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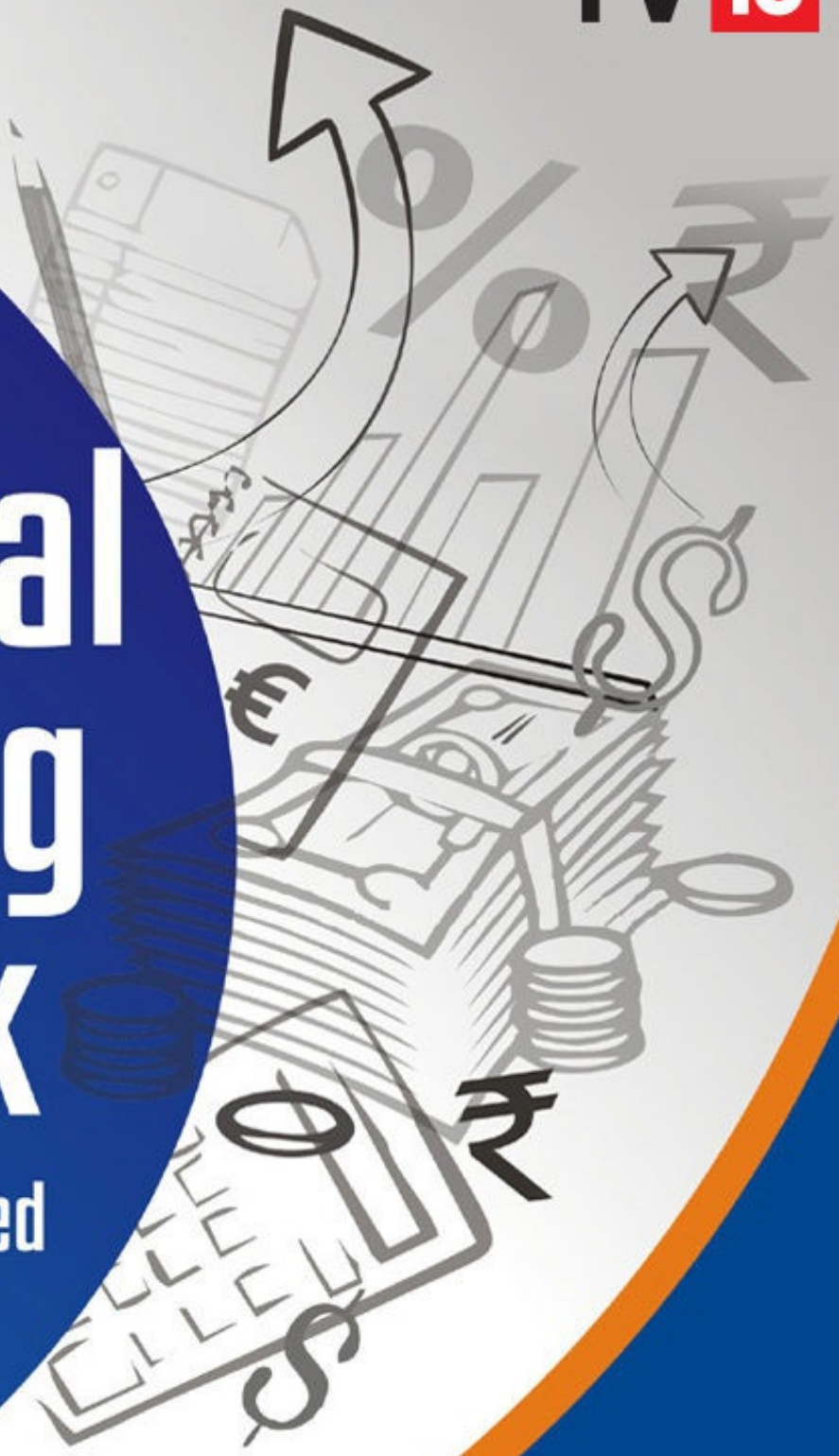
The only Financial Planning Book that you will ever need



Amar Pandit

Bestsellers 18

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Dedicated to my amazing team at

"My Financial Advisor"

whose rock solid support

and encouragement

made this book possible.

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Introduction

Financial Literacy is a very important but the most neglected area not just in schools but also in colleges and business schools. This results in people who are mostly intelligent and hardworking, scoring low marks on the financial literacy quotient front. This deficiency leads to poor choices in loans, investments, insurance, tax planning instruments and faulty decisions. Although many people would not like to admit to this shortcoming, those who have a progressive mindset understand this quite well and are constantly looking out to learn and re-learn.

There is no doubt that Indian people (whether IT Professionals, corporate executives, business owners, professionals, film stars and sports personalities) are top notch but sometimes it is this very quality of being knowledgeable and intelligent in general affairs that makes Indians commit many financial mistakes. It normally takes a personal financial disaster, introspection or peer feedback that makes a person realise that he needs help.

Financial Planning, Money Management and Financial Literacy are too important topics for people to explore and learn from mistakes. Some of the financial mistakes can often prove to be catastrophic and hence, it is a prudent idea to teach these concepts in schools and colleges itself. An hour or two on a bi-weekly basis right from school will go a long way in laying the foundation of a person’s financial success. Once people are immersed in professional or corporate life, they rarely commit to studying personal finance because of time poverty and sometimes because they believe that they know enough.

Most people generally take a rudimentary or a product-centric approach when it comes to making prudent choices about money. Very rarely, do they take a holistic view of their financial situation. Most think of financial planning as investment planning or tax planning. This book is an attempt to help people from all walks of life understand the different areas of financial planning and to help them make smart and informed choices about money.

This book starts with the most common money mistakes people commit and a categorisation of a person's economic life cycle. I then delve into what financial planning is all about, concepts of financial planning and why one must plan. There is a lot of emphasis on the various risks every person and family faces, risk management and the choices that one should make while effectively managing these risks. Several key concepts such as how much life insurance you need, what kind of policies you should ignore and what type of policies you should focus on are explained in detail. Terror insurance, personal accident insurance, professional liability insurance and asset protection insurance are also covered.

In my experience with many Indian families, I have observed that most families are heavily invested in life insurance, fixed deposits and real estate. At the same time, they pile on several loans with the intention of buying real estate and hence are stressed in terms of their cashflows. I have highlighted why people should limit debt and diversify beyond real estate. We then move on to some common financial goals that families have, how best to fund each of these goals and the various investment avenues. We then discuss the nuances of different investment avenues available in India today.

Basic taxation concepts that people need to understand and taxation of real estate (often a family's biggest investment) are covered. Finally, there is a chapter dedicated to creating a legacy and concepts of estate planning.

Areas such as how you should seek advice and the kind of team you should form or have are reviewed. This book is replete with examples of real life

stories (although some names have been changed on request) to give you a better perspective and insights.

This book is not meant to be an academic piece of work. Instead, it is something that is example-oriented and more hands-on, created with the intent of inspiring a person or family to adopt financial planning as a process of taking prudent financial decisions.

Finally, this book is not a "get rich quick" kind of a book; there is a lot of useful information that every person can act on. Even financial experts who pride themselves in knowing everything will benefit by a quick read of this book.

I welcome any feedback (great or otherwise) on amar.pandit@myfinad.com. It will be a pleasure to hear from you.

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SEVEN COMMON MONEY MISTAKES THAT PEOPLE MAKE

CHAPTER 1

Indians are among the best in the world in most professions and are highly respected in the global community. However, when it comes to money management, most people are guilty of several mistakes. We list seven major, common money mistakes that most smart, intelligent people commit.



1 Too many expenses and loans

Banking is a booming business in India as more and more people are continuously borrowing. At the same time, recovery agencies are also a booming business as more and more people continue to default on their loans. Although India has one of the best savings rates when compared with western nations, the same really cannot be said of the next generation. Although most people today have a high and stable income (than what their earlier generations earned), their expenses are equally high. One of the key reasons is that they have many expenses and loans. There are too many temptations today and all one needs to do is call a bank or financial institution for a personal loan. In this process of keeping up with the next iPad, gadget or car,

many young people end up paying a substantial amount of their income towards EMIs.

Besides EMIs, insurance premiums and personal expenses eat into earnings quite quickly. Hence, I am sometimes surprised to see people having a seven-figure monthly salary finding it difficult to save. This is because they have other major expenses such as penthouses, bungalows, yachts and so on. Since these are big-ticket items, servicing debt and maintaining these often result in a liquidity crunch even for affluent families with very high incomes.

Some people, especially business owners and professionals, take on loans because their accountants advise them to do so from a tax planning perspective. This is primarily to harness the advantages of depreciation and interest deduction. However, such ad-hoc decisions are considered without taking a holistic view of the family's liquidity, present needs and future requirements, which often puts a family in severe cashflow problems.



2 Over-concentration in real estate

Although it sounds stereotypical, most people hoard real estate like there is no tomorrow. One of the biggest reasons is our love for real estate, which many feel are great investments. Besides there is an abundance of black money in the system and many people have a lot of income in cash that can be comfortably cushioned in real estate investments. Additionally, they believe that not only is real estate insulated from market vagaries, but that it also gives stellar returns along with tax benefits. As a result, they borrow to invest in real estate and are leveraged (which means they take on debt).

Most Indians have completely forgotten the great Indian real estate crash of 1995 and the subsequent lull for several years until 2003-2004. This is a very dangerous strategy to adopt as this can prove to be lethal during real estate crashes, especially since real estate is an illiquid investment.



3 Inadequate insurance against risks of death, disability, professional liability and loss of income

Most people buy life insurance as an investment and pump in a lot of money into life insurance policies. This is because there is a lot of emphasis on life insurance as a great tax saving tool and many people are enamoured with tax saving instruments. Besides the fact that most people are so busy with day-to-day activities, they often wake up between January and March every year to do something to save tax. The answer is very simple. “Let’s buy a life insurance policy. In any case my friend, banker or family member has been after me to buy one.” Due to such adhoc purchases, most people end up with a plethora of irrelevant policies. The best part is that most people pay high premiums and get a very low cover.

Despite paying high premiums, most people are under-insured when it comes to life insurance in a big way. There is no assessment of the actual financial risk their family will face, in case of their premature death, and most liabilities are not covered.

At the same time, they have negligible or no critical illness cover, negligible disability cover, no income protection and no social security benefits.

This area must be adequately addressed to ensure lifestyle maintenance, wealth creation and wealth protection.



4 Investments done in an ad-hoc fashion, due to time constraints

The portfolio of most people would probably look like this: more than 50-60% in real estate investments, 30-40% in debt (PPF, insurance policies, fixed deposits ,bonds and post office), 5-10% in cash (savings account, short term fixed deposits and cash), gold (primarily bought as jewellery) and very negligible equity.

Most people have just these investments: Real Estate, PPF, EPF (for employed people), gold and insurance policies.

Considering that people are getting busier by the day, sometimes they do not even have time for their families. The little precious time that is available is completely for the family and most of the time, financial planning takes a backseat. This is when people end up taking decisions based on advice of different sets of people (chartered accountant, colleagues, banks, real estate agents, family members, insurance agents and financial advisors). There is no co-ordination between all the advice sought from these different sets of people and hence actions are extremely haphazard in nature. Hence if you see the finances of most people (even the most sophisticated), you will clearly see that it is a hodgepodge of products accumulated over time.



5 Lack of goal–setting and planning

"I take life as it comes. I don't plan for it," said a leading Bollywood actress. It's very easy to say this but nothing meaningful can be achieved in life without setting goals and planning. Yes, life will happen as you plan and sometimes you will need to course-correct but there are certainties in life that will happen for e.g. death, retirement (everyone will grow old and will stop working or slow down at some point of time), paying taxes and so on.

I am sometimes appalled when people plan for their vacations for several months or discuss as a family on the next big car to be bought, but when it comes to financial planning and goal setting they say, "I will do it after a few months or I don't have time right now."



6 No written financial plan

Most people do not understand the concepts of financial goal setting, cashflow and debt management, insurance planning, asset allocation, maximization of post-tax income, retirement and estate planning (wills, power of attorney and trusts), for the simple reason that there is no formal education in personal finance or financial planning.

It is because of this limited knowledge that they end up making costly mistakes. Their realization of the importance of a financial plan is reactive rather than proactive, in that it is only when an event happens that they realize the need for a financial plan or the need to take a holistic view of their financial situation.



7 Myopic view of tax planning

Most people generally believe that the objective of tax planning is to minimize taxes and often do things that are not in their best interest. They take several loans, buy real estate and life insurance in an unplanned fashion and indulge in tricks to fool the taxmen such as showing limited income or a weak balance sheet with the only objective of not paying tax. However, the right goal of tax planning is to maximize post tax-income.



AN INDIVIDUAL'S ECONOMIC LIFE CYCLE



CHAPTER 2

An individual's economic life can be categorised into three distinct phases:

1. Start up Phase (Age 21-35 years)
2. Peak Earning Years (Age 36 – 55 years)
3. Cooling Off Period (Age 56 – 65 or until health permits)

Professional education is quite expensive in India and for a lower to middle-income family the fees and related expenses are a huge burden. The high cost of education is often a deterrent for intelligent and capable students to take up professional education. A child's education is an important goal for most Indian parents and hence some sort of planning starts from the day a child is born. However, most planning is just restricted to buying child life insurance plan.



Many students in India will start working after college or post-graduation. Very few will take the entrepreneurship route on their own. Children whose

parents are business owners, professionals (such as doctors, CAs or lawyers) and film personalities often have a choice to follow their parents vocation.



START UP PHASE (Age 21-35 years)

This is the one of the best phases for most people. You have just started working and there is a steady inflow of money every month. There are no real liabilities as you are either living with your parents or with your friends. There is no family responsibility and hence your entire income is available to you. There is a strong urge to spend and buy the latest mobile, gadget and bike. A few years in this phase and many would think of a MBA degree to bolster income. There is no vision yet or even clarity about the kind of career that you want. It's all about today and there is not even a thought about financial planning. However, even a MBA degree is a very expensive affair and can easily set you back by Rs. 8-10 lakhs.

For those who are starting on their own (especially professionals), the battle can be quite daunting. At the outset, one needs to scout for a location that would serve as your business for the next several years. In fact, this is one of the most important decisions of your career. The choice of location will of course depend on your type of business and the kind of clients that you plan to target. Additionally, at this point, you need to decide whether you should rent a place or buy one on loan. At this point in the decision-making stage, there are numerous tasks including creating a budget (which is often outsourced to an accountant), deciding how much to spend on interiors, taking up debt, hiring employees, and so on. These activities often overwhelm people in the initial phases of their career and hence you must start planning for these events from your time in college or business school itself.

In the start up phase, a business owner or professional normally has a peon who doubles up as a receptionist and a Man Friday. Therefore, although employee expenses are low, infrastructure-related expenses can be on the higher side, and hence you often face a cashflow crunch situation.

At the same time for some people, there could be family responsibilities that have to be addressed right from money for parents or spending for a sibling's education and wedding. Keeping all the above goals in mind, every individual during this phase should focus on "Living Life Modest Size". The whole focus should be on savings and creating a solid base for the next phase of life.



MARRIAGE AND KIDS

This is generally the period when you find a life partner and start a family a few years later. Considering the high cost of living and career aspirations of men as well as women, both partners look to work and support their families. In financial terms, this is a huge boon as one spouse's income can be completely saved. Yet one needs to be careful: double high income ideally should not mean doubly high expenses.

Even if the expenses are split, a family with double income can manage to save significantly higher amounts than a family with just one earning member. An earning spouse can be a great support for an entrepreneur, as he/she does not have to worry about day- day expenses.

Knowing that your spouse's income can also take care of family's needs can take many worries off your head. However, in reality very few married people are able to take benefit of this unique and wonderful situation. This is primarily due to no focus on financial goals or savings, budgeting and cashflows. Couples in the early part of their marriage have many expenses

and many couples prefer living on their own and end up buying or renting a house.

Towards the end of the start up phase, your expenses tend to be on the higher side due to the birth of children and initial year expenses. At the same time, spousal income can reduce because of pregnancy and child rearing breaks. This is the period when most families feel the pinch if expenses are very high and income suddenly drops.

In fact, childbirth and the accompanying drop in income are events that need to be carefully planned for by couples, much in advance. This is so important that building a cash reserve for drops in income should be one of the first financial goals besides owning a house. The birth of a second child also has similar financial effects.

SUMMARY

1. Limit debt payments to around 30% of your gross income. Draw up a budget and be very judicious in your expenses.
2. Focus on cash conservation and savings. During the initial years and when you are single, attempt to save at least 30% of your gross income in assets such as cash, debt, equity and gold.
3. Plan for events such as slowdown in income during the birth of a child and initial child rearing years.
4. Opt for higher debt or real estate debt only after you have accumulated substantial savings and have a relatively stable income. Buy a house in your early thirties if you get it at a decent and affordable rate. Do not buy a house just because you have to or are under peer or societal pressure. Be patient and even wait for 2-3 years to get a fair deal. Ideally, buy a house when you are married and have a double income. Be very careful now to not go overboard and wipe out all your savings and assets for the down

payment and interiors.

5. Create a strong balance sheet and show a solid income statement even if that means paying higher tax. This allows you to approach banks and financial institutions to fund your home purchase or any growth plans through debt.

PEAK EARNING YEARS (Age 36-55 years)

This is a phase where a person's income scales new highs and it is in this phase that most people can create wealth. However, in this phase the high income can also entail very high lifestyle expenses, which if not managed well can spell trouble. This is the period when a person's income actually peaks.

However, the reality is that few people manage to create a solid asset base in this period. This is primarily because as children are growing, so are lifestyle expenses. There are many claims on the family budget. At the same time, income has peaked. At this time, the real winners are people who have saved really well early on, and cleared off their liabilities on the home front.

These are also the same people who have set goals in their life and have planned well in advance.

Why are most people unable to capitalize during this period?
Let's look at Atul Shinde's cashflow and current situation to get an idea of where things go wrong. Atul Shinde is a 48-year-old corporate executive living in Mumbai with his homemaker wife Asha and two sons Ajay and Rahul.

2010-2011	Atul Shinde (Rs.) Annual
Cash Inflows	

Salary Income (Post taxes and contributions to PF)	28,00,000.00
Total Cash Inflows	28,00,000.00
Cash Outflows	
Mandatory Outflows	
Home Loan EMI	8,40,000.00
Car Loan EMI	3,60,000.00
Insurance Premiums	4,00,000.00
Children's Education Expenses	2,00,000.00
Lifestyle Expenses	6,00,000.00
Voluntary Expenses	
Entertainment / Vacation	3,00,000.00
Total Cash Outflows	**27,00,000.00**
Current Surplus/(Deficit)	**1,00,000.00**

As you can see, a substantial portion of his income goes in servicing debt. Although his income is high, expenses are higher and there is practically nothing left every month. At the same time, he is paying too high premiums as compared to his income for a very nominal cover. In terms of assets, Atul has been able to accumulate practically nothing except real estate, EPF and some insurance policies.

This story is often reflected across many families. The solution for this problem lies in limiting debt (taking on less liability initially), scaling up income and diversifying this additional cash generated in assets other than real estate. At the same time, one must limit insurance premiums as a percentage of their income and go for pure risk cover called term plans to cover all liabilities and family goals. The start-up and peak earning period are periods when people can save and invest wisely.

COOLING OFF PERIOD (Age 56 - 65 years or until health permits)

This can ideally be the best phase of your life. This is when many people like to slow down and work not because they have to but because they want to. On the other hand, business owners and successful professionals continue full throttle beyond their sixties. Some have even commented, “I don’t see myself stopping work or slowing down because this is not my work, this is my life. This is what I stand for.” The other set of people who must work are people who have not saved well or planned well. Some continue to work even beyond their sixties and seventies because they have no choice. Nevertheless, many slow down and work for a couple of hours every day so that they have more time for family, friends, philanthropy and recreational activities.

By 55, children are independent and could possibly start their careers. You have funded their education by now or they are in their final years of completing their education. This is the first time when some people actually think of spending money on themselves.

This is also the age by which most people who have saved well would have amassed reasonable amount of wealth mainly in the form of real estate, PPF, insurance policies, some fixed deposits and cash. They are at their peak of their careers.

This does not mean that people who have not amassed wealth should lose hope. If they are in good physical health, they still have another 10-15 years to go. This means that this period could be utilized for building a retirement corpus and wealth creation. Travel generally gets hard once you cross 70 and hence it might be a good idea to travel between the age of 55 and 70. Business owners, professionals and consultants can extend their working life but at the same time cut back on the number of hours they work. This way they have the best of both worlds where they can work selectively, but at the same time pursue hobbies, relax and have a great time.

People who work until 65-70 years generally do not have to draw down on their capital until they completely stop. This means that their accumulated

investments and annual savings until retirement can be used to build a sizeable corpus for themselves.

Those who have slowed down have plenty of avenues to keep themselves busy. However, once again, planning is the key. Start thinking about this phase not when you enter this phase but much earlier in your thirties or at least in your forties.

SUMMARY

1. Cut down on your working hours and focus on things such as travel (if you enjoy it), fitness and relaxation.
2. You will be able to cut down on working hours even if you have not accumulated enough wealth. Working longer until 65 to 70 instead of 60 can help. Don’t forget to focus on maintaining good health. Eat healthy and exercise.
3. Invest surplus money not needed in the next 10-15 years in equity only.
4. Do not assume new debt at this point of time. Keep yourself 100% debt free.
5. Evaluate all the real estate that you have accumulated and whether you will be able to maintain outstation properties and vacation homes. We have seen many senior citizens, unable to maintain vacation homes often selling properties in distress. Think early and keep it simple during the cooling off period of your life.


Rs.

WHAT IS FINANCIAL PLANNING AND WHY IS IT IMPORTANT FOR PEOPLE?

CHAPTER 3

When people hear the term, “Financial Planning”, some are immediately put off, as they simply do not have time to plan. They think of the process as complex and time-consuming; in fact, most believe they should think of a financial plan once they have enough wealth. Some even think of financial planning as investment planning or tax planning. There are many such myths about financial planning and it’s important to understand what financial planning really is.



Any decision about money impacts your overall finances. In fact, deciding not to invest or not to plan is also a decision. Any decision that you take about money and that has an impact on your overall financial situation is financial planning. The irony is that most people do financial planning unknowingly and in an unstructured manner, whether it is buying insurance policies, or stocks, or investing in real estate or taking a loan. **These decisions are generally taken in isolation, with no relation to each other, and without considering the impact of one decision on the other.**

So, why not do it in a structured manner?

Financial Planning is the process of utilizing your Financial Resources in the best possible manner to achieve your Financial Goals. Financial Planning is not the same as Investment Planning or taking advice from a chartered accountant or a banker. Financial Planning encompasses several areas of personal finance such as:

a. Cashflow and Debt Management
b. Risk Management and Insurance Planning
c. Asset Allocation & Investment Planning
d. Taxation Planning
e. Retirement Planning
f. Estate Planning (Transfer of Wealth, Wills, Power of Attorneys and Trusts)

What is a Financial Goal, You Might Wonder?

Setting financial goals is the heart of the financial planning process. It's a critical component that you should be clear about.

A financial goal is a clearly defined, quantified and time-bound goal that a person or family has. Buying a house is a goal but buying a house for Rs. 3 crore by March 2014 is a precisely defined financial goal.

We will cover financial goals in the Vision for the Future Chapter 5.

Does Everyone then Require Financial Planning?

Some people live in the fallacy that just because they are successful they do not need to plan or they know what planning is all about. At the other end of the spectrum, there are people who think they do not have money to plan.

Every person, however poor or wealthy, requires financial planning just as any poor or wealthy person requires medical treatment.

Every person and family needs to plan because:

a. There is a finite source of money that needs to be allocated for different needs, wants and requirements. Hence, there is always a strong need for prudent cashflow and debt management.

b. There is no social security system in India and one must plan properly for retirement, contingencies (including medical) and unforeseen events.

c. There is a need to have discipline into their financial matters.

d. They must invest surplus cashflows in line with their overall objectives and financial goals.

While taking a drive to an unknown place, the first thing that people will do is to zero in on the driving directions. Similarly, when cooking a new dish, most people will want to ensure that they have the recipe in place.

Having a financial plan is like having a recipe when you plan to cook a dish. This is to ensure that the right ingredients in the right proportion are thrown in to meet your cooking expectations. Financial planning is not about being a financial whiz kid, but all about making sure that you meet your goals and dreams.

We plan most things in life right from taking a vacation to which car or gadget to buy, but when it comes to financial planning, most of us take a reactive approach. It is only when our cashflows are in a mess, or we realize we have been taken for a ride or have suffered a loss do we realize the need for financial planning.

Why don't People Plan?

There are several reasons why people don't plan.

1. **Time Poverty:** Most people do not have time to even think about financial planning. Planning requires a dedicated effort to set aside some time and meet up with someone who can help you achieve it.

Even if a person is capable of doing it on his own, he still does not have the time to do it.

2. Most people do not understand holistic financial planning and think it is the same as investment planning or tax planning. Just because they are investing in real estate, insurance policies and PPF, they think they are already doing everything. Some are advised by their friendly bank manager / relationship manager, Chartered Accountant and believe that their planning is being taken care of.

3. **Myth of No Money or Enough Money:** There are people who believe that they do not have sufficient money to plan. What they do not realize is that less money means you need to plan even more. At the other end of the spectrum, some people believe they have enough and are doing well so they do not need to plan. This category lives in an illusory world until some disaster strikes and causes financial problems.

When a patient goes to a doctor,

Does the doctor show the patient a Cipla or Ranbaxy medicine and then starts explaining the features of the medicine? OR

Does he first diagnose the patient, understand the problem and then prescribe appropriate medication?

All people would agree on the second approach. Additionally, does the patient directly go to the chemist and ask for a medicine or does he go to a doctor?

However, when it comes to financial planning, most people first look at the products being pitched to them, the attributes of the products and then see how it fits in their life.

Is this the right approach? No certainly not, it’s an insane approach of seeking advice or doing financial planning.

THINK ABOUT IT.

Answer the following questions

- ☞ How do you plan your finances?
- ☞ How much time do you devote for it?
- ☞ Do you buy insurance and investments in an adhoc fashion?
- ☞ Do you have a written financial strategy?

WHAT SHOULD BE INCLUDED IN YOUR FINANCIAL PLAN?

CHAPTER 4

In fact, 99% people in India today do not have a written Financial Plan that will clearly tell them the following:

- What are my financial goals?
- How much money do I need for my financial goals?
- How much loan should I take?
- Am I paying too much interest or appropriate interest?
- Am I paying too much premium?
- What are the financial risks that my family and I face?
- How do I plan to address professional risks such as liabilities and lawsuits?
- Do I have enough life insurance for my family to fall back on to maintain their lifestyle and take care of the children's education and marriage goals?
- Are my liabilities covered through insurance?
- What kind of returns are my investments generating?
- How much return do I need to achieve my financial goals?
- Are my portfolio returns in line with my risk profile or are they commensurate with the risks I am prepared to take?
- What are the post-tax returns that my long-term investments are earning? What are the returns that my short-term investments are earning?
- Am I paying too much or too little tax? What kind of tax planning should I be doing?
- Does my spouse know where all the financial papers are kept?
- What is my net worth today and what does my net worth need to be for me to retire?

Not having a plan in place makes people go bonkers in volatile equity markets that we are witnessing today and have witnessed earlier. Rather than taking advantage of the wonderful opportunity that was presented at 8,000 index levels in 2008 and 2009, most investors focussed on trivial matters and missed out the opportunity.

It is in times like this that a written strategy works wonders and allows you to invest confidently and sleep comfortably, ignoring the entire bloodbath around you.

Ashwin Modi is one such business owner who commits mistakes day in and day out. He has some faint idea of his objectives and goals, is not very sure of his risk tolerance and even worse, **thinks long-term means 1 year.** Sure, he made some gains in the market and believed that this experience made him a fund manager overnight. He dabbled into futures and options repeatedly because of the gains he had made earlier but lost twice as much as he earned, the second time. I told him **"Two of the biggest mistakes in the investment arena are not poor product selection and performance of investments but not having a plan and not knowing what to do in various market situations."**

Unless you know where you are going, how will you get there? How will you also know that you have reached your destination and it's time to get down?

Hence, there are few cardinal questions you must have a clear understanding of and must answer.

a. What are my personal financial goals and objectives?
b. What is my capacity to take risks and my behaviour towards risk? This will help establish your risk profile whether you are conservative, balanced, growth-oriented or any other combination.
c. What is my investment horizon? Generally, people underestimate their time horizon. For example, if you say that your investment horizon is 3 years, it essentially means that you will need the money for a goal,

expense or need after 3 years, but many times this is not the case. For example, if you ask someone with 20 years to go for retirement, about his time horizon for investment in equity, he might say 5 years or 3 years, whereas he can very well afford to be invested for 20 years. Similarly, retirement is a very long period, often stretching 25 years or beyond; yet, when people enter their 60s, they are advised to exit equity completely or reduce equity exposure drastically. There is no silver bullet here but relying on general formulas can be dangerous for your wealth and your health.

d. What are my liquidity needs? Do I need money 1 year down the line or regular income or any other requirement?

e. What is my asset allocation and is it in line with my risk profile? Many people have no clue about this, which is one of the reasons why people panic when markets correct and get euphoric when the markets go up.

f. Do I have unemotional rules on when to buy and when to sell?

g. Do I have adequate insurance policies in place? This one area needs to be addressed first and without which any financial strategy can crumble.

At the Same Time, One of the Best and Biggest Investments for Business Owners is their Business.

They must answer the following questions:

- What are my short term (0-2 years), medium term (2-5 years) and long-term (5+ years) business goals?
- How much money do I require to fund these business goals?
- How do I plan to raise the funds required for funding these goals?

Going back to Mr. Modi, he watches business channels daily and reads every possible financial magazine and paper. Looking at the tips and thoughts presented there, he feels he has a good financial strategy and takes impromptu calls every other day. The result is that his equity allocation is not

in alignment with his risk profile: he spends sleepless nights (counts his gains every now and then as if the figures will change just by counting them or looking at them) and is not sure what to do for funding his son's US education coming up shortly (he is facing some losses and does not want to book it). He did not have a proper plan for his needs at various points of time. This does not mean that Mr. Modi will miss a meal or will not be able to take care of the expense, but it could have been done in an efficient and effective manner.

I can bet that there are so many people around who do not have any written financial strategy and might not be as lucky as Mr. Modi.

Finally "If you do not know where you are going, any road will do." Do not fall into this trap and ensure this does not happen to you.



VISION FOR THE FUTURE. WHAT'S IMPORTANT ABOUT MONEY TO YOU?

CHAPTER 5

Before you frame your financial goals, it's very important to reflect and introspect on what money and wealth actually mean to you.

In the quest for money, sometimes people just go too far. You certainly have to make money. But at the end of the day you are not a money making machine. You cannot take it away with you.



There is a story of a surgeon whose CA seems to dictate the number of operations he should do in a year. While he certainly has to recoup the investment of Rs. 1 crore in an expensive hi- tech equipment, it does not mean he has to conduct a surgery that should not have been done. Yes, money is important, but it should not be more important than the wellbeing of the patient.

Ask yourself these questions:

- What is my ultimate purpose in life?
- What do I want to be known as?
- Who will remember me after I die?

If I have to choose between money and someone's trust, what will I choose?

Money could mean different things to different people. There are many values that are attached to money and unless you are clear on what is actually important to you about money or what money means to you, your financial planning will be soulless.

Money could mean the following to people:

- a→ Security
- b→ Freedom to do things
- c→ Education
- d→ Power to do great things or evil or just show off
- e→ Entertainment
- f→ Philanthropy
- g→ Luxury – King/Queen of good times.
- h→ Travel

When I asked "What's important about money to you" question to one of my clients, he was zapped. He did not know how to answer this question for 5 minutes.

Another client had tears in her eyes when I asked this question. She remembered her childhood and initial memories about money when we were discussing her values about money. She is a dentist and had to struggle early on in her life. In fact, it was a very emotional moment. Having come from a very modest family, they were always short of money but were very strong in terms of confidence. She managed to come out on top with flying colours with the help of good Samaritans. She herself encourages and sponsors kids to study; she is a philanthropist and helping others is something that is very close to her heart today.

Most of our values about money are inculcated at a very young age through our family, friends, schoolteachers and close associates. Many of us believe in teaching our kids as many skills as possible, be it arts or school subjects. But how many of us actually remember that when our kids enter the real world, the first thing they will confront is money. Many of you probably pay your children pocket money but what you don't realise is that this is not teaching them about the value of money or how to manage it. Amidst all the classes that we push our children to take, we forget an important life skill – Financial Literacy. Although some schools touch upon economics or basic finance courses, no school is equipped to analytically teach Financial Literacy to our kids.

Most parents do not take an initiative in teaching their children about money. They might touch on the concept of piggy banks and savings early on but are usually reluctant to discuss the topic of money and family finances with their children. In the Indian context, money is a touchy issue and in terms of discussing sensitive topics, ranks as high as sex education; thus, it's not surprising that most parents are loath to discuss it. This is because many parents think that they lack the skills to teach children about money and frankly speaking, the pressure of conventional education is so much that there is no time for financial literacy. My book "The Art & Science of teaching children about money" is a useful resource for parents to teach their kids about money.

I strongly believe that the best way to teach children about money is to let them deal with money early on. It's far better that they commit mistakes at a young age with smaller amounts than commit financial blunders when they grow up. They will thus experience handling their own money and making decisions around it. I believe this is a strong competitive edge that you can give your children for their future financial success.

THE KEY LEARNING POINTS FOR KIDS SHOULD BE:

- Having healthy values about money

- Setting goals and priorities
- Thinking and making prudent choices
- Not living for the weekend: delay instant gratification
- Understanding the virtues of hard work

The onus of imparting and inculcating money values and morals, and teaching personal finance is left to the family since schools shy away from educating their students about money.

At best, we learn about savings from our family who try to inculcate good values and learning in us. This is one reason you will see that most Indians (the earlier generation) are good savers (which may not be true of the future generation), but the important question is, are we good investors?

The answer is a resounding No. However, many people think that they have substantially higher Financial IQ. This is one of the reasons why Ponzi schemes and scams flourish throughout the country. I have come across many investors who have said, "What's so great about financial planning or I make 15% returns in 2 weeks or real estate is the safest investment and no one can ever lose money in it". Their general IQ is a different matter altogether as many times, they do not even apply basic common sense in financial decisions they take.

Some people are indeed capable of taking prudent decisions; even then, **there are so many things like those that we discussed in the earlier chapters that people do not know.** Even today, so many smart people in this country are paying huge premiums but are still under-insured and have wrong policies. In fact, life insurance premiums are one of their biggest investments. They pay substantial premiums only to get a low cover. There are several other mistakes, some of which we covered in Chapter 1 that most people are guilty of.

Ask yourself, “What’s important to me about money?” Bill Bachrach, a renowned US financial coach, has written a book, “Values Based Financial Planning”, where he has described and illustrated money values in depth.

Note down your responses to “What’s important to me about money” as follows:

1.	
2.	
3.	
4.	
5.	

Responses

Now let’s say you wrote “Security’ as the first answer. Ask yourself “What’s important about security to me?” The possible answers could range from “I want to ensure that my wife’s and children’s lifestyle are taken care of” to “I want to ensure that my kid's education is taken care of and so on”.

You can extend each response by asking further, “What’s important about ensuring my wife’s and children’s lifestyle?” Continue this exercise until you conclude understanding your ultimate mission, the reason you exist. Until you answer, “This will fulfil my life’s purpose”, keep asking yourself “What’s important about” questions.

Once you are clear on what money means to you, the next step is to understand your tangible financial goals for which you will need money.

SAMPLE FINANCIAL GOALS (AMOUNTS ARE IN TODAY’S RUPEES)

1. Buy a house for Rs. 6 crore in April 2013

2. Build a corpus of Rs. 1 crore for daughter’s US education in 2021
3. Build a corpus of Rs. 50 lakh for daughter’s marriage in 2026
4. Retirement income of Rs. 5 lakh per month starting January 1, 2028
5. Buy a vacation house in Goa for Rs. 2 crore in 2015
6. Set up a Family Foundation with an initial corpus of Rs. 40 crore by 2027

CLEARLY DEFINE YOUR GOALS AND QUANTIFY THEM IN TERMS OF AMOUNT AND TIME.



What are your Financial Goals?

1.	
2.	
3.	

4.	
5.	



BASIC FINANCIAL PLANNING CONCEPTS & RATIOS

CHAPTER 6

Once you are clear about your financial goals (where you want to go), the next step is to understand where you really are.

To do this, you must have a handle on two important statements.

a. Cashflow Statement
b. Net Worth Statement



a. Cashflow Statement

This statement takes stock of your income and expense from every possible source. The period for this can be taken as April 1, 2011 to March 31, 2012. If you find it difficult to project your income, then you could take last year's income as well and make a prudent projection based on current progress.

Salaried people have a fixed income every month. Most business owners and professionals will have a variable income depending on great, good, average and bad months. Certain professionals and businesses charge fees in cash and their inflows vary from month to month. In my experience, very few people are able to exactly account all the details of their income. Another reason for this is the discipline demanded for recording accounts and creating financial

statements, which people lack. Most professionals have no clue of their profitability in a month or a month where their expenses have exceeded their income.

Similarly, many salaried people have no clue about their total expenses, savings capability and budgets.

The cashflow statement is the first statement that must be created by every person or family. It serves two purposes:

1. It tells a person whether he is generating surplus cashflows post taxes and personal lifestyle expenses. He can then make prudent choices of these surplus funds and use them for fulfilling personal financial goals.

2. If he is not generating surplus cashflow, then this statement and the following financial ratios can probably point out problem areas.

SAMPLE CASHFLOW STATEMENT

2010-2011	Ashish Punjabi (Rs.) Monthly	Anjali Punjabi (Rs.) Monthly	Total Family Monthly (Rs.)	Total Family Annual (Rs.)
Cash Inflows				
Salary Income	5,50,000	3,30,000	8,80,000	1,05,60,000
Income from Consulting	1,00,000		1,00,000	12,00,000
Dividends				
Interest Income		20,000	20,000	2,40,000
Rent				
Total Cash Inflows	**6,50,000**	**3,50,000**	**10,00,000**	**1,20,00,000**
Cash Outflows				
Mandatory Outflows				
Home Loan EMI	2,40,000	1,00,000	3,40,000	40,80,000
Donation	5,000		5,000	60,000
Personal Expenses				
Public Provident Fund (annual)	70,000	70,000		1,40,000
Insurance Premiums (annual)	6,00,000	4,00,000		10,00,000
Children's Education Expenses	10,000	10,000	20,000	2,40,000
Groceries	20,000	10,000	30,000	3,60,000
Transportation	10,000	10,000	20,000	2,40,000
Utility Bills	10,000		10,000	1,20,000
Tax (annual)	18,00,000	12,00,000		30,00,000
Clothing & Personal Care	30,000	30,000	60,000	7,20,000
Others (Home/ Car Repairs)	10,000	10,000	20,000	2,40,000
Medical & Dental Treatment				
Savings into any investments				
Voluntary Expenses				
Entertainment / Vacation (annual)	5,00,000	5,00,000		10,00,000
Total Cash Outflows				**1,12,00,000**
Current Surplus/ (Deficit)				**8,00,000**

Current surplus/deficit indicates any excess cash available or shortfall at the end of the current year once all expenses have been covered and investments made. The family's ending surplus or deficit is the sum of the individual family member's ending surpluses or deficits.

Once this statement is filled, the following two ratios are important:

Ratio Calculations	**Actual**	**Ideal**
Savings: Gross Income		Minimum 25%
Debt Payments: Take Home Pay		Maximum 35%

One more ratio that should be checked is the Cash: Expenses Ratio

This ratio is equal to the amount available in your savings account, FDs and cash divided by your monthly expenses. Let's say you have Rs. 12 lakh in your Savings Account and your monthly expenses are Rs. 1 lakh. This means that your Cash: Expenses ratio is = Rs. 12 lakh /Rs. 1 lakh = 12.

Income fluctuates for business owners and professionals from month to month based on several parameters. May and June might see lower business for many professionals as many people take vacations during this period. In the case of a doctor or a practising CA or lawyer, a 2-3 week holiday might mean income is low, but expenses remain the same or are slightly lower.

To tackle this issue, people with variable income must keep surpluses aside from great months to even out the bad or slow months. This sort of planning and detailing is very important and must be done as soon as possible.

b. Net worth Statement

A net worth statement gives you a snapshot of your financial situation at a certain point in time. It includes what you own (assets), what you owe to creditors (liabilities), and the net value or difference between the two (net

worth). In simple terms, the net worth statement shows how much money would be left if everything you owned was converted into cash and used to pay off your liabilities.

Net Worth Summary

As of December 20, 2010

	Ashish Punjabi	Anjali Punjabi	Punjabi Family
Liquid Assets	**Rs.**		
Savings Account	10,00,000	10,00,000	20,00,000
Bank FD	10,00,000	30,00,000	40,00,000
Liquid Fund			
Cash			
Invested Assets			
Stocks	1,00,000	50,000	1,50,000
Equity Mutual Funds	5,00,000	3,50,000	8,50,000
Bonds (RBI)			
Debt Mutual Funds			
PPF	10,00,000	10,00,000	20,00,000
NPS			
Post Office Investments			
Senior Citizen Savings Scheme			
Gold	1,50,000	32,50,000	34,00,000
Real Estate	1,50,00,000	1,50,00,000	3,00,00,000
Life Insurance Cash Value	25,00,000	15,00,000	40,00,000
Real Estate PMS			
Private Equity			
Art			
Life style Assets (Residence, Car etc.)			
Residential House	1,50,00,000	1,50,00,000	3,00,00,000
Car	15,00,000	12,00,000	27,00,000
Jewellery		19,00,000	19,00,000
Total Assets			**8,10,00,000**
Liabilities			
Home Loan	60,00,000	60,00,000	1,20,00,000
Car Loan			
Total Liabilities	**60,00,000**	**60,00,000**	**1,20,00,000**
Total Net Worth			**6,90,00,000**

Ratio Calculations	Current	Ideal	Comments
Liquidity : Net Worth		5-10% if shares and mutual funds are excluded. 15-25% if included	Divide liquid assets (savings accounts, fixed deposits, liquid funds and cash) by your overall net worth. Shares and mutual funds can lose money on a day when you wish to exit and there is another name that could be used if we use shares and mutual funds in liquid investments (Marketability: Net worth)
Liabilities : Assets		Max 30-35%	The lower the better however one needs to strike a balance so as to leverage in the most appropriate manner.
Investments : Net Worth		Min 50%	The higher this ratio, the better. This indicates that a significant portion of your networth comprises of your investments.

c. Spending Budget or Savings Budget

One of the things that you must do is to have a Savings Budget

Most budgets we create fail, as we keep a spending target based on our expenses. This is not only difficult but also almost impossible to implement, as there are several expenses that keep cropping up right from that iPod to the latest Plasma TV. Hence, the best strategy is to have a savings budget in place, to save and invest at least 25% of your gross income.

