Bridge the gap between dreams and reality

Financial Planning

HSBC Asset Management

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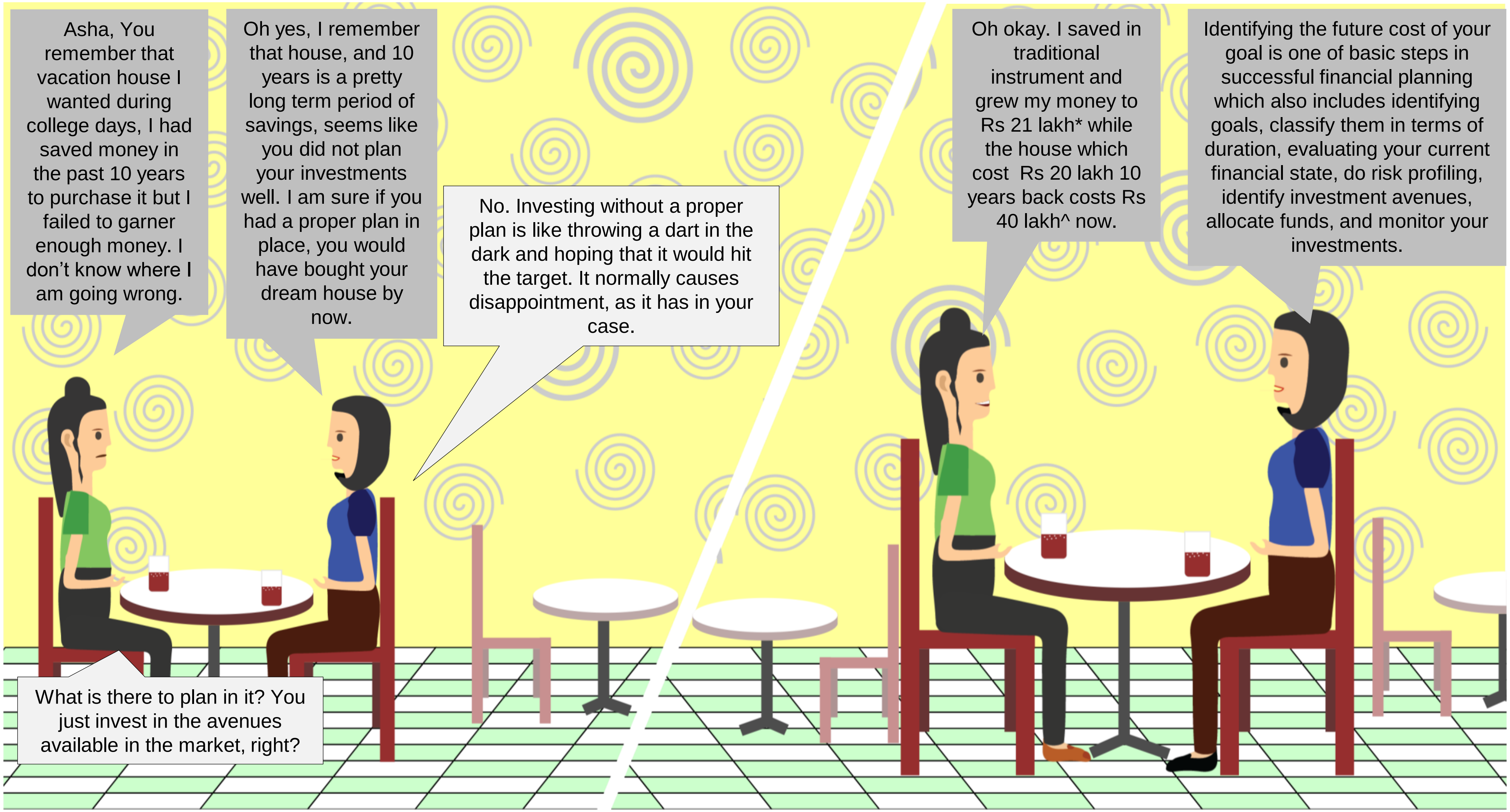
Financial planning – failing to plan is planning to fail

Nisha and Asha meet after 10 years and the topic about finances comes up



Past performance may or may not sustain and does not guarantee future performance.

