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Rebuilding Your Wealth

With challenges staring in your face and losses to contend with, how do you put your future plans back on track ?

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Man screaming at his wealth manager: You told me that the losses were notional and on paper!

Wealth manager (with a smile): I agree, but wasn't your money printed on paper?

Was 2008 annus horriblis for your money? With the value of stocks, equity mutual funds (MFs) and unit-linked insurance plans (Ulips) down by 50 per cent or more in this lost year and real estate investors finding themselves stuck in their investments like a deer staring at headlights, few would have escaped the meltdown in their wealth. The downturn hit harder as it came with almost no notice for most people who were ecstatic over supernormal gains in the 2004-07 period.

You may have invested with due diligence and after proper research. You may have become yet another victim of rampant mis-selling of financial products. Or greed may have got the better of you when you succumbed to the tip of an ill-informed advisor or friend. Whatever be the reason, the fact is that the mess that you may find yourself in today needs to be cleaned up.

In the course of 2009-10, not only will you have to mend your finances, but also get them growing to make the previous year seem like just a bad dream. So don't lose heart as it is possible to get your wealth creation back on track this year with a little effort and planning.

We will give you the nuts and bolts of a gameplan that we have specially created for you. But to make you appreciate it better, we will first make you understand the challenges that will confront you while planning for the future and the macroeconomic conditions you will have to contend with.

The Ponderables

Shoring up liquidity without sacrificing returns. The way the global meltdown has unravelled so far and the way it is expected to pan out, it will threaten jobs. A job loss not only stops the current income flow that funds your regular household expenses and existing and fresh investments, it also whittles down what you have accumulated. To prepare for such an eventuality, you need to enhance your liquidity. But the moment you do that, it will threaten your returns in a bad year like this one.

Servicing your loans. The loans that you took in the past will still have to be serviced. With low or no pay hikes this year or a job loss, and recent investment losses, the loan burden, especially from car and personal loans and credit card debt, might suddenly seem heavier to bear.

Repairing your investment portfolio. If you had invested in stocks, market-related MFs and Ulips, you will need to sift out the ones which will work but have just fallen on bad times from the lemons that need to be dumped. This is easier said than done. And then where do you reinvest the money?

Ensuring growth with security. After having lost out on growth last year, you wouldn't want to take undue risks. Yet, withdrawing into the shell of secure investments will threaten your future in equal measure. Compared to equity, the lower-risk investments such as National Savings Certificates (NSC) or 5-year notified bank fixed deposits (FDs) pay much less, at 8 per cent and around 8-8.5 per cent per annum, respectively, and have reasonably long lock-in periods. Since their interest payouts are taxable, the effective income from them is falls further. Inflation, too, will make a dent. So, a fine balancing act will become critical.

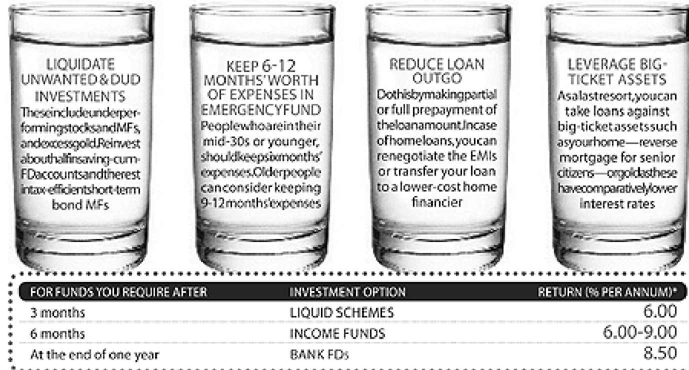
Curtailing, postponing or sacrificing your impending plans. The new car, the expensive vacation, the second home, the early retirement and other similar goals that you were planning to achieve by the end of 2009 will need a thorough relook. You will have to accordingly curtail, postpone or sacrifice them. If you were planning for a 4-bedroom apartment as your first home, you might have to start looking at a smaller option.

