Long term Investments

Prakash explains to Rajendra and Leela that while planning for long term investments, they need to choose suitable long term investments to help them achieve their goals. The three main long term investments that help in meeting long term goals are equity (and equity based investment products such as MFs, etc), long term bonds and insurance. All these three products perform a unique role based on their features.

Shares

Any investment plan to meet any long term goal is incomplete with shares, irrespective how risk averse you are. Studies from across the world and across different time frames show that shares give the best return from all investment products, when kept for a long period of time – at least 7-10 years. Of course the assumption here is that you have invested in the shares of companies which have good investment potential.

For instance, Rs. 1000 invested in shares of SBI for a period of 10 years (March 2001 to March 2011) would have become Rs. 11,750. Similarly, Rs. 1000 invested in BHEL, Tata Motors and HDFC for the same 10 year period would have become Rs. 26,500, Rs. 15,770 and Rs. 1,67,500, respectively. These are just a few examples of how money can grow when invested in shares for a long period of time.

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Equity or shares differ from fixed income products such as bonds and deposits. In the case of the latter, you are lending your money to some organisation or depositing it with an organisation. They make use of your money for a certain period of time and give it back to you. They pay you a fixed amount of money for allowing them to use your money. In the case of equity, you are actually purchasing a part of a business, although it may be a very small part. That's probably why what you own are called “shares”.

So, for instance, let's say a company Lakhpati Ltd. required an amount of Rs. 1,00,000 to start its business. Assume it divided that amount into 1000 shares of Rs. 10 each. Then various people invested in that business by purchasing those 1000 shares. Some people purchased just 10-15 shares while others, especially those who are actively running the business may have purchased even 500 to 600 shares. And all those who own shares in Lakhpati Ltd. are part owners, to different extents.

Now suppose the share is listed on the Bombay Stock Exchange for trading. Since the company is performing well and has a bright future, people are ready to purchase a Rs. 10 share for Rs. 15. Some people who purchased a few shares may want to sell their shares and get a profit. So, once the company is listed on the stock exchange, any share-holder can sell shares and anyone else can buy shares. Buyers and sellers of shares will contact brokers to do their buying and selling through the exchange. This is because the exchange only allows registered brokers to buy and sell. In exchange for their services, the buyers and sellers will pay brokerage to the brokers.

Every year, when the company makes profits, it shares some of this profit with share holders and uses the rest to grow the business. The amount that is given to share holders is called dividend. It is given to the shareholders who own the shares on a particular date. This is because the shares keep getting bought and sold, sometimes during the same day!

Now, as years go by, and the company keeps doing well, the price that people are willing to pay for the shares of the company keep increasing. The amount of profit that a company distributed to its share holders may also increase. It is for this reason that investing in well chosen shares can give investors a very good return over the long run.

Advised to keep shares for a long period of time

- It takes time for businesses and companies to grow. So investing and expecting good results immediately is not possible
- The prices of stocks are affected by factors other than the performance of the company. Political events, economic performance of the country, natural calamities, international happenings, etc. All make the price of shares go up or down. So investing for the long run usually insures that though prices may move up and down due to other factors in the short run, they will reflect the value of the company in the long run.

Cautions while investing in shares

- If somehow, you purchase the shares of a company that does not do well, the value of the share may fall and although you invested Rs. 50 to purchase one share you may get back only Rs. 20.

- Worse still, no body may want to purchase your shares when you need the money and want to sell them. This is a rare case... but it is possible.
- When you need your money urgently, you may be able to sell your shares but you may not get a good price for them, simply because you sold during a down market.

Useful advice while investing in shares

- The most important precaution is 'do your homework'...understand the business of the shares you invest in. Make sure you are truly convinced that the company will do well. Learn about its management and how they plan to grow the business; who requires their products and will the demand for such products keep increasing; who will be supplying them raw materials and will the prices of these keep rising. Take interest in every little aspect of the company. It is, after all, partly your company.
- Stay invested for the long term but keep a track of the performance of the companies that you have invested in from time to time. Don't panic and sell your shares if the price of the stock is falling – especially if the prices of most stocks in the market are falling. Don't be greedy and sell off your shares if you find that the price of the company you have invested in has risen a little – especially if the prices of most stocks in the market are rising. Only if you feel that the company does not show any future promise, it's time to sell your shares.

Bonds

From time to time, the government, government companies and private companies issue bonds. These are fixed income instruments with a specific investment tenure and a specific rate of interest. The investment term of these financial products is usually long and the rate of interest is usually higher than the rate paid on shorter term products from the same borrower. For example, a 5 year government bond will offer a lower rate of interest than a 10 year government bond. Similarly, a 5 year corporate bond (a bond from a private company) will offer a lower rate of interest than a 10 year corporate bond. A longer term bond usually offers a higher rate than a shorter term bond because your money will be blocked in such investments for a long period of time.

