INVEST-WISE

An Investor Education and Awareness Initiative from HDFC Mutual Fund

USE EQUITY MUTUAL FUNDS TO BEAT INFLATION

INVESTORS COULD FIND RESPITE FROM HARSH INFLATIONARY SHOWERS BY INVESTING IN EQUITY MUTUAL FUNDS

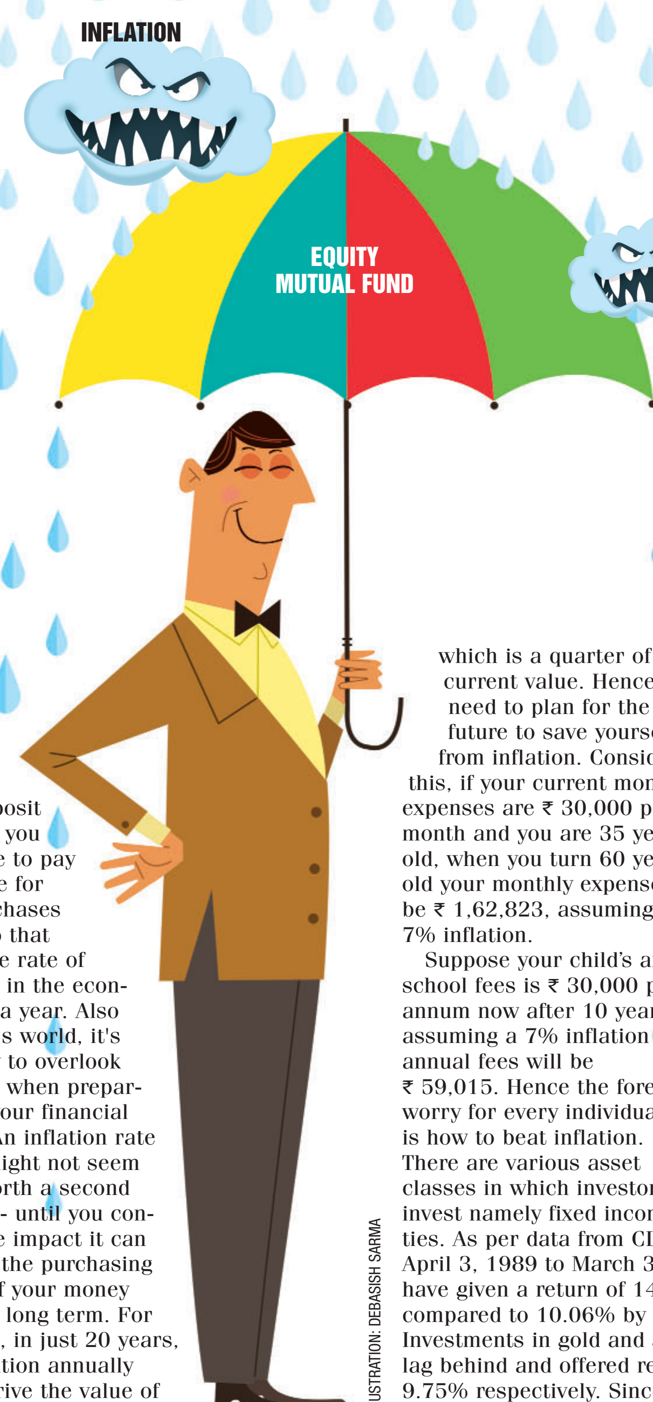

ILLUSTRATION: DEBASISH SARMA

Inflation is that monster that reduces your purchasing power with every passing year. However if you invest in equity mutual funds, and stay invested for long periods of time, it is possible to beat inflation. You can use equity mutual funds to plan for your long term goals such as your child's education, marriage and so on.

Inflation continues to haunt one and all. It is that monster which eats away the value of money that you earn. Simply put inflation reflects the rate at which the prices of food and other commodities increase over a period of time. The most commonly referenced measure of an increase in inflation is the consumer price index (CPI), which measures the consumer prices of a basket of commodities. There is another measure, termed the Wholesale Price Index (WPI) - This measures the different prices of a basket of commodities in the wholesale markets. The basket broadly constitutes primary products, fuel products, and manufactured products. Inflation is known to every household and leads to a decrease in purchasing power of money that actually affects everyone. It implies that if you buy a packet of biscuit today at ₹ 10 today, you will have to pay ₹ 14 five years down the line for the same packet, considering an inflation rate of 7 per cent. Prices of various commodities have increased over time due to inflation. For example, price of petrol which was ₹ 9.84 per litre in 1990 is now ₹ 69 per litre. LPG cylinder which cost ₹ 59.6 in 1990 now costs ₹ 414, while a non subsidized cylinder costs ₹ 880.

So how does inflation affect your savings and investments? Take a look at this example-- If you deposit ₹ 1 lakh @ 9% p.a., with the annual inflation rate being 7%, then the real return on your deposit is 9%(nominal rate) minus 7%(inflation rate), i.e.2% p.a.(real rate) This is because after one year when your deposit matures you will have to pay 7% more for any purchases owing to that being the rate of inflation in the economy for a year. Also in today's world, it's not easy to overlook inflation when preparing for your financial future. An inflation rate of 7% might not seem to be worth a second thought - until you consider the impact it can have on the purchasing power of your money over the long term. For example, in just 20 years, 7% inflation annually would drive the value of ₹ 100 down to ₹ 25.84, which is a quarter of the current value. Hence you need to plan for the future to save yourself from inflation. Consider this, if your current monthly expenses are ₹ 30,000 per month and you are 35 years old, when you turn 60 years old your monthly expenses will be ₹ 1,62,823, assuming a 7% inflation.

Suppose your child's annual school fees is ₹ 30,000 per annum now after 10 years assuming a 7% inflation their annual fees will be ₹ 59,015. Hence the foremost worry for every individual is how to beat inflation. There are various asset classes in which investors can invest namely fixed income, gold and equities. As per data from CLSA over the period April 3, 1989 to March 31, 2014, equities have given a return of 14.99% return, as compared to 10.06% by bank fixed deposits. Investments in gold and government bonds lag behind and offered returns of 9.61% and 9.75% respectively. Since inflation erodes the purchasing power of money, it is important to invest in assets that produce returns that beat inflation. For example, if the inflation rate is 7% in a country and bank deposits earn 9% and equities return 15% it does not make sense to save in bank deposits since one would make just 2% in terms of actual income by investing in bank deposits. This would also give a relatively lower purchasing power as compared to the investor who has put his money in equity mutual fund.

Also equity mutual funds are tax free after holding them for a period of one year, which improves tax efficiency for those whose income is subject to tax.

Hence equities are one of the best asset class to beat inflation. Equity mutual funds with their consistent return are a good long term option to beat inflation if you stay invested for long durations of time.

Equity mutual funds invest in a basket of well chosen companies which come from a diversified set of industries. With the GDP growth at around 6%, most companies in a portfolio would grow on an average of 14% (considering around 8% inflation). This earnings growth would consequently see the share price moving up.

Choose diversified equity funds which allocate money across sectors. Stay invested for the long term to enable these companies to grow and give better returns, which will help you beat inflation in the long term.

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

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