# Re-Assemble

by freefincal.com

Step-by-step Money Management Basics For Beginners

# Introduction

Dear reader, Re-assemble or ₹e-assemble is a series on the basics of money management aimed at beginners and young earners. My aim was to provide a focussed step-by-step guide to understand where we are today with respect to money, where we need to be and how to get there by protecting our family against the uncertainties of life and by investing right.

The series was started on Nov 5th, 2017 and ran up to April 2018. I am happy and proud that it was welcomed by readers. This pdf is an "as-is" compilation of the steps covered. Some intermediate posts are not included but are linked in the next page.

I wanted each step to include one video but could not do this after the first few steps. The links to the videos also included and these can be viewed from your browser.

If you find this useful, do support freefincal by asking your friends to use the site. You can also consider disabling ad-blockers.

I am always on the look-out for problems that money-managers like us face. So, if there is any aspect not covered in this series, do let me know.



Cover photo by Ella's dad

Sincerely yours,

Pattu

# Links to all post in the Re-assemble series

(as on May 23rd, 2018)

**Step 1:** Listing your goals dreams and nightmares

**Step 2:** Lay the Foundations to Get Rich creating an emergency fund

**Step 3:** How to buy Term Life Insurance

**Step 4:** How to choose a suitable health insurance policy

* Apollo Munich Optima Restore Benefit vs Max Bupa Re-fill Benefit

* Star Health Comprehensive Insurance vs Religare Care Comprehensive Insurance

* Building a health insurance comparison chart + Cigna TTK vs Royal Sundaram Health Policies

* How to buy a Super Top-up Health Insurance policy

* How I selected a health insurance policy

* Why we all need a corpus for medical expenses and how to build it

**Step 5:** How to select a credit card for maximum benefit

**Step 6:** How to track monthly expenses and manage them efficiently

**Step 7:** How to close your loans and live debt-free

**Step 8:** How to buy a personal accident insurance policy

**Step 9:** Are you ready to let go and let your money grow?

**Step 10:** Investment planning case study 1: How to create an investment plan

**Step 11:** Case study 2: Retirement planning for 27-year old Amar

**Step 12:** Three Key Factors that decide how we achieve our financial goals

**Step 13:** How to start investing in equity?

**Step 14:** What should be my first mutual fund?

**Step 15** (not part of this e-book) *:

(old) How to select an equity mutual fund in 30 minutes!

(New) How to select mutual funds after the SEBI categorization rules

**Step 16:** How to buy a house with a home loan: Tips to maximize benefits

**Step 17:** How to reduce risk in an investment portfolio

**Note:** * Mutual fund selection has become bit difficult after a reshuffle of fund categories by SEBI. Hence, I have decided to leave out step 15 from this compilation. Young Earners and beginners may instead choose from my hand-picked mutual fund list: PlumbLine

# Re-Assemble Step 1: goals, dreams and nightmares

freefincal Re-assemble November 5, 2017

Dear reader, starting this week I would like to cover the basics of money management and goal-based investing for absolute beginners in the form a video series: **₹e-assemble**. Each week I will discuss one step. The first step covered in this post is: **goals, dreams and nightmares**. Each step will take between 30 minutes to a couple of hours to implement. Assuming it takes about a week to implement each step, in about 1-2 months, your money management will become simplified focussed and on auto-pilot. As always, I look forward to your support, encouragement and feedback.

**Why ₹e-assemble?** Well, when I want to name something, I simply ask my wife (and I don't question her). Reassemble means "put something back together". It can mean this for someone who is unfocussed with regard to money or it can mean rupee-assemble (put something together for the first time) to a young earner. Good or bad, as long it sticks, I am happy.

**Why should money management be set on auto-pilot?** Because you and I have (or should have) better things to do than to worry about money! Our true wealth is health and time. How well we use that little time we have with us and spend it on things that we love will define our happiness and contentment.

## Step 1: goals, dreams and nightmares

Remove all distractions and human contact. Get some alone time to think about your life.

*Where am I today?*

Where would I like to be 5 years from now, 10 years from now?

What are my responsibilities (goals)?

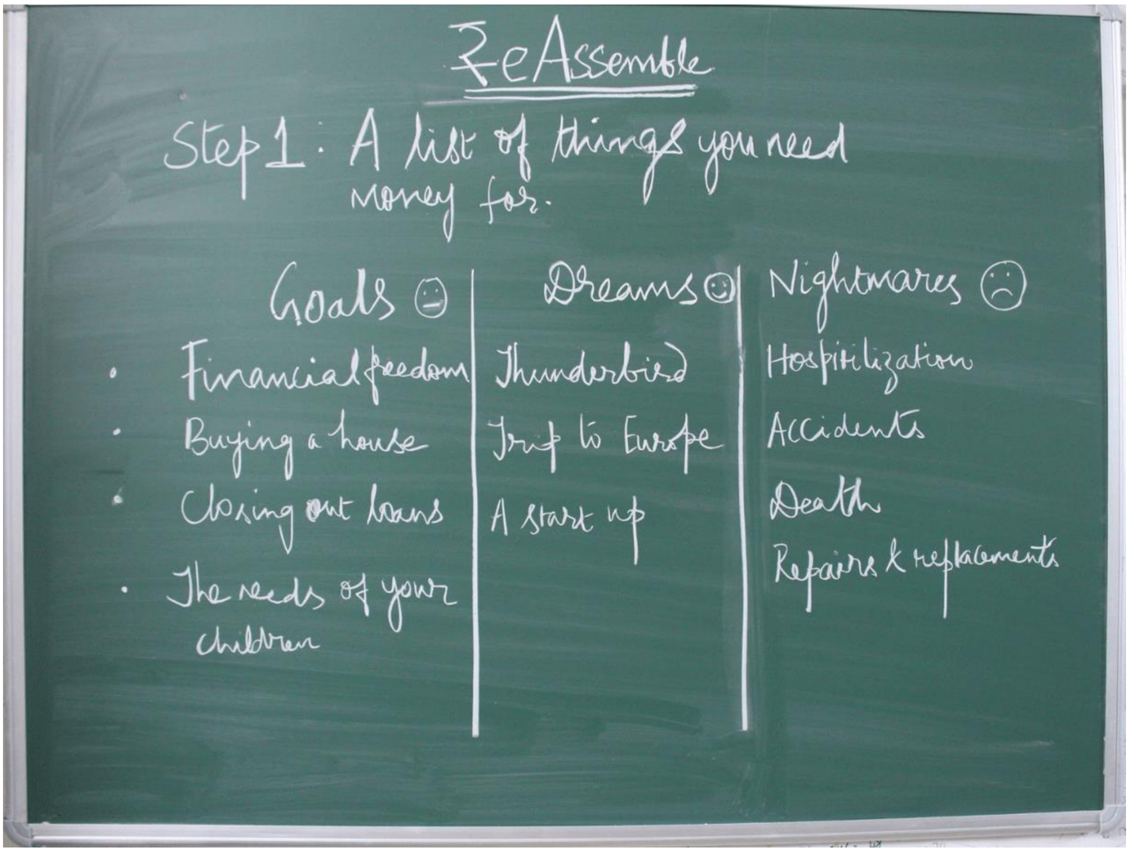
What are my dreams?

What are the nightmares that can prevent me from achieving my goals and attaining my dreams?

Listing this is the first step. It does not matter whether they involve money or not. The list will give us a roadmap and we can begin preparations for each step. Once we complete, money-management will be on auto-pilot.

If you are a couple, I would suggest doing this exercise separately and then consolidate. If you fear arguments might break out, better to do it together and ~~hear~~, listen to what the wife wants/says. Better to let the stronger sex call the shots.

Here are some examples of goals, dreams and nightmares. The idea of each step is to make the next step obvious.




Yup! That is a green board I finally purchased and asked my wife to write (my handwriting is horrible, and I only write math in my classes).

[**Click to watch the video in your browser**]

# ₹e-Assemble Step 2: Lay the Foundations to Get Rich

freefincal Re-assemble November 11, 2017

**₹e-assemble** is a video series covering the basics of money management and goal-based investing for absolute beginners. Last week, in step 1 we consider the need to list our *Goals, Dreams and Nightmares*. In part 2, we will consider the essential foundations for getting rich and staying rich.

When we talk about getting rich or building wealth, we often focus on investments – where, when, how much, how effective etc. While that is important, an unexpected expense can result in redemptions. So, before we talk about investing, we need to anticipate the unforeseeable! Account for possible unexpected/unsavoury expenses.

The next four steps are:

- Building an emergency insurance (discussed in this video)
- Getting life insurance
- Health insurance
- Accidence insurance

Once these essentials are in place, we would feel that much more secure and in peace. Debts can be handled better and investing started when possible.

In the video, I list common ways in which emergencies can arise. It is not possible to have a fund large enough to accommodate all of them at the same time. However, it is important to be able to handle at least two of them simultaneously. This means accumulating an emergency fund for life!

When I talk about this, someone in the audience always goes, "but life is uncertain, no? No matter how much we plan, there will always be something that we did not anticipate, so why worry too much?"

Well, only when we can prepare for sudden expenses that can be anticipated, can we be ready (mentally and financially) if our entire wealth becomes an emergency fund!

Please do not get scared of what I am trying to say below. Start small and build your emergency fund gradually. Remember that this would be one of the best investment that you would ever be making!

There were some focussing and sync issues in the YouTube video of the first part. Hopefully, things have improved now. The drawings that you see on the left side are my son's. My entire house is filled with his doodling.

**Would you like me to speak on the basics of money management to your co-workers?** Then you could write to me at freefincal [at] gmail.com. I do not charge a fee for this and only request that my travel expenses be compensated.

**Click to watch step-2**

# Re-assemble Step 3: How to buy Term Life Insurance

freefincal Re-assemble November 19, 2017

**₹e-assemble** is a video series covering the basics of money management and goal-based investing for absolute beginners. Step 1 was listing *Goals, Dreams and Nightmares*. Step 2, laying the foundation of wealth with an emergency fund and in this week, we shall move on to step 3, buying life insurance policy. If you already have such a policy, do check if you completed these tasks: Things to do AFTER you take a term insurance policy! Also, please do share this article with friends who don't and use the calculators linked to check if your life is cover sufficient.

This week, I wanted to make two short videos, it ended up in three: **Part A:** we discuss the basics of a life insurance purchase on the blackboard – what to look for and more importantly, what not to. **Part B:** we head over to a term policy comparison portal for selecting a policy using the grand technique of inky, pinky, ponky. **Part C:** I run through the basics of a life insurance calculator.

Let us first get to the videos. After that, go over a summary and additional resources.

## Part A: How to buy Term Life Insurance – What to look for?

[Click to watch this part]

## Part B: How to buy Term Life Insurance: Comparing policies

You may need the headphones for this one. I mention my life insurance cover as 44K, that is my health cover premium. My life cover from LIC is 10Y old and costs 36K for 60 Lakhs (loaded due to obesity and BP). Sorry for the mistake.

**Why LIC?** Because I am opinionated and pig-headed and mis-trust privates. I only trust LIC because it is a Sarkari dinosaur (slow but gets there eventually) not because of its high claim settlement ratio. Just like claim settlement ratio, it is psychological garbage. I must live with it but cannot thrust it on you. Everything has a price, and, in this case, I got to pay more. Thanks to time and inflation, the premium is not so big today, but it was 10Y ago. You can make smarter choices. At that time Aegon was the only online player and there was no way I going to buy from a new kid on the block.

**Would I change my stance now if I could go back in time?** We can't go back in time, but if we could, yes. With age I have become less stupid in some directions and more stupid in others.

**Why am I am not asking you to buy LIC?** As choices go, LIC is not a bad choice though (personal finance and all that sort of thing) but I am sure you choose on your own and make a smart choice that you can live with (I have no issues with mine)

**Why have I not changed my policy for something less expensive?** Inertia (I hate change) and with age developed an auto-immune condition (Myasthenia Gravis) which meant my premium will not go down!!

**Click to watch this part**

## Part C: How to buy Term Life Insurance: How much life cover do we need?

**Click to watch this part**

## How to buy Term Life Insurance: Executive Summary

1. Find out if your employer offers a group life cover in addition to the usual group base health cover. If yes, make sure it is activated. If they also offer a group super top-up health cover, find out the conditions and the cost. If it is not too expensive opt for it.
2. Life and health insurance premium payments are an investment for our peace of mind. If we treat them as expenses, we will end up buying bad products
3. When you browse for products, some features will catch your eye. They are meant to! The more attractive the feature in life insurance and health insurance, the more useless it is! Read policy wordings to find out the real pros and cons.

4. Do not waste time thinking about claim settlement ratio, solvency ratio etc. They are of no use. Insurance, unlike investment, is a personalized product. **Read more: How to choose a term life insurance provider in 30 minutes!**
5. The insurer looks you (the wonderful and unique 'you') and offers a policy for 'you'. That is the premium is a personalized number. Therefore, asking others about their experience is useless.
6. Get a simple term life cover: nominee gets 100% of sum insured in one shot upon death.
7. Avoid all riders. get an accident policy separately (that would be step 5 in this series)
8. Avoid premium-back policies. It is a waste of money
9. Get a cover only up to age 55 or at beat 60 (longer the duration, more the premium = waste of money)
10. Avoid policies that offer the lump sum in stages and/or pay a monthly income to the nominee. It is a waste of money.
11. Read policy wordings again! Look for exclusions. Preferably the only exclusion should be suicide in the first year (or two). Remember, death by accident is also death and will be covered by a life insurance policy (even if the insured breaks the motorcycle act)
12. Do not take the premiums shown in policy comparison portal too seriously. They are only indicative.
13. Choose a comparison **only** to find a list of insurers who offer the product. opt for a portal that does not insist on a real email and

real phone no (this is an old list might still work: Non-intrusive term insurance comparison portals)

14. Remember: insurance is a contract based on good faith. Be honest while applying and provide all relevant information. Although the onus on proving fraud is on the insurer, they can be pretty good at it and sometimes even deny genuine claims: The Games Life Insurers play! and No insurer will hand life insurance claim amount on a platter!

15. Remember buying life insurance is the first step to building wealth. If you do not invest right and grow your net worth quickly, the sum insured will lose value due to inflation!

16. You will have to find the courage and common sense to make a quick choice. If you don't have this,

17. Choose an insurer and find out the maximum cover that they will offer you (based on your income and risk profile). If you are a young earner, go for the maximum amount if you can afford the premium. It will come in handy if you get married and have children.

18. Use this Insurance Calculator for the Young if you unmarried and this Step-by-step guide to plan for your child's education and marriage if you have children to plan your life cover needs.

19. Always evaluate your life cover if you get new dependents (wife and children)

20. Be sure to write down an action plan: how should your family use the sum insured after you are gone. They may not do it that way, but at least you tried!

21. Give your family the contact of a fee-only financial planner to manage the sum insured. Otherwise, your friendly neighbourhood sales agent will ...

Buy *after* reading; buy with confidence. A term insurance policy is just the beginning of our wealth building process. Here's hoping we stay alive long enough to burn the policy document (when the policy ~~matures~~ expires).

You can catch the other videos here: ₹e-Assemble

# ₹e-Assemble step 4: How to choose a suitable health insurance policy

freefincal Re-assemble November 25, 2017

**₹e-assemble** is a video series covering the basics of money management and goal-based investing for absolute beginners. Step 1 was listing *Goals, Dreams and Nightmares*. Step 2, laying the foundation of wealth with an emergency fund step 3, buying a term life insurance policy and this week in step 4, we shall consider choosing a suitable health insurance policy. Buying a health policy is one of the most difficult decisions in personal finance as this space is filled with needless jargon and buyers often fail to look deeper than the sugar coating.

Also, unlike a term insurance policy, a health policy is a not a "fill-it, shut-it, forget-it" arrangement. The premium increases every 5 years or so. Or it may increase by a huge amount if the insurance company suffers several claims from its customers. We may need to increase the sum insured from time to time. The terms of the policy or the very nature of the policy can change upon renewal.

Unlike a term policy that can be discarded upon retirement or even earlier, it is prudent to continue health cover even when one has (more than) "enough" wealth. Therefore, it is important to take a long-term view when it comes to health insurance purchase. The premium could well be (if not already) our biggest annual purchase sooner than later.

Unlike a stock or a mutual fund, a bad purchase cannot be easily transferred (sold). Although it is possible to shift the insurance from one company to another, only applying for a transfer is a right. Accepting the porting request is up to the (new) insurer.

I don't wish to scare you. Thankfully, the core features of most policies are identical. So, it is not as hard as it looks *provided* we ignore the fringe benefits discussed below.

## My health insurance policy

I hold an individual United Indian Platinum Health Cover for self, wife, son and a Gold Cover for my mother for the last 10 years with three claims – one for myself, wife and mother. It was not exactly an informed purchase as I got it out of fear and in a hurry when my late father was hospitalised with cancer without any insurance.

Over time I got to know the policy features well and read other policy wordings. So what follows is not from an expert but from someone interested in the nitty-gritty of a product and scraps of gyan collected from here and there. What I discuss (as always) is nothing more than common sense.

## The plan

In the first video, let us consider the essential aspects of buying term insurance. In the second, we go through the process of comparing health insurance policies. These two are covered in this post.

In the next post (tomorrow), we shall walk-though the policy wordings of few policies voted by members of the Facebook group, Asan Ideas for Wealth. Many of them also listed what covers they have and why they purchased it. I thank them for their support and participation. Let us get to it.

## How to buy health insurance: What to look for and what to ignore

**Click to watch this part**

## How to compare health insurances: creating a shortlist

**Click to watch this part**

**How to buy health insurance: Slide deck**

## Executive summary for ₹e-assemble step 4: How to buy health insurance

**1:** Get yourself a personal cover asap. Do not assume you can shift your company policy to an individual cover – it may have limitations. Do not get a super top to your corporate cover with no base cover. See:

Health Insurance: Switching out of my job current – My experiences

Experience: After porting from group health insurance to a family floater

Do not buy a top-up policy for your company mediclaim!

**2:** A company cover may help in case your parents or in-laws have pre-existing diseases. Getting them a separate cover (if possible) is always a good idea though. You may need the help of an intermediary (broker/agent) if insurers start rejecting you. The intermediary may get you the policy because of the sales they bring in.
However, *always* disclose all details no matter how you buy.

**3:** Get a base policy for a few lakh + top up (will cover this next week) **OR** get a large floater cover for your family (get a separate policy for parents or for those with fragile health) for say 15-20 Lakh.

**4:** It boils down to how much money you can spare!

**5:** Discounts and bonuses only matter for expenses. Health insurance is an investment for your peace of mind

**6:** Buy a policy that works for you. Not the "best" policy. This means you should know what you want! That is hard for a lot of people!

**7:** Focus on core benefits on health policy: hospitalization cover and day care cover for major procedures.

**8:** Ignore fringe benefits like restore, recharge, health check-up*, non-allopathic care** etc. More the fringe benefits, more expensive the policy and more confusing the terms.

* I will not provide periodic updates on the status of my health to the insurer. Health check-ups are important, and I will pay for them from my pocket. Please note that insurer cannot increase the premium or deny renewal based on these results or your claim history. However, they are free to deny an increase in cover based on your claim history and/or health check-up results. The Same logic applies to the fancy "benefits for staying fit".

** **non-allopathic** hospitalization is rare, and a policy will not cover casual doctor visits (any kind of doctor)

**9:** Build a relationship with a family doctor. I have family doctor + family neurologist + family orthopedist, dentist, dermatologist, ophthalmologist …. (yeah, I am sick in more ways than one)

**10:** Understand what a pre-existing condition is. It need not be declared in the policy. If they find evidence that it could have existed before the inception of policy a claim can be denied. Moral: read policy wordings. Remember that there is a good reason that policy wordings are in dull font and located in hard-to-find places. They are hoping that you will not read it!

**11:** Understand how room and ICU daily rent limitations affect you. Those who live in expensive cities should avoid them. Others can get by with these limits but need to find out room tariffs from local hospitals. A policy with no sub-limits will cost more (obviously!)

**12:** Along with sub-limits, avoid co-payments, and disease-dependent limitations in cover amount (e.g. only 40% of sum insured for piles, fistula, hernia, etc.)

**13:** Do not get attractive to restore option, re-fill option and discounts.  They are being provided *only* because the insurer is betting that they will not be utilised often. Remember they have legal help in wording policies carefully.

**14:** Before you start comparing policies, have a list of conditions that are important to you (e.g. lower pre-existing disease waiting period)

**15:**  I have shown policy comparison results from https://www.gibl.in/health-insurance/ in the second video. Please note, I found this website by accident when writing about: Illustration: Factors that matter while choosing health insurance. I have no connection with the owners of the website. Do not assume that all data provided in this comparison portal are accurate. Use it for a short-list of 2-3 policies and read the *latest* policy document (old clients may have a different policy document).

**Bottomline:** All insurance is a game of probability. The insurer is betting on you to not get sick often. Two can play this game. I would not pay for any feature that I am least likely to use. For example: non-allopathic hospitalization, maternity expenses (company cover provides this or I will happily pay (how many children am I going to have?!) ambulance cover (I have 5 hospitals within 200 metres of where I live, so will pay from my pocket).

In other words, ask yourself which features matter the most and focus on them.

Do not go by feature listings on webpages. For example, many people incorrectly believe that PSU insurers (United India, Oriental, New

India) do not provide day care coverage. They do not advertise it prominently enough. If you read the policy document, it will be clear enough.

When you read an article about health insurance find out who has written it. If it is a broker or agent or aggregation portal, do cross-check facts. Do the same with this post. As regular readers will tell you, I am clumsy and make mistakes often. I have only one thing going for me – I mean well. Cheers.

Health insurance is a complex subject. I would like to continue talking about it next week too. Please suggest issues and policy features that would benefit many.

# How to select a credit card for maximum benefit

freefincal Re-assemble, Young Earner December 2, 2017

I discuss simple ways to select a credit card, use it efficiently and maximize its benefits. This post is part of **₹e-Assemble**: a series on the basics of money management for young earners. You will be surprised as to how many people do not understand how a credit card works and how many people get into huge credit card debt because they did not read the terms and conditions before using it.

A few years ago, I took my M. Sc class out to lunch. Since I rarely eat out, I wanted to figure out ball-park costs. One kid said, "just use your card, sir, swipe karo". He assumed that if I swipe my card, I don't need to pay the bill! Personally, I am not a fan of credit and inspired by Jack Reacher cancelled my SBI card as I was not using it. My wife has had the same Citibank card for the last 17 years (which do I use as mentioned below) and we have never once bothered to find out the benefits it has or used its reward points. We just are not wired that way. So, you might be surprised to see this post from me. Am I the right guy to start a discussion on how to select a credit card?

Yes, I am. For the simple reason that credit card selection is hardly difficult and anyone who has the common sense to put in a little effort can choose well and more importantly use it right.
In **Gamechanger**, my young co-author Pranav Surya discusses how

to choose select cards and maximise benefits. I cannot match up with him, but try my best, I will. Let us get started with the basics.

## Before you select a credit card, ask: what is a credit card?

This is how the average young earner thinks a credit card works:

The credit company offers us a line of credit. That is, we can spend up to a certain limit, withdraw cash from ATMs up to a certain limit. Each month a bill listing our usage will be generated and a due date for payment will be set. If we do not pay the full amount that we spent or withdrew before the due date, we will be **fined** by the card company. The more we spend, the more we get rewards.

This is, word-for-word true. However, what that "fine" is, how it is calculated, the difference between using a card for spending and withdrawing money is what matters.

At least, the above definition is way better than what a retiree told me:

I never fail to pay the minimum amount due each month

If you think there is nothing wrong with the above statement, you need this section!

Let us pause for a moment and look at the similarities between a credit card and health insurance that was considered last week. Both products come with a lot of window dressing:

Credit cards talk about fuel waivers, restaurant discounts, lounge access, airline miles etc (the more you earn, the more the credit line and more expensive the benefits).

Health policies talk about restore, re-fill, multiplier benefit, bonuses etc. However, as we saw last week, these benefits are offered to hide the most important features of the policy and come loaded with terms and conditions. Credit cards are not very different. Their benefits are also subject to several limitations and they too are used to hide the essential working of the credit card.

## Before you select a credit card, ask: Who needs a credit card?

To borrow a line from Ratatouille:

Anyone can use a credit card, but that does not mean anyone should!

- Today internet-based transactions, a credit card is *essential* only for those who make international transactions *frequently,* who travel around a lot (even within the country). Consider the purchases associated with freefincal: domain renewal, hosting renewal, adding CPUs or ram to the cloud hosting, backups, plugins etc. Practically all of these are USD or Euro transactions. If I did not have a credit card, I will have to use a Paypal account Of course credit cards and PayPal have the same no of steps involved but a card is a bit more convenient.

- As discussed in ₹e-Assemble Step 2: Lay the Foundations to Get Rich, a credit card can be used as a source of instant emergency purchases.
- Building a line of credit (promptly repaid) is important for your credit score. This will come in handy if you apply for a car loan or home loan. Pranav discusses this too in Gamechanger.

Aside from these three usages, I cannot think of any exclusive credit card usages. A debit card, or IMPS or NEFT or the good old chequebook or plain old cash would suffice.

Buying credit cards *only* for its rewards and benefits is fine but buying it for a revolving line of credit (paying only min due) is a bad idea. That is, this month's credit card purchases **must** be cleared **in full** with at least the next month's salary. Any later and you are in trouble. If you need more time to pay your credit card bill, you have a spending problem and must immediately do this to your credit cards. Why? Read on.

## Before you select a credit card, ask: How does a credit card work?

If you never withdrew money from an ATM with a credit card and always ensure to pay the balance in full, well before the due date, the inner workings of a credit card should not matter to you. If you are a heavy spender, then before selecting a credit to be sure to understand how it works.

Suppose you fail to pay a due of Rs. 10,000. Then, the interest you must pay **per day** in addition to the principal is:

10000 x (2.5% x 12 /365) = Rs. 8.22

Here 2.5% is the typical monthly interest (See HDFC document snapshot below, the rate is 3.49%!!)

2.5% x12 = 30% = year rate of interest of the borrowing.

so, 2.5% x12/365 = 0.08% daily interest

So, interest payable per day = Amount Due x daily interest

Amount Due = total principal outstanding. This means if you have a credit card due of 10,000 and make another 10,000 purchase, immediately the interest will be calculated on 10,000 + 10,000 per day!! How do you think credit cards survive? On the weight of our stupidity.

In addition, GST of 18% will apply to the interest. Then there are late payment fees of a few hundred rupees (higher the due, higher the fee) which will also attract GST.

This is the reason why people keep shouting:

**Rule no 1:** Do not just pay the minimum amount due (rest will accumulate daily interest as above), pay the full amount well before due date.

When you make a purchase with a credit card, interest will apply only after the due date and from the date of purchase to due date is about 3-4 weeks depending on the card. If you withdraw money from an

ATM, the daily interest rate will apply **from the date of withdrawal!**

**Rule no 2:** Never withdraw money from an ATM with a credit card

**Rule no 3:** Never take a loan on your credit card. Works the same way as above, with possibly a lower daily interest rate. Both rate and processing fee is subject to GST. Here is an illustration from Axis Bank

Like it is important to read and understand the entire policy document of an insurance policy, it is important to at least read the "MOST IMPORTANT TERMS & CONDITIONS" of a credit card. Here is a snapshot of this document from HDFC Credit Card. Every word of this is important!