If you are unable to save 25% of your gross income, you should then save at least 25% of your net income. This is something that you must do every month and is popularly known as the “Pay Yourself First” concept. The idea behind this concept is that you pay everyone right from the government

(taxes), banks (interest), restaurants (dining bills) and others, yet you neglect the most important person to pay out. You.

How do you save?

- Do you first spend and then save whatever is left from the monthly income? OR
- Do you save first and then spend?

I strongly recommend the second approach, which also means keeping a Savings Budget.

d. Time Value of Money

We all know that a rupee earned today is far more valuable than a rupee earned tomorrow. You can invest the rupee earned today so that its value is much greater tomorrow or you can consume with the rupee earned today. Present value is the value of money you have today. Future value of money will be based on what the money will grow to in the future.

Generally, people take on many loans thinking that their future income will be much higher than today's income and hence, the debt will be comfortable going forward. However, many fail to understand the opportunity cost and whether that money earned today could have been put to better use to have a much higher amount in the future.

$$FV = PV\ (1+i)^n$$

FV is the Future Value, PV is the Present Value, I is the interest rate and n is the number of years. The formula is the same that we learnt for compound interest in school.

Time value of money concerns with the subject of spending in future versus spending today. Ask yourself, “Am I better off paying a home loan today or am I better off retaining the loan and utilizing the surplus funds that I have to grow my investments? If there is a sudden opportunity that comes up, do I have surplus liquid assets that I can possibly utilize?”

e. Compound Interest

According to Albert Einstein, compounding is the eight wonder in the world. You will not know the enormity of compound interest until you actually experience it over a period. Many people with very modest incomes and savings have amassed Rs. 5 crore by just investing Rs. 10, Rs. 50 and up to Rs. 500 in equities in a span of 25-35 years.

Sharad Sharma always felt that the cost of 65% he paid in the first year on one of his insurance policies was not much. He said, “My bank has said that in the long run it will even out and the investment will recoup all the costs”. True, the investment might recoup all costs in the long run, but what it will not recoup is the difference if the same amount had been invested in an investment with a much lower cost of 1-2%. The overall damage done by the 65% upfront cost over a period of 25 years is extremely high **and a Persian Emperor’s story might help explain the enormity of compounding**.

Story

A Persian emperor lost a bet with one of his court members. The emperor haughtily told the court member, “Ask for whatever you want.” The court member, a mathematician, was a sharp cookie. He said, “My lord, all I ask for is one grain of rice for the first square of the chessboard and then double the grain of rice for every following square.”

The emperor thought that the mathematician was crazy to ask for such a modest reward when he could have asked for something bigger. On the day of the reward, in front of the entire court, the emperor gave the mathematician one grain of rice for the first square. The emperor then

went on to give him another grain of rice for the second square. The mathematician said, "My lord, you were to double the amounts for every following square". The emperor said "Oh yes, Here you go." The third day the emperor gave 4 grains of rice, then 8, followed by 16, 32, 64 and 128. On the 14th square, the emperor had to give 2048 grains of rice. Things became interesting after 28 days when the amount of grains had crossed almost 1,000 tonnes. By the 60th day, the king had to give 1,15,29,20,00,00,00,00,00,00,00,000 grains of rice. The king could not pay and was declared bankrupt. The mathematician then took over the empire and lived happily ever after. By the way, there was no need to go on until the 64th square. This is the power of compounding.

Rule of 72

The Rule of 72 is a quick and simple rule to calculate how much time it will take you to double your money. For e.g. to double your money in 4 years, you will need a return of 72/4 = 18%. Similarly a 12% return will double your money in 72/12= 6 years. This is a very basic calculation that can be done even with a simple calculator or without it.

Rule of 115

Like the Rule of 72, the Rule of 115 is a quick rule to calculate how much time it will take you to triple your money. For e.g. to triple your money in 5 years, you will need a return of 115/5 = 23%. Similarly a 10% return will triple your money in 115/10 = 11.5 years.

f. Inflation

Inflation is a silent money killer. It erodes the value of your money over time and in a high inflationary environment, you will consume less every month for the same amount of cash. As an example, a movie ticket in the late 1990s was around Rs. 50. Can you buy a ticket today at the same cost? Not unless you go for the early morning show on Sunday.

The point is that a rupee earned in the future can only buy less than a rupee earned today thanks to inflation. If your monthly living budget is Rs. 10,000 today, you will require Rs. 20,000 to maintain the same lifestyle 10 years down the line. Of course, this is also based on the kind of lifestyle you lead, as lifestyle inflation is much higher than the "newspaper headline" inflation for normal living needs. **Hence, your primary objective should always be to earn positive real returns post inflation and taxes.**

In 2008, inflation touched 13% and in 2011 onion prices jumped up by 200% or more. Similarly, petrol and diesel prices have been on their way up practically every year. Benign inflation for an emerging economy such as India is in the region of 5-6%, however there will be periods of high inflation like the one we are witnessing now.

g. Short Term Assets

Short-term assets are assets that can be used to fund short-term goals (between 0-24 months). They can be liquidated immediately without any risk of capital erosion. Short-term assets can be your savings accounts, cash, fixed deposits, liquid funds and short-term bond funds. Although the returns earned on these investments can barely beat inflation, these assets are a key component of your overall portfolio. Make sure you have sufficient short-term assets to address all your short-term liabilities and short-term needs.

Sometimes, these short-term assets come in handy to buy distressed assets or when assets/investments are on sale.

h. Long Term Assets

These assets are ones that are not required in the next 10-20 years. Long-term assets include real estate, stocks, equity oriented mutual funds, life insurance policies, gold, and PPF. These are typically investments made with a view that the capital amount might not be required for several years.

Returns from long-term assets can be very high depending on the type of investment. All your long-term goals should be funded with long-term assets.

For e.g., retirement income corpus accumulation should be done with stocks/shares, equity oriented mutual funds, real estate, gold, and PPF and never with savings accounts, fixed deposits and bonds.

i. Short Term Liabilities

Short-term liabilities are the liabilities or debts that have to be immediately or shortly paid off. These include credit card payments, personal and consumer loans. These also include day-to-day expenses, rent, taxes and utility bills. These liabilities carry a high interest cost or are payments that must be made immediately. Make sure you have sufficient short-term assets to address short-term liabilities. You must have short-term assets worth at least 6-12 months of short-term liabilities. People with fluctuating incomes can have short-term assets to fund at least 12-18 months of liabilities.

j. Long Term Liabilities

Long-term liabilities are those that are secured by the asset against which the borrowing is done. These are primarily home loans, commercial property loan, loan against property, car loans and equipment loans. However, of these, education loan is an uncollateralized loan that is a long-term liability. In fact, the payment of education loans starts several months after the student's education is complete. The interest rate on long-term liabilities is significantly lower than that of short-term liabilities.



KEY POINTS

- Keep your short-term liabilities to a minimum.
- Do not fund short-term liabilities with long-term assets. Aim to fund these with short-term assets.

COMMON CASHFLOW & NET WORTH BLUNDERS

1. I have met several people who have several lakh in their savings account earning 4% interest whereas they are paying 16% or more on personal loans.
2. Not knowing when you are heading in a debt trap
3. Not managing financial leakages well

Your Financial Leakages Can Sink Your Financial Ship

Arjun Nair, an advertising industry executive in his late forties has been suffering from what I call the "Financial Leakages Syndrome". Although he earns an enviable Rs. 24 lakh per year, he finds it difficult to save a single penny. His argument is simple: "Life has become so expensive, plus these taxes and loan EMIs are killing me." His wife, Deepa, however disagrees with Arjun and says that this has been their case for the past 20 years of their marriage. She strongly felt that they could save much more as a family. I completely agree with Deepa and I believed there were several avenues to cut down on their financial leakages.

The starting point was to look at the monthly inflows and outflows of the Nair family. Overall, things looked fine and there were common outflows such as home loan EMI, daughter's college and tuition fees, groceries, transportation, utility, entertainment and vacation. But when we drilled down further, we found that his branded alcohol and cigarette intake was costing him around Rs. 2-3 lakh per year. His monthly alcohol intake was costing him around Rs. 14,000 (which included occasional consumption in restaurants) and cigarettes around Rs. 4,000 per month. Besides this, there were two dinners on an average a week, which cost around Rs. 2,500 per week. Also, three visits to multiplexes in a month clubbed with some shopping cost him another 10,000. It's not a difficult exercise but if you add the numbers, the total is around Rs. 30,500 per month. This is excluding the vacation and other lifestyle expenses, which the family had.

Let us see how much savings he could achieve if some of these leakages were cut by half.

A branded pack of cigarettes costs around Rs. 100 today. A 50% cut in consumption, is not only good for one's health but will also help build a corpus. Similarly, a quarter of alcohol costs around Rs. 165 (I am referring to Indian whisky, foreign brands are certainly higher). A 50% consumption cut here will mean drinking every 2 days or gulping down two small pegs of 30 ml instead of two Patiala pegs. A movie ticket at a multiplex costs Rs. 300 per person (the same would cost Rs. 70 for a Sunday morning or the 11:30 am show).

Financial Leak	Monthly Cost Today (just considering 50% of his actual expenses)	Value if amount invested at 12% in 10 years	Value if amount invested at 12% in 20 years (approximate figures)
Alcohol	Rs. 7,000	16,10,271	69,24,787
Cigarettes	Rs. 2,000	4,60,077	19,78,511
Watching movies at multiplexes and spending at malls (besides regular shopping)	Rs. 5,000	11,50,193	49,46,277
Eating out regularly	Rs. 5,000	11,50,193	49,46,277
Total		**43,70,734 (~ Rs. 44 lakh)**	**1,87,95,852 (~ Rs. 1.88 crore)**

SOME TYPICAL SOURCES OF FINANCIAL LEAKS THAT MOST PEOPLE ARE EXPOSED TO

- Addiction to cigarettes, alcohol, certain foods and drinks
- Not shutting off heaters, air conditioners and electronic equipment after use
- Buying on credit and making only minimum payments on credit card outstanding balances
- Keeping money in low-interest savings accounts and fixed deposits

> and at the same time keeping high interest loans

Occasional indulgences are perfectly fine, but if you are addicted to certain items that do not seem to cost a lot of money now, some financial plumbing might help. The whole idea is to either seal the leaks completely, or run a tight ship, so that these leaks don’t sink your financial ship.

Savings are the building blocks of wealth creation and you must keep a portion of what you earn today no matter how poor or how wealthy you are. Your lifestyle should match your current income, savings and financial situation or one day these financial leakages can take you down. Even celebrities (their leaks could well be termed as financial drains), such as Michael Jackson, Mike Tyson and some Bollywood celebrities of yesteryears went down as they forgot the **cardinal rule of managing money: spend wisely or any income, no matter how high, can be spent completely.**



WHAT IS RISK?

CHAPTER 7

Webster defines Risk as “possibility of loss or injury” or “the chance that an investment will lose value”.

Everyone faces two types of major risks:

a. Pure Risk
b. Speculative Risk (risk that arises from making choices)

Pure Risk represents a situation where there can only be a loss to an individual should some unfortunate event take place. This could be in the form of risk to life, whether by accident or illness. It could also mean risk to property such as houses or cars by means of theft, fire and floods.



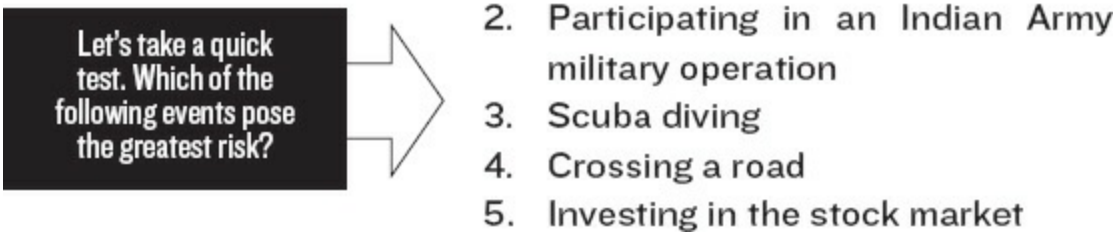
Professional Risks such as **Professional Liability of Doctors, Accountants and Lawyers** are also examples of **Pure Risk**.

On the other hand, **Speculative Risk Can Result In a Gain or a Loss.**

For example, **running a business or practice can lead to a loss or a gain.** The gain that arises is the reward for taking the risk and hence could be

termed as speculative. I do not know if business owners and professionals who say they are conservative have really thought of running a business or practice as a speculative activity. At the same time, someone who is very conservative and who feels that fixed income is the way to go might be in for a surprise when his financial institution or bank goes bust.

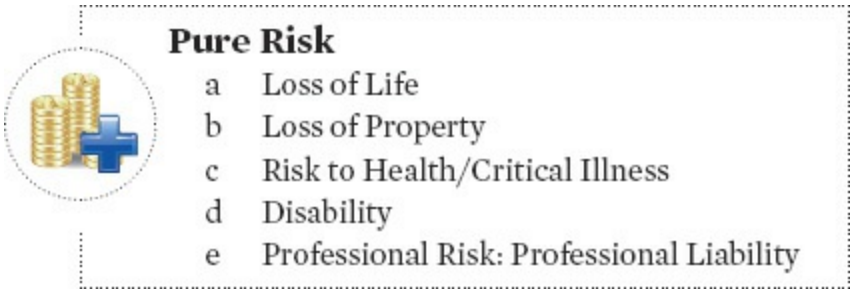
In fact, all of us are exposed to risks at different points of time. All these risks have financial implications for each family. **The recent Mumbai attacks have once again demonstrated the kind of pure risk that we are exposed to in our daily lives.**



The first few thoughts that are likely to come in your mind are investing in the stock market, military operation and scuba diving.

The reality is that crossing a road and driving on highways are the top two risks. More people are killed just crossing the road and in accidents than by any other way. Yet, people feel the utmost comfort crossing a road or driving on highways. Yet, the moment you hear of the stock market or scuba diving, the fear of an unknown element takes over and leaves you cold. The only thought that comes to your mind is "I can't do this and I don't want to do this".

Under the categories of risks discussed above, there are various types of risks such as:



Speculative Risk

Unlike pure risk, speculative risk can result in a gain for the person in case of a fortunate situation. So besides the chances of a loss, there is a probability of gain as well, e.g., running a business, investing in equities, commodities, real estate, gold and gambling, to name a few.

The situations can swing in any direction. In good times, returns from a professional practice or business can be very lucrative but at the same time during initial or bad years, one can incur huge losses.

Besides the above, there are certain professional risks such as the ones faced by doctors, sportspeople, actors, corporate executives and other professionals.

Special Risks that Doctors, Sportspeople, Actors and other Professionals are Exposed To

Most people are exposed to several pure as well as speculative risks, but there are three special risks that only professionals are exposed to.

a. Professional liability (doctors, professionals and directors of companies)
b. Loss of income due to an injury to hands (surgeons, musicians and sportspersons)
c. Risk of being physically assaulted or beaten by aggrieved patients or their families (doctors)

Generally, people are exposed to these following risks:

d. Loss of life

e. Health and critical illness
f. Disability
g. Risk of loss in business, investments and other ventures
h. Loss of property

You might be lucky enough not to be affected by most pure risks and all speculative risks, but there is one risk that you simply cannot avoid. This is the risk of an early death and the financial implications that it has on your family.

The key is to figure out how to manage these risks.

There are generally three ways to manage risks:



None of the pure risks can be avoided but you can certainly avoid some of the speculative risks. This leaves you with two choices namely RETAIN or TRANSFER.

Retaining risk is again something that is a privilege for a select few and some day you should get there by implementing the principles of financial planning. However, for most people, transferring the risk is the first prudent solution.

Who is willing to accept these risks?
An insurance company accepts all the pure risks at a cost, often called as the premium.

At the same time, it is important that you build a solid base of contingency funds, and investments that can supplement insurance and ensure that you sail smoothly through the journey of life.



LAYING A SOLID FOUNDATION - BUILD YOUR WEALTH PYRAMID

CHAPTER 8

To address the risks explained earlier and to create wealth in the long run, you must have a solid base – typically in the form of a Pyramid. Let's call it your "Wealth Pyramid".





The base of the pyramid consists of contingency funds (cash, savings account, fixed deposits, insurances, overdrafts and sources of debt that can be

tapped).

Many people only focus on asset accumulation primarily in the form of real estate and some investment-oriented insurance policies. As you can see, real estate is on the top along with equity. Equity and real estate is what you must invest in, in that order, after your Wealth Pyramid's base is strong. In the event of an unfortunate incident, if your wealth pyramid has a weak base, your overall financial strategy can just collapse.

Contingency Funds and Opportunistic Cash

The first step is to have liquid contingency funds. Although you might earn a little less on these cash investments, you must have cash assets (savings account, liquid funds, fixed deposits: more on these investments later), primarily for three reasons.



a. You should have sufficient funds when monthly bills are due or when insurance premiums, salaries and other expenses have to be paid. If you are earning a solid income but always have liquidity problems, there is certainly something wrong with your cashflow and budgets. You need to do a reality check with a financial planner/advisor as soon as possible.

b. There are various events such as accidents, illnesses or surgeries (that might put you out of the game for several months) and events such as floods or terrorist attacks that we should factor in our planning. These events might never occur in your life but should they occur, you need to be adequately prepared.

c. The stocks markets came down from 21,000 to 8,000 levels. The real estate market had peaked in 2007-2008 but builders, real estate consultants, real estate agents, sellers and even buyers did not accept this fact. However, in early 2009 there were some excellent deals available. The best time to buy real estate and equities are when they stink.

However, one should have what I call opportunistic cash available at that point of time to buy good bargains.

The quantum of cash assets that you should hold is actually a function of:

- Stability of your income
- Your current net worth and cashflow
- State of the economy and markets
- Your current debt and liquidity situation

Most financial planners would advocate keeping anywhere between 3-4 months' expenses in the form of cash assets.

I advocate a simple formula.

1. Pay yourself a Monthly Salary. The way most people work is that they first pay all the bills and then consider what is left as their income. This is a rudimentary way of doing things and gives you no control over your finances. Pay yourself a fixed salary every month that should take care of all your personal bills. This way you can use your surplus funds better every month by investing it in productive avenues such as blue chip stocks, diversified equity funds, gold and building up the opportunistic cash reserve that can be used for real estate and other one-time investments.

2. Keep 2 months of personal expenses in your savings account with a sweep-in facility and 4-10 months of expenses in liquid funds or fixed deposits. This figure can be higher based on your overall financial situation and risk profile. Business owners and professionals should have an additional contingency to cover business expenses as well.

3. Alternatively, you should have an OD facility of a similar amount that can be utilized in case of any contingency. This is a much better option as you only pay interest for the period you utilize the money for and at the same time are able to deploy the funds productively.



HAVE APPROPRIATE INSURANCE IN PLACE

Life Insurance

What is Life Insurance?
98% of Indian policyholders are under-insured and have an irrelevant type of policy with them. They have bought life insurance either to save tax or as an investment. The entire focus is to get a tax deduction now and the amount that one would get at the end of the term. In this process, one often ends up paying a huge premium and getting a negligible cover. This low cover bit was amply demonstrated by the KILB (Kum Insurance Lene ki Bimari) Aegon Religare Life Insurance advertisement. Besides KILB, most people are also afflicted with what I call IIMB (**Investment Insurance Mix** karne ki **Bimari**).

You know that you are going to survive the term and hence focus more on what the maturity proceeds will be. If you know you are going to survive the term, why buy life insurance at all? Why don't you keep the funds under the mattress or in a bank account or just invest the amount?

Life insurance is not about saving tax nor is it about making an investment or maturity amount. Life insurance is all about providing for your family, protecting their lifestyle if you are not around and ensuring that the goals for which you have worked so hard are achievable in your absence. Don't think of insurance as a tax saving or as an investment or an expense. Just like you insure your car, and home, insure yourself. **It is primarily a risk cover, and that's the way to look at it until you are sufficiently insured.**

Your presence and contribution are of utmost importance not only emotionally but financially as well. **Make sure you leave your family with at least the financial support they need should something happen to you.**

On an average, people would have life insurance covers of anywhere between Rs. 5 lakh – 50 lakh. What good is a cover of Rs. 50 lakh if there is a Rs. 40 lakh liability to be paid? The balance Rs. 10 lakh will be spent in a couple of years.

What after that?

Ask yourself the following question:

- How much life cover do I have?
- Is it sufficient to cover all my liabilities, my children's education, their wedding and my family's monthly expenses until my children become independent?

Once you think through this question, ponder on the points made in this section. Then, do a thorough assessment of your needs through the Needs-Based Analysis method covered in the following chapters, and ask yourself the following questions:

- Is my policy relevant for me?
- Am I paying the right amount of premium? Is my premium high and cover low?
- How much life insurance do I need?
- How much premium should I be paying?
- Which product should I opt for?
- What should I do about my current life insurance policies?

Mumbai Terror attacks

Individuals not just in Mumbai but also in other cities are angry, frustrated at the loss of lives and injuries of innocent people in the 2011 blasts. Unfortunately, most people feel helpless about such situations. A person remarked, “My brother was shot dead in 2008 but even in 2011, Kasab continues to live.” Noted Lyricist Prasoon Joshi remarked in an interview “We seem to have accepted terrorism as a part of our life just the way we have accepted corruption to be a part of our life.” This remark has a lot of meaning and it should make people think on how we really look at things. Every individual must be alert and aware of his surroundings to ensure his own as well as other citizens’ security.

During the 2008 terror attack, I came across a victim’s brother’s interview where he said, “My brother had a policy but I do not know the details of the same or where he has kept it”. Another asked, “Is terrorism covered?”

Terrorism is a horrendous event that is covered in most policies. Most people are simply unaware of the fine print when it comes to insurance policies. However, a rider such as Accidental Death is not covered under Terrorism. For e.g., if a person has a basic cover of Rs. 40 lakh and at the same has an accidental death rider of Rs. 10 lakh, then the person’s family will receive insurance proceeds of Rs. 40 lakh only. The accidental death rider will not be honoured.

Generally, there are no standalone products that offer only Terror Insurance. However, in these uncertain times, many people tend to have certain questions such as:

1. Do I have sufficient life insurance?
2. Does my policy cover terrorism?
3. Are there any standalone products in the market today?

The fine print could certainly vary across insurance companies and it will be a prudent thought to check with your insurance company. At the same time,

many general insurance companies offer terror cover as an add-on to the main policy.

Insurance is an extremely important tool in transferring your risks if you are unable to retain them on your own.

Every individual must not just look at life insurance but also medical, disability, home and property insurance. Although there are very limited options on the disability front, there are many options for life, medical and property insurance. You must carefully evaluate your needs and ensure that you have sufficient cover to address any financial risk.

Most people pay hefty premiums for their cars but when it comes to property and life insurance they often have second and even third thoughts. A home cover is also important; however, you need to carefully look at the exclusions and inclusions.

Your Policy Will Describe the Kind of Coverage You Enjoy

a. A life insurance cover will give your family an assured sum on your death.

b. At the same time, Property cover will cover any damage to property even the ones witnessed in the Taj and Oberoi Hotels and could also cover public liability, which includes the risk of death or injury to people in the premises.

We must certainly ensure our own security by being vigilant and taking measures along with media, self-help groups, corporates and individuals; however, first be self-reliant.

1. Ensure that details of your existing life insurance policies are known to your family members. Details include the type of policy, coverage and what must be done in case of claims settlement.

2. Review details of all policies and benefits under each policy and maintain a log, a copy of which must be with your spouse or in a locker.

3. Update family members on where all the policy documents are kept.

4. Last, if there is a shortfall of insurance, ensure that you transfer it to an insurance company at a low cost.

So How Much Life Insurance do you Need? How Should You Calculate Your Life Insurance Needs?

Calculating how much life insurance you need is one of the most important financial decisions you will ever make. It should never be an isolated decision **focusing only on how much premium you can afford.**

There are several ways of calculating your life insurance needs such as the Income Replacement Method, Human Life Value Method and Needs Analysis Method.

I believe that you should go for the Needs Analysis Method to calculate the minimum Life Insurance that you require. This is because it is the most accurate method of calculating your life insurance needs based on your unique situation.

STEP 1

Determine the one-time expenses of your dependants (clearing off liabilities, corpus for parents, siblings education and/or marriage, children’s education expenses and marriage) (A)

STEP 2

Estimate dependant's annual recurring expenses (B)

STEP 3

Estimate survivor's annual income (C)

STEP 4

B – C = Annual Shortfall (D)

STEP 5

Multiply D by the number of years you expect the youngest dependant or child to become independent and after that until your spouse is 80 or 90 years old (E)

STEP 6

A+ E = FINANCIAL RISK YOU NEED TO COVER (F)

STEP 7

Calculate the total investments and assets that you own (G)

STEP 8

Amount of current life insurance (H)

STEP 9

F – G – H = I, if **I is negative you are either sufficiently insured or do not need life insurance, else I is the amount of life insurance cover you need to buy today.**

EXAMPLE

Let's take the case of Hari Subramanian, a corporate executive in his late thirties. He lives in Bandra with his wife (who is a homemaker) and daughter.

STEP 1

- One-time expenses of your dependants.
- Clearing off liabilities: Rs. 2 crore
- Corpus for daughter's education: Rs. 50 lakh
- Corpus for daughter's marriage: Rs. 30 lakh
- Total one-time expenses: Rs. 2.8 crore (A)

STEP 2

- Dependant's annual recurring expenses
- Monthly Expenses: Rs. 50,000
- Annual Expenses: Rs. 50,000 *12 = Rs. 6 lakh (B)

STEP 3

- Survivor's annual income is Rs. 0 (C)

STEP 4

- B – C = Rs. 6 lakh – Rs. 0 = Rs. 6 lakh = Annual Shortfall (D)

STEP 5

- Multiply D by the number of years you expect the youngest dependant or child to become independent and after that until your spouse is of 80 (E)



Number of years his daughter will take to become independent: 12 - until her age of 22. By then, his wife will be 50, so add an additional 30 years until her age of 80

Total no of years: 12 * 6 lakh = Rs. 72 lakh (until daughter becomes independent)

– 30 * 4 lakh (income for wife's retirement) =Rs. 1.2 crore

– Total E = Rs. 1.92 crore

STEP 6

- A+ E = FINANCIAL RISK YOU NEED TO COVER (F)
- F= Rs. 2.8 crore + Rs. 1.92 crore = Rs. 4.72 crore.

STEP 7

- Total investments and assets that you own (G)
- Rs. 3 crore

STEP 8

- Current life insurance you have = (H) = Rs. 20 lakh

STEP 9

- F – G – H = I

  I = Rs. 4.72 crore – Rs. 3 crore – Rs. 20 lakh = Rs. 1.52 crore

---

Rs. 1.52 crore is the additional cover that Hari needs to have if something happens to him today.

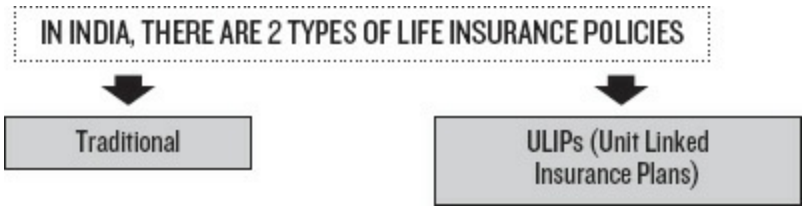
Once you have calculated the cover that you need, **just go in for a Pure Term Plan. A Term Plan is the simplest and cheapest form of life**

insurance and one that has no maturity value. It works similar to a car policy **except that the premium for a similar cover is much cheaper than the car premium.**

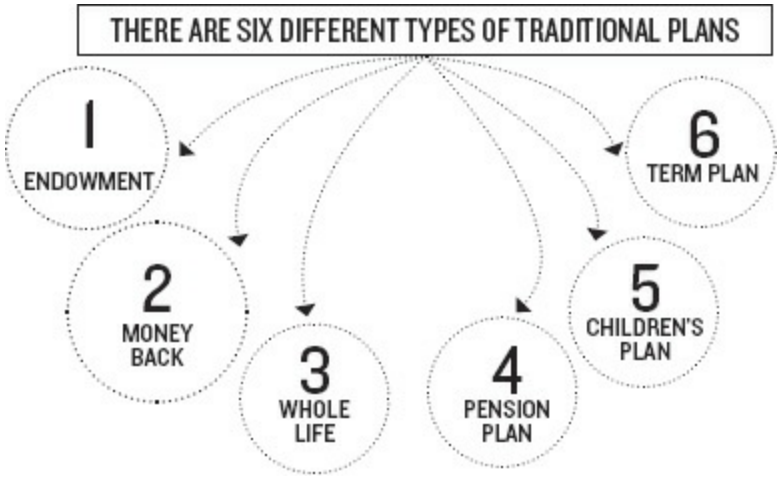
Premium for a Rs. 10 lakh car would be Rs. 30,000 per annum. A similar amount life cover for a 30-year old will be Rs. 3,000 per annum and for a 40-year old around Rs. 4,500 per annum.

Finally, remember that your insurance needs go down over a period. Hence, if you have a sudden windfall or accumulated enough wealth, then you can evaluate the need to altogether terminate your insurance policy.

Different Types of Life Insurance Policies



Traditional Plans



Except for Term Plan, the other five are available in ULIP flavours as well.

Traditional Plans are insurance policies where the policyholder has no control or choice over where investments will be made whereas in a ULIP, a policyholder has around 5-6 choices based on different combinations of equity, debt and cash.

Endowment combines both saving and protection. The investments here are done in debt investments. If you die during the policy period, your beneficiary will get whatever amount you are insured for. However, if you live, an amount will be paid to you on maturity of the plan.

This kind of policy combines savings (because money is given to you on maturity) with some protection (your nominee gets an amount if you die).

A Money Back policy combines saving and protection as well but it gives back money to the policyholders at different points in time, usually 4-5 years. In short, a money back policy will give you 20% of the Sum Assured after first 4 years, next 20% after 8 years and the remaining 20% on maturity along with accumulated bonuses.

The investments done are similar to endowment plans.

Returns that can be expected from money back, endowment and whole life policies are to the tune of 4-6% unless they are guaranteed for higher amounts.

You can see the low returns from the various bonus announcements that life insurance companies have been making for the last few years. Many private life insurance companies are not yet profitable, so there is no question of a bonus payout unless there are guaranteed payouts in the scheme.

Policyholders have no clue of where their investments have been made or even how much of their money gets invested. In short, traditional plans are like black boxes, in which you only know the premium to be paid and

have some indication of maturity amount. There is no clarity on charges, or even where your money is invested.

How many people would buy an investment that would cost them at least 35% in the first year and minimum of 5% from second year onwards but will only return them 4-6%? How many of you will actually do it? Not many sane people would make such investments.

Yet, day in and day out, people buy such traditional insurance policies from different insurance companies.

KEY POINTS TO BE NOTED

1. Returns are given in the form of bonuses
2. Illustration as per IRDA (Insurance Regulatory Development Authority) guidelines has to be shown with 6% and 10% calculations
3. Returns shown in the illustration are not actual ones
4. Bonuses are generally not calculated on compound interest basis but on simple interest basis
5. Bonuses are calculated on the Sum Assured

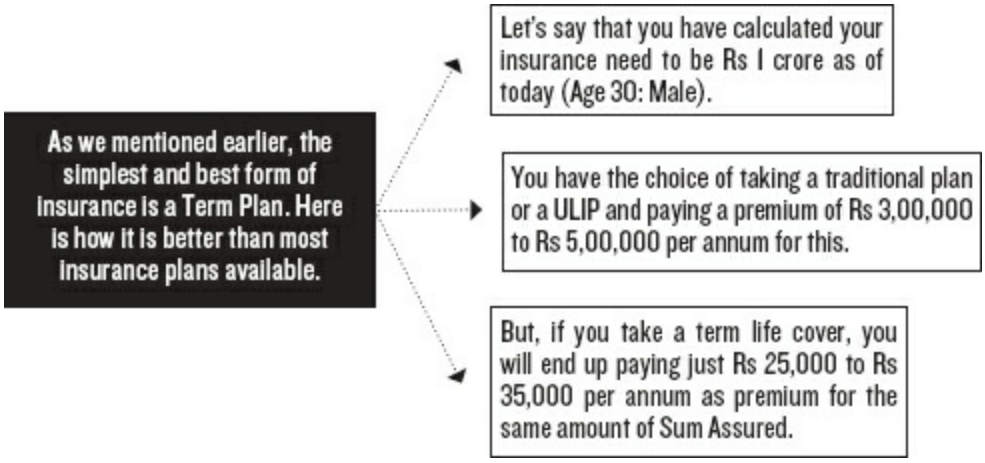
On the other hand, **a ULIP invests money like a** mutual fund where you are allotted units. Part of the premium you pay goes to provide you with an insurance cover and a part of it is invested in your choice of investment.

ULIPs were a rage in the past and were sold aggressively. However, there were many flaws with ULIPs (from a policyholder's perspective), the biggest one being its high upfront cost of around 15-81% in the first year. In addition to this, there were product administration charges and several other charges. Such charges are not noticed in a bull market but in a bearish market like the one we witness now or in normal markets, the charges can be lethal. **What**

people fail to realize is that high cost policies will take several years to just breakeven.

In 2010, the then SEBI Chairman C.B. Bhave (Securities and Exchange Board of India – Stock Market Regulator) banned 14 life insurance companies from issuing fresh ULIPs. However, within 24 hours of this ban, IRDA responded to the SEBI notice stating that life insurance companies can continue ULIP business as usual.

There was a public showdown between the two regulators where in SEBI's point was that since a ULIP invests in the stock market, SEBI should have a control over it just like the way it has over mutual funds. The Finance ministry had to finally intervene and it was not difficult to figure out who would win this round. IRDA won this ego-battle but in the end came out finally with some customer-friendly moves to reduce costs sharply.



BENEFITS OF TAKING A TERM PLAN

1. You pay much less premium.
2. Over time, as you create wealth, your insurance needs go down. So if you do decide that you do not need insurance and do not wish to continue your policy, simply stop paying premiums. But in an

endowment plan or traditional plan if you suddenly stop a policy, you end up losing a lot of money because of surrender charges.

3. You have the right kind and amount of insurance and have not compromised by being under-insured. Normally, people make a big mistake when taking investment-oriented plans where the premium is higher but the cover is lower (the policyholder is under-insured).
4. Most people are able to maximize their Section 80C investments through home loan principal, children school fees and PPF. The limit under Section 80C is Rs. 1 lakh only. So, if you are paying a higher premium there is no benefit anyway. **Term Plan premiums are fully tax deductible.**

In conclusion: You are much better off buying a term plan and investing the rest in a risk-free offering such as PPF, Fixed Deposits or Equity Linked Saving Schemes (ELSS) depending on your risk tolerance.

Should you take a cover for your spouse if she is a homemaker?

You first need to do a similar needs analysis exercise for your spouse i.e. the same calculation that we did earlier for you. If there is a shortfall, you should go in for a cover. Even if there were no shortfall, I would recommend taking a minimal cover. If an unfortunate event like a spouse's death were to happen, there would be disruptions in your income as well. Your work might be affected for several weeks or months. At the same time, there are several expenses such as taking care of children and home that would come up.

ASK YOURSELF THE FOLLOWING QUESTIONS:

1. Is my income sufficient to take care of my children, liabilities and family goals?

2. Are there any immediate expenses or recurring expenses that would come up should something happen to my spouse today?

If a husband has sufficient life cover, there is no pressing need for a homemaker to buy life insurance. However if one must buy life insurance, then it's best to go for a simple term plan that will give a high cover for a low premium. Most insurance companies will either refuse a pure term plan in the name of financial justification, moral hazard or give a low cover of around Rs. 5-10 lakh. A term cover of Rs. 10 lakh for a 35 year old woman will cost Rs. 3,400 per year. Premiums might vary from company to company but in general, there is no need to pay anything significantly more than this number. This means that you can comfortably stay away from investment-oriented policies.

Folks from insurance companies are generally of the opinion that since homemakers are not earning, there is no question of replacing income in case of their death. On the other hand, they readily agree to give you insurance if you opt for an investment-oriented insurance policy.

The right approach to buying life insurance is to consider whether the risk has the potential to jeopardize the family's future.

Should you go for Children's Plans?

There are two different kinds of children plans, one in which the life insured is that of the child and the second where the life insured is that of the parent. There is no need for you to opt for the first kind of plan, as children do not have any liabilities or dependents. It is you who needs a sizeable cover.

So, should you then go for a children plan where you are the life insured? The answer is again a no for reasons explained earlier on in this section.

Several children plans are tied to goals such as their education or their marriage. However, these goals can be achieved through any investment. There is no pressing need to club insurance and investment and then do it.

Some people are sold children plans with the argument that it is cheaper to buy insurance for them now. Nothing could be further from the truth. There is hardly any difference buying an insurance policy at the age of 16 and at the age of 24.

If life insurance is so important for a child, try buying a term plan for a child and see what the life insurance company tells you. Children are not eligible and you will not get a pure term plan from an insurance company.

Should you go for Pension Plans?

Retirement plans like children plans also suffer from what I call the "label" effect. Emotionally appealing advertisements like "Sar Uthake Jiyo" or "Jeetey Raho" or "Zindagi Ke Saath Bhi aur Zindagi ke baad bhi" induce people to buy pension or retirement plans. So, what exactly are pension plans?

BASIC DEFINITIONS TO UNDERSTAND:

a. Webster defines pension as a fixed-sum paid regularly especially to a person retired from service.

b. Annuity: A sum of money payable annually or at other regular intervals.

c. Deferred annuity: Unlike an immediate annuity where the pension starts immediately, deferred annuity has two main phases — the savings phase in which your premium is invested, and the income phase in which the corpus you have accumulated in the savings phase can be utilised to buy an immediate annuity **(In a nutshell, they are accumulation instruments carrying the misleading tag "pension").**

d. Immediate annuity: A pension plan that starts an immediate payment of a sum of money at yearly or other regular intervals (immediate

annuities are actual pension plans that keep the sanctity of the word “pension” intact).

Most pension plans in India are deferred annuities, where the premium you pay is invested to build a retirement corpus for you. Does that mean retirement plans are the best way for you to build your retirement corpus? Certainly not!

These deferred annuity plans can be either the endowment or unit-linked type. Some of these plans also come clubbed with life insurance.

While traditional life insurance policies protect your family against the risk of “dying early”, a pension plan can be used as an insurance against “living too long”. So, the very fact of combining these two is not a good recipe and can be avoided. This means that you should give deferred pension plans that come with life covers a miss.

So, why should you avoid deferred annuities that are sold as pension plans?

Costs: Most deferred annuities have a first year charge ranging from 5-25%, which is exorbitant for any investment product. **Some are cheaper and you can look at such low-cost products but after exhausting all options.**

Taxes and lack of flexibility: Only 25-33% of the corpus you build through the savings phase is tax-free on maturity and you would compulsorily have to purchase an immediate annuity (which is taxed as income in your hands) with the remaining corpus at the prevailing rates at that point of time.

Surrender charges: Surrender charges can be very high and you will get around 50% of the premiums paid from the second year onwards, provided you have paid the premiums for at least 5 years.

Should you Buy Home Loan Insurance?

It was hard to miss the HDFC home loan insurance advertisements on television sometime back “Mr. Kumar Rahe Na Rahe, Kumar Sadan Hamesha Rahega”. However, unlike the fictitious Mr. Kumar there are many individuals who worry that if something happened to them, what would happen to their home loans? This is where a home loan insurance product comes to the rescue.

Home Loan Insurance Plans, also known as Mortgage Redemption Plans, are insurance plans that cover your home loan liability. Although there are some minor variants, most plans offer a sum assured that reduces as your outstanding home loan reduces every year. In such plans, it is not your home but your loan that is covered should something happen to you. In short, it is a life insurance with the homeowner being the life assured. Let’s take an example: suppose you have taken a home loan of Rs. 40 lakh and covered this through home loan insurance. If in the year, your outstanding loan comes down to Rs. 39 lakh, then your sum assured also comes down to Rs. 39 lakh. Put simply, the sum assured is adjusted against your home loan liability.

This insurance is much like the Term Plan or Pure Risk Cover plans that are available from various insurance companies. There are exceptions like ICICI Bank and ING Vysya Bank’s home insurance loan where (Sum Insured remains constant) in the event of death of the life assured, the outstanding home loan is cleared off, and the principal that the life assured has paid so far is paid to the family.

So What Is the Similarity and Difference between Home Loan Insurance Plans and Term Plans?

THESE PLANS ARE SIMILAR IN THE FOLLOWING MANNER:

- Premiums are low and cover is high
- There is no maturity amount on survival of the term

- There is a choice of a one-time premium or regular premiums

DIFFERENCES

- The covers in term plans available in India are level term plans where the cover remains the same. Cover in home loan insurance plans decrease as your home loan liability decreases. Recent Term Plans have been launched with an increase in sum assured by a certain percentage.
- Term plans can be taken for a much higher amount to include other liabilities of the person, dependent goals and dependent income, whereas home loan insurance is capped to the amount of home loan outstanding.
- Most term plans can be bought until the age of 65, whereas home loan insurance for most companies can be bought until the age of 60. However, medical underwriting is stringent and policies are issued only after adequate tests are done.
- At the time of making the payment, the insurance company will directly pay the bank and clear off the loan. This same feature is available in a term plan if you take one and assign the policy to your bank.
- Premium is doubled in case of joint applicants; however, some discounts on the second life assured are offered by some insurance companies. If one of the joint applicants dies, the loan is paid off by the insurance company and the cover ceases.

HOW ARE THE PREMIUMS CALCULATED? ARE THERE ANY TAX BENEFITS?

- Like term plans, medical underwriting is stringent based on your age and medical record. The premiums will be based on the following conditions:
- Age of the Life Insured (Person taking the loan): Premiums increases with

age. Medical tests increase with age and are mandatory above 40. Below this age, a simple declaration is good enough although this varies from insurance company to insurance company.