For illustration purpose only

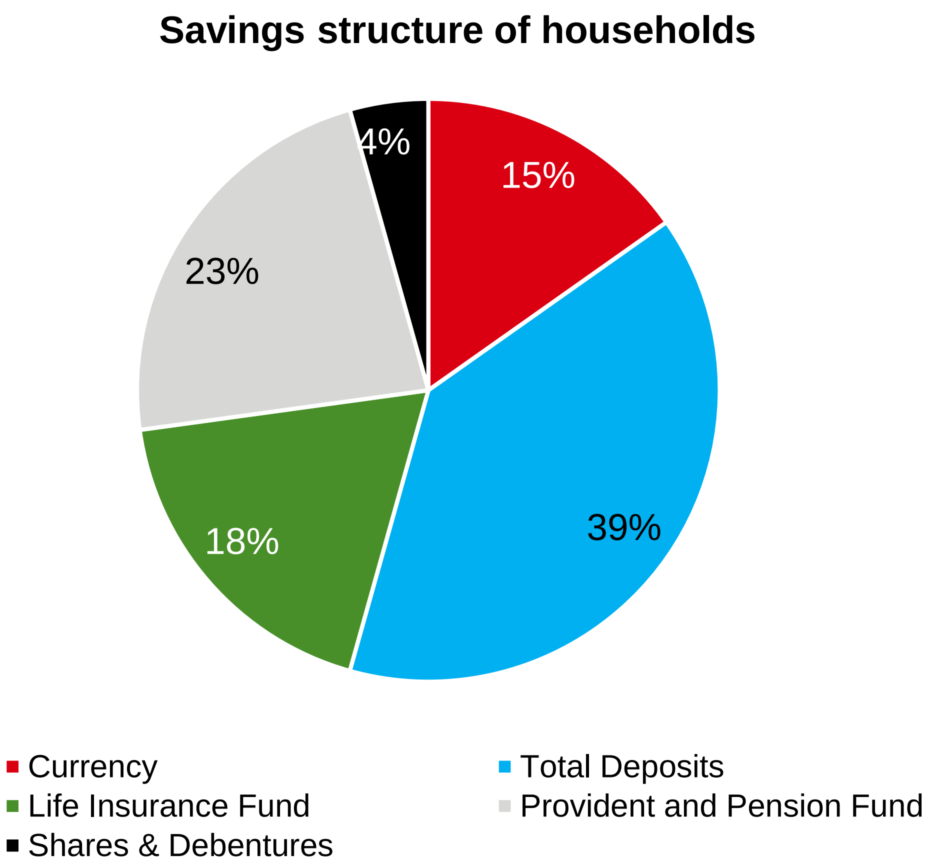
^Assuming rise in price at an 7% per annum which is the average CPI iW inflation rate between 1993 and December 2020

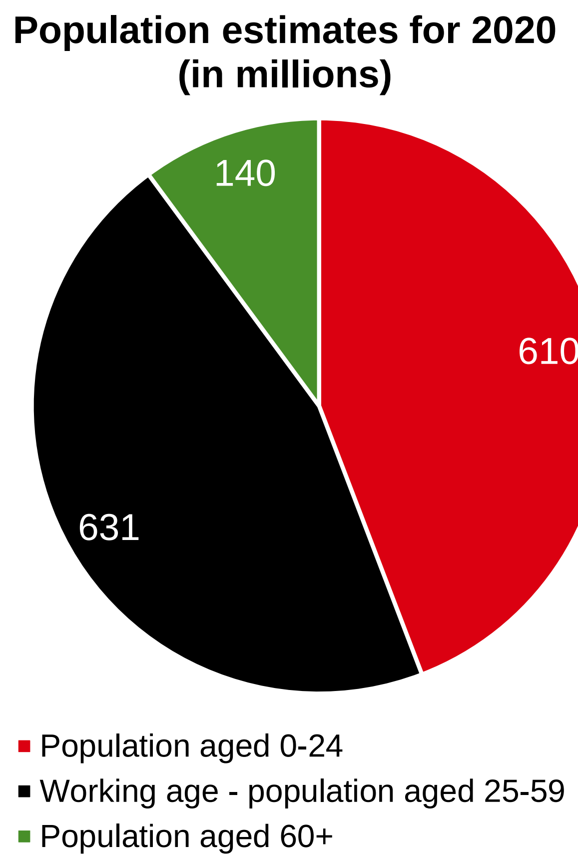
***Grown at 7.5% represented by 1-year FD index returns between October 1999 and December 2020**

Traditional methods of savings versus financial planning

Traditionally, investments have been without a plan

- This is seen in the financial investment pattern of Indian households, which is skewed towards fixed income despite having a large young population





Source – United Nations, RBI, CRISIL

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Are you prepared to achieve goals on time?