- Finance charges on cash advances are applicable from the date of transaction until the payment is made in full.
- When the customer carries forward any outstanding amount or avails of Cash Advance, a finance charge calculated by average Daily Balance Method, will apply to balances carried forward and to fresh billings.
- If a Cardholder avails of the revolving credit facility of the HDFC Bank Credit Card and hence chooses to pay an amount less than the total amount due reflected in the monthly billing statement, the entire outstanding amount would attract finance charges and all new transactions will also attract finance charges till such time as the previous outstanding amounts are repaid in full.
- Late Payment Charges will be applicable if Minimum Amount Due is not paid by the payment due date, Clear funds need to be credited to HDFC Bank Card account on or before the payment due date, to avoid Late Payment charges. Late payment charges are applicable as:

| Statement Balance | | Late Payment Charges |
|---|---|---|
| Less than ₹100 | - | Nil |
| ₹100 to ₹500. | - | ₹100/- |
| ₹501 to ₹5000 | - | ₹400/- |
| ₹5001 to ₹10000 | - | ₹500/- |
| ₹10001 and above | - | ₹700/- (₹750/- wef 15th August 2017) |

- Over limit charges are applicable on total outstanding exceeding the Credit Limit at the rate of 2.5% of the over limit amount subject to minimum of ₹500.

**The following illustration will indicate the method of calculating various charges**

Assume that you have paid all previous dues in full and do not have any amount outstanding in your Card Account. Your statement date is 18th of every month. The following is the list of transactions you have done on your card account.

| Date | Transaction | Amount |
|---|---|---|
| 17-Apr | Purchase of Grocery | ₹15,000 |
| 17-Apr | Purchase of Electronics | ₹5,000 |
| 18-Apr | Statement Date | ₹20,000 |
| 7-May | Payment into Card account | ₹2,000 |
| 14-May | Purchase on Dining | ₹1,000 |
| 15-May | Payment into Card account | ₹18,000 |

Thus, on the statement dated 18th May, the following will reflect as the component of the total amount payable by you before the due date of 8th May

Interest calculated = (outstanding amount* 3.49%Pm*12 months*no of days)/365. Therefore,

a. Interest on ₹20,000 from 17th April - till 18th April = ₹45.90
   Interest on ₹20,000 from 19th April - till 6th May (18 Days) = ₹413.06
   Interest on ₹18,000 from 7th May - till 13th May (7 Days) = ₹144.57
   Interest on ₹19,000 on 14th May = ₹21.80
   Interest on ₹1,000 from 15th May - till 18th May (4 Days) = ₹4.59
   Thus Total Interest of ₹629.92
b. GST @ 18% on interest and other charges = ₹113.39
c) Total Principal Amount outstanding = ₹1,000
   **Hence Total amount due = (a) + (b) + (c) = ₹1,743.31**

Please note that the Finance Charges and other charges are subject to change at the discretion of HDFC Bank.

Also please note that if the Cardmember exceeds the credit limit of the accounts, Over Limit Charges will be levied on the account. For a list of charges that may be levied at specific instances, please refer to the Schedule of Charges available at the end of this document.

If you have a spending problem, do not get a credit card. If you already have one, shred it into pieces.

## How to select a credit card in India

As long you follow rule no 1 and rule no 2 mentioned above, the daily interest rates,

**Step 1:** Go to a random card comparison portal that does not seek personal information. I chose

https://cards.paisabazaar.com/credit-card/ (not affiliated in any way)

**Step 2:** Enter the true nature of your income, annual income, and city, provide a dummy phone number, agree to terms of use* and proceed

* **Why provide a dummy number:**

Paizabazaar T&C states: You agree and consent to receive all communications at the mobile number provided, even if this mobile number is registered under DND/NCPR list under TRAI regulations. And for that purpose, you further authorize Company to share/disclose the information to any third-party service provider or any affiliates, group companies, their authorized agents or third-party service providers.

So, use these portals for comparing with dummy information. How you choose to apply for a card is up to you. I would prefer to apply "directly". Remember to read the eligibility conditions before applying to avoid disappointment.

**Step 3:** You can either filter by provider, fees or rewards. If you are a regular card user, then a nominal annual card fee is more than acceptable if the rewards are good. Some cards will waive off the fees if you use it above a limit. Typically cards with fees offer better rewards.

You also opt for a card with high fees and benefits and then after some period of heavy usage, persuade them to waive the fee. Pranav discusses how to negotiate this effectively in **GameChanger.** You can also search the archives or FB group Asan Ideas for Wealth where these "strategies" and cards are discussed.

When it comes to rewards, it is simply common sense that you choose the rewards that you use often. If you do not travel by air often, a card with lounge access does not make sense.

## Maximise Credit card benefits: Ignore reward points that cannot be redeemed against dues easily

Credit cards offer users reward points on each spend (on certain items, subject to limitations). However.

Cardholders cannot redeem their Reward points against dues outstanding on their (HSBC) Credit Card

can be a serious limitation. This means that reward points can only be redeemed in a certain way – that is purchase certain items above certain costs in certain stores. So, I would straightaway ignore such reward points. Reward points must be redeemable against card balance and must be cumulative and should not expire soon.

Many cards do allow rewards points to pay for the outstanding due, subject to terms and conditions. As long the as such redemption process is easy, it is fine. Shavneet 'cryto' Singh tells me that it is possible and easy to do it with Amex Cards. It is also possible with Citibank but seems to be a pain

## opt for waivers, discounts, cash-backs, lounge access

I would also prefer to see an actual reduction in the amount of credit I borrow. For example, a fuel spends of Rs. 399 or below could result in a credit card surcharge of Rs. 10 and a spend above that could result in 2.5% surcharge. Many cards waive this surcharge up to a certain limit (e.g. above 400 and below 4000). This surcharge offsets the transaction fee for the pump station.

It makes sense for car owners to prefer this surcharge waiver. Two-wheeler owners may prefer a surcharge waiver without lower cap. Of course, one could argue that cash or debit cards are better because this is an artificial discount – credit cards create the cost and then offer a discount on it. But it is acceptable if they carry reward points (fuel does not for many cards) and if these reward points can be easily redeemed (especially for fuel, see below)

Ignore juicy welcome offers and focus on long term benefits that will work with normal spending.

Discounts on garments, electronics and restaurants make obvious sense. Free lounge access at airports works for those who often need to take personal flights (but these are limited in number and come with other terms and costs). So, the idea is to **focus on tangible benefits that make you spend less**. A discount must be direct and reflect on the bill. A cashback must reflect on the credit limit. Those are the real benefits. Not reward points (unless they can be offset easily against card balance)

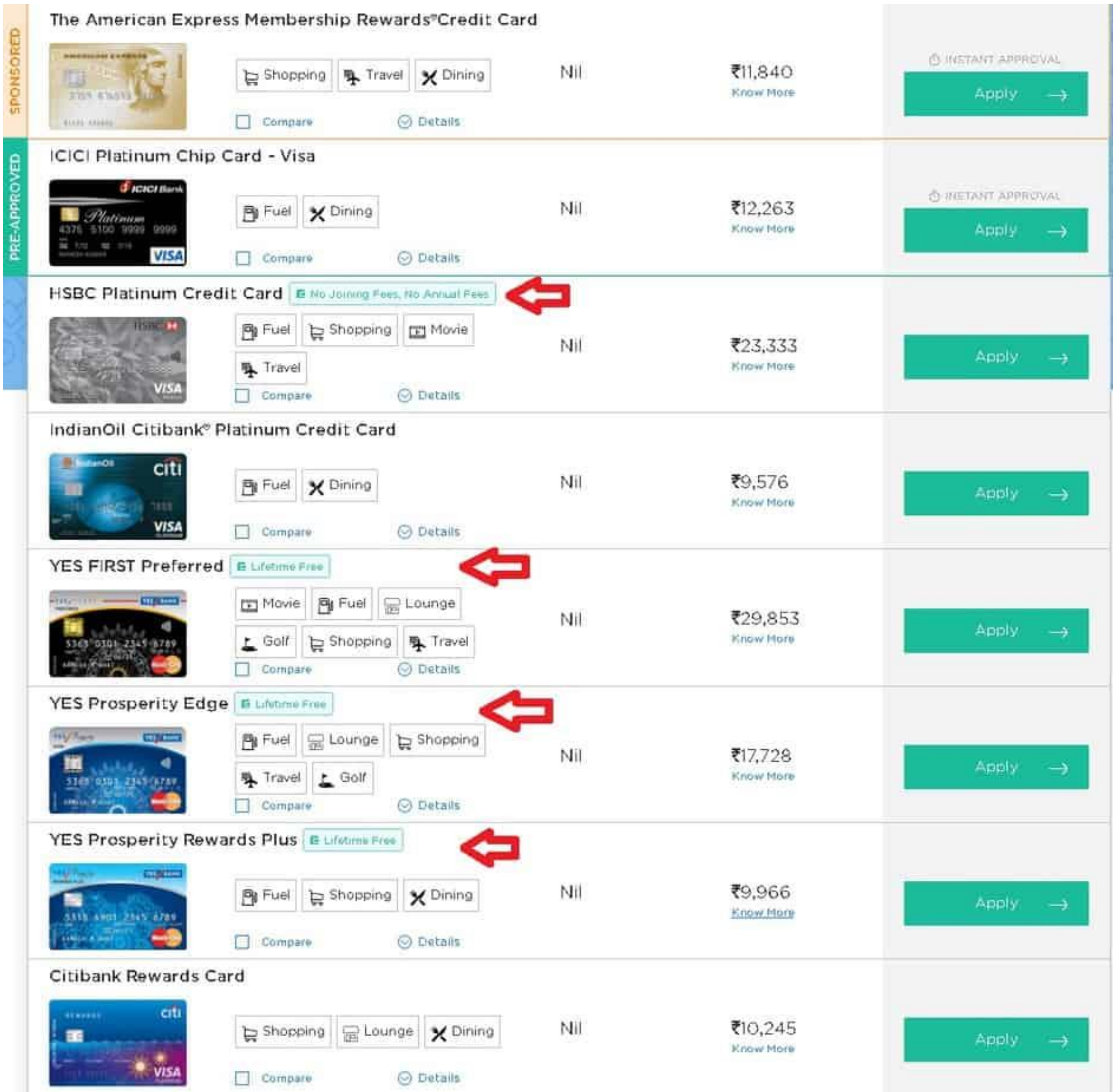
Of course, some people spend more so that they become eligible for discounts. They need counselling, not credit. That is the problem with many credit card benefits. They kick in only after a certain lower threshold spend and disappear after a higher threshold spend. It is always better to opt for a straightforward % benefit on all purchases.

A card offering fuel surcharge waiver on all petrol spends is likely to set a threshold on other benefits and vice versa. Therefore, it is important to identify which benefit matters the most and choose a card that offers a flat benefit on that for *every swipe*. As simple as that.

## Selecting Credit Cards with no annual fees

If you used the no annual fee option for a start, you will get two types of cards. Those that have an explicit no fee and those that have a fee waiver below a certain spend limit. I would avoid the latter as it will make me spend more just to avoid fees. The flat no fee option works well for light users. The trade-off is likely to be on the benefits.

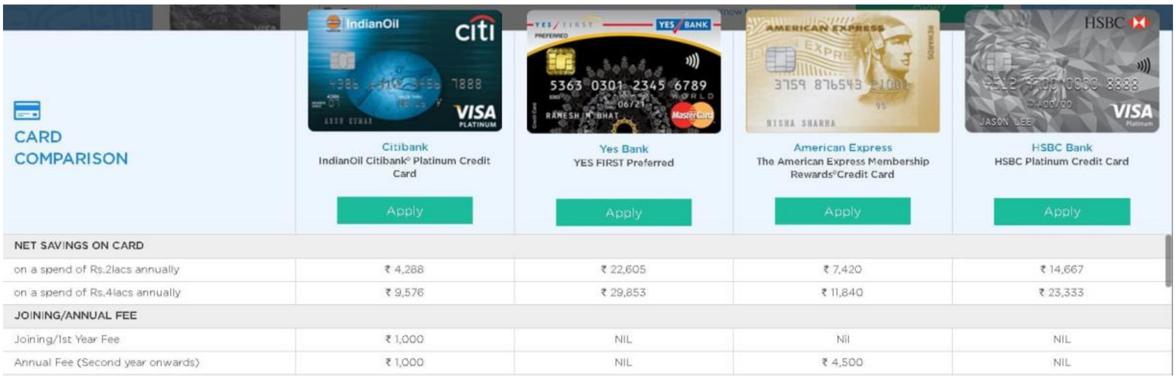
This is a list of such cards at paisabazaar.com.




The ones marked with an arrow are flat no-fee cards and the rest (except Amex) have a fee waiver option.

## Comparing credit cards

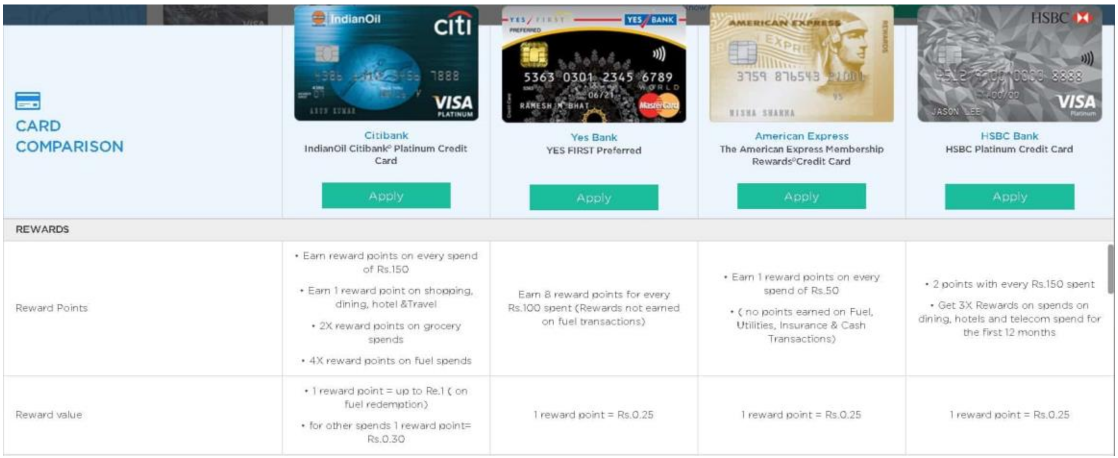
I chose an assortment of cards from above. The sponsored Amex card which does not fit in the filter and those with fee waiver and flat free cards. Let us go through them feature by feature. If we had to choose only among these cards, what would you choose? What would I choose?



| CARD COMPARISON | Citibank<br>IndianOil Citibank® Platinum Credit Card | Yes Bank<br>YES FIRST Preferred | American Express<br>The American Express Membership Rewards® Credit Card | HSBC Bank<br>HSBC Platinum Credit Card |
|---|---|---|---|---|
| | Apply | Apply | Apply | Apply |
| NET SAVINGS ON CARD | | | | |
| on a spend of Rs.2lacs annually | ₹ 4,288 | ₹ 22,605 | ₹ 7,420 | ₹ 14,667 |
| on a spend of Rs.4lacs annually | ₹ 9,576 | ₹ 29,853 | ₹ 11,840 | ₹ 23,333 |
| JOINING/ANNUAL FEE | | | | |
| Joining/1st Year Fee | ₹ 1,000 | NIL | Nil | NIL |
| Annual Fee (Second year onwards) | ₹ 1,000 | NIL | ₹ 4,500 | NIL |

The Amex card is simply too expensive for my usage and I don't have the necessary skills to get it waived. So that is off the chart for me straight away. It is not a question of affordability. I don't like to be forced to spend more on my card or spend more period.

The Citibank Indianoil card has a ₹1000 fee only if the usage is less than ₹30,000 a year. The others are flat fee. So that leaves 3 cards for now.



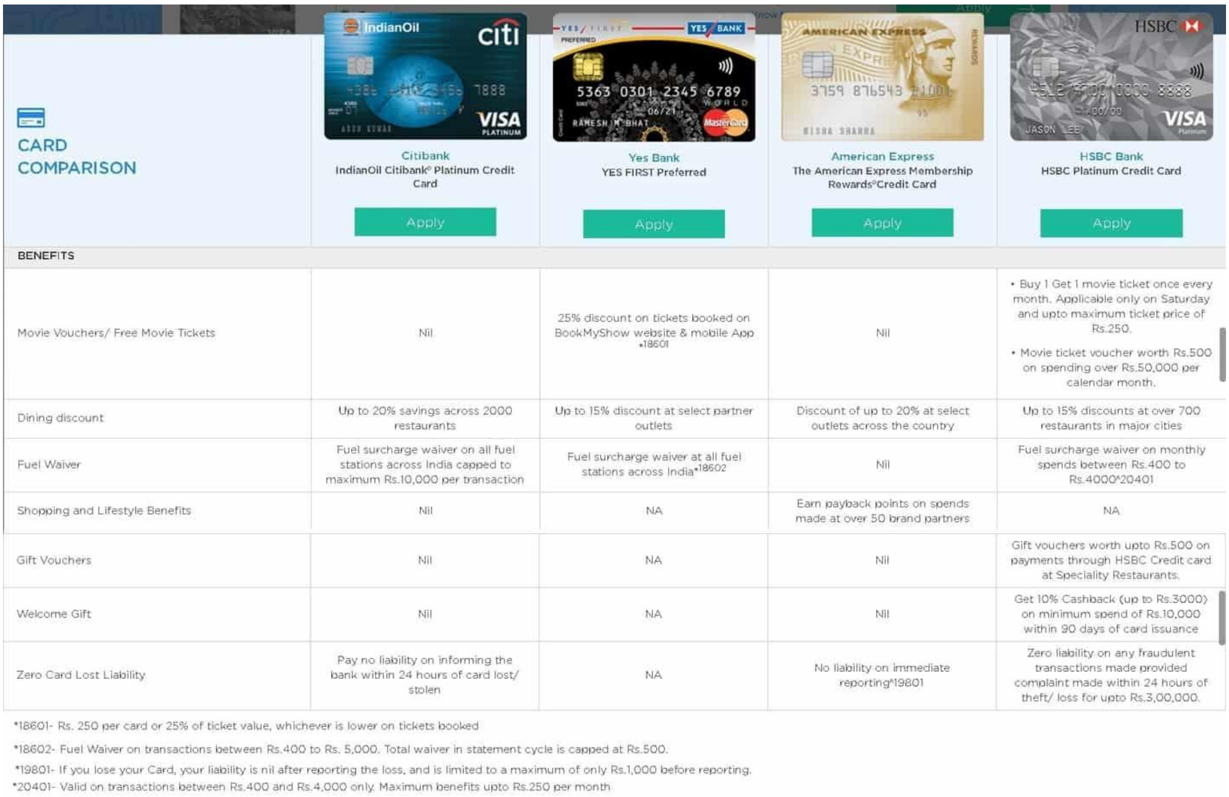
| CARD COMPARISON | Citibank<br>IndianOil Citibank® Platinum Credit Card | Yes Bank<br>YES FIRST Preferred | American Express<br>The American Express Membership Rewards® Credit Card | HSBC Bank<br>HSBC Platinum Credit Card |
|---|---|---|---|---|
| | Apply | Apply | Apply | Apply |
| REWARDS | | | | |
| Reward Points | • Earn reward points on every spend of Rs.150<br>• Earn 1 reward point on shopping, dining, hotel &Travel<br>• 2X reward points on grocery spends<br>• 4X reward points on fuel spends | Earn 8 reward points for every Rs.100 spent (Rewards not earned on fuel transactions) | • Earn 1 reward points on every spend of Rs.50<br>• ( no points earned on Fuel, Utilities, Insurance & Cash Transactions) | • 2 points with every Rs.150 spent<br>• Get 3X Rewards on spends on dining, hotels and telecom spend for the first 12 months |
| Reward value | • 1 reward point = up to Re.1 ( on fuel redemption)<br>• for other spends 1 reward point= Rs.0.30 | 1 reward point = Rs.0.25 | 1 reward point = Rs.0.25 | 1 reward point = Rs.0.25 |

Notice how the reward point benefits are structured. The IndianOil card and HSBC cards offer reward points on fuel purchases too. It is amusing that one that reward point is 25 paisa for a card charging 4500 a year (Amex), but it has other rewards (see below).

In this screen, IndiaOil is the clear winner. Not only is 1 point = 1 Rs. for fuel, the reward point can be swiped for free petrol at IndianOil outlets. Now that is reward redemption which is probably the most direct and easiest that I have seen.

At this point, I would dig deeper into the Citibank IndiaOil most important terms and conditions. I don't know if other companies do it (I am sure they do), but I like the fact that Citibank has organised its cards in terms of petrol, shopping, cash back and airline miles. This makes it so much easier for the user to pick one according to what matters to them.

Choice becomes easy when we realize all desirable features cannot be packed into one product (hence the need to choose!)  Let us continue with the comparison to illustrate this point:



| CARD COMPARISON | Citibank<br>IndianOil Citibank® Platinum Credit Card<br>Apply | Yes Bank<br>YES FIRST Preferred<br>Apply | American Express<br>The American Express Membership Rewards®Credit Card<br>Apply | HSBC Bank<br>HSBC Platinum Credit Card<br>Apply |
|---|---|---|---|---|
| BENEFITS | | | | |
| Movie Vouchers/ Free Movie Tickets | Nil | 25% discount on tickets booked on BookMyShow website & mobile App *18601 | Nil | • Buy 1 Get 1 movie ticket once every month. Applicable only on Saturday and upto maximum ticket price of Rs.250.<br>• Movie ticket voucher worth Rs.500 on spending over Rs.50,000 per calendar month. |
| Dining discount | Up to 20% savings across 2000 restaurants | Up to 15% discount at select partner outlets | Discount of up to 20% at select outlets across the country | Up to 15% discounts at over 700 restaurants in major cities |
| Fuel Waiver | Fuel surcharge waiver on all fuel stations across India capped to maximum Rs.10,000 per transaction | Fuel surcharge waiver at all fuel stations across India*18602 | Nil | Fuel surcharge waiver on monthly spends between Rs.400 to Rs.4000^20401 |
| Shopping and Lifestyle Benefits | Nil | NA | Earn payback points on spends made at over 50 brand partners | NA |
| Gift Vouchers | Nil | NA | Nil | Gift vouchers worth upto Rs.500 on payments through HSBC Credit card at Speciality Restaurants. |
| Welcome Gift | Nil | NA | Nil | Get 10% Cashback (up to Rs.3000) on minimum spend of Rs.10,000 within 90 days of card issuance |
| Zero Card Lost Liability | Pay no liability on informing the bank within 24 hours of card lost/ stolen | NA | No liability on immediate reporting^19801 | Zero liability on any fraudulent transactions made provided complaint made within 24 hours of theft/ loss for upto Rs.3,00,000. |

*18601- Rs. 250 per card or 25% of ticket value, whichever is lower on tickets booked

*18602- Fuel Waiver on transactions between Rs.400 to Rs. 5,000. Total waiver in statement cycle is capped at Rs.500.

*19801- If you lose your Card, your liability is nil after reporting the loss, and is limited to a maximum of only Rs.1,000 before reporting.

*20401- Valid on transactions between Rs.400 and Rs.4,000 only. Maximum benefits upto Rs.250 per month

The IndianOil card has the best fuel waiver benefit (no surprises), but it also has a decent dining discount. On the other hand, HSBC and Yesbank have good movie deals. Which one is better for the movie deal: HSBC or YesBank?

In this window too, IndianOil is the winner considering that you need fuel to go to the movies. Now, moving on:

| CARD COMPARISON | Citibank<br>IndianOil Citibank® Platinum Credit Card<br>Apply | Yes Bank<br>YES FIRST Preferred<br>Apply | American Express<br>The American Express Membership Rewards® Credit Card<br>Apply | HSBC Bank<br>HSBC Platinum Credit Card<br>Apply |
|---|---|---|---|---|
| LUXURY BENEFITS | | | | |
| Lounge Access | Nil | 4 Complimentary Access of lounges on Priority Pass membership in a calendar year | Nil | NA |
| Golf Benefits | Nil | Waiver of green fee at select golf courses in India & One complimentary golf lesson every calendar month | Nil | NA |
| INSURANCE/PROTECTION BENEFITS | | | | |
| Insurance Cover/ Benefits | Nil | Up to Rs. 1 crore worth of Life/ Medical Insurance coverage *18603 | Nil | NA |
| REWARDS AND PAYBACK | | | | |
| Additional Reward Points on higher spent on yearly basis | Nil | • 20,000 bonus reward points on spends of Rs.7.5 Lac or above in each anniversary year<br>• 1000 reward points on each YES PayNow registration | Earn 1000 Bonus Membership Rewards Points by using your card 4 times every month | Get 5X Rewards on subsequent purchases after crossing spend of Rs.4 lac in a year up to a maximum of Rs.10 lac in a year. |
| Cashback on regular spends | Nil | NA | Nil | Cashback upto Rs.10,000 in your wallet on International flight booking through MakeMyTrip. |

*18603- Life Insurance Cover of Rs. 1 Cr for death due to flight accidents.

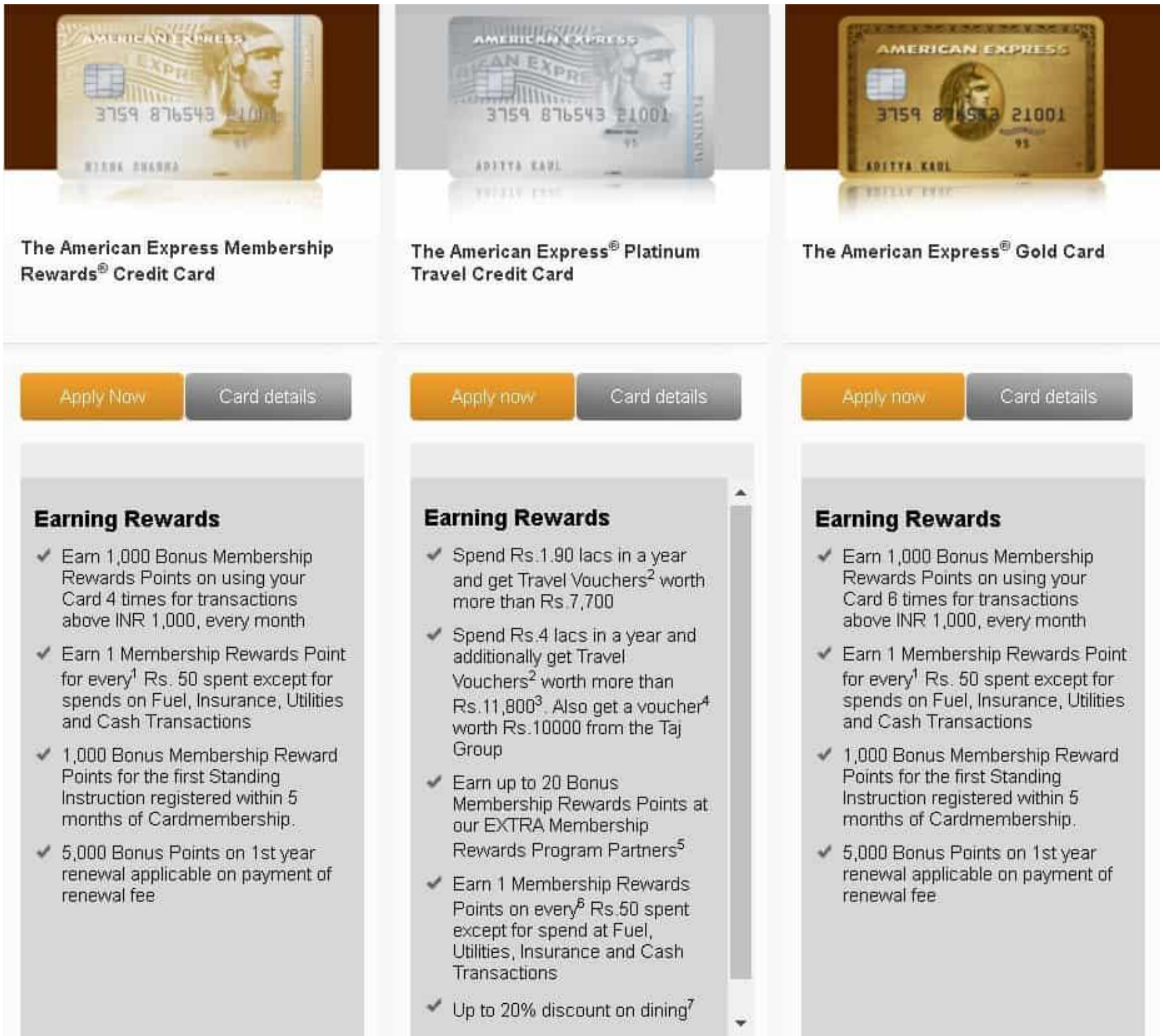
HSBC card offers 10,000 cashbacks on international flight booking. You can get Pranav Surya's Travel Training Kit (pdf for ₹199), check for cheap flights (really cheap!) and find out if it makes sense to use MakemyTrip on those days (it may not!). This is the problem with many card benefits. You can only avail them in a certain portal. There may be cheaper ones available.

