

RupeeCamp Reading Material

RupeeCamp

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IMC, Churchgate,



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An old joke among Science students which says that Money(Wealth) is inversely proportional to knowledge.

Here's the proof: If ΔW is the amount of work performed during a period of time of duration Δt , the Power P over that period is given by the formula

$P = \Delta W/\Delta t$. In other words Power is inversely proportional to time. It means that as time increases, power decreases or as power increases, time decreases (for the same work done, of course)

Now, they say that **Knowledge is Power** and **Time is Money**. So replacing P with Knowledge and t with Money, we see that Knowledge is inversely proportional to Money. **QED!**

Now this post is in a lighter vein. However our belief system does make an impact on how we manage our money. Are you aware of your money belief systems?

Funny but fact: Bombay Dalal Street is the only place where people come in a BMW to take advice on how to make more money.....from those who come in local trains

Stop Your Brain To Take Quick Investment Decisions

That's what the book, Your Money & Your Brain by Jason Zweig says! Zweig simply points out that making investment decisions is one area where intuition and snap judgments simply don't work and where our first reaction is usually the wrong one.

[Read the review of the book here.](#) Excerpts:

Zweig's basic premise is that our the function of our brains evolved to serve early humans in their quest to survive in a sometimes hostile world. While few can argue that humans have succeeded in dominating the planet, our brains haven't quite kept pace. We still react to investment news and make decisions with the same mental firmware that allowed our forebears to avoid getting eaten by large carnivores, and that often leads us to poor investment choices.

Zweig points out the foibles of our investing brains, which are programmed to find patterns in the world around us. That may be good for coping with the natural world, but it is less useful for investing. For one, we leap to conclusions. If something happens twice in a row, we automatically project a third occurrence. We do this automatically and unconsciously.

Our "prediction" circuits are driven by the release of dopamine, a powerful brain chemical related to pleasure and rewards. This is one reason why people are drawn to stocks that keep going up; unfortunately, this neural extrapolation is usually setting us up for a fall.

The Yaksha Story

In Mahabharata, the great Indian epic, there's a story of a Yaksha asking some intriguing questions

to Yudhisthira. The story goes like this....

One day while living in exile in the forest, Yudhisthira finds that while attempting to drink water from a lake, all his brothers have been killed by a mysterious Yaksha (a celestial entity). When Yudhisthira arrives the Yaksha challenges him to answer all his questions or else face the same consequences as his brothers.

One of the questions was ***what is the most wonderful/surprising thing in the world?***

Yudishthira answers that the most amazing thing is that even though every day one sees countless living entities getting old and/or dying but no one can imagine him/herself getting old and/or taking that last journey!

I guess that's why even though Insurance is an important financial product, people have a natural tendency to avoid it. Infact most of us cite the agents nesting and tax issues for taking insurance!

7 Deadly sins of Personal Finance

Financial planning is a critical necessity for each one of us who seeks financial control of our affairs and wish to create wealth. Then why is it that most of us do not have a Financial Plan or have not even given a thought to it?

Why is it that we keep trudging along and feel that all will become right one day? Why is it that we always think of how to earn more but hardly give a thought to what our earned money is earning for us? Most of us have not even thought of having a dual income stream – one from our work and the other from our investments.

Whether we accept or not, each day or each time we think about creating wealth we are imprisoned by what I call - the seven deadly sins.

Pride: Caused by excessive belief in one's own abilities, Pride happens because in school we were taught to believe in ourselves. But that belief was with knowledge. This sin is committed when we believe in ourselves and choose to act without adequate knowledge. All we want to have is only some idea of what is the best investment. And believing it to be the best for us, we commit that sin forever under the pretext of "I know how this works."

Envy: You've just seen someone make a killing. And you think, that is reason enough for you to take the plunge as well! But then what if you have taken the plunge at the wrong time. We all know the old age wisdom, "Do not break your own hut by seeing someone else's palace." Then why is it that we change our asset allocation and bet on something that has worked for another?

Gluttony: Have you incurred credit card debt? Well...in that case know for sure that you are

committing a sin each day. Have you taken a loan for a depreciating asset? Now that's an example of financial gluttony. But then, if you're able to manage the installments of that depreciating asset from your investment returns you're a smarty.

Lust: Whatever you do you are driven by money only. And if you're prepared to move from one job to another for a 20 per cent rise without considering the credentials of the company and the nature of job, you're far from being smart. What if you've just missed on the stock options there. Besides you could have always had the opportunity to create a niche for yourself no matter how large the organization.

Anger: This is widely seen when you are dealing with an agent to who comes to make a sales call and objects to your knowledge or when your broker did not sell when the markets were falling. In both the cases, you were to take the decision. You recall that with anger and/or arrogance you commanded that nothing be done without your consent. Know that in financial management there are two choices – either you take all decisions yourself or let your advisor take that for you. Of course given that you trust his skills and knowledge.

Greed: I hardly need to say anything here. Most people rush to invest in the stock markets when they touch an all time high. Others think markets will go up forever. Surely you cannot time the market but when the goal is achieved why not sell? After all, that's precisely the reason why you invested in the first place. Now if there is no goal and no plan to manage that goal, it is quite likely that this sin will keep revisiting you from time to time.

Sloth: This is the one that I love to talk about. The bible says, "Whatever we do in life requires effort" so if we wish to ask for tips and then act, it is a sure way to disaster. Either we must take effort to do all the hard work ourselves or take the effort to search for a trusted advisor and outsource our efforts. Finding a trusted, knowledgeable and skilled advisor is not a very easy task to do.

