PERSONAL FINANCE

- Planning
- Concept
- Approach

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Financial Management : Meaning and Importance

Meaning :-

"Financial management is nothing but to manage cash out flow by considering the cash inflow and future obligation towards family."

Why is Financial Planning Required

- Long term and short term objective.
- Secure the future of yourself and family.
- Unpredicted events.
- Family future protection
- Peaceful retired life
- Discharge of family obligation

Impact of Inflation on Personal Finance

- If inflation remains high, household budgets is not the only thing that will be affected.
- In the long run it is going to adversely affect the common man's savings which are largely dependent on fixed income instruments.
- It looks like investors might have to settle for negative returns, considering that inflation rates have been consistently higher than provident fund rates (8.5%), small saving rates (8%) and bank deposit rates (less than 8%).
- Real return on fixed income securities like bonds and fixed deposits decreases. For example, (Real return = Rate of return from investments – Inflation rate). So, a bond which pays say 8.5% interest rate actually gives a real return of just 1% if the inflation is 7.5%.

Savings Habits

- A proverb says “Money saved is the money earned”. So we have to save our money which increases our income.

- It's not only how much money you make, it's how much you keep.

- As cash flow comes in, you have to be watchful not to spend it as fast or faster than you make it. Track and control your finances.

Saving Habits: Money saving tips

- Everybody in the world wants to earn and enjoy good money. But most of the people may not know how to save money for future.
- Always try to save 30 % or more of your earnings.
- First try to satisfy yourself that you have not earned that 30 % money. Then only you are able to save money.

Savings Habits (Cont'd)

1. Pay yourself first: -

- Saving is your first source of capital, so pay yourself first.
- Spending means you pay others first.

2. 70 / 30 Rule :-

- Active Income - (Earned Income)

  70% to fund your needs and living expenses

  30% to build your wealth

- Passive Income – (Unearned Income)

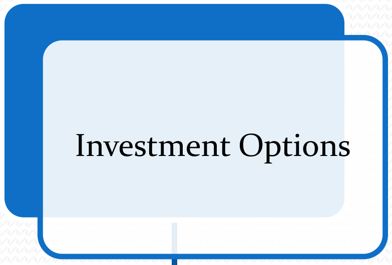
  Income from "rental activities" and "trade & business activities in which you do not materially participate".