- Your Medical Record: If you are in good health, the premiums will be regular but if the insurance company's medical tests and prognosis on the life assured indicates higher risk, then the premiums will be higher. A past family history of early death or critical illness could also increase the premiums.
- Loan Tenure: The premium will increase with the duration of the loan. A cover of Rs. 50 lakh for 5 years and a cover of Rs. 50 lakh for 20 years will attract different premiums with the latter being more expensive.
- Loan Amount: The higher the loan amount, the higher the premium.

Since this is a life insurance plan issued by an insurance company, the premiums paid towards life insurance schemes are eligible for deductions under Section 80C. However, if the premium is clubbed within your EMI, then you might not get the Section 80C benefit.

Is it better to opt for a Term Plan or a Home Loan Insurance Plan (Single Premium or Regular Premium)?

Term plans tend to be cheaper than home loan insurance premiums and the cover remains constant. Most plans under the home loan insurance category prefer a lump sum premium payment whereas limited players do have a regular premium payment option available. It is better to pay regular premiums as most home loans are foreclosed much before time. Also, in regular premium paying plans, you get the same cover by paying lower initial premiums (which are comfortable); should something happen to you in the initial 10 years, the premium outgo is certainly lower than making a single premium payment. At the risk of sounding repetitive, you should get thorough Needs Analysis done and not just cover your home liability but other liabilities, dependent goals and dependent income goals as well. After this, take a term plan for the requisite cover needed. For those who cannot

undergo this exercise or always procrastinate, opting for the home loan insurance cover might make sense.

Married Women's Property Act , 1874

Most life insurance policies in India are not endorsed under MWP Act. Every married man (including a widower) can take out a life insurance policy under the provision of the Act (Section 5) for the benefit of wife and/or children. If the insurance is taken under MWP Act, the policyholder (in this case, a married man) will lose all control over the policy except payment premiums from day one and policy will become a trust (wife) property.

The beneficiaries will only be wife and children. For example, in case the policyholder i.e. the husband was in debt before he died, his creditors will get nothing out of this policy, not even with the help of the court. Therefore, the policy becomes free from the vice of policyholder's creditors, court/attachments or even tax attachments etc. MWP act is applicable for all married women of all the religions. The policy will take care of only the wife and the children completely.

Trust/ trustee Policyholder can appoint trust / trustees. It could be his wife or his adult child. The policy becomes the trust property. In the absence of this, official trustee of the state will be the trustee. The policyholder will have no stake in the policy.

The moment the policy is issued it shall insure as a trust, without the requirement of a stamped deed under Indian Trusts Act. There is no need for creating a separate Trust.

Beneficiaries When a policyholder chooses the beneficiaries as a class, the wife and children surviving with the policyholder till the date of maturity shall be the beneficiaries. Further no changes whatsoever can be effected without the consent of beneficiaries. Only wife and children can be beneficiaries.

This endorsement of life insurance policy is extremely important for builders, business owners and others as a way to create a cost effective and secure protection of assets.

SUMMARY

1. Ensure that you do a thorough Needs Analysis for yourself and your spouse and take appropriate life insurance.
2. Buy a term plan by paying a low premium and taking a high cover.
3. If your spouse is a homemaker then buy a basic level of cover for her of around Rs. 10 lakh. This again should be done through a term plan.
4. Give children and pension plans a miss.
5. Endorse all your life insurance policies under the Married Women's Property Act (MWP Act, 1874).

TAXATION OF LIFE INSURANCE

The annual premium payable on a life insurance policy is allowed as a deduction from your taxable income under Section 80C. This means that premiums reduce your annual tax outflow. Under Section 10(10D), any sum received under a life insurance policy is also exempt from taxes. Pension received from annuity plans are not exempted from income tax.

However, there is an exception that one needs to understand. If the premiums payable during the term of the policy exceeds 20% of the sum assured, then the policy proceeds are taxable. Any sum received under such policy on the death of a person shall continue to be exempt.

There is another important point that you need to understand before you surrender any policy. If, in any previous year, you:

(i) Terminate your insurance policy or the contract ceases to be in force because of failure to pay any premium

(a) In case of any single premium policy, within two years after the date of commencement of insurance; or

(b) In any other case, before premiums have been paid for two years; or

(ii) Terminate any unit-linked insurance plan, by notice to that effect, or where you cease to participate by not paying any contribution, or by not reviving your participation, and where earlier contributions have been paid for five years then,

(a) No deduction shall be allowed to you on any of the premiums paid in such previous years; and

(b) The total amount of the deductions of income so allowed in respect of the previous year or years preceding such previous year shall be deemed to be the income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

HEALTH INSURANCE

Although many people have a medical insurance policy, they are generally unaware of the nuances of medical insurance, exclusions and claim settlement. I have come across many people who have a negligible cover of around Rs. 1-2 lakh. A few surprisingly don't even have it. Most people do not appreciate the benefit of health and other insurances until they pay for the costs from their own pockets. Some people also think of insurance as just another expense and hence there is little appreciation for the kind of cover that is required.

I believe that people sometimes underestimate the expenses that they would probably incur for themselves or their family members. There cannot and

should not be any compromise on the size of medical cover that you have. Take a sizeable cover of at least Rs. 4-5 lakhs per person or an umbrella (floater) cover of Rs. 5+ lakh for the entire family.

I personally recommend having an individual policy per person so that the cover available is decent. The no-claim bonus in the initial years would up the cover to Rs. 5 lakh over time.

If you have an existing policy from a general insurance company, continue it. Do not switch unless you are completely dissatisfied or believe there is no recourse within that company. You tend to lose when you switch to another company.

a. Pre-existing illnesses are covered by most insurance companies after 2-4 years. You will lose out on this benefit if your policy has been in existence for more than 2-4 years and you will again have to complete 2-4 years with the new insurance company. So, it is advisable to continue with the same company.

b. You also stand to lose the no-claim bonus that you have earned with the insurance company over time.

When Medical Insurance Portability is implemented effectively, you can look at changing your insurance company but until then stay put with your existing insurance company.

PSU and private insurance companies offer medical insurance policies. However, most insurance companies have the same 3-4 TPAs (Third Party Administrators) settling claims. Hence, it is also important to know which TPA has a better track record of claims settlement.

In the past few years, several life insurance companies such as LIC, Reliance, Birla and ICICI Prudential have ventured into the health products space,

considering the demand and potential. They have come out with Unit Linked Health Insurance Plans.

THE FEATURES OF SUCH PLANS ARE AS FOLLOWS:

- Hospital Cash Benefit (HCB): Daily allowance between Rs. 250-Rs. 2,500
- Major Surgical Benefits (MSB): Maximum up to 200 times of Daily Cash Benefit of Initial Daily Benefits (IDB), which is Rs. 5 lakh; Only open heart surgery, brain tumour, renal and lung transplantation covered 100%; rest all covered between 40-60% of Sum Assured
- Domiciliary Treatment Benefit: This can be claimed after 3 premiums are paid and a maximum of only 2 payments are made towards this benefit. A maximum of 50% of the fund value can be withdrawn with the condition that a balance of at least one annualized premium should be there in the policy fund
- Maturity Benefits: Fund value, if any, is payable to you at the end of the term

THE WEAKNESSES FAR OUTWEIGH THE STRENGTHS OF THESE PRODUCTS. WE TELL YOU MORE

- Expensive policies with high premium allocation charges of 30% in the first year and 6% every year. Additionally, there could be high charges for daily allowance. Besides these charges, there are MSB charges, policy administration charges, fund management charges (1.25% per annum) and service tax (12.36% on health insurance charge)
- Low coverage for daily allowances; the cover provided by the policy is not very high. Even in surgical benefits, there are various subsections and the maximum benefit for most surgeries are only 40-60% of the cover opted for. These benefits are only for the principal sum assured.

For the spouse and children, the benefits are much lower.

- One-time surgery in a category; for example, if you undergo eye surgery, you may not do the same surgery again, because it now comes under a pre-existing clause. Hence, you could possibly do any surgery right from an angioplasty or peptic ulcer surgery only once and if the same surgical needs occur again, you will not be eligible to claim benefits.
- Limited benefit period: the maximum benefit period for the cover is 365 days with only 18 days in the 1st year and 60 days inclusive of ICU stay from the second year onwards.
- Inconvenient, as this is not a cashless policy, and the benefits can only be claimed through reimbursements. This means that you still have to ensure that the initial expenses are paid from your funds.

Once again, these products are complex and you can bypass them comfortably. Additionally, if you must buy such a product, it should never be the key policy that should drive your medical insurance portfolio. At best, it can be a supplementary policy to augment your main medical insurance policy.

DISABILITY INSURANCE

Disability insurance is one of the most important insurances as **the likelihood of becoming disabled is significantly higher than the risk of an early death.**

Unfortunately, there are few options of disability insurance products in India. Most of the products available are for disability due to accident. There is hardly any product which comprehensively covers disability due to sickness e.g. paralysis. Most products will offer similar benefits and offer a cover of Rs. 1-2 Crore. The benefits under such plans are given on death in an accident, permanent or partial disability. Disability covers loss of limbs, loss of eyesight and so on.

There is no maturity value in such products; however, there are rewards such as an increased sum assured in case there are no claims. You can also add your family members on this plan with you.

Tata-AIG General Insurance has a product called Secured Future Plan that covers risks of accidental death, dismemberment and paralysis, and permanent total disability. Again, paralysis that is covered is only due to accident. The maximum cover that can be obtained is around Rs. 35,000 per month for around 20 years. This product can be useful in terms of dismemberment and paralysis, and permanent total disability.

This is like an income protection plan that will provide you with a steady stream of income in case of paralysis due to accident, disabilities and accidental death etc.

This plan is not so great if you consider the effects of inflation but is one of the choices that can be made.

Bajaj Allianz General Insurance is one company that offers a cover for paralysis due to sickness.

Disability cover can also be taken as a rider with most life insurance policies. Take this rider in life insurance policies, as the premium for this rider is quite low. This rider is mostly restricted to Rs. 10 lakh by most life insurance companies. At the same time, a standalone policy also makes sense if there are some decent benefits on offer. Although there are limited options, it is worthwhile taking a cover such as a Secured Future Plan or a Bajaj Allianz Personal Accident Cover.

The annual premium for a 35-year old for a Rs. 35,000 per month income cover for 20 years is Rs. 12,284.

However, you should also check out better options if any are launched in the future. If there is a good one on offer, you can then cancel the existing policy

after one year and go for a new one.

Check the exclusions and policy wordings carefully. You can't go wrong by applying some common sense and spending a little time on your financial matters.

CRITICAL ILLNESS INSURANCE

Critical illness is generally a Benefit Plan and not a reimbursement plan such as Mediclaim.

Unlike Mediclaim, where you first need to spend money and then claim or go through a cashless route; in a critical illness policy, you are paid the sum assured once you are diagnosed with a certain critical illness. This diagnosis must be done by the insurance company's panel of doctors and once the critical illness is confirmed, payment is made irrespective of whether it has been spent or not.

Most insurance companies cover anywhere between 12-16 critical illnesses under this policy. Some of the common illnesses covered are cancer, stroke, major organ transplants like kidney, lung, pancreas or bone marrow, heart surgery, renal failure (failure of both kidneys), multiple sclerosis and primary pulmonary arterial hypertension.

However, if you die within 30 days of the illness being diagnosed, you will not get the sum assured. You will also not get the cover if the illness is diagnosed within 90 days of taking the policy.

You can show the policy wordings to your doctor who can understand exclusions and coverage very carefully. He can update you whether the conditions for critical illness claims settlement are appropriate or too sketchy.

Few doctors that we have shown the critical illness policy language are of the opinion that the wordings on the policy are fair. However, you should read

the wordings and make sure there is no ambiguity left before you sign on the dotted line.



“Again, the maximum cover for critical illness rider through a life insurance policy is Rs.10 lakh. When taken as a rider to your life insurance policy, the approximate premium for a 35-year old male will be Rs. 6,000 per annum. The premium will remain constant for the entire duration of the policy.

On the other hand, if you take a standalone policy, the premiums for the covers will change every 3 to 5 years depending on your age band (36-40, 41-45) and insurance company. **This means that you often end up paying a much higher premium for a critical illness standalone** cover. On the other hand, standalone policies can offer a higher cover of around Rs. 25 lakh.

Given below is the premium payable for a standalone critical illness policy for a cover of Rs. 10 lakh.

Age	36-40	41-45	46-50	51-55	56-60
Premium on 10,00,000 cover	5,500	8,000	12,000	17,500	30,000
Plus Service Tax					

PROPERTY & ASSET INSURANCE

Most people have comprehensive covers for their cars but seldom do they have comprehensive covers for their home and properties. Some people have

basic cover for their commercial property and home. However, most are under-insured on the home and property cover front.

Architect Kamlesh Doshi felt that he did not need any office or property insurance until 26/7 happened to him. His office was completely flooded and there was a sizeable damage to his property. In fact, furniture, inventory and paintings worth Rs. 20 lakh was damaged in these floods.

Why do we wait for these events to make us understand the concept of risk and the importance of insurance? We may never see a natural calamity again in our lifetimes but the point is to have adequate protection should any untoward incident happen.

A Homeowners' policy and Office Package policies are good ways to keep your home and office safe. These policies are in fact very easy to get and the premiums are very reasonable. A homeowner's cover of Rs. 25 lakh will cost around Rs. 5,000 per annum. An office cover of a similar amount also costs approximately Rs. 5,000 per annum.

General insurance companies offer discounts if you take this cover for 5 years and pay the premium in advance. This is a good proposition and you should certainly look at it.

What Do These Policies Cover?

This policy has ten different sections. You have the option of choosing a comprehensive policy (inclusive of all ten sections) or selectively choose sections.

THE TEN SECTIONS INCLUDE THE FOLLOWING:

1. **Fire:** This section, a base cover, safeguards the losses that arise due to a fire; building and its contents can be covered. Perils covered are fire, riot, strike, storm, aircraft damage, tornado, flood and earthquake.

The sum insured can be either on a reinstatement/replacement value basis (which is the value for replacing old item with a new one of same make). This claim will be settled without any depreciation.

Or on a Market Value Basis: This is replacement value, less depreciation, based on the age of the item. This claim will be settled after applying depreciation.

The policy excludes 5% of the claim amount for every claim arising out of “Act of God” perils. It also excludes terrorism cover, which can be taken by paying an extra premium.

❷ **Burglary**

❸ **Jewellery and Precious Stones:** A valuation certificate might be required if the sum insured is above Rs. 5 lakh.

❹ **Plate Glass**

❺ **Domestic Appliances:** These include air conditioners and refrigerators that can be covered against accidental electrical and mechanical breakdown. The list of items along with their replacement value basis should be mentioned. Losses that can be repaired will be settled by paying repair costs without applying depreciation. For total losses, depreciation at 10% per year will be applicable subject to a maximum of 50%.

❻ **Electronic Equipment:** The list of items along with their replacement value basis should be mentioned. Losses that can be repaired will be settled by paying repair costs without applying depreciation. For total losses, depreciation at 10% per year will be applicable subject to a maximum of 50%.

❼ **Pedal Cycle**

❽ **Baggage Insurance**

9. **Personal Accident Insurance:** This is disability insurance and is often restricted to a multiple of your monthly income.
10. **Public Liability:** This section protects your legal liability for bodily injury to or loss or damage to property of any third party. The maximum sum assured will be Rs. 10 lakh.

Like all other general insurance policies, the householder's policy also has to be renewed every year. Of course, insurance companies offer discount on premiums, if you buy five or more sections.

Sections 1, 2, 3, 5 and 6 are the most common and applicable to everyone. However, remember a few things when buying property insurance.

1. Give the replacement value of the insured product. Giving the market value of the product might not help if the product was bought several years ago. Giving the replacement value might mean higher premiums but it ensures that you do not have to shell out extra money from your pocket. For example, if you are covering your LED TV, the policy should cover it for replacement value else you will receive the depreciated market value.

2. Take a video of all the items that you plan to insure and take photographs of every item that you plan to insure. Additionally, scan or keep copies of bills and invoices of the products, home and office premises that you have insured. Having bills, photos and videos of the covered property and its belongings help in claims settlement. For jewellery, an independent valuation along with details is important.

3. Inform the insurance company if any of your insured items are no longer in existence and new ones needs to be added.

4. There is an additional cover on offer due to terrorist attacks, which is also reasonable.

5. Several exclusions must be kept in mind such as war, civil war or

destruction by order of government.

CLAIMS SETTLEMENT

1. Immediately call the insurance company to know the details of the event.
2. The insurance company will send a surveyor who will ask for relevant documentation and other reports.
3. An FIR will be needed in case of theft.
4. A fire brigade report will be needed in case of fire.

PROFESSIONAL LIABILITY INSURANCE

This insurance covers legal liability arising from errors and omissions on the part of professionals such as accountants, doctors and lawyers while rendering professional service.

This is a key insurance every professional must have. However, I have come across many professionals who do not have it and even if they do have, it's negligible. This insurance assumes significance when a doctor is a surgeon, gynaecologist, paediatrician or any other specialist. This might not be very significant for general physicians or accountants handling basic tax returns of individuals (where liabilities are not high); nevertheless, this should be an important part of every professional's insurance portfolio.

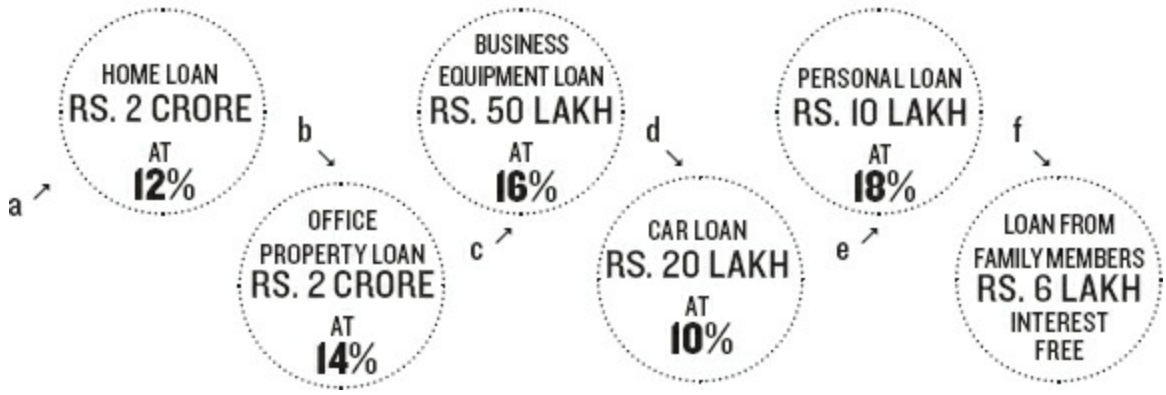
This premium is cheap and can be around Rs. 1,500- Rs. 3,000 for a Rs. 10 lakh cover. Make sure you take a high cover.

Limiting Debt

An inability to control spending is the root cause of most personal finance disasters, well ahead of unwise investment choices, faulty financial decisions or a sudden financial disaster.

Take the case of Bimal Parekh, a businessowner in his early forties. He strongly believed that things were fine as his income was good and he had managed to grow his business well. On the surface things looked fine as he had his own house in a posh suburb, a thriving business, a Mercedes and a steady base of clients.

However, what he missed out was the rate at which he was piling up debt. He had seven loans:



Though he was generating revenue of Rs. 3.5 crore per annum, his income was around Rs. 45 lakh after paying for office loans and office expenses. On the personal front, his EMIs were a sizeable portion of his income. His EMI payments were more than Rs. 2.5 lakh per month. This along with his living expenses and lifestyle expenses (exotic vacations, spending on white goods) ensured that he lived from month to month. Although the income was good, expenses were equally high and sometimes tended to exceed the income earned.

This ensured that when real estate market was booming, his net worth looked good and he was Asset Rich but Income Poor. However when real estate corrected in 2009, his overall situation could be termed as Asset Poor and Income Poor. Today he is comfortable again as real estate prices are up; however, the strategy that he has adopted is a very risky one.

His net worth statement looked like this.

Net Worth Summary

As of September 30, 2010

	Parekh Family
Liquid Assets	Rs.
Savings Account	3,00,000.00
Cash	1,50,000.00
Invested Assets	
Stocks	20,000.00
ULIP(Cash Value)	3,80,000.00
Equity Mutual Funds	50,000.00
Peerless Deposits	40,000.00
Real Estate	80,00,000.00
Lifestyle Assets (Residence, Car etc.)	
Residence	4,40,00,000.00
Car	29,00,000.00
Jewellery	4,00,000.00
Total Assets	5,62,40,000.00
Liabilities	
Car Loan	20,00,000.00
Home Loan	2,00,00,000.00
Personal Loan (Interiors)	10,00,000.00
Loan from Family Members	6,00,000.00
Total liabilities	**2,36,00,000.00**
Total Net Worth	**3,26,40,000.00**

His monthly expenses (Living and Lifestyle) along with EMIs are to the tune of Rs. 4.5- 5 lakh. Hence, the bank balances and liquid investments are extremely low.

DO YOU SEE THE PROBLEM HERE?

When unexpected things come up, managing day-to-day expenses and debt becomes a huge issue.

Any income can be spent. I have seen people earning extremely high incomes but not saving or creating liquid assets at all. At the same time, there are some people with modest incomes but with prudent debt and cashflow management have accumulated several crores by their retirement age.

Running up huge liabilities is a stupid idea if you do not have liquid assets, or if you are blowing your entire income servicing the liabilities.

Borrowing money to buy something means that you are unable to afford something in the first place. At the same time, most people do need to borrow for house purchase. Professionals and business owners have to additionally borrow for office space, equipment and growth.

However, do not go overboard. If you can afford a 2-bedroom house for Rs. 90 lakh, go for it. A 3-4 bedroom house can wait until your financial house is in order. **Use debt to create assets to boost your income and improve productivity rather than taking on debt for things that will not really add value.** As an example, for a business owner, it is far more important to have the best equipment rather than spending lavishly on interiors or on a big expensive car when a smaller one could have done.

Debt, if used well, can create income-generating assets and can do wonders for a portfolio. **Understand your actual cost of borrowing.**

There was a lot of outcry in 2011 when headlines screamed, “Inflation at 11-12% and Interest rates inching upwards”. People were contemplating paying off their home loans earlier as the home loan interest rate had gone up to 12% or more.

Roshni Johari was confused whether she should prepay her home loan of Rs. 50 lakh, or continue 12% on a 20-year loan or utilize the funds for her business. For a moment, let us consider that interest rates were likely to remain at 12% for the next 15 years. Also, let’s consider that you might just earn 7% compounded on your investments. To most people the analysis was done, it was better to prepay the entire loan or not opt for one at all. 12% seemed much better than 7% and any person with a little bit of common sense would have told you so.

Her husband was after her life to pay off the home loan. While telling her to pay off the loan, he had not taken into account that she might need some funds a few months down the line for her business. The decision to pay off the loan was taken in isolation by just looking at the interest rates. However, I told her that home loan is the cheapest form of loan and if she needs to borrow for her business, she should retain the home loan and not pay it off. This way, there was no need for her to take on a higher interest rate business loan or line of credit.

Home loans interest rates are always calculated on the reducing balance methodology, which effectively means that your interest is calculated every month (or a frequency as per the terms of the loan) on the outstanding loan amount. This means that your EMI has been calculated not based on 12% flat on the entire loan amount for 20 years but 12% on the outstanding loan amount every month.

Let us assume that the interest rate of 12% today remains constant throughout the term. Now does this mean that Roshni is paying Rs. 2.4 lakh (12% of Rs. 20 lakh) as interest every year? If this were to be the case she would end up paying Rs. 2.4 lakh * 15 years = Rs. 36 lakh as interest. Not by any means is

she paying this interest, because the interest rate here is not calculated on a flat rate basis but on a reducing principal basis.

This is why you see that the total interest paid out over a 15-year period for this loan would be Rs. 23,20,605. **This means that the total interest + principal of Rs. 20 lakh paid would be Rs. 43,20,605.**

Now at the same time, Roshni invests Rs. 20 lakh in her business that let's assume gives her 8% compounded interest per annum for next 15 years. What do you think would be the corpus at the end of the term? Rs. 63.44 lakh and it is Rs. 20 lakh more than the amount that she would have paid to the bank. If she manages to earn 10% and 12%, her corpus at the end of 15 years will be Rs. 83.54 lakh and Rs. 1.09 crore, respectively. This means on a return of 12% compounded (same percentage as your home loan), she will be left with a tidy difference of Rs. 1.09 crore – Rs. 43.2 lakh = Rs. 66.26 lakh.

The above calculations are excluding the tax benefits that she might get which would further subsidize the home loan and increase the overall benefits for Roshni. Incidentally returns from her business were anywhere between 12-15% and she would do well by retaining the home loan.

After looking at the numbers, queuing at the bank to pay off the loan might not look like a great idea. Here are some simple pointers.

1

Don't just look at absolute numbers and decide on whether to retain the loan, prepay partly or completely payout the loan. Think about your overall finances. Would there be a need to borrow again in the next few months or years? Will you have sufficient liquidity after prepaying the loan to take care of contingencies and to look at attractive investment opportunities that might come up in an uncertain world? In short, in times of uncertainty, cash is absolute king if you manage it well.

2

Review your amortization schedule and calculate the exact interest + principal that you are bound to pay over the duration of your loan. In short, calculate the total payout to the bank or financial institution.

3

If your tenure has gone up substantially, look at making minor one-time repayments to bring your tenure down to original tenure or lower. Prepay the amount that you can do so. Start making incremental EMI payments if you cannot make one-time payoffs. Even if you are unable to do so, do not fret. All is not lost. Floating rate loans will not remain high forever and they will go down. Interest rates are likely to go down further but the point is “Never overstretch yourself when you buy a house or take a loan and always keep a buffer for higher EMIs to be accommodated”

4

If you have the means to pay off the entire loan, don’t just queue yet at the bank. Look at the potential investment options and evaluate whether you can earn 8%, 10%, 12% or 15% returns on such investments in the next 20 years. See whether an investment in your business or another piece of real estate or stocks can deliver stellar returns. If so, just make the business investment that you have been thinking about for some time. Do not waste on interiors but on growing your business. If you are a salaried person, you should evaluate investment options as well.

5

If you are planning to take on another loan after some time don’t pay off the home loan, as home loan is still the cheapest form of loan next to taking an overdraft on fixed deposits.

Roshni has decided to utilize her funds to invest in her business. She is very confident of earning 12-15% compounded returns and has decided to retain the home loan.

People often go overboard with their home loans and other loans. They miss out a very important clause in their home loan agreements and can land in deep trouble when the real estate market goes sour.

Have you read your home loan agreement carefully? Do you recollect reading the **“Depreciation of Security Clause”?** I bet not many would have read.

When home and real estate prices were going up to crazy levels in 2007 and early 2008, your equity in your house also went up. Let’s understand this with an example. Say, you had bought a property for Rs. 1 crore (in 2005) by making a down payment of Rs. 10 lakh and taking a Rs. 90 lakh loan. The property value today is Rs. 2 crore which means that if you clear off your home loan today you will be a “crorepati” as you will have Rs. 2 crore- Rs. 82 lakh = Rs. 1.18 crore. This Rs. 1 crore increase in the home value increases a person’s home equity, a concept quite common in the US. This means that you could have taken an additional loan against the property if you had not sold your property. This is called a top-up loan in India where borrowers can borrow further amounts on top of an existing loan if their debt exposure on their house is much lower than their equity. In short Debt : Equity ratio is low and hence you can borrow more.

Now what happens when the value of your property goes down? Your equity in your house will go down and can trigger an innocuous clause in home loans called as “Depreciation of Security” clause.

Let’s understand the ramifications of this clause with the above example where you have bought a Rs. 1 crore flat by contributing just 10% and borrowing Rs. 90 lakh (90%). If the real estate market corrects by about 25%, the value of your existing house is down to Rs. 75 lakh. However, the bank has lent you Rs. 90 lakh. The bank could come back to you and ask for more security as their exposure should be restricted to 90% of the overall property value (90% of Rs. 75 lakh = Rs. 67.5 lakh). This means that the bank could ask you to pay Rs. 90 lakh - Rs. 67.5 lakh = Rs. 22.5 lakh. Once the bank

asks you to pay this amount, not paying so would tantamount to a DEFAULT on your home loan (even though you are paying EMIs on time).

HERE IS A SNAPSHOT OF LEGAL LANGUAGE IN YOUR HOME LOAN AGREEMENT:

Article 5 Remedies of Financial Institution (ABCD)

If one or more of the events specified in this Article (hereinafter called "events of default") shall have happened, then ABCD by a written notice to the borrower may declare the principal of and all accrued interest on the loan that may be payable by the borrower under or in terms of this Agreement and/or any other Agreements, documents subsisting between the borrower and ABCD, as well as all other charges and dues to be due and upon such declaration the same shall become due and payable forthwith and the security in relation to all loans shall become enforceable, notwithstanding anything to the contrary in this Agreement or any other Agreements.

Events of Default

Depreciation of Security (one of several events): If the security depreciates in value to such an extent that in the opinion of ABCD further security to the satisfaction of ABCD should be given and such security is not given, in spite of being called upon to do so.

I can stick my neck out and say that most people do not know about this clause or have not even bothered to read the home loan agreement in detail. In the rush of buying a house, such key points are overlooked and people tend to overstretch their budget.

Buying a residential property on loan means that you are leveraging on the bank's money. This is something similar to leveraging yourself in the stock

market where you buy a stock by borrowing from a broker. In good times, all is hunky dory but what happens in case of a downturn?

Most people who have been worried about rising interest rates and EMIs have completely ignored the biggest risk that they face. The risk of not being able to pay upfront funds when asked for, as the payments asked could be sizeable. More than rising EMIs and tenure, one should be prepared to make such one-time payments in case of eventualities.

If you are unable to pay additional amount of money when asked by your bank, it means you have defaulted on your loan. When you default on a loan, your outstanding loan becomes payable immediately. Banks do have the right to seize your flat and sell it to recover the pending loan amount.

Key things to remember:

1. Never overstretch your budget. If you like to have that extra bedroom think several times about the consequences of such events. It is better to delay your purchase than to overstretch your budget.
2. Just because the bank is lending you 90-95% of the funds doesn't mean you should be borrowing to the hilt. Restrict your borrowing to around 80% (which is currently the case) and make some sizeable contribution as a down payment.
3. Always keep a buffer for EMIs to increase and be ready with contingency funds if you have to.
4. More importantly, always pay a fair price for your house and not the crazy prices that are seen now.

If you pay a fair price, borrow prudently and do not overstretch your budget, you should be able to tide any downturns.

SUMMARY

I am not recommending that you should not go for a bigger car or house, but your financial security is far more important than owning assets that just make you look rich. **Being rich and looking rich are two different things.**

Your first priority should be to limit your unnecessary expenses and not use debt to fund any consumption. This means do not use personal loans or credit cards to fund any consumption. **If you cannot to afford to pay, just don't buy it until you get in good financial shape.**

Quick things to check and remember

1. If the difference between the rent and EMI on a commercial property is substantial, prefer renting out a place.
2. If the difference between rent and EMI is not substantial, then you should buy the property.
3. Before you buy, question yourself "Is this an income generating asset or is a depreciating asset? If it's a depreciating asset then do I really need this now or can this wait?"
4. Pay for consumption or depreciating assets in cash. Do not compromise your overall financial security by consuming things you cannot afford today.
5. Limit your overall debt payments to a maximum of around 35% of your gross income. The lower, the better.
6. Do not borrow to invest in equity or volatile assets.
7. Delay the decision to buy something more than Rs. 5,000 or Rs. X amount by 48 hours.
8. Use debt wisely by utilizing low-interest loans (first from family and then

institutions) and opting for overdrafts on any fixed deposits, mutual funds, stocks or property (loan against property). These normally come at lower interest rates than personal loans and credit cards. Personal loans and credit cards should be the last resort, only in cases of extreme emergency or contingency

9. When utilizing credit cards, pay the balance in full each month, or at least pay more than the minimum required each month.

A credit card is a convenient payment tool if you pay the full balance on time every month else it is a smartly packaged and atrociously priced LOAN. In fact, most credit card users today don't even understand what a credit card is let alone their charges. Most of the institutions charge in excess of 42% and some as high as 49%.

Some time back, the Supreme Court refused to stay a national consumer forum directive that banks cannot charge more than 30% interest per annum on defaults of credit card payments. The interest rates and charges levied by banks is nothing but atrocious and Supreme Court has done a great favour to many people. Banks however believe that the high charges are justified and some foreign banks namely Citibank, American Express, HSBC and Standard Chartered had appealed against the consumer forum order and asked for a stay on it.

So, what are the Charges on a Credit Card and How are They Calculated?

1. The biggest charge that takes the cake is the interest cost. This can range from 2.79% to 3.9% per month.
2. Late payment charges: Rs. 350 for a statement outstanding less than Rs. 10,000. Rs. 500 for outstanding between Rs. 10,000 and Rs. 20,000 and it goes up to Rs. 600 per statement.

3. Over limit fees if the credit limit is exceeded (thankfully there are no recovery agent fees or they are probably priced in the product).
4. For overdue accounts, Rs. 75 (Standard Chartered) will be levied for payment collected by authorized representatives.
5. Cash advance fee: ATM Withdrawals: 3% of Cash Withdrawal amount subject to minimum Rs. 300. For teller withdrawals at branches, an additional Rs. 500 is levied.
6. Joining and annual fees: Considering the solid competition in the credit card space, lot of banks entice customers with no joining fees, lifetime free cards (with no annual cost) and sometimes a free credit period of 3 months for rollovers.
7. Duplicate statement fee: Rs. 25 per statement (if statement more than 3 months old) for Standard Chartered and Rs. 100 for SBI Credit Card.
8. Foreign Currency Transactions: All non-Indian transactions are converted into Indian Rupee at a rate advised by Visa/Master. The bank charges an additional 2.5% on transaction and an extra 1% towards reimbursement to Visa/Master.
9. Several other charges such as return cheque fee, PIN replacement, card replacement, outstation teledraft fee and cheque return fee are applicable.
10. Finally, there is service tax payable at 12.36%.

A person can pay a minimum of 5% of the outstanding balance and rollover credit to the next month. The biggest mockery is that if the credit card holder just prepays a portion of his bill, his entire outstanding balance (before paying the 5%) will attract interest charges and all new spends on the credit card will also attract interest charges until the balances are repaid in full.

It also means that if the credit card holder does not pay his outstanding balances in full every month, there is no grace period for him. Similarly,

taking out cash advances from the credit card also takes away the grace period. So, if a credit card holder withdraws cash using his credit card, the interest rate is applied to the amount from the very first day and will apply until the amount is repaid in full.

These are financial products of wealth destruction. If not used properly, it can lead to financial ruin. **An inability to control spending is the root cause of most personal finance disasters and a credit card just speeds this process if not used responsibly.** On one hand, banks pester consumers to buy these products, send recovery agents if they are unable to pay and then as a gesture come up with some counselling centres for credit cards holders unable to come out of debt.

This act reminds me of the greedy moneylenders shown in Hindi movies. They used to lend at atrocious rates and ensured that people were unable to come out of the debt cycle. They also had recovery agents and the only thing missing was the counselling centre.

In fact, the best customers of credit card companies are not people who pay on time but people who just pay the minimum balance and carry forward credit month on month. What a pity that in an era when people are concerned about investments and returns, no regulator is raising its voice about this ridiculous practice of charging unreasonable rates.

Why pester people to buy these credit cards in the first place? People who cannot use credit card responsibly can survive without credit cards. If you need emergency loans, they can always as a last resort go for high-cost personal loans, which are much better than a credit card.

Of course, the best way to deal with credit cards is to use them as a convenient payment mechanism and to limit purchases to what you can pay off each month. This will ensure that you do not carry a balance and not incur any interest charges.

Simple, isn't it? Sounds like an excellent weight loss plan that one cannot implement.

SOURCES OF FUNDING FOR PEOPLE

It is very important that you establish sources of funding for your needs. You might not require the funds, but should you require them, you should at least know the options and have the basic ones in place.

Family, Friends and Spouse

When you first set up a business or practice, your own funds if any, through employment or inheritance, come in handy. Besides this, the best and first source of funds that you can tap would be family and friends. At this point of time, you have accumulated little to no assets and hence family and friends are of great help here.

Of course, you must pay interest on it, which can also be deducted from your income. This is the easiest and fastest source and often requires no documentation. This is important because at this point of time you do not even have a balance sheet. However, understand that you must cover this liability through life insurance and mention this in your will. If possible, do appropriate paperwork and give PDCs (Post Dated Cheques) based on the terms and conditions of the loan.

However, some people might not be comfortable tapping this source of funds because of the family and friendship angle in it. I am not advocating using this route to fund consumption or routine expenses. This should not be used to fund lifestyle expenses. It should only be used in case of emergencies, business or professional practice setup and growth needs.

There is no collateral, minimal documentation and funds can be transferred quickly. You can also look at sharing a percentage of your profits model with

the family member and friend who has given you the loan. The best way is to pay regular interest and principal, and clear off the loan over a short period.

Debt- Banks and Financial Institutions

There are different types of loans that a person can avail of from banks, mentioned as follows:

SECURED LOANS	
1	**HOME LOAN**
2	**OVERDRAFTS AGAINST FIXED DEPOSITS**
3	**COMMERCIAL PROPERTY LOAN**
4	**LOAN AGAINST PROPERTY AND INVESTMENTS**
5	**BUSINESS OR PRACTICE EQUIPMENT LOAN**
UNSECURED LOANS	
6	**PERSONAL LOAN**
7	**CREDIT CARDS**

The interest rates for such loans will vary depending on the type of loan, your balance sheet and loan tenure.

Secured loans are loans that are backed by some asset be it a house, car, office property or any other asset. Hence, the interest rates on secured loans are between 9-15%. Unsecured loans on the other hand are riskier ones for the bank and hence the interest rates can vary from 16-22% for personal loans and 36-49% for credit cards.

Big-ticket, secured loans can be availed after you have a solid income and balance sheet. A repayment track record of an existing loan helps and you must have a decent income to avail big-ticket loans.

Floating home loan rates were down to 7% in 2003 and 2004, and the current floating rates are around 10.5 - 11%. Fixed rates today are around 12-13%. Rising EMIs and loan tenures that were witnessed this year have made people believe that they should opt for fixed rate loans only. This is again a wrong time to do. You must decide on whether to go in for a fixed or floating rate loan, based on the prevailing situation.

When interest rates are low and fixed interest loans are available in the region of 7-10%, you must opt for fixed rate loans. However, if floating interest rates are above 10%, which means the fixed rate is around 11% and above, you should opt for floating interest loans.

Your existing home can also be a low-cost source of funding for your business. Let’s say the value of your house is Rs. 80 lakh but the outstanding loan on it is around Rs. 10 lakh. You can still take another Rs. 30-40 lakh as a top up loan on your existing loan. The interest rate would be fairly low and you can utilize this to fund your business needs.

EQUIPMENT LOAN

Equipment loans are secured loans and interest rates for such loans fall between 13% to 16%. A minimum margin of 20% of the cost of equipment needs to be paid. Loan tenures are typically 3-7 years but can be longer until around 10 years.

This option is a good one but should be considered after exhausting options such as overdraft on fixed deposits and top-up home loans (as cost is lower and tenure can be longer).

OVERDRAFT AGAINST FIXED DEPOSITS

Having an overdraft account against your fixed deposits is also a great option. This way you only pay interest for the amount that you have utilized and the cost is often 1% over the FD rate. It certainly is a good idea to have some fixed deposits in place.

LOAN AGAINST PROPERTY

Considering that Indians have a lot of property, loan against property is the cheapest option after a home loan and overdraft on FDs. This is another option to fund your needs or emergencies and you can get a substantial amount of loan for a long tenure. This can only happen if you have accumulated enough property and is often a good option for people with steady incomes and a healthy asset base.

You can get a loan of around 60% of the value of the property. Maximum tenure is restricted to 10-15 years and is normally cheaper by 4% as compared to a personal loan.

The documents required while applying for loan against property are similar to those of home loan except for three additional documents. The documents required will vary from bank to bank.

IDENTITY PROOF

• A copy of any of these - passport, driving license, voters ID or PAN card with your photograph - will act as proof of identity.

PROOF OF RESIDENCE

• A copy of your passport, ration card, driving license, telephone bill or electricity bill to show that you reside at the same place as mentioned in the documents.

INCOME PROOF

• Self-employed people need to provide their IT returns for the past two years, balance sheet, profit & loss account and bank statements for the past 6 months as proof of income.

• Photocopies of all the property documents need to be handed over prior to sanction of the loan.

• The customer also needs to give a declaration stating that the loan amount would not be used for the purposes of carrying out any illegal activities or speculative activities.

• A valuation report of the flat from the professional valuer appointed by the bank.

Documentation requirement source: www.apnaloan.com

Personal Loans, being high-cost loans, must be the last debt option to fund personal or business needs.

Credit card purchases cannot go beyond a particular point, as the credit limits are mostly restricted. At the same time, the cost of funding is so high that it just does not make sense to fund an asset with such high costs. Hence, credit cards are not a great source of short-term funding. You should only use credit cards to fund some purchases if they have to be done in a short period and you are confident of paying the loan in about 2-3 months. However, this should be avoided at all costs and should be the last source that you should tap.

LARGE SCALE FUNDING REQUIREMENTS

When the funding requirements are fairly high (more than Rs. 10 crore), there are 2 ways of addressing your needs.

a. Strategic Alliance/Joint Venture

b. Venture Capital

STRATEGIC ALLIANCE/JOINT VENTURE ▶

Ashish Shah is a young entrepreneur in Bangalore. He is very passionate about running an IT products business that caters to small and medium enterprises. He understands that there is huge untapped potential for enterprise products in small and medium businesses.

He discussed with many small business owners and then decided to start his venture. He sold off some of his prime real estate in Bangalore, raised a couple of crores and set up a solid management team in place. The team then came up with an initial roadmap of what they wanted to achieve, operational details and the kind of capital they would require.

Instead of going in for venture capital, they relied on promoter capital and some angel investors who wanted to support Ashish. He is on his way to build a sustainable and scalable business model with some out-of-the-box thinking.

VENTURE CAPITAL ▶

This is another source of large scale funding that could be tapped. Venture capital is typically an early stage investment in the life cycle of a business. This is done based on a lucrative business model, and the promoters' experience and credibility. There are specialized venture capital firms that deal with funding of medical and health care startups. This type of funding is even done when there is no proven financial history of the company.

This is the least risky of all routes for promoters as the entire funding for the venture can come through venture capital. However, this is easier said than done and there is a lot of effort that goes in to secure venture capital funding.