Sins that were spoken of centuries ago are still so relevant. Needless to say, it is up to us how much we wish to cleanse ourselves from them!

Cognitive Biases & Mental Heuristics

Doing a PhD in Financial Markets wouldn't make you a successful investor. You also need to overcome your fears and greed to make balanced, rational decisions as against emotional decisions.

Here's some excerpts from a study done by [CFEB](#)

The study demonstrated that the classic economic laws of rationality do not lie at the heart of

human decision making.

Our behaviour is not guided by a kind of super-computer that can analyze the cost and benefits of every action and determine maximum wellbeing. Instead, it is led by our adaptable, sociable, emotional, instinctive brain which uses mental heuristics – ‘rules of thumb’ – to deal with the myriad choices we face.

Generally these serve us very well, but they can sometimes lead to misperceptions and misjudgements. So the mental shortcuts that enable us to cope with a complex world can sometimes get us into trouble, both as individuals and collectively.

Two processes operate in the brain. One is reflective (controlled, effortful, deductive, slow and self-aware), and the other is automatic (uncontrolled, effortless, emotional, fast and unconscious).

In real life, the distinction is not so clear-cut: a dynamic mix of both reflective and automatic processes generally governs our behaviour. When driving a car, for example, we can focus on the radio and apparently drive on autopilot. Our reflective system is ignoring everything but the radio, but our automatic system is not because if we hear the sound of a horn we break off from listening to the radio and focus all our attention to the situation on the road.

Two general models for population-wide behaviour change have emerged in recent years:

1. Interventions that aim to change behaviour by providing information, education and tangible incentives; and
2. Interventions that change behaviour by changing the environment within which the person acts.

Read this interesting [post on how our brains work](#). Excerpts

It seems that our conscious and unconscious brain creates a comfortable set point where we operate. And no matter how hard we might try to logically create a new goal (or set point) or how hard we work at tasks, our brain is on autopilot.

Brains are pattern and predicting machines. Old patterns yield predictable results and predictable results are safe. It seems that our brains are still trying to protect us from being eaten by a mastodon. While that may no longer be true; the fear or anxiety of entering a new market or presenting to the HUGE new client is the same.

The ONLY way that you can re-set your brain to think and act towards achieving a new goal (or set point) is to re-train, re-wire and re-program new information into your sub-conscious. In other words, you have to program these new circumstances into your brain so that they become old and familiar – instead of new and scary. And this is where meditations and the affirmations come in.

[Andrea Zvinakis](#), (on Quora)

- **Self-Serving Attributions:** Explanations for one's successes that credit internal, dispositional factors and explanations for one's failures that blame external, situational factors.
- **Ultimate Attribution Error:** The tendency to make dispositional attributions about an entire group of people.
- **In-group bias:** The tendency to reserve positive feelings and special treatment to people we have defined as being part of our in-group (the group with which a person identifies and of which he or she feels a member), and negative feelings and unfair treatment to people we have defined as being part of our out-group (groups which an individual does not identify with).
- **Out-group homogeneity bias:** The perception that those in the out-group are more similar (homogenous) to each other than they really are, as well as more similar than the members of the in-group are (i.e., the belief that "they're all alike").
- **Illusory Correlation:** The tendency to see relationships, or correlations, between events that are actually unrelated, this is one way stereotypes form and endure.
- **False Consensus Effect:** The tendency for people to overestimate the extent to which others agree with them.
- **Representativeness Heuristic:** The tendency for people to use similarity or representativeness as a proxy for probabilistic thinking; this can lead to **base-rate neglect**, the tendency for people to insufficiently take into account the overall frequency (base rate) of an event in a population.
- **Hindsight Bias:** The tendency for people to exaggerate how much they could have predicted an outcome after knowing that it occurred.
- **Projection Bias:** The tendency for people to exaggerate the degree to which their future tastes will resemble their current tastes.
- **Conjunction Fallacy:** The tendency to assume that specific conditions are more probable than general ones.
- **Gambler's Fallacy:** The false belief that in a sequence of independent draws from a distribution, an outcome that has not occurred for a while is more likely to come up on the next draw.
- **Hot-Hand Fallacy:** The false or exaggerated belief that a person's performance varies systematically over the short run.
- **Availability Heuristic:** The tendency for people to assess the frequency of a class or the probability of an event by the ease with which instances or occurrences can be brought to mind.

- **Anchoring and Adjustment Heuristic:** The tendency for people to answer a question by starting at some first-pass guess based on memory or the environment, and adjust that guess until they are satisfied with the answer.
- **Memory Biases:** The **serial position effect** refers to the finding that recall accuracy varies as a function of an item's position within a study list.
- **Primacy Effect:** the tendency to weigh initial events more than subsequent events. People tend to recall items that were at the beginning of a list rather than items that were in the middle of a list.
- **Recency Effect:** the tendency to weigh recent events more than earlier events. People tend to recall items that were at the end of a list rather than items that were in the middle of a list.

[Guy Kawasaki tried an experiment](#) where he placed two rubbish cans next to each other. One had no cover, so people could throw anything into it. The other had a cover with a six-inch round hole—the perfect size to drop cans and bottles. There were no oral or written requests to segregate and recycle the trash.

Kawasaki was amazed by the results of the experiment: the trash can with the round hole was filled with bottles and cans. There wasn't anything other than bottles and cans in it. There were a mere five beer bottles in the whole thing.

