

Not Enough Aggression

Panchkula-based Meenu and Amit Sharma must invest more and increase equity exposure to make full use of the power of compounding

With a sound investment strategy and sizeable monthly surplus, one would expect Amit and Meenu Sharma to have a meaty portfolio. They enjoy all the financial advantages of a young, well-heeled couple—high risk appetite and no dependents. Yet, the total value of their investments is much lower than it should have been. What went wrong?

Two things—they don't invest all that they save. And they don't invest enough in equities.

Still in their twenties, the power of compounding can work wonders on their investments—the longer they stay invested, higher will be the returns. So the few thousands idling in savings accounts will cost the Sharmas a few lakhs in the long run.

It's time to rev things up in their portfolio. Twenty-nine-year-old regional manager, Amit, is open to risk. Meenu, a manager with an asset management

Name: Amit (left) and Meenu Sharma
 Age: 29 and 28 years
 Monthly income: Rs 80,000 (post-tax)
 Financial dependent: None

company supports his view.

But before we set about putting their finances in top gear, a quick look at their current investments.


The Sharmas' monthly pay packet is Rs 80,000 (post-tax). Routine expenses skim off nearly Rs 20,000. Another Rs 13,300 goes towards the combined EMI of a personal and car loan. The couple has booked an apartment for which they pay a pre-EMI of Rs 10,000. Once they take possession of the property, tentatively in February 2008, this amount will be replaced by an EMI of nearly Rs 16,000.

Net of these expenses, the Sharmas have a handsome surplus of Rs 36,700 a month. Of this they invest Rs 13,000 in equity-linked savings schemes (ELSS) via systematic investment plans (SIPs). Their mutual fund corpus is now about Rs 5.5 lakh.


Recently Amit bought stocks of Rs 1 lakh. "I borrowed the money from Meenu with



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Amit and Meenu Sharma

Rx

INCOME & EXPENDITURE




INVEST SURPLUS IN EQUITIES
About 65% of savings idling in bank accounts. At this age, entire surplus should be invested in equities through stocks or mutual funds

CASH FLOW	CURRENT	SUGGESTED
Income per month (post tax)	80,000	80,000
Monthly expenses	20,000	20,000
Monthly EMI	23,300	23,300
Money saved	36,700	36,700
Monthly investments	13,000	36,700
Surplus	23,700	nil

Investments increase from 16.3% of Income to 46% of Income


GOALS



	TIME HORIZON	FUTURE COST (Rs)	INVESTMENT NEEDED (Rs/month)
House furnishing	3 years	2 lakh	5,000
Retirement	29 years	5 crore	15,000

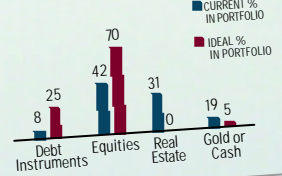
The Sharmas are stepping into their thirties. They should start thinking about stashing away three months' expenditure as emergency fund

ASSET ALLOCATION




SECTORS (%)	EQUITY HOLDINGS (%)
Financial services 18.45	Reliance Industries 7.93
Basic/Engineering 15.69	Larsen & Toubro 6.97
Diversified 15.07	Bharti Airtel 6.01
Technology 14.92	Bhel 5.11
Energy 11.45	Kotak Mahindra Bank 4.65

*Including investments in mutual funds



INSURANCE AND RETIREMENT



- + Should consider surrendering whole life plan after three years when policy acquires a surrender value
- *** Amit should buy a term plan of Rs 20 lakh for 20 years. Annual premium will be about Rs 8,000
- + Meenu can buy a term plan of Rs 5 lakh. It will cost approximately Rs 2,500 a year
- + The couple shouldn't lock in money in any pension plan now. Instead they should concentrate on maximising returns through equity investments

RECOMMENDED MUTUAL FUNDS

- Reliance Vision
- Birla Frontline Equity
- Sundaram Select Focus
- HDFC Equity
- HDFC Prudence
- Birla Sunlife MIP
- UTI MIS Advantage

The Sharmas should choose from these funds for increasing equity exposure

the promise of returning much more," he says. The kitty includes stocks like Reliance Industries and Reliance Petroleum.

Not very keen on debt instruments, the couple has parked only Rs 1.3 lakh in national savings certificates (NSCs) and provident fund. "The investment in NSC was a blunder. The long lock-in period has me fretting," says Amit.

The apartment that the couple has invested in (under construction) is valued at about Rs 21 lakh. A home loan of Rs 16 lakh reduces net investment in property to about Rs 5 lakh. Jewellery worth Rs 3 lakh forms the near-cash component of their portfolio.

The couple are not heavily insured. Meenu has no life insurance while Amit has one whole life policy of Rs 3 lakh. Annual premium is Rs 13,000.

The Sharmas have rightly avoided fixing any long-term goals. That should happen once they have children. But it is always better to have a rough estimation of a retirement corpus. To maintain their current expenditure level (which is quite low), they will require a whopping Rs 5 crore at retirement. This calculation should help focus their strategy towards investments that accelerate growth.

In another three years the couple will require about Rs 2 lakh for furnishing their house. This requires a monthly investment of Rs 5,000 which can easily be met from their current investments.

It is the surplus of Rs 23,700 (net of all investments) which is the eyesore of their finances. So much money sitting in savings accounts and depleting in value. We suggest

investing all of the Rs 23,700 in mutual funds via SIPs.

But the couple must be careful about choosing the right funds. Already, they have too many funds (13) in their portfolio. Worse, the portfolio lacks high-quality funds—star performers which have a long track record.

Another fault in their mutual fund investments is low diversifica-

HDFC Equity. If they want a small debt component in their portfolio, we recommend investing in balanced funds and monthly income plans (see recommended list of mutual funds).

However, they must be careful not to further bloat their portfolio. Ideally, all fund investments must be consolidated in 3-4 funds with distinct features.

Amit has just started investing in direct equities. This is consistent with our thrust on accelerating growth of their investments. But buying stocks is tricky. Amit should invest in them only if he has the three Ts: time to monitor their performance, talent to spot good stocks and the temperament to absorb big losses.

Regarding life insurance, Amit has bought a costly plan and he knows it. Also, the cover is abysmally low at Rs 3 lakh. Since the couple has no dependents they can postpone increasing their life cover. However, they would lose out on the cost advantage of buying an insurance policy at a young age.

We suggest Amit discontinue this life insurance policy. But he should do it only after three years when the policy acquires a surrender value.

In the meanwhile, Amit can buy a term insurance of Rs 20 lakh for the maximum period available. It would cost about Rs 8,000 annually. Meenu should also consider buying a term cover of Rs 5 lakh. The couple will have to review their life insurance after a few years when they have financial dependents and responsibilities increase.

HOW TO CHOOSE A MUTUAL FUND

The Sharmas have invested in some funds on advice from Friends. This can be risky. Consider the following parameters before choosing a fund:

CONSISTENT PERFORMANCE Choose a fund that has been consistently performing well over the long term (3-5 years)

TRACK RECORD OF AMC Invest in a fund house that enjoys an impeccable reputation of timely service and prudent management

SCHEME PORTFOLIO Large-cap funds are slow but steady movers. Mid-cap and small-cap funds are high-risk high-return propositions. Balanced funds are low-risk low-returns

INVESTMENT HORIZON If short term (6-18 months), go for debt funds. If medium term (2-3 years), it's balanced funds. Long-term (over 3 years) go for equity funds

COST Besides entry and exit loads, funds also charge an annual management fee

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