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An Investor Education and Awareness Initiative from HDFC Mutual Fund

INVESTOR EDUCATION
AN INVESTOR EDUCATION AND AWARENESS INITIATIVE FROM HDFC MUTUAL FUND

USE THE RIGHT FORMULA TO ACHIEVE FINANCIAL GOALS

THERE ARE MANY FORMULAE YOU CAN USE TO REACH YOUR FINANCIAL GOALS AT THE RIGHT TIME

Everyone wants to achieve some key financial goals in life. These vary from one individual to the other: some look to building a nest egg for their retirement, while for others, funding their children's education and marriage are prominent goals. But in order to achieve all these goals, you need a proper plan in place — an investing roadmap that can help you reach your financial goals at the right time. For this, you have to plan your investments around each of your goals. If your investments are not linked to your goals, you will not only remain clueless about how much you need to invest, but also whether it will be enough to meet your requirements.

Fortunately, drawing up a financial plan is not as difficult as it sounds. Microsoft Excel is an excellent tool that you can use. The first step in solving the investing puzzle is to figure out your financial goals. However, goal setting is more than just scribbling down some ideas on a piece of paper. You must set goals that are realistic and rooted in pragmatism. Once you have articulated these goals, ascertain a realistic time frame within which to achieve each financial goal. This will give you an idea of how much money you need to accumulate towards each goal. Based on the current cost of your goal, estimate the likely future cost taking into account the impact of inflation. (*See box: 'How much do you need?'*)

Once you arrive at a rough estimate of the amount you require for each goal, you will be able to figure out how much you need to save each month to achieve those goals. Use the formula mentioned in the box *'How much to invest?'* to arrive at the right amount.

Now that you know how much you need to invest, how best can you invest to achieve this corpus? One can do so with the help of systematic investments across a basket of mutual funds which are suited to various requirements. An SIP is a safer and more convenient way of building savings towards a particular end.

HOW MUCH DO YOU NEED?

Let's assume you want to send your child abroad for higher studies 15 years from now. If the current cost of this foreign degree is ₹12 lakh, use Microsoft Excel to calculate how much it would cost you 15 years later by using a simple compounding formula:

=a*(1+r)^n

Note:
a is Current Value
r is Rate of Inflation
n is Number of Years.

Assuming the expected rate of inflation is 7%, you would need to type

=12,00,000*(1+7%)^15

The resultant figure of ₹ 33,10,838 (about ₹ 33 lakh), is the corpus you would need 15 years later.

HOW MUCH TO INVEST?

Now you know that you need to save about ₹ 33 lakh in 15 years for your child's higher studies, and that you would be starting with a zero balance. You could use the PMT function in Excel to calculate how much to save each month to accumulate that amount. Assuming the expected return to be 12%, the formula that you need to use is:

= PMT(rate, nper, pv, fv). In the above example, this would translate as:

= PMT(12%/12,15*12,0,3310838)

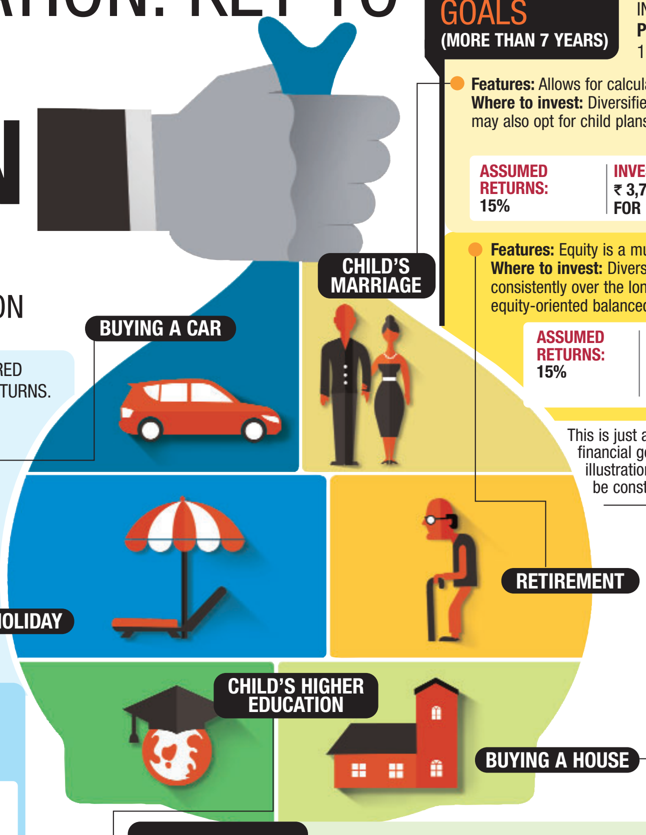
Note:

- **Rate** is expected annual rate of return of 12% is divided by 12 to reflect the monthly return.
- **NPER** is number of payments during the 15-year savings period. This is multiplied by 12 because you will be making 12 monthly payments each year.
- **PV** is present value. The same formula can also be used to calculate EMI for a loan in which case PV is the outstanding loan amount. This should be zero in the current calculation.
- **FV** is future value, the target amount you wish to reach. In this case, it is ₹ 33,10,838.

The resultant figure is ₹ 6,627 which is the amount you need to save every month to reach your target goal.

ASSET ALLOCATION: KEY TO WEALTH CREATION

YOUR ASSET MIX SHOULD IDEALLY MATCH YOUR RISK TOLERANCE, FINANCIAL GOALS AND TIME HORIZON



SHORT-TERM GOALS (1-3 YEARS)

CONCENTRATE ON SAVING THE REQUIRED AMOUNT, NOT ON GETTING HIGHER RETURNS.
PROPOSED ASSET ALLOCATION: 100% DEBT

Features: Negotiable goal, can be postponed by 2-3 months if funds are short.
Where to invest: Start putting your money in an open-ended short-term debt fund. These funds are very liquid and you can withdraw anytime you need the money. They are also not very volatile and give returns comparable to fixed deposits.