Kawasaki thinks that this illustrates how you can change behavior if **you create paths or flows of the smoothest kind**. Would you agree?

I think you can teach behavior when you make it simple. We overcomplicate so many things in the workplace. It also shows that people will do the right thing when you make it easy to do so.

Persuasive technologies can bring about positive changes in many domains, including health, business, safety, and education. Stanford Persuasive Tech Lab believes in that. Welcome to the [world of Captology](#).

It's an awesome resource and here's just one example.

[Top 10 Mistakes in Behavior Change](#)

Playing with Numbers

Personal Finance is about income, expenses, savings and investments and moving them forward/backward in time. Let me explain.

You maximize your income and optimize your expenses in the present time to plan for your retirement expenses in the future. You make efforts to maximize your savings and investments of

the present time to plan for your future goals.

What we just discussed can be represented in a personal finance equation, which is:

$\text{Income}(t) - \text{Expenses}(t) = \text{Savings}(t) + \text{Investments}(t)$ where time t signifies moving money, or purchasing power, forward in time.

Much of financial planning is based on mathematics. But fortunately the mathematics is not really complicated. You probably learned the basic principles in School.

It is practically all based on the idea that principal multiplied by interest rate over time equals interest earned. **Interest = Principal \times Interest Rate \times Time.**

Mathematical reasoning is necessary all through life, while also **affecting decisions we make in personal finance.** So it is a good idea to understand/visit the basic principles of maths that you need to understand to manage your financial planning. And these concepts can help you with all your financial decisions like retirement planning, planning for your investments and calculating the returns.

We will cover a lot more questions. Like,

1. How to find a Future Value using a Present Value over a period of Time and an Interest Rate when there are No Payments
2. How to find a Future Value using a Present Value over a period of Time and an Interest Rate when there are Payments
3. How to calculate the Payment required to Accumulate a Given Amount over a Given Time period
4. Calculation of Interest to Deplete a Given Amount, or Pay Off a Loan
5. Time required to Deplete a Given Amount, or Pay Off a Loan

My point is that the basic principle applies to all these questions. And it's very simple.

The formulas are programmed into most financial calculators and several spreadsheet functions (such as PV, FV, RATE, NPER, and PMT). You'll definitely find it very interesting to toggle with your assumptions and play around with numbers.

The Time Value of Money

Let me take a simplistic example to understand the time value of money. Imagine you have Rs 1,00,000 with you and you have the following options (inflation rate is 5%):

1. Give it to a friend who will return Rs 1,00,000 after one year.
2. Put it in a Savings account which gives you 5% annualized return.

3. Invest in a Mutual Fund/Stock which can give you a return ranging from -50% to +50%
In option 1, The present value of the Rs 1 lakh that you get after one year is actually $(1-5/100)$
(1,00,000) = Rs 95, 000. Do you realize that you have actually lost money?

In option 2, the money grows by 5% to Rs 1,05,000 but once you factor the inflation (5%), you are back to the square one. Better to spend the money today rather than wait for one year.

In option 3 , your future value can be **higher or lower** than the present value.

All of the standard calculations for time value of money derive from the most basic algebraic expression for the present value of a future sum, "discounted" to the present by an amount equal to the time value of money.

For example, a sum of FV to be received in one year is discounted (at the rate of interest r) to give a sum of PV at present: $PV = FV - r \cdot PV = FV/(1+r)$.

Some standard calculations based on the time value of money are:

1. **Present value:** The current worth of a future sum of money or stream of cash flows given a specified rate of return. Future cash flows are discounted at the discount rate, and the higher the discount rate, the lower the present value of the future cash flows. Determining the appropriate discount rate is the key to properly valuing future cash flows, whether they be earnings or obligations.
2. **Present value of an annuity:** An annuity is a series of equal payments or receipts that occur at evenly spaced intervals. Leases and rental payments are examples. The payments or receipts occur at the end of each period for an ordinary annuity while they occur at the beginning of each period for an annuity due.
3. **Present value of a perpetuity:** is an infinite and constant stream of identical cash flows.
4. **Future value** is the value of an asset or cash at a specified date in the future that is equivalent in value to a specified sum today.
5. **Future value of an annuity (FVA)** is the future value of a stream of payments (annuity), assuming the payments are invested at a given rate of interest.

The Magic of Compounding

If we could appreciate the "Magic of Compounding" we would understand the benefits of starting early and discipline!

Let us explain the power of compounding with the famous story of the Persian emperor who was so enchanted with a new 'chess' game that he wanted to fulfill any wish the inventor of the game had. This inventor, a mathematician, decided to ask for one seed of grain on the first square of the chessboard doubling the amounts on each of the following squares. The emperor, at first happy about such modesty, was soon to discover that the total yield of his entire empire would not be sufficient to fulfill the 'modest' wish.

The amount needed on the 64th square of the chessboard equals 440 times the yield of grain of the entire planet. Just try converting into money in any currency and you will realize the importance of compounding.

The key step in using compound interest is to actually start saving. You don't have to save a lot – just save what you can. Compound interest will do the rest of the work for you.

Compound interest is so fascinating that Albert Einstein referred to it as "magic" and called it "The most powerful force in the universe." Remember, this was a guy who knew a thing or two about forces in the universe.