The Amex Express Membership Rewards Credit Card offers

- Earn 1,000 Bonus Membership Rewards Points for using your Card 4 times for transactions above INR 1,000, every month
- Earn 1 Membership Rewards Point for every Rs. 50 spent except for spends on Fuel, Insurance, Utilities and Cash Transactions
- 1,000 Bonus Membership Reward Points for the first Standing Instruction registered within 5 months of Cardmembership.
- 5,000 Bonus Points on 1st year renewal applicable on payment of renewal fee

This will work well with heavy usage that is normal *before* buying the card.

## American Express Credit Card Bonus Membership Rewards Comparison




See here for the full comparison of Amex cards

You can further filter by a benefit and so on. I hope the essential idea of credit card choice is clear.

## Summary: How to choose a credit card

Decide on whether you wish to pay a fee or not —> Decide on the benefit you need most often —-> Choose a card that offers the most direct benefit for the lowest fee —> Read about eligibility, important T &C before applying ——> Always remember rules 1,2, 3.  Easy peasy lemon squeezy! People get confused only when they do not what they want.

**Maximize credit card benefit by choosing a card that does not make you spend more!**

## Credit Card Usage Tips

1: Do not use your credit card on any purchase that you cannot afford.

2: Pay this month's credit card purchases with this month's salary or at best next month's salary.

3: If you want to set up an automated card payment with your salary account ensure that payment date is a good seven days before due date.

4: Don't overthink about the great interest you will generate from a 6% SB account or liquid fund by delaying credit card payment until just before due date. Wealthy people do not worry about crumbs. They plan to bake the whole pie and eat it too.

5: Get only one credit card and use it when needed. Using a card for benefits alone is lame (there I said it. Feels good)

6: If you use a card intelligently, you can build a good credit score – a proof to banks that you are worthy of loans. The rewards points and cashbacks are only a fringe benefit. Wealthy people only focus on core benefits.

**Parting thought:** If you found the article useful or meaningful then I have proved that anyone can pick a credit card. If you think I have missed out something important, please feel free to add them to the comments section.

Ps. I am referring to a wealthy person, not a rich person. All wealthy people are rich in multiple ways. Rich people are only rich in money.

# How to track monthly expenses and manage them efficiently

freefincal Re-assemble, Young Earner December 9, 2017

This week in ₹e-assemble, we shall discuss how to track monthly expenses and manage them efficiently. ₹e-assemble is a series on the basics of money management aimed at young earners. If you ask me now, "how should I track expenses?", I would say, "do not track, instead invest first and spend later". However, I am jumping the gun. I need to put myself in the shoes of a young earner and discuss the issue of expense tracking and management.

## Why should we track monthly expenses?

Ask this question and you will get responses like: "it is good to know our spending patterns and analyse them". Excuse me, but this makes no sense at all. If I am eating out four times a month, do I need to track restaurant bills or enter them in a mobile to app to understand that I am spending a good amount of money dining outside? Can't we recall from memory that a good chunk of our salary goes "there"?

Why do you need to track expenses to know your spending patterns? You are the one who spent the money. It is that hard to remember? If it is, you have a spending problem and tracking will not help.

My point is, when it comes to managing expenses, recording an expense *after it has occurred* has little value. We need to track expenses by budgeting and not track expenses by spending or staring at fancy pie charts. Understanding this difference is crucial to expense management.

## How to track monthly expenses using the envelope system

**Click to watch the video**

There is a lot we need to learn from our parents. My mom and dad maintained an accounts notebook – several of them. So, did my grandfather and my great-grandfather. Each month they did not record expenses in the notebook but accounted for them *before the expenditure*. That is, they budgeted for each expense using what is known as the envelope system.

Each month, dad would bring his accounts notebook and mom an array of dabbas. Dad would first copy the entries from last month onto a new page with the current month and year as the title. Then he would read out each entry. Mom would take out an amount and put it in a labelled dabba. The first entry was always "temple". She would put Rs. 1/20/50/100 in a dabba meant to be transferred at an appropriate time to a temple Hundi. Next came milk – Rs. 300 went to a box named milk. Rs. 1000 went to a box name grocery (provisions, cosmetics etc.), Rs. 500 went to a vegetable box, etc. you get the picture. These numbers are from a couple of decades ago.

This is known as the envelope system because at the start of the month we allocate a sum to each envelope/dabba for a specific expenditure. The idea is to not overshoot it as much as possible. My parents have an "extras" or "miscellaneous" dabba. This was a mini-emergency reserve for the month. If dal prices shot up or vegetables become more expensive, they would take some money from the extras dabba to handle the shortfall. They also had a leisure/pleasure dabba. This was for going to the cinema, buying me toys or books etc.

If there was a shortfall in the needs dabbas – milk, groceries, petrol etc. – they would use funds from *extras*. If there was a shortfall in the wants/leisure dabba, we just had to wait until next month. I am not making this up! This is how my parents handled family expenses for 31 years until my father fell sick with cancer. Then I and my wife took over. We continued to use the same dabbas but a few years, I started using a spreadsheet/graphing software for this (not excel). I still use that software and still have the file. Once I started goal-based investing, the envelope process became redundant and we no longer track any expenses now, only investments. That story is here: **How tracking investments instead of expenses changed my life!** This post also has a template of the tracker that I now use.

In the context of the post, look us consider the simple beauty of the envelope system. Notice you are not tracking expenses *before the spending*. Both needs and wants are budgeted into specific bins with a spares bin. If the needs bins are exhausted, we can borrow from the spares bin. If the wants bin becomes empty, we sit it out. This obviously requires discipline, but so does everything else in life. The spending becomes organized from day one with no further need to track it after each spend.

There were times when mom and dad had to consistently borrow from the extras/spares dabba. For e.g. due to temporary/permanent inflation, the amount they would usually allocate to the vegetable dabba was insufficient. After 2-3 months, they would allocate more the vegetable dabba.

**Click to watch the video**

Now consider the value of this information recorded over years. I can pick December and find out how the allocation to "vegetables" has increased over the years. Then I can calculate the average rate of year on year increase. This is known as inflation.

For example, allocation to vegetable in

Dec. 2015: 2000

Dec. 2017: 2500

Then 2500 = 2000 x (1+ inflation) x (1+ inflation) —> multiplied twice for 2 years elapsed

or 2500 = 2000 x (1 + inflation) ^2 —> ^ stands for "to the power of"

or inflation = (2500/200) ^ (1/2) -1 = 12%.

This is how I was able to write this post: **Inflation in India: Some Real Numbers**. Here is an image from the post.

| Item | Inflation* |
|---|---|
| Flat Maintenance | 5.467% |
| Provisions | 5.84% |
| Cable TV | 6% |
| Milk | 6.55% |
| Coffee powder | 7.4% |
| Cooking Gas | 8.68% |
| Petrol | 9.04% |
| Electricity | 9.17% |
| Paid-help salary | 9.71% |
| Vegetables | 11.35% |
| **Overall** | **7.83%** |

**Calculation is from Jan 1995 to May 2014**

I would strongly recommend that you use this simple **Personal Inflation Calculator** to understand the overall rate of increase in your expenses. It will help you become a better investor.

## What are the benefits of using the envelop system to track monthly expenses

1: A system cannot make you disciplined. That is up to you. For those who can be disciplined, the envelope system gives a fantastic sense of purpose.

2: By binning expenses, we immediately know our limits and there is no need to track expenditure.

3: It ratifies expenditure for leisure but within limits (which you get to set!)

4: If you manage to not breach the limits of leisure spending and can wait for the next month, you develop a sense of delay gratification.

5: It makes you aware of inflation in a simple and direct manner.

I believe this system is superior to one in which spending patterns are analysed *after the expenditure*.

## How to track monthly expenses: digital or non-digital means?

Whatever works for you, BUT if you are married or have a live-in partner and can stomach sitting 15 minutes together with that person, do it together. It is essential to manage and track expenses together and be completely honest about our spending.

## What does tracking monthly expenses "efficiently" mean?

Whatever method you adopt, it should make you spend in a controlled manner. Wild swings in expenditure should be reduced.

your personal rate of inflation is the most important output of expense tracking. This will help you choose suitable investment products.

**So, what is the system you follow to manage expenses?**

# How to close your loans and live debt-free

freefincal Re-assemble, Young Earner December 16, 2017

Follow these simple steps to learn how to close your loans and live debt-free. This week in ₹e-assemble, we shall discuss one of the most important money management problems for young earners – handling debt. You will be surprised as to how many people in their 20s and 30s nurse huge credit card debts, personal loan EMI and car loan EMI. In addition, many also have an education loan or later a home loan or dream of owning a home 'soon'.

This is a basic article meant for young earners. If you do not have a problem with debt, please do consider sharing this with those who do. There is more to personal finance than investing. Living in debt can be a horrible and demeaning experience. So, it is essential to be free of at least credit card debt and personal loan debt before one can think of having/clearing a car loan and a home loan. The basic principles of how to close your loans and live debt-free are essentially the same for all kinds of loans, so we shall start with how an education loan/home loan/car loan differs from a personal loan/credit card debt.

## The main difference between a home/car loan vs personal loan & credit card debt

Young earners buy a car either because they want one intrinsically or due to peer pressure and at times due to pressure from parents. The same is true of a home (with pressure from relatives often more important). Whatever be the reason, at some basic checks about the property or vehicle would be done. So, I would not call these as hasty purchases even if emotions play a big part.

The same logic applies to an education loan. It is a loan for an essential need. Read more: Paying off Education Loan in India

Many people simply have a spending problem and/or do not understand how credit cards work (read the basics here: How to select a credit card for maximum benefit). So, they end paying just the minimum balance and soon stare at a mountain of dues to pay that just keeps getting bigger with time due to the high daily interest. I know a guy who kept withdrawing money using a credit card and then transferred it to another card assuming the (lower) teaser interest rate is the final one – both big no-nos. So, it is often a debt incurred from ignorance and recklessness.

**If you have credit card debt, STOP USING YOUR CARD!! Every purchase you make after you have dues will *also* be subject to high daily interest.**

Personal loans (from banks, relatives, credit cards) are often due to circumstances and emotions or recklessness. I know many young people with huge money problems because their parents or siblings need it urgently. So, if they cannot get one from relatives, they borrow from banks or credit cards. If my brother-in-law had not given me an interest-free, no questions asked loan, I would not have managed my (late) father's illness Remember that movie dialogue where the mother tells the son, "what use are my mangal sutra and jewels when your father is on his deathbed? Sell them" (or some such variant), my mother actually said that to me and I felt gutted.

A couple of years later I and two other cousins were handling the hospital expenses of my (late) uncle who was a bachelor. As he became comatose we could not access his money. Things came to such a head that I asked my banker cousin if she could apply for a personal loan. The very next day, I took my uncle's bank branch manager to the hospital to get his thumb impression on a cheque. Within 30 minutes of this, he passed away due to a cardiac arrest. To be frank, I heaved a sigh of relief.

My point is, we should not be dismissive of people who take personal loans. They often have personal issues and *at that time* cannot sit and worry about processing fees, pre-payment fees, part-payment fees for a personal loan. They just want the money. So, the circumstances surrounding these loans are different.

There is also another important technical difference. The interest rates on a home loan are lower than that of a car loan, which is, in turn, lower than that of a personal loan (bank/card). Why is this so? For this, you need to understand one of the most important concepts in finance: **What is risk premium and why it is important**

In a loan, you want a lump sum money from an institution and in return, offer to pay an equated monthly instalment = part principal (less initially) + part interest (more initially). Why should the institution trust you? Even if you have a high CIBIL score, past performance is not a guarantee of future repayment! If you ask the bank for only a lakh or two, it will take its chances with you. But if you ask it for 10 Lakh or 20 Lakh, it will offer you a choice:

Either pay higher interest rate or lower rate by pledging an asset. The latter is known as a secured loan. The asset will be liquidated (sold) by the bank to make good its losses if you default on payments (fail to pay EMI regularly). This is risk premium at play. When the bank takes a risk by offering an unsecured loan, you pay the premium (higher rate). If you offer an asset as pledge, then the rate is lower.

Home loans are always secured loans and hence have a lower rate. Car loans can be secured or unsecured. Even if secured since the car is a depreciating asset, the rate is higher than that of a home loan. Personal loans up to a limit are unsecured and have the highest rates. These are all examples of risk premium at play.

*The logic and math behind lending and investing are the same. Check this out:* ***Understanding Loan EMI Calculation as a Monthly SIP Investment!***

With this out of the way, let us consider how to close your loans and live debt-free step by step.

How life appears when you close your loans and live debt-free. Picture by Gonzalo Baeza

## How to close your loans and live debt-free – A: Slow down and make a list

The biggest problem when you live in debt is the feeling that someone else is in control of your life and fear for your future. So, the first step is to slow down and make a list. List making is a great way to slowly regain control of your life. It could be a list like this.

| | A | B | C | D | E | F | G | H |
|---|---|---|---|---|---|---|---|---|
| 1 | Loan Name & Type | How many months to closure | Amount outstanding | EMI | part-payment possible | part-payment fee | pre-closure possible | pre-closure fees |
| 2 | Personal loan 1 | 17 | 95,000 | 8,000.00 | No | - | only after 1Y | 2% of principal outstanding (+ tax) |
| 3 | Personal loan 2 | 8 | 26,000 | 3,000.00 | up to 25% a year | - | only after 6 months | 5% of principal outstanding (+ tax) |
| 4 | Credit card debt 1 | 23 | 1,15,000 | 10,000.00 | Yes | - | Yes | - |
| 5 | Credit card debt 2 | 14 | 83,251 | 7,500.00 | Yes | - | Yes | - |

Please note above numbers were entered randomly for illustration only.

Then make a second list like this

| | A | B | C |
|---|---|---|---|
| 1 | Cash flow entry | Value | Notes |
| 2 | Total Income per month | | Take home pay |
| 3 | Total expenses per month | | |
| 4 | Total EMI per month | | |
| 5 | Total amount of money in investments that you can withdraw partially of fully from | | |
| 6 | PPF | | How old is it? |

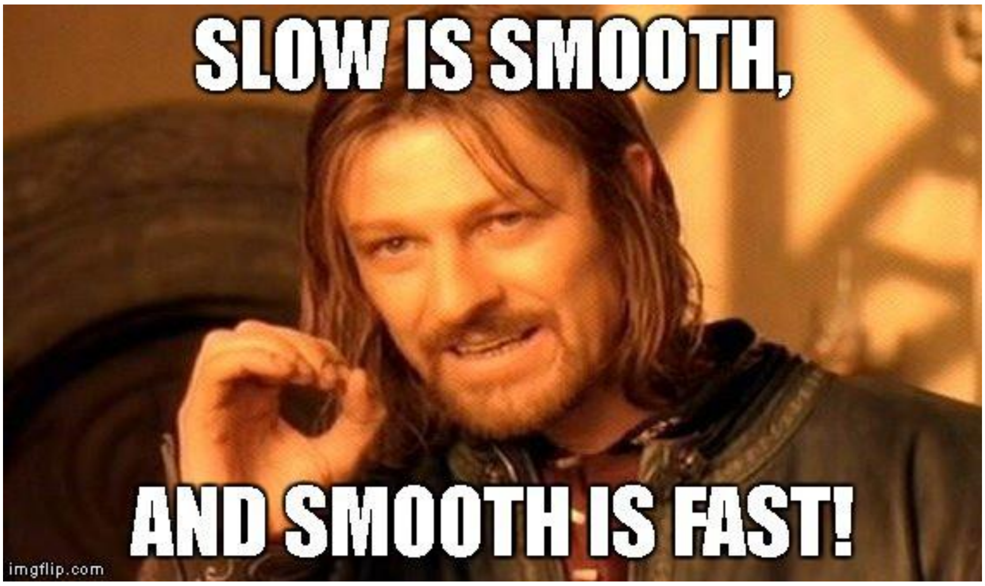
The first list tells you what you owe and the second, what you have/get/spend. This is your roadmap. Your goal is to check off the items in the first list using the resources in the second list. Wait a minute, there is one important resource missing – the most valuable one, time

## How to close your loans and live debt-free – B: Manage your time better

How is time management linked to closing loans you ask? On two accounts: (1) if we manage our time better, we can take better decisions and ensure we never find ourselves in overwhelming debt again. (2) Too much debt often means there is a need for a secondary income source. Time management is key to this.

Many people have asked me how I manage time between work, teaching, freefincal and AIFW – by doing one thing at a time ☺ Yes, the most efficient way to parallel process is to serial process. There is a saying associated with the military that applies to time management and debt clearance:

*Slow is smooth, smooth is fast!*




This essentially means we can be more productive by planning well and doing things one at a time. Time management is about productivity. It not about when to do what. If you can be productive wrt to your existing duties, you will find the time to make more money. Loan/debt clearance is also about productivity and not about which loan to clear first. This is an important step in having a say in what goes on in your life!

## How to close your loans and live debt-free – C: This is not the time for math!

Questions like which loan should I close first – the ones with a higher interest rate, the one with depreciating asset etc. should be asked *before you take the loan* and not when you are neck deep in debt, struggling to make ends meet and waiting for the next pay date in the middle of the month.

**1:** First tell yourself, this is the last time that you will be in such a situation. Next time you need money, you will not borrow but use your existing resources. I told myself that when I borrowed, and the fear of debt drove me to manage money better and then to freefincal (not passion: I see it as a regimen like the blogger Julie from the movie Julie/Julia)

**2:** This is not the time for math. This is not the time for calculating costs. Clearing loans is all about regaining your peace of mind, self-esteem and some measure of control in your life. It is about going from 4 loans to pay off (for e.g.) to 3 loans to 2 to 1 and zero. It is about slowly checking thing off that list. Slow is smooth and smooth is fast.

method 1: So, pay the shortest loan regularly and finish it off, if you spare some money from your existing assets, use to part-pay or pre-close the next longest loan.

method 2: Pre-close the shortest loan if you can scrape out some money and then focus on the next.

Whatever you do, try not to default on EMI payments. This could mean paying only a minimum due on your credit card and letting the debt get bigger. It is, what it is. No point worrying about it. Focus on one loan first, but do not neglect the minimum requirements of the other loans.

If 6 financial years have passed after opening your PPF, you can make partial withdrawals (50% of closing balance 3Y ago can be withdrawn each year). Before that you are eligible for loans (repayable in 36 months), you can opt for a loan (25% of the 1Y closing balance in 3Y and so on each year). However, if you cannot repay the principal within 36 months, there is a penalty of 6% + prevailing PPF rate. You can get the full set of rules from **The PPF rule book from nsiindia.gov.in**. It is better to withdraw if possible than take a loan.

Loans are also available after 3Ys from LIC policies. However, these are best avoided as the annual interest rate will be 10% or so.

If you are not the sentimental type, sell gold jewels at home. It is not an ideal choice, but at this stage, what is? You can always buy it back when you get your life in order.

**Whatever you do, leave at least a few months expenses as an emergency sum**

**3:** Try not transfer your credit card debt to another card or get a personal loan from a bank to close other debts. This can land you in bigger trouble if you do not stop to understand the terms of the transfer. It is not easy to find another lender with a low enough interest rate for the transfer to be meaningful if all costs are accounted for.

**4:** If you do not have any assets to part-pay or pre-pay, borrow from relatives or friends. If you cannot get it gratis (like I did), suggest that you will pay an interest rate say 1% to 1.5% above FD rates. So, this will be a good deal for both parties (can you guess why?). Of course, if you already borrowed and did not pay back, don't expect them to oblige again! Again, risk premium at play!

**5: Reduce expenses**: I cannot stress the importance of this. Give up on the pleasures of life.

- As mentioned above, stop using your credit cards. Stop using your debit cards as well. Remove swiping from your life.
- Get rid of 3G or 4G from your phones. Use the office internet and stay away from it at home.
- Say no to all forms of eating out, watching movies etc. Every paisa counts towards part-payment of your loans. If your friends do not understand your behaviour, they are not your friends.

When my father was sick I also changed jobs and due to a "technical issue" during the changeover, I went three months without salary. This at a time when were we spending anywhere between 25,000 to 30,000 on his medicines. These are 2006 prices. If we had gone one more month without my pay, we would have had trouble managing basic expenses. This was a time when I used to squeeze out every bit from the toothpaste so that we could delay taking a new tube by a few days. Thanks to a relative, I found a way to obtain expensive injections for RBC growth at wholesale prices (my father had a form of bone marrow cancer). I used to buy as much of his medical equipment at wholesale prices as I could. This saved me anywhere bet 30 to 50K over the 1Y,8 months he was bed-ridden.

My point is:

*Human beings are capable of infinite adaptability. The only problem is that they must first convince themselves of the reason to adapt. Sometimes life will offer you a reason (like it did for me) but sometimes we must dig deep and motivate ourselves to change. If you do not have the desire to become debt-free no one can help you.*

**6: Find a second source of income:** I asked FB group Asan ideas of wealth members about how they generate a second source of income. The answers were incredible. This is a compilation: Here Are 1001 Ways to Make More Money!

If you have a skill that can be used to make money, fine. Else you may need to work a second job in the evening – e.g. deliver for Swiggy or dinner places, waiting tables etc. No such thing as an inferior job, just inferior money management. Either way, here is where the time management will help.

## Debt reduction is the same as fat reduction

Both require consistent effort and discipline. Both will come back if we slip back to old ways. Both require a permanent modification in lifestyle for eradication.

## How about education loans or home loans?

As mentioned above, these loans are usually not the result of hasty purchases. These can be pre-closed too but take last priority as they come with cashflow benefits. I did not say tax benefit because – Can you really save tax with a home loan?!

For education loans consult: Paying off Education Loan in India

For home loans consult: Why this kolaveri to pre-pay home loans?! for an alternative way to pre-pay home loans without stress.

### Home loan tools

Home Loan Transfer Calculator (Mortgage Refinance)

Excel Home Loan Amortization Schedule Template This will help you plan for systematic part-payment.

### Your Call

Would you like me to write on how to choose home loans, cars loans and personal loans? It is not rocket science but if you wold like to me write about it, I will.

### Remember

Slow is smooth and smooth is fast. If you keep at it, you will soon become debt free. Maybe it will waste a year or two of your youth, but the experience will guide you for the rest of your life.  Best wishes for a happier 2018. Live long and prosper.

# How to buy a Super Top up Health Insurance policy

freefincal  Health Insurance, Re-assemble  December 17, 2017

I discuss how to buy a super top up health insurance policy with examples on how it differs from a top-up policy and a base policy and why we need one. With medical costs increasing day by day, a medical cover of just a few lakhs will not be sufficient for us. Every day I am hearing accounts of medical bills in tens of lakhs. The average upper-middle-class salaried individual is unlikely to have a personal basic health insurance coverage. Most of them rely on their corporate health cover. Even those who have one are likely to have a cover of only a few lakhs. Most of us need much higher cover **and** a medical corpus. I shall talk about the medical corpus next week and focus on super top up health insurance in this post.

## What is a super top up health insurance policy?

To understand how top up insurance works, the idea of a deductible must be understood. In a normal health insurance policy, if the cover is Rs. 5 lakh, in any policy year it will cover hospitalization expenses up to Rs. 5 lakhs.

You can make any no of claims in a year, but the total expenses covered will be the first Rs. 5 lakhs. For example:

1st claim: Rs. 2 Lakh (will be paid in full; remaining cover: 3 lakh)
2nd claim: Rs. 4 lakhs (only 3 lakhs will be paid; remaining cover: zero)

3rd claim: Rs 1 lakh (claim will not be paid by the normal/base health cover as the remaining cover is zero).

A top cover will help in such situations. However, a top up cover will only come into play after a certain amount has already been spent. This is known as the deductible.

Consider a top up policy with a threshold/deductible of Rs. 3 lakhs.

1st claim: Rs. 2 lakhs (you will have to use the base cover for this as the expense is less than the deductive of 3 lakh)

If the 1st claim had been 5 lakh, you have two options:

(a) use the base policy to pay for the 5 lakhs

OR (b) use 3 lakhs from the base policy and the for the remaining amount (expense – deductible or 5L – 3L = 2L) use the top up policy.

Now consider the remaining amount calculation. This is equal to hospital expenses – deductible. A natural question to ask is:

“how is hospital expense defined? Is it per claim or the sum of claims made in a year?”

A policy that pays only when:

hospital expense *per claim* – deductible >0 is known as a **Top Up Health Insurance policy**

A policy that pays only when:

the sum of hospital expenses in the policy year – deductive >0 is known as a **Super Top Up Health Insurance Policy**

Let us consider an example.

## Super Top Health Insurance Policy vs Top Up Health Insurance Policy

Let us consider a base insurance policy of Rs. 3L and a Top Up with deductible of Rs. 3L and 5L cover. Super top also has the same 3L deductible and 5L cover.

**Example 1:** Single claim of Rs 3L

The base policy will pay this 3L. Both top up and super top up cannot be used here as the 3L does not exceed the 3L deductible.

**Example 2:** single claim of Rs. 4L.

The base policy will pay 3L and both top up and super top will pay the extra 1L. Why?

Remaining cover for top up: expense for 2nd claim – deductible

So 4L – 3L = 1L —-> Top up cover will kick in.

Remaining cover for super top: total expenses for that year – deductible

So 4L- 3L = 1L ——> Super top up cover will kick in.

**Moral:** If there is only one claim, there is no difference between a top up and super top policies with same deductible and cover (other terms being the same)

**Example 3:** Two claims, 1st for 2L and 2nd for 2L.

First, claim the base policy will cover for 2L.

Now for the second claim, the base policy will cover 1L and 1L remains.

The top up policy will not cover this 1L. Why?

remaining cover for top up = hospital expense per claim – deductible.

This is 2L – 3L = -1 L. Therefore, the top up cover will not kick in.

However, a super top up policy will cover this 1L. Why?

remaining cover for super top = total hospital expenses – deductible

(2L + 2L) – 3L = 1L —> Super top up cover. will kick in.

**Example 4:** Let us try one more:

1st claim: 4L, 2nd claim: 3L.

1st claim: base policy will cover 3L and top up will cover 1L as the expense *for that claim* is above the deductible of 3L.

