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6 bad money habits that investors should give up

Synopsis
Some habits can exact a heavy toll on your finances. We look at a few common ones that you should give up.

A cluttered portfolio is difficult to monitor, which prevents the investor from weeding out underperformers.

It is said that we first make our habits, and then our habits make us. Save more, spend less and avoid unnecessary debt are a few good habits that can ensure a financially comfortable life. However, people, including those who are financially literate, also pick up **bad** habits that ultimately disrupt their finances.

Procrastination is the root cause of many bad **financial** habits. It is not unusual to see six-figure balances idling in a savings bank account. That **money** is losing value with every passing day as inflation erodes its purchasing power. That money can be put into a more lucrative investment option with just a few clicks of the mouse. Why, you can even do it on the go using financial apps such as ETMoney. "Funds lying idle in a savings bank account can move instantly into a liquid fund to earn better returns using the Smart Deposit option," says Mukesh Kalra, CEO of ET Money. Just 10-15 minutes can help you earn Rs 4,000-5,000 more on an investment of Rs 1 lakh.

Of course, money idling in a bank account will not have a very serious impact on your finances as some other ruinous routines. Spending too much on needless items, buying life insurance policies to save tax or investing in risky stocks to make quick money are prime examples. Unless these habits are rectified, they can prove detrimental to financial health.

This week's cover story looks at six such common financial habits that need to be 'unfriended' by individuals if they want their finances to be in fine fettle. If you have any of these habits, make sure you stop doing that.

1. Investing in stocks directly without research
Buy stocks directly only if you understand markets and have the time to research and analyse stocks.

The sharp fall in the stock markets has shaken **investors**. Many stocks have fallen to their 52-week lows after the budget. Even bluechips and index stocks have not remained insulated. But several stocks had gone into a tailspin much earlier and for entirely different reasons. DHFL, which was trading above Rs 600 about a year ago, has lost almost 92 percent. On the other hand, mutual funds have not done so badly. Though equity funds will necessarily dip when markets fall, the diversification principle helps in cushioning the fall. Even the worst performing schemes from different categories have not fallen as much as the top losers in BSE 100 in the past one year *(see table).*

BACK TO TOP

Stocks are far riskier than mutual funds

Even bluechip stocks can slip, but diversification cushions the fall for mutual funds

Biggest losers of BSE 100	1-year change (%)	Worst performing funds*	1-year change (%)
Yes Bank	-75.2	ABSL Equity Advantage	-13.0
Indiabulls Hsg Fin	-58.8	DSP Top 100 Equity	-6.5
Edelweiss Fin Ser	-52.8	UTI Mid Cap	-15.9
Motherson Sumi	-50.3	ABSL Resurgent India	-26.0
Tata Motors	-48.7	Sundaram Small Cap	-21.7

**In respective category. Data as on 31 July 2019; Source: ACE MF*

This statistic holds an important lesson: small investors should not invest in stocks directly unless they can give enough time to research. “Retail investors should not venture near direct stocks. Investing in a mutual fund is a much better way to earn money from stocks,” says Suresh Sadagopan, Founder, Ladder7 Financial Advisories. Choosing mutual funds as an investment vehicle will not cut the risk entirely, but it will certainly reduce it.

This simple rule is ignored by millions of investors who are lured by the excitement of buying and selling stocks on their own. Hyderabadbased R.S. Babji *(see picture)* invests in stocks directly as well as equity funds. While his fund portfolio has delivered around 8% returns, he has lost almost Rs 1 lakh in stocks. His stock portfolio is a mix of bluechips such as HDFC Bank, Reliance Industries and Aditya Birla Capital but also has little known names such as Bhansali Engineering Polymers and Butterfly Gandhimathi Appliances. The portfolio also has wealth destroyers such as DHFL and Sintex Plastics. “My foray into the stock market has cost me a lot of money,” rues Babji.

R.S. Babji, 45, Hyderabad

"Investing in stocks directly is not my cup of tea. My foray in this field has cost me dearly. Regular investing in equity funds is a better way to make money."

Money-unfriendly move: Investing randomly in stocks. He has gained Rs 65,000 from his equity funds but lost over Rs 1 lakh in stocks.

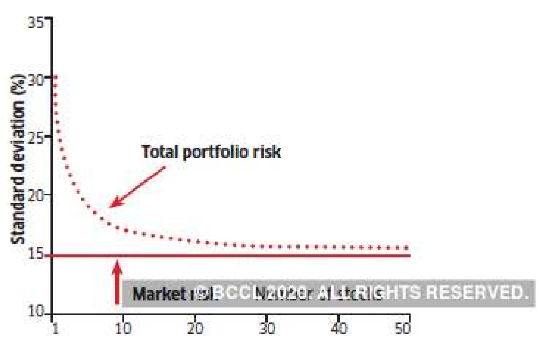
Lesson learnt: Investing through mutual fund route is a better idea if have the time or expertise.

2. Buying too many stocks, funds to diversify

Investing in too many stocks or several funds from the same category does not completely reduce the risk.