Getting plans for kids' futures and your retirement back on track. If stocks, MFs and Ulips were bought for these goals, how do you make up for the lost time and money? With all these assets down in the dumps, the catch-up is not going to be easy. The question is: do you keep doing more of what you were doing in the past the since markets are now priced more reasonably or tinker with your approach? Or do you go for a total overhaul?

GETTING A FIX ON THE BIG PICTURE
You cannot hope to grapple with the challenges listed above without getting some kind of a fix on the emerging macroeconomic environment. It was the rapidly deteriorating macroeconomic situation that has landed you in this mess in the first place. Without getting some idea of the direction of currents, or cross-currents, you are unlikely to have a better voyage this year.

Tepid economic growth. The World Bank expects the global economy to shrink in 2009 and industrial production to go down by 15 per cent. Says Madan Sabnavis, chief economist at commodities exchange NCDEX: We are looking at something in the region of 6.5 per cent for the full year. For 2009-10, the estimates are much lower. Says Sonal Verma, India economist, Nomura, For FY10, we expect growth to be 5.3 per cent. While this is much better than that of developed countries, it is a signal of much pain ahead. Starved of growth and plagued with declining profitability, companies are unlikely to reward employees with double-digit pay hikes. Lower economic growth also means that you are unlikely to see across-the-board recovery in the stockmarkets. This means that the road to recovery for your market-related investments will be long and tortuous.

The message in short: you will have to live within your current salary and whatever increments you get, as well as save enough and invest prudently to make your investments grow.



FOR FUNDS YOU REQUIRE AFTER	INVESTMENT OPTION	RETURN (% PER ANNUM)*
3 months	LIQUID SCHEMES	6.00
6 months	INCOME FUNDS	6.00-9.00
At the end of one year	BANK FDs	8.50

Inflation and interest rates reined in. How will interest rates play out? This has profound implications not only for those with floating rate loans, especially home loans, whose EMIs and tenures went up dramatically in the last few years, but also for those who are planning to buy a house. Declining economic growth gives crucial pointers. Says D.K. Joshi, director and principal economist at rating agency Crisil, A decline in credit demand by the private sector would also help in bringing the interest rates down at a faster rate. Declining economic growth and successive economic stimuli by the government, the recent ones being passing of the decline in international crude prices to consumers and the reduction in CENVAT by 4 per cent will keep inflation in check. The inflation measured in terms of the consumer price index will come down in the next couple of months, predicts Joshi. This means that we can expect no immediate surge in loan rates and, perhaps, look forward to some fall. Says Kaushal Sampat, chief operating officer, Dun & Bradstreet, a company that provides business research and information, In 2010, we expect inflation to be around 3 per cent.

Fixed income options such as fixed deposits will progressively offer lower interest rates. Among debt MFs, short-term bond funds will hold out hope. Potential real estate investors will surely be discouraged by this scenario as servicing a home loan could be a worry in the midst of uncertainty in their earnings.

GAMEPLANS
Now that you are familiar with the conditions in which you will have to overcome the formidable challenges, we give you the game plans to tackle each of these hurdles.

I. ENHANCING LIQUIDITY
A downturn makes you financially more vulnerable because what you set aside for the rainy day, a job loss or a medical emergency might suddenly seem inadequate. What's worse is the prospect of distress sale of investments in the absence of liquid assets, especially in bad markets. Says Lovaii Navlakhi, Bangalore-based financial planner, For the next one year, safety and liquidity are more important than returns. You can begin to create a cushion by adequately insuring your life, health, home and big-ticket assets like vehicles and then create an emergency fund through existing and new liquid investments.

Squeeze the lemons. In addition to your liquid investments in bank accounts and FDs, enhance your emergency money by liquidating duds like underperforming stocks and equity MFs and excess gold. These need to be reinvested, about half in a bank savings account and the rest in tax efficient short-term bond funds. Says L. Ravindran, managing director, Wealthmax Enterprises Management, a financial planning and wealth management firm: A buffer of about 10 per cent should be retained in banks [savings accounts], even though the returns are taxable since it enables liquidity at unearthly hours.