If you have a great idea and do not know how to proceed, there are consultants that could help you create a business plan, guide you through the process and approach venture capitalists. Some details on venture capital can be found on the following websites:

Indian Venture Capital Association (IVCA): *www.indiavca.org*
Global India Venture Capital Association: *http://www.us-ivca.org/*
Indian Venture Capital Journal: *http://www.vcindia.com/*
VCCircle: *http://www.vccircle.com/*

Asset Allocation - Diversifying Investments – Why should people not just focus on real estate?

As mentioned earlier, most Indians focus on real estate as their primary form of investment. For most people, real estate is often between 40-80% of their overall invested assets. This is excluding the home, as your home is your residence and should not be considered an invested asset.

This is one of the biggest risks that most people face. An over exposure to any asset class with leverage built in (borrowed money to buy real estate) can spell disaster as we have seen in the earlier sections.

Everyone must own a house and aim to make it debt-free much before they retire. Making real estate investments is important but one must understand the actual cost of ownership and the overall return, post-tax, which you are likely to earn. At the same time, understand the risk that is associated with such investments.

In a market that is going up, things are rosy and it's easy to hear of stories of doubling your investment in 6-12 months. In a downturn, your real estate investment can not only erode but can make an exit very difficult. Sometimes there is distress selling that happens at a very sharp discount.

You should own real estate to the extent that you:

a. Do not have to sell real estate in tough times when income slows down
b. Are not dependent on it for additional funds. Have sufficient liquid assets in terms of cash, debt, gold and equity

Not more than 50% of your net worth should be tied to real estate. This is only for business owners and professionals who effectively use their commercial real estate to run their practice or business. Others should limit real estate exposure to 30%.

The asset allocation decision is probably the most important decision you can make in achieving your financial goals while effectively managing risk. Diversification in asset classes can help reduce risk and boost returns but it is important to strike an appropriate balance here. There are many cookie cutter formulas for achieving the right asset allocation, some of which are simply mediocre.

For solid investment performance, over-exposure in certain assets at the right time is very important, keeping in mind the overall need for diversification from a portfolio security perspective. There should be a right balance between diversification and over-exposure to assets based on your return expectations, financial stability, security and risk profile.

Balance holds the key.

The best way to explain and drill the importance of asset allocation was to use an analogy from the fitness world. The mantra to great health would be to EAT a balanced MEAL with the right mix of essential proteins, carbohydrates, minerals and vitamins, and EXERCISE. The mantra to great wealth is all about having an asset allocation (balanced mix of various investments such as bonds, real estate, equities and gold) and a behavioural discipline to implement and follow it.

SAMPLE ASSET ALLOCATION

Specific asset allocation will vary based on a person's unique situation. For people who have exposure to real estate other than their house, a sample could be as follows.

Real Estate	30-40%
Cash	5-10%
Debt	20-30%
Equity	30-40%
Gold	5-10%

Asset allocation is a function of return requirements, liquidity, time horizon, risk behaviour and taxes. This exercise certainly need not be done on a daily basis. Like your annual health check-up, a financial fitness check-up every six months should be sufficient.

SOME CARDINAL RULES TO FOLLOW

- Never allocate money required for short-term goals (1-2 years) to equity.
- Never allocate money required more than 15-20 years later to a cash or debt form of investments except for PPFs and Employee Provident Fund.
- Understand your capacity to take risks and your behaviour towards risk.



KEY PERSONAL FINANCIAL GOALS

CHAPTER 9



Besides these goals, there are household expenses that have to be met and goals such as vacation, acquisition of lifestyle assets (such as vacation home, luxury cars), building a business and philanthropy. These could vary from family to family. We will restrict this chapter to these four basic goals and the things you need to keep in mind about these goals. We have covered cashflow management earlier.



BUY A HOUSE

There is a strong myth “about a house being a great investment” that runs across generations. The reality is that a house is a personal asset (one that has a lot of emotional value) and not an investment. Yes, it is an investment for

your children and grandchildren, but not for you. You will not sell your house just because the house has gone up in value.

Having said that, buying a house is one of the best decisions that every person should make. The key is to realize that you do not overburden yourself with debt (that feels like death in tough times) to acquire the most important personal asset of your life. Additionally, you should set a goal of paying off this debt well before you retire.

You should acquire your house by paying a price that you can afford to and one that leaves you with some additional surplus to save and invest. Most people commit the mistake of overstretching their home budget and paying EMIs that leave them with no monthly savings to invest. You need to ensure that your home loan debt payments are around 30% of your gross income.

Take the real life case of Arvind Tripathi, a chartered accountant from Mumbai. He has a solid practice and a fantastic income. He always felt that a chartered accountant of his calibre should be staying in a place like South Mumbai. Napean Sea Road, Altamount Road or Malabar Hill is what he aspired. He bought a house by paying an atrocious price of

Rs. 55,000 per sq. ft. On paper, it looked like he was going great guns owning a fantastic house in a location that has a high snob premium, but his balance sheet was completely off balance.

He is “Home Rich, Liquid Asset Poor” or “Home Rich, Income Poor” although he has a very high income. I am not saying that one must not aspire to buy such expensive homes but then they should not be confused with investments. At the same time, one should only buy such properties when you have excess money that you do not even have to take a loan or you have excess funds after paying your EMIs. His net worth is fantastic but is restricted just to his home and office properties.

Arvind fails to understand that should he require money today, he cannot sell a room of his 5-bedroom apartment overnight. Yes, you can certainly take a loan against property (LAP), but this is not how a high-income chartered accountant should plan his finances. An LAP is an option to have in case of contingencies and extreme emergencies but this should not be the bedrock of your personal financial planning strategy.

Arvind wanted to raise Rs. 10 crore (in 2011) for his business venture and was considering selling his Malabar Hill house, as it had appreciated in value to Rs. 65,000 per sq. ft. His plan was to relocate to a similar place in Bandra, pay off the loan and utilize the balance funds for his venture. However, in the current environment, there are no buyers for his house.

There were some queries initially but the queries stopped later. It feels good to know that your home is valued at Rs. X crore but the more expensive a house, the fewer are the takers. This makes it difficult to sell such properties in tough times. And in tough markets, high net-worth buyers are the first ones to postpone their plans. They are equally aggressive when times are good but are extremely cautious at the slightest sign of trouble or when investments should actually be made in tough times.

In fact, it is far easier to sell a 1-3 bedroom house than a 5-6 bedroom house. So please understand that your home is not an investment and you should not depend on it to fund your other goals; you should have surplus funds available for investments after paying your monthly home loan EMIs.

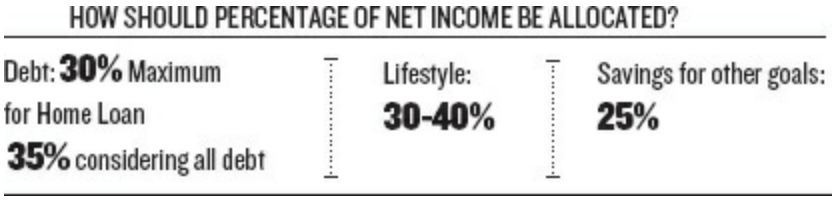
Even in the current financial turmoil, there are minimal transactions happening. Real estate agents have finally started to accept the slowdown and are asking sellers to cut down on prices. When business owner Rahul Sharma contacted a real estate agent, he said, “Rahul, this is a premium property in Juhu and it’s next to Amitabh Bachchan’s house. There are several people waiting to buy this by paying a top-notch premium. Buy this prestigious address before it is too late.”

Rahul was a prudent person who did not let the sweet talk about prestige and ego cloud his judgement. He decided to let the deal go, as the price quoted was unreasonable. His patience and prudence has paid off and the same property was offered to him now at a 15% discount.

One of the key ratios to consider before you buy a house is the Debt Payment to Gross Income or Debt Payment to Take Home Income ratio.

Let's say your gross income per annum is Rs. 24 lakh. Your net take home income is around Rs. 18 lakh. The answer to the question, "How much loan should I take?" will rest on the kind of lifestyle you lead. If your annual expenses are Rs. 12 lakh, all you can afford is Rs. 6 lakh. At the same time, if your expenses are Rs. 6 lakh then you could afford Rs. 12 lakh.

You should always pay yourself 25% of your net income first and invest this in equity, debt, cash and gold. You should limit your home loan debt to around 30% of your gross income or 40% of your net income. Lifestyle expenses should account for the remainder after home loan debt and savings towards retirement, children and other goals.



Before you take on debt, ask yourself, "How will I service loans in the event of income slowdown, financial crises or any other catastrophe?" In 2008, when interest rates were on their way up, many homeowners contemplated suicide, as they were unable to cope up with rising EMIs. The financial stress that the home loan caused was tremendous. Hence, it is always better that you borrow for your house or properties prudently.

Your financial planning should consider ownership of a house as a very important goal but you must decide prudently on the price that you wish to

pay for it.

FUNDS FOR CHILDREN'S EDUCATION 

This is a key financial goal that most parents have. Most parents would prefer their children to study well and become engineers, doctors, lawyers or chartered accountants. Business owners would want their kids to participate in their business whereas professionals would want their kids to be professionals and take their practice forward. Well, we all know how expensive education is and that a parent hopeful of his child studying engineering, medicine or even business education must start planning for it as soon as the child is born. The sooner the better, and there are some smart folks who start building a child's corpus even before they get married.

We are not talking about nursery or primary school fees but fees of any Graduate Program. Even though today nursery and primary school fees are expensive, they can still be managed from annual incomes. Most parents, given their cashflows and income, are able to address their day-to-day expenses and their child's initial education. However, the cost of education simply goes up post the 12th grade and must be planned in advance.

Unlike our western counterparts, Indians are expected to fund their children's education and it is taken to be one of our primary responsibilities. There is no question of asking your son or daughter to work and fund his fees. Most parents will not prefer this and will want their children to focus on education while they arrange for the funds.

Additionally, many students fund their post-graduation expenses anyway so the burden is restricted to your child's graduation needs. If your child joins some other vocation, then he might require your help to do his MBA or any other post-graduation program.

The first step in any education-planning goal is to ascertain the cost of education as of today. There are several additional questions such as:

- What kind of expenses do I have to cover?
- Will this education be available here or abroad?
- Do I plan to cover post-graduation as well?

Once you have ascertained the cost of funding the education today, the next step is to calculate the future value of the education corpus. To do this, you must consider education inflation.

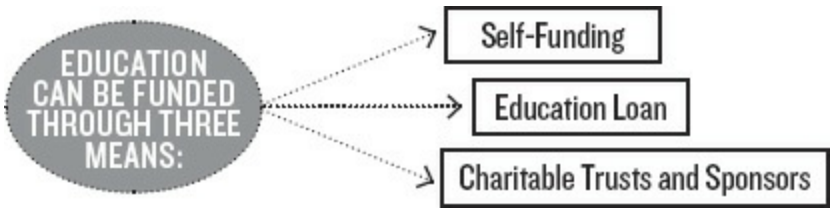
Education inflation is always higher than normal inflation and can be taken at 10% every year. There are several calculators on the internet that will allow you to calculate the future value if you enter the current cost of education and inflation. Once you have calculated the present and future value that you require, the next step is to see where you are today and the returns that you would require to achieve this corpus accumulation goal.

Next is to determine which investments can give you the required returns with a minimal amount of risk.

So How Do People Plan for Children's Education?

Most people simply opt for a children's insurance plan and believe their planning is done. In fact, planning for your child's education is a corpus accumulation goal and one that can be achieved by any investment.

A children's insurance plan is a very inefficient way of doing it as has been explained in the Wealth Pyramid Chapter "Should you opt for Children Insurance Plans?"



One also has the option of going for a combination of self-funding and education loan.

Self-Funding

This can be done through various investment avenues namely PPF, fixed deposits, mutual funds, stocks, insurance policies, real estate and gold. The choice of investment will be based on the time horizon for the goal, return requirements, current portfolio and risk profile. As discussed earlier, avoid children insurance plans. However if there are good insurance options that can give you 8% tax-free returns without any high costs you can look at these options but the cover should be on your life.

A SAMPLE EDUCATION PORTFOLIO CAN BE STRUCTURED AS FOLLOWS

PPF: **Rs. 70,000** every year	Mutual Funds (Equity) and Blue chip Stocks: **60%** allocation.	Debt Funds and Additional Debt that can generate 8% post tax: **20-30%**.	Gold: **10%**

Education Loan

Education loan can be availed for education in India or overseas. This loan not only covers tuition fees but also covers living and other expenses connected with education. Your child will need a guarantor (you) for this loan.

Interest rates are generally around 13-15% per annum with tenure of 7-8 years. The loan repayment can start after completion of education or after getting a job, whichever is earlier. The interest is calculated on a daily or monthly reducing balance method. There is no prepayment penalty on an education loan and you have the flexibility to finish off this loan as soon as possible. If for some reason you are unable to finish your education, you will need to pay the EMIs immediately.

The key point to remember that interest rate of 14% is not a flat rate but calculated on reducing balance methodology as explained in the Home Loan section.

On the taxation front, the entire interest that you pay on an education loan can be deducted from your taxable income. This means that if you are paying an interest of 14% per annum, considering the tax deduction, your net interest rate will be substantially lower, based on the income tax slab.

Let's illustrate this with an example. Consider an education loan of Rs. 10 lakh for 7 years with an interest rate of 14% per annum. Your EMI for this loan will be Rs. 18,740. Of this, the interest component in the first year will be Rs. 1,34,336. If you are in the highest tax bracket, you will save Rs. 45,661 in taxes.

If you have not managed to accumulate the corpus on your own, this is a good option to explore.

Charitable Trusts and Sponsors

There are several religious and charitable trusts that sponsor education of children. This is normally done at no cost and is completely taken care of by the trust. The funding will depend on the specific nature

of the trust and parameters such as need of the child, socio-economic background, course, academic record of the child, caste and several other factors. Often, this is a good source of funding if you can get it for your child.

I strongly recommend planning for more than for less. Having more at the end of the day will leave you in a comfortable position even if your son or daughter does not pursue any expensive education programme.

Deven Mishra, a corporate executive in his late fifties is a very prudent gentleman. He has built a solid corpus of PPF, bonds, stocks, mutual funds and fixed deposits for his son. His son plans to get into music production and requires funds to set up his studio. Deven has ensured that a quarter of the corpus that he had built for his son's education can now be utilized for his son's entrepreneurial venture and the balance can be used by him for his vacations and medical emergencies.

CORPUS FOR CHILDREN'S MARRIAGE

This is again a very common goal and is one that must be self-funded. The sources and strategies for self– funding are almost the same as the ones for a child's education. One of the key things that should be done by parents is to buy gold for kids on a monthly basis through SIPs (Systematic Investment Plans – physical or ETF) or annually on certain festivals (auspicious days) and birthdays. One can start small with gold and gradually scale it up over time. Gold investment details are covered in the Investments chapter.

As I am writing this book, gold is trading at Rs. 29,000 per 10 gms and hence it would be a prudent strategy to invest in a staggered way. One-time exposures can be taken during sharp declines.

RETIREMENT INCOME

This is a key goal most people must have. Indians do not have the luxury of the little social security generally provided by most developed countries around the world. Social security is a far-off expectation, as today we cannot even expect basic security from our government.

Hence, it is important that people take charge of their "Sar Uthake Jiyo" in their own hands. Yes, funding your son's education in the US is important but funding your retirement is equally important. Make sure that you have sufficient funds to fund children's education goals and your retirement goal. Your children would have graduated by the time you retire and would be self-supporting. If there is a shortfall and you have to make a choice between your child's post-graduation and your retirement, fund the shortfall with an education loan. As mentioned earlier, this loan can be cleared by your child when he/she starts working. You can also pay it off if you manage to accumulate the shortfall by your retirement. The idea is not about being selfish but about being secure in your golden years.

In ancient times, retirement planning was simple: **"Have a Son".**

An even better idea was, **"Have More Sons".** In portfolio theory, this is called diversification, spreading portfolio risk across many sons.

For most people, retirement is a distant goal and hence they hardly plan towards this goal. Most employed people contribute to their Provident Funds with their employers making matching contributions. However, self-employed people, film and sports stars have no employer or government-sponsored social security. Hence, they often end up just buying insurance policies, pension plans from insurance companies and real estate.

For most people, the first 15 odd years goes in providing for dependents, buying a house, marriage, and providing for children. It is only after they

have reached their forties and most of the time late fifties do they realize the need for some retirement planning. It is at this point of time when the children have grown up, people start to wonder:

- Have I saved enough?
- When can I slow down or retire?
- How much will I need during retirement?

Take the case of Chintan Gala, a corporate executive in his late fifties. He is working as hard as he was in his earlier days. Like most people, he put in a lot of money in his house. In his initial days, retirement was like a distant dream for him and his entire focus was on living a luxurious lifestyle and to be seen in a posh house. Besides this, he made sure that the family had great vacations every other year. His sons went for post-graduation abroad for which he spent a lot of money.

This was followed by lavish weddings for his two sons, for which he took a loan against his property. He is in the final year of repaying his loan and has virtually little savings. The sons have moved off to other cities on their own and the couple is left worried about their future.

There was no focus on building a retirement corpus and hence most of the money was spent on living expenses, housing needs, children and luxuries. Today he is still running from month to month and is concerned about his retirement. Considering their excellent health, they can expect to live until 90. This has further added to their worries, as they would need income for an additional 33 years from today. Thankfully, he can still accumulate sizeable funds if he is able to work for the next 10 years and is focused on saving every rupee earned.

What would happen if he could not work beyond a certain age on medical grounds? The answer would have been scary.

The problem in retirement planning is that people do not have a written strategy and there are no separate investments made with a view of corpus accumulation. In fact, most people believe that they still have time to accumulate wealth. However, one of the biggest mistakes that people make is not allowing time to work on their retirement goal.

Time Creates Money. In other words, compounding and its direct effects will work wonders on your portfolio.

Let's take an example of just Starting Early by 1 Year

If you start at 39 and invest Rs. 10,000 per month in an investment that yields 12%, you will have Rs. 1.12 crore by the age of 60.

However, if you start at 40, and invest Rs. 10,000 per month in an investment that yields 12%, you will have Rs. 98.9 lakh by the age of 60.

The difference is Rs. 13.8 lakh even though you started investing just 1 year late. In short, Time creates Money.

Now consider the difference at 15% return. It's a staggering Rs. 25 lakh!

If you start at 39, and begin by putting Rs. 10,000 per month in an investment that yields 15%, you will have Rs. 1.75 crore by the age of 60.

If you start at 40, and invest Rs. 10,000 per month in an investment that yields 15%, you will have Rs. 1.5 crore by the age of 60.

The above figures mean that when it comes to money, time is probably the most important factor in the growth process.

Moral of the Story: Start Now. A delay of even a year can cost you a fortune.

How Many Of You Have Started Planning For Your Retirement?

In Case You Have, What Have You Done So Far?

If there are no or very few basic answers to the above questions, it means you have not seriously started to plan for retirement.

Do not delay any further. If you have not planned for your retirement, do so as soon as you complete this chapter.

With advancements in medical science and technology, I won't be surprised to see a much longer life expectancy. This means that you must plan for at least 25-30 or more years in retirement during 30-35 years of your working life. If you plan to retire early, you must plan for at least 40 years of non-working life in around 20-25 years of your working life.

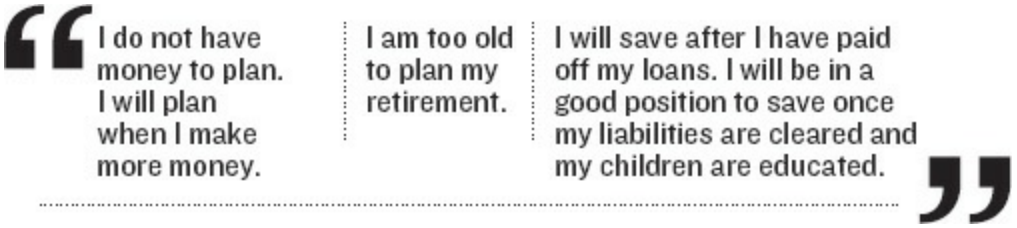
The first step is to figure out what age you wish to retire or slow down. The idea being that you can work only if you want to not because you have to. The second step is to figure out the income that you would need if you were to retire today. Exclude children's expenses, loan EMIs from your current monthly expenses and add expenses such as travel and entertainment if you are not doing them now.

State clearly "I will retire on January 1, 2020 and want to have an income of Rs. 2 lakh (as on today) per month until my age 90".

Besides the first 2 questions, you must think about the following questions:

1. Where will I live? Do I plan to move out of the metros?
2. How will I address my medical and other contingency needs?
3. What kind of investments should I make now to build my retirement corpus?
4. What kind of risks am I exposed to now?
5. Am I taking excessive risks or Am I not taking risks at all?

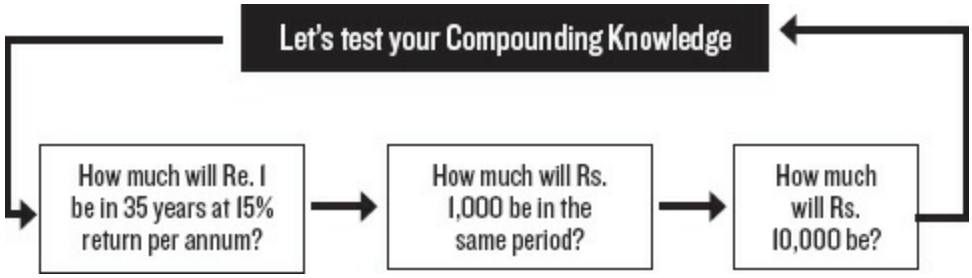
There are a lot of excuses and myths about not planning for retirement. I have heard many affluent people say:



The best period to start planning for retirement is as soon as you start earning.

The first account that you must open besides a Bank account is your PPF (Public Provident Fund) account. Start contributing Rs. 100,000 per annum to your PPF account and let compounding do its magic over 15 years. Even if you are initially unable to contribute Rs. 100,000, start investing Rs. 5,000 – Rs. 10,000 every month or whenever you can. Do not wait until the end of the financial year to make this investment. If you invest in your PPF account at the start of the year in April, instead of March of the following year, the difference in your maturity value is as high as Rs. 1.5 lakh.

PPF gives you 8% compounded return. The concept of compounding was explained in the Basic Financial Planning Concepts chapter with the Emperor's story.



Re. 1 will be a staggering Rs. 133 in 35 years. This means that Rs. 1,000 will be Rs. 1.33 lakh and Rs. 10,000 will become Rs. 13.33 lakh. A lakh today will become Rs. 1.33 crore in the next 35 years.

Next time before spending Rs. 10,000, understand that you could be spending Rs. 13.33 lakh. We are not suggesting that you be a MISER, but certainly don't live for Saturday night or Sunday night.

Your retirement planning will be completely based on your current age, current asset base, expenses and overall risk profile. Depending on your liquidity needs, financial goals, return requirements, time horizon and risk profile, you should select from a variety of investments covered in the Investments chapter.

During the accumulation phase, your objective should be to maximize returns while taking a certain level of risk. You should therefore skew your portfolio towards equity and real estate. During retirement phase, your objective should be to preserve capital and current income. Your portfolio should therefore be skewed towards debt-oriented investments covered in the Investments chapter. You must also have exposure to equity to prevent wealth erosion and grow your assets reasonably.

However, these are mere pointers and your actual investments should be based on your individual circumstances. A 75 year old can have 90% exposure to equity if he has taken care of his liabilities, children, has solid income from bonds, dividends from stocks and rent, and understands that a 50% decline will have no impact on his lifestyle or wealth. At the same time, a 25 year old can have a 90% exposure to cash and debt if he has dependents and goals that he needs to care of now.

HOW SHOULD YOU MEET YOUR HOUSING NEEDS?

As mentioned in the earlier chapter, you must buy a house very early in your career. More importantly, it should be something that you plan to live in for quite some time. House upgrades do not happen frequently, as it is a very emotional asset. You must buy a property considering your expected family

size (children, parents and dependents) and clear off the loan much before retirement.

If you delay this beyond 45, banks will give you shorter duration loans and hence you should look out for a loan when your age is between 30 and 40 years. This will ensure that you have cleared off your liabilities much before you retire.

Today, a house can be Reverse Mortgaged to the bank so that you are able to live in it and at the same time continue to enjoy a steady monthly income.

REVERSE MORTGAGE

A reverse mortgage is a loan under which you can pledge your house for 15 years, continue to live in it and get a monthly income or lump sum payment. If you opt for the lump sum amount, you can deposit this in a Fixed Deposit or Senior Citizens Saving scheme and get a monthly interest (Fixed Deposits) or Quarterly interest (Senior Citizens Savings Scheme).

Several banks and financial institutions offer this product. PNB, Bank of Baroda, SBI, Indian Bank, Allahabad Bank and Union Bank of India are some banks that have come up with this product.

The loan amount would be 90% of property value and ranges between Rs. 3 lakh and Rs. 1 crore. The loan would include interest until maturity. The loan shall become due and payable only when the last surviving borrower dies or opts to sell the home, or permanently moves out of the home.

The loan instalments payable to the borrower would be as follows for a loan amount of Rs. 1 lakh (at interest rate of 10.75% p.a.):

Loan Tenor (years)	**10**	**15**
Monthly instalments (Rs.)	468	225

Quarterly instalments (Rs.)	1,423	687
Lump sum payment (Rs.)	36,022	21,619

(Table sourced from www.sbi.co.in)

The settlement of loan along with accumulated interest should be from proceeds of sale of residential property or prepayment by borrowers and legal heirs.

However, the product is not attractively priced. If your house is worth Rs. 1 crore, the loan is Rs. 90 lakh and you get a monthly income of Rs. 20,250. At the same time if you take a home loan of Rs. 90 lakh at 10.75% today, you end up paying an EMI of Rs. 1,00,885. Look at the huge difference.

It is better to skip reverse mortgage and consider the following options:

1. Create your own reverse mortgage if you plan to live in the same house and do not want to relocate.

2. Sell house, put the money in a Fixed Deposit, Senior Citizens Scheme and buy another house.

CREATE YOUR OWN REVERSE MORTGAGE

You can create your own reverse mortgage agreement with your children where they will agree to pay you a fixed amount for the rest of their lives. This amount could be around Rs. 40,000 for a Rs. 1 crore house. This is much beneficial to your children as they get to own a house at less than half the cost.

You benefit from a much higher income (double) than the one through reverse mortgage.

It is a win-win situation for both children and parents. If, however, you take a reverse mortgage from a bank then it's expensive for your child just to clear off the loan in case he wants the property. At the same time, you receive a paltry income for your property value.

Creating your own reverse mortgage can address these issues.



How Will You Meet Your Health Needs?

1. Ensure that you have taken a Mediclaim policy of Rs. 5 lakh and have established a track record of no claims.
2. Ensure that you have sufficient contingency funds to take care of any surgeries and prolonged hospitalization. You can supplement your Mediclaim with Daily Cash Allowance policy from a general insurance company.
3. Finally, eat smart, exercise regularly and stay fit.

INCOME SOURCES DURING RETIREMENT

Senior Citizens Savings Scheme (SCSS - 9%) or high-interest fixed deposits

Ladder of high-yield fixed maturity plans

Dividends from mutual funds and stocks

SCSS: interest payable quarterly with excellent liquidity options

Post Office Monthly Income Plan

Rental income

Reverse mortgage

Withdrawal from PPF

SWP (Systematic Withdrawal Plan) from debt funds after 1 year so (LTCG – Long-term capital gains tax is only 10% excluding surcharge and cess)

Pension Plans: immediate annuities

It is important that you not just ensure your retirement but also leave something for your children and grandchildren. Don’t let a recent private bank’s advertisement happen to you. In the advertisement, a lawyer reads out the will of a seemingly wealthy person. The will reads, “Light Bill will be paid by Kamlesh bhai, Lawyer will be paid by Jignesh bhai, others by my dear wife and so on.”

Make sure that your Sar is Uthake not only when you are alive but even after you are gone.



INVESTMENTS

CHAPTER 10

An individual must make several investments to ensure his financial success.

Wealth could mean different things to different people but wealth can be divided into the following types.

WEALTH = Physical Health + Financial Health + Mental Health + Family Health + Philanthropic Health



INVESTMENTS THAT MUST BE DONE

- Knowledge (basic business skills and continuous learning)
- Business
- Cash
- Debt
- Real Estate
- Equity

- Gold
- Personal fitness and relaxation
- Family and kids
- Philanthropy

Knowledge (Basic Business Skills and Continuous Learning)

It is often said that Knowledge is Power. Napolean Hill, in his book “Think and Grow Rich”, has stated “Knowledge is Potential Power”. I completely agree. It’s what you do with knowledge that is far more important than just having knowledge.

An individual must be committed to the continuous learning process to better understand and implement innovations in technology, processes and methods. In short, learning never stops and one must continuously upgrade skill-sets through coaching, reading or attending courses.

Business or Practice

This is a key investment that successful professionals or business owners make and it is often the best investment that helps increase their income and give substantial returns. They then should divert a certain portion of their income from the business into other asset classes such as equity, debt, gold and real estate. Over time, the invested assets become substantial enough to maintain and enhance their lifestyle.

To invest well in your business or practice, you must have a clear vision of what you hope to achieve during your career. Your vision will dictate the kind and quantum of investments that you should make in your practice or business. In fact, this is one of the biggest goals that all professionals and business owners should have. You must quantify this goal by writing, “I will

need Rs. 2 crore in the next 3 years for a warehouse in Taloja that will increase capacity by 2 lakh units".

A business owner or a professional must make productive investments in people, equipment, technology and quality processes. "Additionally, a professional is the brand of the practice and hence he must invest in knowledge, best and next practices, and in building the brand.

The subject of building a business is a very expansive subject and I will not be able to do justice in a couple of pages..

Cash

The following comprises Cash Assets. In the previous section, we have analysed the utility of cash in detail. We will briefly touch upon the avenues in the cash asset class space.

1. Savings Account	2. Cash	3. Cash Management Funds/Liquid Plus Funds

	Return	Taxation	Liquidity
Savings Account	4% per annum	Taxed according to your tax slab. Post-tax returns for someone in the highest tax bracket is 2.8% per annum	Anytime access through ATM, Branch, Phone and Internet Banking
Cash	0% or depending on what you do with it. A lot goes in real estate.	Depending on your disclosure	Anytime Access
Cash Management Funds/Liquid Plus Funds - by Mutual Funds	7-8% per annum in the current context else in the range of 5-6%	No Income Tax Lower Capital Gains Tax or Dividend Distribution Tax (DDT) Higher post-tax return of 5-7.5% per annum	Accessible in 1 day

Every person must have investments in cash form of assets primarily to:

- Cover day-to-day expenses
- Provide contingency funds for personal needs
- Buy investments at an appropriate time: opportunistic cash

The amount of cash that you hold is a function of your overall asset allocation and can vary from 5-15% of your assets depending on your overall net worth, current economic scenario and opportunities available in the market. In extreme bubble scenarios where real estate and equity prices have moved beyond proportions, one could also have a significant portion of assets in cash.

Every person should have funds in a savings account. Considering that the post-tax return is fairly low, a person can also park a substantial portion of his cash assets in cash management funds by mutual funds.

What are Cash Management Funds or Liquid Funds and Liquid Plus Funds?

Cash Management Funds or Liquid Funds are debt-oriented mutual funds that invest in money market instruments and short-term bonds with a maturity of 3 months or lower. Liquid Plus funds invest in debt securities that have tenure of around 6-12 months.

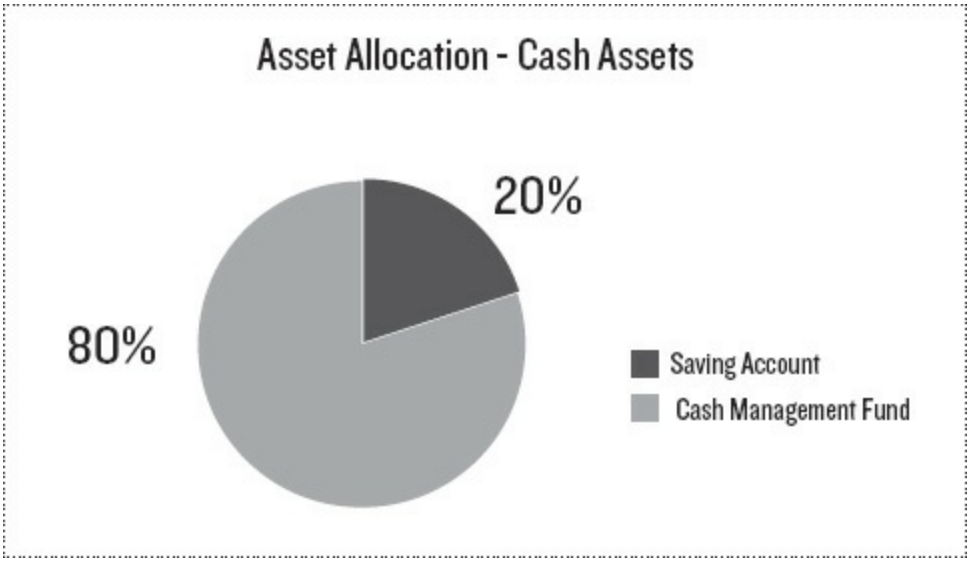
The key advantage of these funds is higher post-tax returns while having excellent liquidity. Higher post-tax returns are because of the lower Dividend Distribution Tax on such funds. The DDT in the case of liquid funds is higher at 27.03% as compared to liquid plus funds. Liquid Plus funds and other debt funds have a lower dividend distribution tax of 13.52%.

You should choose to invest in liquid plus funds instead of liquid funds as the higher DDT (27% +) reduces the tax arbitrage between DDT and Income Tax on interest income (30.9%).



We recommend the following ballpark asset allocation:

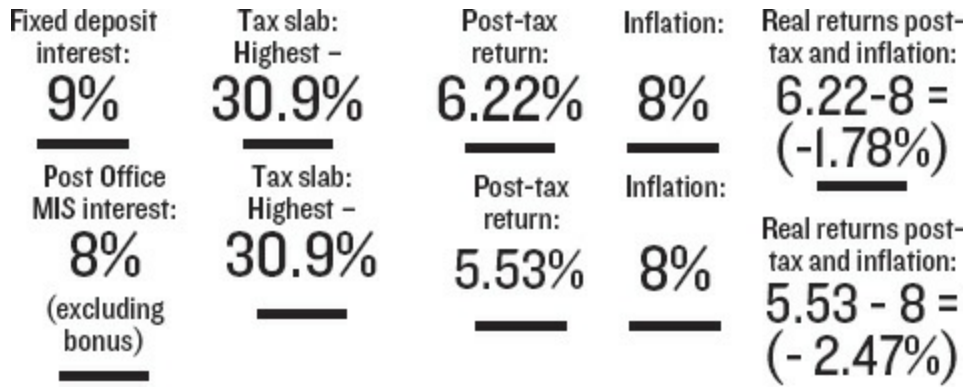
Savings Account:	Cash Management Funds:	Hard Cash:
20%	80%	**Depending on your overall situation**



Debt

Debt is one of the key investments of every portfolio and must be done wisely. Debt investments yield lower returns than growth-oriented assets such as equity and real estate. At the same time, debt investments are sometimes unable to provide positive returns post-tax and post-inflation. This means that the actual value of a debt asset will erode after factoring in inflation and taxes. You might not be able to see the effects of inflation and taxes in the short run but over a period there is wealth erosion and you will eventually dip into your capital.

For example, corporate executive Arun Nabar who falls in the highest tax bracket has several lakh worth of FDs and Post Office MIS and deposits.



On the surface, the returns look decent, but real returns post inflation and tax can lead to serious erosion over time.

Debt investments must be done but the focus should be on maximizing real returns post-inflation and tax. Hence, you must opt for debt investments that are either tax-free or tax advantaged.

The following investments come under the debt umbrella:

- Fixed Deposits
- PPF
- Traditional Life Insurance Policies
- Post Office Investments such as POMIS, KVP, NSC, Recurring Deposits and Time Deposits
- GOI/RBI 8% Taxable Bonds
- Senior Citizens Scheme (for people above 60 only)
- EPF (Employees Provident Fund)/VPF (Voluntary Provident Fund)
- Debt Mutual Funds (Fixed Maturity Plans, Bond Funds, Income Funds, Gilt Funds and others)

Most people will have the first four types of debt investments mentioned above. Professionals will not have an EPF or a VPF unless they work for a

corporate. Rarely do people have exposure to debt mutual funds.

The only tax-free investments from the above are PPF, EPF/VPF and traditional life insurance policies. Tax-advantaged debt investments are essentially debt mutual funds and are investments where there is no income tax but either Capital Gains Tax or DDT. Since Long Term Capital Gains Tax and DDT are much lower than the highest income tax rate, there is a direct tax arbitrage of around 20% for someone in the highest tax bracket.

If you are in the lower tax bracket or zero tax bracket, then tax-advantaged investments generally do not matter.

Every debt investment is exposed to the following risks:

a. Credit Risk: Risk of default by the borrower. A high credit risk means that a borrower would not be able to pay back an investment at all.

b. Interest Rate Risk: Interest rate on investments could go down, yielding a lower return. PPF returns were 12% in early 2000, and since then are 8% for several years now.

c. Liquidity Risk: Ability to exit the investment quickly at no or minimal cost/penalty.

So which investments should you generally have?

This will be based on your tax slab, liquidity needs, return requirements and risk profile but for most people, PPF is the first debt investment to have. You should also have high-interest fixed deposits as they can also be utilized from a contingency planning perspective for overdrafts.

If you are in the highest tax slab, besides PPF and High Interest Fixed Deposits, you should look out for debt mutual funds namely gilt and income

funds (when general interest rates are coming down only – don't opt for these when interest rates are on their way up).

GILT FUNDS

Gilt funds are mutual funds that invest in long-term government securities (government bonds). Government securities mean and include central government dated securities, state government securities and treasury bills. The gilt funds provide to the investors the safety of investments made in government securities.

In government securities, credit risk is generally considered zero. In other types of fixed income investments, this risk is higher. In any economy, government securities are considered to be of the lowest risk. Therefore, a gilt fund is considered as a far safer investment avenue than others.

There is an inverse relationship between interest rates and prices of securities. This is reflected in government bonds first. So, if the interest rate goes down, the prices of bonds rise and vice versa.

These funds deliver excellent returns in a falling interest rate scenario. Some of the gilt plans have delivered returns in excess of 16% in just one month ending January 4, 2009. Investments made in gilt funds in December 2011 yielded excellent returns in just a month or so.

INCOME FUNDS

Income funds are mutual funds that invest primarily in corporate bonds. Most income funds also have exposure to Gilts (government securities) and Quasi-Gilts (PSU Bonds such as NABARD, Indian Railways etc.). Corporate bonds are exposed to credit risk and hence it is important to check the portfolio of the scheme before making investments in it.

At the same time, income funds are exposed to interest rate risk as well i.e. if interest rates go up, bond prices go down and hence income funds can even give a negative return.

FIXED MATURITY PLANS (FMPS)

Fixed Maturity Plans are essentially close-ended income schemes with a fixed maturity date i.e. they run for a fixed period. This period could range from fifteen days to as long as two years or more. For instance, in a FMP, when the period ends, the scheme matures, and your money is paid back to you.

Just like an income scheme, FMPs invest in fixed income instruments i.e. bonds, government securities, money market instruments etc. The tenure of these instruments depends on the tenure of the scheme.

FMPs are a good investment, as they effectively eliminate interest rate risk. FMPs make sense for someone in the highest tax bracket but you should double check the portfolio of the FMP to make sure that it has good quality debt in it. The post-tax return on an FMP can be 2-3% higher than the one from a fixed deposit.

Debt investment	Return	Risk	Taxation	Liquidity
PPF	8%	Risk Free	Tax Free	Illiquid and funds can be partly withdrawn after 6 years
Fixed Deposit	8-10.5% Lower for shorter-term deposits Prefer PSU Banks here as they offer higher interest rates	Insured up to Rs. 1 lakh only	Interest is added to income and taxed as per your tax slab	Withdrawal can be made but interest could be deducted
Post Office Investments	8% (For POMIS). Different for PO Time Deposits and PORD	Risk free	Interest is added to income and taxed as per your tax slab	In Time Deposit scheme, if the account is closed within 6-12 months then no interest is paid
RBI Bonds	8%	Risk Free	Interest is added to income and taxed as per your tax slab	The funds are locked in for 6 years
EPF/VPF	8.5%	Risk free	Tax free	The sum can be withdrawn after 5 years or retirement. In case of death, the nominee gets the money. There are special cases where you can withdraw the money
Fixed Maturity Plans	8-10.5%	Credit Risk: Is riskier than FDs	No Income Tax. DDT or Capital Gains Tax based on option chosen. Much lower than income tax and hence post-tax returns are **substantially higher than FDs (for people in the highest tax bracket)**	Limited liquidity available on stock exchange.
Gilt Funds	No guaranteed returns. In an era of declining interest rates, returns can be handsome at anywhere between 12-14% or more (depending on rate cuts, bond yields and other parameters) When interest rates go up, these funds deliver negative returns.	No credit risk: exposed to interest rate risk. An environment when interest rates go up does not bode well for these funds	Taxation is the same as FMPs	Exit load of 0.5-1% for 1 year could be charged. Some schemes do not have exit loads.
Income Fund	Same as above, except returns can be 2-3% higher than a gilt fund	Exposed to credit and interest rate risks	Taxation is the same as FMPs	Exit load of 0.5-1% for 1 year is charged
Fixed Maturity Plans	8-10.5%	Credit Risk: Is riskier than FDs	No Income Tax. DDT or Capital Gains Tax based on option chosen. Much lower than income tax and hence post-tax returns are **substantially higher than FDs (for people in the highest tax bracket)**	Limited liquidity available on stock exchange.
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Income Fund	Same as above, except returns can be 2-3% higher than a gilt fund	Exposed to credit and interest rate risks	Taxation is the same as FMPs	Exit load of 0.5-1% for 1 year is charged
Senior Citizens Savings Scheme	9% interest paid quarterly	Risk Free	Interest is added to income and taxed as per your tax slab	Partial withdrawals not allowed. Exit between 1st and 2nd year and 1.5% of the deposit shall be deducted After 2 years, 1% of the deposit will be deducted.

REAL ESTATE

Most Indians think of real estate as a safe investment. Just because daily quotes are not available, they think of real estate as safer investments. They believe that not knowing the current price of an investment makes it less risky.

Many Indians have real estate exposure primarily in the form of their house, land and/or ancestral property. Professionals and business owners will have a higher exposure to real estate than other similar income earners. A professional or business owner, besides commercial properties and house, must make further real estate investments only after he has built a diversified investment base across other asset classes namely equity, debt, cash and gold.

