your Liabilities
- ✓ Your Cash Inflows
- ✓ Your Cash Outflows

And most importantly…

- ✓ Your Financial goals and dreams

Every person needs his or her own financial plan – after all, you wouldn't go on a holiday without proper planning, so why live your entire life without properly planning your finances?

And we at *Personal*FN would like to help you do just that – with our own knowledge and expertise poured into this Guide – in as simple and easy to understand a manner as possible.

Read on…

Warm regards,

Vipin Khandelwal,

Chief Executive Officer

Personal FN

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I: Introduction

"Life is full of uncertainties. Future investment earnings and interest and inflation rates are not known to anybody. However, I can guarantee you one thing... those who put an investment program in place will have a lot more money when they come to retire than those who never get around to it."

Noel Whittaker

Why do you need to Plan Your Finances?

Let's start at the very beginning.
What is Financial Planning?

Financial Planning is a process whereby you will have a roadmap of your personal and financial life, which will help you to meet all your life's expenses – both the expected... (household expenses, discretionary expenses, children's school and college fees, putting money together to buy a home, EMI payments, saving and investing for your retirement and so on)...
and the unexpected...(medical contingency, creating a safety fund to compensate for loss of a job, and so on).
It is easy to say that as long as you are earning, your monthly salary will cover your expenses, and whatever you save you will invest, and on your retirement, hopefully, you will have enough set aside to live the rest of your life maintaining a good lifestyle.

But we all know that there are 2 things that go against this thought:

The first is Inflation – the one thing that kills the value of your money.
Something that costs you ₹100 today, could cost you ₹110 tomorrow. Imagine what it would cost you when you retire in so many years.

An example to bring out the point:
Monthly Household expense today: ₹30,000
Years to Retirement: 15
Inflation Rate: 8% p.a.
Household expense at the time of retirement, to maintain the same lifestyle:
₹95,165 per month

We will deal with inflation in greater detail in a following chapter.

The second is the improper investment of your money.
This is what can kill the potential future value of your money.

For example, if you have surplus funds which you will not need for the next 5 year, and you choose to lock them into a 5 year FD to save on tax, consider that you might have been better off investing into the equity markets perhaps by way of a tax saving mutual fund – thereby getting the benefit of equity over the long term and also saving on tax.

It is the improper investment of your surplus funds that can reduce the power of your money to maximize your wealth.

Because of these 2 major factors, it is absolutely essential to have a strong Financial Plan that will give you awareness on where you stand today, and what steps you need to take to achieve your financial goals.

We have also seen that there is a common mis-conception among investors today, wherein they believe that doing your tax saving investments during the year is the same as doing financial planning.

These investors are mistaken.

Making tax saving investments is often misconstrued as proper financial planning but financial planning is a lot more than this.

Financial Planning involves planning for your life goals such as your own retirement, your child's education and marriage, purchase of an asset such as a house or a car, planning for annual family vacations and any other goals you may want to achieve.

When doing financial planning, you perhaps with the help of your planner, will first determine and quantify your goals, and then assess your cash flows to see how to allocate funds towards your goals in a manner that your goals are suitably achieved. Once a plan has been created by taking all your personal financial requirements into account, then you would begin investing towards the goals.

The recommendations for investments are the last piece to fit into the financial plan. These recommendations may also include tax saving investments.

Thus as you see, tax investments are only a small part of overall financial planning.

II: Financial Planning – The First Steps

"Would you tell me which way I ought to go from here?" asked Alice.
"That depends a good deal on where you want to get," said the Cat.
"I really don't care where I get" replied Alice.
"Then it doesn't much matter which way you go," said the Cat.

Lewis Carroll, Alice's Adventures in Wonderland

Where do you stand Today?

The first step in doing anything of importance is to first assess where you stand today and where it is that you want to reach. To do this, you need to first measure your financial health, and then determine how your money moves.

Measuring your Financial Health

When dealing with your personal finances, it is therefore important to start by knowing how financially healthy you are today.

Generally most of us get a complete physical health check up once a year, especially after a certain age. This is done so that we know our health issues if any, and can treat any ailments before they cause any damage. Your finances are as important to you as your health, and deserve at least the same amount of care and attention.

Here we will cover 3 simple personal finance rules that you can start with, to see where you stand today.

- **Debt to Income Ratio**

$$\text{Debt to Income Ratio} = \frac{\text{Total monthly outgoings on liabilities (EMIs)}}{\text{Total monthly income from fixed sources}}$$

Ideally, your debt to income ratio should not be higher than 30% as this means you are straining your income. This means you should not be spending more than 30% of your income on paying loans / interest on loans.

❖ Savings to Income Ratio

$$\text{Savings to Income Ratio} = \frac{\text{Total monthly savings}}{\text{Total monthly income}}$$

Ideally, you should be saving at least 20% of your monthly income to save and invest.

❖ Contingency Reserve

Contingency Reserve = 6 to 24 months of living expenses

You should set aside 6 to 24 months of living expenses as a contingency fund to be used only in times of emergencies. This should include any EMIs that you may have.
Once you implement these simple rules, you will find that your finances are more in your control and manageable.

Determining How Your Money Moves

What are the financial habits, or lack of them, that have brought us to our current level of financial health? When you sit down to assess yourself, it is all really about only 2 things:
1. Are you living **"within"** your means or **"below"** your means?
By this we mean, is your level of saving the level that you require, or do you save that little bit extra and – invest it?

2. What do you **spend** on and how much do you **invest**?
This means, is your expenditure primarily on luxuries or necessities? And accordingly, are you investing as much as you can or are you spending the cash that could have been invested instead?

These 2 all important factors will determine whether you will be able to send your child to that excellent school, or buy the more beautiful house, drive the bigger car, take the longer vacations and retire those few years earlier. Let us go into this in some more detail…

Broadly, you have four important financial quadrants, i.e incomes, expenses, assets and liabilities.

Money tends to flow between the above quadrants – your income will fund your expenses and will take care of the full or part purchase of any assets you may buy.

Part purchase of assets can be supported by taking on liabilities.
Your liability payments are in turn again funded by your income.

Thus, the most important way to generate wealth is to live within or preferably below your means by keeping an eye on your money flow. For this, you need to first be aware of what your means are and what you are spending your money on.

The use of a personal budget is the simplest and quickest way of analyzing whether you are a spender, or a saver.

Step 1

Be aware of your Net Monthly Income (post tax).
This can be more than just your pay packet. You can be receiving income from rent, from interest, from dividends and so on.

Step 2

Make note of your Expenses.
The main Expense items that show up in everybody's budgets are:

- ✓ Grocery bill
- ✓ Spending on children's school / college tuition fees
- ✓ Shopping and entertainment, including eating out
- ✓ Electricity bill
- ✓ Travelling / fuel expense
- ✓ Telephone and cell phone bills
- ✓ Medical expense
- ✓ Miscellaneous expenses such as society charges if you own a home and others

Often, part of one's cash outflow is for expenses and the other part is to fund existing liabilities. So we come to Step 3.

Step 3

Keep track of your Liabilities
The main Liabilities that people can have are:

- ✓ Home Loan (the biggest and longest EMIs you will ever have to pay)
- ✓ Education Loan
- ✓ Car Loan
- ✓ Personal Loan

Cash outflows that go towards repayment of existing liabilities such as home and car loans, are funding the respective asset purchases.

For example, EMI payments are regular, and significant, outflows from your monthly income. Be aware of the rate of interest on each of your liability, whether you can avail a better rate elsewhere, and know the tenure of your loan.

Step 4

Invest your Net Free Cash to build your wealth
The free cash you have left after your expenses are taken care of is your net free cash. This is the money that will go towards building wealth for your financial goals and accumulating assets. And this is the most important part of your money life.

