ASCENT FINANCIAL SOLUTIONS

2024
E-Book

TRANSFORMING FINANCIAL LIVES

Preface

Welcome to this Ascent Financial Solutions ebook! We're thrilled to share our knowledge and insights on Financial Planning with you. This ebook is designed to provide you with valuable information and practical strategies to help you achieve your financial goals. Whether you're just starting out on your financial journey or looking for ways to improve your current situation, this ebook has something for you.

Within these pages, you'll find approaches for Smart Investing, Financial Planning, Building Wealth, Making Money Work and much more.

We've taken a clear and concise approach, making the information accessible to everyone, regardless of their financial background.

We encourage you to read through this ebook at your own pace and revisit sections that resonate most with you. We're confident that the information you gain here will empower you to make informed financial decisions and build a secure financial future.

Note from the Founder

To the readers,

I'm Prakash Lohana, founder of Ascent Financial Solutions. As someone who has always been passionate about the concept of finance and helping others, I've dedicated myself to assisting individuals in navigating the often complex world of finance.

This ebook is a culmination of our team's expertise and experience at Ascent Financial Solutions. We're passionate about financial literacy and believe that everyone deserves access to the knowledge and tools needed to make sound financial decisions.

Remember, taking charge of your financial well-being is an active process. This book equips you with the foundational knowledge to chart your course. Don't be afraid to ask questions! Ascent Financial Solutions is here to support you every step of the way. Whether you have specific questions or need personalized guidance, we're here to be your partner in achieving your financial goals.

Let's build your financial future together!

Sincerely,

Prakash Lohana

Founder, Ascent Financial Solutions

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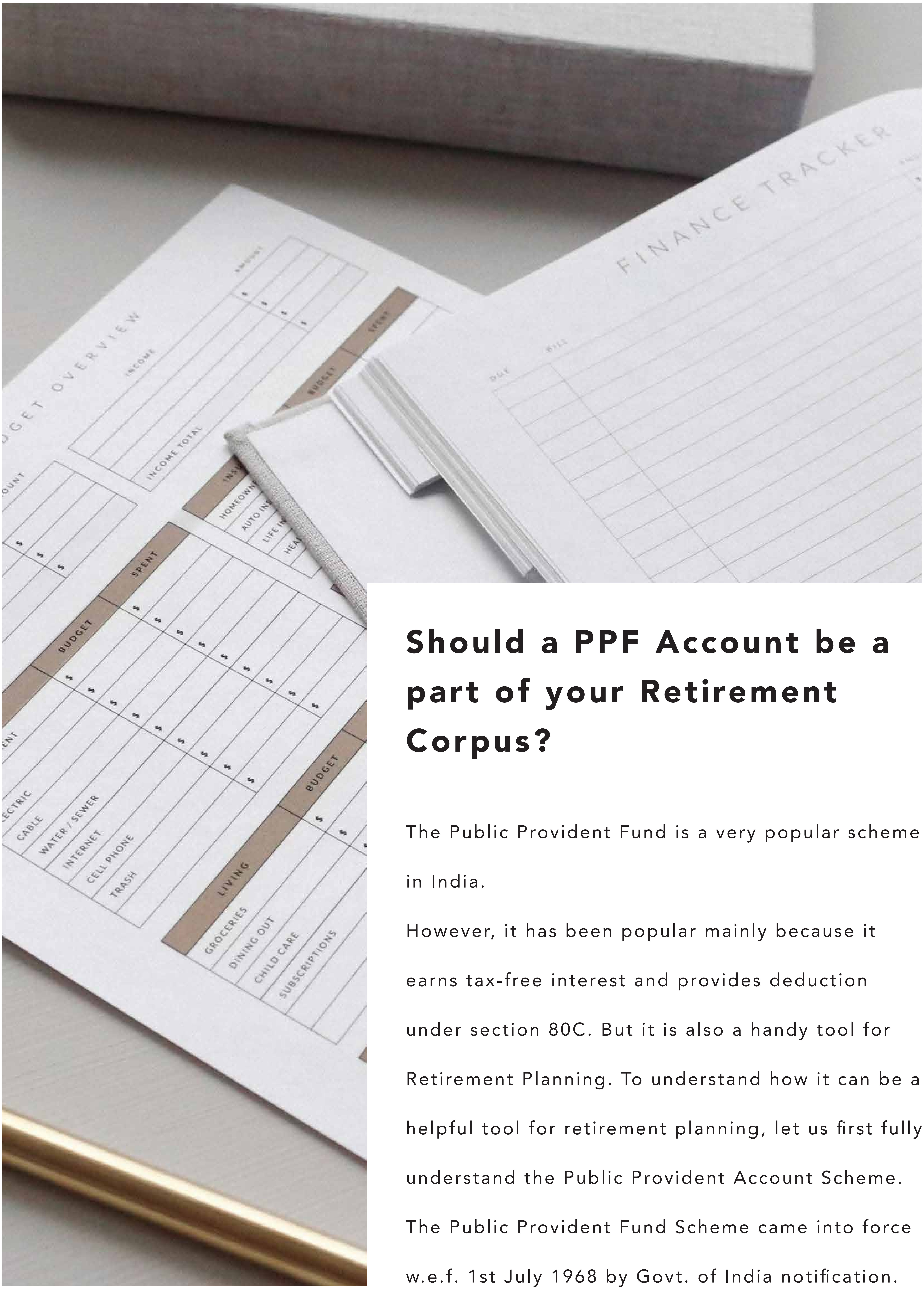


Should a PPF Account be a part of your Retirement Corpus?

The Public Provident Fund is a very popular scheme in India.

However, it has been popular mainly because it earns tax-free interest and provides deduction under section 80C. But it is also a handy tool for Retirement Planning. To understand how it can be a helpful tool for retirement planning, let us first fully understand the Public Provident Account Scheme. The Public Provident Fund Scheme came into force w.e.f. 1st July 1968 by Govt. of India notification.

Who can open a Public Provident Fund Account

- Any Individual can open a PPF Account.
- PPF accounts can also be opened for minors by their guardians.
- PPF Accounts cannot be opened for HUF (Hindu Undivided Family), AOP (Association of Persons), and BOI (Body of Individuals).
- Non-resident Indians cannot open a PPF account. But in the case where the account was opened by a Person when he was an Indian Resident and subsequently became a non-resident Indian, the account can be continued by making subscriptions till it matures on a non-repatriation basis.

Mode of Holding

- PPF Account can be opened only in a single name (the joint account cannot be opened).
- Nomination Facility is available in the PPF account.

Tenure of PPF Account

- PPF account matures after expiry of 15 years from the end of the financial year in which the account was opened. For example, the account opened on 01/01/2000 will mature on 01/04/2015.
- PPF account can be continued for a block of 5 years after maturity. This facility is available for any number of blocks after the expiry of the extended period. The continuation can be with or without contribution. The option cannot be changed once an account is continued without contribution for more than a year. Non-resident Indians cannot extend their PP Account.

How much amount can be deposited in PPF?

- Minimum Amount of Deposit: Rs.500/- should be deposited in the PPF Account during a financial year.
- Maximum Amount of Deposit: During a financial year, a maximum of Rs. 1,50,000/- can be deposited in a PPF account.
- Subscriptions should be in multiples of Rs.50. Maximum of 12 deposits can be made in a financial year.

What are the tax implications of a PPF account?

- Subscriptions made in the PPF account during the year are eligible for Deduction u/s 80C of The Income Tax Act 1961.
- Interest earned in the PPF account is entirely exempt from Tax U/s 10 of The Income Tax Act 1961.

Interest Rates

- The government decides the Interest rate for PPF accounts through notification in the official Gazette. Right now, the interest rate is 7.1% p.a.
- PPF interest is calculated monthly on the lowest balance between the end of the 5th and last days of the month. However, the total interest in the year is added back to PPF only at the year-end.

Loan Facility

- There is a loan facility available. An investor can borrow at any time after the completion of 2 years. The amount of the loan cannot exceed 25% of the balance in the account at the end of the second year immediately preceding the year in which the loan is applied.
- A fresh loan is not allowed when a previous loan or interest is outstanding. The interest rate is 1% if repaid within 36 months and 6% on outstanding loans after 36 months. The repayment must be made either in lump sum or installments.
- **It is recommended to avoid loans since interest is paid out of nontaxable interest, and therefore, the advantage gets diluted.**

Partial Withdrawals

- Partial withdrawals are allowed beginning from 7th year and every year after that. An account holder can withdraw 50% of his balance at the end of the 4th or the 1st previous financial year, whichever is lower. For example, if the account was opened in the financial year 2001-2002, You may add six years to the financial year, i.e., 2002+6=2008 (FY 2007-2008). Accordingly, the 4th preceding year will be 2008 -1 = 2007 (FY 2006-2007). So, the amount of 1st withdrawal in the 7th year, FY 2007-2008, is 50% of the balance to the credit as of 31-03-2004 or 31-3-2007, whichever is lower.
- In post-maturity continuation without fresh subscriptions, any amount, in part or whole, can be withdrawn in installments but not exceeding once a year.

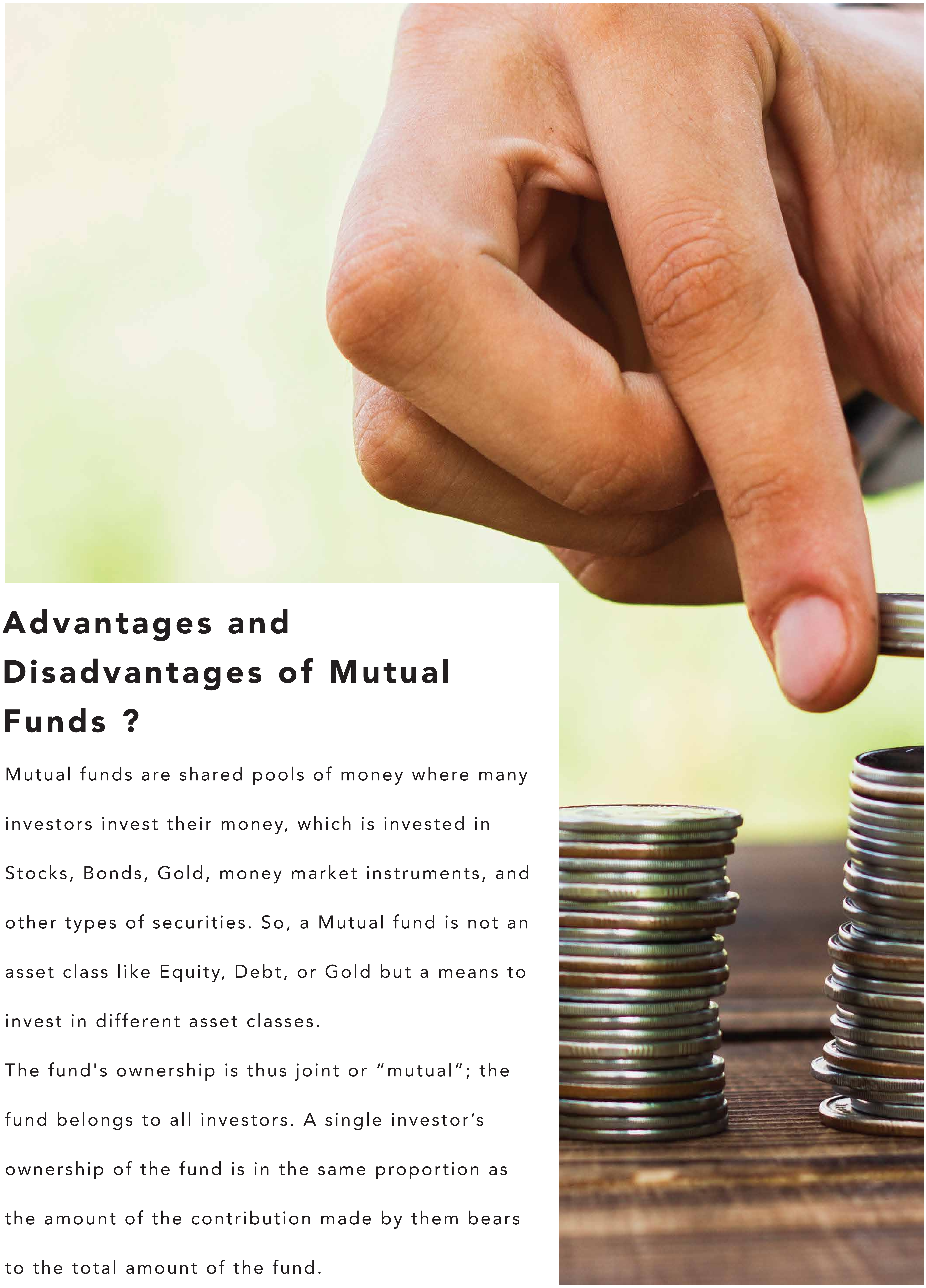
Notes

- A PPF account is not subject to attachment (seizure of the account by Court order) under any order or decree of a court. However, income tax authorities can attach PPF accounts to recover tax dues.
- A person can have only one account in his name. Two accounts, even at different places anywhere in India, are not permitted.

RETIREMENT

Conclusion

As PPF generates a tax-free interest, one can plan part of his retirement corpus in a PPF account, and there is also an option where if one continues his PPF account without a fresh deposit, he can withdraw any amount from it every year. So, in that case, if the Husband and wife both start contributing regularly to their PPF accounts at an early age and create a good corpus till their old age, they can continue their PPF account without contribution and withdraw any amount every year. So, in conclusion, one should put a part of his Retirement corpus in the PPF Account.



Advantages and Disadvantages of Mutual Funds ?

Mutual funds are shared pools of money where many investors invest their money, which is invested in Stocks, Bonds, Gold, money market instruments, and other types of securities. So, a Mutual fund is not an asset class like Equity, Debt, or Gold but a means to invest in different asset classes.

The fund's ownership is thus joint or “mutual”; the fund belongs to all investors. A single investor’s ownership of the fund is in the same proportion as the amount of the contribution made by them bears to the total amount of the fund.

The legal structure of Mutual Funds is that of trust, which accepts savings from investors and invests the same in diversified financial instruments in terms of objectives set out in the trust deed with the view to reduce the risk and maximize the income and capital appreciation for distribution for the members. A Mutual Fund is a corporation, and the fund manager's interest is to professionally manage the funds provided by the investors and provide a return on them after deducting reasonable management fees. The following chart summarizes the advantages and disadvantages of Mutual Funds, which are explained below.

Advantages	Disadvantages
Portfolio Diversification	No Tailor-Made Portfolio
Risk Management	No Control over Cost
Professional Management	Managing a Portfolio of funds
Reduction to Transaction Cost	Dilution
Liquidity	
Well Regulated	
Transparency	
Convenience to Unit Holders	

Let us see the advantages of mutual funds

1) **Portfolio Diversification:** As discussed above, a Mutual fund is a shared pool of money. So, when a large number of investors invest their money in a Mutual Fund Scheme, they become joint owners of this scheme, and then that scheme will invest into a number of securities as per the objective of the scheme. Mutual funds help Investors to get diversified at two levels. First, diversification happens at the Asset class level because different mutual fund schemes have different objectives; some may invest in Equities, and some may invest in Gold and Bonds. An individual investor can invest in various schemes and diversify into other asset classes quickly. The second level of diversification happens at the securities level for investors. Like a scheme that invests in shares and stocks and will invest in shares of many different companies, an equity mutual fund generally has a portfolio of around 30 to 40 stocks. So, when an investor invests in an equity fund, he automatically gets diversified to 30 to 40 stocks. When we invest in 5 equity funds, we may diversify to the shares of more than 100 companies (considering some companies will be common). It is challenging for an individual investor to understand the prospects of 100 companies, invest in 100 companies, and continuously research them to make buying and selling decisions. So, by investing in mutual funds, an investor gets diversified into different asset classes and securities.

2) **Professional Management:** Mutual Fund companies appoint highly qualified fund managers and research analysts for continued research and effective management of portfolios of the different schemes. Also, it uses costly technologies for such research and analysis. When an individual investor conducts his own research on different securities for his own investment

it is not easy to meet the same excellence level those professionals maintain due to their education, experience, use of technology, and teamwork. Daily, we use the services of many professionals like Doctors, Chartered Accountants, Lawyers, Architects, etc. Similarly, when it comes to investing in different asset classes and securities, we should use the services of these professionals. So, by simply investing in different mutual funds, an investor is getting the service of all these professionals. This professional management helps investors to reduce risk and improve returns.

3) **Effective Risk Management:** Risk Management is the most critical aspect of investing, and as discussed above, due to proper diversification and professional management of funds by the fund management team in mutual funds, different types of risks are reduced significantly. By diversification into different asset classes and securities, the risk of investors is decreased considerably. On the other hand, professional management by fund managers and research analysts further reduces the risk.

4) **Reduction of Transaction Cost:** All the types of costs related to fund managers, research analysts, expensive technologies, or the use of different entities like custodians, Registrar & Transfer agents, etc., get spread over a large number of investors and vast amounts of investments, so their effect individual investors reduce significantly which helps to reduce overall cost on a particular investor.

5) **Liquidity:** When individual investors are holding securities and want to liquidate them, sometimes they find it difficult to liquidate them immediately. In the case of mutual funds, when an investor wants to sell his units, mutual funds buy them from investors in case of open-ended schemes. In the case of close-ended schemes, investors can sell them on stock exchanges where that scheme is listed. So, mutual funds offer relatively easy liquidity options.

6) **Well Regulated:** All Mutual Funds are registered with SEBI, and they function within the provisions of strict regulations designed to protect the interests of investors. SEBI approves all the schemes and continuously monitors the Mutual Funds' functioning.

7) **Transparency:** Mutual funds operate in a very transparent manner. They have to give different disclosures related to NAV, portfolio of schemes, expense ratios, etc., to the investors, as per norms of SEBI. So, investors get all kinds of information about their funds.

8) **Convenience to Unit Holders:** Mutual funds offer investors convenience in investing in different asset classes and other securities at one window. All the processes are designed to provide operational convenience to investors. All the responsibilities, like maintaining records of different securities, buying and selling securities promptly, collecting interest and dividends of different securities in which schemes have invested, etc., are on mutual funds and not individual investors. This makes an individual investor's life easy.

Let us see the disadvantages of mutual funds

1) **No Tailor-Made Portfolio:** A mutual fund is a pool of money, so the portfolios of mutual fund schemes are created as per the schemes' objectives, and they are generalized. It is impossible to create a customized portfolio for an investor as per his choice. However, Mutual Funds offer different schemes with different investment objectives. Like equity-oriented schemes, they offer schemes investing in large-cap stocks, mid-cap stocks, etc. So, investors have a wide choice of schemes.

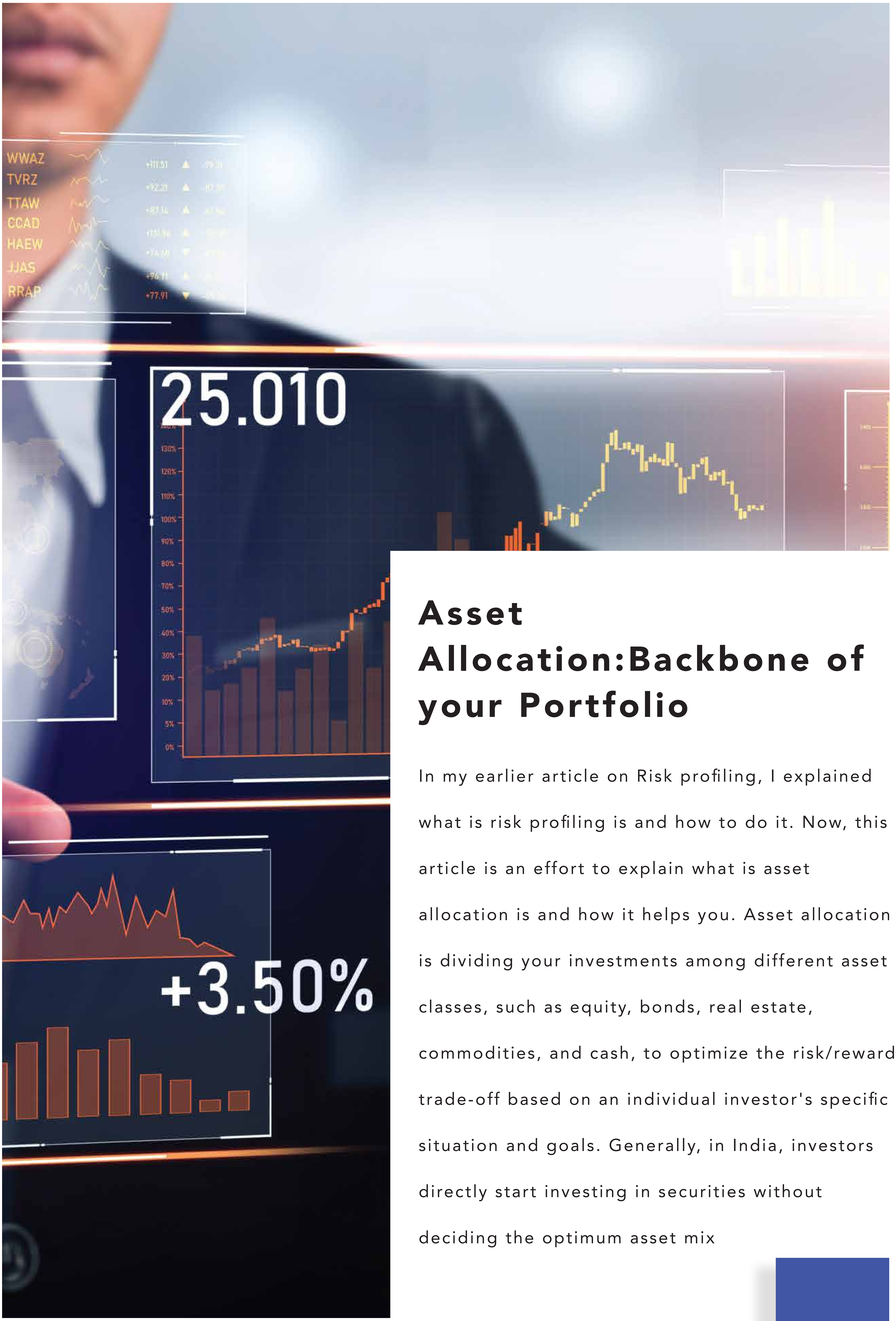
2) **No Control Over Cost:** The investor has no control over different costs incurred by the asset management company. He is charged fund management fees as long as he remains in the scheme. However, these fees are charged as per the regulations formed by SEBI, and these fees are not significant against the benefits offered by Mutual funds. On the other hand, if an investor directly tries to hire such professionals to manage his fund, the cost will be unbearable. Against that, the fee he pays here is reasonable and bearable.

3) **Managing a Portfolio of Funds:** Due to the availability of many schemes, investors sometimes need clarification in choosing the suitable scheme for themselves. This leads to investing in schemes that may not suit their objectives or investing in a large number of schemes that they are not able to track. This can be managed by consulting qualified financial advisers.

4) **Dilution:** Although diversification is essential, investing in too many securities by mutual fund schemes sometimes leads to over-dilution in the portfolio, which also dilutes the returns. So, by investing in mutual fund schemes, investors' portfolios don’t go up sharply when an individual stock or security gives a high return run. However, at the same time, it doesn’t fall sharply when a particular security or stock falls sharply.

Conclusion

From the above discussion, it is evident that mutual funds are practical tools for allocating different asset classes and securities. They offer a variety of advantages against investing directly in other securities. There are minor disadvantages also, which can be managed by consulting qualified financial advisers. So rather than directly allocate to different asset classes and securities, investors should take the route of mutual fund schemes.