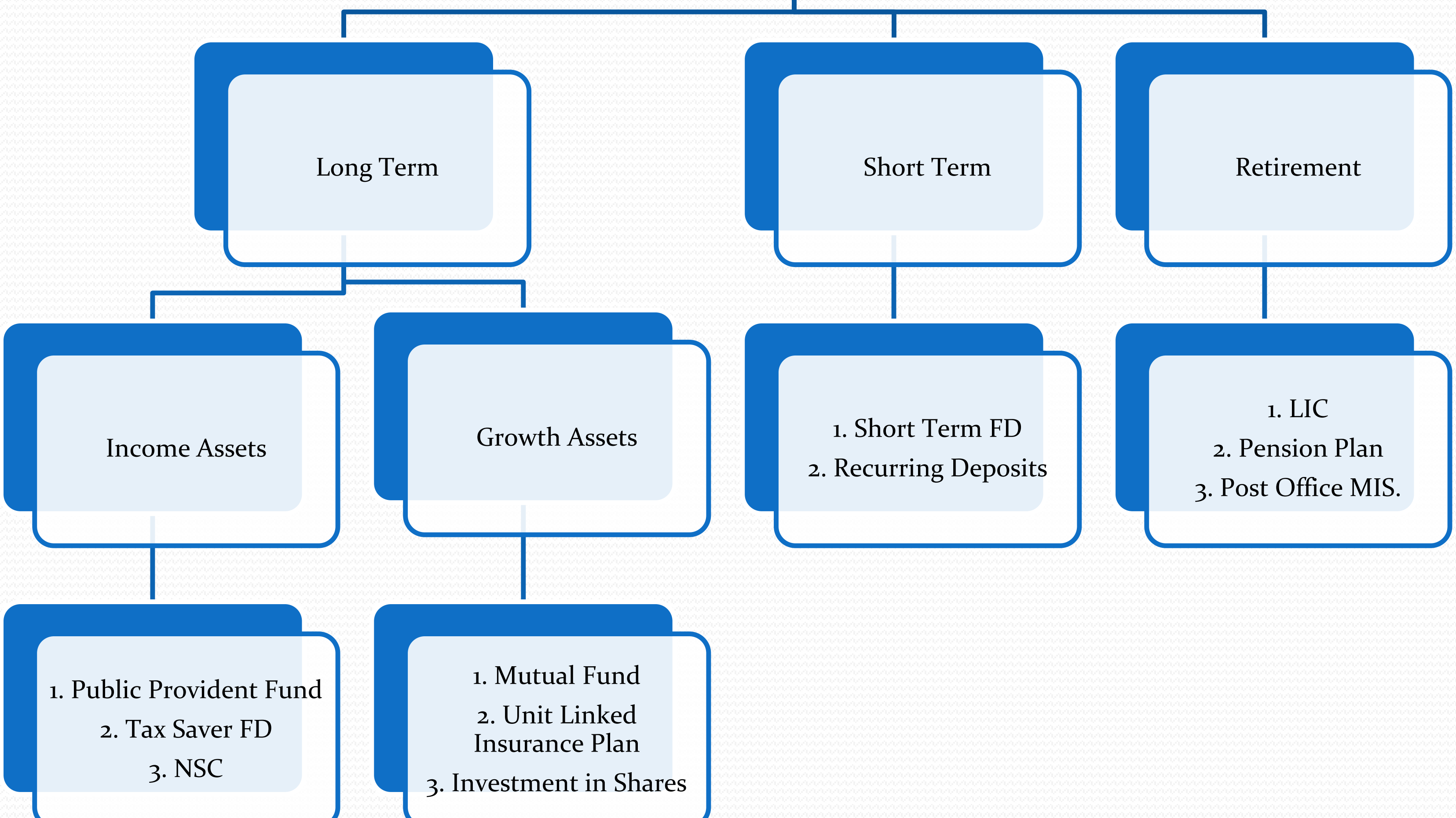
Personal Budget

To prepare the personal budget is most important for every individual because it helps to manage cash & investment in order to meet short term and long term objective of his & his family.

Category	% of net spendable	Annual Amount	Monthly Amount
Net Income			
Less: - Saving (save up to 30% of Income)			
Net Spendable			
Less: - Various Expenses			
Residual Income			

Investment Options





Investment Options (Cont'd)

1. Mutual Fund: - is an investment trust that collects money from investors having a common financial goal.

   Types of Mutual Fund :-

   a) Fixed Income

   b) Growth

2. Bank Fixed Deposit :-

   i) The tenure can vary from 7, 15, 30, 45 days to 3, 6 months, 1 year, 1.5 years and 5 years.

   ii) Investors also have the flexibility to take the interest income as a lump sum amount on its maturity, monthly & quarterly.

   iii) interest income earned on fixed deposit is taxable.

   iv) It is also possible to get loans.

Investment Options (Cont'd)

3. National Saving Certificate : -

i) Investments in NSC are eligible under section 80 C of Income Tax Act.

ii) Annual Interest income qualifies for tax rebate under section 80C of income tax act, if it is deemed to be reinvested

iii) Interest income is taxable but not deducted at source.

4. Public Provident Fund (PPF):-

i) Investment up to Rs 1,50,000/- per year is allowed.

ii) Can take a loan on the PPF account after completion of the third year opening of the account.

iii) Interest on PPF is exempt from tax.

iv) Deduction u/s 80C (revised as per Finance Act-14) up to Rs 1,50,000/- (assumed no other deductions claimed).

Investment Options (Cont'd)

5.Unit-linked insurance plan (ULIP) :-

i) A ULIP is basically a combination of insurance as well as investment.

ii) A part of the premium paid is utilized to provide insurance cover to the policy holder

while the remaining portion is invested in various equity and debt schemes.

iii) Deduction u/s 80C is allowed.

How much to Invest in each?

Best way is to invest your 30% savings based on risk and return strategy.

Assessment of Risk Appetite

- Risk appetite of a person depends on the person's attitude.
- One principle is to be born in mind no Risk no High Return.
- Younger persons can take calculated risks to build their corpus to beat Inflation.
- Otherwise the corpus will not grow at higher rate.
- History has proved that only equity class of assets has given Higher returns in past.
- However direct exposure of equity should be avoided & MF route is better option.

Assessment of Risk Appetite (Cont'd)

There are various models are available to assess each individual Risk Profile.

Generally on conservative basis at the age of 30 years the portfolio distribution of a person should be minimum 40% in risky assets (equity MF) & remaining debt (risk free).

On the flip side person who is willing to take risk, the investment in the equity based MF should not exceed 65% of the total investment.

As the age increases risk appetite of person reduces. Risk taking ability reduces by 10% in every 10 yrs.

So at the age of 60 only 10% investment should be in equity.