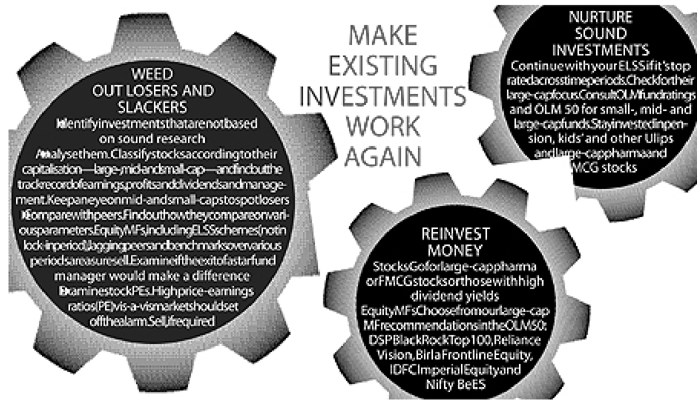
Another option is to go for a sweep-in account, wherein the accountholder keeps a minimum amount in the savings account. Funds in excess of this amount are transferred automatically to a higher interest-earning slab.

Keep 6-12 months expenses as emergency cash. Says Manish Jain, Gurgaon-based financial planner: For people in their 20s [or mid 30s], a contingency fund of up to six months of expenses is adequate. However, for those in their late 30s or 40s, at least 9-12 months expenses should be kept aside. In case of a job loss, finding employment can be difficult for those in the higher age group. For a 12 months expenses, hold three months requirement in your bank account. If you invest the rest in short-term FDs, stagger the maturity in accordance with your needs. Funds that may be required in six months or more can be invested in short-term bond funds. Maneesh Kumar, head (wealth management solutions), ASK Wealth Advisors, suggests, They may deliver a higher yield than a liquid fund. This option has other advantages, too. Says Veer Sardesai, Pune-based financial planner, The less risk-averse may choose to put half their emergency funds in short-term bond funds since these are more tax efficient for those in the higher tax brackets. For the highly risk-averse, a sweep-in account is a good option.

Reduce loan outgo. By reducing your regular monthly outflows, you can supplement your efforts to shore up liquidity. You can make a big progress here by reducing your loan outgo through partial prepayment or foreclosure of loans. In case of home loans, you can renegotiate your EMIs with your lender or transfer your loan to a lower-cost lender. We will deal with this aspect in greater detail later in the story.

Leverage big-ticket assets. One way of generating short-term cash is to take a loan against your existing assets like FDs. As a last resort, you can take loans against big-ticket assets. They include your home; the elderly can rely on reverse mortgage where a percentage of the value of the house is provided to the home owner

either in a lump sum or instalment and gold. The reason: the rates for loans against home and gold are much lower at around 10-11 per cent and 11-12 per cent per annum, respectively, than 16-22 per cent for personal loans. With the markets tanking, loans against shares and MFs are ruled out. In a steep market plunge, banks might sell off some of the shares or units to maintain the margin. Do not tap into your Public Provident Fund (PPF) or Employees Provident Fund (EPF) since you will do serious damage to your future prospects by disturbing their compounding growth.



II. MANAGING THE LOAN BURDEN
With the prospects of income from salary and investments being less-than-bright, you will have to organise more funds that could be invested for creating future income. This definitely means staying away from fresh loans unless you are comfortable buying your first home with a loan. It is otherwise unadvisable to take any long-term financial liability. Says Brijesh Dalmia, Kolkata-based financial planner, If possible, avoid new loans as interest rates could fall further.

Get rid of high-cost loans. These include credit card debt and personal and car loans, which should ideally be foreclosed in the mentioned order. You could use thumb rules of prudent borrowing to find out the urgency of the matter. Says Gaurav Mashruwala, Mumbai-based financial planner, EMIs should not be more than 40-45 per cent of inflows if you have a home loan and not more than 20-25 per cent if you don't.