These bonds are a very good investment for meeting long term goals due to their long term and high rate of interest. However, they require a lump sum investment. Further, if you would like to disinvest from bonds, you can. However, you will receive a market rate for the bond which may be higher or lower than the rate at which you have purchased it. For instance, an 8% Rs. 100 bond may sell for Rs. 98 if interest rates are rising. Then again, if interest rates are falling, you may get more than Rs. 100 for the same bond.

Some bonds even offer tax incentives.

A Systematic Investment Plan (SIP)

A Systematic Investment Plan (SIP) is a vehicle offered by mutual funds to help you save regularly. It is just like a recurring deposit with the post office or bank where you put in a small amount every month. The difference here is that the amount is invested in a mutual fund. The minimum amount to be invested can be as small as Rs 100 and the frequency of investment is usually monthly or quarterly.

How A SIP works

A SIP allows you to take part in the stock market without trying to second-guess its movements.

A SIP means you commit yourself to investing a fixed amount every month. Let's say it is Rs 1,000.

When the Market price of shares fall, the investor benefits by purchasing more units; and is protected by purchasing less when the price rises. Thus the average cost of units is always closer to the lower end. { NAV: Net Asset Value , or the price of one unit of a fund. Can be computed as follows: NAV = [market value of all the investments in the fund + current assets + deposits - liabilities] divided by the number of units outstanding.}

Date	NAV	Approx number of units you will get at Rs. 1000
1-Jan	10	100
1-Feb	10.5	95.23
1-Mar	11	90.9
1-Apr	9.5	105.26
1-May	9	111.11
1-Jun	11.5	86.95
	TOTAL	589.45

Within six months, you would have 5,89.45 units by investing just Rs 1,000 every month. Over the long run, you make money

Let's say you invested in Prudential ICICI Technology Fund during the dotcom and tech boom.

Say you began with Rs 1,000 and kept investing Rs 1,000 every month. This would be the result:

Investment period	Monthly investment	Total amount invested	Value of investment of Mar 7, 2005	Return on investment
Mar 2000 -Mar 2005	Rs 1,000	Rs 61,000	Rs 1,09,315	23.87%

Had you bought the units on March 13, 2000 at Rs 10.88 per unit (that was the NAV then), you would have lost because the NAV was just 7.04 on March 7, 2005. But because you spaced out your investment, you won.

How an SIP scores

It makes you disciplined in your savings. Every month you are forced to keep aside a fixed amount. This could either be debited directly from your account or you could give the mutual fund post-dated cheques.

As you see above, it helps you make money over the long term. Since you get more units when the NAV drops and fewer when it rises, the cost averages out over time. So you tide over all the ups and downs of the market without any drastic losses.

Also, a number of mutual funds do not charge an entry load if you opt for an SIP. This fee is a percentage of the amount you are investing. And if you do not exit (sell your units) within a year of buying the units, you do not have to pay an exit load (same as an entry load, except this is charged when you sell your units).

If, however, you do sell your units within a year, you would be charged an exit load. So it pays to stay invested for the long-run.

The best way to enter a mutual fund is via an SIP. But to get the benefit of an SIP, think of at least a three-year time frame when you won't touch your money.

Of course you would lose money if your units lost value over time.

What most SIP Mutual funds don't tell you is that they recover their fees as monthly charges by selling your units, so while you are buying more units when the market is down, more of your units are also being sold to fund the monthly charges of the Mutual fund. Also the Bid and Offer of the Mutual Fund is around 7% and this is the front load or expense you pay for buying the units each month. Also sometimes the Mutual fund will have annual fee charges.

In spite of the above drawbacks the retail investors' benefit in the long term horizon of 5–8 years is enormous. Only make sure that you can switch your funds from stock market to money market at short notice when the markets are really in a correction phase to safeguard the profits which you have made when the market was in a booming phase.

Insurance

As Prakash explained, there are two main challenges while planning for long term goals. Firstly, inflation increases the value of the goal and secondly, there is a risk that due to some unforeseen event - like the death of the sole earning member of the family – the financial plan may get upset.

Insurance is a product that helps to reduce risks by compensating the family economically. When it is combined with the features of a long term investment product, it also helps to reduce the effect of inflation.

Insurance involves paying a small fixed sum of money (**premium**) for a specified number of years (**term of the plan**) and then receiving a lump sum payment in the event of the death of the insured (sum assured). If the insured lives beyond the term of the insurance policy, you get back nothing. Such insurance plans are called term plans.

However, insurance has changed over the years. Insurance products which help you to meet long term goals have developed. These goals could be anything from giving your children an expensive post-graduate education to funding your retirement. At the same time, they give you the traditional insurance protection and financial security in the event of the death of the insured.