Real estate investments are like managing a business and a lot more effort goes in here than any other investment. Besides, the time commitments needed are higher than required for other investments.

Real estate is a good investment and should be a part of every portfolio within the framework of your overall asset allocation. Real estate, being an illiquid form of investment, should never be more than 30% for most families. Professionals and business owners though can have a higher exposure to real estate considering that a substantial portion of this exposure is being utilized to generate additional income. Even then, they should restrict their real estate exposure to around 50% of their overall asset allocation.

There are several advantages of investing in real estate:

a. Rental income

b. Capital appreciation

c. Leverage helps boost returns - one can own real estate with limited capital

d. A good asset to borrow against

At the same time, there are some distinct disadvantages of real estate investments as well.

a. Illiquid form of investment – difficult to exit in rough times and even in good times takes a few weeks to months to get the right price
b. Difficult to manage or keep a check on
c. Tenancy risk – risk of tenants not vacating
d. "Khosla Ka Ghosla" Risk – if land records and documentation are not in order, there are chances of fraud, litigation and multiple people claiming a stake in the property
e. Leverage is a double-edged sword and can magnify losses and can wipe not just individuals but institutions too
f. Risk is concentrated in one or two investments
g. Real estate downturns can bust banks and can wipe out the fortunes of countries

One of the cardinal rules to remember in Real Estate is "Always Buy Cheap if not Cheapest". If residential rental yields are 5-6% pre-tax and commercial rental yields are 8-9% pre-tax, then a real estate investment can deliver great returns.

However, it is a broad asset class and investments can be divided across various investments such as:

1. Residential Real Estate
2. Commercial Real Estate
3. Real Estate PMS (Portfolio Management Services)

4. Real Estate Mutual Funds or Real Estate Investment Trusts

 RESIDENTIAL REAL ESTATE 

Residential real estate comprises more than 70% of the real estate transactions in the country today. There is a good scope for rental income as well as capital appreciation. Rental yields on residential real estate have traditionally been around 4-5% but in today's scenario, the yields are down to 2-2.5%. Yields fall because of capital appreciation in home values.

Just as we have Price-Earnings ratio for stocks, for Real Estate it is the Price-Rent (P-R) ratio. A lower rental yield means a lower rent as compared to price. This means a much higher P-R ratio and it signals overvaluation in property prices.

The mantra for success in any good real estate investment is LOCATION. The capital values and rental yields are a function of the location, state of general economy and type of property.

There is a sizeable market for residential real estate mainly from corporates, professionals relocating from other cities, expatriates and students.

Although the risk in residential real estate is far lower than the risk in commercial real estate, one still needs to exercise caution before you rent a property. Do thorough background checks on the person or family. Preferably give it to families but make sure you check their antecedents. Given the spate of terror strikes, ensure that you do a police verification of the family before they move in.

Being a landlord is not an easy task, especially if you have troublesome tenants. You can get a call to fix the plumbing mess or the leakage in the apartment. Make sure you are able to address these routine requests on time.

You personally do not have to fix the plumbing request but you must have the necessary people who can do this for you.

 COMMERCIAL REAL ESTATE 

Commercial real estate is a very broad term and comprises office space, warehouses, malls, ATMs and venues other than residential real estate. Though commercial rental yields are around 8-9% pre-tax, they come with many risks with the biggest one of tenants not paying on time or causing damage to the property. You should be capable enough of handling such situations and be strong and resourceful enough to vacate the tenants forcefully in case of any mischief.

Returns from commercial property over the long run will be much higher than residential ones and have the potential to deliver stellar returns if bought at the right price. Once again, the key elements for success are LOCATION, size of the property, type of property, economic situation and a realistic expectation of rent.

Commercial leases are generally long-term in nature whereas residential rentals can be short-term. Tenants renting homes generally do so from a short-term perspective whereas businesses normally prefer going in for long-term leases as location is the key for a successful business and business owners normally prefer the security of going for a long-term lease.

Some people just prefer commercial real estate whereas there are many who prefer diversifying into residential and commercial real estate. However, residential real estate always leads to a cashflow shortfall because of the lower yield whereas commercial real estate can be cashflow positive.

People should not get into any investment that generates negative cashflows and puts a burden on their overall finances. People should prefer commercial

real estate to residential real estate, but this is again based on their ability to address the unique risks that commercial properties bring.

However, the ticket size to buy any meaningful commercial property is significantly higher than residential real estate. You must be careful not to go overboard with real estate investments as one bad investment here has the propensity to bring your entire financial plan down.

At the bare minimum, people must at least own a house. Once they have done this and accumulated a substantial sum in equity, debt, cash and gold, they can then look at making investments in commercial real estate that can be rented out to corporates or land (for capital appreciation). However land investments can be extremely risky and hence due diligence is a must.

A few things that must be understood when it comes to commercial and residential real estate.

1. Long-term returns are in the range of 9-12% post tax or lower.

2. Real estate investments can be and must be timed. To get stellar returns, you must buy at a low price or look out for upcoming places that have potential for development. Smaller upcoming towns, though at higher risk, can deliver much higher returns than an investment done in a metro city.

3. Real estate prices can go down by as much as 50-75% even for prime locations. You can lose money on a real estate investment if your purchase price is not appropriate or high.

4. There are several costs in real estate, which are much higher than other investments. Let us understand the different costs in a real estate transaction:

    - Stamp Duty: 5% - varies across states.

- MVAT: 1%
- Service Tax: Service Tax on Construction and Preferential Location (approximately 4% + of the consideration value)
- Registration Charges
- Brokerage: 2%
- Maintenance: Rs. 5-15 per sq. ft. and upwards depending on the type of property
- Wear and Tear
- Legal Fees and Litigation Costs
- Property Taxes (proposed new laws in which property owners will have to shell out a minimum tax to the municipal corporation)
- Higher Taxes when compared to Equity and Dividends: Rental taxed as per your tax slab
- Long Term Capital Gains: 20.6% if sold after three years whereas stocks and equity oriented mutual funds are tax-free after one year
- Short Term Capital Gains (STCG): 30.9% if sold before three years whereas equity attracts 15% STCG before one year

EXERCISE

If you have ever made a real estate investment, calculate the returns that you have earned over the past 10, 15 and 20 years after factoring in the various costs and taxes (if you had to sell it today):

There are also a few peculiar things about commercial property:

- 1. Prices are much higher than an equivalent residential property. This can be addressed by going in for smaller properties such as Bank ATMs and investing with a group.
- 2. Sometimes it is far more illiquid than a residential real estate investment. Commercial properties are far more affected because of an economic slowdown, but this risk can be mitigated to a certain extent by keeping the LOCATION, LOCATION and LOCATION mantra in mind.
- 3. One of the biggest things that should be kept in mind is the sustainability of rent. Check if the rent is realistic. I have witnessed several tenants vacating their premises because of unviable rents leaving the property vacant and almost worthless. In one instance, there was a huge commercial property bought by an investor and rented to an IT company. Because of defaults in the US, the IT firm was unable to continue paying such high rents and vacated the property. The investor is now saddled with monthly payouts and has his mind anchored on the high rents witnessed in the past. The property was vacant for the more than 18 months and the owner realized that he needed to curtail rental expectations by 30%.

Things to remember

1 Get the property title, liens and other documentation verified by a lawyer. Most people act penny wise-pound foolish while paying a lawyer. I have seen some very bright people compromising on this step just to save a couple of lakhs when the size of the transaction was in crores (and ending up in trouble).

2 Since this is often a huge transaction, get a real estate broker and a qualified lawyer involved in the process.

3 Don’t get emotional about any property and rush into it. Make sure you have taken care of repayment aspects if you are taking a loan and that the deal makes economic sense.

4 Often, negotiation with a seller is on the basis on some small issues you find with the property. Negotiate on the basis of logic, future rent potential, margin of safety if prices come down etc.

If you are not comfortable owning commercial property directly or do not want the hassles that come with direct real estate investments, you can also look at investing in real estate indirectly through Real Estate Portfolio Management Service (PMS) and Real Estate Mutual Funds.

INDIRECT REAL ESTATE INVESTMENTS

This is a good way to invest in various types of commercial and residential real estate. You can address various risks of concentration, illiquidity, litigation, tenancy risk, difficulty of management and high prices by investing indirectly through a Real Estate PMS, Real Estate Mutual Fund or Real Estate Investment Trust.

Through these indirect investments, you can take exposure to investments that no individual investor can have the luxury of while reducing risk significantly. The ticket size for these investments is low as compared to lump sum investments needed in properties.

You can take exposure to office spaces, buildings, malls, warehouses, premium residential projects and many others through these investments.

REAL ESTATE PMS

A Portfolio Management Service is a collective pool of investments managed by a Portfolio Manager. The Portfolio Manager will take investment calls on your behalf according to the mandate of the PMS.

The strategy of the PMS can vary from offering to offering. A PMS can also invest in only commercial rental properties on long-term leases (with MNCs and big corporates) where the yields are high and the risk is low. There are different strategies that a PMS can apply and these are clearly stated in the offer document of the PMS.

Your stake in a PMS is limited to the contributions that you have made. You are allocated units as per your contribution and you will receive rental income, interest income and capital gain or loss according to your share of the property.

There have been several real estate PMS offerings in the last few years namely:

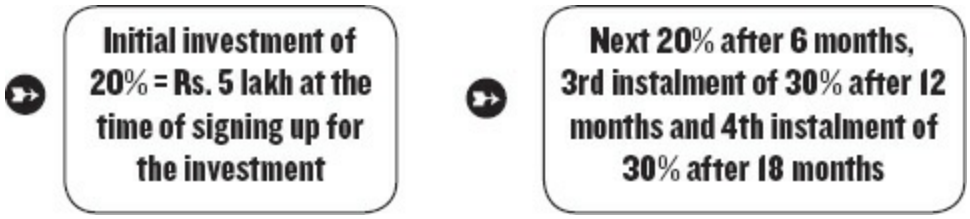


SALIENT FEATURES OF THESE OFFERINGS

Minimum Investment Size: Rs. 10 lakh to Rs. 5 crore depending on the PMS or Structure

DRAWDOWN PERIOD

This is the period over which the PMS will draw down funds from a client. E.g., if a PMS has a minimum investment of Rs. 25 lakh, the drawdown schedule could be as follows:



TARGETED RETURNS

These are the projected or targeted returns by the PMS. These are indicative returns and are not guaranteed. In fact, returns from such investments can also be negative. In fact, the track record of most PMS has been uninspiring.

HURDLE RATE

Generally, in PMS there is an element of profit sharing of returns above a minimum return. This minimum return is called the Hurdle rate. E.g. Suppose a PMS takes 25% of the profit above hurdle rate of 12% as its additional compensation. Now if the PMS delivers 20%, hurdle rate being 12%, the first 12% will go to the client. The difference, 20-12=8%, will be split in the following manner. 75% of 8 = 6% will go to the client and 2% will go to the Portfolio Manager.

CARRIED INTEREST AND CATCH UP

Carried Interest is the profit sharing as discussed above. Normally this is in the range of 20-30% over a hurdle rate of 12%. If there is a clause of catch up included this means that after the initial 12%, 25% goes to the PMS and then the split is done in the agreed ratio of 75-25%. In short, the entire returns are split with 75% going to the investor and 25% going to the client. Make sure you understand this terminology well.

SETUP COST

This is the initial sales or distribution cost incurred by the Portfolio Manager. This is a one-time fee and typically around 1.5-2%.

MANAGEMENT FEE

This is the annual fee charged by the Portfolio Manager for advisory and management services. The fee is around 2% and charged on a quarterly basis.

Make sure you understand these basic quantitative parameters before you invest in a PMS.

Besides the above, you need to be aware of the Portfolio Strategy to be adopted by the Portfolio Manager, his track record and the various risks the PMS is exposed to.

You can get specific information on these offerings by visiting their web sites.

ADVANTAGES

1. The investment size is much lower than actually buying a commercial or residential property and you are able to diversify across several properties.
2. Ease of management.
3. Access to deals that you cannot as an individual investor. Returns can be higher as PMS or Fund can form joint ventures with builders at very attractive rates.

4. Better liquidity and peace of mind.

DISADVANTAGES

1. No direct control over the property.
2. No direct ownership of the property and hence cannot use it for personal purposes.



REAL ESTATE MUTUAL FUNDS



These mutual funds invest in real estate based on the overall objective of the scheme. There is no real estate mutual fund in India at this point of time. SEBI (Securities Exchange Board of India) has come out with guidelines on Real Estate Mutual Funds and there might be some launches in the future but as of now, there are none.

All PMS offerings have a minimum investment size of anywhere between Rs. 10 lakh and Rs. 5 crore. Most PMS providers have reduced the figure to Rs. 10 lakh and above but this could still be restrictive and often is beyond the means of several investors.

This is where real estate mutual funds could play a part by giving investors the choice by investing with as little as Rs. 5,000.

What is the Real Estate Scenario in the Country Today?

Real Estate prices today can be called nothing short of crazy. However, there are many crazy people available and hence prices could even get crazier. My apologies if I am sounding a little overboard, but the reality on the ground is that I cannot understand how people can let builders, investors and the entire corruption cycle fleece them big time. How can USABLE CARPET AREA become an accepted norm? If you see the actual carpet area of an apartment

and the one that the consumer pays for, there is often a difference of 50-100%. Such practices and corruption have led to an asset bubble in real estate that can crack anytime but will really depend on who blinks first.

As mentioned earlier, real estate is a good form of investment, but only if you pay the right price for it or if you time your entry in the real estate sector well.

1997-2006 was a great time to buy real estate, however, many people just stayed away from it until 2003. It is only since 2003 that buying interest came back to real estate. Once you see easy and stupid money being made, more and more people join in. This is how most bubbles are created and the Great Indian Real Estate Bubble was no different. In fact, in October 2007, the real estate bubble had peaked although many people, including developers, were not admitting it until September 2008. However, between March 2009 and July 2009, builders had developed cold feet and many were offering fantastic discounts. In fact even in the secondary market (second sale), prices had come down and were at interesting levels. The stock market rally that started in May 2009 and the subsequent easing of liquidity have once again taken real estate prices beyond the means of people who actually need it. On the other hand, interest rates going up in the last one year is also making difficult for people to buy homes as their eligibility has gone down.

Since there is no price discovery mechanism or a market to know details of transactions that have taken place, prices do not slide down, as there are no immediate margin pressures. Additionally, individuals as well as builders have a holding capacity and they can wait for a certain period before being forced into a sale. It is this period that we have been witnessing for the past several months, where we have almost reached a tipping point.

Cashflows have dried up for builders and with no sales happening, the leveraged ones will be forced to slash prices to boost sales or abandon projects and ultimately get out of business. Here, we are not talking about small and mid-size builders but builders with scale and moneybags. The

bottom line is that land bank does not translate into cashflows and hence real earnings are always important. Whether it's eyeballs or land bank, unless there are actual earnings and cashflow, no business can grow and valuations will just bite the dust. We have already witnessed real estate stocks correcting by more than 80-90% from the peak prices whereas the Sensex is just down by 12-15% from it's peak.

No real estate market can go up forever based on some faulty valuations and the India Shining theory. People must be able to afford to buy houses to stay. Real estate prices can only go up on a sustained basis if people can afford houses and interest costs are reasonable.

The entire real estate boom that we witnessed from 2003 to 2007 was on the back on low real estate prices, low interest rates and increasing incomes. We are in a situation today where prices are high, interest rates are high and incomes are stagnating or coming down. Additionally banks are not lending as they used to earlier; they now expect people to put in more margin money or down payment (minimum of 20%).

This means that people are still unable to afford houses and prices have to correct sharply from these levels. A correction of 25% or more along with interest rate cuts that we could see in the future will bring back genuine demand and lay the foundation for the next rally in real estate.

Should you Buy Real Estate Now?

Would you if you can get it 25% cheaper in 2012-2013? This real life incident might provide some guidance. Hemant Benegal was planning to buy residential real estate in Hiranandani, Powai for Rs. 5.6 crore in 2008. This was a 2,800 sq. ft. flat and the price quoted to him was around Rs. 18,000 per sq. ft. What kind of a ridiculous price is this especially when the prices back in 2004 were around Rs. 4,000-4,500? Why should you pay these prices to live in such places? The owner of this place had bought it for Rs. 4,000 in 2004 and was demanding Rs. 18,000 saying that prices are likely to touch to Rs. 25,000.

I told Hemant that it made no sense to me and how could he ever make money on this investment if he paid such ridiculous amounts. There is no way to justify this except the emotional and snob value that comes from premium locations and apartments.

He decided to wait for 9-12 months. In November 2008, he got a call from the seller to check if he was still interested. I advised him to quote Rs. 2.25 crore (Rs. 8,000 per sq. ft., which was still 100% higher than the seller's cost price) as a fair price considering Hemant was emotionally attached to the property. Hemant felt that Rs. 2.25 crore might sound cheap considering the initial Rs. 5.6 crore price tag. So, he quoted Rs. 3.25 crore and the seller readily agreed.

Patience always pays and you must only pay a fair price for a real estate investment as it is a big-ticket item, leveraged, illiquid and occupies a huge portion of your portfolio.

This is still not the time to buy real estate and you must wait until prices correct at least 25-30% and when interest rates come down. Banks will start cutting lending rates to push slowing demand and they will cut it down further to single digit levels in the next 1-2 years.

A rate cut of 1% on a Rs. 90 lakh loan can mean a savings of Rs. 15 lakh over a 20-year tenure of the loan. See the table below that highlights the amount saved by taking a loan amount at 1% less. The existing interest rate is 10.5%. If you get a loan for 9.5%, what are your potential savings?

Loan Amount	Tenure (Years)	Interest Rate Saving	Amount Saved
Rs. 50 lakh	20	1%	Rs. 7.94 lakh
Rs. 50 lakh	15	1%	Rs. 5.5 lakh
Rs. 90 lakh	20	1%	Rs. 15 lakh
Rs. 90 lakh	15	1%	Rs. 9.9 lakh

Prices will (I am using the word will and not might) come down across the board and hence being patient will translate into huge savings for you. However, in certain elite areas where there is very little stock, prices can continue to be firm.

Don’t be emotional about missing out on an opportunity or place, as there will be several better options that would come up. Whether it is a home or an investment, it just does not make sense to pay any price for it. Quote 10-20% lower than the last asking price if you must buy. Even if you buy a house of Rs. 1 crore, getting the price down by even 20%, means a savings of Rs. 20 lakh of principal amount plus a direct savings of several lakh in terms of interest. This brings me back to a key point, which is “A real estate purchase must always be timed”.

Unlike the stock market, where the fluctuations are on a second-by-second basis and hence it is difficult to time, this is not the case in a real estate market. Prices do not fluctuate every now and then and hence it is relatively easier (if you use common sense) to time the real estate market. End users, typically homebuyers, mostly drive the real estate sector. Developers who have money from IPOs and Private Equity Funds have invested these funds in buying additional land at huge premiums for which there are no takers now. Additionally, banks and financial institutions have stopped lending, sensing the grave risk and private moneylenders charge exorbitant rates of 21-36%. Hence, it’s going to be difficult for most builders to even complete unfinished projects.

In case you must still buy real estate now, as I mentioned, negotiate a good deal for yourself. Cash is king and you might be able to get a decent deal. Additionally evaluate under construction projects critically and avoid projects of leveraged builders that are even a couple of years away from completion. Go in for projects that are complete and ready to be occupied or just a couple of months away from occupation. Due to cashflow issues and excess leverage, we are witnessing projects being delayed and there are a few that

are being abandoned (even though several floors have been constructed). Additionally in Mumbai, many projects are stuck because of lack of approvals from the Municipal Corporation. Also in the wake of anti-corruption drive that is happening, many projects that have flouted the norms or have not got proper approvals yet could be in trouble. It is very surprising to see people invest in projects due in 2016-2018 of some leveraged builders. The silly reasons given are

- I am getting a discount of 15% to the market price.
- I might not be able to get the flat that I want later.
- Everybody has been flouting norms. Nothing will happen in real estate.

The point is that it is better to be safe than sorry and getting out of real estate in a downturn is certainly not an easy task. People have been trying to sell for the last few months even at a discount are finding it difficult to exit.

Since real estate markets can be timed, one must utilize extremely bullish phases to exit the real estate market and enter when prices and interest rates are lower again.

If you have been eyeing a property for some time or waiting to buy your dream home, don't just think twice, think several times before you sign on the dotted line. Be patient and you are bound to come out a winner.

EQUITY

Most Indians think of equities or stocks (shares) as risky investments. This is precisely why you see very little participation in the equity market. Most people who have exposure to equity markets have predominantly done it based on tips from friends, television, portals or stockbrokers.

Most Indians are under-invested in equities. To scale up the equity participation in the country, the government has doled out incentives in the

form of a beneficial capital gains tax regime. There is ZERO tax on long-term capital gains (after 12 months holding period) and a 15% short term capital gains tax if one sells before 12 months. Dividends are tax-free in the hands of the investor.

Equity, as an asset class, should be a key component of every portfolio as this asset class has the potential to provide the highest post-tax returns in an emerging economy such as India. The proportion of equity in your portfolio can vary based on your overall objectives, returns needed for goals, time horizon, investments in other assets and ability to sleep well in volatile markets.

Let's see how equity has delivered over the past 18 years (from 1990 to 2008) in India. I have excluded the meteoric rise of the Sensex from 13,000 to 21,000. Equity over a period of 25 years has delivered around 16% per annum (as on September 30, 2008 when the index level was 13,000 odd levels). If we look at the numbers since 1979, then the Sensex has gone up 6 times in every 10 years.



Year	**Sensex Level**
1979	100
1988	600
1998	3600

2008	21200
2018	????

Has this return come in a linear fashion? No, certainly not. In fact, equity markets operate in bullish, bearish and consolidation modes. There are times where markets go up for an extended period of time, there are times when markets go down for an extended period of time by as high as 60% (individual stocks can even go down 95% or more), and there are times when markets consolidate at particular levels or are stagnant.

Equity is one of the worst investments in the short run, being a very volatile asset class. Sure, you can make money in days and weeks, but you can quickly lose your shirt too. Hence, it is important that you never invest money that is needed in the next several months or 2 years in stocks.

Over time, an emerging market such as India will move up as long as growth visibility remains. Given the position of India in the global economy today, every person must take cognizance of equity as an asset class seriously and give it due weightage in the overall portfolio.

How Does One Make Money in Stocks/Shares?

You make money in stocks primarily through dividends and capital gains. Dividends are a portion of the profits that a company distributes to its shareholders. Capital gain is the appreciation in the price of a stock.

When you sell a stock after holding it for 12 months, there are no capital gains on it and returns are completely tax-free. In some years, investors enjoyed abnormally high returns of 40-60% per annum tax-free. These are abnormal returns and should not be expected by you in the long run.

Over time, markets have the potential to deliver 12% in line with long-term corporate earnings growth. Although the range of equity returns over a period of 20 years can be in the range of 12-15%, you should make assumptions based on a 12% equity return.

STOCK MARKETS IN INDIA

There are primarily two major exchanges:

- Bombay Stock Exchange (BSE- *www.bseindia.com*)
- National Stock Exchange (NSE – *www.nseindia.com*)

In each exchange, several indices are tracked. The primary index of the BSE is the popular SENSEX and that of NSE is NIFTY. Besides these, there are mid-cap, small cap and sectoral indices (banks, capital goods, pharmaceutical, FMCG and so on).

SENSEX & NIFTY

SENSEX, first compiled in 1986, represents 30 large, well-established and financially sound companies across key sectors. The base year of the SENSEX was taken as 1978-79. S&P CNX Nifty on the other hand is a well-diversified, 50 stock index accounting for 21 sectors of the economy.



There are two ways of investing in the stock market.

- **DIRECT**
  - → Direct Stocks
- **INDIRECT**

- Mutual Funds
- PMS (Portfolio Management Services)
- ULIP (Life Insurance Policies)

DIRECT STOCKS - How do you buy stocks?

You can buy stocks during a company's Initial Public Offer (IPO) or from the secondary market through a broker. When you buy stocks directly, you become one of the minority shareholders in a company.

To buy or sell stocks on the secondary market, you need to open a trading account as well as a demat account through a broker. The trading or broking account is connected to your demat account. Stock purchases have to be done through a trading account and the stocks bought then go in your demat account.

Buying and selling of stocks can be done online or by a phone call to your broker.

Brokerage charges vary from broker to broker and are generally in the region of 0.25 to 0.55% per delivery trade (every buy and sell). However, there are discount offerings that have come up today where the brokerage charges can be as low as 0.10 to 0.15%. Also, Securities Transaction Tax (STT) is levied on every transaction on the stock exchange. STT is 0.125% (on sale and purchase) on delivery-based transactions.

Make sure your broker is well capitalized, not very aggressive, follows the old school of conservatism and realism when it comes to growth.

Most brokers grow through a franchisee network so make sure that you understand the service levels and strategy of the franchisee. You do not want to be in a situation where the franchisee has wound up and gone one fine day. Several large brokers who were extremely aggressive in 2007 were shutting branches at the same speed in 2008-2009 during the financial crisis.

Service levels vary from broker to broker and no broker today can be said to give you impeccable service unless you have a huge portfolio. Even then, service levels can falter and hence it is a prudent strategy to understand whom you will be dealing with and the communication protocol that needs to be followed.

How Should You Select Stocks?

There are two types of analysis that must be done before buying stocks or evaluating the market as a whole.

- **Fundamental Analysis**
- **Technical Analysis**

Fundamental analysis deals with the actual fundamentals of a company such as cashflows, balance sheet, profit & loss statement, book value, debt to equity ratio, sales and profits and so on. Fundamental analysis is comprehensive and the subject has various books to its credit. However, every investor must understand a few basic things.

- What business does this company do? Is it focused or meaninglessly diversified?
- Is this company making profits? How much profit is this company making?
- How has this company grown in the last three years? What are the projections for the next one year?
- How has the company fared in terms of innovation and technology? Are they providing innovative solutions or coming out with cutting-edge products that have a huge market?
- Does the company spend on R&D (especially for a pharmaceutical company)? Have they discovered any blockbuster drug?
- Who are the promoters and the management team? How is this firm in terms of Corporate Governance and overall integrity?

Quality and integrity of promoters and management team is far more important than any other parameter. Good and capable promoters can survive bad times and tough markets but this can be rarely said about incompetent and dishonest promoters as has been amply demonstrated by the Satyam saga in 2009. One also witnessed many stocks with poor corporate governance levels being hammered in 2010 and 2011.

In addition, you must have a basic understanding of the general economic situation as the stocks of even the best companies can be hammered beyond proportions. Does anyone remember the correction in Bharti? This stock was down 50% from 2009 levels. Many self-styled market gurus and brokerages had predicted the fall of Bharti to sub 200 levels and that it would take a lot of time for the whole telecom sector to recover. All of these forecasters have been proved wrong and these very same people are recommending a buy on Bharti now. Even in the current correction of 2011, Infosys has lost more than 40% from its peak whereas SBI and L&T is virtually down by 50%.

The point is that some of the best run companies can be ravaged by savage bear markets that will continue from time to time in the next 30 years or so. At the same time, we have witnessed stocks with little or zero sales, be it some of the power companies of 2008 or (dot).com companies of 1999 multiplying in value because of the bull market mania.

The point is that a company that is generating profits and cashflows and innovating, with a top-notch management with integrity is likely to deliver stellar results. Stock prices are slaves of earnings growth and you will see the result of a company’s earnings growth in its stock price at some point of time. Even if a good stock does not deliver results today, it will at some point of time if the fundamentals are strong.

P/E RATIO

One of the simplest ways of evaluating a specific stock or the index in general is to look at its Price/Earnings Ratio often called the P-E Ratio.

P-E ratio is the market price of the stock divided by its Earnings Per Share (EPS).

P-E = Stock Price/Earnings Per Share

Although P-E ratios should never be taken as the sole indicator of value, there is a strong reason why investors look P-E ratios very closely. The P-E ratio of a stock tells you how much investors are willing to pay for every Re. 1 of earnings that a company generates. The lower the P-E, the lower investors are willing to pay for it, whereas the higher the ratio, the higher the price investors are willing to pay for it. Some stocks like Titan Industries and HDFC Bank will command a very high P-E ratio primarily because of the confidence investors place in such companies. For e.g., Amazon.com has a P-E ratio of more than 100. At the same time, there are some companies where P-Es are always low.

You should however not just take a low P-E as a sacrosanct indicator of bargains or value. Similarly, just because a stock has a high P-E ratio does not mean it will go down in value or that it's expensive. Many stocks go even higher despite having higher P-E.

Hence, besides P-E ratios you should look at a company's earnings growth prospects over the next several quarters, quality of management, execution capability, new business opportunities, business cycles and several other fundamental parameters. In short, a fundamental evaluation of the business prospects of the company is extremely sacrosanct before you decide to marry a stock.

If you are keen to master fundamental analysis, I would suggest reading Security Analysis by Benjamin Graham and David Dodd.

If you are unwilling to invest your time to learn this craft then you can seek the advice of a qualified well-intentioned advisor or buy a diversified mutual fund with a consistent track record of performance.

Technical Analysis on the other hand is a way of evaluating securities by forming trends and patterns generated by market activity, such as past prices and volume. Technical analysis is a very exhaustive subject in itself. Technical analysts use charts and other tools to identify patterns that can suggest future activity.

However, technical analysts rely on past data to predict future trends. Though history is repeated, it has been proved enough that market movements are random and so just depending on technical analysis can be extremely risky for you.

So How Much Risk Should You Take and Are Your Investments Risky for You?

"The biggest risk in life is not taking one" was the tag line of a Hindi movie. According to me, "The biggest risk in life is taking one but believing you have not taken any" or "Taking one but not understanding the consequences of your decision".

Too often, investors focus on the wrong set of parameters such as index levels, oil prices, share prices or interest rates when it comes to making equity investments. People spend countless hours watching business channels, reading magazines for hot tips and tracking the unknown but there is hardly any time spent on the "knowns" that are solely in your control.

I have shared some of the UNKNOWNS that we so often focus on and the KNOWNS that we ignore most of the time.

Unknowns: Is this in Your Control or Someone Else's? There is No Way these Issues can be Predicted

- Sensex and Nifty Behaviour

- Stock Prices
- Oil Prices
- Interest Rates
- Inflation
- Tax Laws and Regulations
- Geo Political Risks

Knowns: This is Surely in Your Control

- My Needs and Goals
- What is My Time Horizon?
- What do I want to Achieve in Life?
- How do I React to Different Things, Including Stock Market Ups and Downs?

In fact, when it comes to investing, to be a winner, one must make as fewer costly mistakes as possible. Many like to believe that they are the better-blessed souls of our century who do not make mistakes. There is no one in the world of investing who has not made a mistake. The key point is to understand how to avoid costly mistakes.

Getting back to my point, understanding and managing risks are the most important parts of the investing process. Take too much risk and you might jeopardize your financial future with huge losses. Take too little and you jeopardize your financial future with low returns barely enough to cover your lifestyle expenses.

So How Do you Determine How Much Risk you should take and Are You Taking Enough?

First, determine what returns you reasonably need to achieve your financial goals (assuming that you know what your goals are). So, if you need a 10%

return, why should you opt for some exotic thing like a derivative or trade like a maniac like some people do.

A business owner that I met tracks the market day in and day out, devours every investment magazine and finally when the stock market closes, switches to the commodity market. Guess how well his portfolio is doing now. From a value of Rs. 4 crore, it has come down to Rs. 50 lakh, most of which I would attribute to a pinch of foolishness (with due respect) and a dash of arrogance.

Second step is to figure out whether you are getting those returns consistently. Knowing your own need or target can help you avoid more risk than necessary.

I have used an anecdote from the book The Intelligent Investor by Benjamin Graham that sums up my point. “I once interviewed a group of retirees in Boca Raton, one of Florida’s wealthiest retirement communities. I asked these people mostly in their seventies – if they had beaten the market over their investing lifetimes. Some said yes, some said no; most weren’t sure. Then one man said, “Who cares? All I know is that my investments earned enough for me to end up in Boca”. Could there be a more perfect answer? After all, the whole point of investing is not to earn more money than average, but to earn enough money to meet your own needs.”

As Ben Graham says, “The best way to measure your financial success is not by whether you are beating the market but by whether you have put together a Financial Plan and a Behavioural Discipline that are likely to get you where you want to go.”

In the end, what matters isn’t crossing the finishing line before anybody else but just making sure you do cross it.

Now How do you Figure you are Taking too much Risk? Three Simple Questions might help

1. Did I lose sleep during the Great 2008 crash or am I losing sleep in the current market volatility?

2. Do I feel pressurized to watch stock prices, fund NAVs weekly or daily?

3. Do the UNKNOWNs listed earlier worry me about my financial future?

If you have answered yes to either of the above three questions, you have taken on more risk than you can stomach.

If you answered yes to all the above, then like the kiddie line “It’s time to put your toys away”, it’s time to put some of your stocks/equity funds away”. As F. Scott Fitzgerald said, “If you don’t know who you are, the stock market can be an expensive place to find out”.

MUTUAL FUNDS

What is a Mutual Fund?
A mutual fund is an investment that pools in money from various investors and invests the money on their behalf in accordance with the stated objective of the fund. **Basically, you do not invest in a mutual fund, you invest through a mutual fund.**

An Asset Management Company (AMC) generally manages a mutual fund scheme, for a management fee. Every scheme will have its own fund manager who is assisted by a team of analysts, co-fund managers and other senior investment professionals. Most fund managers these days manage anywhere between 2-6 schemes. Consistency of performance, ability to spot excesses (and avoid these) and more importantly ethics should be the basis for selecting fund houses and fund managers.

There are different types of mutual funds namely ones that invest in equity, debt (bonds), cash (money market instruments) and gold. Then there are

hybrid mutual funds that will invest in a combination of equity and debt and more recently in equity and gold. There will soon be mutual funds that will invest in real estate as well.

Today there are more than 42 AMCs and the number will just go up every year given the interest of several foreign players in India. There are more than 380 equity-oriented schemes and more than 750 debt schemes in India.

When you buy an equity mutual fund, you make or lose money based on the performance of the underlying portfolio of stocks in its portfolio. A stock can fall down by more than 70% in a day; a mutual fund will never fall by a similar amount in a day. The reason is that mutual funds are generally diversified and it is unlikely that all stocks in the portfolio fall sharply by 70% in one day. Take the case of Satyam: the stock was down by more than 80% in a day. However, some of the mutual funds that had an exposure to Satyam fell by around 2-7% only.

A share can go down in price and never recover. On the other hand, a good diversified equity mutual fund managed by a reputed fund manager will almost always stage a recovery after a severe decline.

Mutual funds make big money by being invested over several business cycles, generally 10-20 or more years. This requires a lot of patience. For e.g. Franklin India Bluechip fund delivered a return of 24.57% CAGR since its inception in 1993.

Within the equity umbrella, schemes can be categorized as:

- Diversified Equity Fund
- Large Cap Fund
- Mid Cap Fund
- Small Cap Fund
- Flexi Cap Fund

- Tax Saving Fund
- Thematic or Opportunity Fund
- Sectoral Fund

Mutual funds offer several advantages and disadvantages.

ADVANTAGES

1. Professional expertise. Access to a professional fund management team that studies the economic, fundamental and technical trends in the market and takes a reasoned call (sometimes they go crazy so a close check on performance is important).

2. Access to a diversified portfolio that can reduce the overall risk of your investment.

3. Tax-neutral as just any equity investment and a big advantage when you sell before 12 months. When you buy and sell a stock within 12 months, you pay a 15% tax on the capital gains. When a mutual fund scheme buys and sells it, there is no tax that the fund or you pay.

4. Convenience: Can invest in different asset classes such as gold, real estate, debt and equity with a small investment amount.

DISADVANTAGES

1. Loss of control on the investment: There is no say on which sectors or stocks your money should be invested.

How do you select mutual funds?

We live in a world ruled by movie stars and ratings. Right from Bollywood to cricket, people tend to favour mega stars such as Sachin Tendulkar, Shah

Rukh Khan and Amitabh Bachchan and recently M.S. Dhoni and Akshay Kumar. What does this have to do with the world of investments you may wonder?

A lot, because when it comes to investments most of us tend to give a lot of weight to the winners of last year. We want the highest rated fund or best performing stock. The financial services industry along with its aggressive marketing entices people to chase performance by touting 5-star mutual funds or emerald stocks. Magazines and television channels are not far behind in getting experts to tell you how you should identify these gems. And for some people it's so easy just pick last year's best performing funds or stocks.

Fidelity Magellan was one of the best performing funds in the US and Peter Lynch was regarded as one of the best fund managers in US history. Under Lynch's management, the fund had a stellar performed and guess what. It had billions of dollars pouring in and as its popularity grew, its performance diminished. But Mr. Lynch retired at his peak when he was doing well and got himself a coveted position of being one of the best fund managers.

Let's take the example of one of the best performing fund of 2003, Franklin India Prima Fund, which delivered around 177% in a year. In April 2003, the fund was approximately Rs. 120 crore and was a small fund. Slowly buoyed by the success of the fund, the fund's returns were aggressively marketed, which saw the fund garner over Rs. 2,000 crore by the end of 2005. Was the fund a star performer in 2006? No, it was not. The fund ended 2006 with a very dismal performance of around 23% against the mid cap index return of 29% and is yet struggling to regain its old glory. At the same time, the top funds in this category Sundaram BNP Paribas Select Midcap gave returns of 60% and SBI Global of 57% in the same period. The question is, why did a star performer of 1-2 years falter in the next and does this happen quite often. Let us try to examine a few reasons.

A few years later Sundaram BNP Paribas Select Mid cap met the same fate as Franklin India Prima Fund. Why did this happen you may wonder?

1. The star performing scheme suddenly attracts a lot of money and is sitting on cash for some time trying to figure out what to do with it

2. Lack of opportunities in the mid cap space for funds collected either makes fund managers look out for large caps or buy more of the same stock

3. When a core product does well, mutual fund houses often tout these returns and launch several other schemes, which tend to dilute the focus of the fund manager from the core product to several other offerings

I am not saying one should not look at these funds or should ignore ratings but you need to keep in mind a few factors.

1. **Look at the risk that a fund comes with, and check if it matches your risk capacity and risk tolerance.** Aggressive funds were down by more than 65% in 2008 whereas some of the best diversified equity funds were down by 40% in the same period. Can you stomach this kind of volatility? It's exciting to look at exotic numbers on the upside, but when the same happens on the downside, you are out of the stock market forever.

I have given the following options in an ascending order of risk:

- Liquid Funds
- Floating Rate Funds, FMPs and Arbitrage Funds
- Monthly Income Plans of Mutual Funds
- Hybrid Funds with 30-40% exposure to equity
- Balanced Funds with 65% exposure to equity
- Index Funds/Diversified Equity Funds
- Opportunity/Thematic Funds
- Sectoral Funds

Besides the range of negative returns, various quantitative parameters are available to analyse the risk associated with a fund.

Standard deviation tells us how much the return on the fund is deviating from the expected normal returns. A higher standard deviation indicates a higher volatility fund.

Beta tells us how the fund would respond to swings in the market. If the beta is more than 1, then the funds swings will be greater than the market swings and vice versa.

Sharpe ratio tells us whether the returns of a portfolio are due to smart investment decisions or due to excess risk. This measurement is very useful because although one mutual fund can give higher returns than its peers can, it is only a good investment if the higher returns do not come with too much additional risk. The greater a portfolio's Sharpe ratio, the better is its risk-adjusted performance.

2. **Consistency of Performance**

   How has the fund performed in rising and falling markets? The best funds are the ones that have the potential to rise fast and fall less. It is hard to identify such funds and there might be very few such funds. Look at performance over the last one, three, five and seven years to see how the funds have done and especially look closely at the fund’s performance in falling markets.

The point that I am trying to make is there is no way to know in advance who the first or the best will be. So, it’s a futile exercise to identify the number 1 and anyone who has this Midas touch is fooling both you and himself.

Mutual funds know that selecting funds based on past returns alone is a lousy concept and hence by law, they are required to give this caveat saying “Past performance is no indicator of future performance” and yet all the funds tout returns as if it’s the only language that people understand. Well it’s partly

true and sad that it's the returns language that supersedes all discussions about risk and the decision is generally skewed in favour of returns.

Should you invest in New Fund Offers of Equity Funds?

We all know the name games that most fund houses play, and enough "gyan" has been published by several authors about New Fund Offers (NFOs), what to stay away from, and the nuances of mutual fund investing.

When new products are launched, fund houses and distributors alike share several themes or marketing wisdom. The lay investor is obviously bombarded with what I call as financial pornography. Innovative themes such as "Invest in all 4 regions of India" or "Invest in India's true potential" were launched practically every month. Given the current market conditions and tight SEBI regulations, new launches have clearly slowed down now but they will return once markets are bullish again.

So, what should an investor do is the key question facing all of us today.

The rat race for becoming the top fund house in the country is getting fund houses to launch several schemes that are actually nothing but a replica of some of their existing schemes. Some of the mutual funds do launch products to complete their portfolio, which is fair (e.g., a fund house with no mid cap or balanced fund launching one). However, hardly any effort is made by the fund industry to educate investors by providing them the right set of offerings, instead most of the focus is on increasing the Assets Under Management (AUM) based on collection in NFOs.

There are no set rules for differentiating advisors either. **To the fund houses, the best advisor is the one who has the most assets. This is like saying that the best doctor is the one with most patients or should I say "lives".**

I restrict this segment to a comparison of two schemes from one fund house to see if NFOs are really anything different or just OLD WINE in a NEW BOTTLE.

At the start of 2006, a prominent foreign fund house launched a new fund called Advantage India Fund. I asked one of their Sales Managers at that point of time “How is Advantage India Fund different from your Equity Fund (which is one of their core and best performing funds)?” I got some gyan on how the fund manager would pick stocks based on several themes prevalent in the industry but most of it was pure marketing talk. Beneath the layer, I could see that most of the fund houses were adopting the “Make hay while the sun shines” approach and were launching another ME-TOO scheme under the garb of fancy terms.