Rupee Cost Averaging

Sameer is a common investor. He wants to invest in the stock market, but is worried that the market will fall after he invests as the market has run up too much too fast. But at the same time he is worried that the market may continue to rise without a meaningful deep correction as it has been doing so since the last 2-3 months and he might miss the rally and the potential gains that he would make with it. Sameer is in a dilemma whether he should jump into the market immediately at the current level or continue waiting for the correction which refuses to come.

In short here Sameer is trying to time the market which lot of common investors try to do. Many a times common investors get it wrong when they try to time their market entry and have burnt their fingers due to the market fall post their investment. Or many a times many investors have been left on the sidelines watching the markets go up, waiting for the correction endlessly which never comes through when required.

Concept of Rupee Cost Averaging

The simple solution to the problems of people like Sameer is Rupee Cost Averaging. It is very difficult for a common man to predict the day to day movement of the stock markets. Hence it is

best to start investing on a staggered basis by making regular monthly investments. This helps the investor to spread out his investments evenly over a period of time. This process of making regular monthly investments over a period of time at various market levels is known as **Rupee Cost Averaging**.

It is not always possible for an investor to buy at the lowest point and sell at the highest point. Rupee cost averaging helps the investor to reduce this risk of timing the market to a great extent. For example Sameer can decide to make a regular monthly investment of Rs 100 in a mutual fund through a SIP.

Month 1: If in the first month the NAV is Rs 10 Sameer will be able to buy 10 units. So in the first month the average acquisition price is Rs 10 per unit.

Month 2: If in the second month the NAV rises to Rs 12 Sameer will be able to buy 8.33 units as compared to 10 units that he was able to buy in the previous month. At the end of the 2nd month the average acquisition price of the 20 units bought so far is Rs 10.91 per unit.

Month 3: If in the 3rd month the NAV falls to Rs 7 Sameer will be able to buy 14.2 units as compared to 8.33 units in the previous month. At the end of the 3rd month Sameer's average acquisition price of the 30 units bought so far is Rs 9.22 per unit whereas the actual average NAV for the 3 months is $\frac{10+12+7}{3} = \text{Rs } 9.66$. Had Sameer invested the entire Rs 300 in the 1st month itself, he would have been able to buy 30 units of the mutual fund. But by investing Rs 100 every month in a staggered manner, Sameer has been able to buy 32.53 units. So due to rupee cost averaging he has 2.53 extra units in his account. But one needs to remember that if the NAV keeps going up continuously over the period of 3 months then Sameer would have been able to buy less than 30 units. So if the market keeps rising continuously then lumpsum investment gives more returns than staggered investments.

But markets being volatile by nature no one can predict the direction of markets and hence its better to play safe by investment through systematic investment plans (SIP).

So in the 3 months the NAV of the mutual fund has fluctuated between a low of Rs 7 and a high of Rs 12. In the 3 months Sameer has been able to buy at an average price of Rs 9.22 per unit despite the fluctuation in the NAV of the mutual fund.

Rupee Cost Averaging helps the investor to buy more units of the mutual fund when the NAV is low and buy less units of the mutual fund when the NAV is high. But eventually the price gets averaged out over the long term. Thus rupee cost averaging helps in lowering the average acquisition price of the units but for this to happen the investor has to be disciplined enough to invest on a regular basis.

Benefits of Rupee Cost Averaging

From the above discussion, in short the benefits of rupee cost averaging can be summarized as follows:

- Inculcates the habit of regular disciplined investing
- Helps to ride out market volatility
- Protects the investor from incurring huge losses when the market falls drastically by averaging the purchase price at lower levels.
- Rupee cost averaging works at the time of buying securities as well as at the time of selling the securities.
- It frees the investor from the tension of trying to time the market or predicting the direction of the market and hence the problem of buying low and selling high.
- It helps the investor to buy more units when the market is down and buy fewer units when the market is high.

Scenario Based Example

Let us take the example of an investor, Sunny decides to invest Rs 100 every month in a SIP for 12 months. When Sunny starts the investment the NAV is Rs 10 and he gets 10 units. During the course of the year the NAV keeps moving up and down. So Sunny also keeps getting units worth Rs 100 as per the movement in the NAV price.

Month	Monthly Amount Invested	NAV (Price Per Unit)	Units Bought
1	100	10	10.00
2	100	10.5	9.52
3	100	12	8.33
4	100	11	9.09
5	100	9.8	10.20
6	100	9	11.11

7	100	8.7	11.49
8	100	9.5	10.53
9	100	10.2	9.80
10	100	11	9.09
11	100	12.3	8.13
12	100	13.2	7.58
Total	1200		114.88
Total Amount Invested	1200		
Actual Average NAV	10.60		
Average NAV for Sunny	10.44		

We can see from the table, Sunny invests Rs 1200 in the entire year and he gets 114.88 units for it. Sunny's average cost per unit is Rs 10.44 whereas the actual average NAV is Rs 10.60.

Asset Allocation

Academic studies have pointed out that replacing active choices with simple asset classes worked just as well as, if not even better than, professional pension managers. Also, a small number of asset classes was sufficient for financial planning. Financial advisors often pointed to this study to support the idea that asset allocation is more important than all other concerns, which the study lumped together as "market timing".

Let's begin with a few snapshot data. In 2000, the Sensex gave you a -26.1% return, Gold -3.33% while Debt Funds gave a +10.19% growth. But in 2006, it was +46.7 for Sensex, +5.28% for Debts and 35.0% for Gold.