Diversification spreads the risk thin across a basket of securities. But too much of it can prove counterproductive. The modern portfolio theory says that 15-20 stocks from different sectors reduces the portfolio risk. But that's where it stops. Adding more stocks does not reduce the risk further *(see graph)* because the market risk cannot be wiped out completely.

Too many stocks don't reduce risk beyond a point



The situation is no different when investing in mutual funds. While it is a good idea to invest across fund categories, buying too many funds of the same category does not diversify the portfolio. “There is very little variation in the portfolios of large-cap funds. The top 10 holdings of the biggest large-cap funds are more or less the same stocks, though the percentage exposure to individual stocks may vary a little,” says Deepti Goel, Associate Partner, Alpha Capital. So, if you buy too many such funds, you are only duplicating your holdings.

Ideally, 6-8 equity funds focused on different segments give the portfolio all the diversification it needs. A well diversified equity fund portfolio will have 40% of the corpus in 1-2 large-cap funds, followed by 30% in 1-2 multicap funds and 20% in 1-2 mid-cap funds. The balance 10% can be put in a small-cap fund as the return booster.

Pune-based Hitesh Siroya *(see picture)* is an avid investor who reads fund reviews and invest in the best performing schemes. But since winners keep changing every year or so, his portfolio is now bursting at its seams with 30-odd fund Siroya wants to reduce the number of funds but is not sure which schemes to get rid off. “I want to cut the number to about 7-8 funds,” he says.

Hitesh Siroya, 39, Pune

“I used to read fund reviews and invest in the best performing mutual funds. However, I now have more than 30 funds and it has become difficult to monitor their performance.”
Money-unfriendly move: Investing in too many mutual funds, leading to an unwieldy portfolio.
Lesson learnt: A cluttered portfolio is difficult to monitor, which prevents the investor from weeding out underperformers.

To be sure, holding too many funds may not actually hurt returns, unless the schemes themselves are doing poorly. “It’s only that a large number of funds are difficult to monitor and one may continue with underperforming schemes. This could hit returns in the long run,” says Raj Khosla, Managing Director, MyMoneyMantra.com.

BACK TO TOP

3. Not saving for emergencies
Be prepared for unforeseen expenses and other financial contingencies.

Rising lifestyle expenses and the proliferation of spending avenues can make people, especially the younger generation, oblivious to the basic necessities of life. A 2018 study by health insurance company Cigna says one in two respondents in India plan to use their retirement savings to fund their medical expenses in old age. Only 40% respondents said they had purchased health insurance, pointing to the extent of unpreparedness. This is still better than the 2016 study, which had found that over 65% of respondents had paid for hospital expenses out of their own pocket.

Aiding the spending spree are credit cards and mobile wallets. While these are tools of convenience, irresponsible use lead one into a debt trap. "Many youngsters spend using credit cards without understanding the interest calculations," points out Tejal Gandhi, Founder, Money Matters.

Mumbai resident Kirti Patial, 30, woke up late when reality hit home. Patial had a good salary but focused on spending rather than saving. New clothes, eating out and travel cornered over 75% of her income, leaving her with very little by the end of month. The reality hit her when she was forced to postpone an eye surgery because she had no savings.

Kirti Patial, 30, Mumbai

"I spent too much on clothes and eating out. As I had no savings, I had to wait for three years before I could afford an eye surgery that cost Rs 65,000."
Money-unfriendly move: Spent almost entire income and did not save anything.
Lesson learnt: Save regularly and build an emergency fund for unforeseen expenses.

Now, she has started two SIPs of Rs 10,000 each in equity funds. However, she also needs to buy health insurance and build a savings kitty for emergencies and other needs. The emergency fund should be equal to 6-8 months household expenses.

If you are living in a metro, look at a minimum cover of Rs 5 lakh, and top it up after a review every five years. Those with dependents should buy a pure risk life insurance cover that is at least 10-15 times their annual income, if not more. Ideally, it should be computed after taking into account your income, family's lifestyle and outstanding liabilities.

Also read: How investors of different ages should handle money

4. Buying insurance to save tax
Tax deduction should not be the primary motive of buying life insurance

Every year, millions of buyers pour crores of rupees into insurance plans they don't need. Most of them are lured by the "triple benefits" of tax deduction at the time of investment, life cover during the policy term and tax-free income on maturity. However, while traditional insurance plans do provide tax benefits, they neither offer sufficient insurance cover, nor give very good returns. Ulips are only slightly better but are plagued with problems such as lack of transparency, liquidity and flexibility.

The real objective of the plan, the insurance cover offered in case of death, is the last thing on the mind of the average insurance buyer. His primary focus is the tax deduction under Section 80C. This is what makes it easy for distributors to mis-sell them to unsuspecting buyers. Meet Raj Naik, a 63-year-old pensioner who was sold a Ulip three years ago. When the bank executive saw his retirement benefits credited to his bank account, he immediately offered him an investment plan to save tax. Naik invested in the plan only because he could claim deduction under Section 80C for the annual premium of Rs 1.5 lakh. But after pouring in Rs 4.5 lakh into the Ulip over three years, he finds that the fund value is only Rs 4 lakh. "The bank staff who sold me the plan are advising me to wait till the fund value recovers," he says.