Asset Allocation:Backbone of your Portfolio

In my earlier article on Risk profiling, I explained what is risk profiling is and how to do it. Now, this article is an effort to explain what is asset allocation is and how it helps you. Asset allocation is dividing your investments among different asset classes, such as equity, bonds, real estate, commodities, and cash, to optimize the risk/reward trade-off based on an individual investor's specific situation and goals. Generally, in India, investors directly start investing in securities without deciding the optimum asset mix

An individual investor must first decide upon what kind of Investor he is, whether he is an aggressive, conservative, or moderate Investor. This can be decided through the Risk Profiling process, considering his Willingness, Ability, and Need to take risks. You can read my article on Risk Profiling for a detailed understanding of this. Once this is done, he has to decide his allocation to different asset classes. Below, I have categorized an investor into five categories and given indicative asset allocation.

Asset Class	Very Aggressive	Aggressive	Moderate	Conservative	Very Conservative
Equity	**70%**	**60%**	**50%**	**40%**	**20%**
Indian Equity	50%	45%	40%	30%	20%
Large Cap	25%	25%	20%	15%	10%
Mid & Small Cap	15%	10%	10%	10%	10%
Multicap & Others	10%	10%	10%	5%	0%
International Equity	**20%**	**15%**	**10%**	**10%**	**0%**
European Funds	5%	5%	5%	5%	0%
US Funds	5%	5%	5%	5%	0%
China	5%	5%	0%	0%	0%
Others	5%	0%	0%	0%	0%
Fixed Income Investments	**30%**	**40%**	**50%**	**60%**	**80%**
PPF, GPF & EPF	15%	20%	20%	30%	50%
Debt Mutual Funds, Fixed Deposit, Post office investments etc	15%	20%	30%	30%	30%

There are different types of asset allocation strategies include Strategic Asset Allocation, Tactical Asset Allocation, and Dynamic Asset Allocation. The most scientific asset allocation is Strategic Asset Allocation. Today, in this article, I will try to explain to you How Strategic Asset Allocation works and how it can benefit you.

Strategic Asset Allocation: In strategic asset allocation, once you decide your allocation to different asset classes like Equity, bonds, commodities, etc., Then you have to stick to that allocation in percentage terms, and for that, you have to review and rebalance your asset allocation either at a periodic frequency or with some prefixed triggers. Let us understand through one example.

Note: To simplify things, I have assumed 8% returns on Bonds and have taken hypothetical values of Sensex so that you can easily understand the functioning of Strategic Asset Allocation.

For example, you have Rs. 10 lacs to invest, and you have, through your risk profiling, come to the conclusion that you want to invest 50% in Equity and 50% in Bonds, and for that, you have invested 50%, i.e., Rs. 5 lacs in a Sensex Fund and remaining 50% in a Bond Fund. Now let us assume Sensex is at 20000.

Chart-1

Investment:100000   Equity: 50%   Debt: 50%

Date	Sensex	Equity	%Allocation	Debt	%Allocation	Total
01-01-2014	**20000**	**500000**	**50%**	**500000**	**50%**	**1000000**

In Strategic Asset Allocation, this allocation of 50% to Equity and 50% to Bonds is reviewed at a regular periodic frequency, say quarterly half, yearly, or yearly basis, and the portfolio is rebalanced to bring it back to the original allocation in percentage terms. Refer to the following chart to understand this.

Date	Sensex	Equity	%Allocation	Debt	%Allocation	Total
01-01-2014	**20000**	**500000**	**50%**	**500000**	**50%**	**1000000**
30-06-2014	**25000**	**625000**	**54.59%**	**520000**	**45.41%**	**1145000**
Invest/ Withdraw		**-52500**		**52500**		
After Rebalancing	**25000**	**572500**	**50%**	**572500**	**50%**	

Now, in the above chart, you can see that after six months, on 30/06/2014, Sensex has grown from 20000 to 25000 that is 25%, so money invested in Equity has grown equally and become Rs.6.25 lakhs from Rs. 5 lakhs, and as per our assumption Bonds have increased by 4%. So money invested in bonds has grown to Rs. 5.20 lakhs and now allocation to Equity has changed to 54.59% and Bonds 45.41% so our original allocation of 50:50 has significantly changed. As per Strategic Asset Allocation, we have to bring it back to our initial allocation of 50% to Equity and 50% Bonds, and for this, we will have to withdraw around Rs.52500 from Equity and invest into Debt. After rebalancing, it will return to the original allocation of 50% to Equity and 50% to Debt.

Exactly reverse to the above scenario, suppose Sensex after six months on 30/06/2014 falls to 15000, then what will happen? Let us see the chart below.

Date	Sensex	Equity	%Allocation	Debt	%Allocation	Total
01-01-2014	**20000**	**500000**	**50%**	**500000**	**50%**	**1000000**
30-06-2014	**15000**	**375000**	**41.90%**	**520000**	**58.10%**	**895000**
Invest/ Withdraw		**72500**		**-72500**		
After Rebalancing	**25000**	**447500**	**50%**	**447500**	**50%**	**895000**

As you can see, Sensex has fallen to 15000. The value of money invested in Equity has fallen to Rs. 375000. However, more importantly, in percentage terms, it has fallen to 41.90% of the total value, and in Debt, it is Rs. 520000, which is 58.10%, so we have to rebalance and invest Rs. 72500 in Equity to make it 50%, and withdraw from bonds the same amount of money.

This is how Strategic Asset allocation works.

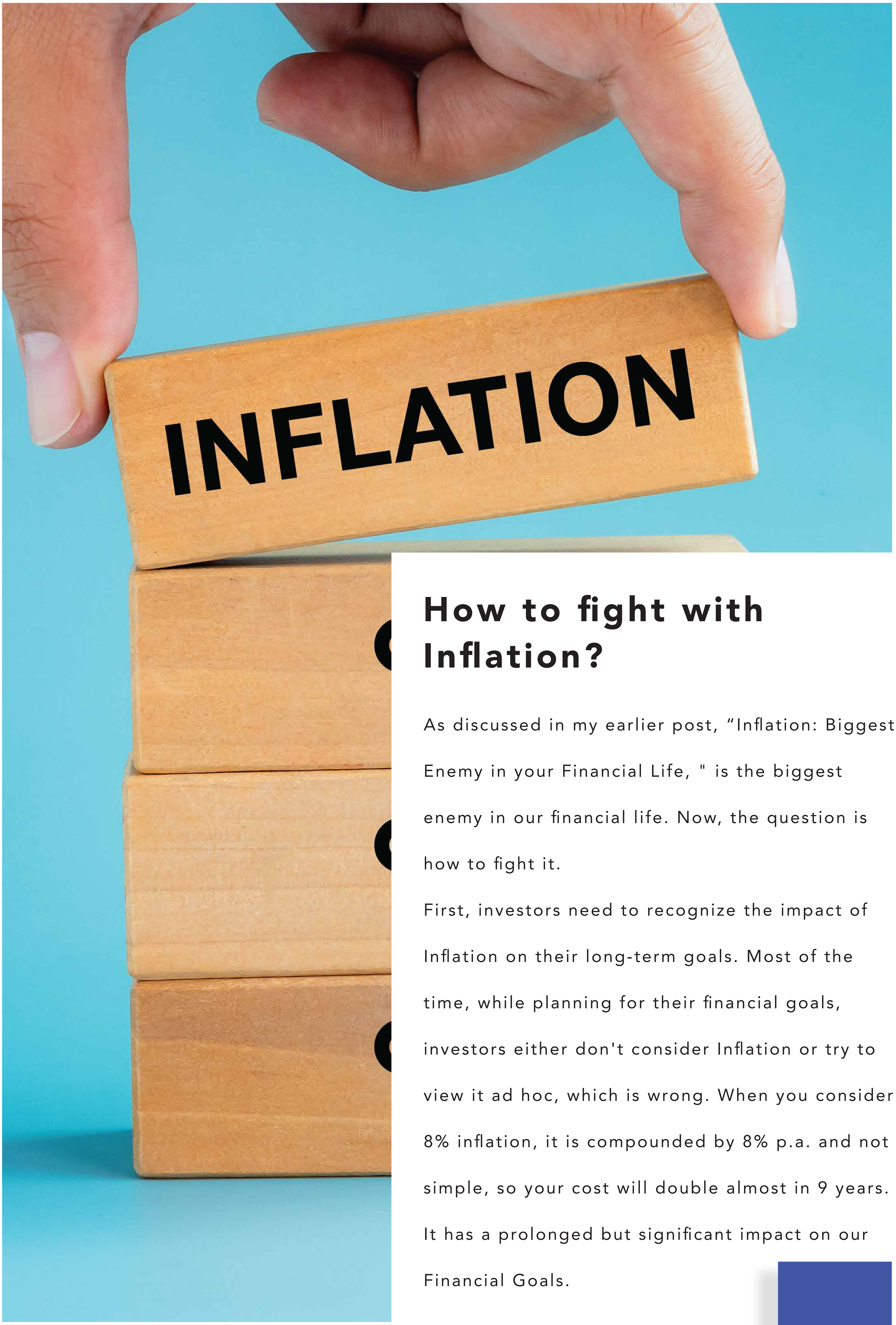
Most significant benefits of Asset Allocation: This is very simple, and you may doubt its benefits.

1.Buy at Low and Sell at High: We invest primarily to buy when markets are low and sell when markets are high, but we usually do the opposite. But Strategic Asset Allocation is a scientific process that keeps our emotions away, and through this process, it assures that we always buy at low and sell at high.

2.Keeps you away from Market Timing: Investors always try to time the market, and for that, they try to predict markets and macroeconomic factors, and most of the time, they fail in this and make losses. Asset allocation helps you keep away from this and remain process-driven.

Conclusion

Asset Allocation is the Backbone of your portfolio, and without a proper asset allocation strategy, you cannot become a successful investor. In my next article, I will give back testing of Strategic Asset Allocation with historical data.



How to fight with Inflation?

As discussed in my earlier post, “Inflation: Biggest Enemy in your Financial Life, " is the biggest enemy in our financial life. Now, the question is how to fight it.

First, investors need to recognize the impact of Inflation on their long-term goals. Most of the time, while planning for their financial goals, investors either don't consider Inflation or try to view it ad hoc, which is wrong. When you consider 8% inflation, it is compounded by 8% p.a. and not simple, so your cost will double almost in 9 years. It has a prolonged but significant impact on our Financial Goals.

The chart below will show you the value of Goal increases at 8% inflation over the years.

		Value After			
Today's Value	Inflation	5 Years	10 Years	15 Years	20 Years
10,00,000	8%	₹1,469,328	₹2,158,925	₹3,172,169	₹4,660,957

Now let us discuss some essential investing aspects to fight Inflation.

Start Early: To fight Inflation, you must start saving for goals as early as possible. The more you delay, the more difficult it will be for you to achieve that Goal. Let us take an example of the education goal discussed in my last post.

Age of Child: 1 year

Current value of Education Goal: Rs. 20 lacs

The age of the child at which money will be required is 18 years

Inflation: 8%

Returns on Investment: 10% p.a

Current age	Money required at	Years left in goal	Current value of education	Inflation	Inflation adjusted value of Education
1	18	17	₹2,000,000	8%	₹7,400,036

The above chart shows that the goal value is 74 lacs from 20 lacs in 17 years. Now let us see how much Investment is required at 10% returns on Investment to achieve the Rs. 74 lacs goal. If we start investing now, delay the Investment for five years (Start the Investment for the Goal when the child is six) or wait for Investments (jump the Investment is 11 years old).

	Annual Investment required if start saving for Education Cost		
	From now	Delay 5 Years	Delay 10 Years
Annual investment amount	₹182,515	₹346,050	₹780,004
No. of years investment	17	12	7
Total investment meets the goal	₹3,102,763	₹4,152,603	₹5,460,032
Additional investment due to delay	0	₹1,049,840	₹2,357,369
Additional % of total investment	0%	33.84%	75.97%

In the above table, the investor selects to save for the goals from now in option A. So, he needs to invest Rs. 1.83 lacs every year for the next 17 years, and the total Investment Is Rs.31.02 lacs. Whereas if he starts after five years (as shown in Option B), he will have to save for 12 years only, but the annual Investment achieves the value of Rs. 74 lacs will be 3.46 lacs, and the total investment Investments of 41.52 lacs. So, a delay of 5 years increases the complete Investment by around 10.50 lacs (41.52-31.02), about 33% more than Option A when the Investment is started immediately. In C, investment years later compared to A, the annual investment are 7.80 lacs, and the total investment achieving the Goal is 54.60 lacs, which is 23 lacs (76%) higher than option A. So, the earlier you start, the better you will be able to beat Inflation.

Try to Earn High Real Returns: Indian investors are traditionally fond of investing in fixed deposits and gold. Typically, returns in these asset classes range between 7% to 9% p.a., and Inflation in different goals is also similar to returns, so they earn very low real returns.

If you are investing Rs. 100 is an 8% fixed deposit, and Inflation is also 8%. After one year, you will get Rs. 108 from your fixed deposit, and due to Inflation, goods or services that you can buy today with Rs.100 will also be available for Rs. 108, so you have just maintained the value of money, and not earn any returns.
Let us once again take the example of the education goal discussed above. To achieve the education goal of Rs. 74 lacs after 17 years of Investment, let us see how much Investment is required if the rate of return on Investment is 10% and 12%.

	Annual Investment at a different rate of return		
	8%	10%	12%
Annual investment amount	**₹219,259**	**₹182,515**	**₹151,381**
Total investment to reach goal	**₹3,727,401**	**₹3,102,763**	**₹2,573,469**
Additional Total Investment required due to lower rate of return	**1,153,932**	**529,295**	**0.00**
Additional % of total Investment due to Rate of Return	**44.84%**	**20.57%**	**0%**

As shown in the above chart, at a 12% rate of return, the annual Investment required is 1.51 lacs, and the total Investment is 25.73 lacs. In contrast, at a 10% Rate of yearly Investment, the return required is Rs.1.82, and the Investment required to achieve the Goal is 31.02 lacs. So, at a 10% Rate of Return on Investment, investment increases by 5.29 lacs, which is 21% higher compared to an investment done at 12% rate of return. Similarly, in the case of 8% investment returns, the annual Investment is Rs. 2.19 lacs, and the total Investment to achieve the Goal is 37.27 lacs. So, at an 8% rate of return, one has to invest Rs. 11.53 lacs more to achieve the education goal compared to the Investment of return.

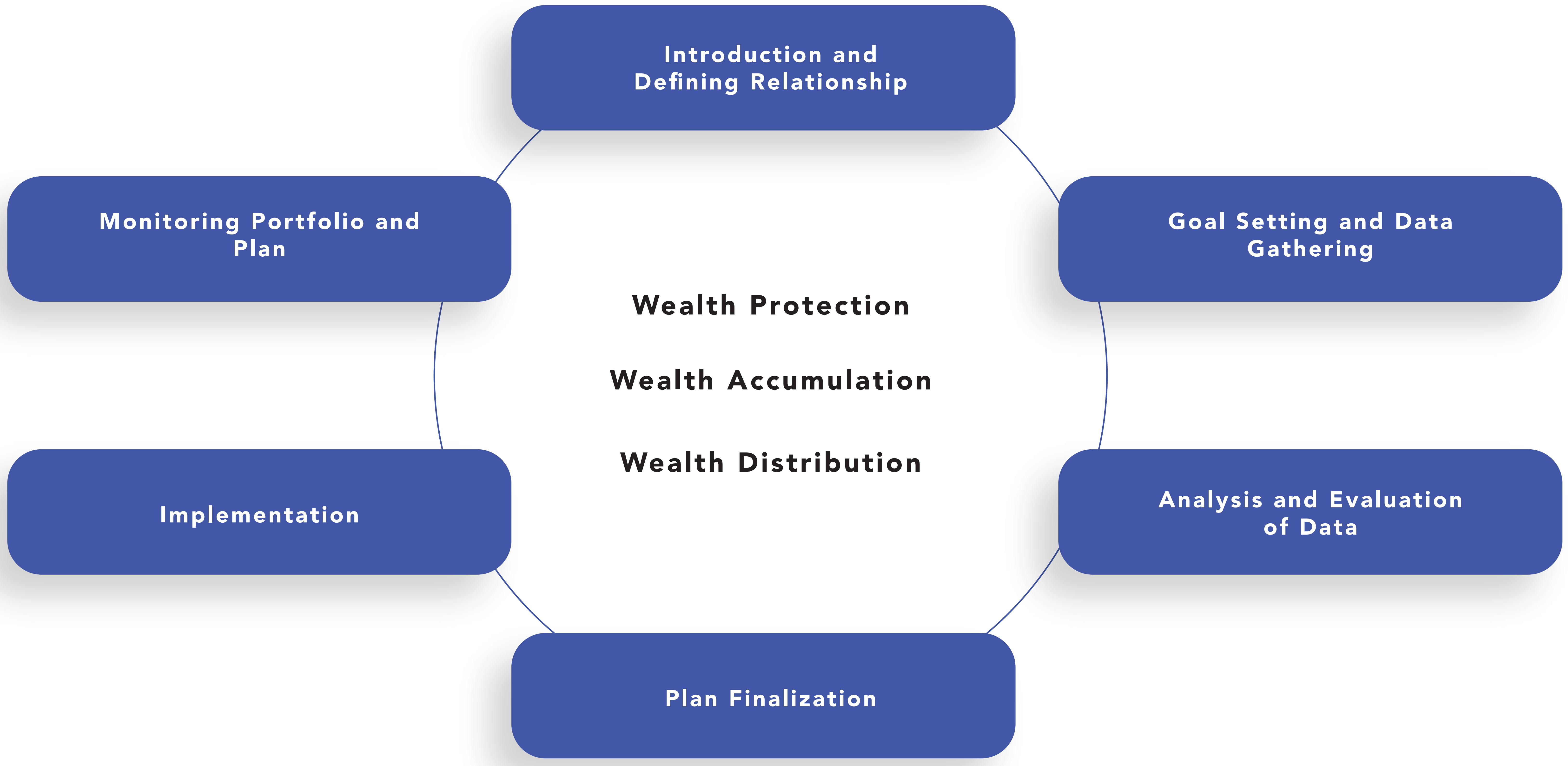
Now, you may have a question about achieving a 10% or 12% rate of returns. So, for your long-term goals, Inflation is the most significant risk, and to beat it, you should invest a part of your investment investments like Equity, which can give you higher returns, and then rebalance your portfolio between Equity and Debt. If you have an investment horizon of over five years, a significant part is invested in an equity-oriented mutual fund. Please remember to decide how much should be invested in Equity and how it should be rebalanced. You should take the help of a qualified financial planner.

Equity as an asset class contains the risk of volatility, but it helps you beat Inflation, and for your long-term goals, you should take the risk of volatility, not Inflation. For short-term financial goals, you should not take the risk of volatility. Most of the time, investors don't consider Inflation as a risk, which is a big mistake that they do.

To conclude, to fight Inflation, you have to earn high absolute returns and start investing as early as possible.

How does the Financial Planning Process work? And its Implications on the client's financial life.

The financial planning approach has a clearly defined six-step process to manage your financial life. The Financial Planning Standards Board of India defines this process. Every financial planner makes a few changes in this process as per their understanding and suitability. Here, we have discussed the process that we follow at our organization.


Introduction and Defining Relationship
Goal Setting and Data Gathering
Analysis and Evaluation of Data
Plan Finalization
Implementation
Monitoring Portfolio and Plan
Wealth Protection
Wealth Accumulation
Wealth Distribution

Step-1 Introduction and Defining Relationship:

This is a complementary meeting where the financial planner introduces himself to the client and defines the relationship between the client and the Financial Planner. Here, the Financial Planner defines his own roles and responsibilities, the roles and responsibilities of the client, what financial planning engagement will include, what the financial planner can do for the client, and most importantly, what the financial planner cannot do. This means it clarifies to the client what he should expect from this relationship and what he should not expect from it. Here, the financial planner will also explain his fee model, ease of charging, and other remunerations he will receive. So, this step sets the platform for a long-term relationship.

Step-2 Goal Setting and Data Gathering:

Once the client and planner agree on the first step to go ahead, the second step is goal setting and data gathering. This step is the foundation for clients' financial lives. People who avoid systematic financial planning commit mainly two mistakes. First, they never set clear goals for their financial life, and second, they never organize their financial data to bring it into one excel sheet or paper.

At this step, the planner sits with the client and their spouse and discusses what they want in their financial life. Here, financial planners try to bring clarity to their minds regarding their financial goals and how they want to approach them. Once the client is clear with his destinations (financial goals), it helps us (the Financial Planner) to choose the right direction and speed. After the goals are set, the planner will collect two data types. First quantitative and the other qualitative. Quantitative data is regarding clients' income, expenses, assets, and liabilities. Qualitative data relates to his health-related issues, investment experience, and approach toward money and other investments.

Step-3 Analysis and Evaluation of Data:

At this stage, the planner analyzes clients' data and tries to do his SWOT (Strengths, weaknesses, Opportunities, Threats) Analysis. Here, at Ascent, we make basic necessary assumptions and project his cash flow till his life expectancy (generally up to 90 years). Here, the planner analyzes where the client stands right now and where he wants to reach, and with the current level of income and investments, what the required rate of return to meet those goals. If the client is not able to meet the goals, the next step is to do a gap analysis and discuss with the client about prioritization of goals.

At this stage, risk profiling of clients is also done. Risk profiling is the process of deciding what percentage of a client's investment should be in aggressive asset classes like equity and real estate and what should be in conservative asset classes like bonds. Risk profiling helps to derive the optimum risk level for the client. This mainly depends upon three factors: his ability to take risks, his need to take risks, and his willingness to take risks. The client's ability and need are financial characteristics, whereas his willingness is a psychological characteristic.

Additionally, here at our organization, we also educate clients with one or two coaching sessions as required regarding the nature of different asset classes, asset allocation, how to manage risk, how compounding power affects their financial life and many other things.

Step -4 Plan Finalization:

At this stage, the planner will finalize the written financial plan. This is a road map for the financial life of a client. The final written plan includes a cash flow statement, contingency fund advice, ratio analysis, asset allocation advice, net worth analysis, analysis of different goals and current achievement levels, and recommendations on insurance as well as investment.

Once the financial plan is finalized, the planner helps the client complete his succession plan by writing the will.

Step-5 Implementation:

Mere planning does not give any results. So, in the fifth stage, the implementation of the plan is carried on. All the steps are taken as per the written financial plan, which is customized to the client's needs.

Step -6 Monitoring Portfolio and Plan:

Here, two types of monitoring are required. The first is at the portfolio level, and the second is at the plan level.

Portfolio Review: At this stage, the portfolio is reviewed at a regular periodic interval. For our clients, we review portfolios at least once a quarter. This includes a review of asset allocation as well as a performance review of financial products like mutual funds, etc. Also, execution is happening as per the plan or not is taken care of.

Plan Review: Whatever plan is made needs to be reviewed every year. So, at this stage, the planner sits with the client and reviews if there is any change in the client's circumstances or basic assumptions, based on which plan was made, then corresponding changes in the plan should be made.

To conclude, financial planning is a process and not an objective, so as shown in the above image, it continuously works and tries to achieve wealth protection, wealth accumulation, and wealth distribution for the client.

Now, those who have not adopted a financial planning approach should ask themselves whether they are doing all the steps like goal setting, analysis of their financial resources, portfolio review, and plan review. If not, they should seriously consider where their financial life is moving. Will they be able to meet their financial objectives comfortably?

5 Money Actions that can create disaster in your Financial Life.

Most of you have been reading my articles for quite a long time. I have written a lot on how you can organize your financial life. This time, I want to tell you what you should not do. Successful Financial life can be achieved by avoiding mistakes and adopting a disciplined approach towards your financial affairs.