- Like Nisha, we all have dreams. But our dreams may not convert into reality as generally we don't quantify them into financial goals
- Every goal requires proper financial planning, which takes into account various factors, including the future cost of goal (which Nisha ignored)
- Below are hypothetical illustrations of various priority and lifestyle goals along with their costs and time horizon

Buying an SUV

Current cost
Rs 8 lakh

Time Period
3 years

Expected future cost
Rs 10 lakh

Foreign vacation

Current cost
Rs 10 lakh

Time Period
5 years

Expected future cost
Rs 14 lakh

Children's education

Current cost
Rs 15 lakh

Time Period
15 years

Expected future cost
Rs 41 lakh

Retirement

Current cost
Rs 1 Crore

Time Period
25 years

Expected future cost
Rs 5 Crore

Note - Assuming a rise in price of 7% per annum, which is the average CPI-IW inflation rate between 1993 and December 2020

Common mistakes in goal planning

Just as many investors fail to factor in future price rise, there are other common mistakes when it comes to goals and investment planning. Some of these blunders are illustrated below.

Failure to think of the goal as a future cost: Investor wants to buy an SUV three years from now. He believes his salary will rise high enough in three years to be able to finance the car.

Resolution: He must estimate the cost of the SUV in three years and predict whether his savings will be enough. If not, he must invest for this purpose.

Not picking the right asset class: A young investor has just begun his career and wants to kick-start retirement planning early. For this, he begins investing his savings in FDs.

Resolution: As the investor is young and is capable at this stage of his career to bear higher risk, he should invest in equity and switch to other safer asset classes later in his career.

Delaying goal planning: Investor wants to build corpus for her children's higher education 15 years from now, which would cost around Rs 40 lakh. She feels she can begin planning for this a little later.

Resolution: Investor should not delay. Assuming that savings can be deployed in an investment that provides 15% annual growth, a person who begins investing today needs to save Rs 5,983 per month compared with Rs 14,534 per month five years later.

The above calculations and potential appreciation of investments are given for illustration purposes only. The illustrative appreciation in investments given above are based on the historical performance of 15% annualised returns of S&P BSE SENSEX i.e. average of daily annualised 15 years' rolling returns of S&P BSE SENSEX as of December 31, 2020 and since June 30, 1979 (Source: CRISIL).

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Behind every successful goal there's an investment plan

- Traditional approach of investing focuses only on return expectations, and uses returns to meet goals as and when they surface.
- In contrast, goal-based planning is a holistic approach that maps investors' goals to their investments in sync with their risk profile, time horizon, inflation, and personal factors such as income, expenses, age and other financial responsibilities.
- The biggest benefit of goal-based investing is that it allows investor to bucket his/her money according to a purpose or goal.
- It increases investor's commitment to goals and helps him/her measure the progress towards meeting goals.