It is these 'leftover' funds, also known as your investible surplus that will build your wealth. So if you find yourself in a situation where your investible surplus is low, or close to nil, you need to very quickly rectify the situation. The only way to do that is to cut back on unnecessary expenditures i.e. expenditure that is not on a necessity.

Remember – it is better to first invest, and then spend out of what is left, rather than to first spend, and then invest out of what is left.

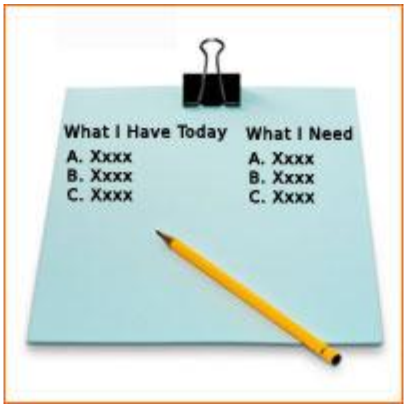
But the beginning of all this is to start keeping track. Maintain your budget. You can use *Personal*FN's free online tool – MyPlanner – to start maintaining your personal budget. Your budget will help you monitor and track your money flow on a month on month basis. You will be able to see how much of your money is spent on necessities, and how much on luxuries. By the end of one month, you will have greater awareness on where your money is going and you will be able to streamline your expenses to increase your investments, ultimately building more wealth.

Go over your cash flows for the month and see how your money is flowing between your four segments.

Also, test the 3 financial rules on yourself – assess your savings to income ratio, your debt to income ratio (if you have liabilities) and see if you have enough of a contingency reserve set aside.

Now that you know where you stand financially today, you can put down on paper where you want to reach.

Where do You Want to Reach?



Now that you have come this far – two things will be clear.

The first is that you need to set a target of where you want to reach in life – list out the things you want to achieve. You need to determine your financial goals.

The second should be that the more you are aware and knowledgeable of your finances, the better they will perform. Everybody would benefit from improving their financial literacy.

Let us address the first factor:

Determining Your Financial Goals

We all live and strive for certain goals in life. Goals and objectives provide focus, purpose and vision to the financial planning process. By setting your financial goals you will be able to define your priorities, establish a direction and identify the results that you expect to achieve.

When listing down your financial goals, take care to make your goals measurable, realistic and time bound.

STEP 1

Identifying Your Financial Goals

Common financial goals can include:

- ✓ Purchase of home
- ✓ Purchase of Car
- ✓ Child's Education
- ✓ Supporting your parents
- ✓ Child's Marriage
- ✓ Retirement
- ✓ Vacation
- ✓ Buying Holiday Home
- ✓ Wealth Accumulation
- ✓ Creating Trusts
- ✓ Charity / philanthropy

STEP 2

Classify financial goals based on their priority and proximity

- Short term (less than 3 years)
- Medium term (3 to 5 years)
- Long term (more than 5 years)

This will help you to know what goals are to be met first and therefore channelize your investments accordingly, based on the time to the goal and your risk profile.

A simple table such as the one ahead will help you decide which goals are the most important (priority) and also see which ones are urgent (proximity).

GOAL	PRIORITY	TIME TILL GOAL OCCURS
Child's College Education	High	9 years
Child's Marriage	Medium	12 years
Retirement	High	15 years
Foreign Vacation	Low	16 years

STEP 3

Quantifying your Goals

If a goal is not quantified, it becomes very difficult to select a path to achieve it. Again this can be divided into two parts, minimum and maximum. For example, you may have a goal of funding your child's higher education.

For this you can consider two scenarios.

The first scenario, of your child being educated in India, may be the minimum that you need to achieve. For this, the fees may be ₹10 lakhs.

Maximum amount for the goal would be sending your child abroad for further studies. For this, the fees may be ₹25 lakhs.

Now you know that the minimum you need to achieve is ₹10 lakhs in today's terms. You can start investing accordingly.

STEP 4

Plan and Invest towards Your Goals

Once your goals are quantified i.e. you have a tenure, an amount and a clear idea of your goals of retirement, child's education and marriage, asset purchase and others, it is time to actually plan for these goals.

Remember, your goals should be

SMART **S**pecific, **M**easurable, **A**ttainable, **R**elevant, **T**ime-Bound

Also note that conflicting goals are a fact of everyone's life. You must do the best you can to resolve this difficulty by allocating your available resources in the most efficient manner possible to those goals that have the highest priority. For example, spending on a lavish wedding for your child should be given lower priority than planning for your own safe retirement.

You must also evaluate your investment progress regularly.

If the progress towards the goal is not satisfactory then one or more of the following options can be exercised:

- ✓ *Review your investments and alter specific investment amounts / investment instruments*
- ✓ *Push the goal further back, where possible. For example, if you are planning to retire at 50, consider retiring at 55 instead, giving yourself more earning years.*
- ✓ *Reduce the goal corpus that is required. If you wanted to buy a house for ₹75 lakhs, consider a house for ₹60 lakhs.*

Setting your Goals is typically not an ongoing process. You can set your goals and begin working towards them. Review of progress towards your goals can happen typically once a year.

But what is an ongoing process is improving your own personal financial literacy. This is the second step you should take to get to where you want to reach.

Improving Personal Financial Literacy

The ultimate goal of improving your personal financial literacy is to make smart money decisions and improve your financial well-being.

Financial knowledge and awareness can help you take mature decisions on every topic of personal finance from your expenses, savings, budgeting to using plastic money wisely. Each of these decisions has an impact on your finances overall, and hence the ability to make good financial decisions is very important.

For example, many people lack the resources to help them rebound from the downturns of the

type witnessed in 2008. This would have been avoided by having access to safe savings products by way of a contingency fund. Creating a contingency fund of 6 – 24 months of your living expenses is good sense, and is a good financial habit.

Many investors were made to believe that insurance products such as ULIPs are the first place they should be investing their surplus funds, however this is a classic case of mis-selling which investors fall prey to. Had these investors been aware of the charges in the product such as the premium allocation charges, surrender charges, and so on that impact the returns of the product and can have a negative impact on the financial life of the product owner, they would not have opted for such products. This is where awareness and strong personal financial literacy would have helped.

Most of us will make many financial decisions including saving for retirement, managing our credit wisely, budgeting, tax and estate planning, insurance etc. which will affect our lives. Each of these decisions is prompted by our own individual needs.

To help make profitable financial decisions, it is necessary to understand the basic purpose of investing.

Example: While most consumers understand that retirement implies the end of work-related income, they may often fail to understand that as a person grows older; his ability to recover any financial losses goes down. It is this knowledge that can truly inspire the decision to save so that you take less risk with your retirement funds.

Improving your personal financial literacy will not only enhance your financial freedom, but also over time provide financial security and stability.

So how do you improve your personal financial literacy?

1. Start by building up your financial awareness – you can read good personal finance websites, newsletters and read the financial newspapers. Warning: there is a lot of noise out there, choose only those information channels that give you impactful information.

2. If there is something you want to understand about a product but don't have anyone whom you can ask, you can always do an internet search on the product and read up on its features. But be sure to access the right information from a website which verifies its information, such as a news website or an independent research website. Avoid reading personal blogs as these are simply an amalgamation of people's opinions and may or may not be based on fact.

3. Speak to your unbiased Financial Planner to give you an honest view on whether a particular financial decision is the right one to make or not.

The more information you gather, the more you will have on hand to make an informed financial decision. Every single informed decision you make will go towards making the most of your financial plan.

III: Basic Elements in Financial Planning

"The distance is nothing; it is only the first step that seems difficult."