The following five money actions will affect your financial life negatively, so I request you avoid these mistakes:

1.Investing without clear Goals: We are very clear on other aspects of our lives, but when it comes to investing, we are always very casual and need to be clear on objectives we want to achieve or destinations we want to reach. We need to define why are we investing? This is as good as leaving your house to go somewhere without knowing where you want to go so that you will be moving here and there without any clear direction. This is the most prominent mistake investors typically make because when you are investing without clarity of your goals, you don't even define your investment horizon, so you can not set a proper asset allocation. You can't select an appropriate product of investment for yourself. Suppose you want to invest Rs. 10 lakh, and you support this money to purchase a house after one year. Then you should invest all your money in debt (Fixed income instruments) instruments like Debt Mutual Funds and not Equity Mutual Funds because your investment horizon is too short. But if you invest this money for your daughter's accumulation of Higher Education, which is 15 years from now, you should invest more in Equity and less in Bonds. The first step to investing is knowing clearly about your goals and becoming clear about what you want from money. So, invest with clarity of goals.

2.Buying Life Insurance for Investment and Tax Planning: This is one of the biggest mistakes people make. Typically, investors prefer to purchase investment-oriented life insurance policies and will return the sum assured with an accumulated bonus or fund value at maturity. Other types of life insurance policies will provide you only life insurance during the policy period but won't give you back anything once the policy period is over, and the policyholder is alive. It seems wise to buy policies that will return you something, but it is not because these policies have lots of charges and don't give you sufficient returns. Also, a significant premium amount is committed for a few years. Against this, policies that provide you only life cover are called term plans and are relatively very cheap. One should buy a term plan for insurance and manage his investments separately. Keep insurance and investments separate. I have written an article on my blog for a detailed analysis of different policies, which you can refer to. Most life insurance policies are purchased in January, February, and March. I don't understand why. People buy life insurance to save taxes, which is disastrous.

3.Avoid Writing Will: Most people live their lives with the mindset that life will continue like this forever and they will not die. When we suggest our clients write their will, their first reaction is, "Am I that old that I should write my will now?" or "I am quite ok so that I will do this sometime later." They believe that only older adults die and that death is predictable. This is a wrong psychological belief.

In India, if one dies without writing a valid will, he is said to have died intestate, and in that case, his wealth will be distributed as per the succession law applicable to him. I have written an article on this topic on my blog, which you can refer to for details. Will is a simple and effective tool for succession planning that simplifies your wealth distribution process as per your wish after your death. So, I recommend all of you write your will as soon as possible. For this, read my "How to write your will?" article.

4.Spending more than what you Earn: Generally, this problem is more severe in the Western world. People in developed countries like the US and the UK are big-time consumers; some consume more than they earn and later face financial crises. But with the changing socio-economic structure in India, we find youngsters spending a lot, and the savings-to-income ratio is falling, which is a severe issue. I recommend you make your budgets and keep an eye on your spending. Give priority to your critical financial goals like retirement planning and the education fund for your children over luxuries like changing cars frequently or traveling during vacations to save more early in life.

5.Market Timing: This is the simplest thing you can do to destroy your wealth immediately. Market timing means predicting whether the market will go up or down from a particular point and changing your investment positions accordingly. Suppose, due to some news or prediction, you believe that in the next few months, Equity markets are going to go up. You invest all or most of your money in Equity and vice versa. This looks simple but is not possible, so don't try to do this because when you try to predict the movement of markets, you are trying to predict the movement of macroeconomic factors, which is impossible. So, keep yourself away from market timing and adopt Strategic Asset Allocation. For a detailed understanding of Strategic Asset Allocation, please read my article on this Strategic Asset Allocation: Backbone of your Portfolio.

Conclusion

To conclude, if you want to live a successful financial life and smoothly create wealth, avoid all the above mistakes. If you have any doubts, you can post me at **lohana_prakash@ascentsolutions.in**

Sukanya Samriddhi Account Vs. PPF Account, which one is more beneficial?

This scheme about whether they should open a Sukanya Samriddhi Account or a PPF Account for their Girl Child? and they also wanted to compare both schemes. So, the following are some points of comparison between both the schemes

Questions	PPF Account	Sukanya Samriddhi Account
Who can open?	Any Individual can open.	Only girl child below 10 years of age can open
Tenure of account	15 years	Can be closed on marriage of girl child. Can continue maximum upto 21 Years.
Maximum investment	Rs 1.5 lakh in a financial year	Rs 1.5 lakh in a financial year
Minimum investment	Rs. 500 in a financial year	Rs. 250 in a financial year
Interest rate for 2023-2024	7.1% p.a.	8.2% p.a.
Tax Benefit on deposit	Upto Rs. 1.5 Lakh U/S 80C	Upto Rs. 1.5 Lakh U/S 80C
Tax on interest	Interest is exempted U/S 10	Interest is exempted U/S 10
Can be continued after maturity?	Yes. For life time in a block of 5 Years.	Yes. But without fresh deposit.
Premature withdrawal allowed?	Yes. After completion of 6 Years of account.	Yes. But on completion of 18 Years of age of girl child.
Loan facility is there?	Yes. After completion of 2 Years of account.	Currently, loan facility is not available.

Both schemes have different features and should not be compared with each other. I recommend that all the parents whose daughters are eligible for a Sukanya Samriddhi Account open both a Sukanya Samriddhi Account and a PPF Account. All parents should make a clear plan for their daughter's higher education and marriage. Most of this provision should go to Equity through the MF route, as this investment is meant for the long term. However, the remaining part, which is to be invested in fixed-income schemes, should be divided between the PPF and Sukanya Samriddhi Account, and some part should be invested in debt funds for rebalancing between Equity and debt.

Sukanya Samriddhi Account A Blessing for your Girl Child.

Our Prime Minister, Mr. Narendra Modi, has launched the Sukanya Samriddhi Account Scheme to facilitate higher education and marriage expenses for Female children, and this is a movement to empower women in the country. Let us all understand the critical features of the Scheme.

Who can open Sukanya Samriddhi Account?

Only for Girl Child: Sukanya Samriddhi Account can be opened only in the name of a Girl Child until she attains the age of 10 years,

Natural or Legal Guardian: The account can be opened by a Natural Guardian (Father or mother) or a Legal Guardian. Where both the natural guardians have expired or cannot act, any person appointed as legal guardian by the competent authority can also open the account.

Only One Account for one Girl Child: A guardian can open and operate only one account in the name of a Girl child. This means a guardian can't open and use another account for the same girl child.

Maximum two accounts for two girls: Any natural or legal guardian can open two such accounts for only two girls.

Third Account for Third Girl Child: As an exception to the above rule, the third account is allowed only in the event of the birth of twin girls as a second birth or if the first birth itself resulted in three girl children. For this, the depositor (guardian) has to provide proof for the same.

Operation of Account:

Till the girl child attains the age of 10, a legal or natural guardian can open and operate the account, but once the girl child reaches ten years of age, she can also use the account.

Where can you open a Sukanya Samriddhi Account?

The account can be opened with the **Post office** or **any commercial bank** authorized to open this account.

Documents Required:

The birth certificate of the girl child is required. Address proof and identity proof of the natural or legal guardian who opens the account on behalf of the girl child are needed. Please note that address and identity proof of a girl child are not required.

How much amount can be deposited? And What can be the mode of Deposit?

Account Opening Deposit: The account can be opened with an initial deposit of Rs.1000; after that, any deposit in multiple of Rs. 50 with a maximum limit of Rs. 1.5 lakh.

Minimum Amount of Deposit: A minimum of Rs. 250 must be deposited in the account during a financial year. Where one fails to deposit the minimum amount of deposits in any financial year, the account can be regularized by depositing a Penalty of Rs—50 along with a minimum Deposit of Rs. 250 for every such year of irregularity.

Maximum Annual Deposit: During a financial year, a maximum of Rs. A total of 1.5 lakh can be deposited into the Sukanya Samriddhi Account.

How long can you Deposit? Deposits in Sukanya Samriddhi Account can be made till completion of 15 years from the date of opening of account.

Mode of Deposit: The Deposit in the Sukanya Samriddhi Account can be made Either in Cash or cheque or by demand draft and online transfer. In the case of a deposit through cheque, the date of credit of money in the account will be considered as the date of Deposit, and Interest will be calculated accordingly.

Interest Rate: Sukanya Samriddhi Yojana interest rate is fixed by the Government based on the yields provided by Government securities. The interest rate is also reviewed every quarter. The Sukanya Samriddhi Account interest rate, once fixed, does not change. Sukanya Samriddhi Yojana interest rates 2024 is 8.2% per annum.

Interest Compounded & Credited Annually: Interest will be calculated on an annual compounded basis and credited to the account every year.

Interest After Maturity of Account: If the account is not closed after maturity, the balance will continue to earn Interest as specified for the Scheme from time to time -

Tenure of the Account:

- Deposits in the Sukanya Samriddhi Account can be made till the completion of 15 years from the date of opening of the account.
- The account shall mature on completion of 21 years from the date of opening.
- If the girl child gets married before the completion of 21 years from the opening date, she can close the account and earn money deposited along with the Interest. In such cases, she has to provide the affidavit that she is at least 18 years of age on the account's closing date.
- If she doesn't close her account at the time of marriage, it will continue to earn Interest in the same manner mentioned earlier.

Premature Closer: Premature closer of the account is allowed only in the following two cases.

- In case of the **death** of the Girl Child, the account has to be closed, and in such circumstances, it will fetch Interest till the preceding month of the premature closer of the account.

- Where the Central Government is satisfied that the operation or continuation of the account is causing undue hardship to the account holder, it may, by order, for reasons to be recorded in writing, allow premature closure of the account only in cases of extreme compassionate grounds such as medical support in life-threatening diseases, death, etc.

Withdrawal from the Account:

Withdrawal from the account is allowed only after the girl child is 18 years of age. Withdrawal of 50% of the balance at the credit in the preceding year is permitted.

Withdrawal is allowed only to meet financial requirements during Marriage and Higher Education.

Withdrawal is not permitted for any other reasons.

Transfer of account:

The account may be transferred anywhere in India if the girl child in whose name the account stands shifts to a place other than the city or locality where the account stands.

Tax Implications:

- A subscription made to the Sukanya Samriddhi Account is eligible for deduction from U/S 80 C of the Income Tax Act 1961 up to Rs. 1.5 lakh.
- Both Interest and maturity in the Sukanya Samriddhi Account will be exempted entirely from tax U/S 10 of The Income Tax Act.

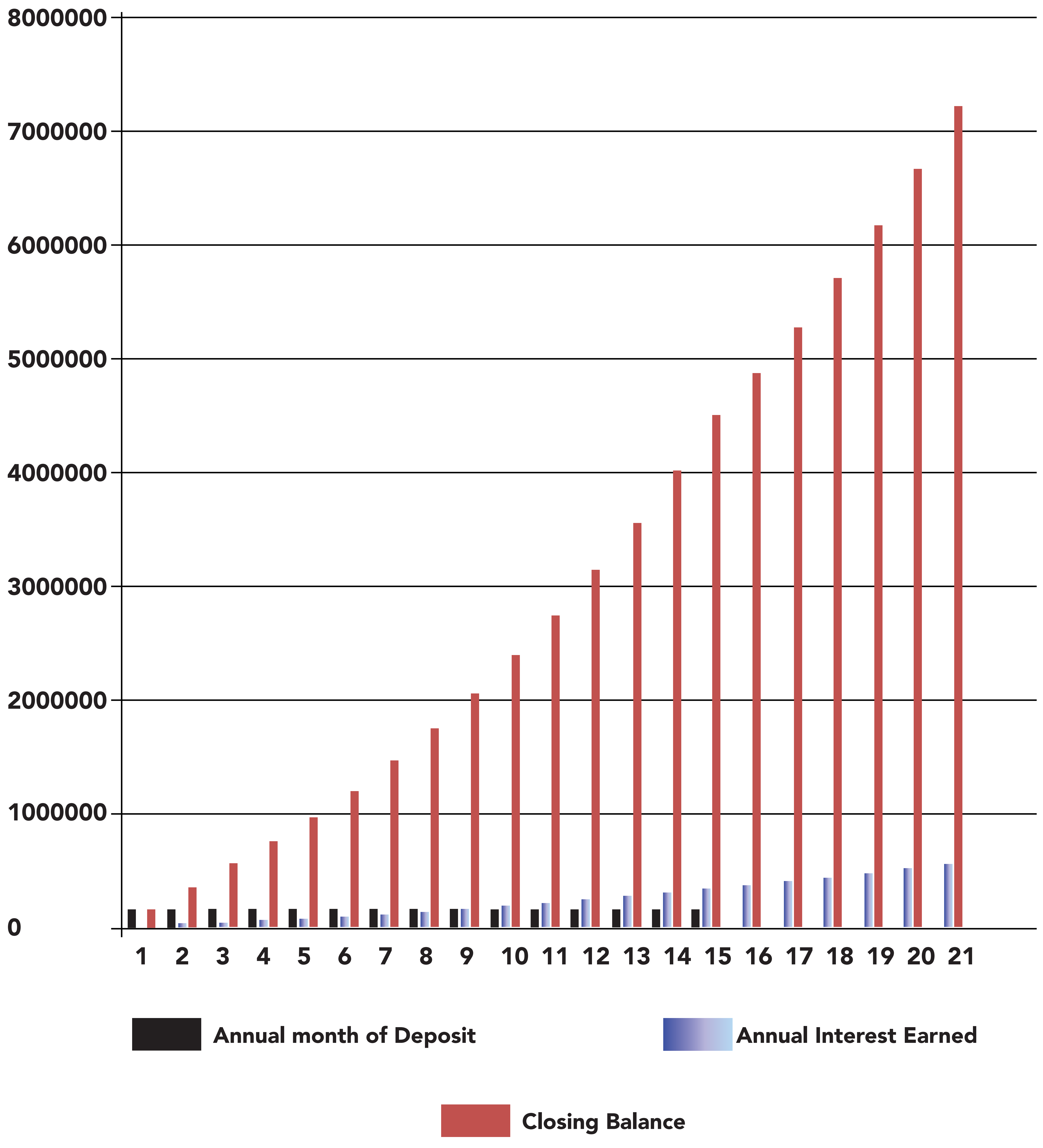
Illustration of Investment:

Below, I have given an illustration through a table and chart to explain how you can accumulate for your daughter by opening a Sukanya Samriddhi Account. To simplify the calculation, I have made the following assumptions.

1. You open the account on the same day your daughter is born.
2. You open an account with an initial deposit of Rs. 1.5 lakhs and keep depositing the same amount on the first day of every new year for the next 15 years.
3. The interest rate is assumed to remain at 8.20% p.a. and constant throughout the account term.
4. The account is closed at the end of the 21st year per the rules

Now, look at the following chart and table. Your maturity value will be around Rs.71.80 lakhs. Look at the chart, which shows you your Annual Amount of Deposit, Interest Earned, and Closing balance at the end of the year.Annual Interest earned is more than the Annual Deposit amount from the end of the 8th year of account opening.

Year	Age	Amount of Deposit	Interest Earned	Closing Balance
1	0	150000	12300	162300
2	1	150000	25609	337909
3	2	150000	40009	527917
4	3	150000	55589	733506
5	4	150000	72448	955954
6	5	150000	90688	1196642
7	6	150000	110425	1457067
8	7	150000	131779	1738846
9	8	150000	154885	2043732
10	9	150000	179886	2373618
11	10	150000	206937	2730554
12	11	150000	236205	3116760
13	12	150000	267874	3534634
14	13	150000	302140	3986774
15	14	150000	339215	4475989
16	15		367031	4843020
17	16		397128	5240148
18	17		429692	5669840
19	18		464927	6134767
20	19		503051	6637818
21	20		544301	7182119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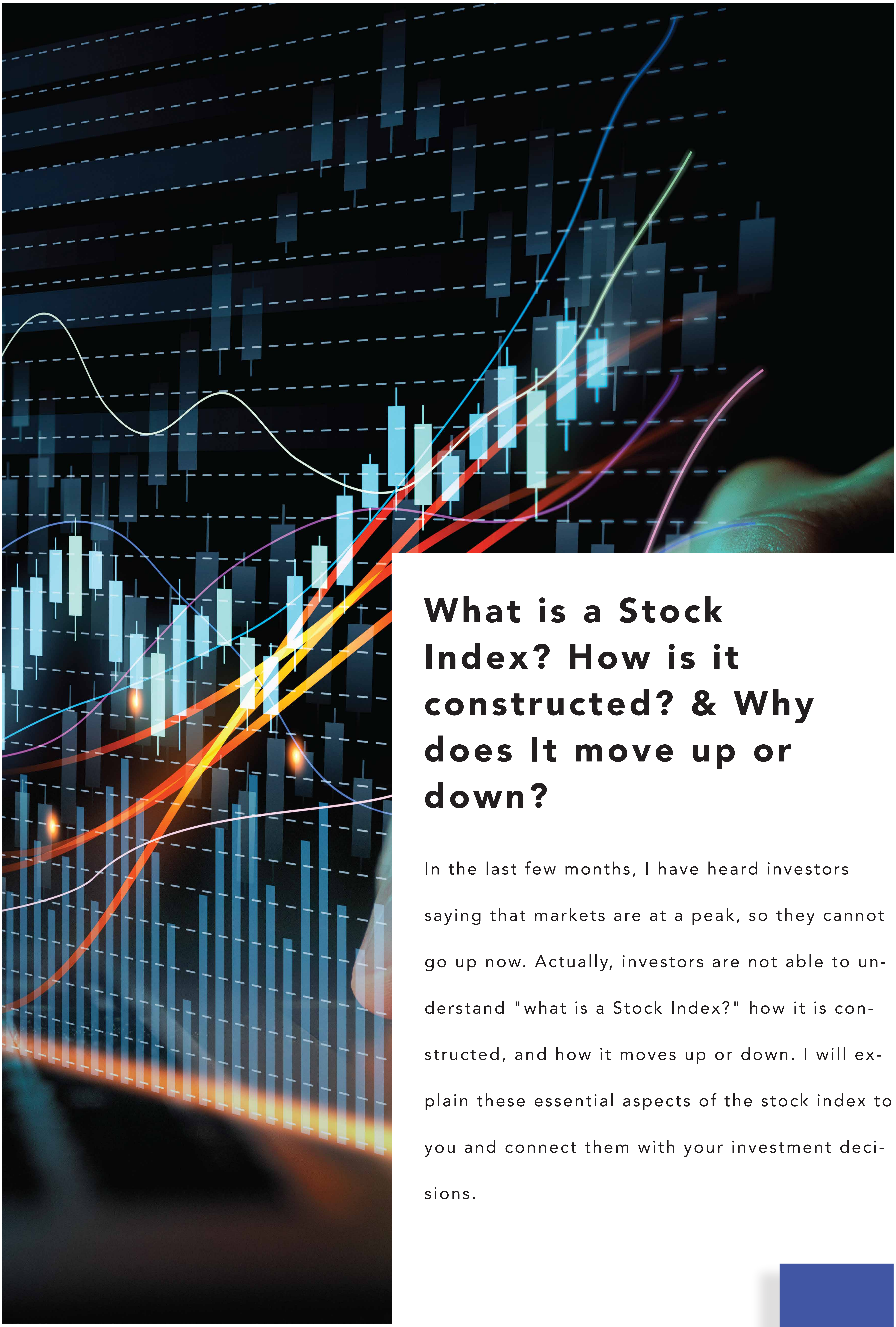
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21
Annual month of Deposit
Annual Interest Earned
Closing Balance



What is a Stock Index? How is it constructed? & Why does It move up or down?

In the last few months, I have heard investors saying that markets are at a peak, so they cannot go up now. Actually, investors are not able to understand "what is a Stock Index?" how it is constructed, and how it moves up or down. I will explain these essential aspects of the stock index to you and connect them with your investment decisions.

What is a Stock Index?

An index is a statistical measure of the changes in a portfolio of stocks representing a portion of the overall market. To simplify, suppose there are 100 companies in exchange, and you want to track the overall performance of those 100 companies. Then, you can create an index of those companies that starts with a certain base value, and the movement of this base value gives you an idea about the overall performance of these companies.

Example of Stock Index:

For example, if we want to track changes in the values of company A, company B, company C, and company D., we can construct an Index called Index ABCD.

	Price	Number of Shares	Market Cap	Weightage
Company A	**15**	**1000**	**15000**	**15%**
Company B	**20**	**1000**	**20000**	**20%**
Company C	**25**	**1000**	**25000**	**25%**
Company D	**40**	**1000**	**40000**	**40%**
Total Market Capitalization			**100000**	

The above chart shows that all four companies have different prices and 1000 shares outstanding. So, market capitalization (Market Capitalization = Total Outstanding Shares x Market Price of the Share) is the company's Total Market Value. Then, the Index will start from 100(The base of the Index is 100). For example, as shown in Table 2, on day one, the price changes as companies A, B, and C's prices go up, but Company D's prices fall by 10%. So, in totality, the Index falls by 1% and becomes 99 from 100 because the impact on the total value of market capitalization is -1%.

	Price	No. of shares	Market Cap	Weightage	% Change	
Company A	**16**	**1000**	**16000**	**16%**	**7%**	▲
Company B	**21**	**1000**	**21000**	**21%**	**5%**	▲
Company C	**26**	**1000**	**26000**	**26%**	**4%**	▲
Company D	**36**	**1000**	**36000**	**36%**	**-10%**	▼
Total Market Capitalization			**99000**		**-1%**	▼

In simple words, a stock index gives you an overall idea of where the prices of stocks are moving, but when a stock index has gone up, it doesn't mean that all the companies in that Index have gone up.

Now, let us understand two major indices in India; Sensex and Nifty.

Sensex: Sensex is an Index of 30 large companies in India listed on the Bombay Stock Exchange. It is the oldest Index of India and is calculated on the weight of "Free Float Market Capitalization." Free Float Market capitalization excludes the shareholding with the management. For example, there are 1 lakh outstanding shares of the company out, of which 30% are owned by management itself, so free float market capital is only 70 thousand shares. So, Sensex is constructed based on free-float market capitalization. Sensex was started in 1978-79 with the Base value of 100. Sensex is trading at around 72,455 as on 29th Feb, 2024.

Below is the current constitution of Sensex. Sensex is broadly used as an indicator of the Indian economy. Market Price updated as on 29th Feb, 2024

Sr. No.	Script Name	Market Price
1	Asian Paints Ltd	2817.25
2	Axis Bank Ltd	1070.05
3	Bajaj FinanceLtd	6494.00
4	Bajaj Finserv Ltd	1591.30
5	Bharti Airtel Ltd	1115.65
6	HCL Tech Ltd	1661.75
7	HDFC Bank Ltd	1403.15
8	Hindustan Unilever	2414.00
9	ICICI Bank Ltd	1055.05
10	Indusland Bank	1457.95
11	Infosys Ltd	1666.00
12	ITC Ltd	408.45
13	JSW Steel Ltd	801.15
14	Kotak Mahindra	1684.25
15	Larsen and Tourbo	3466.00
16	Mahindra & Mahindra	1947.20
17	Maruti Suzuki	11254.05
18	Nestle Ltd	2581.45
19	NTPC Ltd	334.35
20	Power Grid Corp	279
21	Reliance Ltd	2917.35
22	State Bank of India	745.35
23	Sun Pharmaceutical	1569.60
24	Tata Motors	951.55
25	Tata Steel	141.05
26	Tata Consultancy	4093.30
27	Tech Mahindra	1276.55
28	Titan Company	3619.40
29	Ultra Tech Cement	9847.05
30	Wipro Ltd	518.05

Nifty: Nifty is the Index representing 50 large companies traded on the National Stock Exchange. It is also calculated similarly and with Free Float Market capitalization. Nifty was started in 1995 with a Base value of 1000. Following is the current constitution of Nifty. Market Price updated as on 29th Feb, 2024.