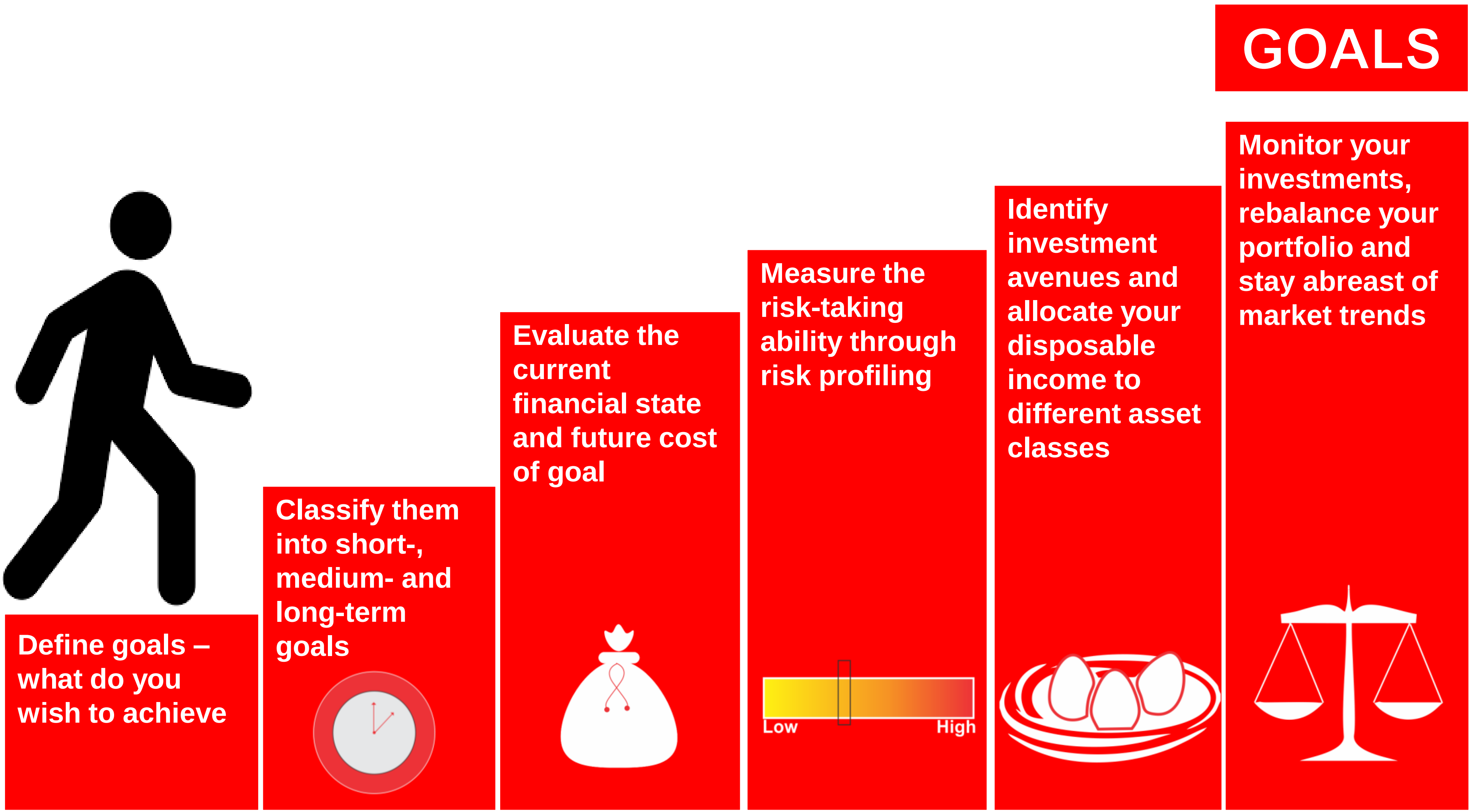
Did you know?

The global financial crisis of 2008 brought goal-based investing into the limelight, as steep portfolio losses experienced during this period made investors realise how poor investment performance could set back the attainment of financial goals by considerably long periods.

Source - CRISIL

Steps to achieve your goals

Six steps to achieve your goals



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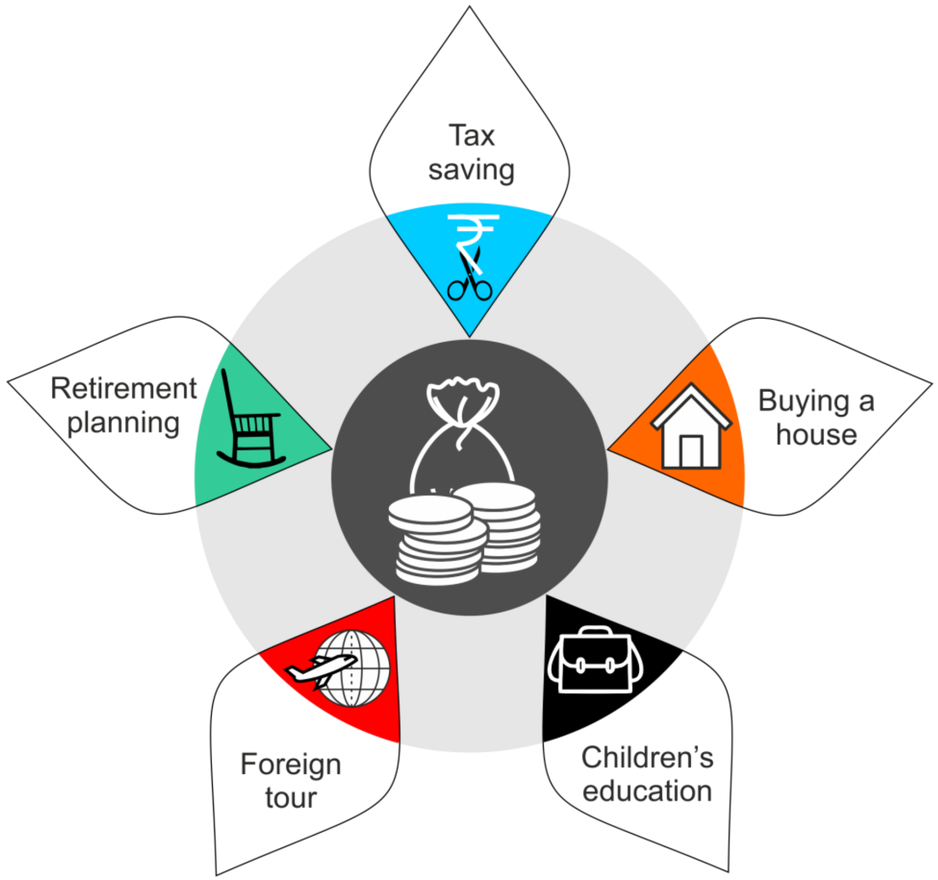
Goal-planning process – identify and segregate