Super top will also cover the 1L

2nd claim (Now things get interesting): The base policy will not cover the 3L as it is already exhausted.

The top up will also not cover the 3L as

<u>remaining cover for top up</u> = expense per claim – deductible

3L -3L = 0 —> This should be above zero for top up to kick in.

However, the super top up will cover the 3L from the second claim. Why?

<u>Remaining cover for super top up</u> = total hospital expense – deductible or

(4L +3L) – 3L = 4L —> Therefore the super top up cover will kick in.

Clearly super top is more advantageous in the case of multiple claims and therefore more expensive (obviously!)

**Top up policy will kick in only if each claim is above the deductible. Super top up will kick in if the sum of total claims is above the deductible.**

Because of this difference, **Super top policy** will have **"aggregate deductible"** in their terms and conditions while **top up policies** will only mention the **deductible**. This is how you differentiate them and not by mere policy name names.

Buy a super Top up health insurance policy without froth ☺ photo by Jenn Dufrey

As a crude analogy, a top up policy is like someone fill-up up your beer glass only when it is empty while a super top up policy is like someone filling up the beer jug only when it comes empty (more er… mileage).

Wait a minute. Policies now come up restore benefit and re-fill benefits. So, do I still need top up insurance? Let us now consider this.

## Top up Insurance vs Restore or Re-fill benefits

**What is restore benefit?** If you have a cover of 3L and completely exhaust it in a policy year the cove will be restored to 3L. But this restore benefit is only for subsequent claims and not for the same/related hospitalization of the same person

**What is re-fill benefit?** If your cover is partial or completely exhausted in a policy year, then the cover will be re-filled up to the sum insured. But this re-fill cover is only for subsequent claims and not for the same/related hospitalization of the same person

I have explained this in detail here: Apollo Munich Optima Restore Benefit vs Max Bupa Re-fill Benefit

Considering that the restore or re-fill benefit will not help if expenses exceed the sum insured and for repeated hospitalizations for the same condition, it is always a good idea to opt for Super top up insurance.

## Definition of deductible in Top Up Health Insurance Policy

**Example: HDFC Ergo Health Suraksha Top Up Plus** (don't let the plus fool you. It is a plain top up policy)

**Deductible:** We are not liable for any payment unless the Medical Expenses exceed the Deductible (as opted on an Individual basis in case of Individual Policy and on Family Floater basis in case of Family Floater Policy). Deductible shall be applicable per Policy Year basis.

## Definition of deductible in Super Top Up Health Insurance Policy

**Example: HDFC Ergo Health Medisure Super Top Up Plus**

**Aggregate Deductible:** Aggregate deductible is a cost-sharing requirement under this Policy that provides that the Company will not be
liable for a specified rupee amount of the covered expenses, which will apply before any benefits are payable by the Company. A deductible does not reduce the Sum Insured. The deductible is applicable in aggregate towards hospitalization expenses incurred during the policy period by insured (individual policy) or insured family (in case of floater
policy)

If your policy wording only talks about deductible, it is only a top up plan. A super top plan must mention **aggregate deductible**

## Pros and cons of super top up health insurance

Compare to a large individual or floater base cover or compared to a base cover that increases each year, a base+ super top up could be less expensive. For example, instead of a 15L floater cover, you can consider a 5L floater baser policy with 10-15L super top up cover with an aggregate deductible of 4L/5L.

However, please keep in mind that you must inform the super top insurer the moment (see policy wordings for exact time limit) you recognise that extra cover will be necessary for your hospital expense. The super top up insurer may ask you to apply for reimbursement instead of offering cashless depending on when the intimation was received. So, you need to have a good enough medical emergency fund. This is a major concern compared to having a large floater cover. However, you need to have a medical corpus anyway!

Please keep in mind Super top up also have waiting periods for pre-existing diseases. So, buy it as soon as possible.

Buying super top up from one insurer with a base policy from another: This might be a disadvantage for cashless processing if the TPAs are different. But not all insurers offer top-ups. So, it is, what it is.

## How to buy a super top up health insurance?

The features of a top up insurance are pretty much like that of a base policy*. So, the main features of the super top up should be similar if not better than the base policy. Keep in mind these conditions while buying super top up health insurance:

1: no room rent sub-limits (if you can afford it)

2: No co-payment at any stage or age (unless you opt for it to lower premium)

3: No claim bonus (if any**) should not decrease the year after a claim has been made.

4: low waiting period for pre-existing conditions. No special waiting periods for any condition relevant to you.

5: day care treatment should be comprehensive.

6: should offer to cover at least 30 day pre- and 60-120-day post-hospitalization treatment cost

7: **Most important:** Read the claim notification and application procedure in the policy document (not on the website, not in the brochure). If they talk about reimbursement a lot, avoid the policy. It should be easy to apply for cashless in a super top up (but may not be)

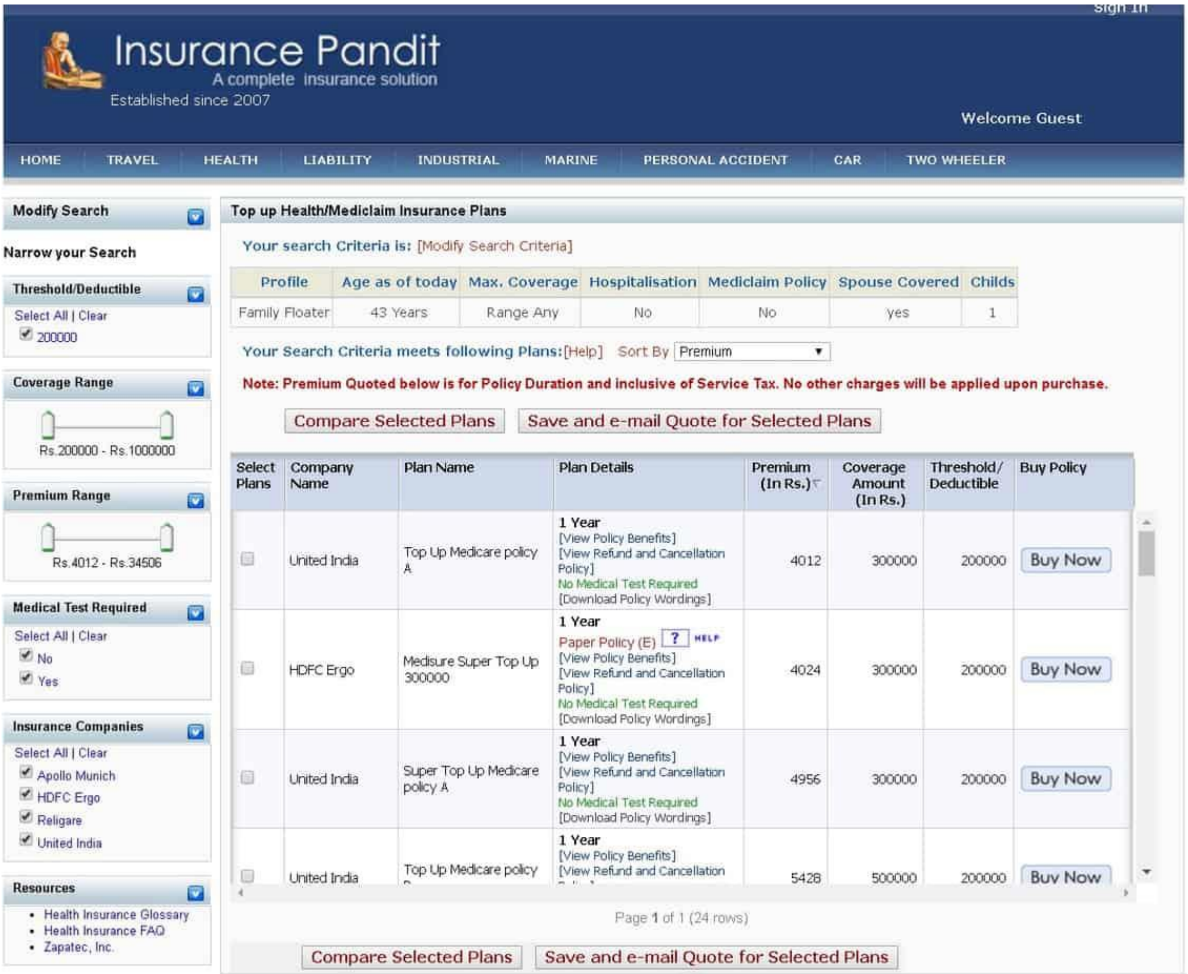
If possible buy it from the same insurer as your base policy.

Always have a decent base cover amount of at least Rs. 5 lakhs and then buy super top up for 10-15 lakh cover. Your deductible can equal to your base cover or a bit lower (say 4L), just in case.

* There are some differences. Domiciliary treatment or treatment at home for more than 3 days when hospitalization, although required, is not possible due to non-availability or inability to transport the patient will usually not be covered by super top ups. Ambulance charges will not be covered.
** no claim may not be applicable to top up policies

## Compare Super Top Up Health Insurance Policies

There are a few portals that offer this (do not enter real email or real phone numbers). This is one from insurance pandit Use it only for basic feature comparison. Please read policy wordings.




That is about it. Next week I will talk about building a health corpus and wrap up this weekly health insurance series. I am bored of comparing policies. If you would like to make a comparison and send it to me, happy to consider it for a guest post (but you must not be a blogger and do not write it *before* contacting me)

# How to buy a personal accident insurance policy

freefincal Re-assemble December 30, 2017

I discuss the factors to consider before purchasing a personal accident insurance policy. The key being to understand the insurers definition of what an accident is, and when a personal accident insurance policy will come into force.  This is step 8 of Re-assemble – a series on the basics of money management aimed at young earner. Here is a summary of all Re-assemble posts.

This post is a sequel to **Buying Accident Insurance Policies in India: Must-know facts.** This covers the basics of accident insurance. I shall cover the basics again here, but strongly suggest that you read that first.

What you and I call as an accident has nothing to do with what an insurer considers an accident.

## Personal accident insurance policy:  What is the insurers' definition of an accident?

An accident is a sudden, unforeseen and involuntary event caused by external and visible
and violent means

This means as you walk on the pavement, if some vehicle hits you from behind, it is an accident. If you walk on the road (as we all do as there are shops on the pavement!), if some vehicle hits you from behind, it is not an accident. Because it was not unforeseen and not involuntary.

If you cross the road, not on a Zebra crossing and when the signals are off, and if a vehicle hits you, it is not an accident. Why? Because it is not unforeseen!!

If you enter the toilet in your house and slip, it is not an accident as it not unforeseen and not violent.

Even if admitted as an accident, the claim will be accepted only if the injury is serious enough to prevent you from performing your usual occupation. For some policies, it could be any occupation!

**Moral of the story:** Do not buy an accident policy hoping it will compensate for anything *that* ***you*** *consider an accident*. It must not only meet the definitions of an insurer but also must be serious enough for you to stop working.

**If so, it is necessary?** Not if you have enough wealth. Although an accident policy is extremely selective in accepting and approving claims, it is quite inexpensive, and the premium is not as age-dependent as health insurance. Therefore, it does not cost much in owning one.

## Personal accident insurance policy: what are the core benefits?

**1 Accidental death:** Death due to an accident *as defined above*. If we fall in the bathroom, hit our head and die, it is not accidental death according to a personal accident insurance policy. However, a term life insurance policy will still honour it. So, if we have a good term life policy (in terms of plan and sum insured), this benefit is not of much use.

**2 Permanent partial or total disability**. This is the key benefit of an accident insurance policy.

However, this is a disability due to bodily injury that persists for at least 12 consecutive months, certified as continuous and permanent by a doctor after the 12-month period and entirely prevent an individual from being gainfully occupied in any way for the remainder their life.

Does the wording sound like you will be compensated easily and immediately? I cannot overemphasise the need to read, understand and assimilate policy terms and conditions.

**Permanent partial disability grid**: Each insurer will have a grid like the one shown below (Max Bupa's)

Permanent Partial Disability Grid

| S. No. | Nature of Disability | % of Sum Assured |
|---|---|---|
| 1 | Loss or total and permanent loss of use of both the hands from the wrist joint | 100% |
| 2 | Loss or total and permanent loss of use of both feet from the ankle joint | 100% |
| 3 | Loss or total and permanent loss of use of one hand from the wrist joint and of one foot from the ankle joint | 100% |
| 4 | Loss or total and permanent loss of use of one hand from the wrist joint and total and permanent loss of sight in one eye | 100% |
| 5 | Loss or total and permanent loss of use of one foot from the ankle joint and total and permanent loss of sight in one eye | 100% |
| 6 | Total and Permanent loss of Speech and hearing in both ears | 100% |
| 7 | Quadriplegia | 100% |
| 8 | Total and permanent loss of hearing in both ears | 50% |
| 9 | Loss or Total and Permanent loss of use of one hand from wrist joint | 50% |
| 10 | Loss or Total and Permanent loss of use of one foot from ankle joint | 50% |
| 11 | Total and Permanent loss of sight in one eye | 50% |
| 12 | Total and Permanent loss of speech | 50% |
| 13 | Uniplegia | 25% |

Even for serious injuries like "Loss or Total and Permanent loss of use of one hand from wrist joint" only 50% of the sum insured will be paid out and don't expect it to be handed to you on a platter immediately.

**3 total temporary disability:** This must be a bodily injury that temporarily and entirely prevents one from performing their usual occupation. As an e.g. complete bed rest due to an accidental injury.

Note that insurers will not cover temporary partial disability!

This is an extract from United India:

If such injury shall be the sole and direct cause of temporary total disablement, then so long as the insured shall be totally disabled from engaging in any employment or occupation of any description whatsoever a sum at the rate of one percent (1%) of the capital sum insured stated in the schedule herein per week, but in any case, not exceeding Rs.5000/- per week in all under all policies per week in any case not exceeding 25% of the Monthly Salary. Provided that the compensation payable under the foregoing sub-clauses shall not be payable for more than 100 weeks in respect of any one injury calculated from the date of commencement of the disablement and in no case shall exceed the Capital sum insured.

**The message:** You will be paid a weekly or monthly sum (typically peanuts) for a short period of time in the case of temporary and total disability.

**Other benefits:** Some personal accident insurance covers can include spouse, children and parents too (HDFC Ergo). You will need to decide if this is necessary.

HDFC Ergo has a feature that pays for the kidnap negotiator (yeah you read that right). E.g. the fees of Russel Crowe in the *proof of life*. Not the ransom though.

## Personal accident insurance policy: what to look for?

**A:** The key is a comprehensive **permanent partial disability table.**

For e.g.

1: Total and permanent loss of hearing in both ears

Max Bupa will cover only up to 50% of sum insured

HDFC Ergo 75% of sum insured

2: Total and Permanent loss of speech

Max Bupa will cover only up to 50% of sum insured

HDFC Ergo: 100% of sum insured.

Do you get the picture? Buying a personal accident insurance policy is a far more difficult experience than even life or critical illness insurance.

You need to look for a cover that pays as much as possible for as many situations. A policy comparison portal will only provide a shortlist. You need to dig deeper.

**B:** Add total temporary disability cover if you can afford the premium.

**C:** Accidental death will be included by default.

**D:** Include your family if necessary. Search for other (un)desirable features in the policy wordings. Don't be lazy and read the feature list on the website or ask in AIFW forum.

## Personal accident insurance policy: how much cover to buy?

If we die, the expenses of our family will reduce. If we become bed-ridden or become disabled, the expenses will increase. So technically speaking, accident cover should be much higher than life cover. This is not the case. Typical accident cover will only for few to tens of lakhs and it depends on your income (typically not more than 10 to 15 times annual income).

As always, the idea is to buy a maximum cover for as much as one can afford.

## Personal accident insurance policy: Comparison

You can compare personal accident insurance policies in the gibl portal.

## Summary

1. Personal accident insurance policies will only pay when their definition of an accident will be met. So common and simple accidents will typically not be covered.
2. You can buy one as they are inexpensive, and the risk of accidents exists for everyone.
3. You need to look at the permanent disability benefits and then choose a policy
4. Please do not forget to read part 1: **Buying Accident Insurance Policies in India: Must-know facts**
5. Health insurance or accident insurance, we all will need a corpus for medical expenses so get to it asap!

Let us hope, pray and wish for a happy, and healthy 2018. If you have accident insurance, do share how and why you purchased it in the comments section.

# Are you ready to let go and let your money grow?

freefincal Re-assemble January 7, 2018

Re-assemble is a series on the basics of money management aimed at beginners and young earners. So far, we have covered 8 steps and completed the basic financial fortification process. Now we are all set to move on to investing – with a clear purpose. In step 9 of re-assemble, I have a few questions to ask you. A few questions that you need to ask yourself. Before that here is a summary of all Re-assemble posts.

## Question 1: Are you ready to let go to let your money grow?

I wanted to first ask, *are you ready to watch your money grow,* but many investors are already practising this quite literally. Why do you think Value Research take a while in loading between 8:30 pm to ~ 10:30 pm every business day?! People are busy finding the impact of the 0.01% market move or "correction" on their portfolio.

So, I decided to switch to: *are you ready to let your money grow?* Yes, we need to let it grow. We are the biggest enemy of our wealth. To let our money grow, we need to let go – again quite literally after the basics are in place. Allow me to explain.

Investing is a lot of like parenting. You need to know when to 'be there', when to intervene and when to stay away. No one becomes a parent after they have become an expert in parenting. We have a child and learn how to parent on the fly. With each passing day, we learn something about little humans and how to work with them.

Investing is pretty much identical. The learning never stops and there is no need to stop, learn all there is to know *and then* invest. That is a waste of precious time. The idea should be to quickly understand the basics and get going. If you cannot do this, you need professional help.

The question you need to ask yourself is, are you ready do what is necessary and leave your portfolio alone and not look at it every day? Like this:

Let your investments on autopilot and get a life! Source: BBC.

Once you start seeing double-digit returns (and above), "watching" money grow can be intoxicating. Look at all those sleep deprived bitcoin investors. Sudden wealth is like an overworked sailor mistaking a fish for a mermaid and jumping into shark-infested waters. It can make you take unnecessary risks and tamper with your portfolio. So, it is important to get a nice unrelated hobby.

## Question 2: Are you ready to say NO to information?

The basics of investing are centuries old and will not change, at least not in our lifetime. So, there is no need to subscribe to blogs and newspapers. There is nothing new that you can learn IF you have identified the basics (see below), understood them and implemented them. You need to let go of information first, to let go of your portfolio.

But, don't I need to stay in touch with latest developments? No, you don't.

Every day someone writes me a nice thank you note for freefincal content. I cannot put into words how grateful I feel when I read those. I would be even more elated to receive messages that say, "thank you, my portfolio construction is complete, I have learnt how to review it, freefincal is no longer insightful and is only information to me now. Therefore, I am moving on" – hey before you do, introduce the site to our friends and colleagues, I would like to move on too, but until I do, I need fuel to keep the site going ☺

I hope you get what I am trying to say. I know people who have unsubscribed from FB group Asan Ideas for Wealth (AIFW) notifications, because “they are done”. Only those with confidence and conviction will do so.

Read more: **The Information Diet: How Less Information Can Make Us More Informed**

The sooner you complete the basics of money management, get into maintenance mode and move, the more time you get to do what you love. Never forget time is the real wealth.

## Question 3: Do you recognise that “Do it Yourself” (DIY) means doing it yourself?

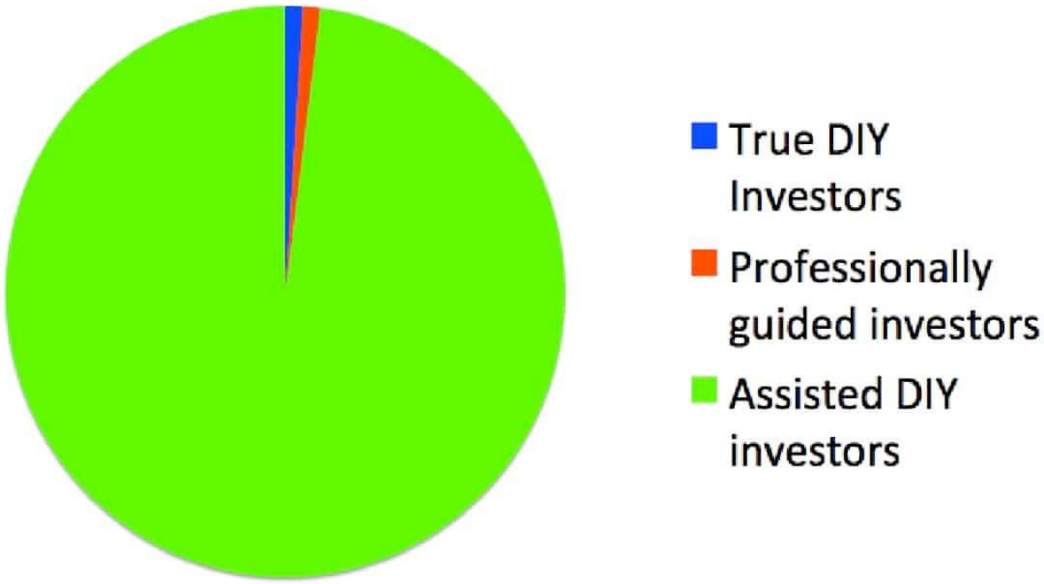
I cannot begin to tell you how frustrated I am with the so-called DIY community. All that most of them are DIYing is free lunch. The true DIY investors are shy to talk about their experience and insights so where does that leave us?

Look at the questions at AIFW: “I am DIY investor and have shorted-listed these funds. Please help me select one”. The whole point of being a DIY investor is to work in isolation, make decisions on our own and face the music on our own.

“But you see, I have starting trouble. I just need some help in getting started.”

Okay, then get professional help! Do not ask in forums or book a personal chat session with Ashal. He does not mind, but should that mean we exploit his good nature?

Remember self-respect, dignity and all that sort of things? A DIY investor is the CEO of their financial life. The buck starts and ends within them.




You can guess who I refer to as assisted DIY investors

DIY the answer to this question: Can you really take decisions on your own? If not, don't waste your time trying. Don't waste your time in AIFW. Seek help from a **SEBI registered fee-only financial planner**. This is short-list, but you still need to DIY whom to choose! Many cannot!

Like I said, Let's Face It: Everyone Needs Do-it-Yourself Skills. If you do not like my style, try Butun Mohapatra's: Reader Story: Are you sure you can be a DIY investor?

## Question 4: Do you have the maturity to understand that no choice will be perfect?

A DIY investor must not only take decisions on their own but also do so quickly. No more than a weekend say, for your first mutual fund. No more than a lunch hour for your second and so on.

You will gain confidence only if you go beyond superficial online comparisons and dig deep into scheme information documents and policy wordings.

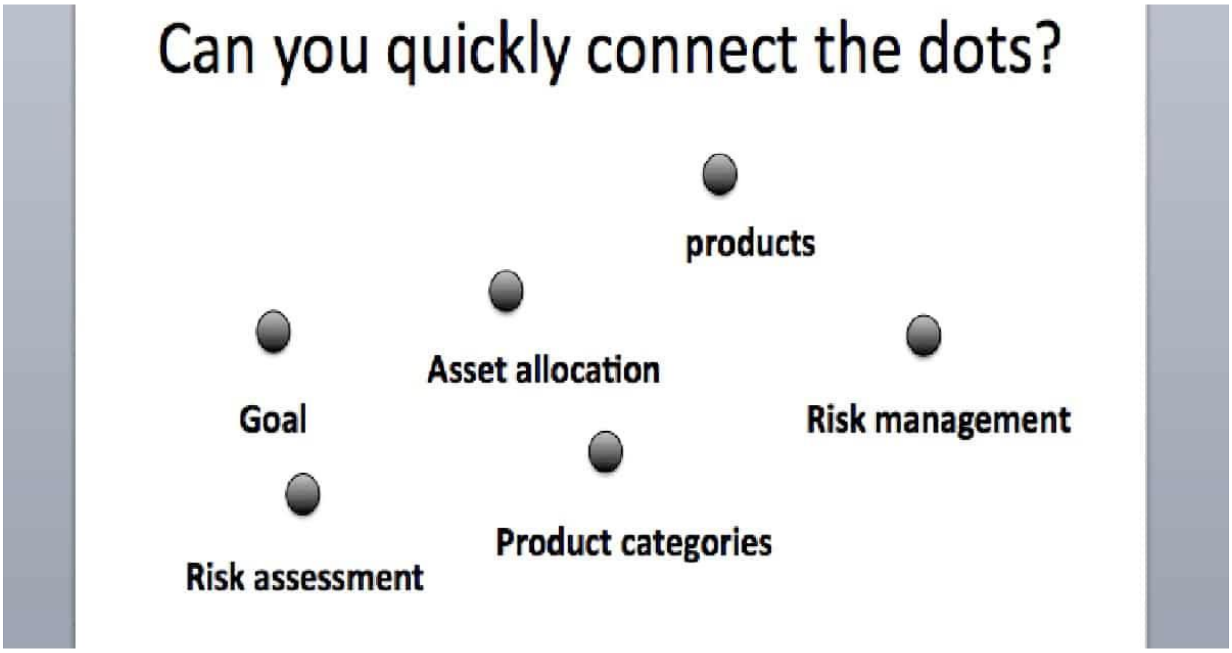
## Question 5: Can you quickly connect the dots?

Investing begins with portfolio construction. This has certain key elements and you will have to go through them in an order. You must first identify those elements and then connect them. That is, understand what to do first, next and last. So many "DIY investors" are in such a hurry to select products. Remember the quote about cutting a tree:

"Give me six *hours* to chop down a *tree* and I will spend the first four sharpening the axe."

the first step is to identify the right tool (axe). The next is to recognize that a sharper axe will cut faster. The next is the maturity to spend enough time sharpening it and only then start cutting.

Here is an example: Financial Goal Planning: How to buy an Audi Car




## Question 6: Are ready to never stop learning?

A DIY investor needs to be factually opinionated. That is base opinions only on current facts and not history. That is also known as being open-minded. Without this, we will never learn to change, adapt and correct our mistakes (everyone will make some).

If you have answered NO to any of the above questions, you need professional help in getting your money matters in order. Consult a planner from **Fee-only India: the launch of a movement to serve investors and advisors.**

If you have answered YES to all the above questions, welcome to the true DIY investor club. We could use some company. We are at different points of the never-ending learning curve, but we can always learn together, separately.

# Investment planning case study 1: How to create an investment plan

freefincal Re-assemble January 13, 2018

This is part one of an investment planning case study in which we consider how to create an investment plan step by step using real data obtained from readers belonging to different age groups. This is step 10 of Re-assemble, a series on the basics of money management aimed at beginners and young earners. So far, we have covered 9 steps and all set to move on to investing – with a clear purpose. In step 10 of re-assemble, let us consider an investment planning case study and learn how to create an investment plan. Before that here is a summary of all Re-assemble posts.

## Investment planning steps: How to create an investment plan

I was going to make a video out of this, but my voice gave out so, excuse me. First, let us have a look at the kind of questions people ask Google.

# Google lists some popular questions!

People also ask

- What is best investment plan?
- What is SIP and how to invest?
- Which investments have the best returns?
- What is the best investment in India?
- What is the best option for investment in India?
- What is the best long term investment?
- How can I invest 5000 dollars?
- What type of investment has the lowest risk?
- Which investment is best for short term in India?
- How do you double your money?
- Where should I invest my money?
- What is the best investment company for beginners?
- What are the best stocks to invest in?
- How should I invest in my 20s?