A senior citizen such as Naik should not have bought a market-linked instrument at this stage of his life. The Senior Citizens' Saving Scheme would have been a better way to save tax and get a regular income.

A Ulip would have been more suitable for a young buyer such as Shrikar Dange *(see picture)*. Instead, he got saddled with low-yield traditional endowment plans. Dange has eight endowment plans and pays an annual premium of Rs 18,000. At his age, he should ideally be investing in equity-oriented instruments such as mutual funds or even a Ulip. He is now contemplating buying a pure protection term plan with a life cover of Rs 1 crore.

Shrikar Dange, 37, Thane

Money-unfriendly move: Bought eight endowment plans that offer low cover.
Lesson learnt: A low-cost term plan is a better alternative to the endowment policies.

Traditional plans often come with words like “guaranteed”, “assured” and “money back” but don’t get lured by such terms. These plans look promising but once you dig deeper, you find that the returns are no more than 5%.

5. Venturing without research
Take major decisions only after properly assessing their viability

The sweet smell of many Indian entrepreneurs’ success over the years has drawn the interest of skilled professionals, who would have otherwise been happy with a day job and a regular salary. However, for every start-up star like Byju Raveendran or Ritesh Agarwal, there are several ventures that have bitten the dust. A study by the IBM Institute for Business Value (IBV) in 2017 estimated that over 90% of Indian startups fail within the first five years. Such failures need not deter up and coming wantrepreneurs, but the data underlines the need to tread cautiously – something that Mitali Palkar, a finance professional, wishes she had done a few years ago.

Palkar quit her stable job in 2011 to devote her time a direct selling venture. She started by putting in Rs 1.5 lakh into the gig, which was originally intended to be a supplementary income source. However, her plans of expanding the venture hit a roadblock when the company faced legal and regulatory headwinds, coming to a halt abruptly in 2014. The loss of regular income was a setback as she and her husband were servicing EMIs on a home and personal loan and had to take care of their kids’ school expenses too. It was a difficult time and Palkar struggled for almost a year before landing a full-time job and regaining the financial security she sought. “I made the mistake of treating what was my second stream of income as my primary earning source and gave up my stable job in the process,” says Palkar.

Mitali Palkar, 39, Mumbai

“Treating a side activity as the primary source of income and giving up my job to pursue business was a mistake. I have now regained my job.”
Money-unfriendly move: Quit a stable job to start direct marketing business.
Lesson learnt: Do not quit your job unless you can stomach risks and have assessed in detail the long-term viability of the business model.

Pursuing your passion can be a highly rewarding experience that is worth the risk at any lifestage. However, you need to put in place adequate safeguards before embarking on such a venture. For one, ensure that the field is compliant with laws and regulations in the country.

Secondly, on the personal front, you need to have enough set aside to fund your entrepreneurial dreams. "Be prepared to to not only invest in setting up the business but also have enough working capital for the first 6-9 months," says Dheraj Kumar, MD of Jumbo King **(see guest column here)** .

Also, set aside at least 6-9 month's expenses to ensure that the household runs smoothly. Most importantly, assess you risk profile – if you cannot do without regular income, you may not be able to stomach the volatility of business.

6. Ignoring outstanding debt
Don't neglect credit card statements and SMS alerts from your bank

Credit card frauds are now as everyday as the common cold. The banking ombudsman report says that credit card related complaints increased by over 50% in 2017-18. Of these, 30% pertained to wrong billing or debits and 8% to wrong or delayed reporting and non-updation of credit status to credit information bureaus.

Credit card charges
Balance rollover: 2-3% a month
Late payment: Rs 250-500
Cash withdrawal: 2.5% of amount (minimum Rs 250)
Annual fee: Rs 500-1,500

Urvisha and Rahul Bhalani faced a similar challenge in 2009, when not monitoring transactions landed them in a soup. Rahul's credit card was used without his knowledge to book flight tickets worth Rs 4,000 online. He did not check his credit card statements then, but later contested the charge. Over the next 11 months, the amount gathered penalties and interest and swelled to Rs 11,000. Finally, the bank sent him a notice. His wife Urvisha, herself a banker, spoke to the bank concerned. The Bhalanis filed a case in the consumer court but the unpaid bill affected Rahul's credit score. When they applied for a home loan, the poor credit score affected their chances. "We finally cleared the dues and got a no objection certificate from the bank," Urvisha explains. Subsequently, the home loan was approved.

Urvisha Bhalani, 39, Mumbai

BACK TO TOP

"When we applied for a home loan, the unpaid bill showed up in the credit report. We had to settle it."

Money-unfriendly move: Ignored credit card bill for a fraudulent purchase for months, which dented credit score.

Lesson learnt: Monitor credit card statements and SMS alerts. Debt doesn't go away if you neglect it.

Now, RBI rules mandate SMS alerts to customers. Do not neglect these messages, particularly multiple transaction alerts. Report any unauthorised transactions within three working days to ensure zero liability for any fraud.