- Make a list of all goals that you want to achieve. Some of the goals could be:



- Segregate goals into priority and aspirational – priority goals are essentials and, hence, get precedence over aspirational goals.

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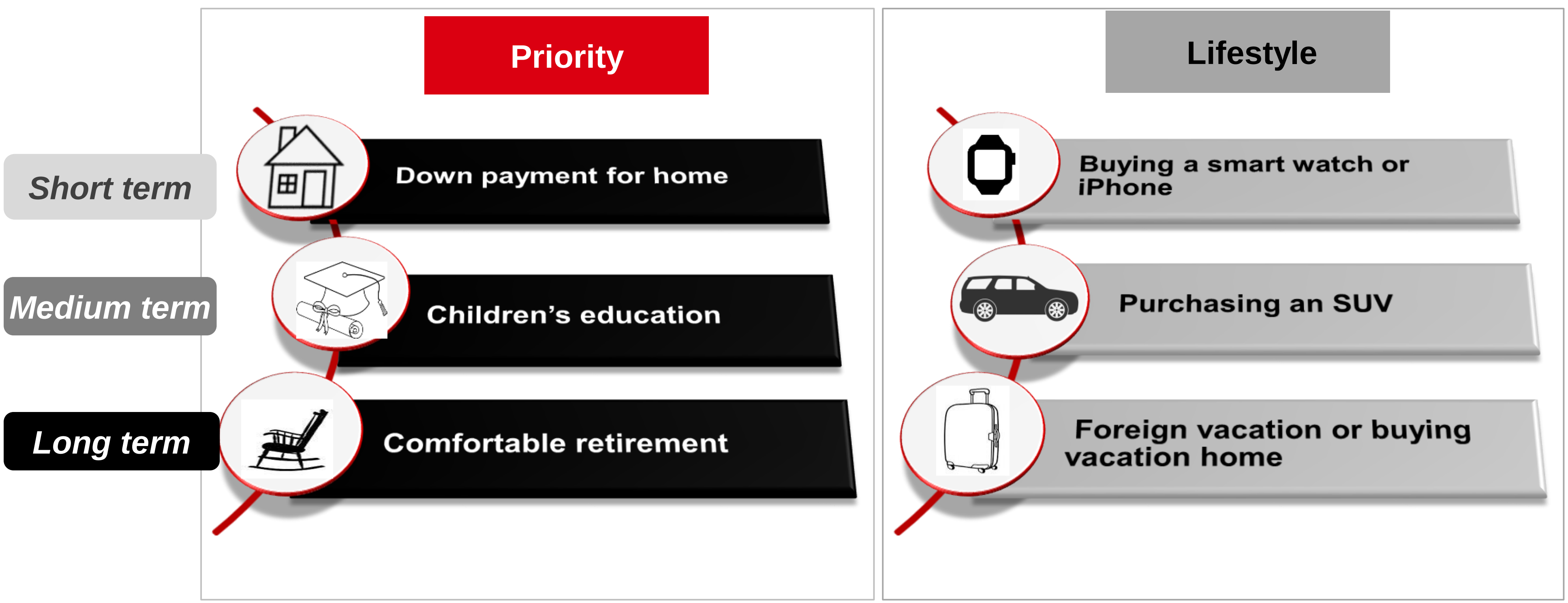
Goal-planning process – classify as per duration

