

# Market Wisdom

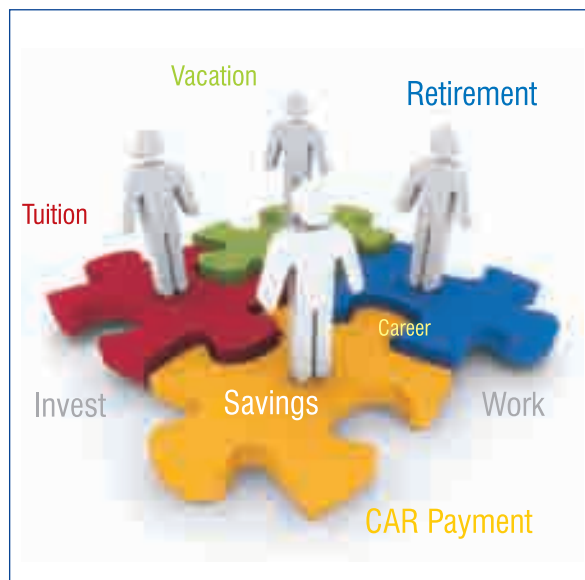
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## Why do we need Financial Planning?

**S**ubse Bada Rupaiah! The saying could not be truer when it comes to the management of Personal finances. There is no getting away from having to manage it properly, irrespective of what one does professionally. Income inflows during our working life of about 35 years has its ups and downs and needs to be properly aligned to outflows (both mandatory and voluntary). We also need to provide for about 15 years post retirement based on average life expectancy of 75 years. For the first 25 years we are the responsibility of our parents and after 60, that is, for the next 15 years, we have to rely on ourselves; or if we are lucky, our children will take care of us. This incongruity between our life's earnings and life span and also uneven nature of flows, requires us to manage our finances properly. We may earn lots of money in our working years, which may be enough to maintain us when we are not working. Yet earning is not enough, we need to preserve and augment this wealth.

Wealth depreciates in several ways. Inflation is a monster that can eat into your savings. Without doing anything, the value of money keeps declining year after year. This is known as a fall in the purchasing power of money. You may be able to buy all your household provisions for say, Rs.5000 today, but over a period of time, the same food items and quantities would cost you Rs.6000. Thus, if you are unable to earn that extra Rs.1000, your capital will reduce due to the extra expenditure. The returns on your capital have to be more than the rate of inflation so that the increases in prices do not make you go out of pocket. The second risk to your capital is falling interest rates. The government and banks assured you of high rate of interest on instruments such as PPF, NSC, bank deposits, etc. . These instruments or schemes are through banks or government agencies which channelized your savings in industrial projects, etc. Due to availability of cheap funds overseas or through equity, the same rates are no longer available to those agencies. Companies are also performing better and are able to get money at competitive rates. The government borrowed for itself in order to fund the fiscal deficits. As per financial

prudence, it is now essential for governments to reduce deficit financing. To look at the overall picture, the reduction in interest rates by banks and the government is an indirect message to the investor: We cannot manage your money any more. Do it yourself. The biggest danger to your money is the desire to spend. During our working years, the flow of money is so good that we may not think of saving adequately. We are busy enjoying our prosperity, going on shopping sprees, taking our families to the cinema or dining out rather than spending time on financial planning and management. We also want to give our families all the comforts that we didn't have in childhood. The residual income, after spending, accrues in a bank account and is often parked in Fixed Deposits with the banks themselves. At the most, we may go in for insurance policies if we bump into a persuasive insurance agent.



Shares and Mutual Fund units are bought every now and then but again there is no conscious attempt at building a portfolio. Thus, a successful company executive, bureaucrat or businessman suddenly finds that after retirement, his monthly cheque stops and his pension is a lot less than that. The shares that he bought and forgot about are worthless, bank deposits and such other fixed-income investments do not yield enough to take care of monthly outgoings to maintain the lifestyle he had. He does not know the investment options

available. He gets some funds at retirement but even before the income on the same starts coming in, it is slowly getting used up. The worst scenario is when an unexpected illness strikes. This is indeed a gloomy picture. I am exaggerating a little to shake you up and take a serious look at financial planning. As we grow in years, we must plan. If you are in your early 20s, the plan would include getting married, buying a house and other symbols of status and comfort, such as a car, television and other white goods. Planning for a child and donations, if required, to secure school admission, would be the next target. As children grow older, a bigger house may be on the agenda. Foreign vacations are add-ons that need to be thought of; higher education of children, settling them professionally, marriages...comes next.

Once family responsibilities are complete, the next challenge is to maintain your standard of living, have the same number of servants, pay your society maintenance and continue to fulfil your social commitments. This is not to ignore medical emergencies, such as a cataract operation, knee replacement, and prostate or bypass surgery if you have led a stressful life. The outlay list is never ending. Thank God no one thinks of building a Taj Mahal in memory of a loved one. It's clear then that at each stage of our life we need a fixed sum of money to meet our financial requirements. Our challenge begins in living within our means and setting aside a certain portion to meet the cash flow requirements. The challenge is also to make the money saved grow at a certain rate so that the shortfall is available and required cash is not there. Based on your targets you can decide where to invest. You have to study the various investment options and the returns they offer and the risk

associated with each of them. Understanding the risk of losing money is as important as knowing the likely returns. At the end of the day, the best return option may not meet with your cash flow requirement. You will then have to prune your expectations and settle for less. Financial Planning is an important means to a contented life. It makes you realize your responsibilities well before they make their presence felt. It makes you aware about the financial instruments that are available and the risk return profile of each of them, apart from taxation laws and their benefits. Investments thus become an important earning member for your family. You are not slogging all the time, but can also enjoy your wealth by letting investments and the return on them share your burden.

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