Sr. No.	Script Name	Market Price
1	Adani Enterprise	3258.90
2	Adani Ports	1311.55
3	Apollo Hospitals	6094.80
4	Asian Paints	2811.10
5	Axis Bank	1073.15
6	Bajaj Auto	7911.35
7	Bajaj Finance	6460.05
8	Bajaj Finserv	1584.25
9	Bharat Petroleum	605.20
10	Bharti Airtel	1160.10
11	Britannia Industries	4943.50
12	Cipla Ltd.	1479.10
13	Coal India Ltd.	435.00
14	Divi's Laboratories	3477.10
15	Dr. Reddy's	6417.35
16	Eicher Motors	3798.30
17	Grasim Industries	2185.25
18	HCL Technology	1661.00
19	HDFC Bank	1403.25
20	HDFC Life Insurance	581.10
21	Hero MotoCorp	4409.50
22	Hindalco Industries	501.85
23	Hindustan Unilever	2412.05
24	ICICI Bank	1050.80
25	Indusland Bank	1469.85
26	Infosys Ltd	1661.85
27	ITC Ltd.	405.95
28	JSW Steel Ltd.	796.80
29	Kotak Mahindra	1693.75
30	Larsen & Toubro	3464.30
31	LTIMindtree Ltd.	5278.20
32	Mahindra&Mahindra	1940.95
33	Maruti Suzuki	11251.00
34	Nestle India	2589.00
35	NTPC Ltd.	335.20
36	Oil & Natural Gas	263.25
37	Power Grid Corp.	279.55
38	Reliance Industries	2935.00
39	SBI Life Insurance	1541.65
40	State Bank of India	746.25
41	Sun Pharmaceutical	1567.10
42	Tata Consultancy	4095.95
43	Tata Consumer	1184.75
44	Tata Motors	951.20
45	Tata Steel	140.55
46	Tech Mahindra	1268.25
47	Titan Company	3595.55
48	UltraTech Cement	9832.70
49	UPL Ltd.	469.70
50	Wipro Ltd	514.80

Many other stock indices, like BSE 100, BSE Midcap, etc., are run by the Bombay Stock Exchange or the National Stock Exchange.

Why do stock Indices go up or down?

Stock Indices can go up or down due to changes in the prices of shares falling in that Index. If, on a particular day, the total market capitalization of that Index has fallen, the Index will fall, but it doesn't mean that the prices of all the companies have fallen. There may be some companies where prices have increased, so it also represents the overall movement of market capitalization, not individual stocks.

"Sensex and Nifty are at peak, so they cannot go up further." It is a joint statement by investors, which is wrong. Now, the Index can go up when share prices are going up, and the total market capitalization of the Index is growing. Why share prices can go up more and more is explained in one of my earlier articles, "What is Equity? And Why do share Prices move up or Down?"

Conclusion

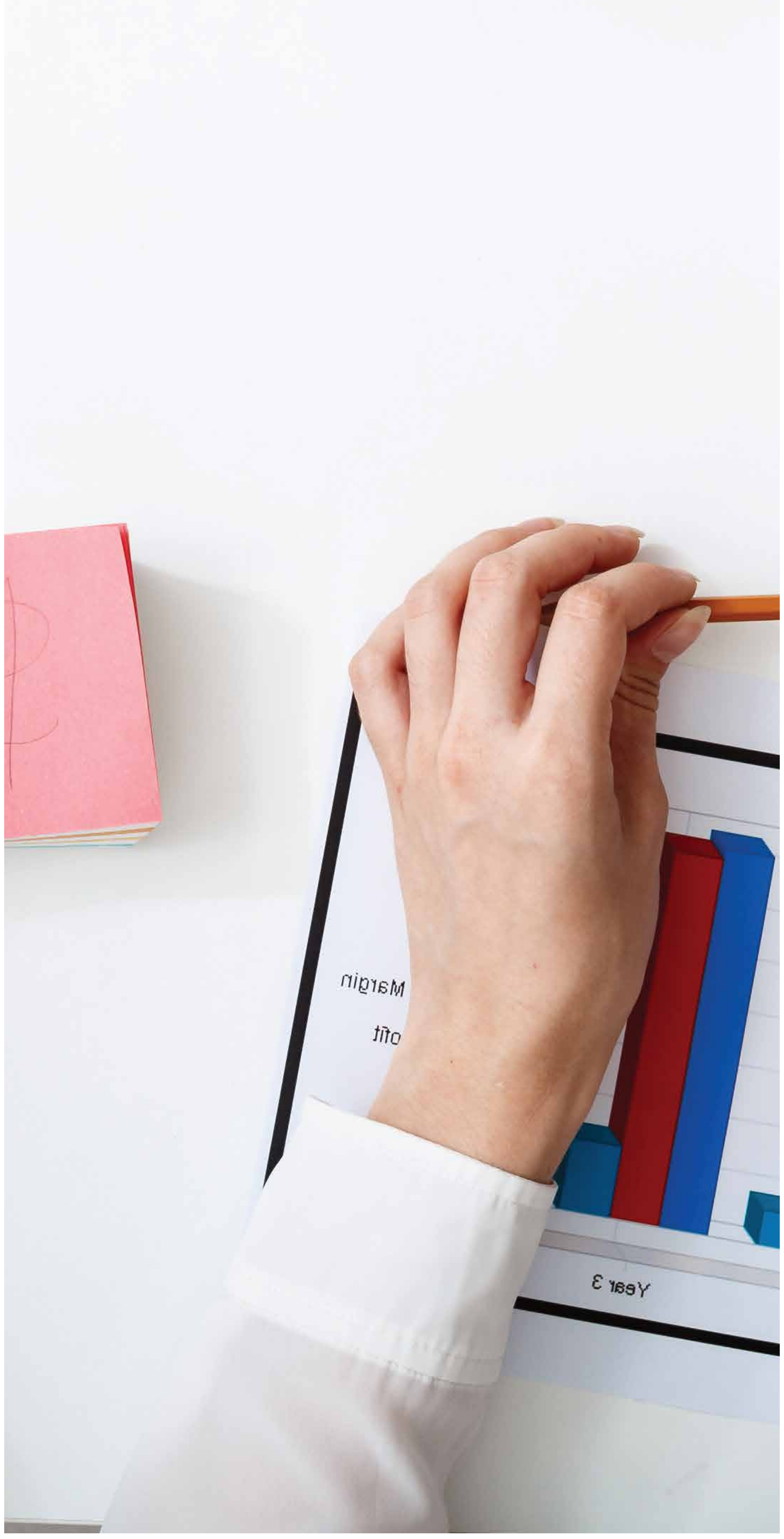
To conclude, indices can go to any level because our economy is continuously growing, and profits of the companies are also continuously increasing, so in turn, share prices will also increase, and finally, this will result in rising stock indices like Sensex and Nifty. As discussed above, Sensex has moved from 100 in 1979 to 72,279.72 in 2024. Rs. 1 lakh invested in Sensex in 1979 have become Rs. 7.22 crores. So, investors should never keep a prejudice that stock indices are at a peak and will not go up from here. They should focus on whether the companies' economy and profits are growing or not. If the answer is yes, then indices will go up.

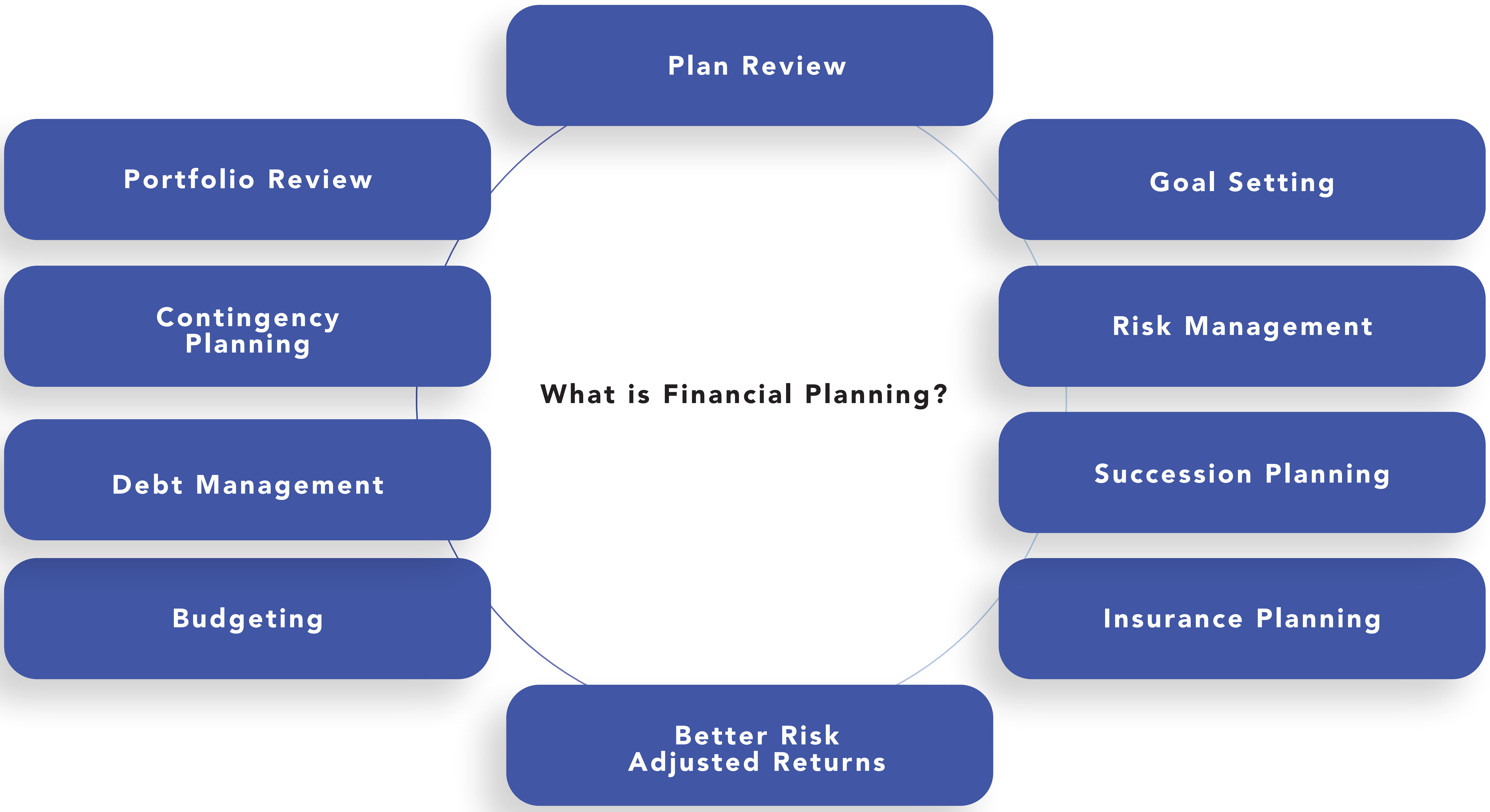
63.772
69.928
70.111
44.870
20.556
26.417
31.012
48.991
12.002

What is Financial Planning?

Financial Planning is a terminology most commonly used as a synonym for investment planning or management and is widely misutilized in India. Every investor believes he is doing his financial planning either on his own or through some life insurance agent or mutual fund distributor who looks like a financial advisor. However, he is a distributor of financial products. This article is an effort to explain what Financial Planning is. And how is it beneficial to investors?

"Financial planning is meeting your life goals through available resources in the best possible manner."




Plan Review
Portfolio Review
Goal Setting
Contingency Planning
Risk Management
What is Financial Planning?
Debt Management
Succession Planning
Budgeting
Insurance Planning
Better Risk Adjusted Returns

Let us first understand this in detail.

A Systematic Process: Financial planning is a six-step process, a systematic series of actions to organize and manage financial affairs. The Financial Planning Standards Board of India defines this Process.

Your Life Goals: The entire focus of the financial planning process is on meeting your Life Goals like Retirement Planning, Higher Education Fund planning for your children, etc. As against this, the traditional investment approach never focuses on life goals. It only focuses on financial products.

Available Resources in the Best Possible Manner: Financial planning focuses on the optimization of your current resources and future resources to meet your life goals. Financial planning always aims at optimization, not maximization, because maximization means maximum risk. Now, you may not need to take that much risk, and it may lead to losses in your investment. Let us take a simple example: Suppose you are traveling from your office to home, and the distance is 10 km, and you have sufficient time, say you have 1 hour to reach, now will you drive at a higher speed in a crowded area? No. But say someone is suffering from a heart attack and you have to reach the hospital as soon as possible. Now, you will try to drive at a higher speed. Similarly, you must check how much risk you should take to meet your life goals; if you are meeting your goals efficiently with available financial resources, why should you take a higher risk when you can avoid it? All these aspects are thoroughly taken care of in financial planning.

How does financial planning benefit you?

Now let us understand How Financial Planning benefits you.

1.Moving towards your Destinations: Financial Planning helps you reach your financial goals. Once the client decides to go for Financial Planning, the first step is to decide on goals. Goals are like the station you want to reach, and you also determine when you want to get to, so now you can decide on mediums like going by road or train or by air. Goals are divided into two categories: primary goals like Home, Child Education fund Planning, and Retirement Corpus Planning, and other luxury goals like Farmhouse, Luxury trips, etc.

Whenever I meet new clients or prospects, I ask about their goals or when I ask them why they have made existing investments. The answer that I get is that they have made investments, but they are not clear about their goals and objectives. It is like I am already traveling on a train but don't know my destination, where I must reach, or why I selected this train.

2.Helps control unwanted expenses: Budgeting is an essential part of financial planning. Usually, people avoid making budgets, but in my opinion, it is vital because once you make a budget, you come to know where you spend your hard-earned money and areas in which you can save some cash or which areas you should stop spending money. This helps you increase your current savings and, in turn, enables you to reach your goals early. After making a budget, you can compare it with actual expenses, analyze the gap, and take corrective actions.

3.Better Risk Management and Risk-Adjusted Returns: Normally, without financial planning, investors focus on returns, not risk. In contrast, financial planning has inbuilt risk management strategies, which help investors achieve better risk-adjusted and optimize their resources.

4.Stops from making mistakes: This is the most critical area where financial planning and financial planner helps the client. When a client is making his decisions on his own, he cannot analyze or understand the implications of his decisions beyond a certain level and beyond a certain time frame, whereas an experienced and qualified financial planner can easily understand the implications, and that's why he will always protect the client from making such mistakes. Financial Planning is being said to be more of an art than a science.

In Personal Finance, it is important to know what to do, but it is more important to know what not to do. An experienced and qualified Financial Planner can help you with this aspect.

5.Succession Planning: Indians are very careless about their succession planning. I hardly meet anyone who has prepared his will or even decided how he wants to distribute his wealth if he is not there. Succession planning is a significant part of financial planning, and a qualified and experienced financial planner can prepare an effective succession plan for the client. This can help the client in two ways. First, it avoids family disputes regarding the distribution of assets upon the death of a family member, and second, it ensures the smooth distribution of wealth as per the client's wish.

6.Saves at the Time of Unfortunate Events and Financial Crisis: Insurance Planning is integral to the entire Financial Planning Process. Events like the early death of the breadwinner, high medical expenses or disability, critical illness, damage to assets due to earthquake, fire, flood, etc., affect the family's financial stability and disturb the financial goals. However, if an insurance plan is designed correctly to handle all these events, these events will not affect the family's financial goals.

The financial plan and Insurance Plan work together in a parallel way. If there is any disturbance in the Financial Plan due to any uncertain events, the insurance plan will come forward and maintain the stability of the financial plan.

Another important aspect of Financial Planning is providing a contingency fund. The contingency fund is provided for medical uncertainties, uncertain job losses, or any uncertainties in the business or profession of the client. Usually, expenses for 6 to 12 months are kept in a savings account to be withdrawn quickly whenever needed.

Liability management is a grossly ignored area in investor's financial affairs. Financial Planning helps the clients in liability management basically in two ways:

1. When a client has to take a fresh loan, he doesn't know how to calculate interest, the tax implication of interest paid, how to compare two loan products of different banks, etc. As a result, he accepts whatever the banker tells him. But an experienced and qualified financial planner can help him with all these aspects effectively and save lots of money.

2. Sometimes, I meet clients who have already taken more than one loan at high interest rates, and all loans are at different interest rates. In this type of case, restructuring between all other loans and assets can save many interest costs.

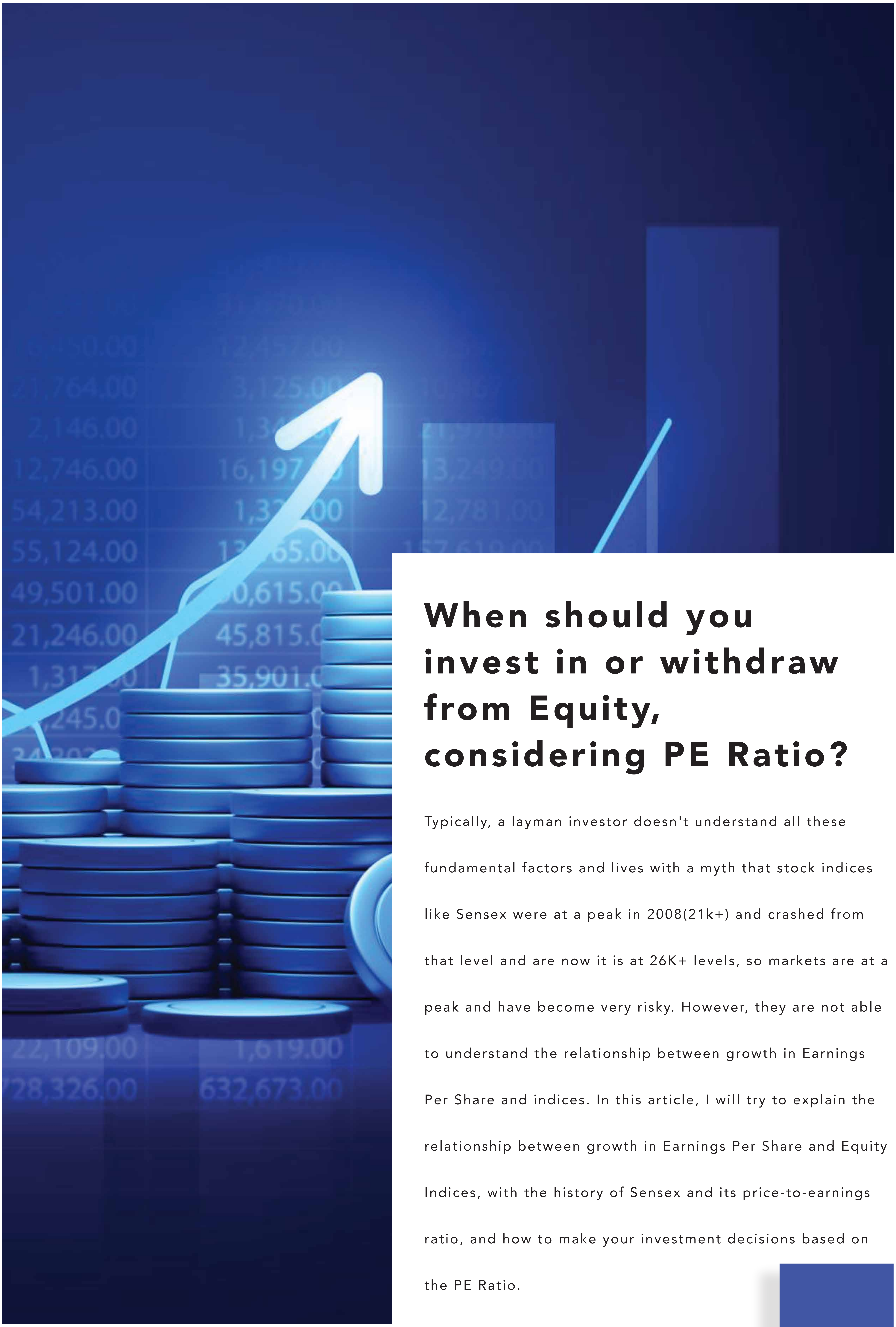
8.Portfolio and Plan Review:

Portfolio Review: Normally, investors, after making investments, never review their portfolios. Portfolio review is an integral part of the financial planning process, so in the financial planning approach, client's portfolios are reviewed regularly, like quarterly, half-yearly, or at least annually. A portfolio review involves a review of asset allocation and financial products in which investments are made.

Annual Plan Review: A financial plan made once doesn't hold good for a lifetime. So, inventors need to review their financial plans every year. Annual review is also an integral part of the financial planning process. In the yearly review, the financial planner reviews the client's income, expenses, assets, and liabilities, and he also reviews the portfolio's performance. Here, the client understands whether he is moving in the right direction and at the right speed.

Conclusion

Financial planning is a broad solution that keeps your financial life on track and helps you achieve your financial goals quickly. Most importantly, it is a general concept against investment management, which focuses on managing your net worth and not only your investment. Apparently, Financial Planning looks like a very simple concept, and you may not realize the benefits in the first instance, but it is a detailed process that keeps your financial life on track. In my next article, I will write about the financial planning process and how it differs from the traditional investment approach.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When should you invest in or withdraw from Equity, considering PE Ratio?

Typically, a layman investor doesn't understand all these fundamental factors and lives with a myth that stock indices like Sensex were at a peak in 2008(21k+) and crashed from that level and are now it is at 26K+ levels, so markets are at a peak and have become very risky. However, they are not able to understand the relationship between growth in Earnings Per Share and indices. In this article, I will try to explain the relationship between growth in Earnings Per Share and Equity Indices, with the history of Sensex and its price-to-earnings ratio, and how to make your investment decisions based on the PE Ratio.

For a better understanding of this article, I would always recommend you to read two of my earlier articles: one was on **"What is Equity? and Why Share Prices Move Up or Down?"** and another was on **" What is a Stock Index? How it is constructed? and Why it moves up or down?".**

Let us first understand Earnings Per Share to understand Price to Earnings Ratio.

Earnings Per Share (EPS): First, understand this with a simple example. For instance, there is a company that has issued 100 shares and has earned a net profit of Rs. 1000. In this case, the Earning per Share would be Rs. 10 (Earning per Share = Net Profit / No. of Shares issued)
Similarly, Sensex is an index of 30 large companies in India. Earnings Per Share of Sensex is arrived at by dividing the net profit of these 30 companies by the total number of shares of these 30 companies combined. Nifty is an Index of 50 large companies in India, and the EPS of Nifty is arrived at by dividing the net profit of 50 companies by the total No. of Shares of these 50 companies combined together.

Price to Earnings Ratio: Price to Earnings Ratio is the Ratio that reflects the relationship between the market price of the share and Earnings per share of the company. It is arrived at through the following formula.

$$\textbf{PE Ratio} = \frac{\text{Market Price of Company's Share}}{\text{Earnings per share of the Company}}$$

The price-to-earnings ratio is an indicator of the valuation of the company. It gives you an idea of whether the company is available at cheaper valuations or costly valuations. Let me explain with an illustration.
There are two companies, Company A and Company B. Both are in the same industry, and the following is the chart of their data

Description	Company A	Company B
Market price of shares	100	200
Earning per share	10	25
PE Ratio	10	8

Looking at the above table, at first instance, it seems like company A is cheaper because its share is available at Rs. 100. And company B's share is available at Rs. 200, so a layman investor would jump up and buy the Shares of the company A considering that he is buying a cheaper company. But look at EPS.

Company B's EPS is Rs. 25 whereas Company A's EPS is Rs. 10 only, so the PE Ratio of Company B is eight times, and it is lower than Company A's, which is ten times. This indicates that your return on investment is 12.5% (25/200= 12.5%) for company B and for company A, it is 10% (10/100= 10%), so if other factors are the same, which company's share would you like to buy now? Company A is expected to give you a 10% return on your investment, or company B is expected to give you a 12.5% return on your investment.