- Once the priority of the goals is done, one can align according to the expected time horizon as per the life stage
- Broadly, the goals can be divided in three durations – short term, medium term and long term
- For instance, the goals can be mapped across life stages in this way:



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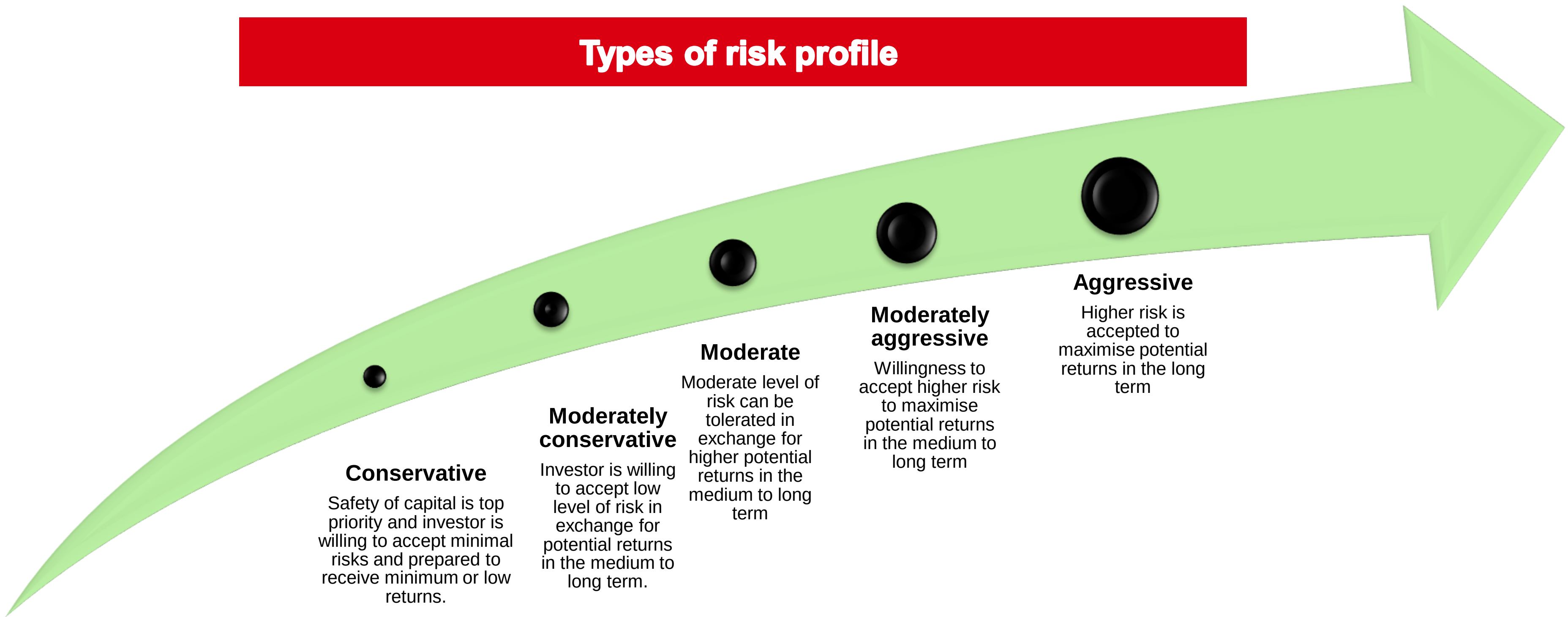
Goal-planning process – do the maths

- Make a cash flow statement to understand your income, expenses and savings
- Find out the amount needed to achieve each goal after factoring in inflation
- This will help you work out the realistic time span for achieving each goal

Goal-planning process – how much risk can you handle?

- Risk profiling caters to investors probing their risk appetite keeping in mind parameters such as age, income, expenses, financial responsibilities, liquidity needs, and time horizon.
- A formal questionnaire-based approach is often the best way to conduct risk profiling. Investors have to answer questions that probe their willingness and ability to take risks.