Feedback

Most investors want quick answers and are impatient. If you are one of them, freefincal is not the place for you. There dime a dozen bloggers who dish out nonsense like top 10, bet mutual fund in 2018. Please consult them for some fast food free lunch. Re-assemble is for those who want to systematically manage their money and create an investment plan.

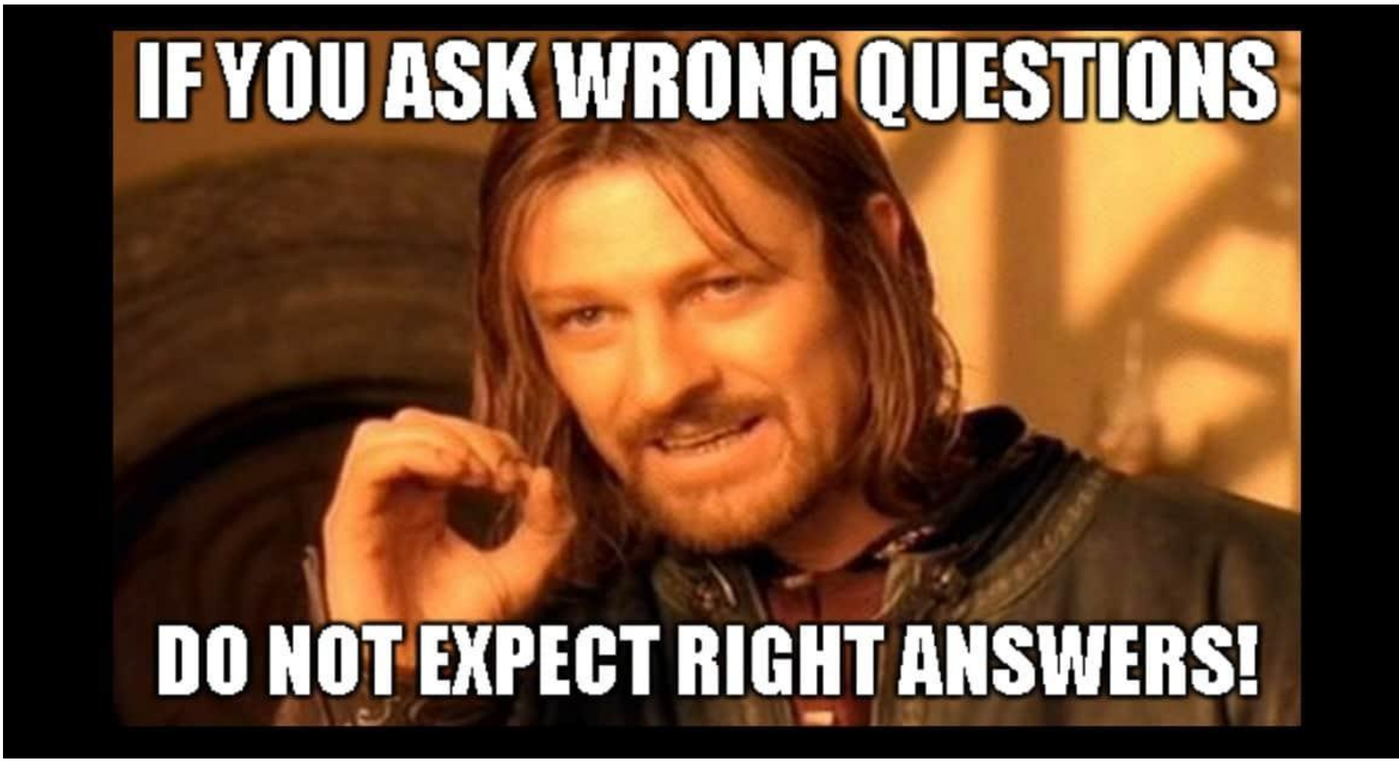
## Step 1: Ask the right questions

If you ask wrong questions, do not expect right answers. The first question should be, **what are the right questions to ask <u>before investing</u>?**

We will start with the simplest two:

1.Why am I investing?

2.When do I need the money?




## Step 2: Why am I investing?

- This has no financial or mathematical relevance
- It gives you purpose and purpose is crucial!
- Many say, “I don’t have a goal, I just want to save/invest”.
- Look harder! We all need to plan for financial freedom the moment we start earning!
- All of us have at least that one goal!

Money is there to be spent. We already have the money to spend for today’s needs (hopefully), by saving we aim to provide for near future needs. By investing we aim to provide for distant future needs.

Recognising the difference between saving and investing will only happen if we are not in a hurry to choose products.

## Step 3: When do I need the money?

- This is crucial to determine how much "risk" you **should** take while investing.
- Your ability or appetite to handle risk is not as important!
- If you know **when** you need the money, you can decide **where** to invest!

Many investors are not clear about this and want to either maximize returns, minimize risk or both! Unless you are clear about when withdrawals will be made from an investment, you simply cannot take on risk! This is the reason why step 1 matters. If you know ***why*** you are investing, you will know **when** you need the money.

If these seem obvious to you, come have a look at how people ask for investment advice at Asan Ideas for Wealth (and how people provide it!). Many spend years buying without thinking, suddenly realise their mistakes and want to correct it in a hurry and make those same mistakes again!

DO NOT BE IN A HURRY TO START INVESTING! INVESTIGATE AND PLAN FIRST!!

## Step 3: when to invest where?

This is the next question to ask.

- What you need is an investment plan **NOT A product!**
- **Investment plan** = a basket of "products" which have different kinds of risks *and therefore different returns.*
- There is no risk-free investment plan and no risk-free product!
- Risks are not obvious and are visible to only those who look!

Take a fixed deposit. If we assume the bank will not run away with your money and honour the interest promise, what are the risks associated?

1. Taxation will eat away gains
2. Inflation will eat away gains – more dangerous because this is not visible until it shows up and hurts!
3. When you renew or reinvest in an FD, interest rates will be low – **reinvestment risk**
4. look around, you will see senior citizens who purchased wrong products because FD rates dropped after de-monetization – **Stupidity risk**

**Inflation example:** If you have Rs. 100 to begin with, and prices increase year on year at 7%, after 5 years, you can only purchase 75% of what you first did. That is 25% loss in your purchasing power. In about a decade, you will lose 50% purchasing power.

## Step 4: What is an asset class?

- Products which have the same kind of risk and reward potential are referred to as an **asset class group**.

- EPF, PPF, FD, and RDs, RBI or corporate bonds held until maturity -> **Fixed Income or Debt**
- Bonds that are traded (by self or mutual fund) –> Tradable **Fixed Income or Debt (higher risks)**
- Stocks (Equity) –> **Ownership** (more risk than fixed income)
- Gold, Silver, Oil –>**commodity** (supply vs demand will result in huge price changes)
- Rupee, Dollar —> Normal currency (exchange rate fluctuations)
- Bitcoin, Litecoin –> Cryptocurrencies (get rich quick risk)

## Step 5: What is Asset Allocation?

Remember that "how much returns will I get?" question? Well, unless you know where to invest and how much to invest, this cannot be answered.

- Investment portfolio = basket of different products
- Investment portfolio = basket of different products= basket of different asset classes
- A portfolio of equity + fixed income (two asset classes) is good enough for all goals. Stay away from Gold (as an investment) and other assets.
- **Asset allocation** = how much we are going to invest in equity and how much in fixed income

## Step 6: when to invest where?

If you need the money within the next few years (<5), use more of Fixed income products with little or no equity.

**Why? Risk of losing money is high!** Due to stock market ups and downs

If you need the money several years (10+) away, use a balanced amount of fixed income and equity.

**Why? Risk of losing money due to inflation and tax is high** if you use only fixed income!

This is the reason you save for short-term goals using fixed income and you invest for long-term goals.

## Investment Planning Case Studies Part 1: Unmarried and below 30 years of age

Upon my request, a few members of Asan Ideas for Wealth had filled the Freefincal Robo Advisory Software Template. I will use their inputs as examples and in part 1, shall consider two unmarried young earners.

**Note to all participants:** Please do not expect me to provide you with a financial plan!

Young earners should plan to Quit as Soon as You Start Working! You may not be interested in early retirement, but a simple plan for financial freedom should be in place and it is trivial to do this!

## A simple plan to become financially free

Suppose Rs. 1000 = your total EPF contribution (forget EPS)

Assume this Rs. 1000 = 40% of your total investment.

Then total investment = 1000/40% = Rs. 2500

Invest 60% of 2500 = 1500 in an index equity fund.

**Invest 40%** in EPF (or NPS – only C and G, no E) Read more: A Guide to investing in the National Pension System (NPS)

**Invest 60%** in ICICI Nifty Next 50 Direct Plan Growth option (if you can stomach huge ups and downs)

Else invest in **Quantum Long Term Equity Direct Plan Growth Option**

**Want to retire early or save up enough to become an entrepreneur?**

Use the same asset allocation: 40% EPF and 60% Equity but invest as much as possible. Download this free E-book: How to retire early in India.

## What about tax savings?

This is trivial if you do not buy products in a hurry.

The EPF/NPS will cover some part of 80C. Invest more via VPF to max 80C and try to maintain 40%: Fixed Income and 60% Equity by adding more in Equity.

Read more: Making the best use of section 80C for tax saving: an example

## short-term goal planning

This we will look at the goals of two young earners, Sanjay and Prempal.

### Sanjay's marriage

| | | | |
|---|---|---|---|
| 2 | Enter name of the goal for your reference | Marriage | Goal 1 |
| 3 | If this goal flexible? That is, if you can delay it by a few years (and hence can a bit more risk)? | No | |
| 4 | How many years from **now** will you need the money for this goal? If money required for ago after retirement, then the onus of investing for it is on you. The retirement planning calculation in the previous sheet(s) does NOT factor in the investment required for any other goal before or after retirement. | 3 | |
| 5 | How many years from **now** will you start investing for this goal? Enter zero for "immediately" | 0 | |
| 6 | | | |
| 7 | How much would it cost if you had to spend for this goal TODAY? | 12,00,000 | |
| 8 | The rate at which the above cost will increase year upon year (inflation) is assumed to be 10%. If you wish to assume a lower/*higher* rate then choose "yes" here and choose the number below. A higher inflation rate may be required for certain goals like children's education, but this also means that you will have to invest more. | No | |
| 9 | | | |
| 10 | The cost of this goal in 3 years | 15,97,200 | |
| 11 | Total amount invested so far (equity + fixed income) | 2,00,000 | |
| 12 | Suggested **initial** equity allocation for current investments (see table for later years) | 0% | |
| 13 | Suggested **initial** fixed income allocation for current investments (see table for later years) | 100% | |
| 14 | Post-tax return from equity instruments expected | 10.0% | |
| 15 | Expected return from all forms of fixed income instruments | 7.0% | |
| 16 | Any amount that you are expected to receive as lump sum close to the goal deadline (eg. An insurance policy pay out) | 0 | |
| 17 | **Annual increase in total monthly investment %** | 0% | |
| 18 | Net corpus that has to be accumulated | 15,97,200 | |
| 19 | | | |
| 20 | | | |
| 21 | | | |
| 22 | | | |
| 23 | Goal 1: Click to find the investment amt required | | |
| 24 | | | |
| 25 | If you wish, you can invest a lump sum as per suggested asset allocation: | 11,03,791 | |
| 26 | | | |
| 27 | Or the Initial monthly investment required when you start investing is | 32,757 | |
| 28 | The monthly investment schedule is shown in columns K and L | | |

| Year of investment | Suggested Equity allocation | Suggested Fixed Income Allocation | Net portfolio return after tax | Monthly investment required (ignore if negative) | Year end Corpus value (including current investment as per suggested asset allocation) | Suggested investment in equity | Suggested investment in fixed income | Lump sum investment required | Year end Corpus value |
|---|---|---|---|---|---|---|---|---|---|
| 1 | 0% | 100% | 7.0% | 32,757 | 6,34,601 | 0 | 32,757 | 11,03,791 | 13,95,056 |
| 2 | 0% | 100% | 7.0% | 32,757 | 10,99,625 | 0 | 32,757 | | 14,92,710 |
| 3 | 0% | 100% | 7.0% | 32,757 | 15,97,200 | 0 | 32,757 | | 15,97,200 |

Read Me First | Step 1 | Step 2A Other goals | Step 2B Other goals (recurring) | Step 3 Other Goals- Plan

Sanjay wants to plan for his marriage in 3 years. He estimates it would NOW cost him about 12 lakhs. So, in three years' time, with about 10% increase in expenses year after year, he will have to be ready with about 16 lakhs.

Since this goal is near-term, I would recommend that he use a simple recurring deposit. He already has 2 lakhs saved up. So, assuming about 7% return, he will have to put in about 32-33K a month.

Naturally, there are guaranteed high-risk, with potential high-reward options, but that depends on his comfort level.

For example, Sanjay can aim for higher risk, returns and lower taxation with a corporate bond debt mutual fund, an equity savings funds or even a balanced fund, but I will discourage such gymnastics unless he has money back up!

**Sanjay's house down payment**

Sanjay wants to build a down payment corpus for a house he wants to buy in 5 years. This is a bit flexible, so he can take on a little risk.

Goal 3

| | |
|---|---|
| Enter name of the goal for your reference | Home Downpayment |
| If this goal flexible? That is, if you can delay it by a few years (and hence can a bit more risk)? | Yes |
| How many years from now will you need the money for this goal? If money required for ago after retirement, then the onus of investing for it is on you. The retirement planning calculation in the previous sheet(s) does NOT factor in the investment required for any other goal before or after retirement. | 5 |
| How many years from now will you start investing for this goal? Enter zero for "immediately" | 0 |
| How much would it cost if you had to spend for this goal TODAY? | 10,00,000 |
| The rate at which the above cost will increase year upon year (inflation) is assumed to be 10%. If you wish to assume a lower/*higher* rate then choose "yes" here and choose the number below. A higher inflation rate may be required for certain goals like children's education, but this also means that you will have to invest more. | Yes |
| Enter any inflation other than 10% that you wish to use | 8.0% |
| The cost of this goal in 5 years | 14,69,328 |
| Total amount invested so far (equity + fixed income) | |
| Suggested **initial** equity allocation for current investments (see table for later years) | 10% |
| Suggested **initial** fixed income allocation for current investments (see table for later years) | 90% |
| Post-tax return from equity instruments expected | 10.0% |
| Expected return from all forms of fixed income instruments | 7.0% |
| Any amount that you are expected to receive as lump sum close to the goal deadline (eg. An insurance policy pay out) | 0 |
| **Annual increase in total monthly investment %** | 3% |
| Net corpus that has to be accumulated | 14,69,328 |

Goal 3: Click to find the investment amt required

| | |
|---|---|
| If you wish, you can invest a lump sum as per suggested asset allocation: | 10,33,047 |
| Or the Initial monthly investment required when you start investing is | 18,654 |
| The monthly investment schedule is shown in columns K and L | |

| Year of investment | Suggested Equity allocation | Suggested Fixed Income Allocation | Net portfolio return after tax | Monthly investment required (ignore if negative) | value (including current investment as per suggested asset allocation) | Suggested investment in equity | Suggested investment in fixed income | Lump sum investment required | Year end Corpus value |
|---|---|---|---|---|---|---|---|---|---|
| 1 | 10% | 90% | 7.3% | 18,654 | 2,40,187 | 1,865 | 16,788 | 10,33,047 | 11,08,460 |
| 2 | 10% | 90% | 7.3% | 19,213 | 5,05,112 | 1,921 | 17,292 | | 11,89,377 |
| 3 | 10% | 90% | 7.3% | 19,790 | 7,96,799 | 1,979 | 17,811 | | 12,76,202 |
| 4 | 10% | 90% | 7.3% | 20,384 | 11,17,424 | 2,038 | 18,345 | | 13,69,364 |
| 5 | 10% | 90% | 7.3% | 20,995 | 14,69,328 | 2,100 | 18,896 | | 14,69,328 |

For those unfamiliar with equity, I would recommend only about 10-20% exposure. Rest can be in a simple RD or liquid fund.

There are so many ways to build the investment plan. The only takeaway from this post is that asset allocation matters. For short-term goals, if you take on too much equity, then you will have to worry about decreasing it before you need money, so it not worth it. Please also keep in mind that I am addressing young earners and first-time investors.

## recurring goal planning

Premal’s European holiday for a month

You can click on each picture to read the inputs and suggestions made.

| | |
|---|---|
| Enter name of the goal for your reference | Euro Trip (1 month) |
| If this goal flexible? That is, if you can delay it by a few years (and hence can a bit more risk)? | Yes |
| How many years from **now** will you need the money for this goal? If money required for ago after retirement, then the onus of investing for it is on you. The retirement planning calculation in the previous sheet(s) does NOT factor in the investment required for any other goal before or after retirement. | 2 |
| How many years from **now** will you start investing for this goal? Enter zero for "immediately" | 0 |
| How much would it cost if you had to spend for this goal TODAY? | 5,00,000 |
| The rate at which the above cost will increase year upon year (inflation) is assumed to be 10%. If you wish to assume a lower/higher rate then choose "yes" here and choose the number below. A higher inflation rate may be required for certain goals like children's education, but this also means that you will have to invest more. | No |
| The cost of this goal in 2 years | 6,05,000 |
| Total amount invested so far (equity + fixed income) | 2,75,000 |
| Suggested **initial** equity allocation for current investments (see table for later years) | 10% |
| Suggested **initial** fixed income allocation for current investments (see table for later years) | 90% |
| Post-tax return from equity instruments expected | 10.0% |
| Expected return from all forms of fixed income instruments | 7.0% |
| Any amount that you are expected to receive as lump sum close to the goal deadline (eg. An insurance policy pay out) | |
| **Annual increase in total monthly investment %** | |
| Net corpus that has to be accumulated | 6,05,000 |

Goal 1

**Goal 1: Click to find the investment amt required**

| | |
|---|---|
| If you wish, you can invest a lump sum as per suggested asset allocation: | 2,50,480 |
| Or the initial monthly investment required when you start investing is | 10,804 |
| The monthly investment schedule is shown in columns K and L | |

| Year of investment | Suggested Equity allocation | Suggested Fixed Income Allocation | Net portfolio return after tax | Monthly investment required (ignore if negative) | Year end Corpus value (including current investment as per suggested asset allocation) | Suggested investment in equity | Suggested investment in fixed income | Lump sum investment required | Year end Corpus value |
|---|---|---|---|---|---|---|---|---|---|
| 1 | 10% | 90% | 7.3% | 10,804 | 4,34,190 | 1,080 | 9,724 | 2,50,480 | 5,63,840 |
| 2 | 10% | 90% | 7.3% | 10,804 | 6,05,000 | 1,080 | 9,724 | | 6,05,000 |

You may be wondering why only 10% or 0% equity. The robo template *only* provides conservative suggestions. Maybe I should write an AI algorithm to offer more dynamics suggestions! Short-term investing in equity is like a lottery ticket. You cannot spend all your money buying tickets!

**Sanjay wants to buy a car every 7 year**

Sanjay wants to buy his first car in 4 years' time. After that, he wants to buy a new car every 7 year and expects to buy 6 cars that way. With a current cost at 8L, inflation at 10% and return assumption of 7%, this is how much he will have to invest for each purchase.

| | | |
|---|---|---|
| 2 | Recurring Goal 1 (enter name below) | |
| 3 | Car | |
| 4 | How many years from 2018 will you first need money | 4 |
| 5 | After that, You will need the money once in (years) | 7 |
| 6 | How many times will you need money for this goal in total | 6 |
| 7 | Present cost | 8,00,000 |
| 8 | inflation in cost year after year | 10.0% |
| 9 | Net rate of return (post-tax) | 7.00% |
| 10 | Annual inc. in monthly invest. % | 0.00% |
| 11 | | |
| 12 | For all these goals, you use a simple RD or sweep in SB acct or liquid fund | |
| 13 | If you wish you can also consider an arbitrage fund and if you want to | |
| 14 | get adventurous an equity savings funds (can lose money) | |
| 15 | | |
| 16 | The investing is assumed to start in the year mentioned and stop when the | |
| 17 | sum is required for spending. | |

| Recurring Goal 1 | | | | |
|---|---|---|---|---|
| Redemption number | Year when sum required | Amount required | Monthly investment required | Year investing starts |
| 1 | 2022 | 11,71,280 | 21,984 | 2018 |
| 2 | 2029 | 22,82,493 | 21,979 | 2022 |
| 3 | 2036 | 44,47,934 | 42,831 | 2029 |
| 4 | 2043 | 86,67,765 | 83,466 | 2036 |
| 5 | 2050 | 1,68,91,021 | 1,62,651 | 2043 |
| 6 | 2057 | 3,29,15,822 | 3,16,961 | 2050 |

Here the asset allocation is a bit difficult to decide. The above table assumes investing for the second car will start after the first car is purchased and so on. So, each goal is near-term. But since it is flexible, Sanjay can take a chance with an equity-oriented balanced fund. Of course, if the markets crash, he will have to say goodbye to the car for a few years. But this is the age for Sanjay to take a chance with flexible and dare I say, optional goals like these.

Sanjay wants to take a holiday every few years

| Recurring Goal 2 (enter name below) | |
|---|---|
| Holiday | |
| How many years from 2018 will you first need money | 3 |
| After that, You will need the money once in (years) | 2 |
| How many times will you need money for this goal in tot | 20 |
| Present cost | 2,00,000 |
| inflation in cost year after year | 10.0% |
| Net rate of return (post-tax) | 7.00% |
| Annual inc. in monthly invest. % | 0.00% |

For all these goals, you use a simple RD or sweep in SB acct or liquid fun
If you wish you can also consider an arbitrage fund and if you want to get adventurous an equity savings funds (can lose money)

The investing is assumed to start in the year mentioned and stop when t sum is required for spending.

| Recurring Goal 2 | | | | |
|---|---|---|---|---|
| Redemption number | Year when sum required | Amount required | Monthly investment | Year investing starts |
| 1 | 2021 | 2,66,200 | 6,900 | 2018 |
| 2 | 2023 | 3,22,102 | 12,967 | 2021 |
| 3 | 2025 | 3,89,743 | 15,690 | 2023 |
| 4 | 2027 | 4,71,590 | 18,985 | 2025 |
| 5 | 2029 | 5,70,623 | 22,972 | 2027 |
| 6 | 2031 | 6,90,454 | 27,796 | 2029 |
| 7 | 2033 | 8,35,450 | 33,633 | 2031 |
| 8 | 2035 | 10,10,894 | 40,696 | 2033 |
| 9 | 2037 | 12,23,182 | 49,242 | 2035 |
| 10 | 2039 | 14,80,050 | 59,583 | 2037 |
| 11 | 2041 | 17,90,860 | 72,096 | 2039 |
| 12 | 2043 | 21,66,941 | 87,236 | 2041 |
| 13 | 2045 | 26,21,999 | 1,05,556 | 2043 |
| 14 | 2047 | 31,72,619 | 1,27,722 | 2045 |
| 15 | 2049 | 38,38,868 | 1,54,544 | 2047 |
| 16 | 2051 | 46,45,031 | 1,86,998 | 2049 |
| 17 | 2053 | 56,20,487 | 2,26,268 | 2051 |
| 18 | 2055 | 68,00,790 | 2,73,784 | 2053 |
| 19 | 2057 | 82,28,956 | 3,31,278 | 2055 |
| 20 | 2059 | 99,57,036 | 4,00,847 | 2057 |

# Investment planning: Key takeaways

1. Define your need
2. Be clear about when you want the money
3. Is your need flexible or rigid? If it is flexible, that is you can wait a bit, take a chance with some equity. If it is rigid, minimize or avoid equity
4. There are multiple ways to create an investment plan. If the plan considers taxation, risk and liquidity, *before* investing, you will be fine.
5. The tough part is not choosing investing products but investing enough! It is childish to assume higher returns and invest less.
6. Do not waste time worrying about products for short-term goals.

Thank you, Sanjay and Prempal for your contributions. Next week, we shall consider 30-year olds who have kids.

# How to create a financial freedom plan for 27-year old Amar (Case study)

freefincal Re-assemble January 20, 2018

We discuss how to create a retirement income plan with 27-year old Amar as a case study. We shall consider asset allocation for each year of investment before and after investment and how Amar can derive an inflation-protected income and be financially free after retirement. This is step 11 of Re-assemble, a series on the basics of money management aimed at beginners and young earners. The full list of steps with links can be found below.

**What is inflation-protected income?** A retirement income that increases each year as per the needs of the family. It considers inflation in expenses as well as due to lifestyle modifications. Young earners today should not be thinking and be talking about constant income or pension in retirement. They should consider how to consistently beat inflation with an inflation-protected income (also known as inflation-indexed income).

**Read more:** Generating an inflation-protected income with a lump sum.

**What is financial freedom?** The ability to generate inflation-protected income for given number of years, preferably until the death of the youngest dependent.

## How to create a retirement income plan

We shall use the free robo advisory template to create a retirement income plan for 27-year old Amar who is married to a 25-year old homemaker. Last week, we had considered a case study for unmarried young earners less than 25: Investment planning case study 1: How to create an investment plan.

Amar is 27 and salaried and hopes to retire by 58. **Recommendation:** this is okay for a start but suggest pushing to lower and lower gradually. Less than 30-year olds today must focus on retirement by 50 (20 years of "bound" labour).

Therefore, we shall plan for retirement income from the time Amar reaches 58 to the time his wife (younger spouse in general) reaches 90. Therefore, Amar has 31 years to invest (the most precious asset) and needs to plan for inflation-protected retirement income for 34 years.

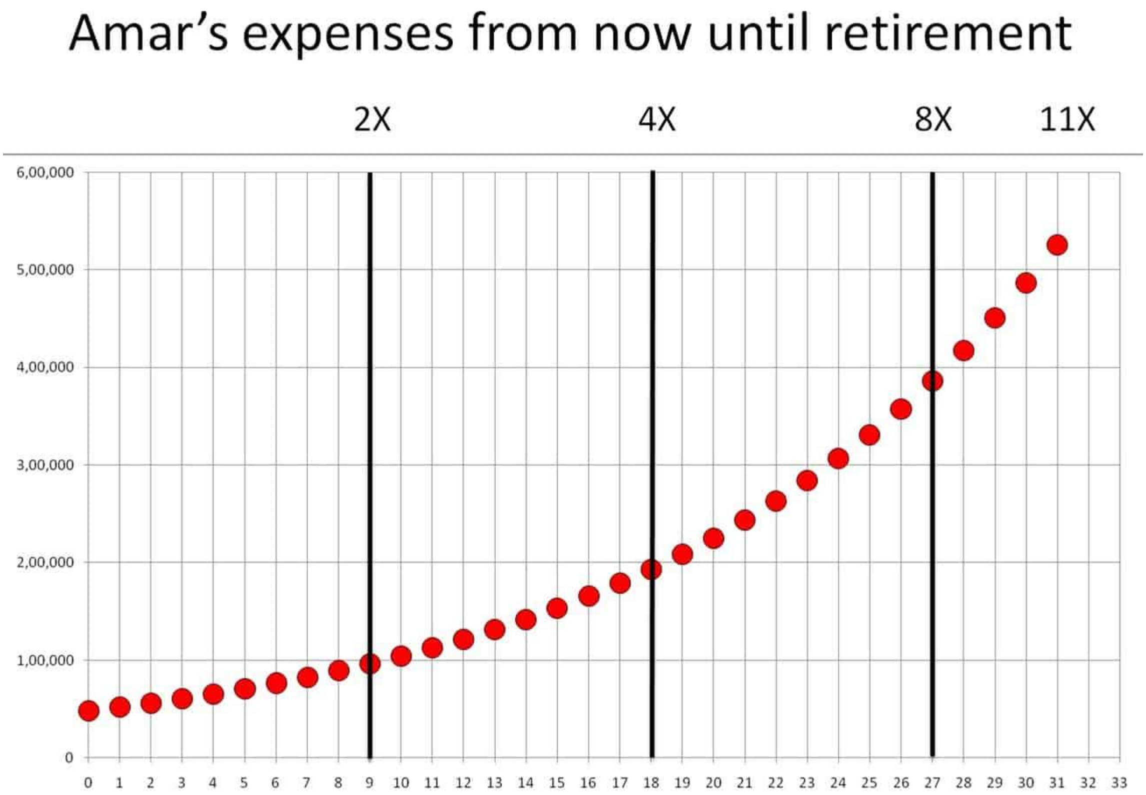
We shall consider 8% inflation before and after retirement. If this seems low to you, it is because you have bothered to calculate your personal inflation rate and/or have not handled unexpected recurring expenses (my prayers that you don't have to). Do not take the inflation numbers published by the government seriously, they mean nothing.