Madame Marie du Deffand

Let's get right down to it. What are the basic things that you need to know to make your financial plan?

By now you would have assessed where you stand today, and you would also have identified and quantified your goals so, unlike Alice, you know where you want to go.
For example: Mr. Verma has the following goals:

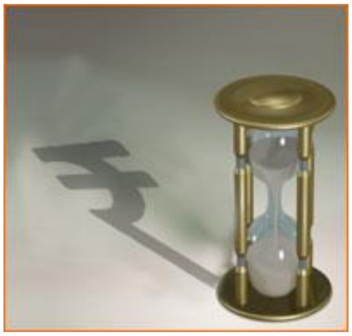
GOAL	YEAR OF GOAL	YEARS TO GOAL	AMOUNT REQUIRED IN TODAY'S TERMS (₹)
Son's Graduation	2020	10	10 lakhs
Daughter's Graduation	2023	13	10 lakhs
Daughter's Marriage	2028	8	5 lakhs
Son's Marriage	2030	20	5 lakhs
Own Retirement	2035	25	Approximately 7.50 cr*

**Mr. Verma has calculated the retirement corpus he requires using PersonalFN's Retirement Calculator*

Now you need to start investing towards these goals based on the goal priorities you have decided.

The first thing you need to know is the Time Value of Money.

Time Value of Money



You may have heard the phrase 'Time is Money'.
Now you will see exactly how true this is.

Let's say that for example you have won ₹50 lakh in a lottery.
Given a choice, would you take the ₹50 lakh as a lump sum in one shot immediately?
Or would you prefer to receive it in equal yearly installments of ₹5 lakh over the next 10 years?

If you are like most people, you will have taken the money immediately. And this is the right decision.
This is because of the Time Value of Money (TVM).

$FV = PV \times (1+R)^N$

FV: Future Value
PV: Present Value
R: rate of return
N: Number of time periods for which the money is invested

Money that is available today is worth more than money available at a later date, because you can invest it and earn a return / interest on it.

So, for example, if you had ₹50 lakh available today, and you invested it into a 1 year Bank Fixed Deposit offering 7.50%, then in 1 year your money would be worth ₹53.75 lakhs.

In your day to day life, the money you can save and invest is the Present Value in your equation.

R is the available market rate of interest – this is not in our control – available investments offer certain approximate rates of return, and what you can do is choose your investment instrument carefully.

So the best thing that can be done that is in your control is increase your N i.e. increase your investing time horizon.

The earlier you start investing, the higher will be your N, and the greater will be your money's Future Value.

Let's take an example of 2 friends – Pooja and Amit.

Pooja starts investing at the age of 20.
Every year she invests ₹1000 into an equity mutual fund. She stops investing after 20 years.
Amit starts investing at the age of 30.
Every year he invests ₹3,000 into an equity mutual fund. He also stops investing after 20 years.

Assuming they both earn the same rate of return on their investment (i.e. 15% p.a.), who do you think will accumulate more wealth by their age of 60?

The answer is Pooja.
Her investment of ₹1,000 per year for 20 years grows to ₹19.28 lakhs by her age of 60.
Amit's investment of ₹3,000 per year for 20 years grows to ₹14.28 lakhs by his age of 60.

By beginning early, Pooja has given her investment the gift of time.

Increasing your time horizon is the best thing you can do to amass more wealth.

This brings us to the Power of Compounding – something Einstein referred to as the Eighth Wonder of The World – with good reason.

You know now that the higher R you can earn and the longer N you can invest for, the larger will be your Future Value of money.

Let's see an example with different rate of return (R) and different investment horizons (N). Assuming your Present Value i.e. the sum you can invest is ₹1,000:

At end of Year	Savings A/c (3.50%)	Bank FD (7%)	Corporate FD (11%)	Equity Mutual Funds (15%)
Year 1	1,030	1,070	1,110	1,150
Year 5	1,159	1,403	1,685	2,011
Year 10	1,344	1,967	2,839	4,046
Year 15	1,558	2,759	4,785	8,137

The above table indicates that for the longer N, equity is a better investment than a fixed income instrument. It is not prudent to let your wealth lie in a low return instrument when your investment horizon is long. Also while over small time periods, the difference due to higher rates of return is not very huge, it is over *longer time periods* that the impact is very significant.

Disciplined and Regular Investing

The most convenient and one of the easiest ways to accumulate wealth is by investing regularly and in a disciplined manner.

This can be done into any asset class, for example when investing into fixed income you can opt for a recurring deposit, or investing into mutual funds whether equity or debt can be done with systematic investments.

But if investing over a long period of time, the asset class that grows your wealth the most is equity.

Often while investing, investors seek the perfect entry and exit point of the market – which amounts to nothing but market timing.

However, it is often very difficult if not impossible to regularly be correct in predicting market fluctuations, and thus know exactly when to enter and to exit.

The benefits of investing via a Systematic Investment Plan (SIP) are as follows:

- ✓ Your investment can be as low as ₹500 per installment – no need for a lump sum of wealth to be accumulated and invested
- ✓ It is absolutely important to invest regularly, and to stay focused when investing – and to keep investing into the right instrument. Investing via an SIP inculcates the very good habit of discipline in investing. It ensures that you will save a certain amount of money every month to invest, thanks to the ECS facility. It ensures that your investments go in regularly regardless of the state of the markets.
- ✓ It removes the need of timing the market. Since you are investing on a fixed date every month, you will get the benefit of cost averaging over long time periods.

So remember, the SIP route will help you answer the question of ‘when to invest’ in the markets. You only need to be very regular with your investments, and remember that market lows will help you buy more units. This is when your SIP will give you the maximum benefit.

We have now seen how giving your investments the gift of time and investing regularly and in a disciplined manner will be beneficial for your financial goals and help your financial plan be on track. Let’s move on to seeing what it is that can harm your financial plan.

How Inflation can affect your Plan

Purchasing power is the number of goods or services that one unit of currency can purchase. It is literally, the power to purchase.

For example, one rupee can purchase much less today than it could purchase say twenty years ago. If your money income stays the same, but the prices of goods or services increases, then the purchasing power of your income is reduced.

This increase in the price level is called Inflation.

Your real income refers to your income, adjusted for inflation.

Thus inflation is the increase in prices that erodes the purchasing power of your money. And this is by far the most important thing to account for when building your financial plan.

Let us see some scenarios where inflation has affected our financial goals.

Scenario 1

Mr. Gupta has a 6 year old daughter. He plans to send his daughter to college for graduation at age 18 and post graduation at age 21, for which he will spend ₹10 lakhs and ₹25 lakhs respectively.

What corpus does Mr. Gupta need to accumulate for his daughter's education goals?

Assuming that inflation in college fees is approximately 10% p.a:

If Mr. Gupta's daughter goes to college at age 18 i.e. in 12 years, college fees at that time will be approximately ₹31.40 lakhs.

This is the amount Mr. Gupta has to accumulate in 12 years to send his daughter for the same standard of college education available today at ₹10 lakhs.

Similarly, for his daughter's post graduation, in 15 years Mr. Gupta needs to accumulate approximately ₹1.04 crore to give the same level of post graduate education available for ₹25 lakhs today.

This is the effect inflation has had on college education fees.

Scenario 2

Mrs. Kapoor is currently 30 years old and wants to retire early – by the age of 50. On retirement, she wants to maintain her current lifestyle. She is currently spending approximately ₹20,000 a month on household expenses, and approximately ₹3 lakhs per annum on travel, medical and discretionary expenditure.

What corpus does she need to live her life post retirement?

In order to maintain her current lifestyle, and assuming her post retirement life expectancy is another 35 years, Mrs. Kapoor will need ₹13 crores to sustain her current lifestyle.