Exactly a year down the line, the December 2006 fact sheet of the fund house revealed the following:

1. 7 of the top 9 holdings in Equity Fund and Advantage India Fund were the same

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Equity Fund

Top 9 Equity Holdings as on Dec 29, 2006

Company	Value(Cr.)	%
Infosys Technologies	74.8	7.08
Tata onsultancy Serv.	51.69	4.89

Reliance Industries	51.44	4.87
Mahindra & Mahindra	47.42	4.49
JaiPrakash Associates.	43.25	4.09
Bharat Heavy Electricals	43.23	4.09
Tata Motors	37.97	3.59
Maruti Udyog	37.62	3.56
Larsen & Toubro	37.56	3.55

2. 28 of the stocks in Advantage India Fund and Equity Fund were common

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Advantage India Fund

Top 9 Equity Holdings as on Dec 29, 2006

Company	**Value(Cr.)**	**%**
Infosys Technologies	83.15	5.93
JaiPrakash Associates.	62.14	4.44
Larsen & Toubro	58.56	4.18
Bharat Heavy Electricals	58.4	4.17
Grasim Industries	54.91	3.92
Nagarjuna Construction	54.68	3.90
Tata Consultancy Serv.	52.42	3.74
Tata Motors	51.73	3.69
Mahindra & Mahindra	44.16	3.15

Take a look at the holdings and does anything seem radically different to you? It doesn’t to me at least but maybe the fund house has a different view on it.

Now let's look at the return component from Feb 24, 2006 (the date of first declaration of Advantage India NAV) until September 30, 2008 (before the markets really collapsed).

Scheme Name	NAV Date	NAV	NAV Date	NAV	Absolute Return
Advantage India Fund – Growth	30/09/2008	11.1638	24/02/2006	10.2976	8.4117
Equity Fund – Growth	30/09/2008	74.4509	24/02/2006	54.3529	36.9769

The Equity Fund scores by over 28%.

So, how much do the investors who had invested close to Rs. 1,700 crore in the Advantage India Fund lose?

28% of Rs. 1,700 crore is a stupendous Rs. 476 crore. This can sometimes be the cost you pay by investing in Billboard advertisements, commercials or rosy themes.

KEY LESSONS

1. Your goals and objectives are key, nothing can supersede your goals and nothing should

2. Make sure you have a firm investment policy in place - one that clearly spells out which product to buy for each goal, why to buy, when to buy and when to sell

3. Finally, say "No" to financial pornography that is thrown at you in the name of newsletters, insights and new fundas

Don't alter your investment strategy or goals just because a new fund is launched in the market. How well it fits within your situation is more important than anything else.

Do not be fooled by the Dividend Strategy -Dividends are a Function of Capital Appreciation

“XYZ Scheme is declaring 100% dividend and my distributor is telling me to invest in this scheme”. “This is important information which I have received from my relationship manager that ABC Scheme is declaring a divided of 50%”. I used to come across statements like this in 2006, 2007 and occasionally now when dividends declared by mutual funds are used as a bait to get investors to invest. The scenario is presented in a manner that if you invest Rs. 1 lakh today, you will receive a Rs. 30,000 as dividend or some other amount based on the NAV of the fund. Nothing could be further from the truth.

Dividends are not any form of additional gains that you can expect. In fact, dividend in mutual funds is a function of capital appreciation. Let’s say you invest on 20th September Rs. 5 lakh at an NAV of Rs. 50. This means you end up getting 10,000 units.

- Investment: Rs. 5,00,000
- NAV: Rs. 50
- Number of Units: 10,000
- Dividend Declared: 100% (i.e. Rs. 10)
- Dividend Received: Rs. 10 * 10,000 = Rs. 1,00,000

Aren’t you happy to receive Rs. 1 lakh as dividend? I wish it were this simple and easy to make money in just a few days. There would be far more billionaires and millionaires than we have now.

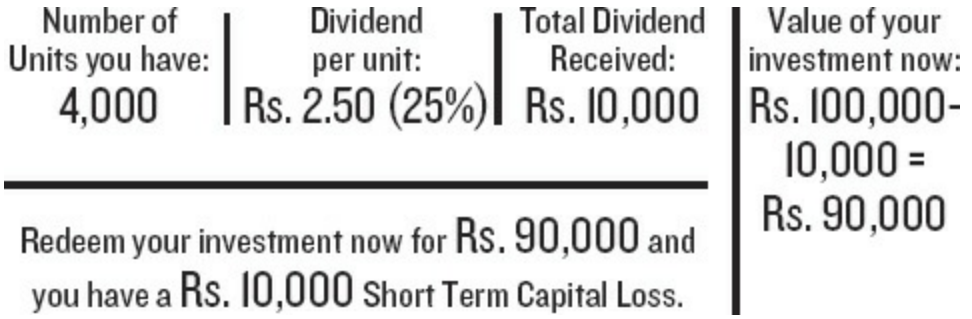
Now for the catch, after the dividend is declared, the NAV of the fund falls down from Rs. 50 to Rs. 40.

Value of your holding = 10,000*40 = Rs. 4,00,000. This along with the dividend already received of Rs. 1 lakh will translate to your original

investment of Rs. 5 lakh. So, you see things are not as rosy as they are projected to be.

So how should one react to these advertisements that a 100% dividend is being declared or should anyone invest just based on this information? The answer is an outright no. However, people have utilized a strategy called Dividend Stripping based on this information. This was more rampant when mutual funds used to declare dividends a month or so before the record date.

The way it works is as follows. Suppose you have a short-term gain of around Rs. 1,00,000. Instead of paying a short term capital gains tax of Rs. 10,000 (considering 10% short term capital gains earlier, now it's 15%), you make an investment of Rs. 1,00,000 in a fund about to declare a dividend of say around 25% (NAV= Rs. 25).



Here you have received tax-free dividend and you have been able to offset this against your short-term capital gains. Now your short-term gain is down to Rs. 90,000.

Earlier Short Term Capital Gain: Rs. 1,00,000

Short Term Capital Loss: Rs. 10,000

Net Short Term Gain: Rs. 1,00,000 - Rs. 10,000 = Rs. 90,000. You will now have to pay tax on a lower amount. The amount might look insignificant because the numbers are small. If you magnify the numbers into lakh and

crore, the capital loss and resultant tax you could have saved was phenomenal.

The Annual Budget fixed this loophole by ensuring following conditions were to be satisfied.

a. Buying or acquiring units within a period of 3 months prior to record date

b. Selling or transferring such units within a period of 9 months from the record date.

SEBI on the other hand issued guidelines that required the AMC to issue a notice communicating the decision to distribute dividends within 1 calendar day of decision by the trustees. At the same time, the record date should be 5 calendar days from the issue of this notice. Although these are steps in the right direction and dividend stripping has been slowed to a certain extent, AMCs, in the race to gather more assets, still sometimes use this as a ploy.

Don’t fall for this or any such trick as your purpose of investing in equity-oriented funds should be capital appreciation and not because a dividend is being declared. Dividend Payout, Dividend Reinvestment and Growth are options to choose based on your situation. Mutual funds can only pay out dividends if they have made gains on the portfolio. Unless the fund performs, the dividends come out of your principal.

PMS

There are several equity Portfolio Management Services (PMS) in the country today. The minimum investments for most of them range from Rs. 25 lakh to Rs. 2 crore.

Besides major asset management companies such as Reliance, HDFC, DSP Blackrock, there are various stockbrokers such as Motilal Oswal, India

Infoline, and portfolio managers such as Karma Capital Advisors and Alchemy who offer PMS.

The minimum investment and strategy varies across offerings but most PMS will have anywhere between 12-15 stocks in their portfolio. The idea is to take a concentrated exposure in a few stocks rather than making broad-based investments like a mutual fund.

Since investments through PMS are direct investments in shares, the taxation treatment is different from the one of a mutual fund. You are liable to pay short-term capital gains tax of 15% if a PMS sells a share you hold before 12 months. On the other hand, if a mutual fund sells the same share, there is no short-term capital gain implication on you or the fund. PMS offerings could have a higher tax outgo if stocks are frequently bought and sold.

Additionally, there is a lack of disclosure when it comes to PMS portfolios and hence less scrutiny by the media.

In a bullish market, some PMS can be more expensive than a mutual fund primarily because of the profit sharing element. PMS charge around 20-25% of the profits above 12%. This can be significant in a year where you have 50-100% return. Sometimes, there is a lot of risk taken to generate exceptionally higher profits as the PMS Manager’s additional compensation is tied directly to returns. This can prove to be dangerous as the portfolio manager has a stake in profits but no stake in losses.

The performance of most PMS schemes has been uninspiring since 2008. Yet many of them have managed to smartly package and fool investors under the garb of offering a customized product dedicated only for them.

Make sure that you evaluate a PMS scheme properly before jumping into any promises of returns that are made.

When Should you Sell Equities?

One of the most difficult questions facing investors in the equity market is, “When should I sell my Stock or Equity Mutual Fund?” I have come across investors who are advised to buy and sell frequently, churning their portfolio in the name of Active Portfolio Management. I also hear some investors say that they are continuously bombarded with BUY messages but rarely do they hear the SELL message. For every 10 Buy recommendations that are doled out, there is one Sell recommendation. Just watch the broker recommendations on business channels for an hour and you will see the issue.

Ask yourself “How do you decide when it time to sell”. Pause for a moment and reflect on this question. So the point really is, when should you sell your investments?

Generally, there are seven times when you should SELL:

1. When you require the money for a goal or need

You have been saving for buying a house, taking a vacation or for your child’s education. You need money for these tangible goals. At least 18-24 months before you need money for a goal, sell your equity investments and move the funds into a fixed deposit or floating rate fund. If the market is down at this point of time, see if you can utilize any other source of funds for your goal and check whether you can wait for an additional period. This decision on whether to ride the downturn a few months before you need money is completely based on your risk tolerance and varies for different people.

2. You need money for a personal emergency

There might be a time when a personal emergency warrants far more money than you have as contingency funds. At such times, when bonds, PPF and post office instruments might have a lock-in, you can look to selling your worst performing investment.

3. Your investment has gone sour

There are periods when your investment will under-perform the broader market. Should you immediately sell at this point? We generally give any fund manager a couple of quarters of under-performance especially if he has a consistent track record of delivering risk-adjusted returns. Check out the reason for under-performance, whether it's due to high concentration in a few sectors, or a fund manager change or bad market timing etc. Generally, when a fund does too well, money inflows increase and hence you might see some under-performance in the fund's performance due to excess cash in its portfolio. In terms of a direct stock investment, check if the reasons that you invested in a particular stock are still valid, be it an excellent management team, earnings growth or innovation. If you still believe in the company or fund manager, then you can also look at making additional investments in the stock or mutual fund.

4. Your return expectation is met or exceeded

Some people set targets such as a return of 15% or 20% and then exit whenever this target is achieved. What do you then do after selling the investment? Generally, you wait for a dip but what if the economy is on a roll like the one we had when the index was going up, whether due to excess liquidity or market fundamentals.

5. When you believe the market is overvalued and that a correction is imminent

This is one of the most difficult reasons to execute and get right. This assumes that one can easily time the market knowing every crest and trough. Although everyone would like to believe this is possible, in reality nothing could be further from the truth. The biggest frustration that investors and investment advisors have is when they sell and the market goes up another 20%. Does this make it a bad decision? There is no definite answer; hence, this decision is situation-specific, varying from investor to investor. Don't

judge yourself on the basis of this decision, it could have gone the other way as well. By the way, it is better to sell an overvalued stock than to buy one.

6. When you need to rebalance your portfolio

Asset allocation is one of the key decisions that any investor must make in his lifetime and studies have proved that asset allocation accounts for almost 91% of your investment performance. Suppose you decide on an equity exposure of 60% and 40% to debt, but because of the bullish market conditions, your equity exposure has gone up to 80%, then to bring back the portfolio to its original allocation, you would need to sell equity and buy debt.

7. When there is a better opportunity available

This last reason is normally one of the most frequent ones and results in churning an investor's portfolio. Webster defines churning as "To make (the account of a client) excessively active by frequent purchases and sales primarily in order to generate commissions". If you feel that your investment has gone sour, you should dump your investment and look out for better options else just stay put. Like elsewhere, fidelity pays in the investing world too, as you lower your costs and taxes and maximize returns.

Now that you have a handle on when you should sell your investments, consider the costs and tax implications before you actually sell. If, however, you have a winner in your portfolio then in Warren Buffett's words, "Our favourite holding period is FOREVER".

Can market movements and different types of risks be predicted at all?

The Sensex's rollercoaster ride over the past several months has shaken the faith of many equity investors. People who prided themselves as long-term investors suddenly question their ability to stay patient as the market moves up and down. Savvy investors who have seen several market cycles and

understand the nature of equity as an asset class are not really perturbed. They see these swings as opportunities to make long-term investments.

However, as soon as investments are done, most people expect markets to rise upwards. If the markets are moving upwards, everyone feels confident and is tempted to invest more. On the other hand, if there is downside or negative returns for more than several months, one tends to get pessimistic about future returns. In such a situation, people are tempted to stop their investments temporarily with the belief that as soon as the market starts moving up, one will start all over again.

Like life, markets do not always move in a linear fashion and hence it's almost impossible to get timing right all the time.

Contrary to what most people would expect, I would feel that if the markets go down after you have invested at reasonable levels, you have every reason to be happy. This is because you can buy at lower levels and the more it goes down, the better your purchase price gets. However, it is extremely difficult to ignore the red numbers that you see across your investments, and this is precisely what shakes up confidence.

The only time you should be concerned about the value of your equity investments is when you really need the money and wish to sell your investments. I am not saying that one should not review investments or just ignore investments once made. The key point is that one should review the fundamentals of the investments made regularly, but if a sound investments goes down for a few quarters, do not be unduly worried about it.

Review whether the same reasons for which you had made this investment still applies. No equity investment is insulated from a downturn and there are times in a stock or fund's life when it will under-perform. There is no equity investment that cannot go down. In bear markets, investments can be down not just for several quarters but several years.

Subsequently, when investments do rise, people who have bought continuously at lower levels earn much higher returns than those who bought only when the markets were going up. Besides global woes, equity markets are exposed to several risks. Some of them are:

- Oil and commodity prices going up
- Inflation
- Sovereign defaults of European countries and global risk aversion
- Earnings slowdown
- Political risks
- Risk aversion
- Foreign Institutional Investors (FIIs) selling and not enough domestic buying

Some analysts will say there is more bad news to come while some will say markets have discounted the bad news. We can only say that the market has discounted the bad news only when it is possible for the market to foresee all types of bad news. As far as market pundits and ability is concerned, no one really talked about the subprime crisis, until it happened, or about the European crisis or the US downgrade being major problems until the events occurred.

This brings me to a fundamental question “Can market movements and different types of risks be predicted at all?” We can only dissect and understand when the initial strong symptoms start to appear or mostly after the event has happened. Like the fury of nature, there will be testing times in the life of every equity investor. One needs to understand the very nature of equities, risks associated with it and that seeing negative returns is not necessarily bad. Yes, it is an unpleasant situation to see negative numbers if you need money for a financial goal (having been invested for several years). To mitigate this risk one should start liquidating equity assets at least 18-24 months before you need money. If the market is down at that point of time,

you should patiently wait for some meaningful recovery to happen. In sound equity investments, markets generally give an exit opportunity to most investors. It is only the greed quotient that determines the final outcome. For all others, seeing negative returns or being in the red isn't really harmful.

Going green is good but when it's a question of your investments, red is sometimes good (i.e. taking a short-time hit) and makes absolute economic sense for a long-term equity investor.

How to avoid the mistakes of equity investing in 2012 and beyond?
As we usher in 2012, it is time to understand the five mistakes, some of which tend to be perennial.

1. Looking at the Stock Market For Making Quick Bucks Just Because Your Neighbour Or Friend Has

Just because the Sensex has delivered 40-150% returns in the past and some of the best funds in excess of 60-180% does not mean that future returns will be similar. Markets can deliver huge negative returns, even a negative 60%. Individual stocks can go down by as high as 90-95% in a short time. Even an index stock like Satyam was down 80% in a day. The reason could be anything but such sharp downturns are possible.

Don't just focus on the past 5 years but also look at the last 10, 15 or 25 years of performance across various timeframes. Try to understand the realities of the stock markets and you will figure out if there is any mismatch between your expectations and what the equity markets can deliver.

Contrary to popular belief, stocks are long-term wealth creation instruments. Most people use them as short-term instruments to make a quick buck; when the tide turns against them, they swear never to look at equities again. Some people religiously follow every piece of investment wisdom available through TV, print media and believe activity is the name of the game. On the contrary, investing in the stock markets is not a game or a contest; it is a continuous process over one's lifetime. The only thing that matters is whether

you have achieved the objectives that you have outlined for your equity investments.

2. Leveraging or Borrowing to Invest

“Borrow at 13% for 1 month and invest in IPOs or tips. I made 50% more by dabbling in futures in 2 weeks. My wife earns Rs. 10,000 every month by trading from her account and she has just put in Rs. 3 lakh, rest is margin money provided by the broker. My son earns his pocket money from stocks” were some common thoughts heard during the bull market. Because of the tantalizing returns, it was very difficult to think sensibly. Some people learnt the hard way that using leverage can get you to lose more than 100%, IPOs can list down 60% on Day One and a lot of IPOs are still way below their offer price. So, for your peace of mind and prosperity, do not leverage or borrow to invest. Understand the risks associated with it and only bite what you can chew and digest comfortably.

3. Believing Nonsense

I often come across messages that state, “Invest only Rs. 50,000 and Earn Rs. 5 lakh, Short Term Tips” to tips such as “Yeh Stock 3 Months main Double hone wala hai”. In bull markets, you will come across plenty of such nonsense, which you can comfortably ignore. On the institutional side, everyone from insurance companies, banks, brokers (commodity, equity), art funds to mutual fund houses had been coming up with a deluge of offerings with everyone eyeing a share of your wallet. I came across a ridiculous ad in November 2006 from a Mutual Fund about a new fund stating “Best of all the 4 regions working for you”. Though this fund house had some best performing schemes, it was shocking to see schemes being packaged and marketed like FMCG products. So, ignore the hubbub.

4. Timing the Markets

Timing the markets is an elusive strategy, yet millions of people aim to do it and many claim to have done it. Whether it's technical analysis, or fundamental analysis or a combination of both, getting your entry and exit right is the most difficult to achieve. This has been amply demonstrated to people who tried to do this in 2006, 2007, 2008, 2009, 2010, 2011 and will again be proved in 2012. I know of people who were bragging of getting out of the market in time, but guess who is in the market now? Market ups and downs happen in very short spurts of time and we have seen wild swings of 35-40% in about 7 days. There is no man or woman in the history of investing who has been able to do this consistently day in and day out and I doubt if such a person exists. Understand the numbers in the next few statements.

If you had invested at the lowest level of the Sensex at every year from 1979-2004, your annual returns would have been around 16.9% and similarly if you had invested at the highest level each year, you would have earned a 15.1% every year. The difference is around 1.8% and it is very unlikely that you will invest at the highest level every year. Considering a fixed date every year, your investment would have grown between 15.1-16.9%.

So, don't fret whether you are investing at the highest level or lowest level, just do it systematically every month.

5. Overconfidence or Pessimism

Everyone likes to talk about their successes but very few people like to talk about failures or even admit them. Overconfidence and pessimism are two sides of the same coin. 2007 and early 2008 saw a lot of overconfidence only to be followed by several months of extreme pessimism. 2009 started on an optimistic note but the overall mood was cautious until 2010. I know of a fund manager who was bearish all through the market rise from 8000 – 12000 saying that we will go down again but turned bullish after the Sensex touched 17000 levels.

A person I knew during the technology boom believed that he had a Midas touch that most of his fellow beings in this century did not. He used to track and trade on every market move and boast of his winners but never talk of his losers. The longer he kept at it, the more overconfident he grew and this was a perfect recipe for disaster. That's because obsessing over the market made him believe in his ability to spot future winners. He made increasingly aggressive bets, which sooner or later were bound to explode and this is exactly what happened. He later on became so pessimistic that he stayed out of the market even during the upturn from 3,000 to 10,000 only to enter in at 15,000.

The stock market will make even the most adventurous person humble and you would excel in investing by understanding this reality.

ACTION ITEMS FOR AVOIDING MISTAKES

a. Make a resolution to spend some time thinking about your future goals and writing them down on paper. Writing your goals on paper has the power of making them a reality. Read “Think and Grow Rich” by Napolean Hill. Yes, you read it right, the key is to think because we live in a world of TDO or THINKING DEFICIT DISORDER. Thinking would certainly take you a step closer to rationality, which is an important ingredient in the world of investing.

b. Keep yourself level headed every year and have reasonable expectations. The key is to exercise self-control, and you can get this to work for you simply by understanding yourself a little better. Socrates said, “Know thyself is the key to human advancement”, and this statement takes the cake for its relevance and importance to how we think and act when it comes to equity investments.

c. Do a Financial Fitness Check-up by looking at your overall asset allocation, products, time horizon, return objectives and risk tolerance.

d. Finally, prepare an investment policy that will form the basis for your buy

and sell decisions. The purpose of a written plan or a policy is to help you prevent costly mistakes, achieve your goals in life, provide comfort during stressful moments, while enjoying the journey called life.

e. Focus on things that you can control for e.g saving and investing regularly, covering your risks, avoiding excessive leverage, and avoiding derivatives and commodity trading. You will just do fine if you do these simple things than worrying about the markets. The truth is “No one knows what the market will do tomorrow.”

Most people spend more time planning their vacations, deciding which car or plasma TV to buy, than planning their finances. It is beyond comprehension why people behave in this fashion, although this is a vital area that will determine your overall financial net worth. A 1999 Fortune magazine article described a study that found investors who made written plans by the time they were 40 wound up on average with five times as much money by age 65 as those who didn't have written plans.

Keep an eye on the mistakes outlined above and ensure that you profit from them.

Most Indians are obsessed with cricket; it is a religion that binds our country together. Sachin Tendulkar is clearly a legend when it comes to the world of Indian cricket.

When Sachin Tendulkar is out for a duck, does that make him a bad player? Most of us would think not. But when it comes to equity investments, one or two bad years or innings or losses and we lose hope in equities and resolve never to dabble in the stock market. Just like Sachin’s long-term average is excellent, the long-term average of equity as an asset class across the world in the past 200 + years has been stellar.

If you had invested money in the equity market every time Sachin played a match in the past 15 years, instead of trying to time the market, I believe that

the results would have been excellent and you would have been laughing your way to the bank.

The markets are volatile but it's the rational investor who will reap the rewards of this volatile time. The dance of stock prices and NAVs might be seductive but it does you no good besides giving you a higher level of anxiety. I am confident this is not why you invest and the few good reasons to invest are to achieve your goals, protect the purchasing power of your money, grow your wealth and leave a legacy for the next generation.

Always keep an eye on the bigger picture. We are living at a time of the greatest economic prosperity in Indian history. Favourable demographics, high domestic consumption, soaring infrastructure spending, innovation and political stability to a certain extent will continue to enhance the standard of living throughout India. This will keep the economy growing and profits increasing, which will eventually reflect in higher share prices.

Charles Ellis noted, "Stay invested through the rough times. That's the only sane way to be there so you will enjoy the great and good times."

The lesson to be learnt is, "Don't let the short-term performances of equities determine its long-term average."

GOLD

India is one of the biggest consumers of gold. This is evident from the fact that every Indian family will have at least some exposure to gold in the form of jewellery.

In fact, my wife has this to say, "Gold is a very wise investment not only from a financial perspective but from an emotional perspective. It keeps the women of the house happy and in times of distress, it can be liquidated

quickly to raise money. Gold is an alternate form of currency." I had to agree with my wife on this one.

Most analysts talk about gold as being a hedge against inflation. At the same time, others say that gold merits no inclusion in any portfolio as the returns are generally quite low or in line with inflation and past performance from 1980 has been uninspiring. We all know that past performance is no reflection of an asset's true potential and hence every asset class must be viewed within the framework of the current economic scenario.

Besides emotional reasons, there are many other reasons why you must include gold now in your portfolio.

1. The uncertainty looming over the weakening US and global economy will make investors look out for alternate form of investments. The dollar is inherently a weak currency and a fear that it could weaken from these levels could see a flight back to real assets such as gold.

2. Oil prices have corrected now but the tide could turn around once the global economy revives. This would mean higher inflationary pressures and investors generally rush to gold during such times.

3. The incidence of terror strikes and war like situations could see a flight of capital from other asset classes as people see gold as a safe haven and alternate currency.

4. Gold acts as a good form of diversification to your portfolio. Generally, there is no direct correlation between increase in share prices or real estate prices and gold. In 2008, when every other asset class was down, gold held its head high and delivered decent returns. In fact, gold has been making new highs throughout 2011. At the same time, it has been extremely volatile, sometimes correcting by as high as 10% in a period of 2 days.

There are many merits on why one must hold gold but what is important is how much gold must be part of the portfolio and in what form should you hold it. Asset allocation is a function of your overall financial goals, liquidity needs, return expectations and risk profile. There is no thumb rule as such but you can allocate anywhere between 5-15% of your assets to gold. This can change on the upper side or the lower side based on opportunities and the economic scenario.



Most people in India hold gold in the form of jewellery. Additionally they also hold gold in the physical form (bars or coins). However, you can also invest in gold through Gold ETFs launched by asset management companies such as Benchmark, Kotak, Reliance, Quantum, SBI, UTI, HDFC, Birla Sunlife and others.

One of the biggest advantages of investing in Gold ETFs over physical gold is that you can buy this real-time at spot market prices. Since Gold ETFs are in dematerialized form, there is no cost of storage, no need of insurance and no fear of theft. The gold is 99.99% pure and you are assured of its purity, which is a concern when buying direct gold. Additionally, Gold ETFs are far more tax efficient than direct gold as can be seen from the following table. They attract no wealth tax and long-term capital gains arise when you sell just after 1 year. On the other hand, physical gold and jewellery will attract wealth tax and long-term capital gains arise only when you sell after 3 years, else it is short-term capital gains.

Besides jewellery, gold coins and gold ETFs, there is another way to benefit from gold’s price increase. This is by investing in gold equities or gold mining companies and is available in India through DSP ML World Gold

Fund and AIG World Gold Fund. These funds do not invest in direct gold but invest in gold mining companies.

The rationale given by fund houses is that investing in shares of gold mining companies as against buying physical gold and ETFs gives investors an opportunity to benefit from the growth potential of equities and the strong fundamentals of gold. Gold mining companies can grow organically or through the Mergers & Acquisition (M&A) route while gold bullion/ETFs cannot. There is a multiplier effect on the profitability of gold mining companies with rise in gold prices because of operating leverage. At the same time, the multiplier effect can also go against them if gold prices decline sharply.

The tax treatment for these investments is similar to that of ETFs and is a good indirect way to take some exposure to gold. These are however more volatile investments than gold and can move sharply up and down as their correlation with the equity market is much higher than that with gold prices.

Investment	**Cost**	**Taxation**
Jewellery	Labour charges & mark-ups are high and can go as high as 15-30% Additionally jewellers will not even buy gold from you at market rates when prices are high	■ Wealth Tax applicable ■ LTCG after 3 years – 20.6% with indexation ■ STCG 30.9%
Gold Coins	■ Are expensive than the spot price of gold. ■ Making charges of gold coins are anywhere between 2.5-8%	■ Wealth Tax applicable ■ LTCG after 3 years – 20.6% with indexation ■ STCG 30.9%
Gold ETF	■ 0.5% Brokerage per transaction (Buy or Sell) ■ 1.0% Annual Expense Ratio	■ No Wealth Tax ■ LTCG after 1 year – 20.6% with indexation or 10.3% without indexation ■ STCG 30.9%
Gold Equities- DSP ML World	■ 0.75% Annual Expense ratio	■ No Wealth Tax ■ LTCG after 1 year – 20.6%

Gold Fund		with indexation or 10.3% without indexation ■ STCG 30.9%

DSP ML World Gold fund had a stellar run of 60% in 6 months since its inception in 2007 but then had a major correction when gold equities took a beating around the world. Even when equity markets continued to slide in the first 3-4 months of 2008, gold equities did exceptionally well. Then they took a sharp beating and under-performed Gold ETFs for a few months until October 2008.

The two gold equity funds that are available to Indian investors are feeder funds that instead of investing directly in gold mining companies abroad do so through a gold fund of Merrill Lynch and AIG Global, respectively. Both the World Gold Funds are treated as debt funds from a taxation perspective.

In the two months ending December 24, 2008, DSP World Gold Fund delivered an astounding 62% absolute. This is something exceptional, since Gold ETFs and physical gold barely delivered around 17% during the same period. Even AIG World Gold Fund managed to deliver a handsome 42% absolute return.

These gains were primarily due to the fantastic recovery of gold mining stocks. Some of these stocks have delivered returns in the range of 50-65%.

Compounded Annualized Returns as of 30/12/2011

Scheme Name	2 Years	3 Years
AIG World Gold Fund – Growth	12.8615	24.416
DSP BlackRock World Gold Fund – Growth	12.1232	21.165
Gold BeES	25.9567	24.6632
Kotak Gold ETF	26.2503	24.9959
Reliance Gold ETF	26.3203	24.651

Source: MFI Explorer

So considering that there are so many choices within the gold asset class, how should you create a gold portfolio? This is just an indicative structure and it could vary from person to person.

INVEST

1. 60-70% of your gold assets in Gold ETFs
2. 20-40% in gold mining companies
3. 10% in physical gold if you like to hold it this way, else give this a miss
4. Jewellery is considered a personal asset and not an investment and hence should be excluded as an investment

ALTERNATE INVESTMENTS

One could look at several alternate investments after building a solid portfolio of debt, real estate, equity and gold.

- Private Equity
- Art

These investments can be made on your own or through a Portfolio Management Service (PMS). Making investments in private equity and art on your own requires substantial capital, expertise and time. This is not a viable option for most people and hence you can look at PMS and funds as a means to make such investments.

However, just as you would evaluate a real estate PMS, you must evaluate a private equity and an art PMS in a similar fashion. The key things to

understand are the following:

- What kind of investments will the PMS make? What is the PMS' investment strategy?
- Who is the Portfolio Manager and what is his experience or track record of managing such schemes?
- What are the entry cost and the annual management fee of this PMS? Is there any profit sharing?
- What is the liquidity available in this scheme?
- How will the proceeds of these schemes be taxed? Will there be any payouts done in between?

Private Equity



Private equity refers to shares of companies that are not listed on a public stock exchange. Generally, these are growth-oriented companies that have not yet gone public but have been in business for quite some time. Private equity PMS or funds typically raise money from institutional and high net worth investors and make investments in private companies that are likely to grow exponentially in the next few years. The exit option for the private equity funds is mostly through Initial Public Offerings (IPOs) and M&A.

The targeted returns in such investments are around 20-25% per annum. Private equity funds suffer from two big disadvantages and hence are beyond the purview of most people.

- Substantial capital commitments: often start at Rs. 50 lakh to Rs. 1 crore
- Investments are typically illiquid as exit options are virtually non-existent for several years

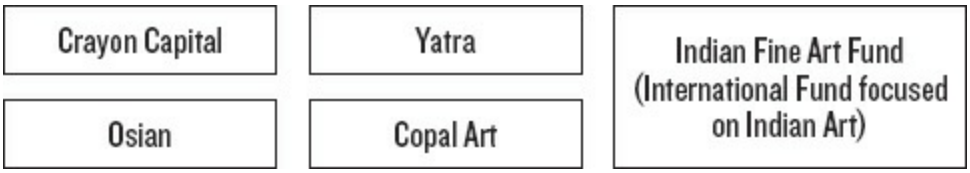
This investment is typically meant for those who can take very high risks and can have their capital locked in for a long period. Thus, one of the key attributes that is required for such investments is patience.

Most people have hardly any exposure to equity, so private equity seems like an investment that is way off their radar. It should only find a place in your portfolio after you have made substantial investments in equity listed on the stock exchange whether direct or through mutual funds.

Some of the sample private equity funds in India have been from ILFS, TVS Shriram Private Equity and others. Some of the leading international private equity players are the Carlyle Group, Texas Pacific Group, Warbug Pincus and KKR & Co.

Art

You no longer need to risk your entire capital in just one painting or end up buying a fake piece from art dealers. Investments in art now can be made through several art funds operating in India. Professionals experienced in buying and selling art manage these funds. The few art funds operating in India are:



Osian's Art Fund was the first one in the country and was subscribed to Rs. 100 crore in just a few days.

The objective of this scheme was to generate medium and long-term income and capital growth through a portfolio of contemporary art investment in the Indian sub-continent. However, this fund was a complete disaster at the time of maturity and most people did not get even their capital at the end of 36 months.

All the funds are close-ended with a lock-in of 3-5 years and an initial investment of anywhere between Rs. 10-40 lakh.

However, Copal Art's Rs. 150-crore fund had some unique features such as low entry-level of Rs. 5 lakh, flexible payment plans and an option to invest in paintings of one's own choice with no lock-in period.

The returns that are often targeted for such funds are between 25-30% per annum. Again, these returns are subjective or indicative returns and are often sweetened by the huge premiums paid for Indian art in international auctions. Since art investments are often illiquid investments, it remains to see how these investments fare in a tough and uncertain economic climate. 25-30% returns are abnormally high returns and hence the risk associated with such returns is always higher. The returns from such investments can be negative and on fund maturity or redemption, the investments might not be liquid at all. Hence, ensure that only a miniscule portion of your portfolio is allocated to art.

Most art funds focus on the work of established players, as the returns are lucrative for a low level of risk. In the future, art funds could focus on emerging players.

There is a six monthly or an annual appraisal of the art portfolio to calculate the actual value of the investments. This detailed report is sent to all investors of the fund.

The cost structures of most funds are on the higher side at around 5-9% and most of the funds are not registered with SEBI (Securities and Exchange Board of India). SEBI has announced very prominently that launching art funds without SEBI registration would amount to violation of its Act. Every investor must check if the art fund is registered with SEBI and must choose only those funds that are registered with SEBI.

As mentioned earlier, it is very important to evaluate the credentials of a portfolio or fund manager and the PROMOTER of the Art Fund. The art fund manager should be experienced enough to understand the nuances of the art market, price discovery mechanisms, potential for gains and risk in every

investment. The reputation and expertise of the art fund manager is therefore sacrosanct.

In fact Osian defaulted on its principal payment and investors had to wait for several months and it is only after a huge public outcry were most of the people able to get majority of their principal back. The art fund picture can be very rosy but it's best to stay away from such investments until a track record of prudent fund management is proven.

Personal Fitness & Relaxation

People, in general, lead a very stressful life and find it difficult to achieve a meaningful work-life balance.

This often leads to them not taking vacations for several years or spending quality time with their families. This is fine when you are young but can take a severe toll on your health in the long run. There are several side effects of this trend and people are well aware of this fact. The issue is of implementation.

Just knowing the ill effects and doing something about it are 2 different things. Implementation is the key and you must set aside time for your personal fitness and relaxation needs. Remember, the first wealth is health or as we say in Hindi, "Jaan Hai to Jahaan Hai".



INCOME TAX PLANNING

CHAPTER 11

Income tax is a very broad and exhaustive subject. This chapter will briefly touch upon basic income tax details that a person should know.

INCOME TAX IN INDIA

The Income-Tax Act governs income tax in India. The Act contains provisions for determination of your taxable income, determination of tax liability, procedure for assessment, appeals, penalties and prosecutions.



Most people look at tax planning with a very myopic view of saving tax. Hence, you will see that most people would have bought many life insurance policies during the tax season. The whole idea is to save tax and to get some returns on maturity of the investment.

This pursuit of saving tax and a blinkered view of tax savings cause a lot of harm to individuals in the form of lower post-tax income, higher costs and a hodgepodge of investments accumulated over a period of years.

GOAL OF TAX PLANNING

Contrary to the above approach, tax planning must always be seen within the broader framework of financial planning. The actual goal of tax planning should be to maximize post-tax income. Tax saving is good but it serves no purpose if your post-tax income is low.

BASIC EXEMPTION LIMITS & TAX SLABS

The first step is to understand the basic exemption limits and tax slabs. The exemption limits and hence tax slabs vary on whether the person is an individual (male below 65 years), a woman or a senior citizen (65 years and above, irrespective of gender).



Tax Slabs

Tax Rate	FY 2011-12	FY 2012-13
Nil	Upto Rs. 180,000 (Rs. 190,000 for women, Rs. 250,000 for senior citizens and Rs. 500,000 for super senior citizens above 80 years)	Upto Rs. 200,000 for general public Rs. 250,000 for senior citizens aged 60 years but less than 80 years Rs. 500,000 for super senior citizens above 80 years
10.00%	Rs. 180,000 to Rs. 500,000	Rs. 200,000 to Rs. 500,000
20.00%	Rs. 500,000 to Rs. 800,000	Rs. 500,000 to Rs. 1,000,000

30.00%	Above Rs. 800,000	Above Rs. 1,000,000

Note: There is an education cess of 2% and health cess of 1%

Once you have understood the different tax slabs and exemption limits, the next step is to understand your gross total income.

You must assess your income of the previous year (previous financial year), pay advance taxes as per the schedule and then file your tax returns in the assessment year.

COMPUTATION OF TOTAL INCOME

Generally, for most people, there are five sources of income or income heads.

A. Salaries

B. Income from house property

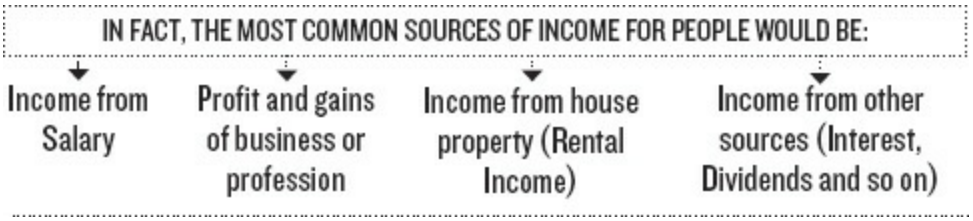
C. Profit and gains of business or profession

D. Capital gains

E. Income from other sources

INCOME HEADS APPLICABLE TO MOST PEOPLE

The primary source of income for most salaried persons would be salary whereas for professionals and business owners would be from their practice or business.



Besides this, there are capital gains when real estate, gold and equity is bought and sold. However, the primary sources of income are salary, profits from business, rental income and interest income.

Once you know your income under various heads, you should calculate your Gross Total Income by adding all income heads.

Tax Payable Calculations

Gross Total Income	=	A + B + C + D + E
Total Income	=	Gross Total Income — Deductions under chapter VIA
Total Tax Payable	=	Tax on Total Income — Rebates and relief under Chapter VIII

Let’s understand the total tax payable calculation for CA Arjun Mhatre.

Gross Total Income: Mhatre

Income from Profession	Rs. 20 lakh
Income from House Property	Rs. 5 lakh
Income from other Sources	Rs. 3 lakh
Gross Total Income	Rs. 28 lakh
Investments under Section 80 C and Infrastructure Bonds	Rs. 1.2 lakh
Total Income	Rs. 28 lakh- Rs. 1.2 lakh = Rs. 26.8lakh
Total Tax Payable (No rebates or reliefs)	Rs.6,75,680

ADVANCE TAX

One has to pay advance tax in the previous year if tax liability is more than Rs. 5,000. The provisions of advance tax are applicable on all types of

persons irrespective of the residential status of the person. The idea is that the tax is paid as income is earned.

What are the Due Dates and amount of advance tax payable?

Due Dates	Amount of Advance Tax payable
On or before 15 September	not less than 30% of tax payable
On or before 15 December	not less than 60% of tax payable
On or before 15 March	not less than 100% of tax payable

Since the actual income and tax payable can be done only after completion of financial year, the income is estimated at certain due dates and should be paid accordingly.

What happens if you do not pay your Advance Tax on time?

There is a penal interest that you need to pay in case you have not paid Advance Tax in full. There are two sections that are applicable, namely Section 234B and Section 234C.

Section 234B - Interest for non-payment or reduced payment of advance tax

If you don’t pay advance tax at all or if the aggregate tax paid by March 31 is less than 90% of the total tax payable, you will have to pay an interest of 1% per month on the deficit amount from April 1 of the following year until the date you file your return.

Section 234C - Interest for deferment of advance tax

If you don’t pay an advance tax instalment in full, you have to pay interest at 1% a month for three months on the amount that falls short of the required payment. However, in the case of default of the last instalment (March 15), the interest of 1% is chargeable for only a month.

Let’s illustrate this with an example: Let’s say your advance tax liability is Rs. 10 lakh. However, you pay Rs. 9 lakh in three instalments.



i. No default on first instalment (Rs. 3 lakh, which is 30% of Rs. 10 lakh)

ii. Default on second instalment as amount should have been Rs. 3 lakh (60% of Rs. 10 lakh). Shortfall is Rs. 2 lakh, on which the interest payable is Rs. 6,000 (1% of Rs. 2 lakh for three months)

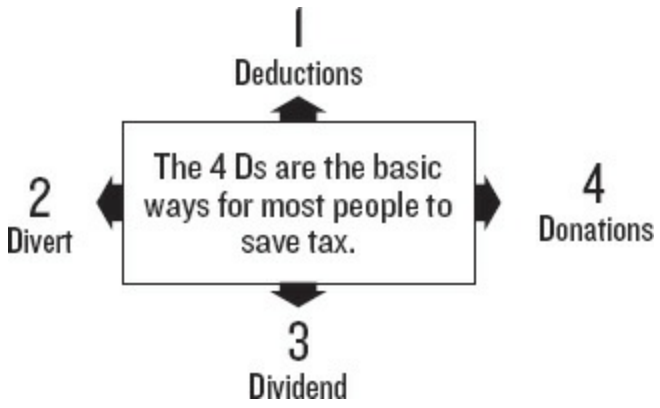
iii. Third instalment is Rs. 5 lakh and there is a shortfall of Rs. 1 lakh, on which the interest charged would be Rs. 1,000 (1% of Rs. 1 lakh for a month)

If you delay your advance tax even by a day, you will have to pay penal interest on it for the entire month.

HOW TO FILE YOUR IT RETURNS?

Salaried individuals need to file their returns using ITR Form 1. Self-employed and Business Owners would need to file their tax returns using ITR Form 4. Additionally business owners and professionals, are subject to a Tax Audit once revenue crosses a certain threshold limit. This means that your accounts will have to be audited and certified by a Chartered Accountant.

HOW SHOULD YOU SAVE TAX?



A. DEDUCTIONS

Deductions help you to lower your total taxable income and hence reduce your tax liability.

There are several deductions available but the most common one is Section 80C. This is the section under which most of the tax saving investments is done. Under this Section, an investment of maximum of Rs. 1 lakh can be deducted from your Gross Total income when you invest in the following investment options.