Some people talk about “real returns” as if it is some profound concept. It is not. All you need to be clear about is (1) a practical inflation in expenses and (2) a practical tax-free rate of return for your entire portfolio. You need to be ready to handle at least 8% inflation. This way, if your actual inflation is less, you would have built yourself a nice corpus to handle medical emergencies.

The video tutorial is linked below. First, an overview is presented.

## Why should Amar worry about generating retirement income?

At 8% inflation, in 9 years, his current expenses will double (repeat, just his current expenses. He will have to re-do the retirement calculation once a year). In 18 years, it will 4 times the current expenses.




In 27 years, 8 times and by the times his income stops (aka retirement!), it will be about 11 times current expenses. So, Amar should worry, but do so productively – by starting investments as soon as possible.

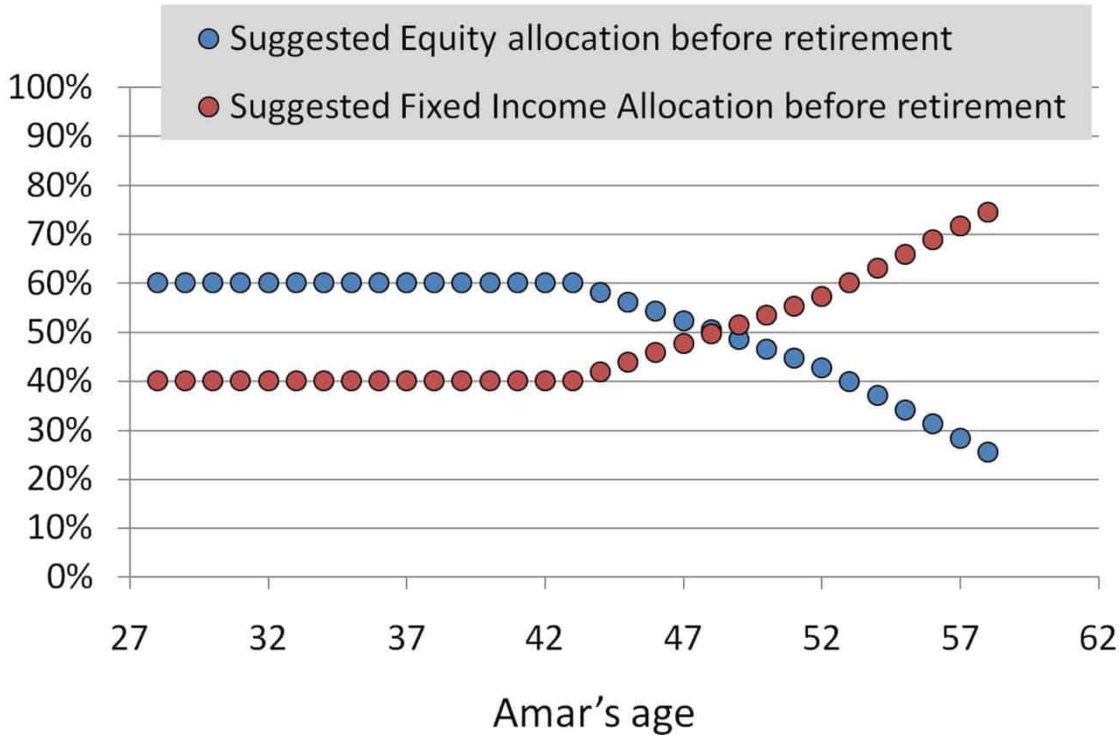
## Why is the corpus needed for inflation-protected retirement income so big?

Hold on to your chairs and take a deep breath. Amar will have to have about 21 Crores, 27 lakhs ready by age 58. He will have to begin investing about 57, 500 immediately increasing at 7% a year, in a portfolio of 60% equity and 40% fixed income. I know people who have lost sleep for days after using my calculators. Amar, however, need not worry *even if he is not able to invest that much*. He has time on his side and the robo template assumes 8% inflation, only 10% returns from equity – hey we are projecting 31 years into the future. I am not a sales guy to assume 18% returns so that my clients "closes" the deal (and his brains).

So, expect the corpus to be high. It is better to aim for the 1st floor even when there is more than ample chance to be able to the 5th. Expect less and you won't be disappointed! Am I being pessimistic, not really. I have quite optimistically assumed 6-7% returns from fixed income. This is unrealistic over the next 3 decades and it is better to expect less but let us not be realistic to the point of discouragement.

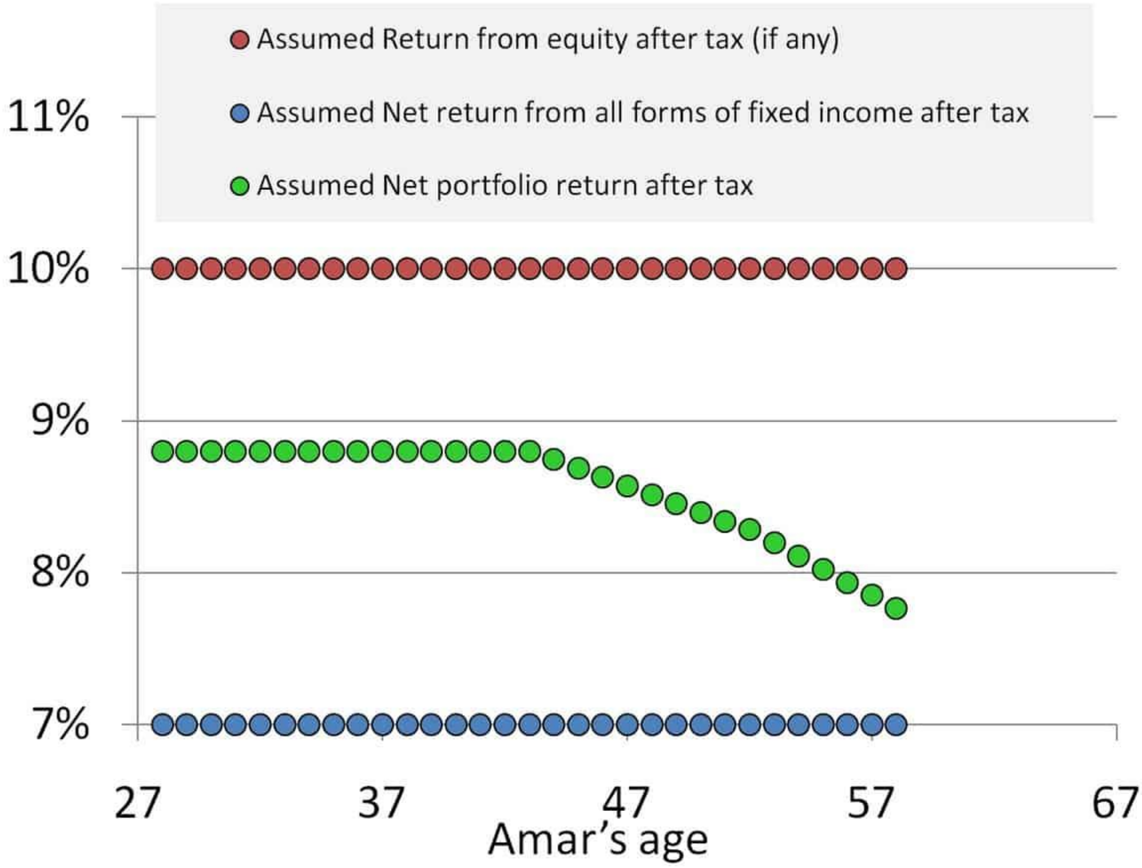
## Variable asset allocation for building the retirement corpus

Starting with 60% equity exposure, Amar can gradually taper down to about 25% at retirement and maintain that.



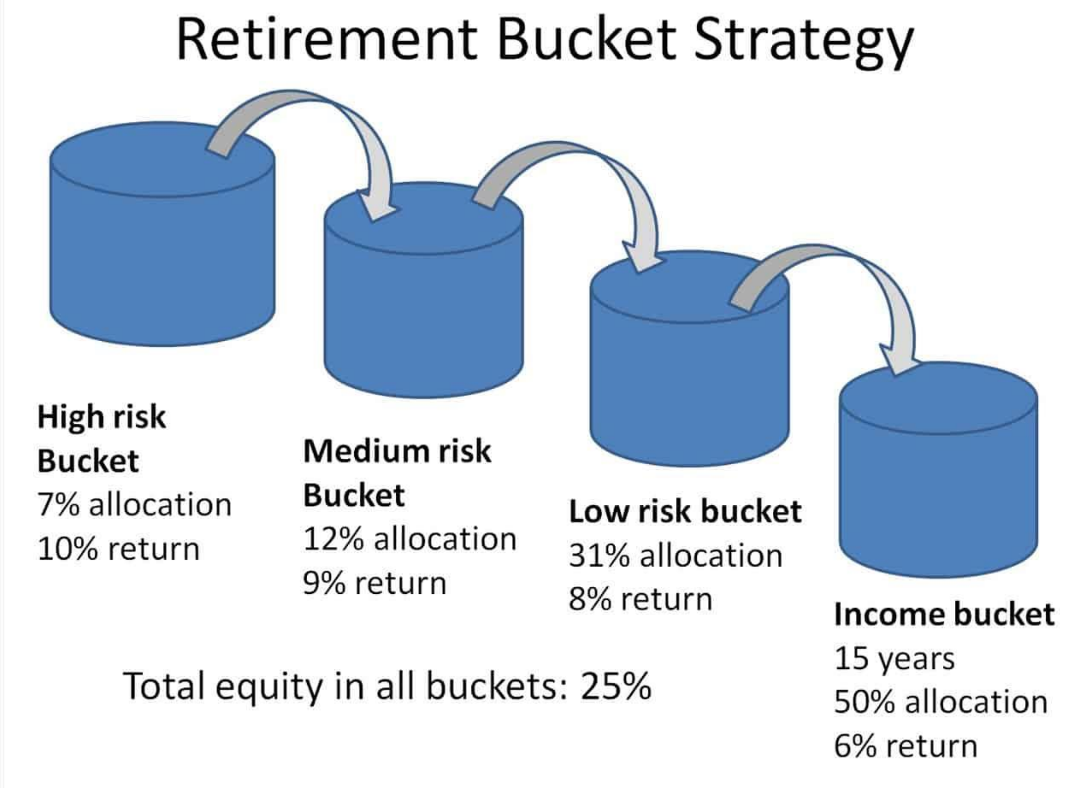

## Variable portfolio returns due to variable asset allocation

As the portfolios equity exposure decreases, so too does the expected net return from the portfolio. The retirement corpus is so big because this is factored in from day one. Most retirement planning tools (including my early ones) do not consider this crucial aspect. Welcome to the real world!

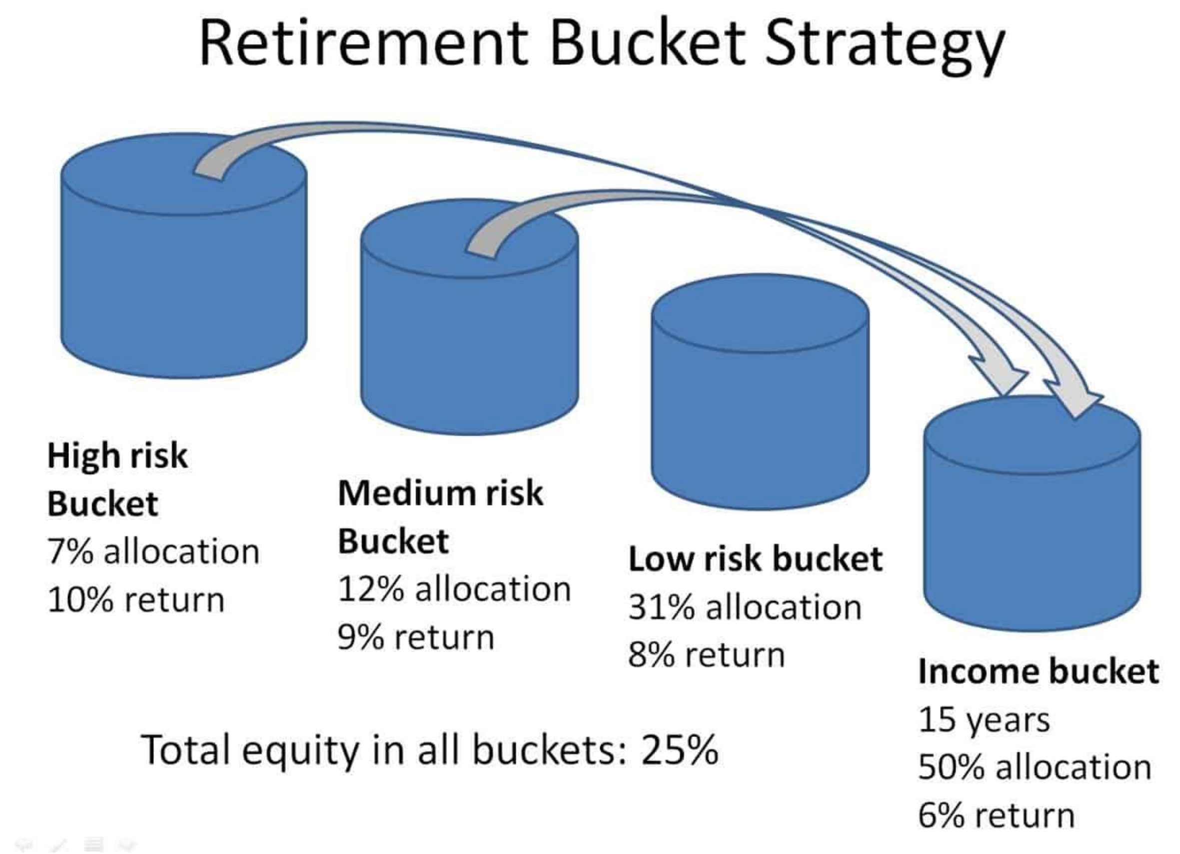



## Creating retirement income with buckets

The robo template assumes that the corpus will be distributed among the four buckets shown below. The income bucket will be used to generate inflation-protected income for the first 15 years in retirement. During the period, as per market conditions, money can flow from one bucket to another.




Another possibility:




Please note that such switches cannot be calculated now.

Rebalancing the buckets is a fantastic game and you can try the switching with random market returns to see how well you are doing:

Play [The Retirement Bucket Strategy Simulator](#)

## How to create a retirement income plan: video tutorial

Here is step by step walk-through of the robo advisory template filled by Amar. I have considered only the retirement planning section. This is an unrehearsed single take video as my Myasthenia Gravis prevents me from talking too much and too long. I wore out my cheek muscles after this, but hey after 5+ years with the autoimmune condition, I have learnt to live with it. If life gives you lemons, you aim to make tequila with it. So please do bear with me as I think on my feet.

**Click to watch the video**

Do explore the videos in **freefincal YouTube channel.**

## Will Amar be able to retire with financial freedom?

Mr. and Mrs. Amar have time on their side. So, I am more than confident that with disciplined investing and disciplined risk management, they will be able to retire comfortably and fight inflation. Let us thank Amar for taking time to fill out the robo template and wish them all the very best.

# Three Key Factors that decide how we achieve our financial goals

freefincal Re-assemble January 29, 2018

All of us dream. Some of our dreams are serious enough to become goals and like it or not, many dreams are financial. That is, they require money to implement. Here are three key factors that decide how well we can achieve our financial goals. Although everyone is different, there are some similarities. This post is inspired by a discussion with fee-only SEBI registered investment advisor Swapnil Kendhe.

## Here are the three Key Factors that decide how we achieve our financial goals

1: Being debt-free for the first few years of earning plus small investing

2: Understanding the difference between a job and a career

3: An understanding, co-operative and non-interfering life partner (if you choose to have one)

Before we begin, it is crucial to recognise that we cannot control everything that happens to us. Our role/responsibility in all the above is only partial. Many cannot avoid debt even before they start earning. Most of us settle for a job instead of a career because of family circumstances or because we do not know what to do with ourselves –

after school, after college or even now (like me). How our life partner will turn out is, well pot-luck. The point of this post is only to recognise the importance of these factors. Often, not much more can be done about it. However, if you are less than 30, chances are that you have time to turn it around. If you cannot, regret will not help.

## 1: Being debt-free for the first few years of earning plus small investing

Building wealth depends on two factors primarily: when you start investing and how much you invest. Where you invest is important, but secondary.

Most young earners today start their earning careers in debt. Aside from an education loan (which is, in one sense an investment), these are car loan/personal loan or credit card debt. There is a home loan too but is often a bit down the line, so not too bad.

If you could repeat, if you could avoid paying EMIs for the first 5 years after you start earning and invest only what you can (enjoy your spending), it will make a huge difference to the corpus you will create 20 years or 25 years later.

Rs. 12,000 a year invested at 10% return for 20 years gives about 6.9 Lakh. If you had started 5 years earlier, the corpus will be 1.7 times higher. If you had started 10 years earlier, the corpus will be about 2.9 times higher. Time is not just the ultimate currency, but it is also the ultimate wealth builder.

## 2: Understanding the difference between a job and a career

In the early 90s when Star TV was it its infancy, I saw a movie scene that changed my perspective on work. A mother tells her young son, who says he will go to a job after college

*not a job, son a career*

Unfortunately, I am unable to recollect the name of the movie. That scene made me understand the difference between a job – doing as told and a career – a chance to progress from “doing as told” to tell others what to do. There are of course many other definitions for “job vs career”.

Swapnil Kendhe’s point is: If a person spends several years after college focussed on building a career, she can start investing late and catch up comfortably as the salary would be high (but would arrive late). Completely agree.

I started earning at 32 and spent 11 years after school pursuing BSc + MSc + PhD + post-doctoral assignments to land a tenured academic position. Though I started investing only by age 34, I could manage.

The point is, young earners even if currently employed can still appreciate the importance of a career and develop their skills. In today’s world, I would wager that it is still possible for anyone below about 40 years of age to move from a job to a career. This transition will cost time. However, if productive, the extra money can be put to good use.

As a parent, our job should be to gently help children understand this difference and push them to work hard. It is not easy and not always possible but try we must (more on this later).

## 3: An understanding, co-operative and non-interfering life partner

An understanding spouse is both a lever and fulcrum combined to move the world! There is no greater gift for those who to share their life. Unfortunately, it almost always a gift. We either get lucky or we don't. If we are not lucky, then we will have to make do with what we have and hope for the best.

## Is there anything that I can do?

1: Avoid debt for at least the first few years of earning

2: Whether you are in a job or career, learn something new. These days, it is easy to make money with new/existing skills. You never know, your skill could become your new passion and your career!

3: Discuss your goals dreams and nightmares with your partner or partner-to-be. Be ready to change and meet her half-way.

May the force be with all of us.

# How to start investing in equity?

freefincal Re-assemble February 17, 2018

This weekend, in a two-part re-assemble series posts, let us consider: (1) How to start investing in equity and (2) what should be my first mutual fund?. The transition from the comfort of fixed income to volatile equity can be quite dramatic. I discuss simple getting-started ways for investors new to equity.

## Investors make two big mistakes when it comes to equity

1: Forgetting about asset allocation (how much is invested in equity and how much in fixed income)

2: Getting over-confident: Not recognising that "*Past performance* is not indicative of future returns". Over-confidence often leads to too much exposure in equity and improper asset allocation.

Starting slowly will help retain some control over asset allocation.

## Use your EPF contribution as a reference for starting equity investments

Suppose your EPF contribution is Rs. 5000 a month. Start investing in an equity mutual fund (we will see which one tomorrow) or a blue-chip stock (if you are comfortable) at Rs. 1000 a month. That is 20% (1000/5000). Do this for about 6 months.

I would recommend that you not start a SIP and manually invest each month. It would take 30 seconds (as long as you do not want to silly things like start investing at 2:59 pm on a business day).

Now you have 6 months, to define your financial goals. This might help: Financial Goal Planning: How to buy an Audi Car. Then you need to determine the asset allocation: Deciding on asset allocation for a financial goal.

For financial freedom that is several years away, I recommend 60% equity and 40% fixed income.

Your fixed income will be your EPF (or PPF if you are not salaried). Say this is Rs. 5000 a month. So, you need to invest a total of 5000/40% = 12,500 a month. That is Rs. 7500 in equity and Rs. 5000 in EPF.

In other words, 7500/5000 = 150%. You have just started with Rs. 1000 in equity (20%). This must be increased to 150% or 7500 a month. I would recommend increasing this over 2-3 years. Since you are investing manually, you have the freedom to increase the amount invested at will (SIPs will be messy).

It is important to keep in mind that asset allocation has two components:

Each month you will invest 40% in EPF and 60% in equity. However, due to interest income and market movements, the value of those investments will be higher or lower than the total invested amount. For the first few years do not worry about this. After that, you will need to reset the portfolio value to 60% equity, 40% fixed income. Then down the line, decrease the equity allocation. You can use the freefincal robo advisory software template to decide this.

Resetting the portfolio value is also known as rebalancing. This means if your equity portfolio is valued at Rs. 1,00000 and your EPF at Rs. 55,000, the EPF allocation is 35.5% and equity 64.5%.

You redeem Rs. 7000 from equity and invest it in EPF (VPF). Then your portfolio would be ~ Rs. 93,000 equities (60%) and ~ Rs. 62,000 (40%) EPF. After the first few years, you need to do this rebalancing exercise *at least* once a year (twice or thrice as you near the goal with lower and lower equity).

If you start slow, you get used to volatility gradually and you always keep an eye on your asset allocation.

## How to avoid over-confidence?

By remembering that

***Past performance* is indicative of future risk!**

Follow this Value Research link and click on 2006 (or the oldest year) and you will get this.

Saturday, February 17, 2018 | Search for funds, stocks or anything else! | SEARCH

| Fund \| Rating | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Taurus Tax Shield Fund - Regular Plan \| ★ | -10.13 | 111.69 | -54.23 | 94.85 | 18.88 | -22.21 | 28.66 | 0.47 | 35.13 | 2.06 | 3.19 | 38.00 |
| BNP Paribas Dividend Yield Fund \| ★★★ | -3.20 | 53.07 | -48.16 | 81.02 | 21.78 | -17.00 | 32.90 | 5.56 | 49.69 | 6.66 | 1.89 | 42.58 |
| Principal Dividend Yield Fund \| ★★ | 3.73 | 62.54 | -55.21 | 78.50 | 24.68 | -26.84 | 41.94 | -5.30 | 44.93 | -3.39 | 7.25 | 46.60 |
| SBI FMCG Fund | 5.58 | 28.38 | -32.97 | 66.37 | 48.08 | 6.18 | 55.30 | 9.29 | 30.89 | 5.32 | 2.39 | 53.10 |
| UTI Pharma & Healthcare Fund | 8.29 | 11.80 | -25.95 | 66.62 | 37.19 | -9.55 | 24.77 | 23.27 | 43.74 | 12.37 | -9.71 | 6.20 |
| Taurus Discovery Fund - Regular Plan \| ★★ | 10.42 | 100.71 | -75.17 | 90.92 | 13.99 | -30.45 | 49.79 | 0.92 | 60.71 | 7.80 | 3.21 | 46.13 |
| Aditya Birla Sun Life Dividend Yield Plus Fund \| ★ | 10.46 | 56.87 | -44.44 | 89.74 | 29.85 | -18.81 | 29.39 | -3.00 | 55.83 | -5.50 | 2.61 | 33.19 |
| UTI Opportunities Fund \| ★ | 10.89 | 71.33 | -49.04 | 97.62 | 19.40 | -12.11 | 27.28 | 5.85 | 41.22 | -5.94 | 2.60 | 29.09 |
| UTI Mid Cap Fund \| ★★★ | 11.85 | 52.60 | -61.17 | 110.88 | 19.11 | -23.89 | 41.58 | 9.68 | 90.44 | 6.60 | 3.48 | 42.01 |
| UTI Transportation and Logistics Fund | 11.87 | -1.02 | -48.68 | 133.35 | 26.44 | -19.28 | 37.62 | 24.72 | 103.95 | 5.72 | 4.79 | 39.61 |
| SBI Pharma Fund | 12.63 | 6.74 | -49.20 | 84.29 | 29.14 | -5.54 | 37.06 | 26.05 | 56.85 | 27.06 | -14.02 | 2.05 |
| Tata Dividend Yield Fund - Regular Plan \| ★★★ | 15.07 | 75.75 | -53.28 | 88.45 | 32.36 | -16.93 | 27.29 | 6.10 | 42.44 | 4.60 | 4.98 | 27.58 |
| UTI MNC Fund | 16.52 | 32.39 | -42.77 | 82.13 | 26.07 | -6.00 | 31.33 | 10.61 | 62.94 | 12.65 | -3.00 | 37.34 |
| Principal Global Opportunities Fund | 16.66 | 24.82 | -44.79 | 62.52 | 11.53 | -2.60 | 21.47 | 5.39 | -2.62 | -9.65 | 10.08 | 30.91 |
| Reliance Pharma Fund | 16.73 | 49.80 | -34.00 | 118.60 | 31.86 | -11.02 | 34.84 | 20.87 | 49.46 | 19.37 | -10.58 | 7.61 |
| UTI Long Term Equity Fund \| ★★ | 18.35 | 50.91 | -54.66 | 72.55 | 17.62 | -23.39 | 26.89 | 7.16 | 40.73 | 2.62 | 3.31 | 33.12 |
| Reliance Banking Fund \| ★★★★ | 18.63 | 76.95 | -37.84 | 82.89 | 46.08 | -31.98 | 60.52 | -10.37 | 64.88 | -6.02 | 11.50 | 44.13 |
| UTI Dividend Yield Fund \| ★ | 20.65 | 70.56 | -44.44 | 85.78 | 24.27 | -17.54 | 22.37 | 0.20 | 41.24 | -5.13 | 6.11 | 28.50 |
| Baroda Pioneer ELSS 96 Fund \| ★★ | 21.04 | 56.00 | -57.15 | 84.03 | 15.07 | -28.65 | 26.17 | 7.34 | 47.84 | -2.26 | 3.16 | 37.17 |

These are annual returns (Jan 1st to Dec 31st). This is how volatile your investment will be. In truth a bit more volatile than this. Never ever assume you will get high returns if you keep investing. That is sales BS.

Start slow, start small, never forgetting the past.

# what should be my first mutual fund?

freefincal Re-assemble February 18, 2018

Yesterday, we considered How to start investing in equity Today, let us discuss what should be the first mutual fund for a young earner or for new mutual fund investors. The financial services industry makes a big deal out of risk profiling. You cannot take theoretical answers about market volatility and provide investment advice on that! The true risk appetite of a person is revealed only when the market crashes.