She can invest this ₹13 crore corpus into safe debt instruments and earn a 5.50% post tax interest on the amount. Both principal and interest will go towards sustaining her lifestyle for 35 years post retirement. At her 85th year (assuming 85 years life expectancy) there will be no money left at all.

This is assuming a simple 7% rate of inflation on household expenditure, and a 10% rate of inflation on other expenditure.

This is the effect that inflation can, *and will*, have on your financial life.

Want to know how much you require to retire? Use PersonalFN's Retirement Calculator

To see how inflation can burn the value of your money, simply see what happens if you invest in instruments that don't match or beat inflation.

Let's take a figure of ₹10,000.

Assume an inflation rate of 10% and take a time period of 20 years.
In 20 years, you will need a figure of ₹67,275 to have the same purchasing power as your ₹10,000 today.

You have 3 choices of where to invest your ₹10,000 today – the bank savings account, a debt mutual fund, and an equity mutual fund.
Let's see how each one fares against an inflation rate of 10%.

INSTRUMENT INVESTED IN	FUTURE VALUE
SAVINGS ACCOUNT (3%)	₹18,061
DEBT (7.50%)	₹42,479
EQUITY (15%)	₹163,665

The amount you require to simply keep the purchasing power of your money constant is ₹67,275. Inflation at 10% has eaten into the value of your money so much that over 20 years, even investing in a debt product at 7.50% p.a. is not enough. You need to earn at least 10% every year to just match inflation and keep the purchasing power of your money intact.
In the table above, it is only equity earning 15% p.a. that matches and beats inflation. You can also match and beat inflation by investing into a mix of equity and debt instruments i.e. diversifying your investments across different asset classes. This brings us to asset allocation.

Building Wealth with Wise Investing

Rome was not built in a day. In the similar manner it is not possible to build enough wealth to achieve financial goals overnight. Achieving a financial goal is a gradual process with series of considered investment decisions.

Almost everyone can accumulate significant wealth over a long period of time by wise investing.

And it doesn't take a significant lump sum of money to start investing, all it takes is good sense, and some portion of your income, over a long period of time.

Wise Investing is not about timing markets or investing in debt when interest rates are at all-time high. It is about being disciplined about investments. Wise investing is all about having a peaceful sleep at night after investing. It is about knowing that you are steadily working towards building the level of wealth you require to achieve all your financial goals.

Here are a few points to be kept in mind before investing:

- ✓ Realistically assess what your investible surplus is – the amount of money you have left after you have set aside enough to run your house and maintain a contingency fund. You will need to take a good look at your finances and the disposable income you have available.

- ✓ Assess your risk appetite and your risk tolerance. It is possible that you are the kind of risk taker that would risk a 50% loss, if the upside means a 50% gain. But can your finances tolerate this level of risk? Or would it be financially easier to handle a smaller gain that comes from risking less?

- ✓ Speak to an unbiased advisor before investing. This is the best way to get a professional view of the investment you are considering. Better yet, ask your advisor what would be a good investment for you to make, considering the various financial goals you want to achieve.

- ✓ Make sure you don't put all your money in one place. Diversification of your portfolio across different asset classes such as equity, debt property and gold is a good way to reduce exposure to the risks of any one asset class.

- ✓ And lastly, to build your wealth, invest your money first and spend what you have left. This is a much better approach than doing things the other way around.

Importance of Asset Allocation

Asset allocation may sound like a complicated concept, but it is really very simple.

As the phrase suggests, it means allocating your investments across various investment avenues or assets so that the poor performance of any one asset does not affect the overall performance of the entire portfolio. Different asset classes are differently correlated with one another. For example, when equity does well, debt or gold may not do well, and vice versa. It is this different correlation that makes asset allocation such a critical component of financial planning.

Asset Allocation depends upon the following factors:

- ✓ Your risk profile (appetite and tolerance)
- ✓ Your financial goal time horizon

Typically, determining the right asset allocation for you is best done by your personal financial planner.

To give a broad idea, let us consider two individuals Mr. Reddy and Mr. Singh.

Mr. Reddy is a 30 year old male who is married and has no children. He wishes to plan for his retirement, and so his goal time horizon is 25 to 30 years.

Mr. Singh on the other hand is 45 years old, married and with a 10 year old child. His goals include buying a house i.e. accumulating a down payment in 5 years, sending his son to college in 8 years, and planning for his own retirement in 15 years.

Asset Allocation for Mr. Reddy and Mr. Singh are as follows:

ASSET CLASS	Mr. Reddy	Mr. Singh
EQUITY	70%	55%
DEBT	10%	30%
GOLD	15%	10%
CASH / LIQUID FUNDS	5%	5%

My Reddy already has his own house and hence his allocation to real estate is simply the value of his own home.

Mr. Singh is buying a home for which he is accumulating down-payment funds. When he purchases the home he will be buying real estate and hence adding real estate to his asset classes.

Mr. Singh has a lower exposure to equity due to the higher number of goals, their comparative nearness in terms of years, and his higher age which reduces his risk appetite and tolerance.

Mr. Reddy on the other hand has higher exposure to equity, a riskier investment, because his only goal is retirement, and the time horizon of the goal is 25 to 30 years i.e. long term.

But remember, asset allocation is not a one-time process. It is not static, but dynamic. As your goal draws nearer, it is important to re-assess your asset allocation and withdraw from risky investments – to de-risk your goal's portfolio.

You can now decide what your asset allocation should be for each of your goals. Here are some guidelines you can follow:

- ✓ If your goal is more than 10 years away, you can invest up to 70 – 75% of your investible funds into equity, depending on your risk profile. The remainder of your investment can be put into debt (15 to 20%) and gold ETFs (around 10%).
- ✓ As your goal comes closer, for example when your goal is 6 years away, you can maintain an asset allocation of 60% in equity, 30% in debt and 10% in gold ETFs.
- ✓ When your goal is less than 3 years away, it would be wise to not expose the corpus to equity market volatility. Maintain a 100% exposure to fixed income instruments.

Remember, those investors who were invested in equity when the markets crashed in 2008, and had a goal such as their child's education or their own retirement less than 3 years away, have had to watch their goal funds get eaten away in the market crash. They also may not have had enough time to rebuild their goal corpus. This is why it is absolutely essential to de-risk your goal portfolio as your goal draws nearer. So the first step of building your wealth with wise investing is to maintain the right asset allocation based on your goal time horizon.

Do you want to know what your asset allocation should be? Use Our Asset Allocator

What's Your Risk Appetite? What's Your Risk Tolerance?

The second step to building your wealth with wise investing is to invest keeping in mind your own risk profile. Your risk profile is made up of two components – your risk appetite and your risk tolerance.

Often in financial planning, we hear the phrase 'risk appetite'. But what does this really mean and is it all that we need to consider?

Risk appetite simply refers to how much risk one is *willing to accept*.
Risk 'tolerance' on the other hand indicates *how much risk our finances can handle*.
The two might be very different.

For example, Mr. Patel might be a young man, married with a child on the way. His risk appetite may be high. This may be based on his investing tendencies, in case he has done well with equity in the past he is confident to do well in the future also and hence has a high appetite for risk.

However, based on his financial situation which comprises factors such as level of contingency he maintains, if he has any EMIs that are eating into his income and so on), his risk *tolerance* might be very low indeed.

You should assess your own risk profile to know where you stand vis-à-vis your own risk appetite and risk tolerance.

Sometimes we can do everything that is necessary to provide financial safety, but situations may still arise that take us out of our financial comfort zone. There may be a financial emergency or an urgent requirement for funds. There are two ways to deal with such a situation.