And nobody knows for sure what 2009 or 2014 or 2020 will give returns on the three asset class. If the papers tell you that Debt funds are doing well and you take out your equity investments and put them into Debt, chances are that the equity is back to performing well and the debt funds nosedive.

Debt and Equity

Before we talk about asset allocation and selecting financial products, we also need to understand the difference between the two broad classification of financial products: Debt and Equity.

The basic difference between debt and equity would be the ownership level. Let's take an example where you invest in me.

If you give out some money to me and expect that I return the money along with interest that I pre promise, that would be a **debt investment**. I'm indebted to you but since I have promised you a return with interest, you don't actually own me.

In another case, you give me money at your own risk. But you trust me/hope that I'll be a billionaire in the future and I'll payback from my profits. The more profits I make, the more you do. If I am bankrupt, you don't get anything back. And so you have invested in my **equity**. By trusting me, you own me in a way!

In other words, by investing in a debt instrument such as a bond, you are guaranteed the principal of the bond, plus any interest that is owing.

However, for equity investors, you become an owner. As such, you also take on the risk of the company not being a success. Just as a small business owner has no guarantee of success with each new venture, neither is a shareholder. As a shareholder, if the company is successful, you stand to make a lot of money. On the flipside, you stand to lose a lot of money if the company is less than successful.

Now debt and equity is just a classification of financial products and not a product by itself. So let me share the products available within the two classifications:

Equity: You can own any stock on the Stock Exchanges and you have invested in an equity product. If you invest through Mutual Funds who have schemes for equity. Even ULIPs invest in equity and so part of your Insurance buy goes to equity. The NPS also invests in equity.

Shares come in different sizes and categories. There are large, mid and small caps and there are penny stocks. As a beginner, you can invest in large and mid cap companies and only after you gain experience, you can consider investing a small portion in small caps and hot penny stocks. These are the riskiest but if handled adroitly, give the largest returns. However, it needs expertise and nerves of steel.

Debt: Mutual Funds also have debt funds where you can invest. Some people may find investing in bonds simpler than investing in stocks. Your friendly neighbourhood financial advisor can provide you with government bonds like NSC/KVP. Your banker provides you with Fixed Deposits and PPF



accounts. You can also pick up some highly rated corporate bonds. Then there are hybrid funds where the Mutual Funds invest a part in equity and a part in debt. To compare debt and equity, you need to consider the risk and the reward tradeoff. But that I guess would be another post.

However, this understanding of debt and equity can help you understand the [Hare and Tortoise story](#) in a better way, where the debt products are tortoise and equity products are hares!

Financial Planning

Opportunity Cost for a 30 Year Old Delaying his Financial Plan				
S. No	Financial Goal	Without a Financial Plan	With a Financial Plan	Opportunity Cost
1	Retirement Corpus of Rs. 4.25 Crores by Age 60	Rs. 15,800 SIP p.m. if investments starts after 5 years	Rs. 7,700 SIP p.m. if investments start immediately	Rs. 20 Lakhs is the additional outflows for delaying savings
2	Funds of Rs. 20 lakhs in today's value for Child's Education after 18 years	Rs. 14,000 SIP if investments in FDs/Insurance plans	Rs. 7,000 SIP pm if investments in Equity MFs/ ETFs/ Bluechip Stocks	Rs. 15 Lakhs is the additional outflows for choosing wrong asset class for long term
3	Park Rs. 4 lakhs accumulated overtime in salary/savings account	Let it lie in SB account earning miniscule 3.5%	Park in a no-brainer FD/CD earning 8%	Rs. 1.2 lakhs is the additional inflows for taking the decision to invest
4	Adequate life insurance cover to safeguard family	Buy 6 investment oriented insurance policies yielding 8% with 15 lakh cover	Buy 1 or 2 Term Insurance policies based on need and invest the rest	Rs 60 lakhs under insured even after heavy premium outgo
5	International Vacation for 2 costing 3 lakhs	Opt for Rs. 10,700 EMI Option to go immediately	Invest Rs. 8,800 p.m and go after 3 years	Rs. 70,000 is the additional outflows for instant gratification

What is a Financial plan?

Financial planning is a critical exercise in ensuring long-term financial security.

A financial plan is a road map to help you achieve your life's financial goals.

Here are three basic questions that you will answer during financial planning:

- Where are you today? What is your current financial situation?
 - Where do you want to get to? What is your vision of your future financial situation?
 - Will you be able to get there? How do you plan to achieve your vision?
- During the financial planning process you analyze what your financial needs and goals are. Then,

you quantify in money terms what resources you need to meet those goals, and quantify the time period during which you want to achieve these goals. Finally, you write an action plan on what you need to fulfill your plan in terms of what products to buy and what types of savings to make.

Can you do Financial Planning yourself?

Of course you can...but just like you won't repair your own watch or car on your own, you need to come to an expert for financial planning. Otherwise, without the right financial skills and tools for financial planning, your finances can end up as a disaster.

If you feel you can do financial planning on your own, it will be a good idea to get initiated into the process by some experienced people. You must see a financial planning specialist who can help you get started on the right path.

The Process

The personal financial planning process is a six-step process as follows:

Step 1: Setting goals with the client.

This step (that is usually performed in conjunction with Step 2) is meant to identify where the client wants to go in terms of his finances and life.

Step 2: Gathering relevant information on the client.

This would include the qualitative and quantitative aspects of the client's financial and relevant non-financial situation.