- EPF and Voluntary Provident Fund (VPF)
- PPF
- NSC
- Bank Deposits
- Life Insurance Premiums
- ELSS
- Pension Policy Premium
- Pension Scheme from a Mutual Fund
- Senior Citizens Savings Scheme

The table below illustrates the returns, taxation of returns and lock-in period of the above investments:

Investment	Returns	Taxation	Lock-in & Notes
EPF & VPF	8.5%	Tax Free after 5 years	5 years
PPF	8%	Tax Free	Partial withdrawal after 6 years. Complete withdrawal after 15 years
NSC	8%	Taxable as per your tax slab	6 years
Bank Deposits	6-9.5%	Interest Taxable as per your tax slab	Depending on tenure of deposit
Life Insurance Premiums	Traditional Policies 4-6% Guaranteed ones can give slightly higher returns ULIPs: Based on market performance and cost of product Term Plans: No Maturity Value – Only Risk Cover	Tax Free	Traditional policies locked in for the tenure of policy ULIPs – 5-6 years
ELSS	Based on market performance. Returns likely to be around 12-15% over a longer period	Tax Free	3 years
Pension Policy Premium	Traditional Policy – 4-6% ULIP- Based on market performance and cost	Taxable	5-6 years
Pension Scheme of Mutual Fund	Based on market performance. Returns likely to be around 8-10% over a longer period. Equity component is between 35-40%	Dividend : Tax Free Long Term Capital Gains: 10% without indexation and 20% with indexation Short Term Capital Gains: As per your tax slab	Until retirement -55-58 years. Can exit after 3 years on paying an exit load of 3%
Senior Citizens Savings Scheme	9% interest payable quarterly	Taxable as per your tax slab	Partial withdrawals not allowed Exit between 1st and 2nd year- 1.5% of the deposit shall be deducted After 2 years, 1% of the deposit will be deducted

Besides the investments mentioned above, two non-financial investment avenues can be utilized under Section 80 C.

- Principal Amount of Home Loan EMI
- School and College Fees

So how do you decide which option to go for?

Ask yourself following questions:

1. **Have you taken a Home Loan?**
2. **Are you paying your children's school fees?**

If you are already doing the above, it means you are already contributing to tax saving instruments under Section 80C. Calculate how much amount you pay towards home loan principal or your children's school fees annually. Now deduct this from Rs. 1 lakh.

The difference is all that you need to invest from a tax-saving perspective.

However, if you do not have a house or children here is how you should go about it.

Look at your overall situation

Do you need a house? This is the first option that you should exercise. You will get a deduction on the principal investment as well as the interest component of the loan. However, as we noted earlier these are crazy rates to pay and you should not rush into buying a house now if you have not until today.

Life Insurance

Do you have any dependents and liabilities? If the answer to any one or both is yes and if you are in the accumulation phase (between 25-50 years), do your needs analysis as discussed in the Insurance chapter and buy adequate life insurance. Go for term insurance.

Let's say you are a 35-year old male and you take a term insurance for Rs. 1 crore for 20 years. Should you die during this period, your nominee/beneficiary will get Rs. 1 crore. The annual premium will be around Rs 25,000.

Which investment option should you go for?

If you want a fixed return investment, then you first go for PPF. It’s an excellent investment for anyone in the highest tax bracket. The only risk here is the risk of interest rates going down. However considering the political compulsions this is unlikely to happen.

Anyone can open a PPF account at the nearest State Bank of India branch or post office. Although traditional insurance policies, National Savings Certificate and 5-year Tax Saving Fixed Deposits also fall into this category, PPF and Senior Citizens Scheme (for senior citizens) remain the best debt investments so far.

On the equity front, the choice is between Unit Linked Insurance Plans (ULIPs) and Equity Linked Saving Schemes (ELSS- Tax Saving Mutual Funds). These mutual funds invest in stocks and give a tax benefit under Section 80C.

Skip high-cost ULIPs as explained in the insurance section. You can however look at Single Premium ULIPs.

What’s the right choice?

When compared with PPF, NSC and traditional insurance plans, the returns from ELSS are the highest. Even as equities provide high returns over the

long term, it’s a risky asset class. It is prone to volatility and there could be periods of negative returns. However, liquidity is the best in ELSS.

The final step is to decide which fund to invest in. And as the choices keep increasing, choosing a fund is going to be even more difficult. Therefore, you should choose your ELSS and ULIP with utmost care. Look at consistency rather than a one-off performance. Opt for investments with a proven track record in good as well bad times and experienced managers.

The trick to investing smartly and boosting returns (at optimal risk levels) lies in investing in a combination of debt, equity and real estate to maximize post-tax income.

Besides Section 80C, some of the other deductions that can be availed are:

a) 80D- Mediclaim. Premiums paid for you, spouse, children and dependent parents.

b) 80E- Interest on educational Loans.

c) 80G- Donations.

d) 80U- Deduction in case of a person with disability.

e) Section 24: Interest up to Rs. 1.5 lakh on one Self Occupied Property.

You can also invest up to Rs. 20,000 in Infrastructure bonds and claim tax deduction under Section 80CCF. If you are in the highest tax bracket, you can save as much as Rs. 6,180 by investing in these bonds.

The Rs. 20,000 limit for investment in infrastructure bonds is in addition to the Rs. 1 lakh tax deduction limit available under Section 80C and hence merits investment. You can choose an issuer of these bonds based on the credit rating, interest rates offered and the financial credentials of the company.

B. DIVERT

This is a strategy where people divert a portion of their income to their spouse's name or a parent if they fall in the lower tax bracket. Gifting is one way you can do this. Let's say you have children who are above 18 or non-earning parents, you can simply gift them and start earning income on their name.

The idea here is to divert income from a higher tax slab to a lower tax slab. If you had invested Rs. 15 lakh in a fixed deposit at 10%, you would have earned Rs. 1.5 lakh as interest. If, however, you were in the highest tax bracket, the amount post-tax would be reduced to approximately Rs. 1 lakh. By gifting it to your parents who do not fall in any tax bracket, you would end up saving close to Rs. 50,000. Even if your parents are in the lower tax bracket, it still makes sense to earn the income on their name.

Similarly, you can extend a loan to your spouse in case she has no income and continue to enjoy a similar benefit. Note that if you had gifted this amount to your spouse, it would have been clubbed with your income. On the other hand, if you give her a loan instead at a very low rate, you can avail of the above-mentioned benefits. Though the interest that you receive from your wife for the loan is taxable in your hands, the tax can be minimal if the difference between Fixed Deposit return and loan interest is sizeable.

C. DIVIDEND (OPT FOR DIVIDEND OR CAPITAL GAINS RATHER THAN INTEREST INCOME)

Dividends from shares and equity-oriented mutual funds are tax-free in the hands of the investor. Even dividends from debt funds are tax-free in the hands of the investor. However, the debt mutual fund scheme has to pay a Dividend Distribution Tax of 13.52%. This dividend distribution tax is actually paid out from your returns; the mutual fund only pays it on your behalf.

D. DONATIONS

This option is actually available as a deduction under Section 80G. This section is applicable for donations given to any approved charitable institution, trust and relief fund. Donation to a Prime Ministers Relief Fund can get you a deduction of 100% whereas others can get you a 50% deduction. The key point to remember is that total amount of deduction available under this provision does not exceed 10% of your total income.

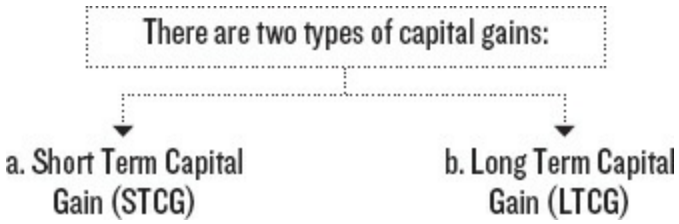
Capital Gains and Capital Losses

Capital Gain is any gain arising out from the transfer (sale) of a capital asset. This gain shall be chargeable to income tax under the head “Capital Gains” unless such capital gains is exempt under Section 54, 54B, 54EC, 54ED, 54F and 54G.

What is a Capital Asset then?

A capital asset is property of any kind held by the assessee but comes with certain exclusions such as personal effects for personal use of assessee and his family. Jewellery is excluded as a personal effect even though it is for personal use. Jewellery is a capital asset for capital gain purposes.

Similarly, although your house property is for personal use, it is still a capital asset.



Except for shares of listed companies and mutual funds, for all other assets, LTCG is when a capital asset is sold after 3 years; transfer before 3 years is STCG. Shares and mutual funds attract LTCG after 12 months and STCG before 12 months.



Four Primary Asset Classes and their Capital Gains Treatment

Asset Type	Short Term Capital Gain (STCG)	Long Term Capital Gain (LTCG)
Debt Mutual Funds	30.9%	10.3% without indexation 20.6% with indexation
Real Estate	30.9%	20.6%
Gold	30.9%	10.3% without indexation 20.6% with indexation
Equity (Listed on stock exchanges)	15.45%	Tax Free

Short Term Capital Loss and how you can benefit from it

Similarly, a capital loss is any loss arising out from the transfer of any capital asset. In case there is a capital loss that arises, you must first understand whether it is a short-term capital loss or a long-term capital loss. The same principles of time apply when it comes to short-term and long-term capital losses.

Unlike capital gains, where you must pay a tax or invest in certain instruments, a capital loss can be set off against other capital gains or carried forward for 8 years to set off against future capital gains.

Remember three important things:

a. There is no LTCG tax on shares traded on exchanges and equity-oriented funds; hence, there can be no setoff for long-term capital losses on these assets

b. Long-term losses from non-market transactions (that are not subject to STT) can be set off against long - term gains ONLY

c. Short-term capital losses however can be set off against short as well as long-term gains

In fact, this is one of the strategies that you can look at if you are sitting on any short-term equity market losses. When things go wrong, you must first evaluate the situation and see if there is any way you can profit by making any course corrections.

A review must be undertaken, especially if you are expecting any capital gains in the next eight years. You can make big tax gains by making use of a tax provision that allows you to offset capital losses against capital gains not just in this year, but also up to eight consecutive years.

Even if you believe in the share of a company, you can still exit the share, create a capital loss and then buy the share again. The sale that you have done will create a capital loss that you can offset against any capital gains that you have. In addition, you have bought the share again so your equity position remains as it is.

There are two things that you must keep in mind. Every buy and sell order will entail a brokerage that must be paid. Second, you must enter quickly because if the markets move up, your entry will happen at a higher cost. On the other hand, if equity markets go down, you will additionally benefit from a lower price. Hence, you must do this transaction swiftly based on your outlook and view of the market.

Additionally, you must file your tax returns before the due date prescribed under Section 139(1) of Income Tax Act and mention this loss in your return.



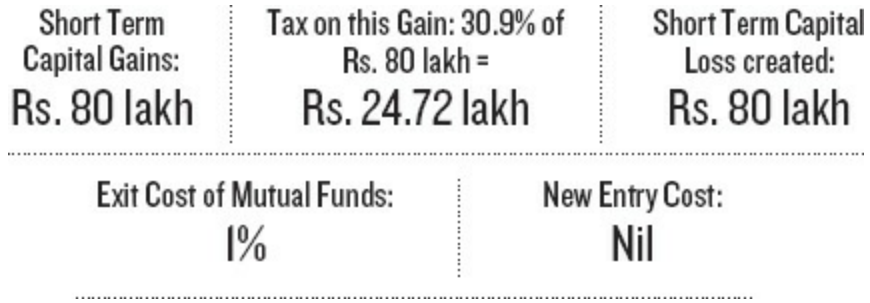
What are the Set-off Options?	
Type of Gains	**Tax Rate%**
Short Term Capital Gains from shares and equity oriented funds sold on exchanges where Securities Transaction Tax (STT) is paid	15*
Short Term Capital Gains from shares outside exchanges where no STT is paid	Marginal Rate of Tax
Long Term Capital Gains from shares and equity oriented funds sold on exchanges where STT is paid	Not Applicable as there is NO LTCG on shares and equity oriented funds where STT is paid
Long Term Capital Gains from shares outside exchanges/debt investments	10* (without indexation) and 20* with indexation
Short Term Capital Gains from other capital assets (Real Estate, Gold and others- sold before 36 months)	Marginal Rate of Tax
Long Term Capital Gains from other capital assets (Real Estate - sold after 36 months)	20 with indexation*

*Education and health cess will also be applicable

Let's illustrate this with the example of Neel Ganesan.

Neel had bought equity mutual funds to the tune of Rs. 1.8 crore in April 2008. He realized that he should not have parked the huge amount in just 1-2 days but stagger it over a period of time. At the same time, one of his properties had been sold and he was expecting a short-term capital gains payout of Rs. 80 lakh from his real estate investment. He had a tax liability of Rs. 24.72 Lakh. He was advised to create a short term capital loss which could be offset against the gains.

The value of the mutual fund portfolio when Neel sold it was Rs. 1 crore. He thus created a short-term loss of Rs. 80 lakh. He decided to invest in well-managed equity funds rather than the aggressive ones he had done earlier. So, he toned down the aggression of the portfolio and entered new investments at much lower levels than he had exited.



He was able to offset the whole Rs. 80 lakh against the short-term capital gains and hence, Neel did not have to pay even a single rupee of tax.

With tact and timely action, he has saved Rs. 24.72 lakh - Rs. 1 lakh (cost of exit 1%) - Rs. 0 (cost of entry in new investments) = Rs. 23.72 lakh of tax.

At the same time, he has reshuffled his portfolio to have appropriate investments in the portfolio and luckily, he has managed to enter at a much lower price. This lower entry price is icing on the cake but you cannot expect it to happen always and must be prepared to live with a higher entry price. This will slightly shave off the gains but this strategy is worth it when the tax saved can be substantial.

Even if there are no capital gains for you now, you can still benefit from exercising this strategy if there is a chance that in the next 8 years, you sell a capital asset such as property and jewellery that will result in substantial capital gains.

What should be the Order for Setting off Short-term Capital Losses?
In case, you have gains in the next eight years from several sources and wish to set off losses, here is the order that you should follow:

1. Short Term Capital Gains (Where no STT is paid. Includes non-listed equity and non-equity assets)

2. Long Term Capital Gains (Non-equity assets)

3. Short Term Capital Gains (Equity-STT Paid and Equity-Oriented Mutual Funds)

4. Long Term Capital Gains (Unlisted Equity and no STT paid listed equity)

We rarely see the tax laws and equity market ganging up to help you save tax. This is one of those times; the last ones were in 2001 and 2008. In 2001 though, there were hardly any gains from other asset classes so one couldn't have really taken advantage of the situation. In 2008, people were sitting on gains from real estate, gold and sale of business that were utilized to their advantage.

Taxation of Investments

Real estate is one of the largest investments for most people and hence it is very important that people are clear on the taxation aspect of real estate.

If real estate (residential, commercial or land) is sold before 3 years, you must pay short-term capital gains tax on it. The tax on it will be your marginal rate of tax.

If, however, the transfer of real estate (except agricultural land) is done after 3 years there are various ways of saving capital gains tax.

1. Section 54 and Section 54F - Invest in another property. There are similarities and three main differences between Section 54 and Section 54F that are explained in the following table in detail. Make sure you understand these properly.

2. Section 54EC - Invest in Rural Electrification Bonds (REC) and National Highway Authority of India (NHAI). However, there is a cap of Rs. 50 lakh for investments in these bonds. The interest rate on these bonds is

quite low at around 6% per annum for 3 years. Moreover, the interest income is taxed according to your tax slab and hence for someone in the highest tax slab, the returns would be around 4.15%.

3. Section 54EB: Capital Gain on transfer of land used for agricultural purposes. The exemption under this section is only available if the following are satisfied:
    - Agricultural land has been transferred by an individual
    - Agricultural land has been used by individual or his parents for agricultural purposes during two years immediately preceding the date of transfer
    - Individual had purchased another piece of agricultural land within a period of two years after the date of transfer of original agricultural land

Section 54, 54F, 54EC and 54EB – Understand the Nuances

Sr. No.	Details	Section 54	Section 54F	Section 54EC	Section 54EB
1.	Type of Capital Asset	Residential House	Transfer of a long- term capital asset not being a residential house	Transfer of any long-term capital asset	Transfer of land used for agricultural purposes
2.	Where should money be invested to claim exemption	Residential House	Residential House	Bonds of NHAI and REC	Agricultural land
3.	Time frame for – new investment purchase - for construction	1 year before or 2 years after transfer (within 2 years) 3 years from date of transfer	1 year before or within 1 year (Notice the small difference here) 3 years from date of transfer		Within a period of 2 years after date of transfer
4.	Limit on number of houses	No limit	Only applicable if investor does not own more than 1 house, other than the new house	No limit on number of properties as such but amount that can be invested in bonds is capped at Rs. 50 lakh	No limit
5.	Amount to be invested for paying Zero Capital Gains Tax	Sum equal to capital gains incurred is sufficient E.g.: Jayant Pai sold a residential house he had bought at Rs. 25 lakh for Rs. 50 lakh His capital gain was Rs. 25 lakh. He was required to invest only Rs. 25 lakh to save his entire capital gains tax (indexation excluded for simplicity)	Entire Net consideration of the sale must be invested to save entire Capital Gains Tax E.g.: On the other hand Arati Pai sold a plot she had bought at Rs. 25 lakh for Rs. 50 lakh. Although her capital gains was only Rs. 25 lakh, she was required to invest the entire net consideration of Rs. 50 lakh to save the entire capital gains tax	Sum equal to capital gains incurred is sufficient	Sum equal to capital gains incurred is sufficient
6.	What if the amount is not invested before the date of filing the return?	Deposit in a Capital Gain Account Scheme (CGAS) in any specified Bank and enclose the proof of such deposit with the return of income	Same as Section 54	Same as Section 54	Same as Section 54
7.	What happens if the deposit in CGAS is not utilized?	The amount not utilized will be charged as long-term capital gains of the previous year in which the 3-year period from the year of transfer expires	Same as Section 54		The amount not utilized will be charged as short-term or long-term capital gains of the previous year in which the 2-year period from the year of transfer expires (Note the small difference here)
8.	What happens if the exempted house property is transferred within three years of acquisition?	The cost of the new house is to be reduced by the amount of LTCG exempted from tax on the original asset and the difference between its sale price and such reduced cost will be chargeable as STCG of the year in which the new asset is sold	The amount of capital gain not charged earlier shall be deemed to be LTCG of the previous year in which such new asset is transferred		In this case it is 2 years and not 3 years. The cost of acquisition of new agricultural land shall be reduced by the amount of capital gain exempt u/s 54B earlier. This will always be a Short-Term Capital Gain

Why is Disclosure of Income Important?

Although many professionals and business owners today have high incomes, very few actually disclose it. They do so primarily to evade taxes. What they do not realize is that there are several benefits to disclose one's income and have a solid income and balance sheet.

Disclosure of income will have you pay more taxes but you will end up having a solid income statement (IT return) and a good balance sheet. Having a solid income and balance sheet serves several purposes.

a. This demonstrates extreme creditworthiness to the bank and they are willing to lend higher amounts at very attractive interest rates. Since loans are a major source of funding for professionals and business owners, this is a very important facility to have.

b. Besides real estate and gold, you are able to diversify into other asset classes and different types of investments where you can only invest your white money (as it is called).

c. Peace of mind. You can sleep comfortably at night by knowing that you have done the right thing.



CREATING A LEGACY

CHAPTER 12

Shekhar Joglekar was a hotshot business owner in Delhi. He was 49 years old, and survived by his wife and two daughters. He had a huge family, owned a lot of real estate and had given out several loans to people for very high interest. An unexpected and severe heart attack resulted in Shekhar's death several months ago. His wife is still trying to get a handle on the overall financial situation.



People who had taken loans from him now refuse to acknowledge the loan. Since there is negligible income from the business now, lenders are now waiting for the debt to be settled. Though Shekhar was paying huge premiums, his sum assured (life cover) was on the lower side and will go in just settling his debt. Additionally, there is a real estate dispute in the family and this has caused considerable stress for the wife. Though he has accumulated assets, nothing was on paper and now there are several claimants for his assets.

Today, many people work tirelessly for several hours and often without vacations or any form of rejuvenation. They lead a very stressful life in the pursuit of wealth creation and wealth preservation.

Ask yourself “What use is wealth creation and preservation if the fruits of your hard labour are not transferred successfully according to your wishes?”

Creation and preservation of wealth are important objectives but it must also be followed by proper distribution of wealth. Your overall financial plan must consider distribution of wealth as a key objective to avoid smooth transition of your wealth and to avoid conflicts within the family.

Ask yourself the following questions:

- What would happen if I die today?
- What would happen to my wealth?
- Does my spouse know about all the insurances, investments, debtors and creditors that I have?
- Will my wealth be distributed as per my wishes?
- Can there be any financial conflicts in my family? Will there be multiple claimants for my assets?

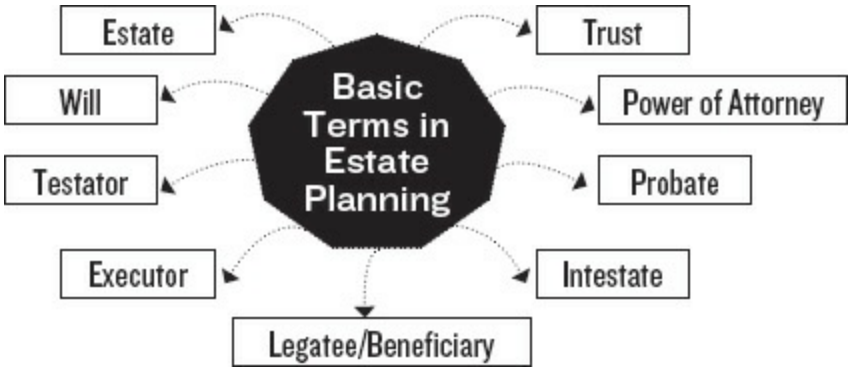
Many of you might have not even thought along these lines.

What happens in case you die (like Shekhar) intestate, without a Will?

The first thing you must **DO NOW** is to **Make a Will**, thereby avoiding the problems of dying intestate.

You should make a ‘WILL’ bequeathing your estate to your spouse “FOR LIFE” and thereafter according to your wishes.

WHAT IS ESTATE PLANNING?



Estate

The sum of all the assets of a person, less his liabilities becomes his estate. In short, all properties, bank accounts, investments, insurances and collectibles, less the liabilities of a person, are collectively called a person's estate.

Will

In simple words, a will is a document that ensures that your wishes with respect to your estate (assets less liabilities) are followed after your death. In legal language, a will is defined as "the legal declaration of the intention of the testator, with respect to his property, which he desires to be carried into effect after his death". In other words, a will or a testament means a document made by person whereby he disposes of his property, but such disposal comes into effect only after the death of the testator.

Testator

A person who makes his will is a testator.

Executor

A person, who executes the contents of the will after the demise of the testator, is called the executor. The executor is the legal representative for all purposes of the deceased person.

Legatee/Beneficiary

Legatee is a person who inherits the estate under a will.

Intestate

Any person who dies without executing (making) a valid last will is known as dying intestate. In such a case, the heirs would be governed by the Succession Act or Personal Law of the deceased. The Succession Act or Personal Law of the deceased gives order of succession.

Probate

Probate is the legal process of settling the estate of a deceased person, specifically resolving all claims and distributing the deceased person's property under the valid will.

Power of Attorney

A power of attorney (POA) is an authorisation to act on someone else's behalf in a legal or business matter. The person authorising the other to act is the principal, or donor (of the power), and the one authorised to act is the agent. Power of attorney can be general in nature or can be very specific such as for opening a bank account or making an investment or representing someone in a real estate transaction.

Trust

A trust is a relationship in which a person, called a trustor (also known as settler or author of the trust), transfers something of value, movable or immovable, to another person, called a trustee. The trustee then manages and controls these assets for the benefit of a third person, called a beneficiary.

A trust can be private or public. The difference between a public and private trust is essentially in its beneficiaries. A private trust's beneficiaries can be an individual or a group of individuals, while a public trust is for the benefit of a larger cross-section having a public purpose.

A trust can be especially useful if you have minor children but it is extremely important if children have certain disabilities and will not be take financial decisions independently.

➲ Do you have a Will?

99% of people in India do not have a will. Even a visionary such as Dhirubhai Ambani did not apparently make one.

Chances are you do not have one. Congratulations if you have one. You should pat yourself on the back for having an important document in place.

Even if you do not have one, don't worry about it. Talk to an estate planning lawyer as soon as possible. Creating a will can cost from a few thousand rupees to much higher amounts depending on the complexity of the document and the reputation of the lawyer.

Appendix A consists of a sample copy of a Will.

➲ Key Pointers

The process of making a will is very simple. It requires no stamp duty or registration, although most experts advise that a will must be registered, so

that it is in safe custody. Two witnesses must attest a Will; one preferably a doctor and other could be your lawyer or advisor.

However, there are certain mistakes you need to be careful about. A common mistake that most people make is failing to appoint trustworthy executors younger than themselves. In case of Hindus, another common mistake is the failure to state if the property is inherited or not.

The question of inheritance becomes important because no ancestral property can be assigned to any person. All rights on inherited property are acquired by birth.

In the eyes of the law, a nominee is a trustee and he need not necessarily be a beneficiary to a will. The nominee is merely a caretaker and the right to the property passes by will or if there is no will, under the personal law of the deceased.

This means that if there is a will, the nominee will only hold the assets as a caretaker trustee for the beneficiary. The nominee will be legally bound to transfer the nominated property to the beneficiary of the will. If there is no will, he will have to transfer to the legal heirs. So ideally, if a will were made, it would be better to name the nominee as the beneficiary to ensure that the distribution is smooth and efficient.

Updating the Will

It is very important to update the will every few years. There could be a lot of changes right from the size and type of assets that you hold to the beneficiaries. Death of an executor and/or beneficiary will necessitate a major change in the will. Instances such as a divorce or a family dispute will also require changes. Make sure the will actually reflects your wishes at a particular point in time.

5 Most Important things to be kept in Mind

Most people have a lot of insurance policies and loans. Despite having many insurance policies, they miss a very important clause of their insurance policies – Married Women Property Act.

- **Insurance policies should be endorsed under Married Women Property Act.** If a policy is taken under this Act, it cannot be assigned and cannot be attached by the lenders; the benefits of the policy will go only to the wife and children.

- **Beneficiaries**

  You should state how you wish your assets to be distributed. This may include naming one or more persons whom you would like to receive all or part of your estate when you die, and who will benefit if your first choice beneficiary (or second or third) predeceases you.

- **Executors**

  You should normally have your spouse as the sole executor of your estate. If your spouse is unable to take prudent financial decisions, you should have an additional executor(s) to take decisions. Choose an executor who is unlikely to die before you and nominate an alternative executor. An executor should be someone who knows and respects your wishes.

- If you have a big estate, make sure you engage the services of a professional executor, who could be your advisor or lawyer along with your spouse.

- **Specific bequests and devices**

  You may wish to consider leaving certain items to specific individuals. This may also have certain advantages, as it can remove the need for the executor to sell an asset of the estate.

- **Power of attorney**

A will takes care of your estate if you die, but you always need to consider who takes care of your affairs and estate if you become physically or mentally challenged to manage. To cover this contingency, I recommend that you speak with your lawyer about establishing powers of attorney.

Philanthropy – An important contribution

For most people, philanthropy is about cutting cheques or volunteering with different NGOs. Most successful people do their bit to fund and promote their charities. Some wealthy people have their own foundations through which they conduct many meaningful programs in the areas of education and healthcare.

HCL Technologies founder Shiv Nadar (fortune of $5.6 billion) has donated INR 580 crore (by selling 2.5% stake in HCL Technologies) towards the charitable work in education sector. The money will be spent by Shiv Nadar Foundation.

The money (sourced through HCL dividends, proceeds from share sales and investment gains) will fund the VidyaGyan schools, a proposed Shiv Nadar University, two planned Shiv Nadar Schools and SSN Institute.

Arjun Alreja, a business owner who sold off his business to a MNC has philanthropic aspirations. He is building a school for the underprivileged in a village in Mumbai. He has already received the land from the government and he has raised funds from his corporate friends. He has managed to create a significant corpus, the returns on which can sustain the annual expenses of a 500 children school. Of course, he has managed to gather the help of many NGOs, high profile people and folks who are just focused on helping other people.

This is all about “Creating a Legacy”. Arjun has managed to put a significant portion of his personal fortune to excellent use and has created a long lasting

legacy, which will continue for generations. He will always be remembered for his contribution in making this world a much better place.

The school, run under the Nalini Alreja Foundation, will serve as a great inspiration for successful people.

Ask yourself these two questions:

- What do I want to be known as?
- What is the purpose of my life?

Your response to these questions will give you some pointers for further introspection and action.

WHERE DO PEOPLE GET THEIR ADVICE FROM?

CHAPTER 13

People generally get advice from a variety of sources namely colleagues, friends, family, banks, stockbroker, chartered accountant, insurance agent, advisor, wealth manager, and planner.

Most people today end up taking advice from several different people and hence end up with so many unnecessary and irrelevant products. Some people are completely fascinated or fixated by the gold or platinum tag their private bank allocates them. They believe that just because they are gold clients, they get the best and customized advice that is possible, and more importantly that their advice is free.



I recently came across an intelligent person who said, “I am a Gold client of this bank. They have allocated a relationship manager specifically for my account. I am being taken care of on a regular basis. Besides, they don’t charge a fee and have given me a financial plan”.

When I saw the financial plan this gentleman had received, it was just a canned copy printed directly from a software. All the relationship manager had to do was sit for an hour with the person, tick off boxes spread over 6-8

pages and the financial plan was done. This gentleman was given a printout of this after 3-4 days to show some additional work was done and that was it.

There was no detailed analysis, no thought given to the overall financial goals and strategy, and no effort that was put in by the relationship manager to create a sound financial plan. There was nothing mentioned about what to do with existing insurance, investment and loans. There was no debt strategy, no estate planning exercise, and no real estate strategy. The ultimate objective was to sell some irrelevant unit-linked insurance plans and proprietary investments that were not required at all. I told him, “This is not a financial plan and this is not how you should be taking advice”.

What is then the Correct Way to Get Advice?

The correct approach is to create a comprehensive written strategy that would cover every aspect of personal finance for you. In short, there is a pressing need to take a holistic view of your overall situation. There should be one person or a team who takes stock of your cashflows, assets, liabilities, liquidity needs and helps you firm up your financial goals.

What is the point of having several lakh earning 4% when you are paying a loan with an interest cost of 16%? What is the point of having several properties, if there are no inflows from them or there are severe negative cashflows for the properties? What is the point of having life insurance if you are severely under-insured despite paying huge premiums?

Just as an infection to your liver can spread across other key organs, similarly a decision in one area of finance impacts another and your overall financial situation. It is very important that people understand this and make prudent decisions.

The first and key decision that you must make is to select a good financial advisor. If you think you are capable enough of making money decisions on

your own, great. Even then, a good financial advisor can prove effective and efficient in managing your overall finances. But, if you do strongly believe that you do not need any, then you should be able to spend enough time to understand several areas of personal finance, changing economic trends, products and options suitable for you. Finally, you should implement the strategies that you have devised for debt management, risk management and insurance, asset allocation and investments, tax planning, retirement planning and estate planning in a TIMELY MANNER. For others who believe that they could benefit from sound financial advice, you must at least understand the basic parameters on how you would choose a financial advisor/ planner.

How should you choose a Financial Advisor/Planner?

Ashish Rastogi is a business owner in his late fifties. He mentioned that he was unhappy with the financial planning that his bank and other financial planners had done for him. I looked at the financial plans that they had done. The bank's one was eight pages long, which was a direct printout from a software with no observations, strategies or explanations. It was so basic in nature with just boxes ticked that I do not know what to call it. His other advisor, an insurance agent who flaunted his fancy certifications was equally clueless about the plan. All he had done was to sell some life insurance policies and called it a financial plan.

A lot of agents, financial distributors and banks try to call themselves financial advisors or planners. They generously also use the term financial planning/wealth management as and when it pleases them. Consumers are naturally confused about the various terminologies used and hence do not actually question what a particular designation means. If you ask a person whom he would go to advice for (of these two titles) given a choice, Certified Financial Advisor or Certified Senior Financial & Investment Specialist (CSFIS), 95% of the time, he will opt for CSFIS. Incidentally, both these certifications are fake.

I was talking to a journalist friend the other day and he asked me what questions a person should ask a financial planner. I told him that more than the person asking the financial planner, what is far more important are the questions the financial planner asks you.

First, how detailed and comprehensive was the data-gathering interview? This is one of the most important steps in the financial planning process and will drive all the advice to be given. Was the data gathering comprehensive enough? Did the financial planner make notes of the information that you did not have and ask you to get back with this information? Did he take in information about you, your family, your aspirations, dreams, goals, income, expenses, cashflows, assets, liabilities, insurances, investments, tax situation, wills, powers of attorneys and information that might be relevant? Did he ask about your behaviour towards risks and how you react in bullish and bearish situations? Did he understand the mistakes that you have committed in the past and how were they committed?

A good financial planner should take anywhere between 3-5 hours including a social chat over 1 or 2 sessions to complete this data gathering process. He will then review the data collected and revert to the client for more clarifications to make sure he has understood the overall scenario well.

This first step itself is the single biggest clue. I find that most people genuinely interested in financial planning are keen to understand how their financial decisions will affect their life, much more than how certain products work or how to get the highest returns. In fact, the biggest value-add of a good advisor is how he utilises his skills to better understand the client’s overall situation and emotional issues and how best he handles the overall picture.

A salesman on the other hand will ignore most of the issues like estate planning, debt and cashflow management and be only interested in how much money you have to invest and how much insurance can be sold. Another category of salespeople will just focus on how their scheme will make you

rich, save tax for you and give you the highest returns. This is the most dangerous category and should be avoided completely.

Second, look closely at how the planner discusses risks and returns with you. Does he promise you the moon and tells you how good he is and that he has provided the highest returns? No good financial planner in his sane mind will ever do so and this is the kind of person you should look at working with. Does he take you through a proper risk profiling exercise, and tell you that the long-term return of the stock market is around 12-15% and therefore one should not believe theories of 30% returns?

Third, don’t look at the bank brand and opt blindly for advice, as the bank is not going to advise, it is the advisor that does. Most relationship managers in banks are primarily salespeople always on the lookout for selling more products to clients. They frequently change employers so a relationship manager at Bank A can tomorrow be at Bank B and then at Bank C.

Fourth, does the financial planner take you through estate planning matters, retirement planning, different offerings, as might be suitable to you, and any other issues? He might not deal directly in any of those things but most good planners will at least give you an overview of what you need and refer you to someone competent.

Finally, the composition and presentation of financial plans can vary immensely. The groups most notorious for doing rudimentary financial planning or misusing financial planning are banks and big distributors of financial products. I told a person, “If you ever want to insult a good financial planner tell him that his plan was as good as the one you got from your bank's financial planner!"

Most of the private banks and distributors have a well-deserved reputation for first selling life insurances as investments and churning portfolios under the garb of financial planning.

As a popular Business Anchor says on television, “Would you go to a chef for a haircut, or a barber for food advice? Then why go to the wrong person for advice?” The problem today in the financial services industry is that you don’t know who the barber or chef is because everyone uses the same title or name. Make sure you understand the terms financial planner, financial planning, wealth management and wealth manager, and that you are not just getting a lemon in the name of financial planning.

Who should be on your team?

Several key members should be a part of your team.

1. Chartered Accountant (CA): Having a good CA on your team is absolutely necessary. CAs today provide help on several areas such as bookkeeping (day-to-day accounting), preparing and filing returns, tax audit, tax planning advice, project finance and so on. Understand that they are professionals and expect to be compensated in a fair manner. Do not cut corners by just thinking about costs. In fact, most times the advice that you will receive will be a function of the fees that you pay.

2. Banker: People are likely to have a high amount of loans. Having a good relationship with a banker could mean preferential treatment and rates on loans and other deposit products. This is also a function of your account size with the bank. If you are unhappy with your bank or if your bank has not acted in your best interests, move on to some other bank.

   Public Sector Banks are likely to give you loans at a much lower cost than private sector banks. Although the infrastructure might not be so great and documentation could take time, the savings that you will make over a period of 10-20 years is likely to compensate for the initial inconvenience.

3. Financial Advisor/Financial Planner: We discussed this in detail above “How should you choose a Financial Advisor/Planner”. This is again one

of the key decisions a person should make. The key requirements here are someone acting in your best interests, his integrity and his skill in creating customized solutions for you.

4. Real Estate Agent: Considering that you are likely to own several pieces of real estate, make sure you have an ethical broker with you who does not just show you some properties but also objectively tells you appropriate prices and gets you the best deals. He should be conversant with the paperwork required, do appropriate due diligence and constantly keep abreast of real estate happenings in the area. You might also want to consider real estate consulting firms if the ticket size of your real estate is sizeable (above Rs. 5-10 crore).

5. Insurance Agent: Most people think of life insurance as an investment and as a means to save tax. At the same time, they think of general insurance as a pure cost. Hence, most people are inadequately insured (low covers), have the wrong set of policies with them and are paying a huge premium. You must get this risk transfer piece of your financial planning process right. Your Financial Planner can help you arrive at the quantum of cover you must take for every financial risk that you are exposed to. A good insurance agent will help you implement action items as detailed out by the Financial Planner and regularly service you with updates, premium collection, submission and receipts.

6. Lawyer: There are several areas, where most people, require legal help. Considering a person’s real estate exposure, it is very important that a real estate lawyer vets all your property-related documents right from title of the property to preparing the legal buy or sell document. Additionally, lawyers can create the leave and license document for you and other paperwork that could be needed. Many people bypass lawyers by letting the real estate agent handle the real estate paperwork. It would always be beneficial that you double-check all pieces of paperwork with a lawyer specialising in real estate. Another area where a lawyer will be

of immense value will be is Estate Planning. A competent lawyer can handle creation of wills, power of attorney and trusts.



MISCELLANEOUS

CHAPTER 14

There are several other things, which might seem trivial but are of extreme importance and must be taken care of.

Keeping and Maintaining Records

People deal with a lot of paperwork every day. Besides this, there is a lot of financial information that needs to be recorded and maintained on a monthly basis.



Most people, almost always rush to their CAs at the last moment. The paperwork needs to be compiled in a very short time and due to this, lapses can happen. Time poverty and lack of a proper system or process are the two main causes for this inefficiency.

a. Have a proper system of making and updating records

Hire a part-time accountant who can come over to your home or office every 2 weeks and help you with financial paperwork. This person can do accounting for you and prepare monthly profit and loss statements for you,

pay advance taxes on time, represent you in IT cases and several other areas. This might be an additional cost but is often well worth it.

b. Maintain a record book/excel sheet and inform your spouse, parents and children

The spouses of many people today are not aware of the family investments, insurances and detailed liabilities.

Always maintain a record book of your bank accounts, investments, life and general insurance policies, properties, lockers and liabilities. People have several bank accounts, investments and insurances that over time become difficult to remember and maintain. Basic things such interest rates on FDs and home loan interest rates are not known. This record book can be useful and meaningful only if it is updated regularly to reflect appropriate changes.

Details of investments, loans and insurance policies should be mentioned clearly along with details on where these papers are kept. These records should be shared with your spouse, parents and children. Your family must also know about the presence and location of your will.

An important reason for sharing these details is that in case of an unfortunate eventuality, the spouse knows the exact financial status. Also, one wouldn't want someone to come out of nowhere one fine day and stake a claim on the family's assets based on some 'fictitious' liability. At the same time, all related (and more importantly affected) people must know exactly what needs to be done in your absence.

c. Keep copies in a separate place

Keep copies of all your properties, investments, insurance policies, PAN card, passport etc. in a separate location, typically in a bank locker or with someone you trust.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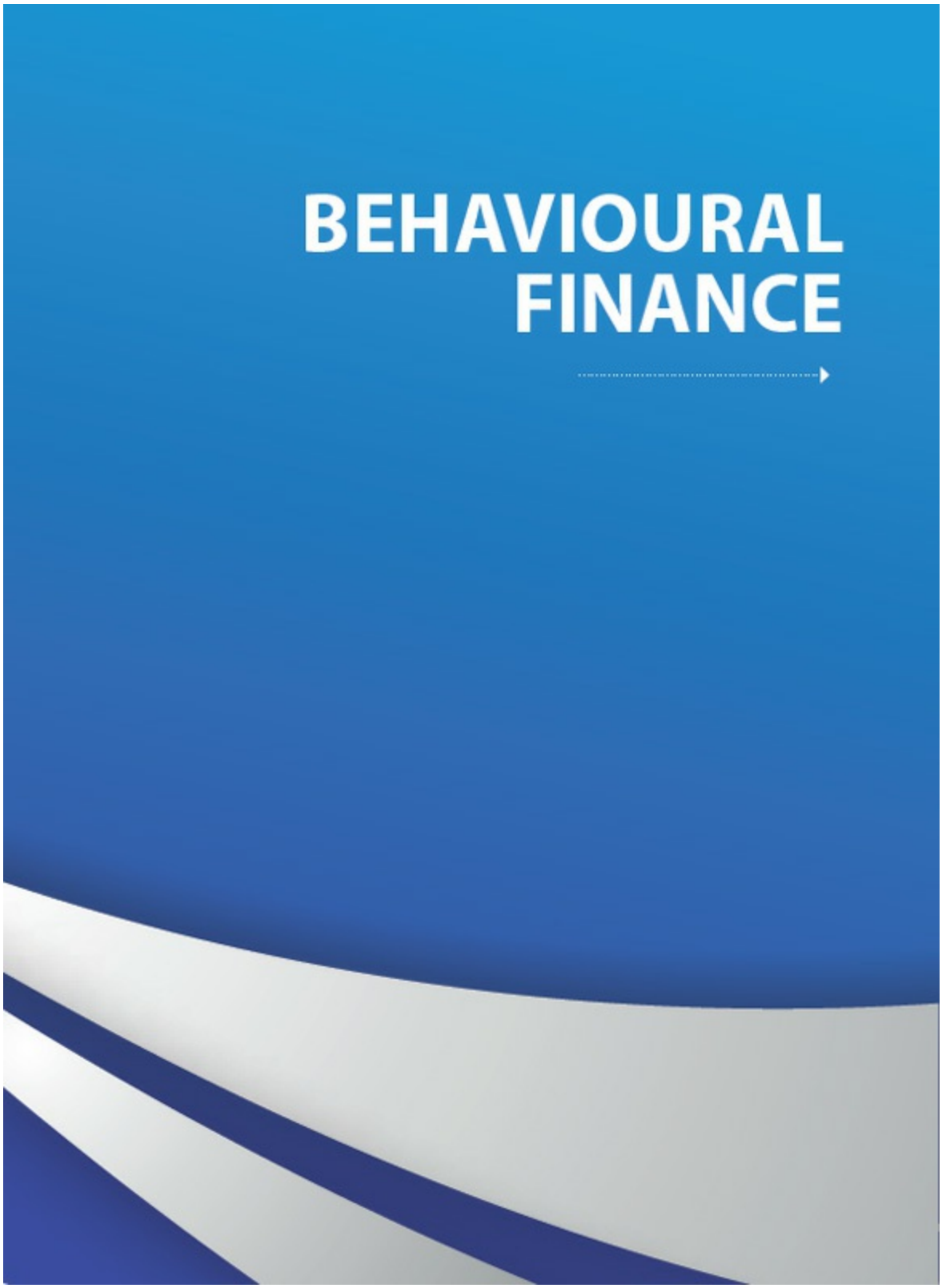
BEHAVIOURAL FINANCE



CHAPTER 15

This is often a neglected area by most people. Behavioural Finance is the study of how emotions and psychology affect financial decisions.