The first way to prepare for a financial emergency is to have a contingency reserve of 6 to 12 months of your total living expenses (including EMIs if any). This can be maintained in a liquid fund and partly in a savings bank account for quick access.

The second thing that will help in such situations is having the right kind of insurance. We will deal with this ahead.

IV: Why Insurance is so Important to Your Financial Health

"Precaution is better than cure."

Edward Coke

What is insurance?

Insurance in its purest sense is protection against a financial loss / uncertainty which includes the risk of illness, disability, damage to property, and the most final of them all – one's demise.

The value of your loved one's life is a very sensitive issue as your loved ones are priceless.

But it becomes necessary to evaluate a human life in terms of money, in order to safeguard from problems caused by under-insurance.

Human Life Value (HLV) of an earning member in the family could be defined as the amount that the family would require to retain the same standard of living in the absence of the earning member. This would be the maximum amount for which a person can seek insurance protection. The amount of insurance you require can be calculated in a few different ways –but a comprehensive method of calculating this is the *Personal*FN's HLV method.

How to calculate HLV

The first step towards calculation of HLV would be to determine the net annual income of the person after deducting the amount spent by him for his personal use. This amount will be the amount that he affords to his family annually.

For Example:

Mr. Sinha, aged 40 years, earns ₹15,00,000 per annum and spends ₹4,50,000 per annum on himself. Hence, he earns a net income of ₹10,50,000 p.a. for his family. Therefore, as income replacement, his family would require ₹10,50,000 p.a. for 1 year of life expenses. Each year, with inflation, the family's expenses would proportionately increase, which must also be taken into account.

The calculation will also include specific goal related expenditure.

For example, suppose Mr. Sinha has a son and a daughter both of whom would require ₹10 lakhs for their educations i.e. a total of ₹20 lakhs. In Mr. Sinha's absence, this amount is still required such that the children's educations do not suffer. Hence this goal amount can be added to the financial value of Mr. Sinha's life.

Once the HLV has been calculated, the next step is to choose the appropriate insurance product to cover your needs. There are a number of insurance products available in the market today – from term plans to ULIPs to endowment plans and so on. It is important to assess the available products and select the right insurance for your needs. At *Personal*FN – we recommend opting for pure term plans.

Term Plans

A term policy is a simple pure life insurance which provides a sum assured in case of the policy holder's unfortunate demise. Most people are not in favour of a term policy, as there is only a death benefit. Also, it is believed that since the insurance is available only for a particular term after which there is no cover, it is not a comprehensive policy.

But the reality is that term policies are the purest form of insurance available today. They are very cheap compared to other insurance policies.

Endowment Policies

These are traditional policies floated by Insurance companies.

An endowment policy covers risk for a specified period, at the end of which the sum assured is paid back to the policyholder, along with the bonus accumulated during the term of the policy.

The returns on endowment policies are typically very low – approximately 3% to 4% per annum – and often do not beat inflation.

Unit Linked Insurance Plans

These are insurance policies with an investment component. In these policies, the policy holder pays premiums (or a single premium) of which part of the money is invested and another part goes towards providing the life insurance cover.

ULIPs therefore combine insurance protection with wealth creation opportunities.

What should you opt for?

It is recommended to always opt for a pure insurance product rather than combining insurance with investments such as what is done by way of marked linked insurance policies i.e. ULIPs etc.

Also, it is seen that traditional policies such as endowment policies and money back policies provide very poor returns, giving a yield of 3 to 3.50% per annum over the entire term. This does not even match inflation and hence it is not recommended to take these products. Products like ULIPs and the like have hidden charges and high commissions, which lead to an inefficient use of your funds which could otherwise have been invested. Until these products become transparent, it is not advisable to opt for them.

At *Personal*FN, we believe taking a straightforward term policy is the best insurance you can take.

It is also advisable to opt for the following policies, in addition to your term policy:

- ✓ Health Insurance (Mediclaim) – this is a must have for every family member. It can be taken as an individual policy or as a family floater. This will cover regular hospital expenses in case of any hospitalization.
- ✓ Personal Accident Policy – this will cover you from loss of income in case of an accident. This is a common policy for those who are employed as the policy partly covers you from loss of income.
- ✓ Critical Illness policy – this will pay out a lump sum upon diagnosis of any critical illness from the defined list of illnesses stipulated. This policy can be opted for by any member of the family – it is not meant only for people who are employed as a critical illness might strike anyone, and costs incurred in case of such illnesses can be very high.

It is advisable to opt for insurance because it is a cover from risk – and while you might believe that something will not 'happen to you' – that is often exactly what your neighbor is thinking. In case of an unfortunate circumstance, insurance can be a financial boon to you or your family members.

V: How to Build your Wealth with a Loan

"When I look at an investment, I don't ask myself, "Can I afford this property?" Instead I ask myself, "How can I strategically use loans to help pay for this investment in a way that enhances my overall return without taking on more risk?"

Michael Yardley

Personal Finance debt, i.e. taking a loan, can be a great tool to build your wealth.

Loans can offer you many benefits, for example home and car loans help you achieve the financial goal of buying a home or a car (by making payments over a period of time) without having to wait and save enough to make an outright purchase.

However loans are often misconstrued as an instrument for the non-wealthy, when this is indeed not the case. Wealthy investors often use loans to help themselves get even wealthier.

Where loans are concerned, you might find that you are one of two broad types of individuals. Each type has a unique viewpoint when it comes to taking a loan.

First, there are the emotional extremes - those individuals who either dislike loans so much that they will not borrow even a rupee, or those who like loans so much that they have over-leveraged themselves and might be now struggling under their EMI burden.

Second, there are the ‘I’ll Take It, But I Won’t Like It’ individuals.
These are the ones that take a middle approach when dealing with their liability. Once they have taken the loan because they need it – the logical step, they then do their best to repay / prepay it as quickly as possible because of the mental or emotional discomfort caused by being ‘in debt’. Most of us find ourselves in this second category.

The simple truth of the matter however, is a very factual truth.

A loan is simply the borrowing of funds, to be used for a particular purpose.
Loans will simply give you the opportunity to incur the expenditure (for example, buy the house or the car) that you wish to incur, when you wish to incur it, and repay the amount a little at a time every month, over a specified tenure.

In this section, we will cover 3 aspects to personal finance debt.

- ✓ Different Kinds of Loans Available, and How to Ensure You Don't Over-Borrow
- ✓ Why it is sometimes Not better to prepay your loan
- ✓ What to do when you find yourself in too much debt

Different Kinds of Loans Available and How to Ensure You Don't Over-Borrow

Unsecured Loans

An unsecured loan refers to any kind of loan that is not attached by a lien on any of your specific assets. This means that in case you default on the loan due to bankruptcy or any other reason, the unsecured debt lender does not have the right to claim any specific asset. An example of this is credit card debt or perhaps a personal loan from a friend or relative.

Secured Loans

A secured loan is one where you, the borrower, pledge some asset of yours as collateral to the loan. This means that in case of bankruptcy or any other reason for defaulting on the loan, the lender of your secured debt has the right to take possession of the asset (known as repossession) , and sell it to recover some of his loss. An example of this is your car loan and home loan.

Thus there are many options of loans and different lenders (from banks to housing finance companies to your relatives), which can help you take a loan when you need one. You need to ensure however that you don't over-borrow and put a strain on your finances.

There is a simple way to check whether you are over-leveraged or not.

It is the **Debt to Income Ratio,** which has also been mentioned in our earlier chapter on **Measuring Your Financial Health.**

As discussed, this ratio is simply the sum of your monthly outgoings (EMIs) on your liabilities, divided by your total fixed monthly income. It ideally should not be more than 0.3 (or 30%), else you may be putting a strain on your income to service your debt.