Step 3: Analyzing the information

The information gathered is analysed so that the client's situation is properly understood. This includes determining whether there are sufficient resources to reach the client's goals and what those resources are.

Step 4: Constructing a financial plan.

Based on the understanding of what the client wants in the future and his current financial status, a roadmap to the client goals is drawn to facilitate the achievements of those goals.

Step 5: Implementing the strategies in the plan.

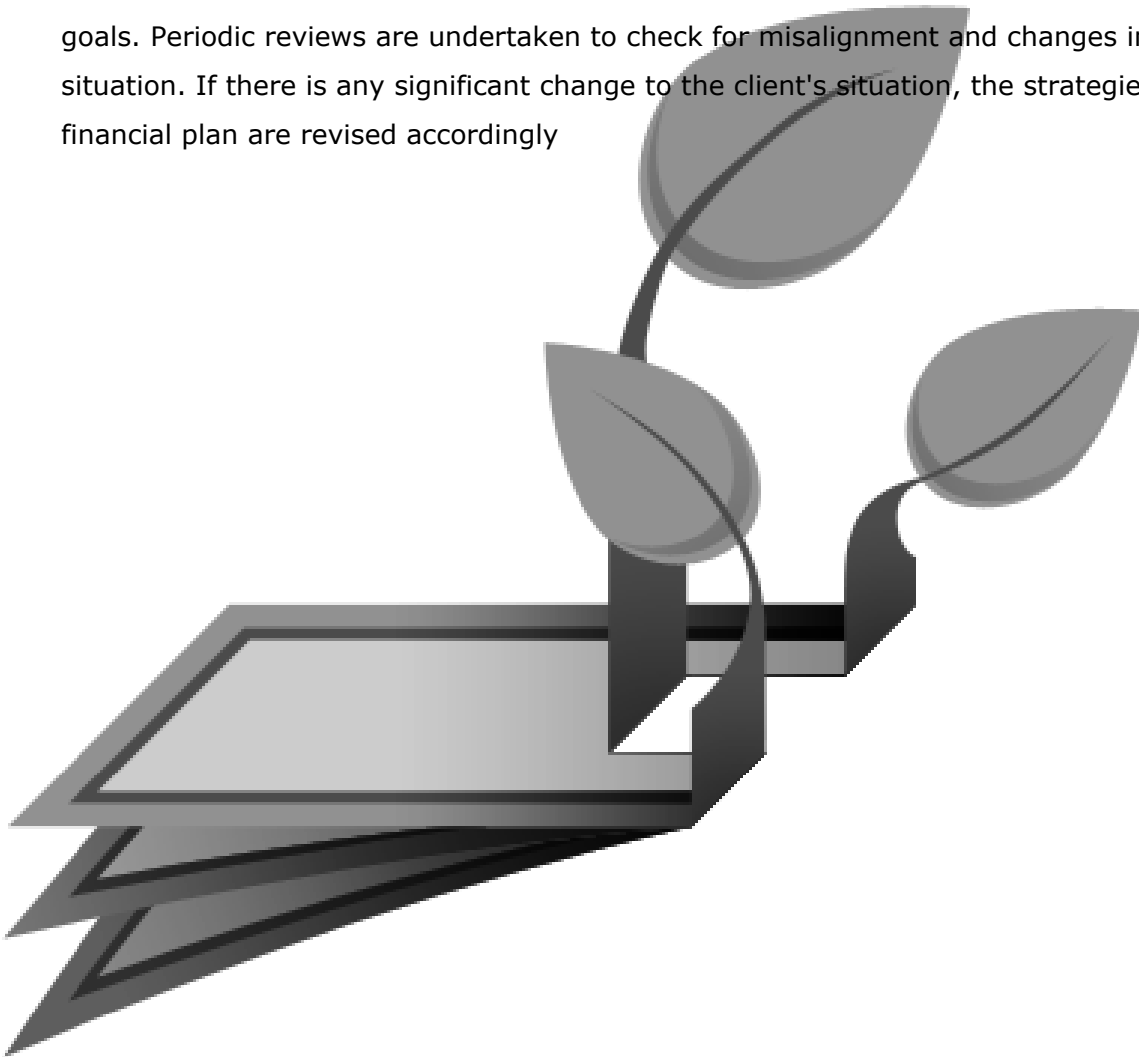
Guided by the financial plan, the strategies outlined in the plan are implemented using the resources allocated for the purpose.

Step 6: Monitoring implementation and reviewing the plan.

The implementation process is closely monitored to ensure it stays in alignment to the client's



goals. Periodic reviews are undertaken to check for misalignment and changes in the client's situation. If there is any significant change to the client's situation, the strategies and goals in the financial plan are revised accordingly



Taking Insurance Cover

"Life insurance is like a parachute, if you ever need it and don't have it, you'll never need it again."

Remember this yaksha question that we discussed in Chapter I, Psychology of Money?: What is the greatest mystery on earth? Yudhisthir answers, "Every one has to die. But no one thinks that for himself. This is the greatest mystery."

That, I feel, is the paradox that makes people avoid life insurance!

That also makes agents take the wrong line of selling Insurance as a tax saving and/or Investment product (ULIP). Indian consumers have bought life insurance for reasons of tax saving rather than the core need of providing for one's family in case of death of breadwinner.

This can be a costly mistake because in the process of buying insurance, investment and tax planning together, we don't get adequate insurance and lose out on better investments and tax efficient products. It's like travelling in 2-3 boats together, all of them going in different directions!!