You can also look at the PE Ratio like this. If you buy company A with Rs. 10 EPS at Rs. 100 per share, you are paying the price of ten years of profit for company A. If you are buying company B with Rs. 25 EPS at Rs. 200 per share, you are paying the price that is eight years of profit for company B, so which one should you buy now?

Lower the PE Ratio, better it is: From the above discussion, one point you should understand clearly is that the lower the PE Ratio, the better it is, so you should buy stocks when they are available at a lower PE Ratio, and you should look at the PE Ratio for a comparison between two companies of the same industry and not the price on standalone basis.

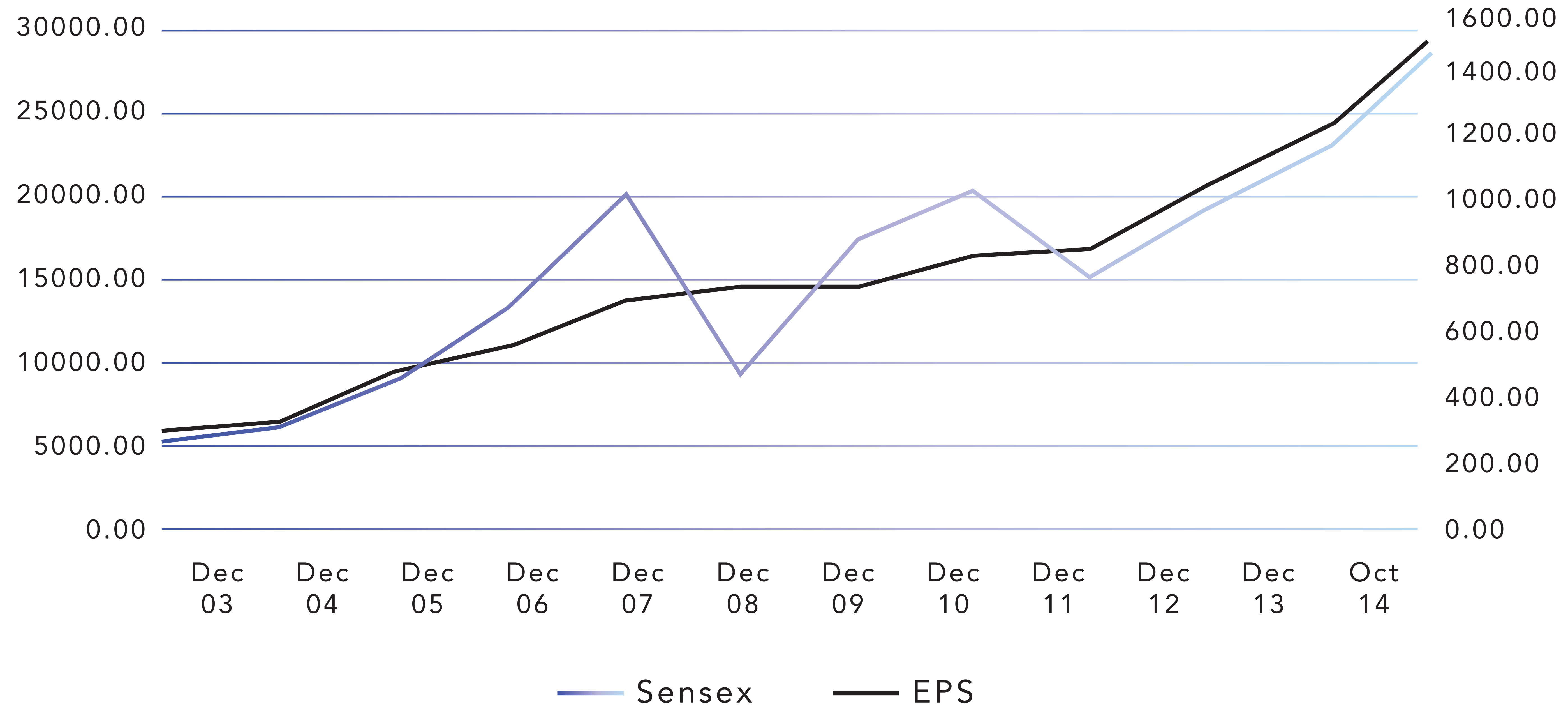
PE Ratio of Sensex and essential lessons: While calculating the PE Ratio for any index like Sensex, we have to take the value of the Index and divide it by the sum total of EPS of all the companies in that Index. Usually, the PE Ratio of Indices like Sensex and Nifty is given on the BSE and NSE websites, respectively.

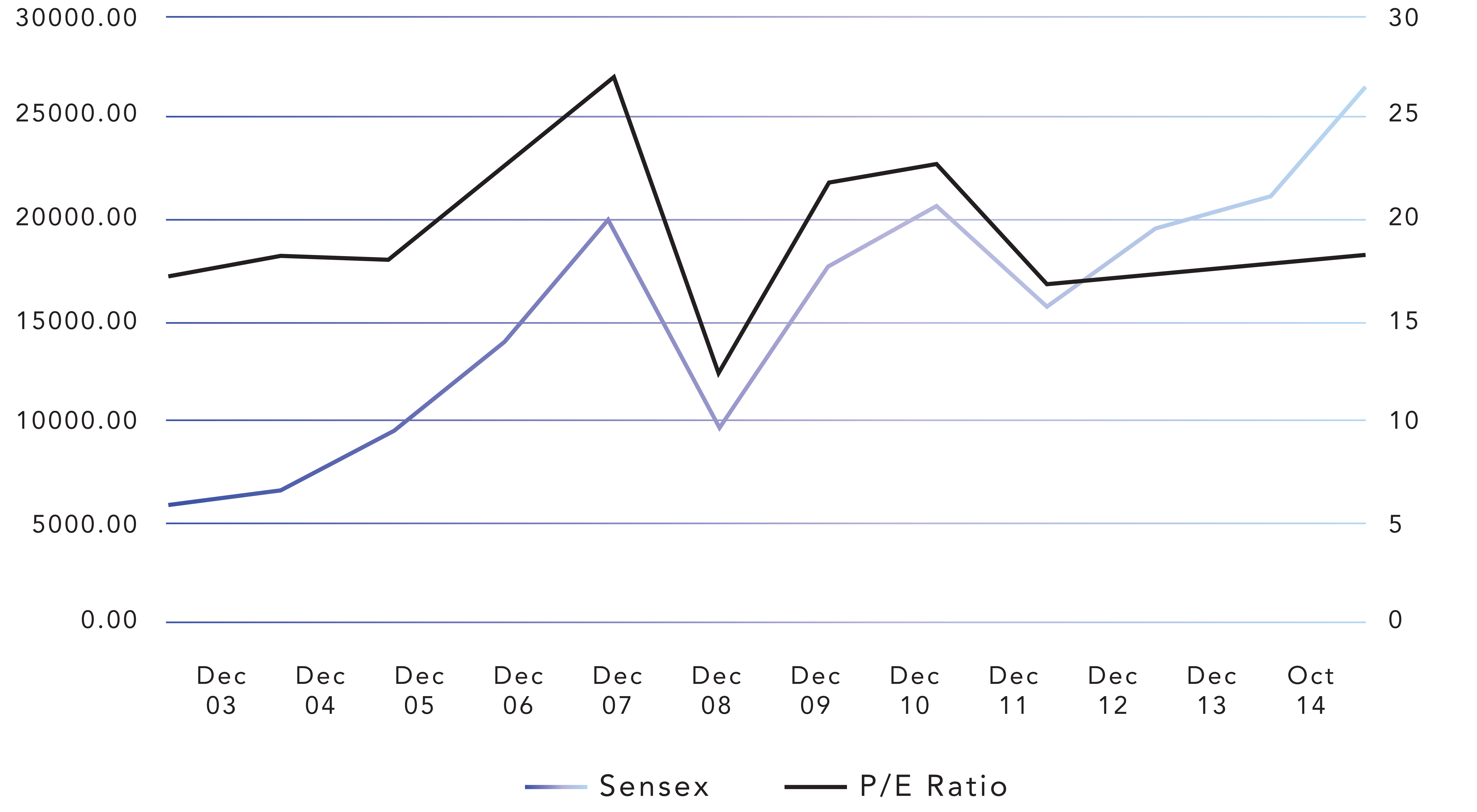
Why you should look at the PE Ratio of the Index: Normally, a layman investor keeps looking at Index value and tries to judge whether it is cheap or costly. This is a wrong way to feel things because whether the Index is cheap or expensive should be considered from its Earnings per share. For a better understanding, look at the table below:

Date	Closing Sensex	PE Ratio	EPS	% Rise in EPS	% Rise in Sensex	% Change in Sensex due to EPS change	% Change in Sensex due to Sentiments
Dec-03	5838.96	17.30	337.51	NA	NA	NA	NA
Dec-04	6602.69	18.15	363.78	7.78%	13.08%	7.78%	5.30%
Dec-05	9397.93	18.07	520.08	42.97%	42.33%	42.97%	-0.63%
Dec-06	13786.91	22.51	612.48	17.77%	46.70%	17.77%	28.94%
Dec-07	20286.99	26.94	753.04	22.95%	47.15%	22.95%	24.20%
Dec-08	9647.31	12.16	793.36	5.35%	-52.45%	5.35%	-57.80%
Dec-09	17464.81	21.82	800.40	0.89%	81.03%	0.89%	80.15%
Dec-10	20509.09	22.80	899.52	12.38%	17.43%	12.38%	5.05%
Dec-11	15454.92	16.92	913.41	1.54%	-24.64%	1.54%	-26.19%
Dec-12	19426.71	17.43	1114.56	22.02%	25.70%	22.02%	3.68%
Dec-13	21170.68	17.78	1190.70	6.83%	8.98%	6.83%	2.15%
Oct-14	26349.33	18.24	1444.59	21.32%	24.46%	21.32%	3.14%

In the above table, I have taken data from Sensex, its PE Ratio, and EPS calendar year-wise, from Dec-2003 to Dec-2013 and at last for Oct-2014. Then, column E and column F give us a Rise in EPS and a rise in Sensex in percentage terms, respectively. After that, column G shows a percentage change in Sensex due to a change in EPS, and column H shows a percentage change in Sensex due to sentiments.

Fundamentally, Sensex or any indices should grow or fall over a long period due to changes in EPS. However, over the short term, news and sentiments also play an essential role, so in the above table, you will see that in 2006 and 2007, EPS grew by 17.8% and 23%, respectively, as Sensex increased by 46.7% and 47.1%. So, Sensex has grown faster than the EPS, which is fundamentally wrong and reflects the positive sentimental impact. As a result, you can see that the PE Ratio increased around 18 times in Dec-2005 and reached 26.94 in Dec-2007. This indicates that markets were overvalued in December 2007. But sentiments cannot drive the markets for an extended period, so in 2008, EPS slowed down and grew by 5.4%, but Sensex fell by 52.4%, and the PE Ratio fell to 12.16 times in December 2008 and became relatively cheaper. Now retail investors they invested at a peak level in 2007 but did not at the bottom levels of 2008.





Now look at the above two graphs; Graph A reflects the relationship between EPS and Sensex from December 2003 to October 2014. It clearly indicates that EPS has kept on growing slowly without much fluctuation. Sensex has grown at the same pace over the same long-term period but has many fluctuations. Whenever it has gone beyond the speed of EPS, it has fallen in the next few years, and whenever it has fallen, and EPS has grown or remained stable, it has gone up sharply in the next few years. Also, look at the relationship between Sensex and PE Ratio in graph B; whenever Sensex has grown very fast without corresponding growth of EPS, the PE Ratio is very high, which reflects markets are very high and prices of individual shares are overvalued. This means people are paying a premium on future expectations, but Sensex has fallen badly after that and vice versa.

Conclusion: All the above analysis brings us to the conclusion that over the long term, markets follow growth in EPS, and over the short term, markets follow sentiments and news because human beings are emotional and react emotionally rather than rationally. One more point that I strongly want to make is while making your investment decisions, you should look at the PE Ratio of the indices like Sensex and Nifty and not their absolute values. The following table will give you an idea of what you should do at different PE levels.

Important Note: Before making investments based on the following valuations, consult a qualified financial planner and do your Risk Profiling and Asset Allocation. Only follow this pattern in your long-term goals and not in your short-term goals, which are within 3 to 4 years from now.

Description	Company A	Company B
Market price of shares	100	200
Earning per share	10	25
PE Ratio	10	8
PE Ratio	10	8
PE Ratio	10	8

Below 12 Times PE Ratio: Below 12 times PE ratio is highly undervalued, so you should invest as much as possible and increase your equity allocation. When the PE Ratio is below 12 times, the risk-reward ratio is favorable because markets are undervalued. Chances of losing money over the long term are almost nil, and chances of making excellent returns are very high.

Between 12 to 18 Times PE Ratio: The Average PE Ratio of Sensex is around 18 times. So, between 12 and 18 times, the market is undervalued, and you can invest in equities. Here also, the risk-reward ratio is favorable, and the chances of making money are high.

Between 18 times to 22 Times PE Ratio: At this range, markets are becoming overvalued, so you should slowly stop investing, and at higher levels, you should also reduce allocation to Equity.

Between 22 to 26 Times PE Ratio: Between this range, markets are highly overvalued, and you should start selling your equities actively without waiting much. Making fresh investments at this equities level can be risky because the risk-reward ratio is unfavorable.

Above 26 Times: Investing at these levels is equivalent to making a suicide attempt. If you invest at this PE Level, you will see negative returns in the short term, and to make positive returns, you will have to wait a very long.

So, the message I want to convey is don't look at index numbers on a standalone basis; also look at its PE Ratio because it reflects the relationship between EPS and Price, and if EPS has grown and the Index is growing, then it is not a matter of worry. However, if the Index has grown faster than EPS, you should be extremely cautious.

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Making no Mistakes is Equivalent to doing a Great Job in Personal Finance

Avoid mistakes and have a significant financial life:

As a financial planner, I meet many investors and try to understand what they are trying to do. I have realized very clearly that investors don't have sufficient knowledge of personal finance, and to generate maximum returns, they keep trying new things every time, make mistakes, and waste essential years of their financial lives. Investors should not try too many different things and make mistakes because every mistake impacts their financial lives.

Why do investors try new things?

Finance is a subject that looks very simple. Doing this or taking this particular action seems very simple and will easily benefit me. However, when those actions are taken, investors' analysis is a primary fundamental analysis and not a detailed exact analysis. Due to this, investors fail, which has a severe impact on their financial lives. Let me explain this with an example. In the 2007 bull market, investors started investing in small penny stocks. They initially made a good amount of money, so they thought it easy to make it here. They started buying this type of stocks and avoided purchasing mutual funds because they felt they were doing better than mutual funds. What happens after that? All those penny stocks are nowhere today; people have lost their hard-earned money, and most mutual funds have given excellent returns.

Another example is that investors keep buying Unit-linked and traditional insurance plans instead of term insurance plans with an understanding that ULIPs and traditional plans return some money, whereas term insurance plans don't. But if you make detailed calculations, traditional plans and ULIPs are relatively costly compared to term plans (refer to my earlier article on which type of life insurance policy should you buy? Another such example is fund selection. I have seen many investors going on different websites, selecting top-performing funds of the last one or three years or five-star rated funds, and investing in them. After a few months, they find that the rating has reduced or the fund has fallen in performance ranking. What do you know? They cannot see non-numeric factors like the quality of fund management, the process followed in fund management, etc.

The Financial World looks simple:

Often, investors commit such mistakes because they see the financial world from one side and can see only what is shown to them, so they keep committing such mistakes. But wealth is created only by consistent long-term returns, so you have to take care that you don't make any mistakes and keep your financial life on track.

Making no mistakes is doing a great job:

While taking such actions, as discussed in the above paragraph, investors feel that they will generate extraordinary returns and are doing a wise thing. However, most of the time, it turns out to be a mistake. It hurts their portfolio severely, so rather than trying too hard to do some miracle, be simple and consistent with your investment strategies and achieve long-term consistent returns. If an investor had invested 50% of his investment in Sensex in 1979 and the remaining 50% in a fixed income instrument giving 8% p.a. kind of return and done re-balancing every year, he could have easily achieved 14% p.a. plus compounded annualized returns in his portfolio, and achieving 14% plus return in your portfolio for 35 years is not less than a miracle. It is easy to double your money once in stock but challenging to make 14% p.a. kind of returns for such a long term.

Your financial life is a Test Match, so never play it like a Twenty Twenty: Your financial life is like a test match; it has long innings to go, and you don't need to hit too many boundaries because you have much time to play. You just need to save wickets and wait for loose balls to come. Similarly, in your financial life, just focus on simplicity and consistency and avoid mistakes to have excellent returns and create wealth over the long term.

Good Debt vs. Bad Debt.

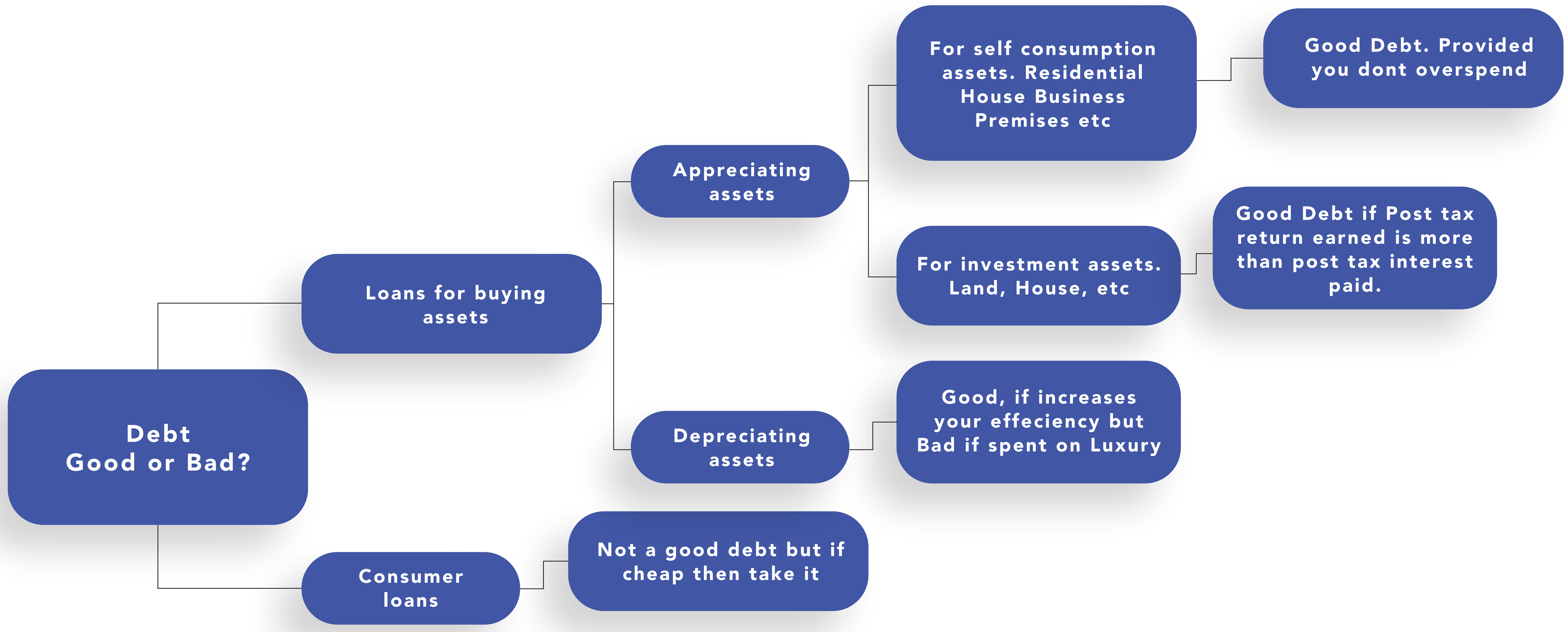
Most of us have taken loans in our lives for one or another objective. However, When I speak with people on whether one should borrow or not and whether the debt is good or bad, I find that most people are on either extreme; some believe that one should always borrow money for their needs, whereas others believe that as far as possible one should not borrow and live within his means. Neither of these approaches is only correct some of the time. One should bring a balance in one's approach towards using borrowed money. Whether the debt is good or bad depends on many factors, like the objective of debt, tax benefits on interest, etc, and cannot be determined on the basis of any one factor. Also, there is only one answer that can be applied to everyone. The answer to this question changes from person to person and situation to situation. This article aims to clarify when a debt can be considered reasonable

and when it can be considered harmful.

Borrowed money comes at an additional cost: First, we must understand that borrowed cash comes at a cost. When you borrow money, you have to repay it along with interest. This interest increases the price of an asset or objective for which it was borrowed.

When you borrow, you consume your future income in the present. Another point you should understand is that when you borrow and finish it for any purpose, you have to repay it and interest costs in the future. So here you are, consuming your future income in the present.

Debt can be considered good or bad in the following aspects.


Debt
Good or Bad?
Loans for buying assets
Consumer loans
Appreciating assets
Depreciating assets
Not a good debt but if cheap then take it
For self consumption assets. Residential House Business Premises etc
For investment assets. Land, House, etc
Good, if increases your effeciency but Bad if spent on Luxury
Good Debt. Provided you dont overspend
Good Debt if Post tax return earned is more than post tax interest paid.

When it is taken to buy an Asset: Money can be borrowed to buy an asset. In such a situation, it can be further classified as Appreciating Assets and Depreciating Assets. Let us understand both the cases.

Appreciating Assets: Appreciating assets are the assets - the value of which will be enjoyed over some time. When a loan is taken to buy any kind of property like a home, land, etc, these are the assets for which value will generally be appreciated. Please remember that value can also go down in these assets, but mostly, value will be appreciated. Now, such properties can be bought for self-consumption, like for residential purposes or business purposes, or they can be purchased for just investment purposes. Below, I have given my conclusion on both.

Properties for self-consumption: When an asset is bought for self-consumption, like residential property or premises to run the business, the Debt (Loan) created to buy that property is good or bad and should not be measured on appreciation of the property because it is for self-consumption. Such property is taken for self-consumption, which is a good debt. But one should remember that he is not overspending on that asset with borrowed money. For example, if I need a 3 BHK flat and I buy a 5 BHK and spend a lot on decorating it with borrowed money, it could be a bad debt. This is because this type of property is bought for self-consumption, so how much it appreciates is optional, but when you overspend on it, you have to pay a high cost for that borrowed money.

Properties bought for Investment Purposes: When an appreciating asset like land, house, etc., is accepted for investment purposes with borrowed money, it is good debt if it fetches you more post-tax returns than the post-tax interest that you pay for the same. When you borrow money to buy a property for investment, you invest in real estate with borrowed capital, so you have to earn more than your interest cost. While calculating your interest cost, you must also consider the tax benefit earned on that interest. So, you have to give the net effect of interest, and similarly, while calculating the market value or sales value of your assets, you have to consider tax to be paid on that.

If you can generate more post-tax returns, it is a good debt; otherwise, it is not. However, the problem is that it is challenging to guess returns when buying such investment assets with borrowed capital. So, in such a case, you should be very conservative while making such buying decisions. It would help if you tried to buy such assets at low valuations as far as possible.

Depreciating Assets: It is generally believed that loans taken to buy depreciating assets are not good debts, but this belief is only a true belief sometimes. If a depreciating asset is bought to increase your working efficiency, it is a good debt. For example, suppose you are purchasing a car or instruments for the hospital with borrowed money. In that case, they are depreciating assets, but they will increase your efficiency, so it is not a bad debt.