Much of economic and financial theory is based on the notion that individuals act rationally and consider all available information in the decision-making process. We all know that this is never the case and human emotions and psychology play a big role in any financial decision making process.



According to Gary Belsky and Thomas Gilovich, authors of a fantastic book, *Why Smart People Make Big Money Mistakes And How To Correct Them*, "Behavioural Finance or Behavioural Economics combines the twin disciplines of psychology and economics to explain why and how people make seemingly irrational or illogical decisions when they spend, invest, save and borrow money."

There are several concepts in Behavioural Finance that you must understand. Some of them are:

Mental Accounting: Phenomenon of treating money differently based on its source. People generally treat money received on a game show differently from what they would it they had earned it.

A classic example was that of a lady on a show “Dus Ka Dum”. This lady, from a modest background, had won Rs. 10 lakh, which is a substantial sum of money. The next correct answer could have got her Rs. 1 crore or she would lose Rs. 9 lakh and take home Rs. 1 lakh. Instead of walking away with Rs. 10 lakh, she bet on Rs. 1 crore and lost Rs. 9 lakh. Would that lady have bet Rs. 10 lakh that she earned on something as risky as this? Never ever but the very fact that Rs. 10 lakh was earned in not even 10 minutes and through a different source made her treat it differently.

Similarly, many people would treat a windfall from parents or other sources differently than they would if the money had come from the fruits of their hard labour.

Just because you have won a lottery, received a windfall or a gift does not mean that the money does not belong to you or that you need to treat it differently. Think of your money (all inflows and outflows) in terms of your balance sheet and not something that you bracket depending from where it has come from. Never act immediately when you receive a bonus or windfall. Think about it for at least 48 hours.

Decision Paralysis: You are afflicted with this one if you delay making investment decisions or cannot decide between investment choices. Some will talk to 10 different people but never end up doing anything. Mark Twain said, “20 years from now, you will be more disappointed by the things that you did not do than by the ones that you did do”.

Loss Aversion: This is how our feelings towards loss can force us not to exit investments, or wait too long or put in more money in an unfinished project. Have you ever watched a movie in a theatre that you felt was complete nonsense and a waste of time? Did you ever walk out of the theatre? Very

few people will because they have paid Rs. 200 per ticket. This is a classic example of loss aversion.

Anchoring: This is one of the most difficult or complex behaviours to overcome. Let's understand this with an example of Mrs. Kulkarni. "In December 2008, Builder X had offered Rs. 1 crore to my neighbour, Mr. Bhatia. Now 8 months down the line, he should at least offer me a higher price. My flat is much better than Mr. Bhatia's. According to the builder, prices have started to go down (although he himself has not cut down prices on his project) and the last similar flat sold was at Rs. 80 lakh." This is a classic phenomenon in real estate where buyers and sellers are anchored to a price. Well, the price was down to Rs. 70 lakh and Mrs. Kulkarni sold her flat later for Rs. 75 lakh.

Anchoring is when you often hold on to a fact or figure and use that as the basis or reference point for making future decisions.

Seeing the rise in real estate prices since 2003, people believe that real estate can only go up. Similarly, equity market investors believed that the markets would always deliver at least 25-30% annually because equities had delivered 40% annually for a few years in the past. Decisions just based on such anchors are rudimentary and can be dangerous for your long-term financial health.

Overconfidence, Greed and Fear

These three very common emotions mostly depend on the external economic and your internal economic situation. People are extremely bullish during good times but the very same people chicken out during bad or tough economic times (even though their situation does not warrant so). You are afflicted with overconfidence if you think:

- Real estate is the best investment and there is no way one can lose money in a real estate transaction

- You have made a wise decision by buying an investment-oriented life insurance policy despite someone telling you a term plan is the way to go
- You can identify the next Infosys of the market but can also easily explain the faulty choices you have made. You can identify all financial trends correctly
- You don’t need a good advisor because you already know a lot

The less said about greed the better.

At the same time, you are afflicted with fear, if you are scared when the equity market goes down. People who wanted to buy real estate in 2007-2008 at any price were fearful in 2009 when the prices were down by around 25%. Fear often makes people commit the biggest mistake of all: “Doing nothing”.

If you understand these and other behavioural issues well, you can actually use them to your advantage. However, this would also require one to keep his ego aside, which can sometimes get difficult for very smart people.

“The Behaviour Gap” by Carl Richards is another excellent book on behavioural finance. Look at a very simple yet powerful sketch on greed and fear by Carl.



Spend time on thinking whether you are really afflicted with any of these emotional biases. Your honest answers and actions to address these can secure your financial well-being.

PARTING THOUGHTS

CHAPTER 16

We are at the end of the book and I like to believe that you have come to this page not by chance or skipping the pages but by actually going through the chapters. This book has been a very enriching experience and I have tried my best to incorporate as many things as I could (without making it boring or too long). I could have missed things. Kindly pardon my ignorance if I have indeed missed some finer points.

I will be happy to receive your feedback at *amar.pandit@myfinad.com*



Before we wind up, I like to share a few key thoughts or Mantras.

1. Early in your career, buy a home and attempt to pay it off much before you retire.
2. Build a solid base first. Your wealth should be like a pyramid with a solid base of contingency funds, relevant insurances (to transfer all risks), limited liabilities and investments.
3. Buy commercial real estate as well (if you are a business owner or a professional), but limit your overall debt to just home and commercial property. If you feel overburdened paying home, office and other EMI,

just don’t do all together. Prioritize your needs. If the difference between EMI and rent is substantial, just rent a commercial property. Most importantly, do not pay any price for your real estate. Make sure that it’s a lot of value.

4. Define your vision, your financial goals and what you like to be known as. These should be the guiding forces for your actions.
5. If you are a business owner, invest well in team members, technology and research. Have a web site.
6. Since most of you lead a very busy lifestyle that leaves very little time for your family, spend time with your family and have fun. Needless to say, you must take good care of your health.
7. Make a will. Do not leave this to chance.
8. The key to financial success lies in limiting debt (taking on debt that generates income), saving a substantial portion of their income, investing in a diversified portfolio of assets (not just real estate), and avoiding speculative risky things such as derivatives and commodity trading.
9. It is also very important to Know Yourself. Socrates said, “It is the key to human self-advancement”. Understanding your emotions and behavioural biases can help you avoid many costly mistakes.
0. Finally, just knowing and reading will not help you. Do not procrastinate, as actions can only generate results. So if you have learnt one, two or more things from this book, make sure you implement them.

Good Luck.

I will be happy to hear your thoughts and inputs.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APPENDIXES - TEMPLATES OF LEGAL DOCUMENTS

CHAPTER 17



Appendix A

ABRIDGED WILL

I, _____ of _____, _____, Indian Inhabitant, residing at _____ hereby revoke any previous will and/or Testamentary Writing that I may have executed and declare this to be my last Will and Testament:—

1. I appoint (1) _____ and (2) _____ to be the Executors of my Will. They shall hereafter be called "My Executors".
2. I hereby authorise and direct my executors to spend a sum to the extent of Rs. _____/- (Rupees _____ _____only) out of my Estate for my funeral and obituary rites. They shall not be liable for rendering any account to anyone for the moneys so spent by them for the said ceremonies.
3. I have my wife _____ and ___ children namely my ___sons/daughters as my legal heirs.
4. Amongst my properties movable and immovable are the followings:—

   (a) Ownership Flat bearing No. _____ on _____ Floor of the building known as '_____' of ____ Co-operative Housing Society Ltd. at _____ alongwith five shares of the said ____ Co-operative Housing. Society Ltd. representing ownership of the said Flat. The said flat is my self-acquired property.

   (b) All my equity shares in _____

   (c) Land at _____, the details whereof are as under:

(d) Bank accounts; shares; securities; debentures; investments in Unit Trust of India, National Saving Scheme, Public Provident Fund Scheme and jewellery etc.; and

(e) Any other residuary estate standing in my name or belonging to me or inherited or bequeathed to me or acquired by me at any time hereinafter or otherwise.

5. I hereby give Devise and Bequeath the estate mentioned in aforesaid Clauses _____solely and absolutely to my _____. _____ shall be fully entitled to deal with the same in the manner as she deems fit and proper and at her own discretion. If _____predeceases me in that event, the said estate shall go to all my ___ children in equal proportion.

6. I have made my Will in my good and sound health and after fully understanding the same in all aspects.

IN WITNESS WHEREOF I the said _____ have hereunto set my hand at _____ this_____ day of _____ 20__

SIGNED AND DECLARED BY)
_____,)
the Testator above named as)
and for his last Will and)
Testament in the presence of)
us present at the same time)
who at his request in his)
presence and in the presence)
of each other have hereunto)
set and subscribed our respective)
names as witnesses:)

Appendix B

SPECIAL POWER OF ATTORNEY

TO ALL TO WHOM THESE PRESENTS SHALL COME:

I, _____ of _____, Indian Inhabitants, **SEND GREETINGS:**

WHEREAS:—

(a) As owner I am seized and possessed of the piece or parcel of land, hereditaments and premises together with structures/buildings standing thereon situate, lying and being at _____ and more particularly described in the **Schedule** hereunder written and hereinafter referred to as the **"said property".**

(b) I am desirous of disposing of the property.

(c) As my work requires me to travel frequently I am unable to personally attend to the transaction of sale of the said property. I am desirous of appointing some fit and proper person to act for me and do all necessary acts and things in connection with the sale of the property.

NOW KNOW YE ALL AND THESE PRESENTS WITNESSETH that I do hereby nominate, constitute and appoint _____ to be my true and lawful attorney to act for me and in my name and do all acts, deeds and things relating to the "said property" that is to say:

1. To negotiate for sale of the said property more particularly described in the Schedule hereunder written with the intending Purchasers and to conclude such negotiations and to enter into an agreement for sale of the said property and sign and execute the same and receive deposit or earnest from the intending purchasers of the said property and give receipts and discharges for the same.

2. To appoint Advocates/Solicitors in connection with the sale of the said property and to pay their remuneration and charges.

3. On receiving the balance of the sale price/consideration to sign and execute conveyance and other documents and assurances in favour of the purchasers or their nominee/s as the case may be and to put them in possession of the same and to sign and execute all other writings and to do all other acts, deeds, matters and things in relation thereto for effectively transferring the said property in favour of the Purchasers.

4. To appear before the Sub-Registrar of Assurances or any other competent authority and lodge the agreement for sale, deed of conveyance and all other relevant assurances for registration and to admit execution of the same.

6. To appear before Talati, Mamlatdar, Collector, Municipal Corporation or any other authority in connection with the transfer of the said property in favour of the Purchasers in Government and Municipal records.

AND I DO HEREBY for myself, my heirs, executors and administrators agree to ratify and confirm all and whatsoever my said Attorney shall or purport to do or cause to be done by virtue of these presents.

IN WITNESS WHEREOF I have hereunto set out my hand at _____ this _____ day of _____ Two Thousand ____.

THE SCHEDULE ABOVE REFERRED TO

(*Description of the property*)

SIGNED by the)
Within named)
_____)

Before me,

Identified by me

Notary

Appendix C

LEAVE AND LICENCE AGREEMENT

This Agreement is made at Mumbai on this 1st Day of December, 2O11 between _____, aged about _____years, an adult Indian Inhabitant having premises bearing _____, herein after called the "Licensor" (which expression shall, unless the context otherwise requires, means and include its successors and assigns) and the party hereto of the first part.

AND

_____, aged _____ years, having his office at _____ and residing at _____, hereinafter referred to as the "Licensee" (which expression shall unless to the context otherwise requires be deemed to mean and include its successors and assigns) and the party hereto of the other part.

WHEREAS, the Licensor is the exclusive and legal Owner and is absolutely seized and possessed of flat admeasuring about _____ Sq. ft. or thereabout bearing _____, (hereinafter referred to as Licensed Unit).

AND FURTHER WHEREAS the Licensor has represented to the Licensee that he is the Owner of the said Unit and the same is free from any charge or encumbrances and that no other person has any right, title, interest thereto

and that the same are not subject matter of any order of attachment or other prohibitory order preventing the Licensor from giving the same on license to the Licensee.

AND WHEREAS the Licensee has requested the Licensor to grant to the Licensee a leave and license of the said flat under section 24 of the Maharashtra Rent Control Act, 1999(Act 18 of 2000) on the representation of the Licensee that the same are required by the Licensee on temporary basis for a period of 36 months.

AND WHEREAS the Licensee has further represented to the Licensor that the Licensee shall vacate the Unit on expiry or sooner termination of the period of fee license;

AND WHEREAS relying on the aforesaid representations of the Licensee, the Licensor has agreed to grant to the Licensee to use and occupy the said flat for his Personal Use and for his family members only on Leave and Licence basis for a period of 36 months from 1st December 2011 to 30th November 2014 on terms and conditions mutually agreed upon.

AND WHEIREAS the parties hereto are desirous of recording the terms and conditions of their agreement as hereinafter appearing;

NOW THIS AGREEMENT WITNESSETH AND IT IS HEREBY AGREED BY AND BETWEEN THE PARTIES HERETO AS FOLLOWS:

1. LICENCE

Subject to the terms of this Agreement, the Licensor hereby grants to the Licensee and the Licensee hereby accepts from the Licensor a leave & license to use and occupy on a specific period basis,

admeasuring about _____ Sq.ft. or there about (hereinafter referred to as the "Licensed Unit) alongwith the easement and usage right on open adjacent floor space area, passage, foyer and common facilities in the said building.

The Licensor shall be deemed to be in possession and the said premises are given purely on Licence as privilege of the Licensed flats and the Licensee shall use and occupy the said flats with the Licence of the Licensor. The Licenses flats shall always remain with the Licensor. Licensee is only permitted to use the said flats under this Agreement. It is agreed that it is not intended to create the relationship of landlord and tenant by execution of this Agreement of Leave and Licence.

The Licensee shall not be deemed to be in the exclusive occupation of the Licensed premises and the Licensor will have the right to enter upon the premises at any given time during working hours to inspect the premises, after giving 48 hours notice in writing.

2. DURATION

This Leave and License Agreement will commence from 1st, December 2011 and will remain in force up to 30th November 2014, subject to sooner termination as hereinafter provided.

3. COMPENSATION & SECURITY DEPOSIT

3.1 During the period of the license hereby granted, the Licensee shall pay to the Licensor a monthly COMPENSATION as follows: -

a) Rs 50,000/- (Rupees Fifty thousand only) per month from 1st December 2011 to 30th November 2012.

b) Rs 55,000/- (Rupees Fifty Five Thousand only) per month from 1st December 2012 to 30th November 2013.

c) Rs 60,000/- (Rupees Sixty Thousand) per month from 1st December 2013 to 30th November 2014.

3.2 The monthly COMPENSATION shall be payable in advance and shall be paid on or before the 7th (Seventh) day of each month of the license period in advance towards the COMPENSATION of the said month subject to deduction of tax at source as per the Income Tax Act prevailing for the period.

3.3. The Licensee shall handover 12 post dated cheques for the payment of monthly COMPENSATION and the Licensee shall also see that no cheques are dishonoured for any reasons. If any of the post dated cheques are dishonoured, the Licensor shall be at liberty to penalize the Licensee.

3.3 If due to any other external circumstances, natural calamity, court order or any other circumstances the licensee is not in a position to have peaceful and free possession of the Unit, the COMPENSATION shall be proportionately be reduced based on the time factor and usage area factor.

3.4 **SECURITY DEPOSIT**

The licensee shall give interest free security deposit to the licensor for Rs.2,00,000/- (Rupees Two Lakh Only) which shall be maintained during the term of this agreement. This security deposit shall be refundable on the date of termination of license agreement or sooner evacuation of Unit by the licensee and shall be made simultaneously while handing over the said Unit, after deducting Electricity/Telephone

Charges as per the average of the three immediate previous bills. After new bill comes, the Licensor will refund any amount kept by him in excess of the Bill amount and vice versa the licensee shall also be liable to indemnify the licensor for any such dues left unpaid on their part in favour of the Licensor. If the Licensor fails to refund the security deposit amount on expiry of this agreement, then the Licensee shall be entitled to use the said unit without having to pay any monthly rent / compensation fees and shall also be entitled to receive interest @ 1% per month till the deposit amount is refunded. The Licensor does hereby admit the receipt of security deposit amount of Rs. 2,00,000/- (Rupees Two Lakh Only).

4. ELECTRICITY CHARGES

It will be the duty of the licensor to provide connection of electricity into the licensed Unit. During the period of the license, the Licensee shall bear and pay all charges for electricity actually consumed by the Licensee in the Licensed Unit in accordance with the separate meter reading thereof.

5. TAXES AND OUTGOINGS

Licensor alone shall regularly bear and pay all present recurring expenses including all water tax, Municipal taxes, service tax, and other local levies, cesses, duties, and all outgoings payable in respect of the Licensed Unit.

6. REPAIRS MAINTENANCE AND OTHER UTILITY CHARGES.

The normal wear and tear shall be borne by the licensee, the repairs of special nature arising from the latent defects of the Unit, shall be borne by the licensor.

7. LICENSEE'S COVENANTS

The Licensee, to the intent that such obligations may continue throughout the term of this license, hereby covenants with the Licensor as follows:-

(i) To regularly pay the COMPENSATION for amount stated above;

(ii) To use the Licensed Unit for the exclusive purpose of personal use of the Licensee and the members of his family and by no other person, office or employee of the Licensee.

(iii) To observe and comply with all rules, regulations and bye laws as applicable to occupants of the said building;

(iv) To use the Licensed Unit with due care and caution and keep the same in good and tenantable condition;

(v) To carry out all minor repairs, if any, in to the Licensed Unit;

(vi) Not to do or suffer to be done in the Licensed Unit any act, deed, matter or thing which may cause nuisance or annoyance to the owners or the occupants of the said building;

(vii) Not to commit any illegal or antisocial activities in the said premises.

(viii) Not to make any structural alterations or additions to the Licensed Unit or any part thereof provided that the Licensee may, if necessary and at its own cost, refurbish the Licensed Unit and for this purpose install in the Licensed Unit any racks, partitions and such fixtures and fittings (including air conditioners) as are of a temporary,-nature, so long as the Licensee does no: impose any additional load on the building. The

licensee shall be entitled at the time of vacating the Licensed Unit (on expiry or sooner determination of the license) to remove and lake away all such furniture, equipment and installations and fittings made by the Licensee in the Licensed Unit and if any damage is caused to the Licensed Unit or to the building as a result of such removal, the Licensee shall repair and make good such damage at its own cost and expense;

(ix) Not store any articles of a combustible or hazardous or inflammable nature in the Licensed Unit and not expose the licensed Unit to the risk of fire or other similar accident.

(x) Not seek or grant any sub-license in respect of or allow any one else to use or occupy the Licensed Unit or any part thereof;

(xi) Upon the expiration or sooner determination of the license hereby granted, to vacate and deliver the Licensed Unit to the Licensor in the same good order and condition in which the same were at the time when the Licensee entered into the Licensed Unit (reasonable wear and tear and depreciation excepted). Failing this, without prejudice to any other right that the Licensors may have against the Licensee, the Licensors shall be entitled a compensation of Rs. 2500/- (Rupees Two thousand five hundred only) per day of default over and above the monthly compensation.

8. LICENSOR'S COVENANTS

8.1 The Licensor to the intent that such obligations may continue throughout the term of this license, hereby covenant with the Licensee as under:-

(i) On the Licensee paying the COMPENSATION hereby reserved and observing and performing the covenants and stipulations herein contained and on its part to be observed and performed, the Licensee shall be entitled to peaceably occupy and enjoy the Licensed Unit during the term of the license;

(ii) To permit the Licensee to affix a name plate of the Licensee on the exterior of foyer of the Licensed Unit and on general common/member /occupant list in Ground Floor Foyer;

(iii) To permit the Licensee & employees of Licenses, to free right to use the open space floor area/foyer/passage & utilities adjacent to the Unit.

(iv) To pay maintenance charges of the building.

(v) To pay municipal taxes, rates and cesses as may be leviable by the Local Authority upon the Licensed Unit and to pay maintenance expenses AND in case the Licensor fails(s) or neglect(s) to pay any taxes and outgoings, the Licensee may, at his discretion but without being bound to do so, pay the same and the Licensor shall within 30 days reimburse the same to the Licensee failing which the amounts so paid by the Licensee shall carry interest at the rate of 1% (one per cent) per month or part thereof from the date of payment. The Licensor shall not dispute the amount of any such taxes and outgoings as proved by the Licensee as having been paid by licensee;

(vi) If in any circumstances, if the licensee is required to pay for any charges/duties/obligation or similar, which should have been paid by the licensor, in such circumstance the licensee will have a right to deduct the same from the monthly COMPENSATION payable to licensor or directly recover form licensor.

(vii) On termination of license agreement, after the expiry of lock in period the licensor shall allow all other furniture fixtures, racks, fittings etc which were purchased or developed during the agreement period to be taken away at the time of evacuation. All movables are impliedly owned and purchased by the licensee except the movables listed in Schedule A.

(viii) To permit the Licensee to install Telephone.

8.2 The Licensor shall be responsible at their cost, to carry out all major or structural (including external plumbing) repairs to the Licensed Unit. The Licensee shall intimate the Licensor in writing of such repairs, if any, to be carried out.

9. DAMAGE TO LICENSED UNIT

If at any time during the term of the license, the Licensed Unit or any part thereof shall be destroyed or damaged by fire, tempest, earthquake, flood, enemy war, civil commotion or other irresistible force so as to become unfit for occupation and use due to any cause not attributable directly or indirectly to the Licensee then and in that event, the license fee hereby reserved and/or a fair and just proportion thereof according to the nature and extent of the actual damage sustained shall be suspended and cease to be payable until the Licensed Unit shall again be rendered fit for use and occupation by the Licensee. PROVIDED THAT in the event of the entire Licensed Unit remaining unfit for use for the purpose for which the same have been granted for a continuous period of 3 (three) months, then in such event, it shall be at the option of the Licensee to terminate and cancel the license herby granted, by giving to the Licensor 30 (thirty) days previous notice in writing in this behalf. It is however agreed that if the damage or destruction of the Licensed Unit or any part thereof is due to any cause attributable directly or indirectly to the Licensee during the period of this license,

the Licensee shall continue to be liable for payment of the full license fee and the Licensor shall be entitled to rectify such damage or destruction and claim reimbursement from the Licensee for the cost of such rectification to the extent that such cost is in excess of the insurance proceeds received by the Licenser from the insurance company, PROVIDED FURTHER THAT if, for any reason, the insurance company, does not pay insurance claim for such damage or destruction attributable to the Licensee, then, the Licensee shall, at its cost, rectify the same and in such case the Licensor shall pay to the Licensee the insurance proceeds, if any, that may be received by the Licensor. In case of destruction or damage of the Licensed Unit, as aforesaid, the Licensee shall forthwith give to the Licensor written intimation thereof.

10. BARE LICENCE

10.1 Nothing herein contained shall be construed as creating any lease or tenancy or any other similar right or title of any nature whatsoever in favour of the Licensee in to or upon the Licensed Unit or as transferring any interest whatsoever therein in favour of the Licensee, except the permissive use and occupation of the Licensed Unit for the period as provided herein and subject to the provisions herein contained.

10.2 The License hereby granted is personal to the Licensee and the Licensee shall not at any time assign the same or transfer the benefit of the Agreement to any other person or party.

10.3 The Licensor shall at all times be in full charge and control and exclusive juridical possession of the Licensed Unit during the license period. The Licensor and their agents and all persons authorised by them shall be entitled at all reasonable times on the Licensor giving to the Licensee prior written notice, to enter upon the Licensed Unit to inspect the state and condition of the Licensed Unit and/or to execute

any repair or work for which the Licensor are liable under the covenant in that behalf hereinbefore contained.

11. STIPULATED LOCK IN PERIOD & TERMINATION BY LICENSOR

It is specifically agreed between lock in period of 1 year applicable to licensor and licensee. Neither party can terminate the agreement during lock in period. Both the parties will have the right to terminate the agreement by giving two months notice in writing to the other party, after the expiry of lock in period, and on such expiration of the notice, the unadjusted deposit will be paid back to the licensee and the licensee shall not be liable to pay COMPENSTION for the delayed period. The Lessors shall be entitled to terminate this Agreement in the event the Lessee shall have committed breach of any of the terms and conditions mentioned.

12. STAMP DUTY AND LEGAL COSTS

The stamp duty, registration fees etc, payable on this Agreement shall borne and paid by the Licensor & Licensee equally.

13. JURISDICTION

Any dispute arising out of or incidental to this Agreement shall be subject to the jurisdiction of the courts at Mumbai.

In WITNESS WHEREOF the Licensor and the Licensee have executed these presents the day and year first hereinabove written.

Signed, sealed and delivered by)

Withinnamed Licensors)

In the presence of _____)

Signed, sealed and delivered by)
Withinnamed Licensee)

In the presence of_____)

RECEIPT

Received a sum of Rs.2,00,000/- (Rupees Two Lakh Only) from within named "LICENSEE" as interest free Security Deposits (Refundable) as mentioned in the above said Leave & License Agreement by Cheque No. _____ dated _____ drawn on _____ Bank.

We say received Rs.2,00,000/-

( )
LICENSOR

Witness:

1.

2.

SCHEDULE A

List of Furniture and fixtures provided:		**No. of Units.**
1.	Beds in all rooms.	3
2.	Cupboards in all rooms and kitchen.	
3.	Air Conditioners in all rooms and Living Room.	4
4.	Fans in all rooms, kitchen, Living room, Lobby.	7
5.	Sofa Set.	
6.	Dining table and 4 chairs.	
7.	Geysers in all bathrooms.	3
8.	Refrigerator.	1

Appendix D

AGREEMENT FOR SALE

THIS AGREEMENT FOR SALE made and entered into at Mumbai this ____ day of _____, 2012 between _____ age __ years, Indian Inhabitant, having address at **Write Full Address** hereinafter referred to as the **"TRANSFEROR"** (which expression shall unless it be repugnant to the context or meaning thereof be deemed to mean and include his respective heirs, executors, legal representatives, administrators and assigns) of the FIRST PART

And

_____ age _____ years, adults, Indian Inhabitant, having address at _____ hereinafter referred to as the **"TRANSFEREE"** (which expression shall unless it be repugnant to the context or meaning thereof be deemed to mean and include their respective heirs, executors, legal representatives, administrators and assigns) of the SECOND PART.

A. The Transferor is the registered and bonafide member of the said Society and as a registered and bonafide member of the said Society, the Transferor is holding _____ fully paid up shares of Rs 50/- each issued by the said Society bearing distinctive numbers from 6821 to 6890 (both inclusive), represented by Share Certificate No. 786 issued by the said society on 15th day of January 1992 (hereinafter collectively referred to as" the said Shares") and is allotted and entitled,

as the sole and absolute owner of, to all the beneficial rights, title and interest into and over the residential premises being the said Flat.

B. The said Flat and the said Shares are hereinafter collectively referred to as “the said Premises”.

C. The Transferor has agreed, declared and represented to the Transferees that:

(i) the said Premises is free from all and any encumbrances, charges, liabilities and / or claims of any nature whatsoever and has a clear and marketable title and that the Transferor is the absolute owner thereof as aforesaid and that there is no one else in possession or occupation of the said Flat or any part thereof.

(ii) the Transferor has not mortgaged the said Premises with any Bank or Financial Institution or any other person or entity as a security by deposit of title deeds or otherwise and that there is no lien or charge created or agreed to be created in respect of the said Premises.

D. Under the circumstances the Transferor herein has been the sole owner of the said Shares and as incidental thereto has been entitled to the share in sinking fund and other reserve fund of the said Society along with his right, title and interest in the said Flat on what is commonly known as “Ownership basis”.

E. The said Society has granted its No Objection Certificate for the transfer of the said Premises in favour of the Transferees vide their letter-dated _____.

F. The Transferor has agreed to sell and the Transferees have agreed to purchase, all his rights, title and interest in respect of the said Premises at and for a total consideration of `Rs. 2,00,00,000/- (Rupees Two Crore only) and on certain terms and conditions mentioned hereinafter which have been accepted by Transferees.

G. The Transferees have agreed to acquire the right, title and interest in respect of the said Premises from the Transferor relying upon the aforesaid declarations and representations by the Transferor.

H. The parties hereto desire to record the terms and conditions of their agreement into writing.

NOW THIS AGREEMENT FOR SALE WITHNESSETH AND IT IS HEREBY AGREED BY AND BETWEEN THE PARTIES AS FOLLOWS: -

1. The recitals shall form part and parcel of this operative part as if the same have been reproduced verbatim herein.
2. The Transferor hereby agrees to sell, transfer and assign all his rights, title and interest to the Transferees and the Transferees hereby agree to purchase from the Transferor all his rights, title and interest into and over the said Flat of the said Society and _____ fully paid up shares of Rs.50/- each bearing distinctive nos. from 6821 to 6890 (both inclusive) evidenced by Share Certificate No. 786 dated 15/1/1992, (hereinafter referred to as “the said Shares”) and all the rights, title and interest in the said Society, free from all or any encumbrances, claims or demands of any nature whatsoever into or upon the same by way of sale, mortgage, lien, charge, gift, trust, lease, leave and license, tenancy or otherwise, howsoever, and together with all rights, title and interest into and over the balance of deposits and funds, including balance in sinking fund and major repairs funds and properties of the said Society and in

the other benefits as given to the members by the said Society at and for a total consideration of Rs. 2,00,00,000/- (Rupees Two Crore only).

3. The Transferees shall pay to the Transferor the aforesaid total consideration of Rs. 2,00,00,000/- (Rupees Two Crore) in instalments as follows:-

a) A sum of Rs. 10,00,000/- (Rupees Ten Lakh only) paid as and by way of token money / earnest money on (Date) Cheque No. dated drawn on Bank of India, Fort Branch, before execution hereof, the receipt whereof the Transferor hereby admits and acknowledges and of and from the same and every part thereof do hereby forever discharge and release the Transferees.

b) A sum of Rs. 25,00,000/- (Rupees Twenty Five Lakh only) paid as and by way of part payments on _____ Cheque No. _____ dated drawn on Bank of India, Fort Branch, on or before execution hereof, the receipt whereof the Transferor hereby admits and acknowledges and of and from the same and every part thereof do hereby forever discharge and release the Transferees.

c) A sum of Rs. 15,00,000 /- (Rupees Fifteen Lakh only) paid as and by way of further part payments on _____ Cheque No. _____ dated _____drawn on Bank of India, Fort Branch, on or before execution hereof, the receipt whereof the Transferor hereby admits and acknowledges and of and from the same and every part thereof do hereby forever discharge and release the Transferees.

d) Balance payment of Rs. 1,50,00,000/- (Rupees One Crore Fifty Lakh only) by way of disbursement of housing loan from a bank

in Mumbai as mentioned in clause 4 herein below.

4. The Transferees have represented to the Transferor that they shall be availing a housing loan from a bank in Mumbai, and part of the balance consideration payable under clause 2(d) herein above shall be made by way of disbursement of loan by the bank directly in favour of the Transferor. The Transferor will give his full co-operation to the Transferees by providing all information, forms, declarations, undertakings, indemnity bond and any other documents as may be required by the said bank in Mumbai relating to the said Premises and/or the said Society, to enable the Transferees to obtain timely disbursement of the loan from the said bank in Mumbai.

5. However the Transferees have represented to and agreed with the Transferor that in case they fail to obtain the bank loan, they are bound to pay the balance sum of Rs 1,50,00,000/- (Rupees One Crore Fifty Lakh only) from their own funds within 60 days from the date of execution hereof, time being the essence of this Agreement.

6. It is further agreed between the parties that the Transferor will handover absolute, legal, quiet, vacant and peaceful possession of the said Premises to the Transferees simultaneously against the Transferees completing payment of the entire said consideration of Rs. 2,00,00,000/- (Rupees Two Crore).

7. The Transferor upon receipt of the aforesaid agreed consideration of Rs. 2,00,00,000/- (Rupees Two Crore) shall grant, assign, transfer and assure all his rights, title and interest into and over the said Premises in favour of the Transferees.

8. The Transferor hereby declares and states that he has obtained the necessary permission i.e. No Objection Certificate from the said society vide society letter dated _____ for the sale of said flat and the said

Shares in favour of the Transferees and the said No Objection Certificate is annexed as Annexure ‘A’ to this Agreement.

9. The Transferor hereby covenants with the Transferees that upon receipt of the said total consideration of Rs. 2,00,00,000/- (Rupees Two Crore only) as aforesaid, the Transferor shall: -

a. absolutely transfer, convey, release, devise and demise his rights, title and interest in the said shares, flat, including balance in major repair fund, sinking fund and other deposits and other incidental rights to transferee on receipt of balance full and final payments;

b. declare that notwithstanding any act, deed, matter or thing whatsoever by the transferor or any person or persons lawfully or equitably claiming by, from, through, under or in trust from them, done, committed, omitted or knowingly and willingly, suffered to the contrary, the transferor now has in himself good right, full power and absolute authority to transfer, assign the said Premises;

c. Handover to the Transferees absolute, legal, quiet, vacant and peaceful possession of the said Flat simultaneously against receiving payment of the entire consideration. Time limit is the essence of this contract.

d. Handover to the Transferees the original Share Certificate No. 786, bearing distinctive nos. from 6821 to 6890 (both inclusive) issued by the said Society and including all other original documents of title of the said Premises that are in possession of the Transferor.

e. Execute and handover the transfer forms and all other forms, documents and writings as may be required under the

Maharashtra Co-operative Societies Act, 1960, the Maharashtra Co-operative Societies Rules, 1961 and the bye-laws of the said Society for the effectual transfer of the said Premises with all deposits and meters in respect of the said Premises to the names of and in favour of the Transferees;

f. Execute and handover to the Transferees (to be forwarded to the said Society) a letter addressed to the said Society requesting them to transfer the said Premises together with all deposits to the names of and in favour of the Transferees;

g. Execute and handover to the Transferees indemnity bond, legal undertakings, declarations if any, and any other forms, letters, declarations or documents as may be required by the Transferees and \or their bankers relating specifically to the aforesaid transaction of sale and transfer of the said Premises;

h. Execute and handover to the Transferees a letter addressed to the Electric Company (Reliance Energy Limited) requesting them to transfer the meters, records and deposits in respect of the said Flat to the name of and in favour of the Transferees;

10. The Transferor further hereby agree and undertakes that from time to time and at all the times hereafter at the request of the Transferees or their heirs, executors, administrators, successors, assigns or counsel in law, to do and execute and/or procure or cause to be done, executed or procured all documents and such deeds and writings whatsoever for the assurance in law and for better and more perfectly transferring the rights, title, interest and benefit in the said Premises and every part thereof to the use and benefit of the Transferees as aforesaid.

11. The Transferees shall, on completion of the transaction of sale as mentioned herein above, shall be entitled to have and to hold the said Premises for, unto and to the use and benefit of the Transferees, their heirs, executors, administrators, successors and assigns forever and without any claim, charge, interest, demand or lien of the Transferor or any person or persons claiming through him.

12. The Transferees shall, on completion of the transaction of sale mentioned hereinabove, be entitled to apply for the membership of the said Society and for the transfer of the said Flat and of the said Shares in their name. On completion of the transaction of the sale, the Transferees shall be entitled to all the benefits flowing from the membership of the said society including share in sinking funds, major repair funds and other reserve funds. The Transferor hereby agrees to sign and execute all such forms, declarations, documents or writings as may be required for the said purpose.

13. The Transferor shall pay to the said Society and all concerned authorities the monthly outgoings and all other dues in respect of the said Premises upto the date of handing over possession to the Transferees and obtain complete discharge of the same. The Transferees shall only be liable to pay the outgoings and dues from the date of receipt of the possession.

14. The Transferor hereby represents and warrants to the Transferees as follows: -

    (a) that the Transferor has duly paid and discharged in full all the dues and liabilities in respect of the premises including the Municipal outgoings, taxes, rates, maintenance charges etc., payable to the said Society up to the date hereof and that nothing whatsoever is outstanding, due or payable to anybody;

(b) that the Transferor is the sole and absolute owner and beneficiary of the said Premises and is absolutely and exclusively entitled to the same and to all incidental rights thereto and to the exclusive right to the use, enjoyment and occupation of the said Flat and except the Transferor no other person or persons have any right, title, interest, claim or demand of any nature whatsoever upon the same;

(c) that notwithstanding any act, deed, matter or thing whatsoever done, committed or omitted by the Transferor or any person or persons lawfully or equitably claiming by, from, through, or in trust for the Transferor, the Transferor has full power and absolute authority in its own right to transfer the Premises and to relinquish and transfer all its right, title and interest therein in favour of the Transferees;

(d) that neither the Transferor nor anyone on its behalf has committed or omitted any act, deed, matter or thing whereby its holding of the Shares and incidental rights thereto including the right to peaceful use, occupation, ownership and enjoyment of the said Flat and other rights and benefits in respect thereof may become or may be prejudicially affected or encumbered in any manner or whereby the Shares or any other right, title and interest therein may become liable to attachment and/or sale whether by a decree or order of the Competent Court or otherwise;

(e) that the Transferor has not created or purported to create any tenancy, licence, charge, lease, mortgage, lien or any kind of third party rights in and over the Premises and no other person or party has any right, title or interest, claim or demand in to or upon the same either by way of mortgage, gift, trust, inheritance, lease or otherwise and that the Premises are free from all encumbrances and there is no pending litigation of any kind whatsoever;

(f) that the Transferees shall, on completion of the transfer peaceably and quietly, be entitled to hold and own the said Premises and all

incidental rights, benefits, privileges and advantages thereto including the right to enter upon and remain in sole occupation and enjoyment of the said Flat and/or any part thereof in the Transferees own right without any interference, disturbance, interruption, claim or demand whatsoever and/or any person or persons lawfully and equitably claiming by from, through, under or in trust for the Transferor;

(g) that the Transferor has duly complied with, and observed all the Rules, Regulations and Bye-laws of the said Society and that the Transferor has neither received any notice from the Society for or in relation to any breach of any of the Rules, Regulations and Bye-laws of the Society nor are there any actions or proceedings pending against the Transferor instituted by the Society or any member of the Society in respect of the Premises including any notice or action for expulsion or termination of the Transferor as members of the Society; and

(h) that the Transferor has not received any notice for acquisition or requisition of the Premises and that the Premises are not a subject matter of any litigation, legal proceedings or disputes and is not affected by any notice or order of requisition, acquisition or injunction or attachment either before or after judgment.

15. Relying upon the aforesaid representation, statements, covenants and assurances of the Transferor, the Transferees have purchased the said Premises.

16. The Transferor hereby agrees and undertakes to indemnify and keep indemnified the Transferees and their respective heirs, executors, administrators, successors and assigns in the event they or any one of them suffer any loss or damage due to any demands or claims by way of tenancy, sub tenancy, licence, lease, mortgage, charge, inheritance, sale, exchange, possession, lien, gift, trust or otherwise howsoever being brought forward at any time in future by any third party due to

the representations of the Transferor being wrong, to the extent of the loss or damage suffered by Transferees or any other person or persons claiming through them.

17. The Transferees hereby covenant with the Transferor as follows: -

    a. That the Transferees shall, from and after the date that they are put in possession of the said Flat, regularly pay to the said Society and all concerned authorities the future monthly outgoings and all dues payable in respect of the said Flat.

    b. The Transferees shall observe, perform, and abide by the bye-laws, rules and regulations of the said Society from time to time in force.

18. The transfer fee and transfer charges payable to the said Society for the transfer of the said Flat and the said Shares to the name of the Transferees shall be borne and paid by Transferor and the Transferees in equal ratio i.e.; 50% each.

19. The stamp duty and registration charges, if any, on all documents pertaining to the sale shall be borne and paid by the Transferees alone.

SCHEDULE OF PROPERTY REFERRED ABOVE

Flat No. _____, area admeasuring about 831 square feet, carpet area on the third floor, in building known as _____, and having ground and four upper floors constructed in the year _____, situated, lying and being at Final _____ and having postal address at _____, in _____ Ward, in the Registration District and Sub District of Bandra, District Bombay Suburban.

IN WITNESS WHEREOF the parties herein have hereunto set and subscribed their respective hands at Mumbai on the day and year hereinabove written.

SIGNED AND DELIVERED by within named)
"Transferor")
)
in the presence of _____)
_____)
)

SIGNED AND DELIVERED by within named)
"Transferees")
)
)
in the presence of_____)
_____)
)
)
)

RECEIPT

RECEIVED of and from the Transferee _____ having address at _____ the sum of Rs. 50,00,000/- (Rupees Fifty Lakh only) being the part consideration in respect of sale of the shares as mentioned in the agreement for sale dated ____ day of April, 2012 together with the right, title and interest in the residential flat no. _____ on the floor situated at _____, details of which are as under:

Date	Cheque No.	Drawn on	Branch	Amount Rs.
				10,00,000/-
				25,00,000/-
				15,00,000/-
				50,00,000/-
(Rupees Fifty Lakh only)				

Witnesses: I Say Received

1.

2.

Books to read

1. The Seven Stages of Money Maturity: Understanding the Spirit and Value of Money in Your Life by George Kinder

2. Why Smart People Make Big Money Mistakes And How To Correct Them: Lessons From The New Science Of Behavioral Economics (Paperback) by Gary Belsky, Thomas Gilovich

3. Against the Gods by Peter L. Bernstein

4. Extraordinary Popular Delusions and the Madness of Crowds by Charles Mackay

5. The Intelligent Investor by Benjamin Graham

6. Learn to be your own Lawyer in 30 days by Ankoosh Mehta

7. Timing the Real Estate Market by Craig Hall

8. The Behavior Gap by Carl Richards