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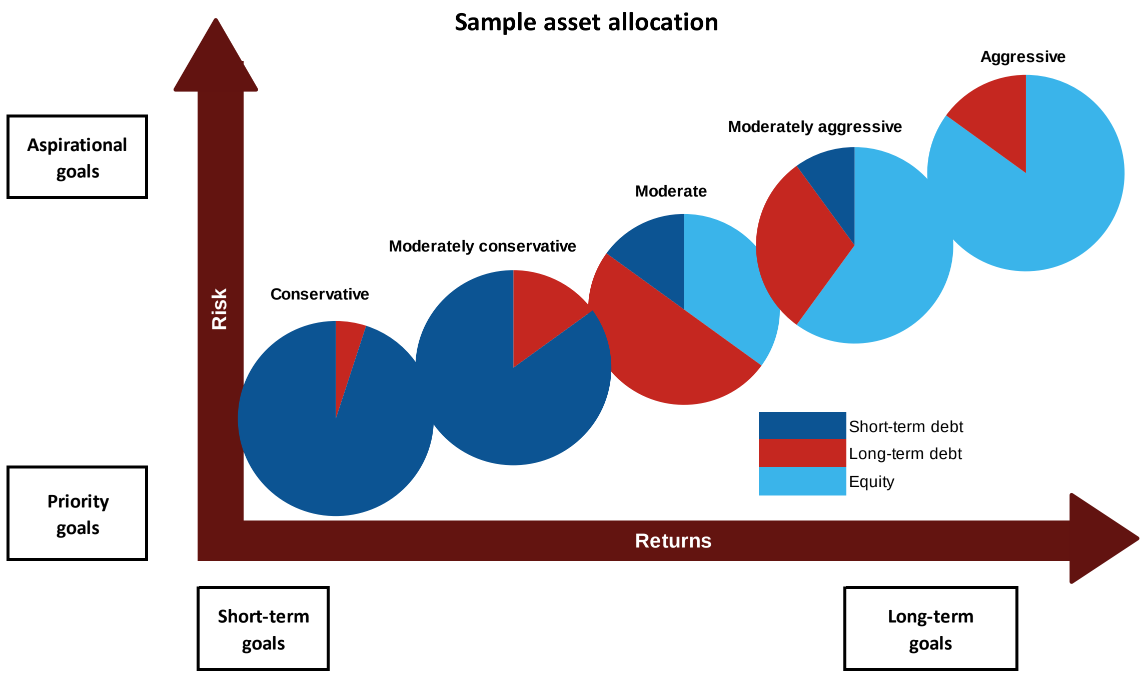
Goal-planning process – deciding investment avenues and allocating disposable income

- Once the risk appetite is assessed, the investor should look at putting his money in different asset classes (equity, debt and cash) to enjoy the benefits of diversified asset allocation
- Generally, priority short-term goals may have a conservative portfolio. A conservative portfolio can include primarily bank FDs/RDs and short-term debt oriented funds like liquid and ultra-short duration funds.
- For priority long-term goals since there is more time at hand, a moderately aggressive equity-based portfolio should be the most preferred option, while for long-term non-essential goals one can have a more aggressive portfolio.



(For representation purpose only, it may differ on a case-to-case basis)

Goal-planning process – RR: revisit and reassess

- Revisit your investments on a semi-annual (six months) or annual basis
- It is crucial as financial markets are dynamic and the portfolio needs to be modified in sync with changes in the underlying asset class
- Reassessment will help you weed out the underperformers and realign investments in line with the asset allocation and risk-return profile

Goal-based investing – what Nisha should have done

Step 1	Goal identification	Buying a vacation home
Step 2	Estimating the time horizon	To own the house after 10 years
Step 3	Evaluate the current financial state and future value of goals	Consider the rise in house price In future, which would be Rs 40 lakh
Step 4	Measure the risk-taking ability through risk profiling	Considering longer time horizon and a lifestyle goal, she can take higher risk
Step 5	Identify investment avenues and allocate disposable income to different asset classes	She should invest in equity. Buying an equity mutual fund would be a good option
Step 6	Monitor investments, rebalance portfolio and stay abreast of market trends	In 10 years, her equity fund investment could garner Rs 40 lakh*, thereby comfortably achieving the goal

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Use new age instruments like mutual funds to achieve goals

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Mutual funds are a good play for all goals

- Mutual funds are an ideal option to achieve goals as they invest across the spectrum, and are professionally managed, lighter on the wallet, liquid and tax-efficient. Choice of a mutual fund should be aligned to investors' risk profile, returns expectations, and investment horizon.