You can continue your existing home loan if you are staying in the same house since this will offer tax benefits and create an asset for you in case you buy a second home. However, if you can organise cash that is more than what you need for your emergency fund, you should consider fully or partially prepaying your home loan. Prepay only if the prepayment penalty is lower than the remaining interest outgo.

Organise prepayment money. Much like enhancing emergency funds, to raise funds for prepayment, liquidate underperforming stocks and MFs and excess gold. Use maturing investments, close dormant accounts and take zero interest loans from parents and relatives. Never touch your emergency funds.

Rationalise home loan EMIs. Says Kartik Varma, Delhi-based financial planner: Consider refinancing or balance transfer option for home loans if the rate you are paying is higher than the prevailing rates, which might have come down. Before switching your loan to a new lender, get an idea of the foreclosure charges that your existing lender would levy. Also, check the processing fee of the new lender.

III. RECHARGING YOUR EXISTING INVESTMENTS
Apart from creating more funds for investment, a more efficient deployment of funds is required to make your money return more than what it did last year.

Weed out the duds. A critical first move in recharging your investments is to amputate the investments hit by gangrene and remove dud investments. Unlike MFs or Ulips where investments are more diversified and are likely to have limited rubbish, stocks pose quite a challenge. Says Sameer Kamdar, CEO (designate), proposed AMC, ASK Group: Stocks can be generally mapped as per their capitalisation large-, mid- and small-cap. Thereafter, one should investigate previous record of earnings, profits and dividends, besides the management track record.

But how do you identify duds? Advises Jain: Typically, dud stocks are shares of small- or medium-sized companies that shot up during the bull run without any fundamentals backing them and came crashing down as fast. You can identify duds methodically. The exceptions would be Ulips since they have lock-in periods and stiff penalty for early exits. Says Manik Nangia, head (products), Max New York Life Insurance, Exiting from a Ulip would mean booking losses since their costs are front-loaded and they have heavy surrender charges.

Reinvest liquidated investments. In case of liquidated stocks, reinvest in large-cap pharma and FMCG stocks or those with high dividend yields. Says Nitin Rao, head (wealth management services), HDFC Bank, The investment should be spread across select large-cap stocks. If you have liquidated underperforming equity funds, reinvest them in quality large-cap MF schemes from the Outlook Money basket of recommended MFs, the OLM 50, including DSP BlackRock Top 100, Reliance Vision, Birla Frontline Equity, IDFC Imperial Equity and Nifty BeES.

Nurture sound investments. Continue with your investments in equity-linked saving schemes (ELSS) if your fund has consistently performed well over different periods of time. Though even top ELSSes have experienced a steep plunge, their performance, as with any equity investment, shouldn't be judged just on the basis of their one-year performance. Looking at their portfolio composition is also critical. If most of their investments are in large-cap stocks, it will reduce the investment risk. Continue sound investments such as those in large-cap stocks and our recommended large-cap funds, but keep tracking their progress actively. Says Kumar: One should set a stop loss and exit when the stop loss is hit. If you have time for your investments to work and don't need funds now, hold on.

IV. ENSURING SECURe GROWTH
Securing your investments and getting them to grow at the same time may well seem contradictory objectives to some. But, during 2009-10, that is the balance you will have to strike for your fresh investments. Thankfully, it isn't as difficult as it looks.

Secure tax-saving investments. Keep investing in top-rated ELSSes with a large-cap focus. Low equity prices make it a great time to buy equity funds. If you want to take lower risk, opt for PPF. With an annual limit of Rs 70,000 and tax exemptions for contributions, interest and the maturity amount, they give an effective post-tax return in excess of 11 per cent. Claim the remaining Section 80C benefits from PF contributions, tuition fees and home loan principal repayments. In case you are risk-averse for your tax saving investments but have more funds, you must make regular and small investments in equity via large-cap or index-based funds. But stay out of money-back plans and capital guarantee insurance plans. As we have argued in the recent issues of Outlook Money, they either have low returns, are costly, or have very limited growth prospects.