This is the reason why asset allocation is so crucial. So, if you have not read the previous post on how to gradually increase equity asset allocation, please do so first and then head back here.

The idea is to:

First, define a financial goal. Example: How to buy an Audi Car

Second, determine a suitable asset allocation for that goal using the robo advisory template

Third, plan to reach the desired asset allocation gradually. For example, from 0% equity to 60% equity in 2-3 years.

Fourth (only fourth), consider how to invest in equity. If you wish to use equity mutual funds, then let us consider the options.

Photo by Christine Rondeau

Before we proceed, two observations.

**1:** Some people recommend an equity-oriented balanced as a "first fund". Nothing wrong with this provided it is treated as pure equity and the exposure to it is gradually increased. Please recognise that the reduction in risk from 95% equity to 70% equity is quite marginal. See Balanced Equity Funds: the low risk, high reward option.

However, choosing a balanced fund can be tough for new investors and they are likely to be misled by star ratings. For example, if say Franklin Balanced is a quiet solid performer in this category, it may not appeal to many.

**2:** Some advisors start clients on a liquid fund or arbitrage fund and then gradually include equity funds. Not a bad idea, assuming other aspects of the plan are done right.

So, let us get to the options.

**A: “I don’t mind volatility*, need a fund without much maintenance”** As suggested before, choose ICICI Nifty Next 50 Direct Plan Growth Option. * Returns will swing either way.

**B: “I want a fund that takes risks but has good risk management and good returns”**. Try Quantum Long Term Equity Fund-Direct Plan Growth Option

Balanced funds will fall in either category A or B.

**C: “I don’t mind risk, but don’t want to worry about fund performance”** Try Quantum Equity fund of funds. Do not worry about it being a fund of fund – extra expenses and extra tax. As discussed before it is one of Turnkey mutual fund solutions to beat inflation.

**D:” I cannot stomach too much volatility. Can sacrifice on returns**” Try Franklin Dynamic PE fund of funds (a debt fund). Or you can try newer funds like MOST Dynamic Equity fund based on the Motilal Oswal Value Index (MOVI) Or Edelweiss Dynamic Equity Fund (formerly absolute return fund) or IDFC Dynamic Equity Fund.

**Be aware of the following:**

Dynamic Mutual Funds vs Balanced Mutual Funds

Do not invest in dynamic equity funds if you wish to chase returns

Performance of Dynamic Asset Allocation Mutual Funds.

**Suggestions:**

1: There is no need for ELSS mutual funds. I would avoid them, especially as your first fund.

2: When people claim there is a “bull run”, euphoria, “markets are at a peak”, then it is a great time to start investing. Any time is good, but when the market is “high” then you can expect some downward or sideways movement soon and it better to begin your equity journey on a dull note. It will serve as a good reminder that the next “crash” is just around the corner. Personally, I had to wait for 5Y for a positive return in my retirement portfolio: The rise and fall of my retirement corpus (not the date of publication of this post)

3: Expect less and you won’t be disappointed!

Live long and prosper!

# How to buy a house with a home loan: Tips to maximize benefits

freefincal  Re-assemble  March 19, 2018

If you are planning to buy a house in the next few years with a home loan, here are some tips to maximize benefits. Wanting to live in a place that we call our own is an emotional and instinctive need. There can be no doubt about that. Very few of us would have no issues with "renting forever". However, careful planning and an all-around perspective is necessary to buy the house or property that we desire. A hurried emotional purchase can come back to bite us years later. If you are servicing a home loan, you can share your experiences in the comment section below.

This post is not about renting vs buying. If you are still debating this, I would recommend the following articles:

To buy, or to rent, that is the question.

The trouble with rent vs. buy calculations

I will state one thing though: Considering the rate at which people buy property "as an investment", renting is an awesome deal if you have no emotional bonding with a property.

Consider this: According to Magicbricks, a 2,200 sqft three bhk Mylapore apartment has a rent of 65,000 rent (incl maintenance) per month. The current cost of a sqft is about 17,800 (avg). This makes the house valued at about 4 crores (min).

Even before tax, this is a rental yield of only ~ 2%. Keeping that 4 crores in a bank will not fetch more, but also fetch it regularly!! Current home loan rates are about 8.5% ish. As a fellow Mylapore resident, I would say, 65K rent for a 2,200 sqft house is a reasonable deal even if the landlord does not furnish a Pan card!

If you are thinking about when to buy a house, you can have a look at this.

When to buy a house: now vs later vs never. Do read the fantastic article by *Yamini Sood*, VP sales of DSP Blackrock (linked within).

## Buying a house: the initial steps

Now, if you have decided that you need to buy a house, here are some initial steps:

1. Do not be in a hurry! Buying property is the important decision in your life. Most of will not be able to buy another.
2. If you have just started earning, think about this and decide if you want to buy and when you want to buy. It is better if you give yourself at least 5 years' time to prepare and invest aggressively towards part payment of the house cost.
3. You can take a chance with an equity-oriented balanced fund and aim to pay anywhere between 20-40% of the property cost. The rest you will pay for with a home loan.

4. Start investing for the down payment and then scout for property (give yourself at one year)
5. Home loan advertisements are meant to give that "fear of missing out". Do not fall prey.

## Planning a house purchase: additional considerations

Speaking of advertisements, there is a "Rent = EMI" campaign going around. The idea is,

*"why to pay rent when you can pay the same amount as EMI and own a house?"*

This is flawed reasoning. The rent paid for a house in the centre of the city (or old parts of the city) is not the same as EMI paid to a house in the suburbs. There will a difference in logistics:

- electricity (power cut frequency; restoration)
- Water supply
- Drainage
- Proximity to schools and basic amenity shops

The point is, will the quality of your lifestyle suffer if you start paying EMI instead of rent? This is the key question to answer. This requires time and maturity to do so.

Buy a house before you have children or at least before they start school. After that, uprooting them can cause them issues if you need to shift schools.

Buying second-hand property makes a lot of sense (especially retirement homes, more on that later), but the price should be reasonable. I know a family that purchased a 20-Y flat for almost one crore close to my house. A 20-Y independent house for a few crores, I can understand, but a 20Y flat? I cannot stomach that.

Think before you buy that dream house! Photo credit Emma

## How to choose a home loan for buying a house?

1. Try not to get a home loan for more than 70% of the cost of the property.
2. Shorter the loan duration, higher the emi, but lower the interest component
   - Here is an example: A 30L loan at 8.5% for 10Y has total interest component of ~ 33%. That if you add all the emis paid, 33% of that will go towards interest. If you increase the tenure to 15Y it becomes ~ 44% and if the duration is 20Y it becomes ~ 52%
   - The EMI for 10Y loan is ~ Rs. 37,200, 15Y is Rs. 29,542 and 20Y is, Rs. 26,000
3. Try to keep the total interest component below 50% of the total amount repaid. This is lower the home loan amount, the better.
4. Try to keep the EMI to about 40% of your take-home pay (post Tds and deductions). Plan for 40% expenses, 40% EMI, 15% investments, 5% emergency fund from your take-home pay
5. You should still be investing at least a small amount when you are repaying the home loan

## What kind of home loan to take? Overdraft (e.g. SBI Maxgain) or Normal?

An overdraft loan is one in which the interest charged is not on the principal outstanding (aka drawing power). The interest is charged on:

Principal outstanding – Amount you put in the loan account (available balance).

In a normal home loan, the interest will be on the principal outstanding.

I would recommend that you choose a normal home loan where you have a facility to make part payments at once a year (or more) instead of an overdraft home loan product like SBI Maxgain. Why?

1: Most home loan takers tend to pre-close the loan after about half the tenure. At the very least, they want to do so and be rid of it. A normal home loan is better suited for this.

2: Overdraft loans are a touch more expensive. The rate could be a few basis points higher. I would rather invest separately.

3: Overdraft loans are only for those who get surplus money from time to time and can use the benefits of the product.

While Ashal Jauhari's videos linked below will help you understand how to use SBI maxgain quiet well, please ask yourself: "Do I really have a surplus?"

If you listed all your short term and long term financial goals and have started investing for them or at least have a plan to do so, any so-called "surplus" amount will go (should go) towards that plan!

If investment and insurance should not be mixed, why should I mix a mortgage with “parking money”?!

Instead of reducing interest burden by having a non-zero available balance, I would prefer to lower the principal directly and either the lower the EMI or lower the duration with a direct part-payment.

‘Who is Ashal Jauhari?’, you ask? Read this to find out: Interview with Ashal Jauhari: Relentless Financial Awareness Activist. He is the owner of FB group Asan Ideas for Wealth.

## How to manage the home loan?

It is important to plan this ahead.  Keep it simple! Get a normal home loan for not more than 15Y. Set up a separate fund called – prepayment fund. Maybe it could be the same balanced fund you used earlier. **After** accounting for your goals and investing for them, **if** you have a surplus, put it in this prepayment fund. Let it grow for a few years. Read more: Why this Kolaveri to pre-pay home loans?!

Once your interest component falls to about 50% or less than the EMI, you can start pre-paying the loan gradually from your fund. In the meanwhile, enjoy the so-called tax saving benefits for the interest component of the EMI (principal component also has benefits, but it falls under 80C).

So-called tax saving benefit because it is only an effective reduction in your EMI outgo, not a real tax saving.

Before we head to Ashal Jauhari's Maxgain videos, note that I am not differing with him with reg overdraft accounts. Such accounts are only meaningful if you have surplus cash to park (he would agree). I am merely asking you to dig deeper and ask, *do you really have a surplus?* Just as he is asking, ***Can you really save tax on a home loan?*** Be sure to this as Ashal talk about *when* you can save tax on a home loan. (Some tax rules have changed since then wrt second home).

## Home loan management Resources

Pay off home loan or invest for retirement? Calculate and find out!

Excel Home Loan Amortization Schedule Template

How I transferred my home loan from LICHFL to SBI and saved 12 Lakhs!

Home Loan Transfer Calculator (Mortgage Refinance)

# How to reduce risk in an investment portfolio

freefincal Re-assemble April 7, 2018

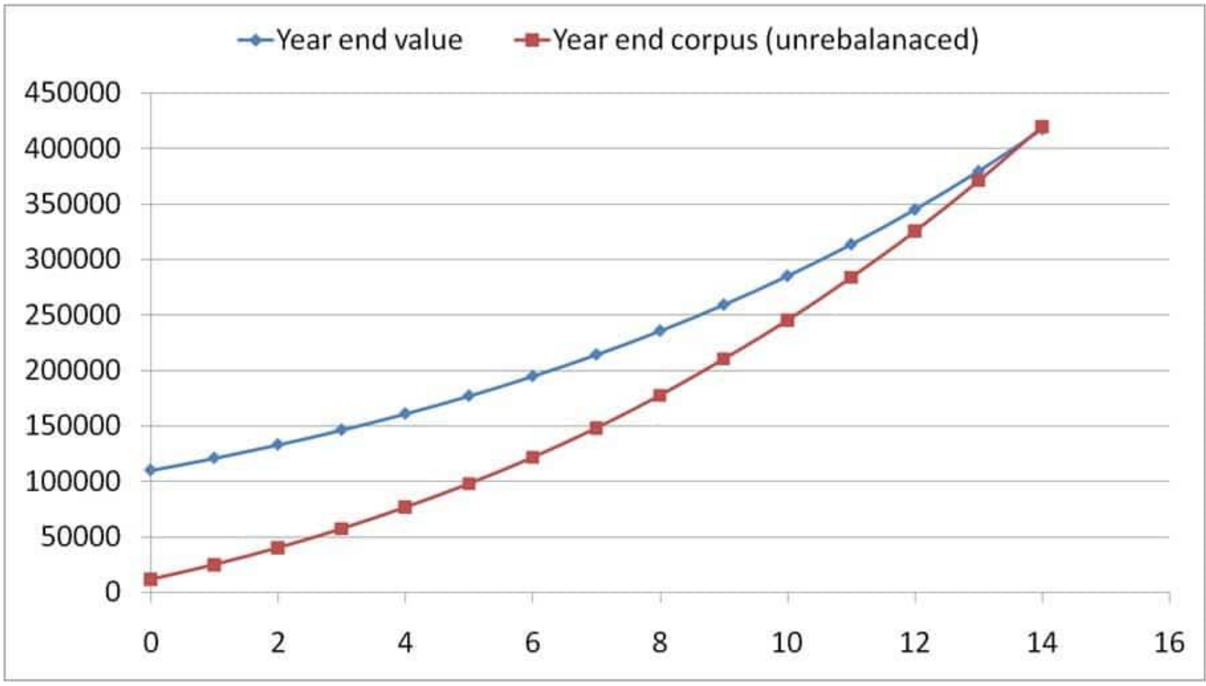
Often, it is only when we see a big drop in the stock market do we recognise the need to worry about risk and how to manage it. What if a market crash wipes all the returns I have got so far? What if there is not enough time to recover before I need to withdraw for my goal? These are some practical questions and I would like to consider practical answers for these in a series of posts, starting with this one: How do I reduce risk in an investment portfolio – part 1: the basics.

I have written about this in some detail: Simple Steps to De-risk Your Investment Portfolio and How can a 400% profit result only in 8% return?! Hodling to the moon Risk! and Want to be financially free? Do not count on frugality! Worry about sequence of returns risk! I would like to test the efficiency of the methods mentioned in these posts with real market data. Instead of taking only the annual returns to form a sequence of equity returns, I will be using the rolling returns calculators, particularly the data presented in this post: Sensex Charts 35 year returns analysis – stock market returns vs risk distribution to create *rolling sequence of returns* from one business day to the next.

This would be my own version of "big data". So, from just on the sequence we can scale up to 1000s of return sequences and back-test the efficiency of different portfolio management strategies. I shall explain how exactly this is created in the second part. In this post, which is part of re-assemble – a series on the basics of money management, we will consider some examples.

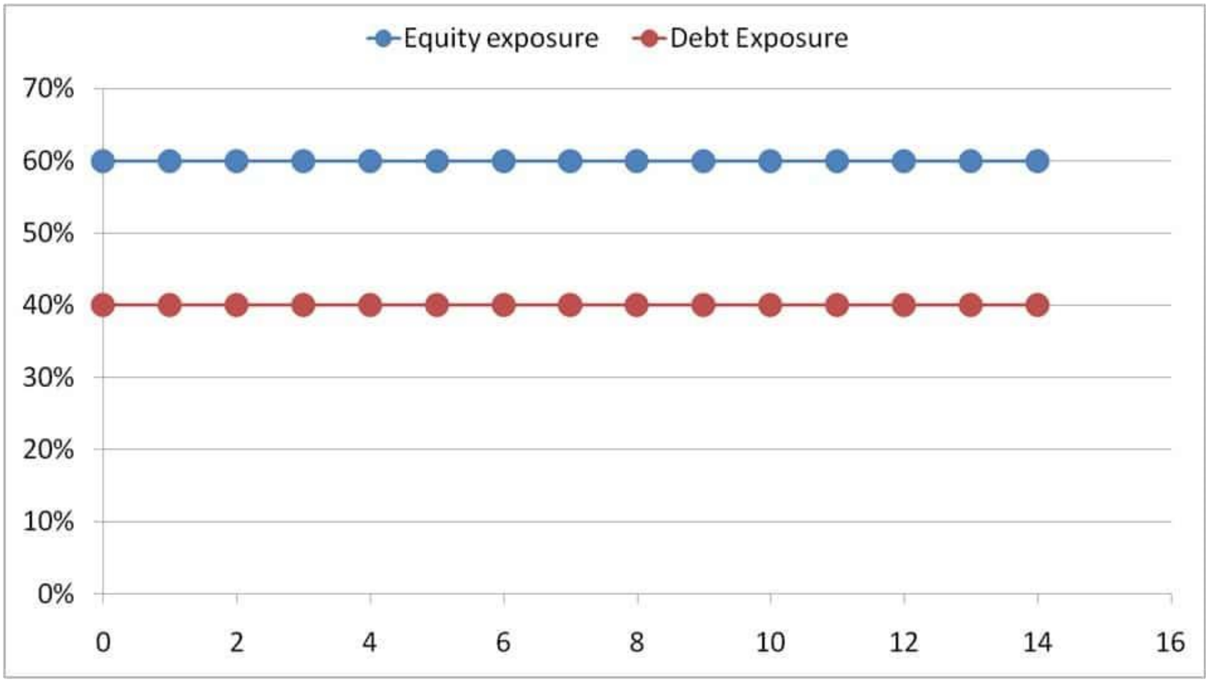
I am surprised at how many people have blind faith in equity. Even if they get sustained poor returns, many are confident that things will turn around just before the need the money. This is atrociously stupid. Please recognise that the money in the stock market is of no use! It is real money *only when you withdraw!*

Let us consider a goal that is 15 years away. The current cost of that goal is 10 lakhs. Assuming 10% yearly inflation, the future cost is shown below (blue dots). If we start investing for this in a mix of equity and debt (fixed income), the corpus assuming same returns (10% from equity and 7% from debt – both post-tax), the total corpus will be shown as below. The investment is assumed to increase 5% each year.

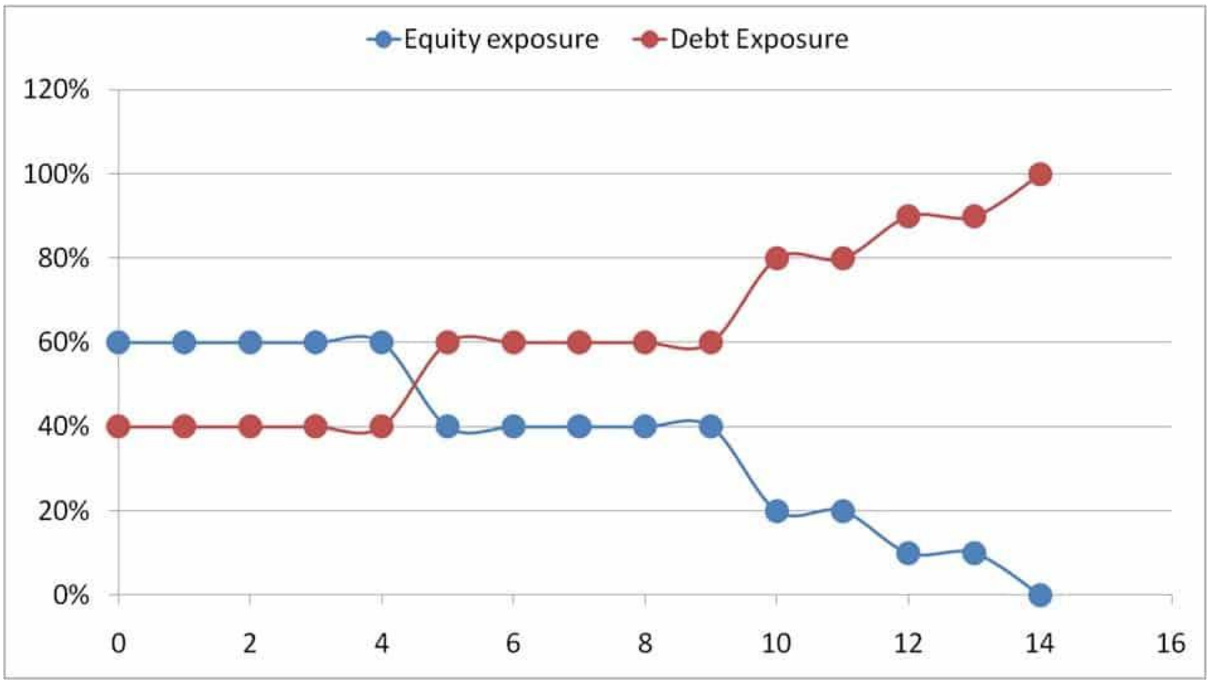



Naturally, the aim should be for corpus (red line) to hit the target (blue line) on or before the end of the 15Y period. We start from 0, so it ends at 14. When the returns are fixed, you get a nice smooth corpus growth. Returns in real life fluctuate wildly as you will see below. This is known as *sequence of returns*.

Now, there are two ways to invest in equity and debt. Use the same asset allocation for each year. Say 60% equity and 40% debt. We will refer to this as **constant equity allocation**




Or we can reduce equity gradually as we approach the goal. I prefer a step-wise decrease (on paper at least) and this is the approach recommended in the Freefincal Robo Advisory Software Template. We will refer to this as the **reducing equity allocation**.

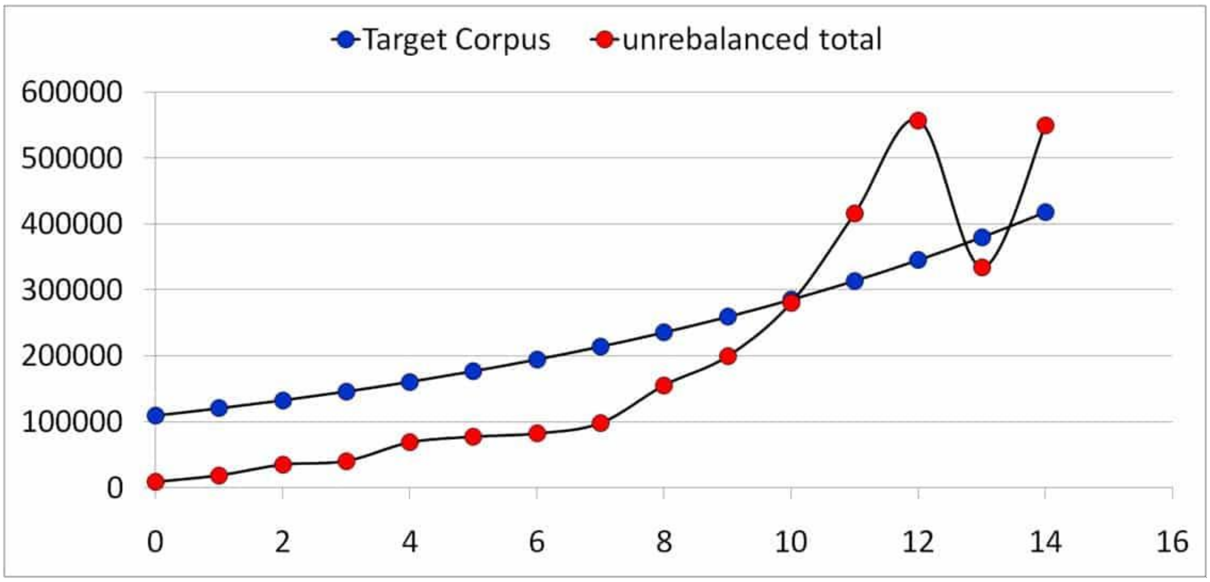


# Portfolio Risk reduction for Return sequence 1 (RS1)

Assuming a 7% fixed return from debt year-on year, this is a real Sensex return sequence from the past:

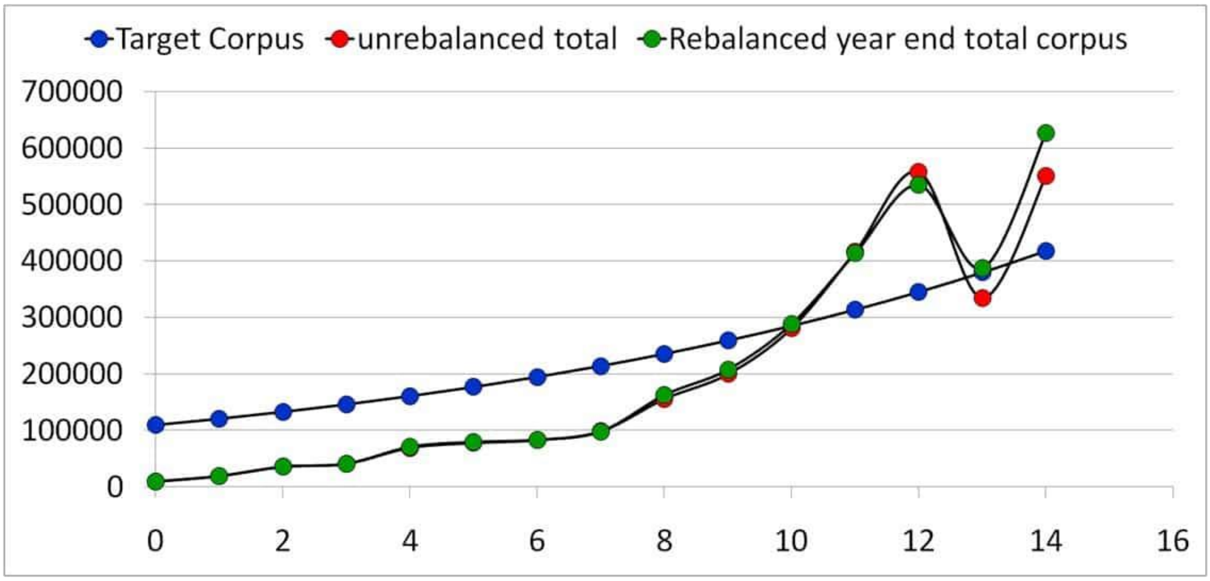
-18%, -12%, 27%, -27%, 52%, -13%, -22%, -3%, 69%, 23%, 43%, 54%, 35%, -55%, 86%. Each of these is a return after one of year of investing. So, 15 annual returns for 15 years of investing.

**RS1: Constant Equity method**




The blue dots represent the increase in target corpus due to inflation. The red dots show the growth of the actual corpus. No rebalancing is done. That is, although we will invest 60% of a sum in equity and 40% in debt, we will not worry about the asset allocation of the corpus. Notice how dangerous the constant equity approach is.

