Introduction to

Investment Planning

Investment means putting one's money to work to earn more money. Done wisely, it can help one meet one's financial goals such as buying a new house, paying for a college education etc. Investing even a small amount can produce considerable rewards over the long-term, especially if the same is done regularly.

To do so, one needs to understand the investment options and the relative risk-to-return profile of each of them. Gone are the days of assured returns, limited choices, insulated capital markets and high risk-free returns. Today, one has to deal with increasing complexities of the market and variable interest rates on traditional savings products.

CHOOSING THE BEST INVESTMENT

Choosing the best investment depends on one's personal circumstances as well as general market conditions. However, in each case, the right investment is a balance of 4 things viz. Liquidity, Safety, Returns and Taxation.

Liquidity – how accessible is the money

This determines how easily the investment can be converted into cash, since a part of the investment money must be available to cover any financial emergencies.

Safety – what is the risk involved

The biggest risk is the risk of losing money that has been invested. Another equally important risk is that the investment will not provide enough growth or income to offset even the impact of inflation. But the biggest risk of all is not investing at all.

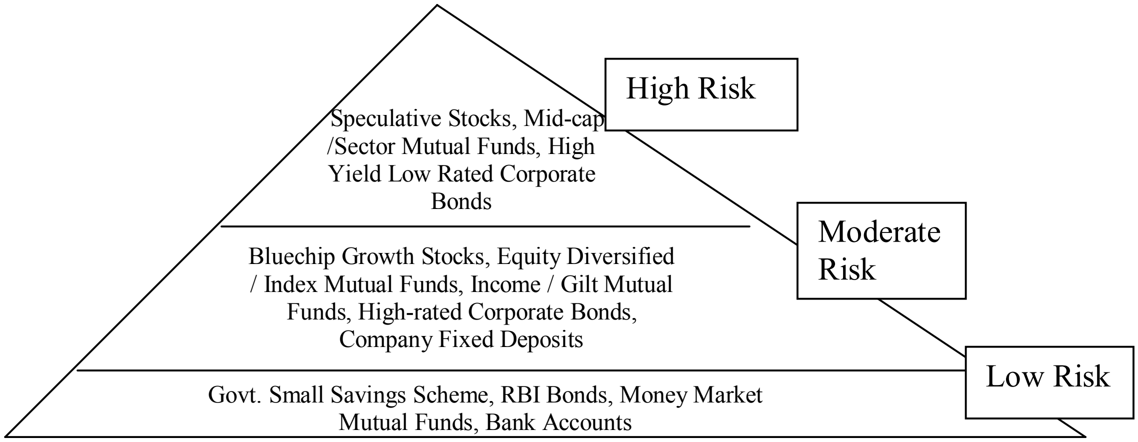
Return – what one can expect to get back on the investment

Investments are made for the purpose of generating returns. Safe investments often promise a specified but 'limited' return. Those that involve more risk offer the opportunity to make – or lose – a lot more money.

Taxation – what tax benefits are available and the investor's tax bracket

Tax payable on the earnings/returns plays an important role in deciding on the suitability of an investment opportunity.

The range of the investment choices and their relative risk factors is often described as a pyramid.



The base of the pyramid consists of those investments, which are highly liquid (enough to cover 3-6 months of living expenses) and/or safe. The bulk of the portfolio (the mid-segment of the pyramid) should comprise the limited and moderate risk investment. And only a small percentage of the total portfolio (or the top portion of the pyramid) should be invested in the high risk category.

TYPES OF INVESTMENT RISK

One is exposed to different kinds of risks with different types of investments and one need to match the same with one's risk profile.

Credit Risk : The risk is that the issuer of the security will default or not repay the principal and/or interest. This risk is mainly valid for corporate bonds etc.

Liquidity Risk : The risk is that the security is not saleable or tradable in the market i.e. the money gets stuck creating an asset-liability mismatch. Valid for stocks, bonds etc.

Market Risk : The risk is that the financial markets are volatile in nature. The more volatile the investment, the more are the chances of making higher profit or loss. Valid for stocks, equity mutual funds etc.

Interest rate risk : The changes in the interest rates affect the returns from the debt-based instruments. This can be a big risk in times of economic uncertainty. Valid for bonds, Govt. securities, debt mutual funds etc.

INVESTMENT STRATEGIES

One can make one's own investment choices or adopt one after consulting financial experts or investment advisors. Whatever method one uses, one should keep in mind the importance of diversification and the need for strategy to guide one's choices.

The options one chooses to invest in, reflect the investment strategy, which can be broadly classified as Conservative, Moderate and Aggressive.

Conservative : Take only limited risk by concentrating on secure, fixed-income investments etc.

Moderate : Take moderate risk by investing in mutual funds, bonds, select bluechip equity shares etc.

Aggressive : Take major risk on investment in order to have high (above-average) returns like speculative equity shares etc.

Portfolio / Asset	Very Conservative	Conservative	Moderate	Aggressive	Very Aggressive
Cash	10%	10%	10%	10%	5%
Debt	90%	80%	60%	30%	10%
Equity	0%	10%	30%	60%	85%

UNDERSTANDING INVESTMENT CHOICES

There are 3 basic investment categories i.e. Equity, Debt and Cash. The key to investment success is in understanding how each asset class performs over the various investment horizons, the choices within each category and risks involved in making investment decisions in each of these choices.

Cash investments include money in bank accounts and other liquid investments.

Debt Instruments or Bonds are loans an investor makes to companies/Govt. They promise a fixed return. However, the promise of the getting the money back is dependent on who is making the promise. In case of Govt., the promise will certainly get fulfilled, but if the issuer of debt is a company, the quality of the issuer needs to be adjudged, to ascertain its ability to keep the promise.

Equity or Stocks are ownership shares, which the investor buys in a company. There is no fixed rate of return as one is taking part in the opportunity and the risk associated with the business. These are relatively riskier form of investment.

Asset Class	Example	Risk
Cash	Savings deposits in a bank, Liquid Mutual Funds	Low
Debt	RBI Bonds, PPF, Post Office Schemes, Company Fixed Deposits, Debt based Mutual Funds, Debentures/Bonds	Low to Medium, depending upon the type of the issuer.
Equity	Equity-based Mutual Funds, Shares issued by various companies	High

INVESTMENT OPTIONS

Mutual Funds

These offer a very wide choice of investment options such as
Debt-based – Liquid, Income, Gilt, Dynamic, Floating Rate, Fixed Maturity
Equity-based – Diversified, ELSS, Sectoral
Balanced – Different mixes of debt and equity

They offer an excellent investment opportunity on account of the

a) wide variety of schemes
b) tax benefits
c) high liquidity
d) professional fund management
e) transparency
f) diversification
g) convenient administration
h) flexibility
i) well regulated.

Equity

Direct investment into shares/stocks listed on the NSE/BSE or thru' the Initial Public Offers.

Post Office Schemes

PPF, Monthly Income Schemes, NSC and KVP, with the returns presently around 8-8.5% and investment horizon of 6-15 years.

RBI Bonds

8% Taxable Bonds with investment period of 6 years.

Insurance

Various plans available such as ULIP, Term Assurance Plan, Whole-Life Plan, Endowment Plan, Money Back Plan, Children's Plan and Pension Plan, each suited to a specific need. As these take care of insurance also, the returns from insurance products are generally lower than pure investment products. As such these are ideally suited in case one is looking for pure insurance or to take advantage of tax concessions available.

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