In such cases, debt is wrong when taken for depreciating assets or luxury assets, such as if you need a car. You can easily do this with an essential vehicle, which may cost Rs.5 to 8 lakhs. However, if you buy a luxury car of Rs. 15 lakhs, money borrowed for such a luxury car is a Bad Debt because here you are enjoying luxury with borrowed money.

Consumer Loans: Consumer loans are loans primarily for personal or family use. For loans taken for buying small items of home use or traveling, etc., ideally, these loans increase your overall expenditure, so they are not Good Debt, but still, if you get it at a lower or zero interest, they are Good Debt.

Why should I borrow if I have the resources to buy Appreciating assets, depreciating assets, or consumer durables?

A question that comes from many readers is why I should borrow for appreciating assets, depreciating assets, or consumer durables if I have my resources. If you can earn more post-tax returns on your own money than the interest you have to pay while borrowing that money, logically, you should borrow rather than spend your own money. But while calculating interest to be delivered, please consider post-tax interest if you get any tax advantage. Most investors need to remember to give tax impact on this.

Most become emotional about this and believe that debt is always wrong and that they should use their own money when they have it, but it is not a rational decision to use borrowed money in such cases.

Good or bad debt is a relative matter rather than an absolute matter: Whether your debt is good or bad is a relative matter and cannot be judged absolutely on a few factors. By relative, I want to say that it is customized to own once circumstances like whether he gets tax benefit or not, he can earn better returns on his own money when he takes a loan for something rather than investing his own money or not, so never try to take this decision just based on a single factor that whether you are borrowing for appreciating asset or not, or whether you will get tax benefit on interest or not.

To conclude, both owned capitals are always at a cost, so be very careful and calculative while using them, and never make decisions based on one or two factors alone.

Inflation: Biggest Enemy in your Financial Life?

Inflation is one of the biggest enemies in our financial lives, but most of the time, I find that investors forget to consider the impact of Inflation on their financial lives. In this article, I will try to explain "what is inflation?" from a microeconomic perspective, and then we will see the impact of Inflation on our lives.

What is Inflation?

As a general definition, "Inflation is a continuous rise in the prices of commodities, goods, and services." This means that when prices of any goods, commodities, or services keep increasing on a continuous basis, that is Inflation. But it is the other way round; prices of commodities do not increase, but the value of currency keeps falling, and that's why its purchasing power also decreases, so what a 100 rupee currency note could buy a year ago, it cannot accept the same goods and services today. So, there is a fall in the value of the Rupee, or the purchasing power of the Rupee has fallen. There are many reasons for this, but one primary reason is that when the government prints new currency and puts it into the economy by spending it on infrastructure, raising salaries, etc., the value of the existing currency falls. This happens because the same commodities are chased by more currency. So, Inflation is a fall in the purchasing power of the Rupee and not a rise in the price of commodities.

How does it affect your financial life?

The biggest mistake layman investors make is that they need to consider the impact of Inflation on their financial lives. Inflation severely impacts our long-term goals like Retirement, Education Cost of our children, etc. Let me explain with a few real-life case studies to bring more clarity.

Recently, a client approached me for his financial planning. He had just retired from senior management of an excellent company. Following are his facts and figures

Age	**60 Years**
Retirement Fund	**80 Lacs** (Received as a Retirement Fund from EPF, Gratuity, Leave Encashment)
Other Investments	**10 Lacs (PPF)**
Value of own residential premises	**70 Lacs**
Pension	**No Pension**
Monthly expenses	**40,000/- p.m.** (Annual Expenses 40000 x 12 = 4,80,000)

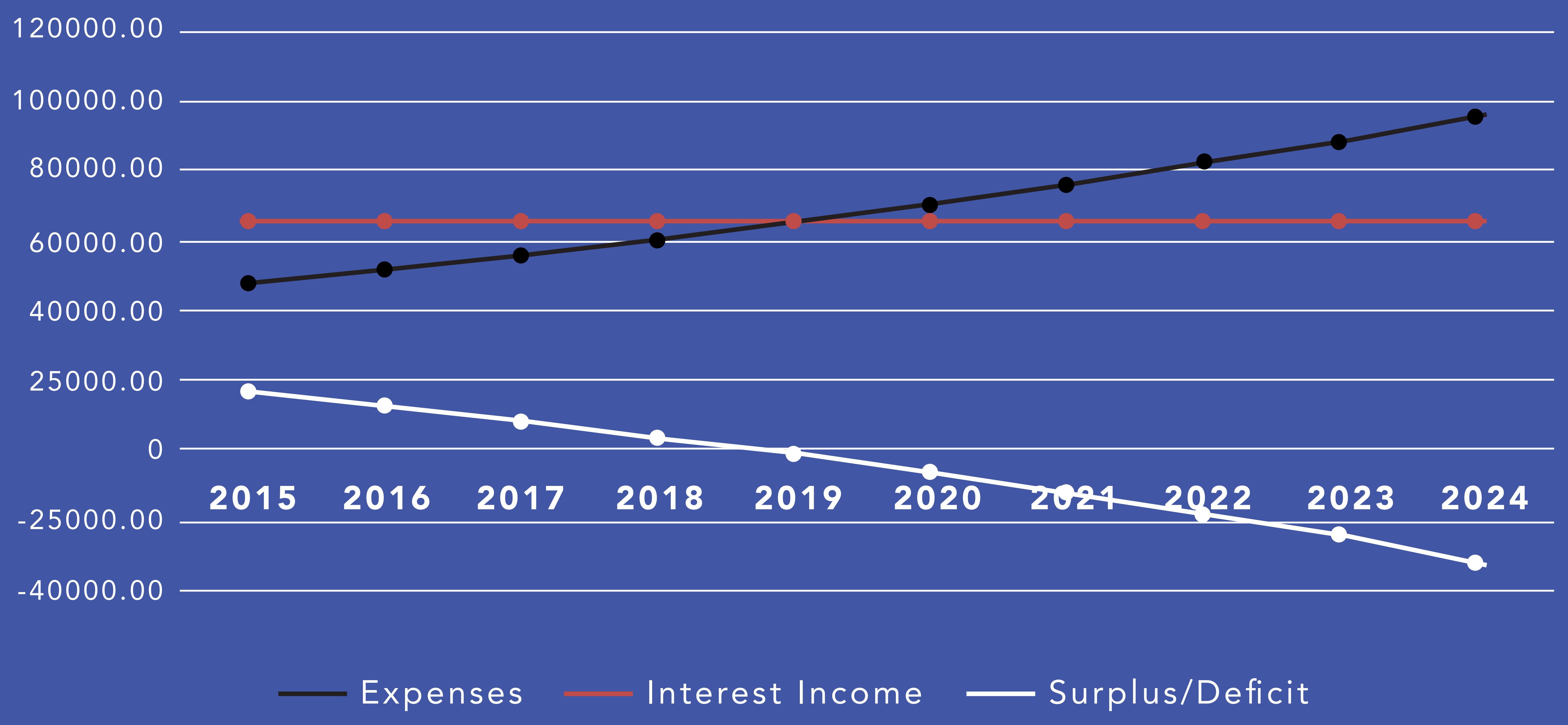
This gentleman had saved in PPF and EPF for his entire life except for some small life insurance policies. When I met him, he believed he had around 80 lacs corpus, sufficient to survive. He told me that he would receive about 8% interest in a fixed deposit, which would come to Rs. 640000 (8% * 8000000). His monthly expenses, including all types of expenses, are Rs. 40000, so annually, he needs Rs. 480000/- and his interest income will be Rs. 640000, so he will save around Rs. 160000 (640000-480000). In this case, if I assume 8% p.a. inflation in his cost of living, let us see How his annual cost of living increases over the next ten years.

For convenience, we have assumed zero taxes and 8% interest rates. The PPF corpus of Rs. 10 lacs is kept for meeting any medical emergencies and hence is not considered in calculations.

Annual Expenses	480000
Corpus	8000000
Interest Rate (p.a)	8%
Inflation (p.a)	8%

	Year	Expenses	Interest Income	Surplus (Deficit)
1	2015	480000	640000	160000
2	2016	518400	640000	121600
3	2017	559872	640000	80128
4	2018	604662	640000	35338
5	2019	653035	640000	-13035
6	2020	705277	640000	-65277
7	2021	761700	640000	-121700
8	2022	822636	640000	-182636
9	2023	888446	640000	-248447
10	2024	959522	640000	-319522

Cash Flow



Look at the above table; in the fifth year (2019), his cost of living is more than his interest income. Please note that he is not increasing his lifestyle; he is just maintaining his lifestyle, and from 2019 onwards, if he wants to maintain the same lifestyle, he will have to withdraw from his essential capital Rs. 80 lacs.

This gentleman's mistake was that he should have considered the impact of Inflation on his cost of living. Similarly, let us see some other life goals and how they are affected by Inflation.

How does Inflation affect your Children's Education goals?

Last month, a couple came to me to plan higher education costs for their one-year-old son. He estimated that his son would need Rs.20 lacs to go abroad to get higher education in a good engineering college when he reached 17, so he wanted to invest now. He wanted to invest Rs. 5 lacs now and believed it would be Rs. 20 lacs when his son reached old. But this Rs. 20 lacs was today’s value of that education cost. When I asked about Inflation on that cost, he was blank and had no answer. The following table will show the inflation-adjusted value of Rs. 20 lacs after 17 years.

Current Age	Money Reqd at	Years left in goal	Current Education Value	Inflation	Inflation adjusted Education value
1	**18**	**17**	**2000000**	**8%**	**7,400,036**

Rs. 20 lacs become Rs. 74 lacs after 17 years. So, the goal which was easy to achieve, now it looks very difficult. When I made the above calculation and showed him that an inflation-adjusted value of Rs. 20 Lacs would be around 74 Lacs, they were shocked and argued that there was some mistake. Afterward, they accepted this calculation.

So, Inflation is our biggest enemy in completing our long-term goals. But the significant issue is that while planning our future goals like retirement, education funds for our children, etc., we need to consider Inflation. Either we feel the same level of expenses in the long term, or we don’t calculate their future values putting inflation percentage properly. In this way, Inflation is the most significant risk to our long-term goals, but it has a very low effect on our short-term goals. Suppose a goal is only one year away from now; then Inflation will not affect it much, but for long-term goals, Inflation is the most significant risk.

Investment, Speculation, and Gambling: How are they different?

Your approach determines whether you are investor, speculator or Gambler?

Most people participating in asset classes like Equities, Commodities, Real estate, or other asset classes don't understand whether they are investors, speculators, or gamblers. Understanding your behavior as an investor is essential because that will determine your success.

Creating positions in Futures and options also believe that they are investing in futures, but that is speculation. So, it is essential to understand the difference between Investment, speculation, and Gambling.

The following chart will clarify how Investment and speculation are different.

Points of Comparisont	Investor	Speculator
Planning Horizon	Usually investors have longer investment horizon which leads to few years. Investors generally opt for longer investment horizon.	A Speculator has a very short planning horizon. his holding period normally extends from few days to few months.
Risk	An investor normally is willing to assume a reasonable and moderate level of risk and he is rarely ready to assume high level of risk.	Speculators, knowingly or unknowingly is ready to take high level of risk. Generally he is ready to lose basic capital also.
Return expectation	An investor usually seeks a reasonable rate of return at limited risk offered by the asset classes	Speculator usually has a very high return expectation and for that he is ready to bear high risk also.
Basis of decisions	An investor focus on fundamental aspects and evaluates the future prospects of the companies in which the investment is made.	Speculator gives more importance to technical charts, news and sentiments of the market.
Leverage	Normally, investors invest only his own funds and avoids borrowed fund. Investors dont create leverage positions.	Speculators may invest borrowed funds and create leverage positions to make more money.

The above chart shows that investors and speculators have different approaches toward asset classes like equity, bonds, etc. Taking positions in Futures & Options or commodities for high returns over the short term are the ways to speculate, and investing in shares and mutual funds or buying Gold through ETF with a reasonable return expectation over the long term are ways to invest in these asset classes. Now, let us understand what Gambling is.

What is Gambling?

Gambling is fundamentally different from Investment and speculation in the following respects.

Quick Outcome: Normally, the Outcome of Gambling is known very quickly. The Outcome of rolling or turning a dice is almost swiftly known.

Results don't depend on Economic activity: Normally, the results of Gambling are not dependent on any economic activity. For example, when you create a position in futures or commodities, the prices of stocks or commodities are somewhat reliant on economic activity, but when you play a card and bet on that, the Outcome doesn't depend upon any economic activity.

Lack of significant Economic benefit: Generally, Gambling doesn't provide critical economic Outcomes. Meanwhile, Investment and Speculation can offer substantial financial outcomes.

Gambling should be for fun: Normally, rational people do Gambling for fun and not to make money.So, it is clear that Gambling should be done more for fun and not for making money.

Investor or Speculator: Who are you?

Now identify yourself, whether you are an Investor or a Speculator? From your approach towards investments. If you invest with a very short horizon, without looking at fundamental aspects, and have a very high return expectation, you are a speculator, not an investor.

Your approach and not instruments only decide whether you are an investor or a speculator: It is not necessary that if you are investing in shares and stocks, then you are an investor because if you don't look

at fundamental aspects of companies and have a very high return expectation over a very short period, you are a speculator, not an investor.

Get ready for the risk and return or change your approach: If your approach is that of the speculator and you want to remain the same, you should be prepared for risk and return of the same. You may make heavy profits in the short term with a bit of Investment and lose your capital within the short term. If you use an investor approach, you may make reasonable returns but relatively, you are in a much safer position.

Conclusion: There is a significant difference in the approaches of investors and speculators. Speculators may make excellent returns over a short-term period once or twice, but a speculator typically loses or only makes a few returns over the long term. So, controlling your greed factor and becoming an investor is better.

Saving Money vs. Investing Money: What is the difference?

Most people think that savings and Investment are the same and use these two words as synonyms. But savings and Investment are two different concepts, and we must realize this. Even many of the finance websites also confuse savings with investments. We often give messages to our children like" a penny saved is a penny earned," "Savings of today is the assurance of tomorrow," etc. while communicating, we use the word savings. But savings have a limited meaning, whereas Investment is a much broader concept in itself. This article is an effort to clarify the difference between the two so that all of you can understand this and then check whether you are a good saver or investor.

What are savings? & How is it different from Investment?

Savings are the difference between your income and all types of cash outflows, like your monthly expenses, EMIs, taxes, etc. See the formula below—& table.

Income – (Expenses + EMIs+ Taxes) = Savings.

So, from the above formula, it is clear that money saved after paying all expenses, liabilities, and taxes is saving. Now, temporarily park it in a savings account, fixed deposits, or liquid funds. But this money starts earning good returns once you apply it towards effective investment instruments as per your financial goals.

So there, the difference between savings and Investment starts. There is a thin line between savings and Investment. Savings are the money left out after you have kept aside all your expenses, taxes, and liabilities. But it becomes an investment when you allocate it for your financial goals and invest in instruments like shares, bonds, etc., with a clear investment horizon and strategy to generate better returns. Money saved should be used to meet your short-term, medium-term, or long-term goals.

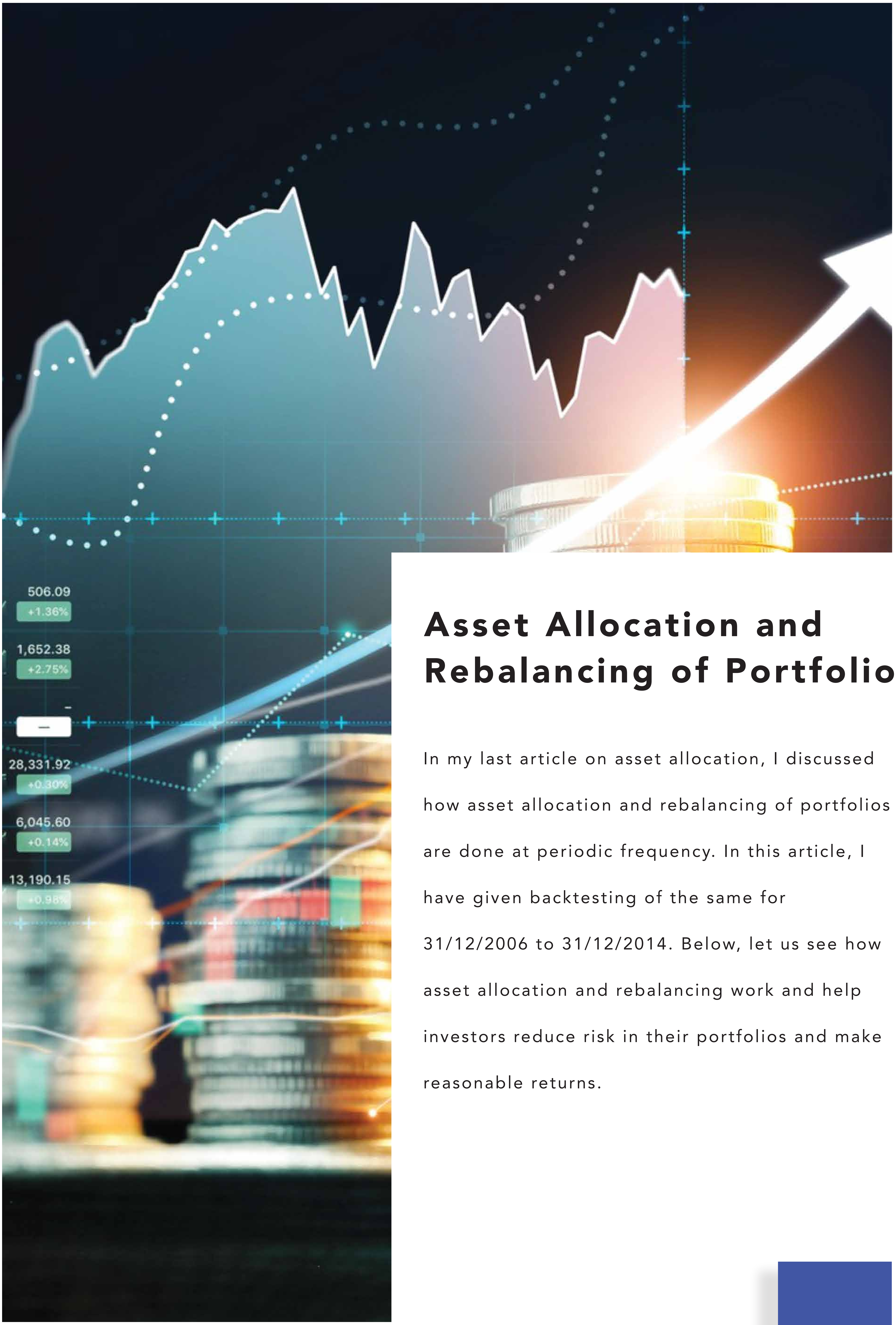
	Savings	Investments
Investment Horizon	Generally savings are kept for short Term Goals, Like contingency fund.	Investments are usually kept for long term goals like education of kids , Retirement.
Liquidity	Savings are generally parked in the instruments which provide high liquidity like liquid funds, short term fixed deposits, Savings account etc.	Investments are usually parked in Long term investments where liquidity is less like properties, Equity funds with long term objectives etc.
Risk	Savings money are generally parked in the instruments which involves less risk like liquid funds, fixed deposit etc.	Investments are generally made into instruments which are more risky like equities property etc.
Returns	Savings money will generally earn less returns because it is invested for short term and in less risky instruments. Returns can be in the range of 5% to 7%.	Investments will generally generate high returns as they are parked in risky and long term instruments. Returns can be in the range of 10% to 15%.

How much should you save? & How do you improve your savings rate?

Your savings have a direct impact on your wealth creation. But the question is, how much should you save from your income? Some say you should save 30%, and some say 50%. But there is no standard for how much should be save from your income. When your income is low at the initial stage of your career, you may not be able to save more. But your savings rate should improve as your income grows and your essential expenses are met.

To improve savings rates, one should focus on budgeting. Once you concentrate on budgeting and writing actual expenses, you can compare them with costs budgeted under different heads and mark out the deviation. If actual expenses under any head are more than budgeted, you can analyze why they are higher. This will help you in controlling your costs and improve your savings rate.

To conclude, Investment and savings are different; part of your savings should be invested for long-term goals and wealth creation.


506.09
+1.36%
1,652.38
+2.75%
28,331.92
+0.30%
6,045.60
+0.14%
13,190.15
+0.98%

Asset Allocation and Rebalancing of Portfolios

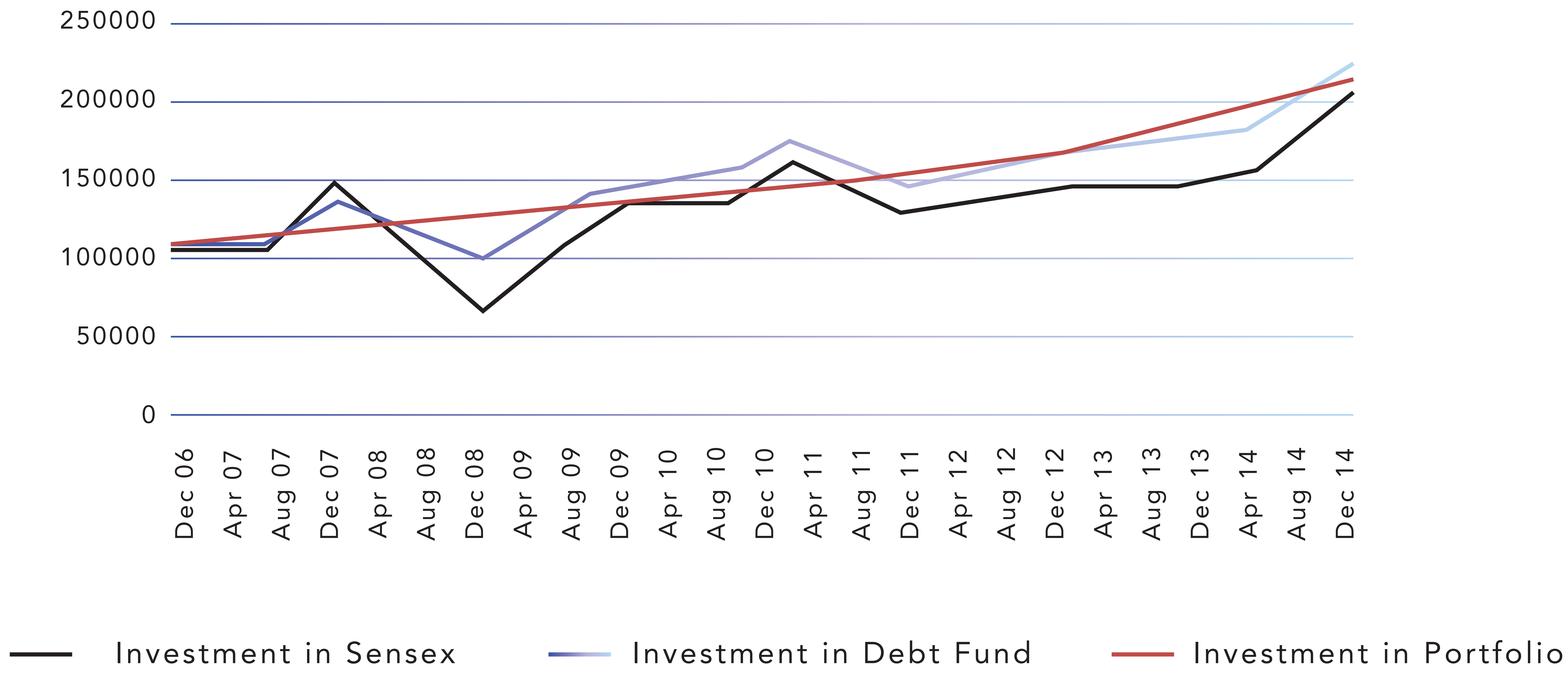
In my last article on asset allocation, I discussed how asset allocation and rebalancing of portfolios are done at periodic frequency. In this article, I have given backtesting of the same for 31/12/2006 to 31/12/2014. Below, let us see how asset allocation and rebalancing work and help investors reduce risk in their portfolios and make reasonable returns.