Insurance is a protective measure for valuable things in your life. It is a contract (policy) in which an individual or entity receives financial protection or reimbursement against losses from an insurance company. The company pools clients' risks to make payments more affordable for the insured.

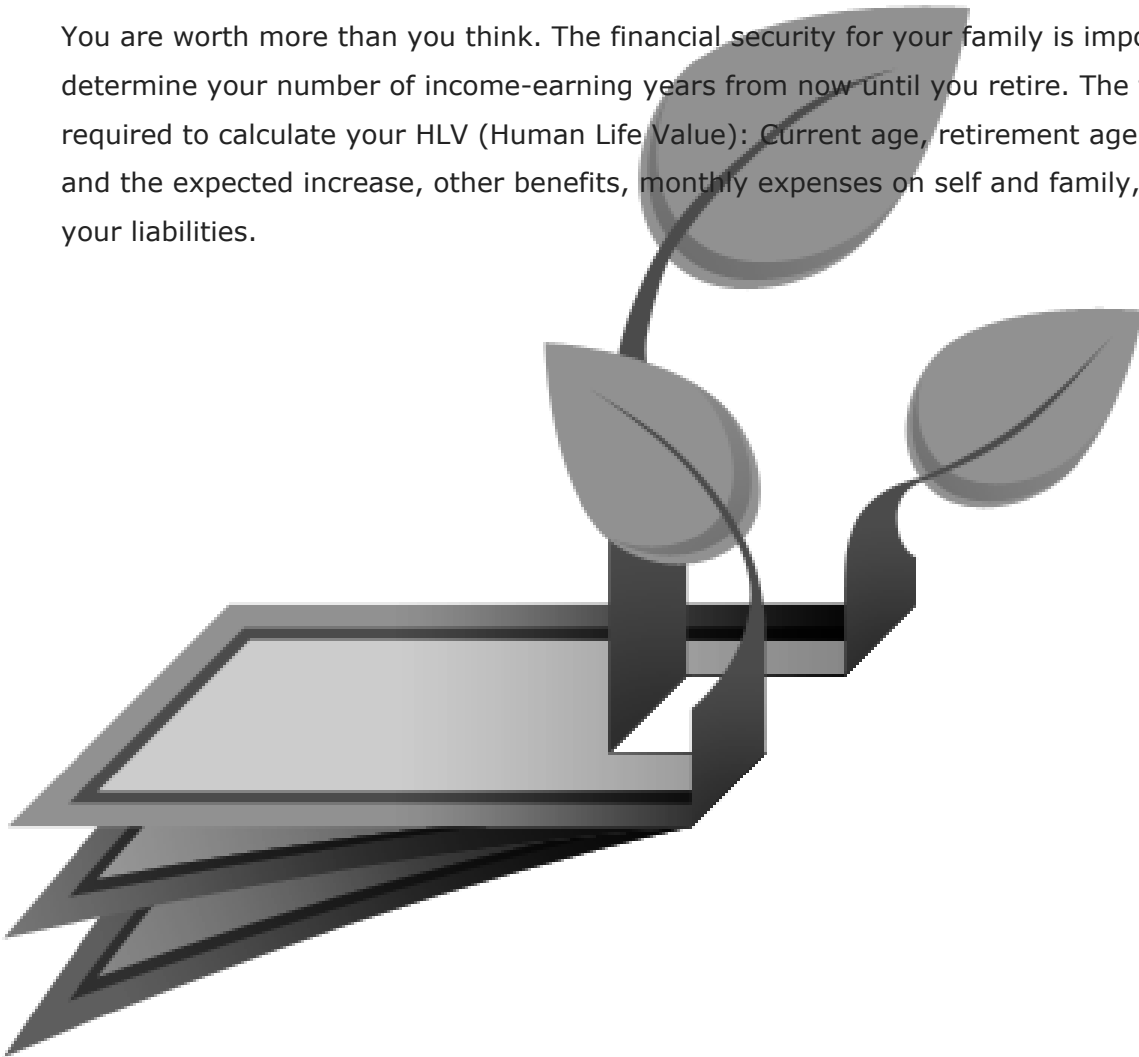
The roots of insurance might be traced to Babylonia, where traders were encouraged to assume the risks of the caravan trade through loans that were repaid (with interest) only after the goods had arrived safely. The Phoenicians and the Greeks applied a similar system to their seaborne commerce. The Romans used burial clubs as a form of life insurance, providing funeral expenses for members and later payments to the survivors.

When shopping around for an insurance policy, look for the best priced package that is right for you - prices can vary from one insurance company to the next. And make sure you know what you want. Some individuals, for example, prefer 24-hour claims service or face-to-face contact with an insurance representative. Also consider the claims settlement process, the amount of the deductible and the extent of the replacement coverage. Insurance companies and the policies they offer are not all the same, so think about more than just the price.

In a broad economic sense, insurance transfers risk from individuals to a larger group, this is better able to pay for losses.



You are worth more than you think. The financial security for your family is important. Let's determine your number of income-earning years from now until you retire. The following data is required to calculate your HLV (Human Life Value): Current age, retirement age, annual income and the expected increase, other benefits, monthly expenses on self and family, your assets and your liabilities.



Types of Insurance

Life insurance allows individuals to opt for cover through two plans namely term and endowment plans.

