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LEARN FROM PAST MISTAKES FOR A SECURE FUTURE

MANY INVESTORS WHO HAVE BURNT THEIR FINGERS IN THE EQUITY MARKET DURING THE GLOBAL MELTDOWN HAVE GROWN WARY OF INVESTING IN STOCKS. SEVERAL BORROWERS ARE REELING UNDER THE BURDEN OF LOANS. YOU WOULD DO WELL TO LEARN FROM THEIR MISTAKES AND STEEL YOUR PORTFOLIO TO FACE TOUGH TIMES LIKE THESE.

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The year-long global downturn and the resultant market meltdown have taught seemingly-infallible, hitherto hallowed multinational corporates and high networth investors some valuable lessons – lessons that you too could use to get your finances in shape so that you are in a position to brave the next storm, if it arrives.

KEEP A WATCH ON YOUR NETWORTH

It is important to strike a balance between your income and loans. Spending and borrowing within your limits will help cushion the impact of any erosion in your portfolio due to market slump. An individual should have the ability to distinguish between a good and a bad loan and chalk out a repayment plan so as to avoid heavy interest costs.

Explains Kartik Jhaveri, chartered wealth manager and director, Transcend India answers: "An individual will run into a problem if he spends an average of 30% of his take-home salary to repay debts. You can afford to exclude home loan as the EMIs as these part payments help you to wholly own this asset at a future date. So it's a good loan. Other debts which should be under constant check are the car loans, credit card outstanding, personal loan etc."

The logic is you will be spending 30-40% of your take home for lifestyle and other living expenses. If you spend another 30% on consumption loans then that leaves little money for your goal management. In good times an individual can increase his loan exposure to 60-65% of his take home salary. But in the wake of the recent slowdown financial advisors ask borrowers to maintain a loan to disposable income ratio at 50:50.

DON'T ATTEMPT TO TIME THE MARKET

Many investors try to time the market, hoping that they can enter at the lowest point and exit at the highest. However, financial planners say that it is not possible to time the markets, and many investors end up losing money while making such an attempt. And then there are investors who jump into the markets when they are on an upswing and pull out the money during a slump fearing further erosion of their capital, when in fact, they should be doing the reverse. Since they invest at the peak and not when market is touching its lows, it takes longer to recover the capital. "For instance, if an individual had invested when the Sensex was at 20,000 levels and then invested again at 10,000 levels, he would recover his capital at the 15,000-level. But if the investment at the low was not done, markets would need to go past 20,000 again for him to recover his capital," explains financial planning firm Right Horizons CEO Anil Rego.

DIVERSIFICATION IS KEY

Also, investors need to remember that diversifying their portfolio is key to cushioning the impact of any sharp fall in the market. "It is very important to have a diversified portfolio – firstly, diversified across mutual funds and stocks. Secondly, you should have sector caps, and a distribution between large-caps and mid-caps. If one is unable to track stocks accurately, one can even have a portfolio comprising mutual funds alone or even use a portfolio management service. This could help recover one's capital and probably make a profit much faster," suggests Mr Rego.

ADOPT A SYSTEMATIC, LONG-TERM APPROACH

Stopping systematic investment plans (SIP) in mutual funds when the indices fall is another mistake that investors should avoid, say advisors. During a market slide, you should look to correct mistakes like excessive concentration of portfolio to one stock or sector or market cap, and continue to invest on a systematic basis through this period. A diversified and systematic investment approach with a long-term horizon in mind would help investors weather the storm during a market freefall and reap the benefits once upswing starts taking shape.

> *It's always better to leverage on your financial assets if you are in debt. A borrower can look at options like loans against property. The interest rates on such loans are in the range of 12-15%. You just pledge your asset and repay the expensive loan.*

DON'T JUMP INTO PREPAYMENTS

Often borrowers are tempted to prepay home loan given the sheer size of debt. But paying off other expensive debt such as credit card or a car loan may make better financial sense.

For prepaying a home loan calculate the amount of interest outgo on the outstanding loan amount. "People often get emotional about repaying the home loan given the sheer size of the loan amount. Even if the a borrower pays 9% on his home loan on paper the actual interest out go will be much lesser as the interest rate is calculated on daily reducing balance," says Amar Pandit a Mumbai-based financial planner. Secondly if the borrower plans to repay in the last few years of the loan, you will not save significantly on the interest outgo as the interest component of the EMI is repaid in the first few years of the home loan.

CONSIDER SELLING INVESTMENTS TO SETTLE EXPENSIVE LOANS

At the same time, an individual should take stock of expensive debt and ensure its timely repayment. Even if a borrower is cash strapped it's better he takes loans against his assets/investments to pay off the expensive debt. By doing so, you will save huge sum from your interest costs.

It's always better to leverage on your financial assets if you are in debt. A borrower can look at options like loans against property. The interest rates on such loans are in the range of 12-15%. You just pledge your asset and repay the expensive loan.

You can trade off some low yielding investments for a costly debt if you are an overleveraged borrower. The fact is that there are not too many instruments in the market today which would fetch you a return of 40-50%, which is what a credit card debt will cost you.

For example, if you have invested in National Savings Certificate (NSC), you will earn a return of 8%. On the other hand if you are repaying a loan at 24%, it makes financial sense for you to repay the loan than hold on to your investments.

On the other hand, if you leave a huge balance idle in your bank account, you would earn 3.5% interest but, on the other hand, you are servicing a debt at 25% it's better to pay off your dues. This is a one time exercise, otherwise you would realise that the debt is eating into all your investments.

Putting a carefully thought-out plan in place with regard to handling your assets and liabilities will help you tackle any crisis and more importantly, will ensure that the your goal of wealth creation for the long-term is not disrupted due to external factors.