In the below calculation, I have taken an investment of Rs. 1 lac and divided it in 50% to Sensex (Equity) and 50% to Franklin India Short Term Bond Fund (Debt) and, after that, rebalanced on a half-yearly basis. Figures of the Sensex and NAV of the Fund are accurate.

Date	Sensex Values	Value	% allocation	Debt Fund NAV	Value	% allocation	Total Portfolio Value
31-12-2006	13,786.91	50,000.00	50.00%	1350.37	50000.00	50.00%	1,00,000.00
30-06-2007	14,650.51	53,131.96	50.53%	1404.94	52020.71	49.47%	1,05,152.67
		52,576.33	50.00%		52576.33	50.00%	1,05,152.67
Invest/Withdraw		**-555.62**			**555.62**		
31-12-2007	20,286.99	72,803.99	56.70%	1485.44	55588.91	43.30%	1,28,392.67
		64,196.45	50.00%		52576.33	50.00%	1,28,392.67
Invest/Withdraw		**-8607.54**			**8607.54**		
30-06-2008	13,461.60	42,598.09	39.20%	1528.61	66062.12	60.80%	1,08,660.21
		54,330.45	50.00%		54330.10	50.00%	1,08,660.21
Invest/Withdraw		**-11732.02**			**-11732.02**		
31-12-2008	9,647.31	38,935.89	40.30%	1622.94	57682.72	59.70%	96,618.60
		48,309.30	50.00%		48309.30	50.00%	96,618.60
Invest/Withdraw		**9.373.41**			**-9.373.41**		
30-06-2009	14,493.84	72,578.50	58.51%	1729.25	51473.72	41.49%	1,24,052.22
		62,026.11	50.00%		62026.11	50.00%	1,24,052.22
Invest/Withdraw		**-10,552.39**			**-10,552.39**		
31-12-2009	17,464.81	74,740.32	53.42%	1816.90	65170.15	46.58%	1,39,910.47
		69,955.23	50.00%		69955.23	50.00%	1,39,910.47
Invest/Withdraw		**-4,785.08**			**4785.08**		
30-06-2010	17,700.90	70,900.89	49.51%	1878.28	72318.50	50.49%	1,43,219.39
		71,609.70	50.00%		71609.70	50.00%	1,43,219.39
Invest/Withdraw		**-708.81**			**-708.81**		
31-12-2010	20,509.09	82,970.34	53.15%	1918.28	73133.98	46.85%	1,56,104.32
		78,052.16	50.00%		78052.16	50.00%	1,56,104.32
Invest/Withdraw		**-4918.18**			**4,918.18**		
30-06-2011	18,845.87	71,722.39	46.82%	2002.09	81463.24	53.18%	1,53,185.62
		76,592.81	50.00%		76592.81	50.00%	1,53,185.62
Invest/Withdraw		**4,870.43**			**-4,870.43**		
31-12-2011	15,454.92	62,811.42	43.98%	2091.21	80002.13	56.02%	1,42,813.54
		71,406.77	50.00%		71406.77	50.00%	1,42,813.54
Invest/Withdraw		**8,595.36**			**-8,595.36**		
30-06-2012	17,429.98	80,532.19	51.86%	2189.44	74760.90	48.14%	1,55,293.10
		77,646.55	50.00%		77646.55	50.00%	1,55,293.10
Invest/Withdraw		**-2,885.64**			**2,885.64**		
31-12-2012	19,426.71	86,541.52	51.47%	2301.17	81608.94	48.14%	1,68,150.46
		84,075.23	50.00%		84075.23	50.00%	1,68,150.46
Invest/Withdraw		**-2,466.29**			**2,466.29**		
30-06-2013	19,395.81	83,941.50	48.63%	2426.57	88656.64	51.37%	1,72,598.14
		86,299.07	50.00%		86299.07	50.00%	1,72,598.14
Invest/Withdraw		**2,357.57**			**-2,357.57**		
31-12-2013	21,170.68	94,196.11	48.63%	2507.32	89170.98	48.63%	1,83,367.09
		91,683.55	50.00%		91683.55	50.00%	1,83,367.09
Invest/Withdraw		**-2,512.57**			**2,512.57**		
30-06-2014	25,413.78	1,10,059.08	53.25%	2642.14	96613.33	46.75%	2,06,672.40
		1.03,336.20	50.00%		103336.20	50.00%	2,06,672.40
Invest/Withdraw		**-6,722.87**			**6,722.87**		
31-12-2014	27,499.42	1,12,816.72	50.53%	2799.53	109492.09	49.47%	2,21,308.81

Rebalancing of Portfolio: In the above table, you can see that every six months, I have made both equity and Debt equal (50%:50%) and for that, I have rebalanced my portfolio; in real life, we try to rebalance the portfolio by putting fresh money in the asset class which has fallen and bring it to the percentage allocation that is required initially and if we cannot meet the required percentage of allocation by putting fresh money then only we rebalance the portfolio and sell the asset class which is above-required allocation and invest in asset class which is below the required allocation.

Asset Allocation & Rebalancing Chart



The above table proves that Rs. 1 lac invested in Sensex (Equity) has given a compounded annualized return of around 9.01% p.a. In contrast, Rs. 1 lac supported in Franklin India Short Term Income Plan (Debt) has given 9.53% p.a. compounded annualized returns, and money invested in 50:50 allocation and rebalanced on a half-yearly basis has given around 10.43% compounded annualized returns which are higher than both asset classes in which investment is made. You can also observe in the above chart that money invested in equity had the highest volatility, and money invested in the Bond fund had very low volatility. In contrast, money invested in equal proportion and rebalanced has moderate volatility but higher returns. So, asset allocation offers higher returns at lower risk.

Benefits of Asset Allocation

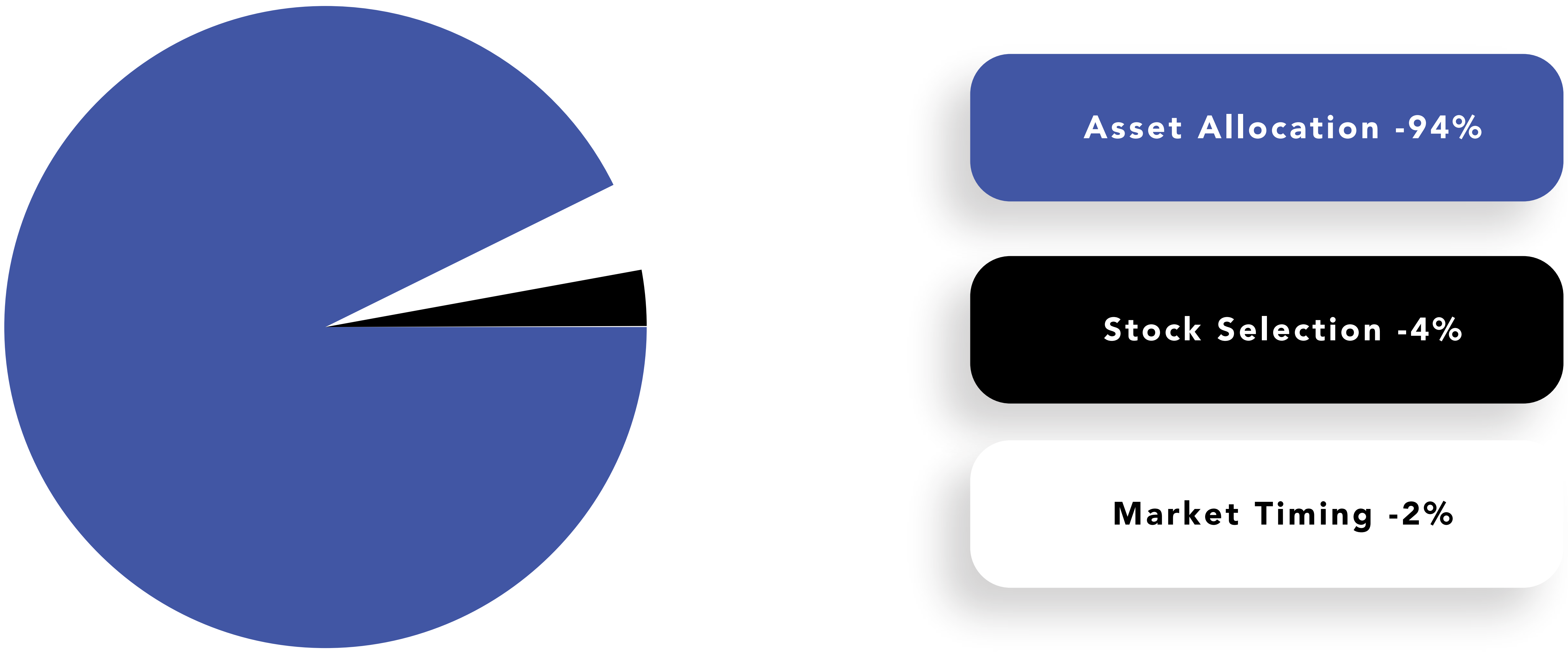
Risk Management: By rebalancing or investing fresh money in an asset class that has fallen, you will be investing in an asset class that has not done well in the past and is available at a cheaper rate and vice versa. The above table shows that in Dec-2007, Sensex increased sharply from 14650 to 20286. Money was taken from Sensex (Equity) and invested in the Bond Fund. In December 2008, when the Sensex had fallen to 9647 levels, money was invested in Sensex (Equity). This helps you to invest in the asset class, which is cheaper, and keeps you away from the asset class, which is overvalued, so the risk of investing in equity or any other asset class at the time when it is overvalued is taken care of, and that is why I always say that Asset allocation is a most effective method of risk management.

Buy at Low and Sell at High: Normally, investors always want to buy when markets are low and sell when markets are high. But typically, most investors fail to do this because they are always confused about

Whether markets are high or low and whether they should buy or sell now. However, asset allocation is a mathematical model that resolves this confusion and helps us to purchase at low prices and sell at high prices.

Keeps you away from Market Timing: Market timing is an activity by which you try to predict the future movement of the market and believe that you can catch the bottom of the market and sell at its peak. This appears very simple, but it is impossible. Research by landmark Brinson, Hood, and Beebower, "Determinants of Portfolio Performance" (1986, 1991), argues that Asset Allocation accounts for 94% of the variation in returns in a portfolio, leaving market timing and stock selection to account for only 6%.

Asset Allocation
Brinson,Hood and Beebower 1986, 1991



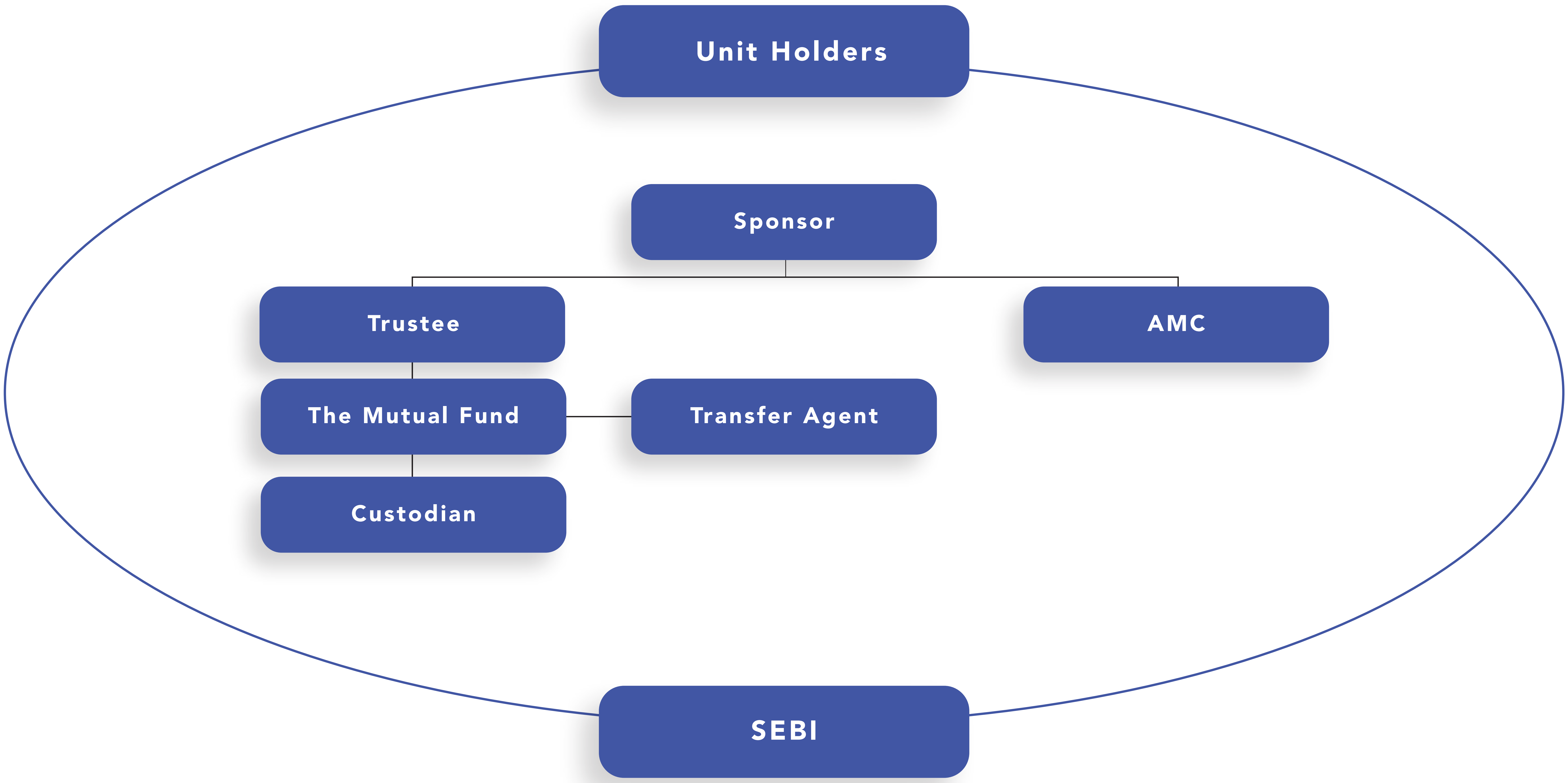
Conclusion

Asset allocation seems very simple, so most investors don't understand its importance. But asset allocation is the Backbone of your portfolio, and you should adopt it.

Structure of Mutual Funds in India

In my last article, “All about Mutual Funds - Advantages & Disadvantages of Mutual funds”, I discussed the basics as well as the advantages and disadvantages of Mutual funds. Mutual Funds are a powerful and stable vehicle for investing in different asset classes. Most investors, whether investing in Mutual Funds or not, need to be more transparent about the Legal structure of Mutual Funds in India. This article is an effort to educate investors about the legal structure and functioning of Mutual funds in India.

Practically, as an investor, understanding the legal structure of Mutual Funds will not add much value to your financial life, but most investors consider Mutual funds as unsafe investments and have lots of misunderstandings about the legal structure of Mutual funds; hence this article will clarify those misunderstandings and will make you understand how safe your money is with Mutual Funds.



Legal Structure of Mutual Funds

Now, we will see what the legal structure of Mutual Funds is & how Mutual fund companies are formed?

Who Regulates Mutual Funds?

1.Mutual Funds are regulated by the Securities & Exchange Board of India in India. SEBI has formed "SEBI MF Regulations 1996" to control the functioning of Mutual Funds.

2. Under this regulation, Mutual Funds are formed as Public Trust under "The Indian Trust Act, 1882".

3. These regulations stipulate a three-tier structure of entities – Sponsor (creation), trustees, and Asset Management Company (fund management) – for carrying out different mutual fund functions but place the primary responsibility on the trustees.

Who is the Mutual Fund sponsor? & What are Roles & Responsibilities of Sponsor?

The mutual fund sponsor is the promoter of the Mutual Fund Company. Sponsor, either on his own or in association with another corporate body, establishes a Mutual to earn money from fund management through its subsidiary company, which acts as the Fund's Investment Manager.

Sponsors then,

1.Set up a Public Trust under "The Indian Trust Act, 1882" and appoint trustees to manage the Trust. Gets Trust registered with SEBI and takes all the necessary approvals from the SEBI.

2.Create an Asset Management Company under "The Companies Act, 1956".

3.As the Sponsor is the primary entity promoting a mutual fund company and mutual funds are going to manage public money, SEBI has kept stringent guidelines for the eligibility of the Sponsor.

Registration of Trust & Appointment of Trustees

Creation of Trust: Sponsors create Trust through a trust deed in the favour of trustees. Trustees manage the Trust and are primarily responsible to investors in Mutual Funds. They are mainly guardians of the Unit Holder’s money.

Appointment of Trustees: With prior approval of SEBI, the Sponsor appoints trustees. There should be at least four members on the board of trustees with at least 2/3rd independent. A trustee of one mutual fund cannot be a Trustee of another mutual fund unless he is an independent trustee in both cases and has the approval of both boards. The trustees are appointed by executing and registering a trust deed under the provisions of the “Indian Registration Act." This trust deed is also registered with SEBI.

Trustees also agree with the Asset Management Company.

Trustees can obtain necessary information from the Asset Management Company. The Trustee must approve all the schemes before they are launched.

Trustees must appoint all key personnel like Fund Managers, Auditors, Custodians, Registrars, Compliance Officers, etc., and inform the SEBI about the same.

Asset Management Company: The Trust will appoint Asset Management Company as Investment Managers through an agreement called "Investment Management Agreement."

The Sponsor creates an Asset Management Company, and the Asset Management Company manages the funds of the Trust, and against that, it charges a small fee. The AMC structures various schemes, launches the scheme, mobilizes the initial amount, manages the funds, and gives services to the investors.

Sponsor, Trust, and Asset Management Company are the Three Tir system that runs the entire Mutual fund Business. Following are some other essential entities involved in functioning a Mutual Fund.

Custodian: In Mutual funds, an Asset Management Company buys different securities in the forms of shares, bonds, gold, etc., in different schemes. These securities are purchased in the Trust's name. Trust is not kept with the Trust. The responsibility of safekeeping the securities is on the custodian. Securities in the material form are kept in the safe custody of a custodian, and securities in the "De-Materialized" form are kept with a Depository participant, who acts on the advice of the custodian. The custodian performs an essential back-office operation. They ensure that delivery has been taken of the bought securities and that they are transferred in the mutual fund's name. They also provide that funds are paid out when securities are purchased. The custodian keeps the investment account of the mutual fund. They collect and account for mutual fund investments' dividends and interest receivables. They also keep track of various corporate actions like bonus issues, rights issues, stock splits, buyback offers, open offers, etc, and act on these as per

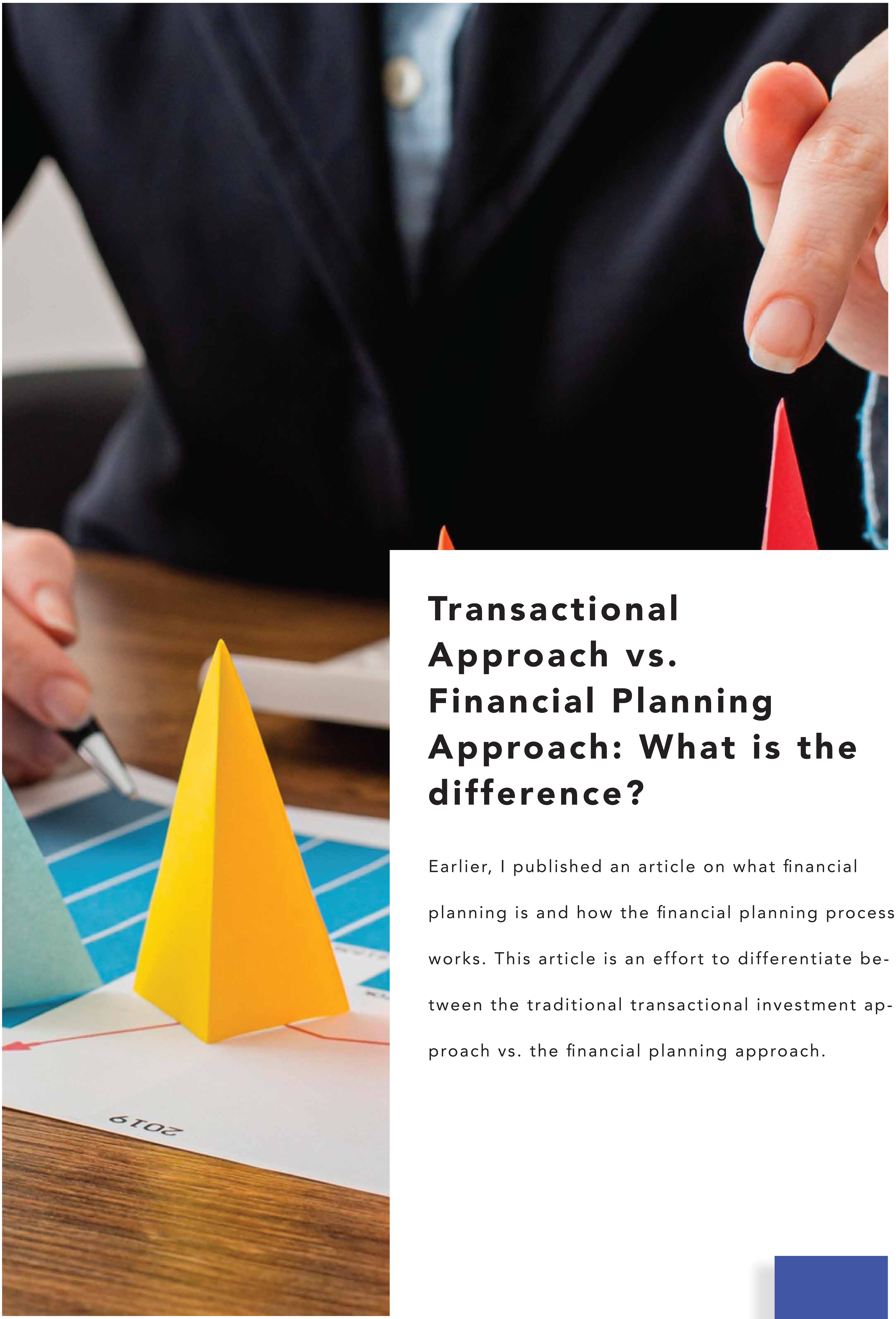
Registrar & Transfer Agent: The registrar and transfer agent are separate entities. The registrar & Transfer agent is responsible for performing many administrative jobs like processing investors' applications, creating units when a new investment is made, removing units when investors made redemptions, keeping complete records of investors, and processing dividend payout. Mutual fund investors are spread across the country to small cities and towns, so it is impossible to provide these services to investors in all these places by Asset Management Company. Registrar & Transfer Agents have their offices spread to these different locations, and they work for many Mutual Funds to perform these jobs. It is possible to provide services to unit holders at various locations in a cost-effective manner..

Auditor: Asset Management Companies must maintain separate books of accounts for all the schemes and prepare different Annual reports for all schemes. An Auditor's role is to examine books of accounts and annual reports of all the schemes as an independent auditor. Asset Management Companies are also required to maintain their books of accounts and get the audit done under The Companies Act of 1956. As per rules, separate auditors are appointed for Asset Management Companies and Schemes.

Brokers: Brokers are registered stock exchange members whose services are utilized by AMCs to buy and sell securities on the stock exchanges. Many brokers also provide the investment manager (AMC) with research reports on the performance of various companies and sectors, market outlooks, investment recommendations, etc.