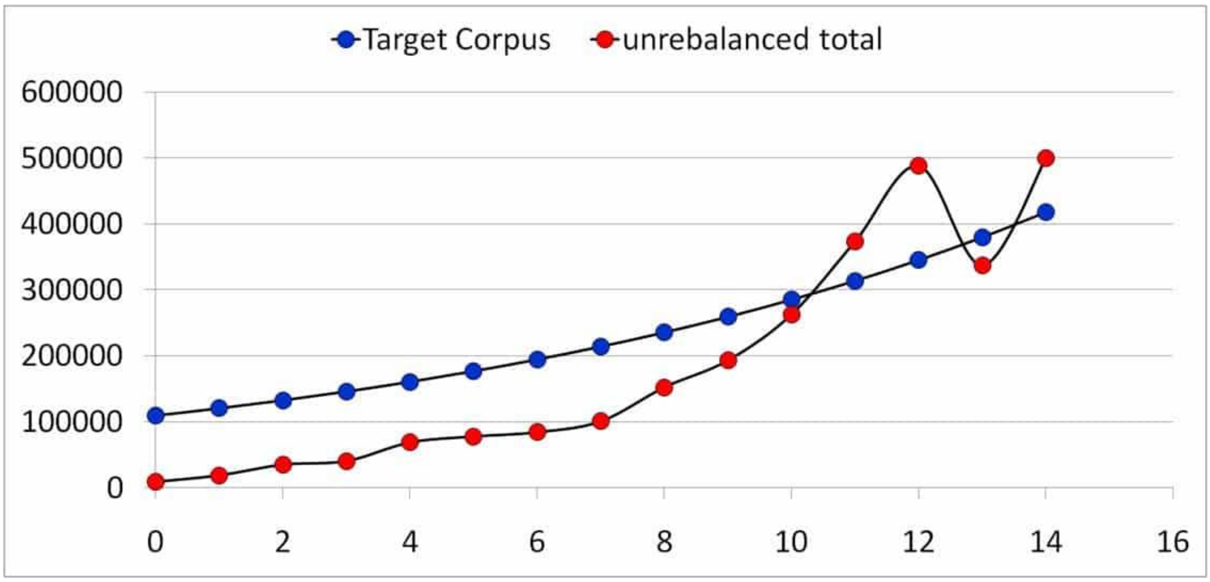
What if we reset the asset allocation to 60% equity and 40% fixed income at the end of each year? This is known as rebalancing. For those are new to this idea, see: How to Rebalance Your Investment Portfolio



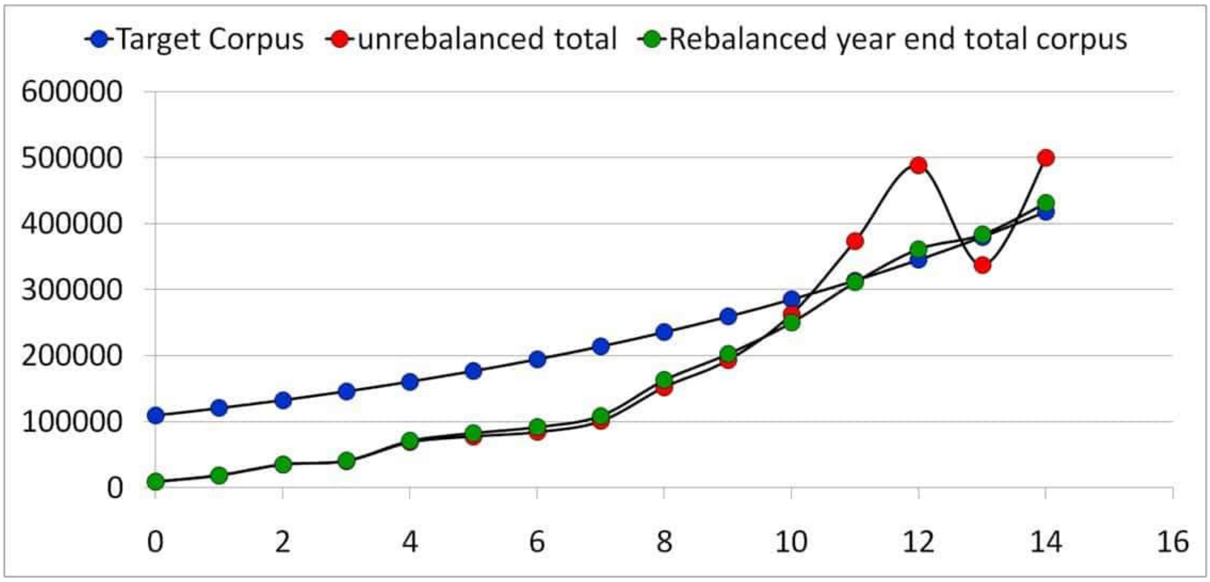

Notice that the risk is reduced, but only by a small amount.

## RS1: Decreasing Equity method

If I decrease the investment to equity but do not do anything to the value of the equity portfolio, that is I do not rebalance, then there is really no benefit.




However, I also rebalance as per the reducing equity schedule as shown above, we get a nice smooth approach to the target corpus well before the target date.



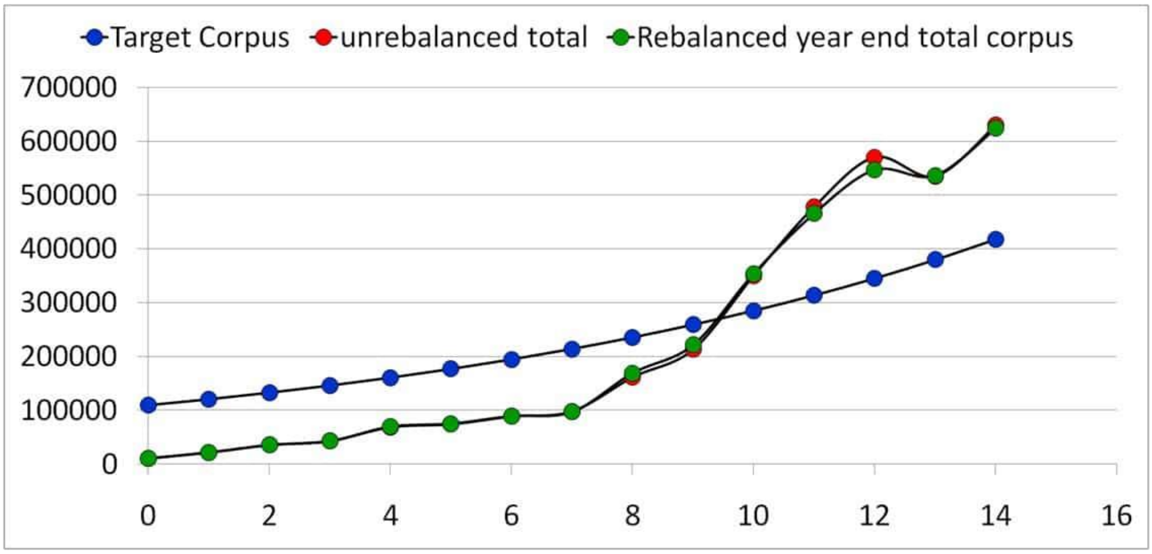

**What is the message here?** (1) Employ a reducing equity schedule and religiously stick to it. This is a simple way to reduce the sequence of returns risk. (2) Do not get married with a SIP. Invest manually on your own. It will take 30 seconds of your time. This will get you into portfolio management mode. You can invest or less each month as per the set schedule or change mid-way.

Hang on, we just tried on return sequence. Let us try some more. In the second part of this post, I will post the results of tens of hundreds of sequences. The following graphs are for food for thought. Please note that in the decreasing equity method, the un-rebalanced graph is not of much use. So, focus on the green dots alone.

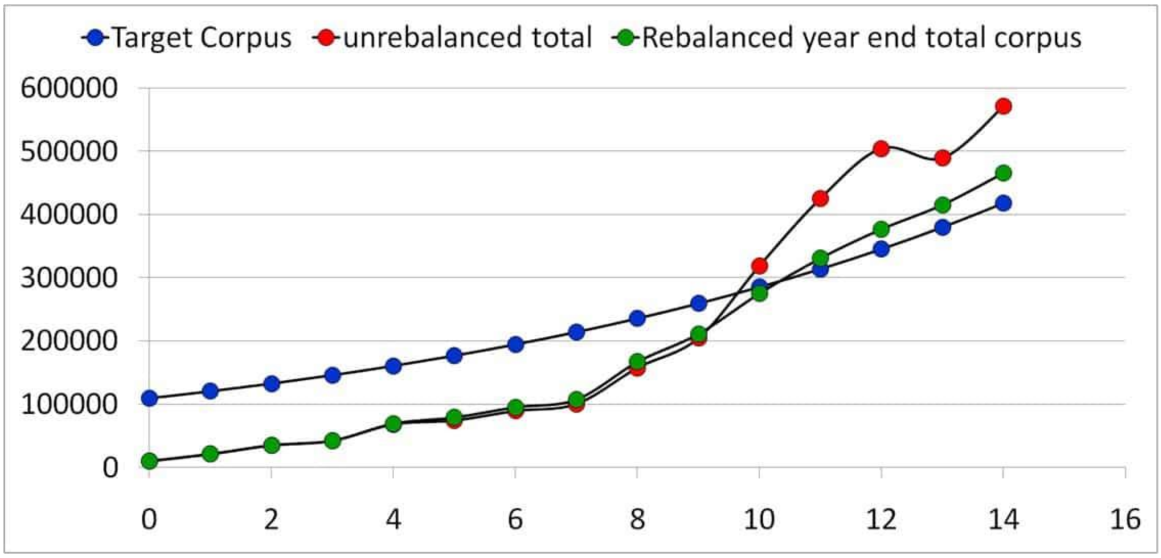
# Portfolio Risk reduction for Return sequence 2 (RS2)

60%, 4%, -1%, 10%, -20%, 40%, -19%, -3%, -15%, 81%, 29%, 77%, 38%, 17%, -13%, 16%

### RS2: Constant Equity method



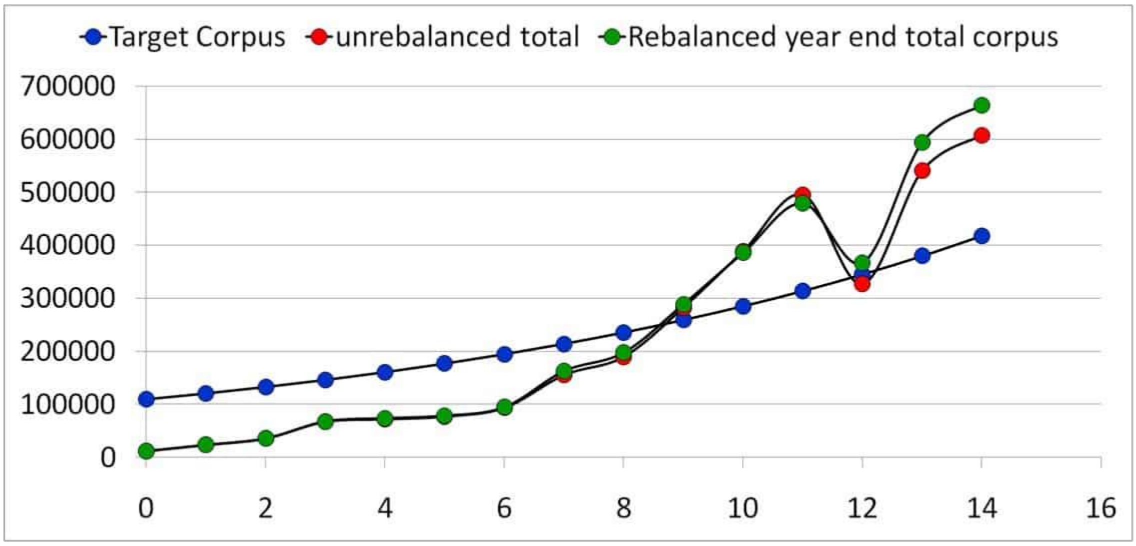

### RS2: Decreasing Equity method



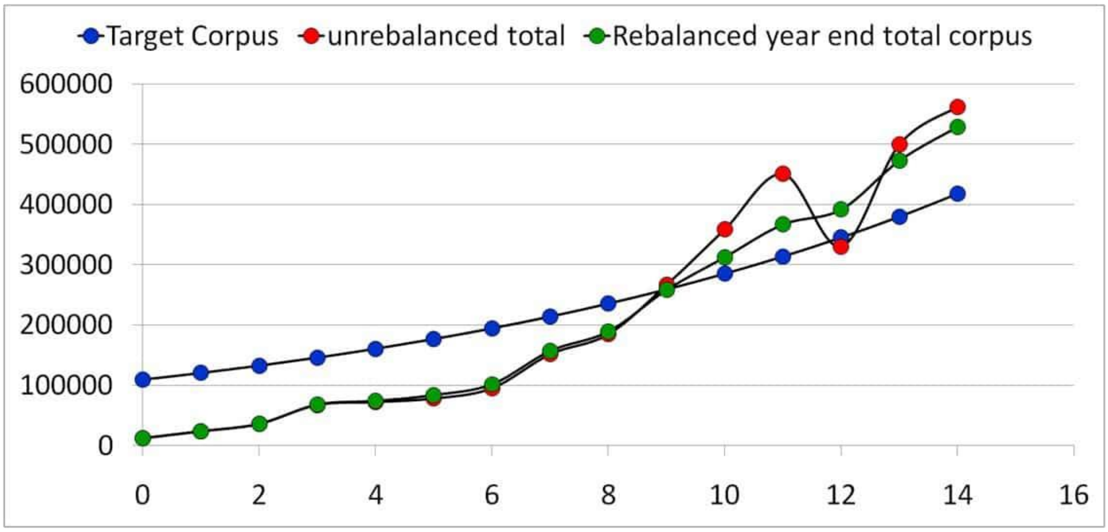

# Portfolio Risk reduction for Return sequence 3 (RS3)

15%, -3%, -3%, 63%, -19%, -22%, -2%, 76%, 13%, 53%, 39%, 26%, -49%, 84%, 8%

### RS3: Constant Equity method



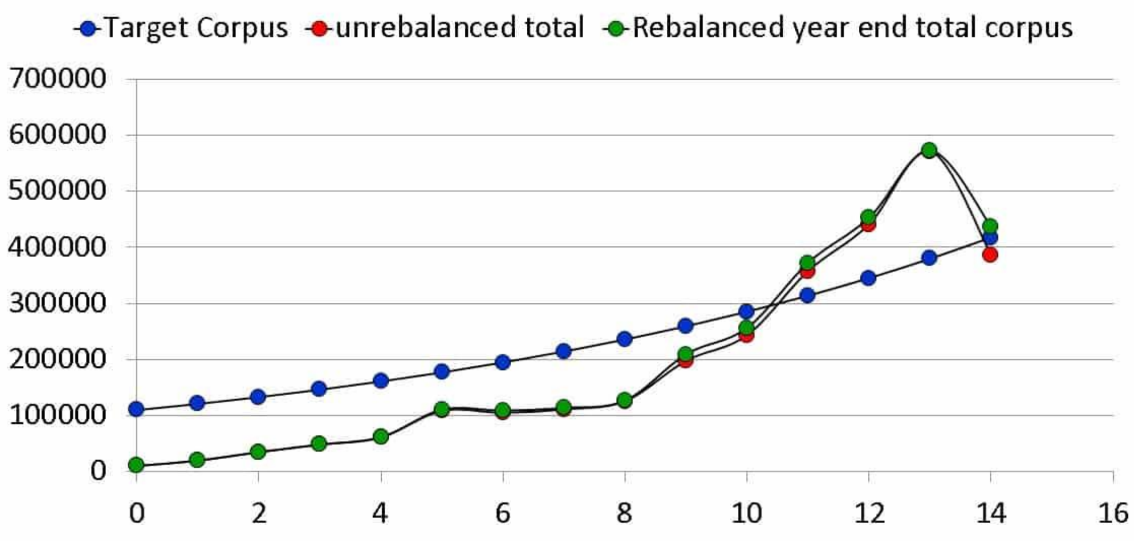

### RS3: Decreasing Equity method



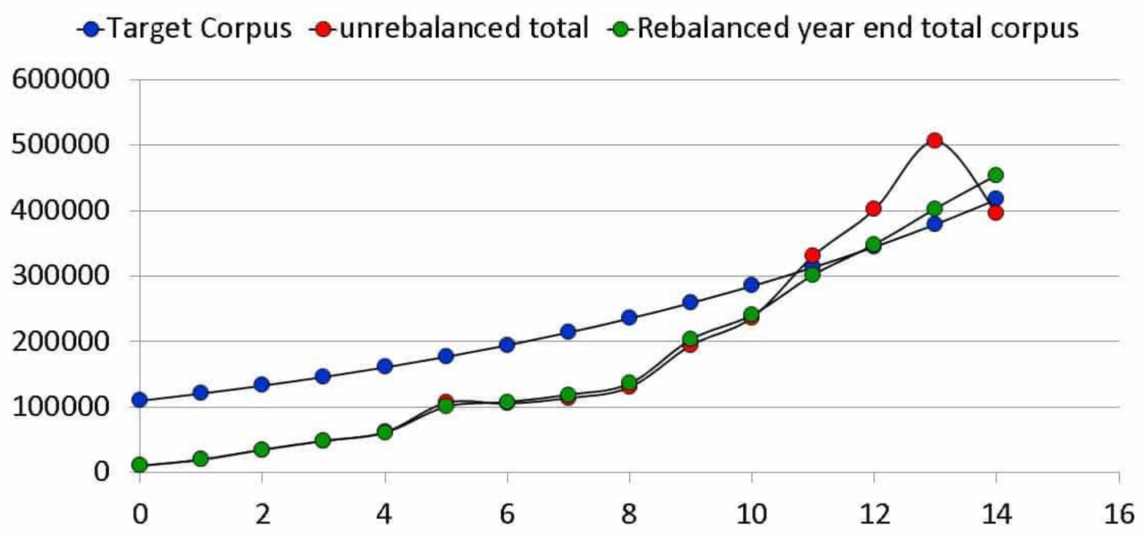

# Portfolio Risk reduction for Return sequence 4 (RS4)

-14%; -19%; 13%; -2%; -5%; 75%; -26%; -19%; -8%; 72%; 17%; 54%; 21%; 30%; -49%

### RS4: Constant Equity method



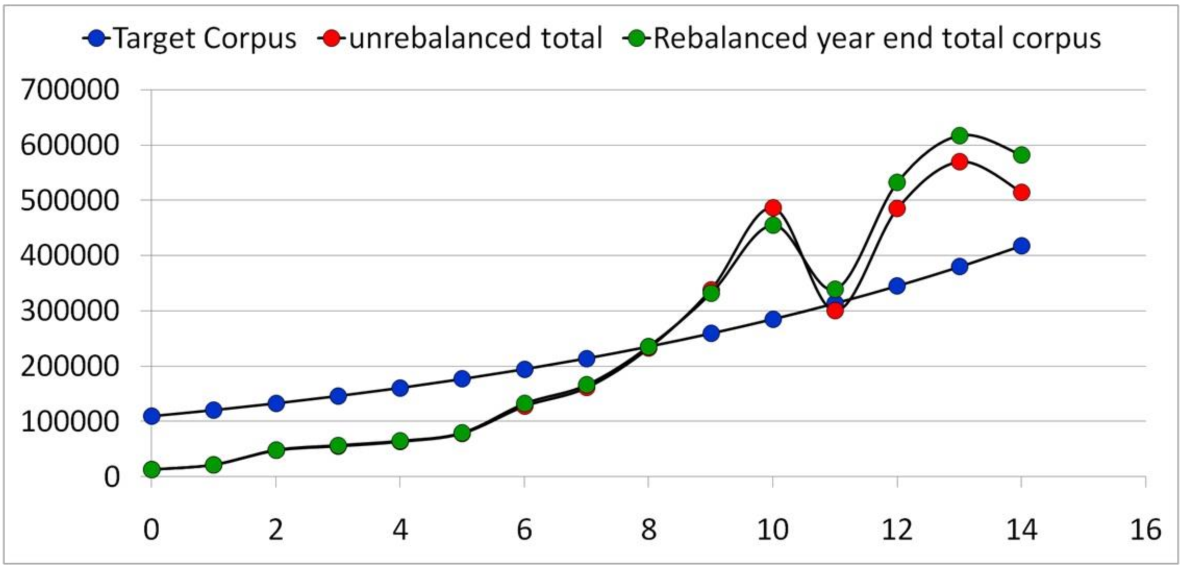

### RS4: Decreasing Equity method



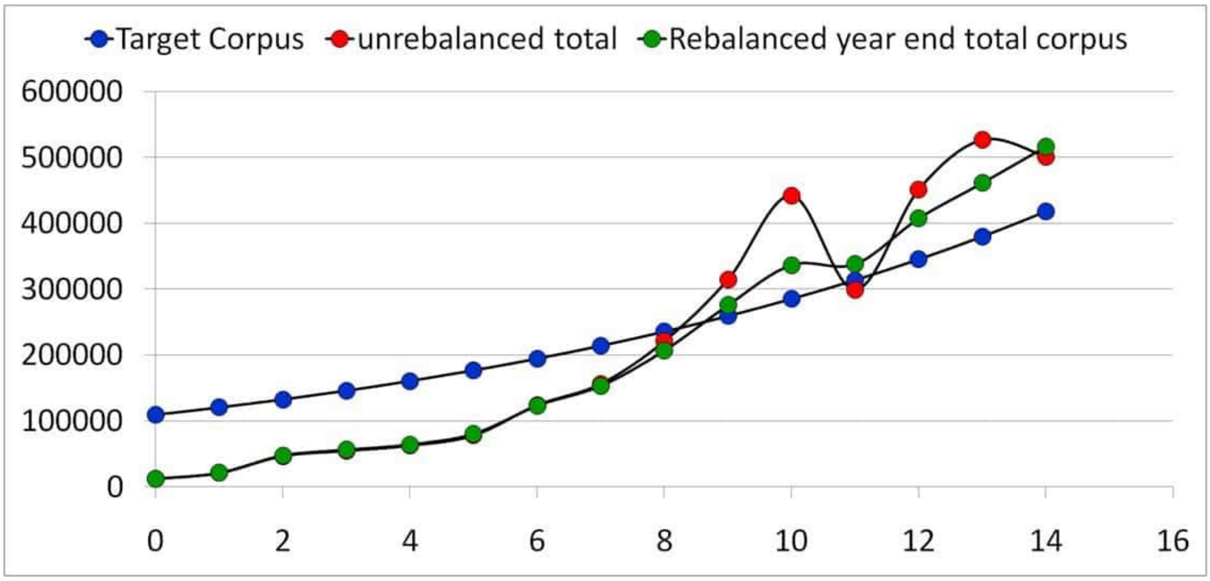

# Portfolio Risk reduction for Return sequence 5 (RS5)

24%; -21%; 68%; -16%; -17%; -3%; 63%; 16%; 45%; 48%; 46%; -52%; 76%; 15%; -20%

### RS5: Constant Equity method




### RS5: Decreasing Equity method

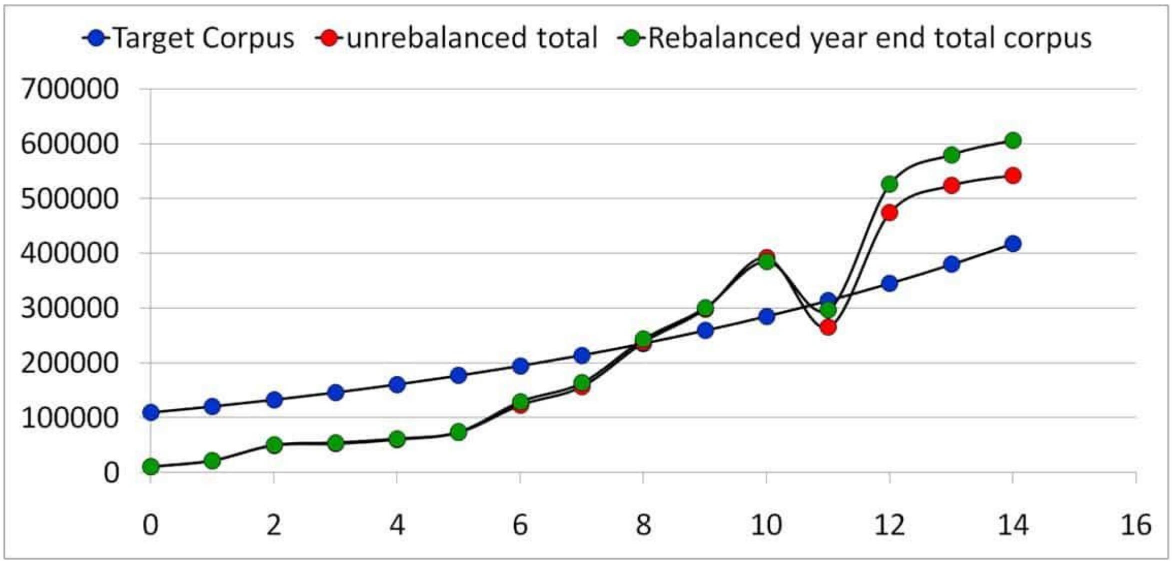



# Portfolio Risk reduction for Return sequence 6 (RS6)

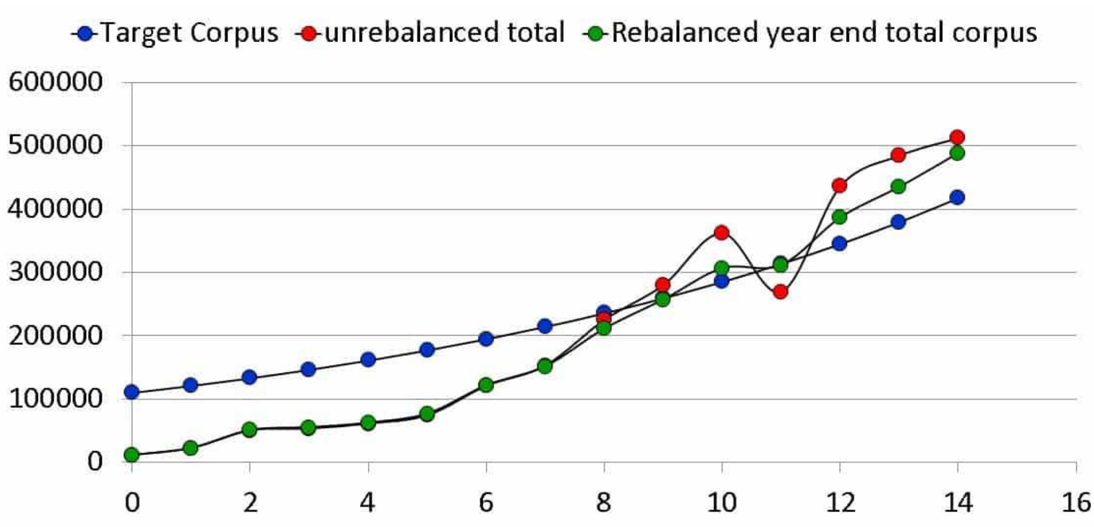
0%; -5%; 75%; -26%; -19%; -8%; 72%; 17%; 54%; 21%; 30%; -49%

106%; 6%; -3%

### RS6: Constant Equity method



**RS6: Decreasing Equity method**




# Impressions

For the six different Sensex return sequences considered, the decreasing equity method + annual rebalancing works even if the return after the first 5-6 years is negative! This means, you need to take the decreasing equity contribution into the investment amount calculation *from day one*. The robo advisory template does this for you. The question is, are there any sequence of returns in the past where it has failed? We will consider that in the second part.

Over the course of this summer, I will gradually expand this analysis to early retirement portfolio as well.

## Re-Assemble: recap of all the steps

**Step 1:** Listing your goals dreams and nightmares

**Step 2:** Lay the Foundations to Get Rich creating an emergency fund

**Step 3:** How to buy Term Life Insurance

**Step 4:** How to choose a suitable health insurance policy

* Apollo Munich Optima Restore Benefit vs Max Bupa Re-fill Benefit

* Star Health Comprehensive Insurance vs Religare Care Comprehensive Insurance

* Building a health insurance comparison chart + Cigna TTK vs Royal Sundaram Health Policies

* How to buy a Super Top-up Health Insurance policy

* How I selected a health insurance policy

* Why we all need a corpus for medical expenses and how to build it

**Step 5:** How to select a credit card for maximum benefit

**Step 6:** How to track monthly expenses and manage them efficiently

**Step 7:** How to close your loans and live debt-free

**Step 8:** How to buy a personal accident insurance policy

**Step 9:** Are you ready to let go and let your money grow?

**Step 10:** Investment planning case study 1: How to create an investment plan

**Step 11:** Case study 2: Retirement planning for 27-year old Amar

**Step 12:** Three Key Factors that decide how we achieve our financial goals

**Step 13:** How to start investing in equity?

**Step 14:** What should be my first mutual fund?

**Step 15** (not part of this e-book) *:

(old) How to select an equity mutual fund in 30 minutes!

(New) How to select mutual funds after the SEBI categorization rules

**Step 16:** How to buy a house with a home loan: Tips to maximize benefits

**Step 17:** How to reduce risk in an investment portfolio

**Note:** * Mutual fund selection has become bit difficult after a reshuffle of fund categories by SEBI. Hence, I have decided to leave out step 15 from this compilation. Young Earners and beginners may instead choose from my hand-picked mutual fund list: PlumbLine