Invest in the index. Investing only in FDs will leave you vulnerable to the triple hits of inflation, tax and low returns. You need to continue investments that promise higher rewards with some risk, but ensure that the risk level is never unreasonable. If you want to take still lower risk, you can invest smaller amounts in index-based funds. Invest money you don't need for at least 2-3 years in index-based funds, exchange-traded funds (ETFs) such as Nifty BeES, or even regular index funds from prominent fund houses. Through them, you get to invest in the equities of prominent stocks and benefit from their eventual turnaround, whenever that occurs. Says Sardesai: Unlike an index fund, in an actively managed fund, you bet on the fund manager's skills. For lay investors, identifying good fund managers is not easy. Then, there are fund manager exits to contend with.

Hunt for quality convertible bonds. The funds crunch will make many good companies come up with convertible bond issues. These can give regular dividends in the short-term and may later enable you to acquire equity.

GET REGULAR REWARDS

Fourstocksthatgiveregular,highdividendyieldsandhavestrongfinancials

COMPANY	CLOSING PRICE (Rs)	PE	YIELD (%)
Castrol India	296.15	13.87	5.23
LIC Housing Finance	188.30	3.29	5.31
Pfizer	506.50	26.82	5.43
Rural Electrification Corp.	78.80	5.77	6.35

As on 9 March 2009 PE: Price-Earnings ratio Yield: Dividend/Share price

Invest in large-cap FMCG and pharma stocks. With a more predictable earnings stream, large-cap stocks in these categories hold a much lower risk than others, especially those that are severely hit during business cycles such as real estate stocks.

Go for high dividend yield stocks. Stocks with regular dividend paying history give you tax-free dividends every year. Later, you can get capital appreciation by selling them.

Diversify into gold. The yellow metal scores in uncertain times. With more uncertainty imminent, some exposure in gold can stabilise your portfolio's returns. You can invest via gold ETFs by Benchmark MF, Reliance MF, Kotak MF and others. Or, you can buy gold coins and bars from a reputed jeweller. Ensure the investment does not cross 10 per cent of your portfolio and earmark them for long-term goals. Says Suresh Sadagopan, Mumbai-based financial planner: Gold investments will stabilise your portfolio. Avoid swinging too much in its favour because it is the flavour of the season.

Continue with Ulips. It makes great sense to do this. Remember this product delivers best in the long run. If you need more cover, you should go for low-cost term plans.

V. ADJUSTING YOUR PLANS

Short-term. Says Jain: [One should] review short- and medium-term targets. Long-term targets that are 10-15 years away are less affected by the downturn. The fund sources that can help raise emergency funds or prepayment of loans can be tapped for short-term needs. Says Kumar: If one is sitting on a lot of gold, and gold prices continue to skyrocket, it may not be a bad idea to unload some and book profits. Since emergency funds are the top priority, followed by loan prepayment, you will realise whether you can service other short-term goals.

Kids' future and retirement. After having made the adjustment to your portfolio, you will not need to do anything special but just keep investing diligently. It would be better to rework long-term target requirements with an even more conservative rate of return, says Jain. Also, you could try and increase your savings, even if it is by Rs 500-1,000 a month. You can add bonuses, interest, dividends or any windfall in the list. This will be particularly fruitful for equity and equity MFs. Says Ravindran, To get a positive net return, one needs to average the cost and even have a top-up of four to six times the SIP quantum as markets seem to be nearing somewhere close to bottom.

If you view it dispassionately, the present downturn is all about market forces adjusting to new realities. While there is pain in this adjustment process, those who will quickly be on their feet and adapt fast will escape with minimum grief and benefit immensely in the future. The tenet of survival of the fittest that father of the theory of evolution, Charles Darwin, put forward seems to be working here. Isn't it a coincidence that all this is happening in the year of his 200th birthday?

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