Conclusion

From the above discussion, it is clear that mutual funds are well-regulated by SEBI. SEBI has formed three tired structures between Sponsor, Trustee, and Asset Management Company to ensure investor money safety. Different agencies are involved in the functioning of the Mutual funds; the custodian is responsible for keeping securities, the transfer agent is responsible for creating units and other services, and Auditors verify that accounting is done correctly as per regulations. Brokers are stock exchange members who provide services for buying and selling securities. Trustees are responsible for taking care of the unit holders' interests and reporting to SEBI. So, the entire functioning doesn’t remain with Asset Management Company or Sponsors.



Transactional Approach vs. Financial Planning Approach: What is the difference?

Earlier, I published an article on what financial planning is and how the financial planning process works. This article is an effort to differentiate between the traditional transactional investment approach vs. the financial planning approach.

Traditional Transactional Approach	Financial Planning Approach
Extra Money	Set Financial Objectives/Goals
Call an agent or advisor	Analysis your Financial Resources
Products which seems best	Risk Profiling & Asset Allocation
Nothing to do with your objective	Written Financial Plan
Shares/ MF/ LIC Policies/ FD/ Gold	Execution of Plan
Never Reviewed	Plan & Portfolio Review

Traditional Approach of Investment:

The traditional transactional approach is the approach that most people in India adopt for managing their financial affairs. In this approach, investors follow a typical sequence of action, which I have mentioned here above in a chart and explained after that.

At first, whenever they have additional surplus money, they will call an advisor who is actually an agent or distributor of different financial products and ask for advice. The funds will then be invested in the best-looking asset class and financial product. By best looking, I mean that if equity markets are doing very well, they will be invested in direct stocks or equity mutual funds. If recent gold prices have gone up sharply, it will be invested in physical gold or gold ETF; if bonds have done well in the recent past, then money will be invested in bonds.

Now, these financial products have nothing to do with the long-term or short-term objectives of the investor. This advisor's academic qualification, knowledge, and process are never necessary. Further, after making this investment, it is never reviewed, whereas finance is one of the most dynamic areas, so ideally, it should be periodically reviewed.

This approach is a disaster because investors first select the product or asset class, which has done very well recently. If you go through history, in 2007, when equity markets were overvalued, most of the investors invested in equity due to this process, and in 2008-09, when equity markets were undervalued, they invested in bonds and other assets. These investments are never made considering clients' long-term or short-term financial objectives. Suppose the client wants to invest for one year, and if equity markets are doing well, money will be invested in the stock market, which is a wrong decision. Due to this, investors are not able to earn decent risk-adjusted returns.

From where do we learn this approach? One question is why investors generally adopt this approach in more than 99% of cases. The answer is that we don't have personal finance education anywhere in our formal education system, so most of the things we learn in personal finance are from our parents. We have never seen our parents doing effective Financial Planning or hiring any qualified financial planner and making a written financial plan to manage their financial life. That's why I call this approach the Traditional approach.

Financial Planning Approach:

Against this, the Financial Planning approach is much more organized, process-driven, and disciplined. As shown in the image of the Financial Planning approach, a qualified financial planner follows a six-step process that works for investors.

1) Setting up Goals/Objectives:: The first step of Financial Planning is setting up clear financial objectives and goals. Financial objectives are like a destination that you want to reach. When people don't have clear financial objectives at the time of investment and try to search for the best investment options, it is like someone arriving at a railway station and asking which train is the best today. Most of the time, this type of investor selects asset classes and products unsuitable to their needs.

Setting financial goals and objectives helps decide the direction and speed a client needs to maintain in his portfolio. It gives a clear idea about the investment horizon, so one can set up a compelling mix of asset classes like equity, bonds, etc., and construct an outstanding portfolio as per the needs of the investor.

2) Analysis of Financial Resources: Once the client's goals are set, the advisor knows where the client wants to reach. In the second step, the advisor analyzes the investor's existing and future resources. This helps him understand where the client wants to get where he is and what speed and direction are required. At this stage, the advisor takes details of income, expenses, assets, liabilities, exiting investments, etc., from the client and works out mathematically whether the client can reach his goals comfortably or not. If there is any gap and the client cannot reach his goals, he will do gap analysis and prioritization between different goals.

3) Risk Profiling & Asset Allocation: At this stage, risk profiling of clients is also done. Risk profiling is the process of deciding what percentage of a client's investment should be in aggressive asset classes like Equity and Real Estate and what should be in conservative asset classes like Bonds. Risk profiling helps to derive the optimum risk level for the client. This mainly depends upon three factors: his ability to take risks, his need to take risks, and his willingness to take risks. The client's ability and need are financial characteristics, whereas his willingness is a psychological characteristic. After risk profiling, asset allocation is done so that at this level, it is clear to the client what his allocation will be to different asset classes like equity, debt, gold, etc.

4) Written Financial Plan: After risk profiling and asset allocation, the financial plan of the investors is discussed and finalized with him. Here, the financial plan given to the client is in the written format. So, all the advice given in the Financial Planning approach is written. Have you ever seen a doctor giving an oral diagnosis and prescription? Never, so it is my strong advice to investors to take all the advice from their financial advisor in written format and never accept oral advice. At this stage, investors also get recommendations on portfolios and products. So, in the Financial Planning approach, products come last, whereas products come first in the Traditional Transactional Approach.

5) Execution of Financial Plan: Mere planning doesn't ensure financial success, so once the plan is ready, investors should start execution as per the plan.

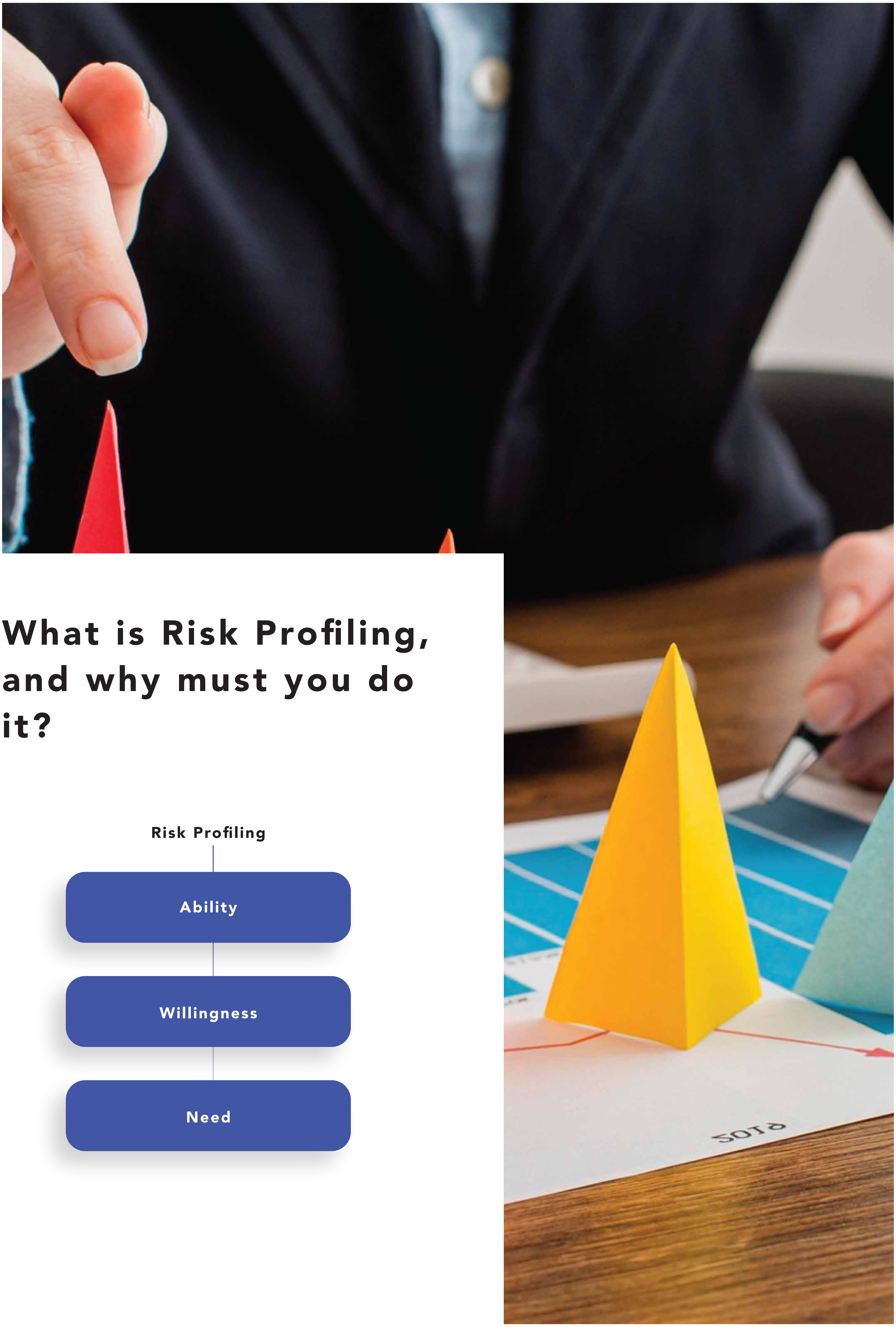
6) Plan and Portfolio Monitoring and Review: The portfolio is reviewed at periodic intervals in the Financial Planning approach. This helps investors to keep their financial health continuously intact. A portfolio review includes a review of asset allocation and products at a regular frequency, say half yearly or quarterly, and also monitoring the execution of the plan.
Another benefit of the Financial Planning approach is that your financial plan is reviewed at least once a year. Your financial plan is made based on certain assumptions related to your income, expenses, assets, liabilities, and many other factors and your circumstances, so a plan that is created once needs revision and adjustment for all these factors at least once a year, which is taken care of in the Financial Planning approach.

Conclusion

As an investor, you should understand that financial life is like a test match, not a Twenty-Twenty. The Standard Transactional Approach will work like a Twenty-Twenty match and lead you nowhere; it will always keep you confused and end up with significant mistakes in your financial life. Financial Planning is a disciplined approach with a predefined process that will smoothly take you to your financial goals.

Following are some significant differences from investors' point of view between the transaction cost approach and the financial Planning approach.

Traditional Transactional Approach	Financial Planning Approach
Product Centric: Transactional approach is product centric approach and therefore it lacks focus on client's needs	**Client Centric:** Financial planning is a client centric approach which focuses on needs of the clients first and constructs client's portfolio accordingly
Focuses on Investment only: Transactional approach is a narrow concept which focuses on investments of the client and misses broad picture of client's financial affairs	**Focuses on financial life of client:** Financial planning it takes a broad view to client's entire financial life and focuses on Net worth of the investor and tries to improve quality of financial life of clients
Lack of process: There is lack of systematic process in traditional transactional approach	**Predefined Process:** There is systematic process to organize and manage client's financial life.
Lack of Risk management: There is lack of strategic risk mangement in this approach	**Strategic Risk Mangement:** Effective risk management strategies are applied to manage risk in investments and other areas of client's financial life.
Agent or Distributor: Agent or Distributor is paid by the manufactures (company whose product is sold) so he is representative of respective company and therefore control of relationship remains with that company	**Financial Planner:** Financial planner is paid by investor so he is investor's representative and therefore control of relationship remains with investor.
Portfolio and Plan Review : Here is no process to review portfolio and make necessary changes as per changing as per changing scenarios of economy and client's life.	**Reviews are part of process:** Portfolios are reviewed and necessary changes are made as and when required at regular periodic interval.



What is Risk Profiling, and why must you do it?

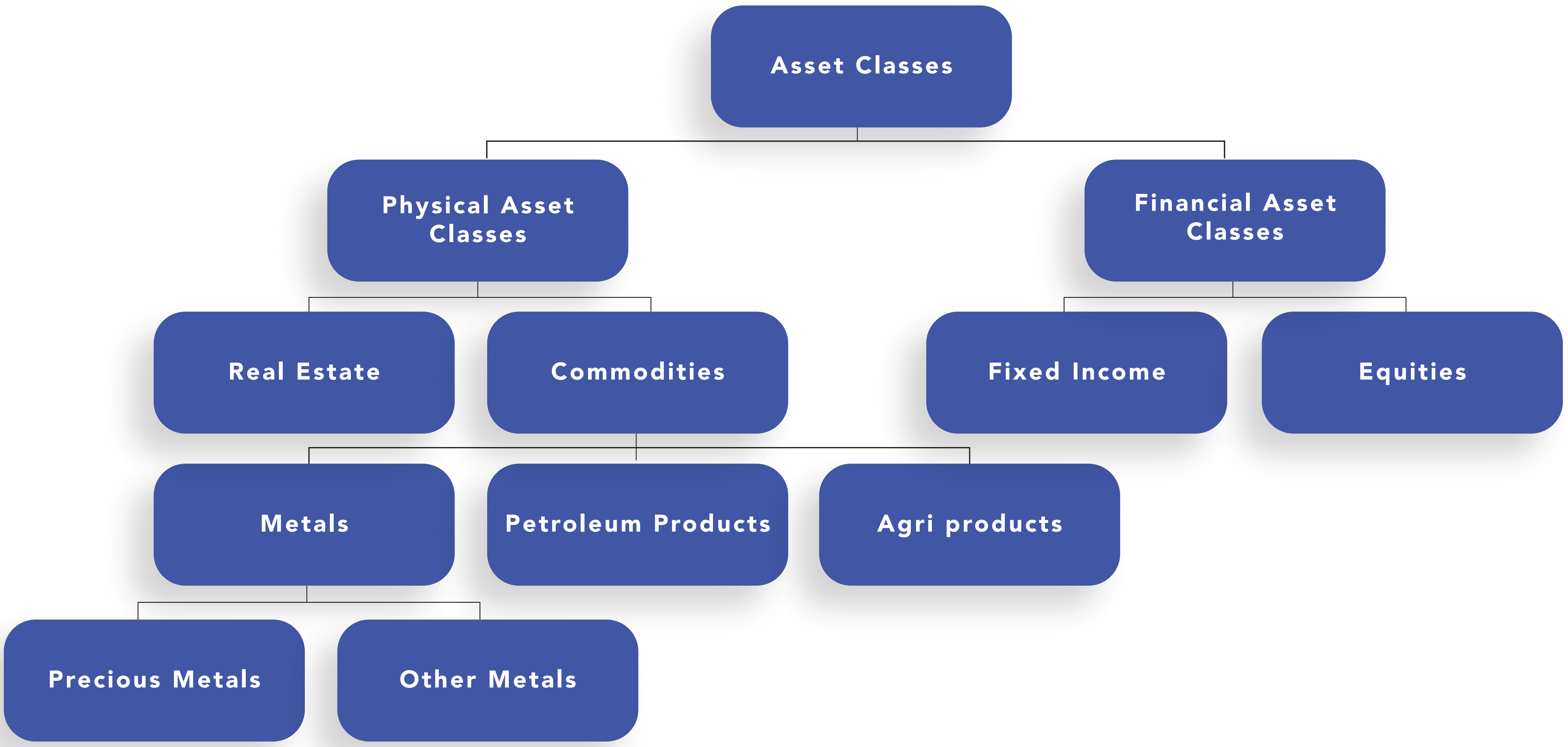
Risk Profiling

Ability

Willingness

Need

Usually, I have seen that when it comes to investing in different asset classes, every investor is confused about how much I should invest in asset classes like Equity, where the Risk is high, and how much should I invest in asset classes like Bonds, where the risk level is low. Most clients who come to me for financial planning are under-invested or over-invested in aggressive asset classes like Equity. There are very few investors who have ideal allocation in all Asset Classes. Deciding how much allocation should be taken in which asset class depends upon the investor's Risk appetite, and risk appetite is determined by doing Risk Profiling. So, this article is an effort to explain Risk Profiling and the factors on which Risk profiling of an investor depends.



Risk profiling decides the optimum risk level an Individual Investor should take in his investments. As shown in the above picture, Asset classes are divided into two segments: Physical and Financial asset classes. Within Financial asset classes, you have two options: – Equity and Fixed Income, and in Physical asset classes, you have Real Estate and Commodities. Now, every investor has to decide on an optimum mix of these asset classes. To choose his optimum risk level, the investor has to determine his risk appetite; for this, he must do his risk profiling. The risk level that an individual investor should take depends upon three major factors, which are as follows

1.Capacity to Take Risk: This depends upon the risk-taking capacity of an investor, depending upon his circumstances. For example, an investor who is 35 years old generally has a higher ability to take risks than an investor who is 75 years old. When deciding on risk-taking capacity, there are a number of factors that need to be considered. Below, I have mentioned a few of them.

- **Age:** One of the significant factors in deciding risk-taking ability is age. Usually, the higher the age, the lower the ability to take risks. But this is not always true. Let me give you an example to explain this. I recently wrote a financial plan for a young doctor who just completed his post-graduation and is about to start his working life. His short-term financial objectives include getting married, buying a house and planning for his clinic. All these objectives are concise, so we cannot invest much money for the long term or take much exposure in Equity-type asset classes.

- **Investment Horizon:** The investment horizon plays a significant role in deciding the risk-taking capacity of an investor. Say if an investor is investing for 15 years, then he has a long-term period so he can take higher exposure to aggressive asset classes like equity and real estate. But if he is investing for two years only, then he has limited time, so he should not invest in risky asset classes, and his risk-taking capacity is low. The longer the investment horizon, the higher the risk-taking ability, and the lower the investment horizon, the lower the risk-taking ability.

Other factors that contribute to deciding risk-taking ability are type of income, health conditions, number of dependents in a family, etc.

1.Need to Take Risk: Need to take Risk is another financial character that decides the optimum risk level for an Investor. Let me explain that you need to Take a Risk with an illustration to make it simple. There are two investors, Mr. A and Mr. B.

Name of Investor	Financial Goal	Age of Child	Money Req. Today	Money Req at the Age of	Inflation	Goal value at 18 age
Mr.A	Creating Child Education Fund	5	2,000,000	18	8%	5,439,247
Mr.B	Creating Child Education Fund	5	2,000,000	18	8%	5,439,247

In the above illustration, Mr. A and Mr. B has the same goal. They have a five-year-old kid, and the education fund required in today's value is Rs. 2000000/- and the fund will be required at 18 years of age. Inflation is assumed to be 8%. The final goal value is around Rs. 54.39 lacs to be achieved. I have purposefully kept all the factors the same for better understanding. Now look at the below table.

Name of Investor	Goal Value	Amount already	Req.Rate of return
Mr.A	5,439,247	1,700,000	9%
Mr.B	5,439,247	1,200,000	12%

In the above case, both Mr. A and Mr. B have the same goal value, but Mr. A has already provided Rs. 17 lacs for the above goal, and Mr. B has provided only Rs. 12 lacs. So, for the remaining period of 13 years, Mr. A can quickly achieve the goal only by investing this fund of Rs. 17 lacs at 9% p.a. returns, which are quite easy to reach and can be achieved with meager equity allocation, say by investing between 10% to 20% in Equity and rest in Bonds. For Whereas Mr. B, to achieve this goal by investing this fund of Rs. 12 lacs, he will have to invest at 12% p.a.; for this, he will have to take high Risk and invest more than 50% in Equity. So, in his case, the need to take risks is increased.

To simplify further, in the case of an investor who has lots of accumulated wealth compared to his financial goals, the need to take Risk is low, so logically, he should take less Risk and allocate less money to high-risk asset classes like Equity and investor who has relatively low accumulated wealth against his financial goals needs to take high Risk. So, he should logically allocate more money to risky asset classes like Equity.

3.Willingness to take Risks: The capacity to take Risks and the Need to Take Risks are two financial characteristics of the investor. The Willingness to take risks is a psychological characteristic of an investor's risk profiling. The Willingness to take Risks is the investor's psychological comfort level with the Risk.

Psychological comfort level means how comfortable you are with volatility in the underlying asset class you are investing in. Suppose you have invested 50% of your assets in Equities, and the equity market falls by 20%. In that case, your equity assets can easily fall by 20% or even more, and your total portfolio can drop by around 10%. Are you comfortable with this fall or volatility psychologically? If you feel disturbed and cannot sleep in the night or focus on your work, you have chosen a higher risk level than you ideally should and should lower your equity allocation.

How to improve your Psychological comfort level with different Asset Classes: I would like to share my experience as a Practicing Financial Planner here. When investors come to me for their financial planning, I realize that their understanding of basic financial concepts is inferior because, in India, we don't have formal personal finance education in any education stream like engineering, medicine, etc. Due to poor

understanding the basics, they are afraid of taking Risks. So, first of all, I try to develop a basic understanding of asset classes, explain basic things about asset classes, investment, and their characteristics, and then make them understand what Risk is. And how to manage Risk. Once this understanding is developed, they are comfortable with Risk, and after that, we decide upon the clients' comfortable risk level.

Willingness to take Risks should not change with market conditions: Many times, I have observed that in times when Equity markets are doing very well, investors invest a significant part of their wealth in Equity, and when the equity market falls, they reduce their allocation to Equity and divert towards other asset classes which are doing good at that time. So, this shows that the Willingness of investors keeps changing with sentiments.

This is a hazardous factor, and every investor should be cautious about this and see that your Willingness should not change as per your sentiments because this will affect your investment decisions adversely.

Many financial planners use psychometric test questionnaires to measure the Willingness of investors to take risks, but I think those questionnaires don't take you to the right conclusion.

From the above three factors, Capacity, Need, and Willingness to take Risk, the optimum risk level of the client is decided, and his investments are allocated to different asset classes and managed accordingly. Most financial planners profile their clients in the following five categories, ranging from Very Aggressive to Very Conservative, and then within that category, optimum allocation to different asset classes is given..

Asset Class	Very Aggressive	Aggressive	Moderate	Conservative	Very Conservative
Equity	**70%**	**60%**	**50%**	**40%**	**20%**
Indian Equity	**50%**	**45%**	**40%**	**30%**	**20%**
Large cap	**25%**	**25%**	**20%**	**15%**	**10%**
Mid cap,Small cap and Value	**15%**	**10%**	**10%**	**10%**	**10%**
International Equity	**20%**	**15%**	**10%**	**10%**	**0%**
European Funds	**5%**	**5%**	**5%**	**5%**	**0%**
US Funds	**5%**	**5%**	**5%**	**5%**	**0%**
China	**5%**	**5%**	**0%**	**0%**	**0%**
others	**5%**	**0%**	**0%**	**0%**	**0%**
Fixed Income Investments	**30%**	**40%**	**50%**	**60%**	**80%**
PPF, GPF & EPF	**15%**	**20%**	**20%**	**30%**	**50%**
Debt Mutual Funds, Fixed Deposit, Post office investments etc	**15%**	**20%**	**30%**	**30%**	**30%**

Conclusion

Risk profiling is an essential part of financial planning. It plays a vital role in the construction of every investor's portfolio. Without completing your Risk Profiling process, you cannot know your optimum risk level and what allocation should be given to different asset classes. As a result, you cannot create a portfolio that is good for you.

I often meet investors who need to take a higher risk, and there is also the ability to take an high risk. However, they have not taken the level of Risk that they can take for some other reason, or sometimes they don't know about their allocation in different asset classes. Similarly, sometimes, I find clients who can't take

High risk has taken high exposure to very risky asset classes. So, I would recommend that investors approach qualified financial planners and go through risk profiling so that, based on the above three factors, they can know the optimum risk level for themselves and accordingly create their portfolio.

Thank You Note

We at Ascent Financial Solutions want to express our sincere gratitude for your interest in our ebook. We believe that financial knowledge is empowering, and we're honored to be a part of your financial journey. A special thank you goes to our dedicated team at Ascent Financial Solutions for their hard work and commitment to creating this valuable resource.We hope you find this ebook informative and helpful. Please don't hesitate to share it with your friends and family who may also benefit from this information.