ASSUMED RETURNS:	INVEST:	CORPUS:
9.5%	₹ 9,500 A MONTH FOR 36 MONTHS.	₹ 4 LAKH AFTER 36 MONTHS.

Features: Discretionary expense; amount saved can be flexible, but time is not negotiable.
Where to invest: Invest in short-term debt funds for the relevant period.

ASSUMED RETURNS:	INVEST:	CORPUS:
9.5%	₹ 10,500 A MONTH FOR 18 MONTHS.	₹ 2 LAKH AFTER 18 MONTHS.

MEDIUM-TERM GOALS (3-7 YEARS)

WITH MORE TIME AVAILABLE FOR GROWTH, TAKING A SLIGHTLY HIGHER RISK IS POSSIBLE.
PROPOSED ASSET ALLOCATION: 60% DEBT AND 40% EQUITY.

Features: Non-negotiable goal. Ensure you money well in time.
Where to invest: Start investing in a monthly income plan (MIP)

ASSUMED RETURNS:	INVEST:	CORPUS:
10%	₹ 13,000 A MONTH FOR 5 YEARS.	₹ 10 LAKH AFTER 5 YEARS.

Features: Flexible goal, RoI is important.
Where to invest: Hybrid funds, particularly equity-oriented balanced funds if the goal is more than 3 years away. If less, opt for debt-oriented hybrid schemes.

ASSUMED RETURNS:	INVEST:	CORPUS:
14%	₹ 14,000 A MONTH FOR 7 YEARS.	₹ 20 LAKH AFTER 7 YEARS.

LONG-TERM GOALS (MORE THAN 7 YEARS)

LONGER HORIZON ALLOWS INVESTMENTS IN VOLATILE BUT LUCRATIVE OPTIONS.
PROPOSED ASSET ALLOCATION: 100% EQUITY

Features: Allows for calculated risks.
Where to invest: Diversified equity funds through a monthly SIP. One may also opt for child plans offered by fund houses.

ASSUMED RETURNS:	INVEST:	CORPUS:
15%	₹ 3,700 A MONTH FOR 15 YEARS.	₹ 25 LAKH AFTER 15 YEARS.

Features: Equity is a must.
Where to invest: Diversified equity funds that have performed consistently over the long term. You can also go for equity-oriented balanced funds.

ASSUMED RETURNS:	INVEST:	CORPUS:
15%	₹ 3,300 A MONTH FOR 20 YEARS.	₹ 50 LAKH AFTER 20 YEARS.

This is just an illustration explaining ways to achieve your financial goals using assumed returns. The above illustration is merely indicative in nature and should not be construed as an investment advice.

If you are investing in a particular company, would you be more comfortable owning a company with diverse set of businesses or one that is dependent entirely on one particular line of business? Having all your money exposed to the performance of a single business avenue will put your capital at risk. This also applies to your investments. If you rely solely on the performance of a single investment avenue, it could lead to disastrous results. In other words, do not put all your eggs in one basket.

It is critical to have a balanced approach to your investments. One can never be sure which asset class will soar and which one will turn sour. Gold ruled the performance charts a couple of years ago, while equities languished at the bottom. This time, a different story is playing out. This is where asset allocation comes in the picture. This means spreading your money across different asset classes such as equity, debt, gold, etc., in varying proportions. Unlike what most investors believe, it is not the instrument that will determine the return on your investment and how much wealth you create but how you allocate your money which plays a more vital role.

HOW TO IDENTIFY THE RIGHT ASSET MIX

Your asset mix should ideally match your risk tolerance, financial goals and time horizon. It should also be dynamic – as your goals and needs change, you should ideally alter your asset mix over time. For instance, when you are just starting out in your career, you have more time to reach your financial goals and can also take on more risk with your investments since you do not require the funds anytime soon. At this stage, your asset mix should be tilted more towards equities, as this is the asset class that has the power to generate huge returns over time. Even though your savings are on the lower side, putting even a little amount of money in equities regularly in these early stages of life goes a long way in helping achieve key financial goals later on in life. Start off by investing across a mix of diversified equity funds including mid-and small-cap focussed funds besides large-cap funds.

Then, as you move into the middle stages of your life, you will be earning a lot more. At this stage, however, your goals might have changed. Having settled down with your partner, you may be paying off your mortgage and saving for your children's education. You should move away slightly from high risk investments and take a more balanced approach at this stage. This means investing a slightly higher portion of your money in debt instruments. However, do not move out from high-return equity investments yet as these will provide the kick you need to achieve your goals on time. Apart from your existing diversified equity funds, you may opt for debt-oriented balanced funds that invest a chunk of the corpus in debt instruments and the rest in equities.

Once you move into the later stages of your life and retirement looms closer, you should start shifting into low risk investments. At this stage, your priority should be to protect your existing savings and wealth. Since you have little time to build further assets, you cannot risk exposing your accumulated savings to the vagaries of the stock markets. So make a gradual move from high risk investments into low risk alternatives that will help preserve your capital. This means switching away from your equity funds to safer options like short term debt funds. You may also want to look into investments that create a steady stream of income such as monthly income plans.

Throughout these stages of your life, review your financial position and investment strategy on a regular basis. Maintain a disciplined approach to your savings, and you will be comfortably placed to achieve your financial goals.

TO KNOW MORE, CONTACT YOUR FINANCIAL ADVISOR TODAY OR WRITE TO US AT **investoreducation@hdfcfund.com**