Why It Is Sometimes NOT Better To Prepay Your Loan

At *Personal*FN we have come across many clients, who once they have taken a loan, prefer to prepay it as soon as possible because the idea of being 'in debt' is not comfortable for them. This is a personal matter and while there is no question that these clients are genuinely feeling uncomfortable about the loan – it does not necessarily make financial sense to prepay as early as possible.

The reason is simply the opportunity cost of your money. This means, if you have a loan which is charging you interest at 12% p.a., and you suddenly come into some surplus funds which you can either use to prepay all or part of your loan, or to invest, the first thing you need to do is check the opportunity cost of these surplus funds.

Would it make more sense to prepay the 12% interest loan, and thereby save yourself from paying the 12% interest?

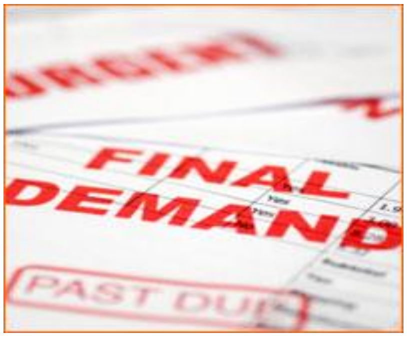
Or would it make more sense to invest the funds into an investment instrument that would earn you more than 12% - based on your risk appetite and time horizon?

So remember, if there is an investment instrument which would give you a long term rate of return that is higher than the rate of interest you are paying on your loan, it would be financially more prudent to invest the funds and earn the higher rate of return, than to prepay the loan (in full or in part) and save yourself the lower rate of interest.

For more information on this, please see our article titled **Home Loan Dilemma: To Prepay Or Not To Prepay**

Now we come to our final part of personal finance debt.

What to Do When You Find Yourself in Too Much Debt



Getting into debt seems to be a very easy thing to do. After all, almost everybody at some point in their lives takes a significant loan or builds up some form of debt i.e. credit card debt, home loan, personal loan, car loans, or even a combination of these loans.

If you find yourself in a situation where you feel like there is too much debt to handle and you need to get out from under the debt as soon as possible, there are some simple steps that will certainly help:

Breathe

It might feel like this is a great burden, and perhaps it is indeed taking a toll on your finances, but worrying about it will not make it go away.
The first thing you need to do is realize that you need to take control of the situation – and the steps to do so and very simple and straightforward. Also remember, this is not an uncommon situation, it happens to a lot of people and everybody gets out of it by taking very simple baby steps towards a solution.

Do Not Increase Your Liabilities

If you find that you are already stretched, you may find that well-wishers are advising you to take another loan to pay off your existing loan – and then worry about that loan later.
This would not be a good idea. You would simply be delaying the time when you do have to sit down and pay off the debt. The most important thing to do is to not add to your existing liabilities by taking on more loans. Once the existing liabilities are cleared, if you find that you need to take another loan – make sure it is easily serviceable by your existing, fixed monthly income, and the terms (tenure, rate of interest) are suitable to you. But that is only after your existing liabilities have been cleared.

Take Stock of Your Liabilities

Maintain a Personal Budget. This simple and under-rated tool is an excellent resource in your battle against debt – and by maintaining a good personal budget, success against debt is practically at your door.

A personal budget will help you know the following:

- ✓ Your exact cash flows i.e. your fixed monthly incomes and all your monthly expenses. Once you know your expenses, you can see where you are spending on luxuries – and rationalize this portion. Spend on the necessities only, save the rest. Calculate an approximate figure of how much extra money you can save each month – and allocate it towards a debt repayment fund. Use these funds to pay off your debt a little at a time. You can reward your family and yourself once the debt has been cleared.

- ✓ Your exact liabilities
  You can track exactly what debts you have and all their details – after all, knowing your enemy is half the battle won!

Create a table which contains the types of loans you have taken, each loan's outstanding tenure, EMI, rate of interest and outstanding amount. If any of the loans are collateralized / a secured loan i.e. you have it backed it with one of your assets – you might want to clear this one first.

The rule to be followed (and every rule has its own exceptions) is pay off the highest interest rate debt first. This is the one that is costing you the most. Typically, this is credit card debt.

A Home Loan might be for the largest amount, but it is not costing you as much per rupee as your credit card debt.

Restructure your Loans

This can be done in two ways.

First, restructure for a Lower Interest Rate

Speak to each one of your lenders. Explain that you have a genuine interest in repaying the debt. Most lenders would rather restructure your loan i.e. change the terms of your loan, than turn you into a 'bad debt' on their books and lose the money altogether – although in the case of a home loan it is you who will be losing the home if you don't pay the EMIs on time.

Try to refinance such that you get a lower rate of interest as well as a lower tenure. Most individuals end up getting a lower interest rate i.e. lower EMIs, but a longer tenure, thereby paying back the same or perhaps a higher amount in the long term. This would be helpful if you need to ease the current strain on your cash flows by reducing your EMI.

Also remember, if you are refinancing a home loan, there are conditions and payments which need to be considered such as minimum number of EMIs paid on the existing home loan, prepayment penalty by the existing home loan lender and processing fees paid to the new home loan lender.

If the new home loan is cheaper and the savings by lower EMIs are greater than the fees you may incur, then refinancing your home loan is a suitable option for you.

Secondly, see if a Balance Transfer is Suitable

For credit card debt, you can opt for a balance transfer. But this is to be done carefully.

There are a number of schemes in the market where you can transfer your outstanding balance on your existing credit card to a brand new credit card with as low as a 0% interest rate! But these rates are introductory only – i.e. they will last perhaps 3 to 6 months. Thereafter, the rate charged on the new credit card will increase to the pre-stipulated rate. This will probably be lower than your existing credit card rate of interest, but ensure that this is indeed the case.

If you have debt on more than one high interest credit card, transferring the balances on these cards to a new credit card with a lower rate of interest will not only save you additional interest payment, but will also take away the mental pressure of paying more than 1 credit card amount each month.
Also note that if you add an outstanding amount to a new credit card, your available credit limit on the new card goes down by the amount of the transfer.

Be The Tortoise from The Tortoise and The Hare

Slow and steady wins the race. It may seem like a difficult task, but a little financial prudence, higher savings and on-schedule EMI payments will steadily reduce your debt. Just keep going and remember to repay as much as you can on a regular basis.

So remember, to get out of debt, your family and you may need to reduce some regular but unnecessary expenses such as dining out and extravagant purchases.

Keep yourselves motivated to go on by planning an occasional family treat to celebrate your progress on the road to being debt-free! Keep up the good work and soon you will find that what felt like a major burden was easily overcome with a little financial discipline.

We have now seen that personal debt can be a good tool to build your wealth, as it helps you have access to funds that you may not have access to without the loan, which you can repay in installments over time. There need not be an emotional approach to taking a loan. And as long as you keep an eye on your personal financial health, you will not find yourself in more debt than you can handle.

VI: Planning For Life Events

"By failing to prepare, you are preparing to fail."

Benjamin Franklin

We have now covered the basics of financial planning. That is, we have looked in some detail at concepts such as the time value of money, how inflation can affect your goals, what should be your asset allocation and how to check your risk profile, how to set your goals, goal future value calculation, the need for contingency funds and the need for insurance.

Now let us see how some people set out to achieve their goals. After all, financial planning is all about planning for and achieving your financial goals.

Over the earlier chapters of this Guide we have so far seen intermittent examples of goals in our chapters on inflation and time value of money, now we will go into specific examples of common goals – starting with the most common goal of all – Retirement.

Retirement Planning

Let's assume the case of Mr. Roy.