In such cases, insurance companies still collect a fixed amount from the insured. Then part of the money goes towards the basic insurance protection and the remaining is invested on behalf of the insured person. Let's look at some of the most popular types of insurance plans which act as a long term financial product in addition to fulfilling the basic function of insurance.

Moneyback plans

In such plans, you pay a regular premium. Part of the premium is invested on your behalf and the rest pays for your insurance. Then, at fixed intervals – for example every 5 years, for the next 20 years - you will receive lump sums of money. If you die during the term of the plan, your dependents will receive the sum assured. If you do not die, you will still receive the payouts at regular intervals.

Such plans are ideal for those who would like to match the incomes from the plan to milestones in their children's lives. For instance, let's say you purchase a Moneyback plan when your child is 10 years old. Suppose this plan promises to pay out lump sums of money every 5 years for the next 20 years. When you child is 15 years old and ready to go to college, you will receive money. Then, when your child completes his graduation and is ready for post-graduation, you will receive money. After 5 years, you can gift your child a lump sum of money to help him settle in his career. When you receive the last lot of money from the policy, it may contribute to your child's marriage expenses.

Endowment plans

These plans require you to pay a regular premium. If you expire during the term of the plan, your dependents will receive the sum assured; if you survive the plan, you will receive a lump sum.

Such plans are made for those who would like to receive a large amount after a fixed number of years. This could be used towards paying for a home or as a retirement kitty.

Unit Linked Insurance Plans (ULIPs)

When you purchase a ULIP, you will have to pay a regular premium as is usual with insurance products. Part of your premium is used to purchase insurance and the other part is invested. In the case of ULIPs, you decide how the money has to be invested –by choosing a fund or combination of funds presented to you by the mutual fund company. These funds work in a similar manner to regular mutual fund. You are allocated a number of units, based on how much of your money is channelled towards investing. If the fund does well, the value of your units increase.

Such plans enable you to shift your money from one fund offered by them to another. They also allow you to withdraw some part of your money, subject to conditions. And, as in the case of other insurance plans, if you die during the term of the plan, your dependents will receive either other insurance plans, if you die during the term of the plan, your dependents will receive either a sum assured or the value of your units, depending on the plan you have chosen.

There are many variants of the above mentioned plans. They are given different names and packaged as solutions to meet different goals. But one thing remains common, they have become financial products which could help you to meet your goals.A lot of people confuse trading with long term difference,let's find out the difference between these two:

Long-term investing refers to a strategy where you hold on to your investments for a long period, which is generally five years or more. It's one of the ways to make meaningful gains from stock market and equity mutual funds investments, which give the desired results only when you remain committed for the long haul.

To put it otherwise, long-term investing refers to the period until which you hold on to your investment.

Unlike long-term investing, where transactions take place once in five years or more, the frequency is pretty high in **trading**. It refers to a practice whereby investors buy and sell stocks, commodities and other financial instruments frequently, sometimes even in a day.

Done primarily for **short-term gains**, trading is one of the common features of the stock market worldwide. With trading, investors look to cash upon price fluctuations within a short notice.

The main difference between long-term investing and day trading revolves around time. The goal of long-term investing is to build wealth over a long period of time by carefully creating a portfolio of stocks and assets such as mutual funds, bonds and other financial instruments. Day trading, on the other hand, is an approach where the trader buys and sells shares very frequently. The transactions could occur even within a single day. The aim of short term trading is to earn high profits from price fluctuations within a small time horizon..Based on their needs and investment ideology, people choose to be either traders or long term investors.

Key factors that differentiate trading from investing:

Risk and return

When you invest for the long term, you can try to minimise the risk of price fluctuations. Plus, through dividends and compounding returns over the long term, you can earn higher returns over a period of time.

Risks are higher but monthly returns can be greater too. Day traders need to invest large sums of money in order to earn substantial earnings from the small price fluctuations in a single day.

Analysis
Long-term investors use fundamental analysis to find out a stock's intrinsic or real value. They do so through financial metrics, earnings reports and ratios.
Day traders evaluate stock movements through technical analysis. Here, the future value of a stock is determined by using charts and historical patterns.

Commission
Such costs can be insignificant in long term trading since they hold onto a single asset/position

for many years or even decades.
The trader conducts a number of transactions during a single day. This can result in higher brokerage or commission costs for the trader.

Type of assets
In long-term trading, you need to carefully pick out good stocks that can grow and deliver good returns in the future. Look out for stocks with high growth potential and good management teams.
Since day traders are more interested in quick returns during a single day, they look out for stocks with *higher volatility*. This way, they can exploit the price movements to make profits.

Pros of Long-Term Investing

- Brings Compounding into Play
- Takes Emotion Out of Equation
- Easy to Correct Mistakes

Pros of Trading

- Easy and Convenient
- Quick Liquidity

Source: *Portal Content Team*