Investment category	Fund type	Expected returns	Expected risk	Indicative investment horizon	Achievable goals
Equity-oriented funds	Large cap equity funds	High	Very High	7 years and beyond	Very long-term goals
	Large and midcap equity funds				
	Flexi-cap / Multi-cap funds				
	Midcap/Small cap equity funds				
	Index funds (passively managed)				
	Focused/value/contra/dividend yield funds				
	Thematic/sectoral equity funds, international funds				
Hybrid funds	Aggressive hybrid funds	Moderate	Moderate	5 years and beyond	Medium to long-term goals
	Conservative hybrid funds	Moderate	Moderate	3 years and beyond	
	Dynamic asset allocation funds	Moderate	Moderate	3 years and beyond	
	Multi-asset allocation funds	Moderate	Moderate	3 years and beyond	
	Equity savings funds	Low	Low	More than 1 year	Specific goals (tax savings, jewellery, etc.)
	Arbitrage funds	Low	Low	More than 1 year	
Debt-oriented funds	Fixed maturity plans	Low	Low	30 days to 5 years	Short-, medium- or long-term goals
	Gilt funds	Moderate	Moderate	3 years and beyond	
	Long-duration funds	Moderate	Moderate	7 years and beyond	
	Medium duration funds	Moderate	Moderate	3 years to 4 years	
	Medium- to long-duration funds	Moderate	Moderate	4 years to 7 years	
	Credit risk funds	Moderate	High	3 years to 4 years	
	Low duration funds	Moderate	Low	Around 6 to 12 months	
	Dynamic bond, corporate bond, banking & PSU debt funds	Moderate	Low	Around 6 to 12 months	
	Short-duration funds	Moderate	Low	1 year to 3 years	
	Floater and ultra short duration funds	Low	Very Low	Around 3 to 6 months	
	Liquid funds	Very Low	Very Low	Less than 90 days	
	Money market, liquid and overnight funds	Very Low	Very Low	1 day to 1 year	
Others	Exchange traded funds (ETFs; including gold)	Moderate	Moderate	5 years	Specific goals (tax savings, jewellery, etc.)
	Fund of funds, solution-oriented funds				
	Arbitrage funds	Low	Low	More than 1 year	
	Equity linked saving scheme (ELSS)	High	High	Lock-in period of 3 years	

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Achieve your goals SIP by SIP

Benefits

- Reduces average price per unit paid through rupee cost averaging
- Makes market timing irrelevant
- Enhances investments as income grows
- Provides compounding benefits
- Instils investment discipline

Illustration – How you can achieve goals by investing in SIP

Retirement	Children's wedding	Vacation home
Retirement kitty of: Rs 5 crore	Children's wedding costing: Rs 80 lakh	Vacation home costing: Rs 75 lakh
Time Period: 30 years	Time Period: 25 years	Time Period: 20 years
Monthly SIP amount required: Rs 7,222	Monthly SIP amount required: Rs 2,466	Monthly SIP amount required: Rs 5,009

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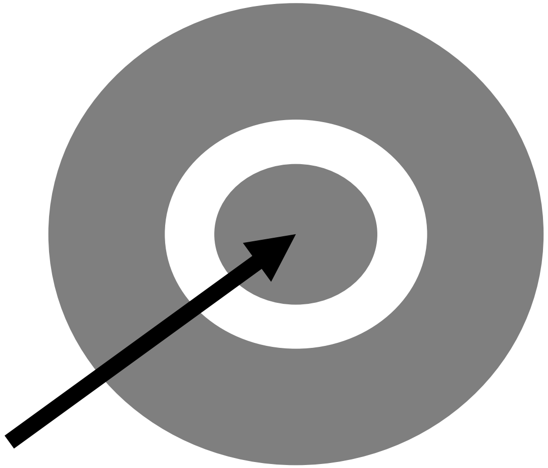
Goal-based investing - Key takeaways

- We all have dreams. To turn these into reality, we need to adopt investment planning
- Often, we are oblivious of our risk profile, our goals, the future cost of goals, etc.
- We need holistic and focused goal-based planning
- It allows us to allocate money according to a purpose or goal
- Don’t forgot the six steps of goal-based planning
  - Define your goals
  - Classify them in terms of duration
  - Evaluate your current financial state and future cost of goals
  - Measure the risk-taking ability through risk profiling
  - Identify investment avenues and allocate your disposable income to different asset classes
  - Monitor your investments
- Mutual funds offer a variety of products suitable for all goals
- SIP in mutual funds is a good and disciplined way to meet goals



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