Major Financial Planning Areas

- Risk appetite of investor is influenced by various financial planning areas which are as follows:
  - Consumption and Savings Planning
  - Debt Planning
  - Insurance Planning
  - Investment Planning
  - Retirement Planning
  - Estate Planning
  - Income Tax Planning
  - Career Planning

Life-Cycle & Financial Planning

Life-Cycle Phases	Financial Planning Areas
Young adult (18–25)	Consumption and savings; career
Family formation (26–35)	Consumption and savings; career; debt; insurance; income taxes
Family development (36–49)	Investment; retirement; income taxes
Family maturity (50–60)	Investment; retirement; estate
Retirement (60–?)	Estate; income taxes

Insurance

- Sum insured should be at least 10 to 12 time of the annual gross income.

- Insurance diversification should be made according to the availability of income to invest.

- In order to maintain the available cash flow substantial part of insurance should be made in term insurance & part should be insured through ROP (return of premium).

- Insurance should not be treated as mode of investment; however it is a risk cover protection.

Investment / Mutual Fund

- Investment in mutual fund should be made in the MF in a diversified manner.
- Investment in MF having top 100 securities or sector specific MF should be preferred.
- Investment selection should be based on 3 aspects: safety, security & liquidity.
- It is preferable to invest in listed instruments in the demat format.
- Investment portfolio should not too long as it gets difficult to monitor the investments.
- We should review our investment portfolio at least once in a year.

Investment / Mutual Fund (Cont'd)

- Investor should have equity & debt mix through same MF house so that shifting of debt into equity & vice versa can be done easily & systematically according to the movement of prices in the market.

- <u>For Example: </u>According to perception of the Investor about current market scenario, investor would decide his appropriate mix of debt & equity instruments. Risk neutral investor would think today's market achieved price index about 80%. Thus he will have his investments in debt securities more than equity. As price increases he will shift his debt fund into equity which will result into gaining more profit due to price rise. When price of the market decreases he will shift amt into debt fund in order to prevent losses & have stable income during the period in which price is low.

Contingency Planning

- Contingency plan should be made in order to secure our emergency cash outflows.

- Amount kept aside for contingency should be at least 1 yr. annual income. It should be kept in liquid FD or any other liquid source of investment.

Buying Dream Home

8 Things to Be Kept In Mind before Buying a House:-

- Conduct your own Survey
- Find out the current market rates
- Make your own Budget
- Get the best rates
- Security
- Check on the surrounding infrastructure
- Keep an eye for hidden costs
- Check on the property

Rent Vs. Buy Decision

- Immovable Asset owned must be utilized & not a better option of investment unless person has enough surplus.
- Immovable asset purchasing decision should be based upon ratio of the “Return of Rent vs. Value of Asset” basis.
- Lower the ratio; rent would be a better option as it will not only save but it indicates less possibility of asset value appreciation in future & vice versa.
- Buying of property is beneficial when the ratio is equal to or exceed 5 to 6%
- Generally rent of the asset is around 2.5 to 6% of the total asset on an average. But in case of Tier I cities the ratio is below 3% (ratio is 2.6%-2.8% in Mumbai)
- Low ratio indicates asset is overpriced & the probability of appreciation in the asset value is less.

Rent Vs. Buy Decision (Cont'd)

- <u>For Example:</u> In Powai 2 BHK flat cost at least 2 crores. Rent per month is 30,000 which make it 3.6 lacs per yr (i.e. ratio of rent to asset value is less than 2%). 8% risk free return is Rs. 16 lacs. Post tax yield is Rs. 9.7 lacs approx. Therefore people will prefer to take flat on rent & invest the surplus. This leads to low demand for purchasing the flat & thus price for the flat falls. Opposite will happen if ratio is more than post tax return of investment.

Things to be kept in mind while taking Home Loan

- How much are you expected to pay upfront?
- How much EMI you can afford?
- What are the tax benefits?
- When is the EMI date?
- How is the rate of interest calculated?
- Insure your property
- Don't hesitate to switch

Investment in Gold

- Comparative analysis of Gold Vs Bank FD (1950 to 2012) is as follows:
  - Price of the Gold in 1950 - 100 approx
  - Price of the Gold in 2012 - 32,000 approx
  - Compounded Annual Growth rate p.a. is 9.75%. Average annual returns of Gold & FD are almost same for the period of 1950 to 2012. But after 2012, price of the gold have fluctuated drastically.

- Therefore gold has not acted as a natural hedge.
- Gold has no utility value & it is a commodity.
- Based on the comparison & taking into account volatility & intrinsic value one should avoid investing in the gold & focus on the other forms of investment mentioned earlier.

Periodical Review of Investor's Profile

- Investor should periodically review his profile & accordingly make changes to his portfolio.
- He should maintain track sheet of all his budget as well as investment portfolio.
- Master track sheet sample is provided for all your personal, investment & documentary records.

Personal Financial Organiser

Thank You
&
Happy Investing