Mr. Roy is aged 45 and currently is working with ABC Ltd. as a software developer. He is earning ₹60,000 p.m. He wishes to retire at age 55.
His current house hold expenditure is ₹25,000 per month.
Over and above this he requires ₹75,000 a year for an annual vacation with his family and ₹25,000 a year for medical expenses.

He wishes to maintain the same level of life-style post his retirement.
He has assumed his life expectancy as 85 years.

His children are already educated and he has no other goals.
He is adequately insured and has created a contingency corpus of 12 months of living expenses and is maintaining this corpus in liquid funds and partly as cash in the bank.

As he is nearing retirement, Mr. Roy is worried about how much corpus he is going to need and whether or not he will be able to build this corpus in his remaining 10 working years.

Mr. Roy's age	45 years
Retirement Age	55 years
Life Expectancy	85 years
Current Monthly Expenditure	₹25,000
Annual Expenditure (Vacation)	₹75,000
Annual Expenditure (Medical)	₹25,000
Inflation (household)	7%
Inflation (Vacation, medical)	10%

Corpus Required at retirement	**₹4,58,22,785**

So now Mr. Roy knows he needs to achieve a corpus of ₹4.58 crore to maintain his lifestyle in his post retirement period. The next question in Mr. Roy's mind is to how to achieve this corpus.

He is expecting to get gratuity of ₹25 lakhs and expects his EPF maturity to be ₹48 lakhs.

Over and above this, keeping retirement in mind he has invested ₹12 lakhs in mutual funds (current value) so far and has allotted his ancestral property of ₹50 lakhs (current value) to his retirement goal.

He also has ₹35,000 surplus savings per month that can be invested towards his retirement.
How much will his total achievable corpus be at retirement?

Gratuity at retirement	₹25,00,000
EPF Maturity Value	₹48,00,000
Future Value of existing Mutual Funds	₹48,54,669
Future Value of Ancestral House (7% p.a. growth)	₹98,35,757
Maturity Value of SIPs	₹96,32,597
TOTAL RETIREMENT CORPUS	₹4,12,55,620

Therefore Mr. Roy has a shortfall of approximately ₹46 lakhs.

Mr. Roy has 3 options in the above situation:
a) To post-pone his retirement by some time i.e. increase his number of earning years
b) To reduce his expenditure post retirement
c) To save and invest a higher amount today and going forward

By choosing one or all of the above solution options, Mr. Roy will be able to build the retirement corpus that he needs, to live his golden years in financial freedom. The corpus that is built by his retirement can be invested into fixed income products and kept away from any market risk / volatility.

It is important to note however, that upon the end of his 85th year, the funds will have been entirely utilized. Hence it is always better to assume a longer life expectancy and plan accordingly – rather than run the risk of outliving your wealth and then being dependent.

Starting Your First Job

It is often said that saving for retirement starts as soon as you earn your first salary.

Ms. Pooja believes in this and has just started her career. She earns ₹20,000 p.m. from which she saves ₹10,000 p.m. She does not know what to do with this money and it is in her Savings A/c. Being 23 years old, she has no current liabilities and no financial dependents. As such she does not need any insurance, so there is no premium outgo either.

The savings can be fully invested with a long time horizon, based on Ms. Pooja's high risk appetite.

	Equity	Debt	Gold
Asset Allocation of Current Salary	7,500	1,000	1,500
Returns Assumed	15%	7%	7.50%
Suppose she invests for 30 years similarly	₹5,19,24,597	₹12,19,971	₹20,21,168

Total corpus with her at age of 53	₹5,51,65,736

This is assuming she does not even increase her SIP as her salary and savings increase.

With constant SIPs of ₹7,500 into equity mutual funds, ₹1000 into debt mutual funds and ₹1,500 into gold ETFs, Ms. Pooja will accumulate a corpus of ***approximately ₹5.51 crore by the time she is 53***.

She has on her side the benefit of time value of money and power of compounding as she is starting early and investing regularly.

Planning for Child's Education and Marriage

Mr. Anup John is 33 years old and has a daughter aged 2.

He wishes to create a marriage corpus that should be ready for his daughter within 22 years. Currently Mr. John imagines that he would spend ₹15 lakhs on her marriage if it were happening today.

How much does he need to save every month or every year for his daughter's marriage, assuming a 10% inflation rate on marriage expenses?

Daughter's Age	2
Years to marriage	22
Cost of Marriage Today	₹15,00,000
Cost at time of Marriage	₹1,22,10,412
Monthly Investment (SIP) required	₹12,810
OR Yearly Investment (lump sum) required	₹171,008

In 22 years, a marriage costing ₹15 lakhs today will cost ₹1.22 crore. This may seem like a huge amount, but luckily Mr. John has a very long time horizon to build this corpus i.e. 22 years!

An investment of approximately ₹13,000 (invested every month) or ₹1.71 lakhs (invested every year) will provide Mr. John with the corpus that he requires, assuming a 10% inflation rate on marriage expenses.

Similarly, Mr. John's friend, Mr. Jack has a son aged 5 years.

Mr. Jack's son is going to graduate after 12 years. Mr. Jack wants his son to do engineering for which he requires ₹5 lakhs currently.

After his engineering, Mr. Jack also wants him to go abroad for post-graduation which costs ₹25 lakhs currently.

How much is Mr. Jack going to need to send his son to engineering college in 12 years?

Son’s Age	5
Years to Graduation course	12
Amount Required	₹500,000
Cost at time of graduation course	₹15,69,214
Monthly Investment (SIP) required for graduation	₹5,677
Yearly Investment (lump sum) required for graduation	₹73,382
Years to post graduation course	16
Amount required today for post graduation course	₹25,00,000
Cost at time of post graduation course	₹1,14,87,432
Monthly Investment (SIP)	₹24,419
Yearly Investment (lump sum)	₹319,542

An investment of ₹5,700 approximately (every month) or ₹73,500 (every year) will help Mr. Jack achieve his son’s graduation corpus.

An investment of ₹25,000 approximately (every month) or ₹3.20 lakhs every year will help Mr. Jack achieve his son’s post graduation corpus.

When investing for both goals, Mr. Jack has to keep in mind that he must invest into the right investment products for his personal risk profile.

When planning for any goal, it is important to invest based on your risk appetite and goal time horizon. It is essential to understand the risks associated with equity investing.

When a goal is drawing nearer, the goal corpus can be de-risked to protect it from equity volatility and invested into debt to provide fixed returns and capital safety.

Managing a Wind Fall

Mrs. Sinha has recently come into a large sum of money through an unexpected windfall (lottery winnings for example). She is very excited about this wealth and wants to use it immediately.

She tells her Financial Planner about it to be included in her Financial Plan, and her Planner helps to set 5 things that Mrs. Sinha must do.

- ✓ Set a Cool Down Period

When coming into a large sum of money unexpectedly, it is likely that one can get carried away and spend the money on an impulse purchase rather than investing it wisely. Setting a cool down period (say 3 months) ensures that the person who has come into the wealth takes time to think about how to use it, and avoids the initial risk of spending it out of excitement. The money can be held in short term debt funds (capital safety, fixed but low return) until the decision is made to use it wisely.

- ✓ Boost emergency funds

The contingency reserve can be enhanced if needed, with a part of the newfound wealth thereby strengthening the safety net in case any unforeseen situation arises that takes a toll on Mrs. Sinha's financial health.

The first step that can therefore be taken with the newfound wealth is to boost the contingency fund.

- ✓ Reduce (or Remove) Debt

If Mrs. Sinha has any liabilities (credit card loan, personal loan, home loan etc) that have very high interest rates, the windfall can be utilized to remove or reduce the extent of the liability. If the windfall cannot fully remove the debt, it can at least be used to partly reduce it (such as by paying off the high interest rate loans), and the remaining debt can be settled by further EMIs. This again would boost her financial health.

- ✓ Prioritize Goals and Boost Them

Certain goals which may be very important to Mrs. Sinha, not necessarily only financially but perhaps also emotionally, such as a contribution of wealth to her parents can be met or enhanced at this time. It would be prudent to also invest more towards certain goals such as her retirement at this time.

- ✓ Last but not least – Spending Money

Financial Planning does not always have to be serious – a portion of the windfall gains can be set aside, say 20%, for Mrs. Sinha to spend as she pleases, to enhance her quality of life. She can also choose to donate part of the funds to a worthy cause.

VII: Estate Planning

"We do make a difference -- one way or the other. We are responsible for the impact of our lives. Whatever we do with whatever we have, we leave behind us a legacy for those who follow."

Stephen Covey

Most of us have the same primary goal in our financial lives – to build wealth.

However, have we ever thought about what will happen to this wealth in case we are not around to ensure it goes to our loved ones?

Estate planning in simple terms refers to the passing down of assets from one generation to another.

Most of us are under the impression that estate planning is only for the very wealthy. But, the fact is that estate planning is essential for all, regardless the size of their portfolio. And it should be done from the very first day we have an asset to bequeath (example – our first investment into a mutual fund).

This prevents the addition of financial and legal grief to the emotional grief your loved ones will already be facing upon your absence.

Here are some advantages of Estate Planning:

- ✓ You can decide who receives a share of your assets
- ✓ You can decide how and when your beneficiaries will receive their inheritance
- ✓ You can decide who will manage your estate in your absence
- ✓ Estate planning saves your family and loved ones from going through the additional burden of reverting to the law to distribute the assets to the legal heirs in case of an intestate (dying without a legal will) demise.

There are some things that must be kept in mind while writing a will:

I) A Will should be Simple, Precise and Clear. Otherwise there may be problems for the legal heirs. It is always better to take the advice of a trusted advocate when writing your will.

II) A Will must always be dated. If more than one Will is made then the one having the latest date will nullify all other Wills.

III) It is better to make a Will at a younger age. As and when events or changes in the family necessitate changes the Will can be changed.

IV) A Will can be hand-written or typed out. No stamp paper is necessary. You can write a Will on a simple A4 piece of paper, sign and date it with witnesses and keep it in a secure location.

V) Each page of the Will should be serially numbered and signed by the Testator and the Witnesses. This is to prevent the Will being substituted, replaced, or pages being inserted by people intending to commit fraud.
At the end of the Will you (the Testator) should indicate the total number of pages in the Will. Corrections if any should be countersigned.

VI) If there are too many changes in the Will, it is better to prepare an entirely new Will rather than making modifications to an old Will.

VII) It is not compulsory for one to register a Will with the Registering Authority, but in case any property or asset is given to any charitable organization, then registration should be done.

VIII) A Will becomes operative only after the demise of the person making the Will i.e. the Testator. There is no restriction in the way you can deal with any assets even after making a Will.

Remember, this is one of the most important documents you will ever create – detailing the distribution of the wealth you have worked so hard to build – to your loved ones. It is important to ensure that it is done correctly –take qualified professional assistance as required, as with all your financial planning decisions.

VIII: Where to Seek Professional Advice

> *"Efficiency is doing things right; effectiveness is doing the right things."*
>
> *Stephen Covey*

Today, with greater awareness on the need for financial planning and the various aspects that go into creating a thorough and precise financial plan, it is important to know that you are seeking professional assistance with your financial plan creation from the right quarters.

Almost everyone in the financial services industry today claims to do financial planning.

In fact, major banks, brokers and distributors of financial products have opened departments or divisions which deal specifically with financial planning.

So, let us understand the various kinds of service providers who are involved in this activity:

1. Banks

   They offer you everything from opening a bank account to remittances, to investments and now they help you get a financial plan as well.

2. Brokers/Distributors

   They offer stocks, mutual funds, insurance, post office schemes, fixed income products etc. Your neighbourhood mutual fund distributor, insurance agent, larger national level private distributors form a part of this segment.

The larger focus of banks and distributors is to sell (and not advise) to you financial products, so that they can earn commissions on those products. In fact, there have been instances of mis-selling, whereby the broker protects his interest (through commissions) first rather than the client's (wealth creation). Yet investors flock to banks and brokers because they offer a one stop solution shop – this is encouraging them to portray themselves as financial planners. It may add a lot of value to the perception of investors, but the focus on your financial health is not much. Most often, this service is offered for free since you are expected to buy financial products from them. Financial planning is not their focus area. It is a means to achieve their targets of selling financial products and earning commissions.

3. Pure Fee based planners

There were not many pure fee based financial planners in the country a couple of years ago. But since then many individuals and companies have emerged on the horizon now, especially in the larger cities where the awareness of the concept is better. They are now quite serious about pursuing the business model of offering pure fee based financial planning services. Some of these planners are well known and others are not. Thanks to the awareness of financial planning education, most of them have also acquired the Certified Financial Planner (CFP) tag.

4. Service providers offering both services

As is evident, these service providers offer financial planning as well as distribute financial products like mutual funds, insurance, stocks, etc. Financial planning becomes a vehicle which they use to distribute their products. A lot of brokerage houses have converted themselves into planners.

Charge for Financial Planning

The financial planning industry is yet to come to terms completely with charging for the service. While some who offer only planning services charge a fee which can vary from ₹5,000 to ₹50,000 and sometimes more, there are others who charge as a percentage of the assets you invest through them which typically varies from 1% to 2.5%. While some others have a mixed fee model and they charge you a flat fixed for a plan and then an investment fee on your investments.

So, given the different type of players in the financial planning space a question which is bound to arise is – **How should I select a "true professional financial planner" who will help me get my financial plan, and provide me unbiased advice?**

The answer to this question is simple.

Check the capability of the individual or the organization that you wish to hire as your financial planner. Ask some few simple questions such as:

A) What is the business model of the company? How does it earn its revenues?
B) What is the process that they would follow in building the financial plan? Have a look at a sample plan.
C) What is the team size? Their experience and qualifications?
D) Are their recommendations based on solid research or driven by commissions?
E) How long has the individual or the organization been in business? How many clients have they made financial plans for?
F) Can they give references of existing clients with whom you can speak to?

Do a detailed discussion with your prospective financial planner. Once you are satisfied on all these parameters, then go ahead and sign him up as your financial planner.

IX: Conclusion

"The value of an idea lies in the using of it."

Thomas Edison

So now we have come to the end of the *Personal*FN Guide on Financial Planning. We hope this Guide has been a useful read for you – and congratulations once again for taking an interest in improving your personal finances and getting your financial life in order – to get the most out of your cash flows!

But remember, you must now start your own planning effort to make the most of your financial life!

Your Call To Action

1. Build up your own financial awareness – read more financial newspapers and websites

2. Plan your Finances!

- ✓ Start by building your contingency reserve and making sure you are adequately insured.
- ✓ Then set and prioritize your goals.
- ✓ Taking inflation figures, find out how much money you need to save for each goal.
- ✓ Start investing in the right products to achieve your goals!
- ✓ Review your investments regularly to see that they are going according to plan.

And one last thing – please remember, the guide offers general advice, not specific advice.

It is very important to speak with your Financial Planner when dealing with a specific situation. Your Planner will be able to provide you with advice catering specifically to your need.

If you have any queries, please feel free to write to us at info@personalfn.com or simply contact us.

Happy Financial Planning!

Warm regards,

Team *Personal*FN

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