Term Plans

- Provide only life cover
- Pay out sum only if individual doesn't survive the term
- Required to pay an annual premium for a predetermined tenure till you encounter an eventuality
- Long term and premium stays the same during the tenor
- Lower premiums

Endowment Plans

- Pay out the sum assured under both scenarios – death and survival, as long as premiums have been paid regularly
- Good avenue for investment for those with low to medium risk appetite
- For investors seeking a combination of insurance and savings
- Downside is low and premium is higher

ULIPs

- Invest in stock/debt market (you have the option to choose allocation)
- Combination of long term savings and insurance in that order
- If objective is life cover, then term plan better than ULIP

- ULIPs have higher expenses

- Pay out the sum assured on maturity

Term Plans are the cheapest form of life insurance and are a must have for all individuals, especially at a young age. ULIPs play the role of enhancing your portfolio and bridging the gap, if any, on your life cover.

Getting Started with Insurance

Life insurance is a potent tool that not only offers the ability to plan for unforeseen events that can affect the family's financial situation adversely, but is also looked up to as an important tax saving cum investment tool.

One needs to do a certain amount of spade work before purchasing a policy, to ensure the best possible coverage at the right price. Here are some helpful tips to get you started:

Explore As premiums vary widely from company to company and cover to cover, it's important to look around. One can try internet sites to get instant quotes.

Plot your value The key to purchasing the right amount of life insurance is to have just enough coverage to meet your needs. If you have more life insurance than you need, you'll be paying unnecessarily for higher premiums. On the other hand, it's important not to have too little coverage, resulting in you being underinsured.

Health matters the most Healthy people get better rates on life insurance. Higher premiums are quoted for anything that poses a risk for longer life expectancy (smoking, on regular medication, etc). Sooner the better As premium rise with increasing age, the younger you are when you purchase life insurance, the lower premiums you will be required to pay.

Review your cover periodically Any life change indicates the need for an overall review of the financial plans. Make sure you have enough cover for all important events of life.

Focus on annual installments You may not realize it, but you may be paying more for your life insurance if you pay your premium in monthly installments. Many insurance companies charge extra fees if you make monthly premium payments instead of paying the annual premium.

Never conceal facts Though, age and negative health related conditions attract higher premium, don't think about lying on the insurance application. If your insurance company gets the knowledge of concealed facts they can terminate the cover.

Please don't buy an insurance policy from me

(Source: The Indian Express, Dated 19th october, 2006). A story worth looking at.

I had been talking to Darshan Kumar (name changed), an insurance agent for some months. One morning in June he asked me "Do you want to become an agent?" "You can earn 40 per cent of the policy premium as commission. If you sell a policy with a Rs 1 lakh premium, you earn Rs 40,000 in the first year alone," he said. When I told him that not all policies yield a commission of 40 per cent, he said he would tell me the ones that did.

I knew insurance agents push policies that maximise their commissions, without caring for a policyholder's needs. However, to check the claims made by insurers that they follow best practices, had qualified agents and mis-selling was not rampant, I played along, and committed. Darshan briefed me on the formalities: 100 hours of class work over 18 days at an insurance training institute, followed by a two-day crash course at the company, then an exam certified by the Insurance Regulatory Development Authority (IRDA). That's pretty intensive and time-consuming, I retorted. "Not to worry, it would be taken care of," he said.

On July 4, I filled up forms to become an agent of the life insurer he represented. I gave him Rs 700 (Rs 150 for course book, Rs 200 to the Insurance Institute of India as exam fee and Rs 350 as the licence fee, which would be refunded if I didn't clear the exam). "But I can't attend classes since I have a regular job," I told him. "No problem, just take a day out to show your face to the people at the institute and take your course book. I will take care of the attendance," he said.

On July 15, I went to the institute showed my face, took my course book and signed the register for 18 days — proof that I had completed 100 hours of class work. But he reminded me that I must attend the two-day learning programme, on August 18 and 19, conducted by the insurer, at their office. When I expressed my inability to come for two days, pat came the reply: "Come for one."

I skipped the August 18 class. On August 19, I attended the class, that too only for the first half. At one point, when I asked the company trainer — the only person who seemed intent on playing by the rules — for a copy of the model test papers, he said: "Most of you don't attend classes at the training institute and then you resort to desperate measures."

The next day, I sat for the exam in a Delhi school, with my mobile phone in tow. The invigilator objected, but when I told her that I had forgotten my calculator, she let me keep it, provided I kept it in 'silent' mode. A week later, my contact informed me I was a qualified life insurance agent and that I can — and should — start selling policies.

When I told him that I didn't have documentary proof, he said: "Everybody sells policies without a licence. Why are you worried? You have cleared the exam. Give me your photograph, and I will get it ready. Meanwhile, you must sell policies."

Two months on, I haven't sold a single policy and I keep making excuses for not giving him my

photographs. From time to time, he calls and asks me why am I not selling. He has to — if new agents like me don't sell policies, the company's premiums don't increase. If premiums don't increase, point-persons like Darshan don't earn more.

11 Goal hacks: How to achieve anything:

<http://www.spring.org.uk/2011/03/11-goal-hacks-how-to-achieve-anything.php>

Goal-setting research on fantasising, visualisation, goal commitment, procrastination, the dark side of goal-setting and more...

We're all familiar with the nuts and bolts of goal-setting. We should set specific, challenging goals, use rewards, record progress and make public commitments (if you're not familiar with these then check out this article on [how to reach life goals](#)).

So how come we still fail?

This psychological research suggests why and what mindsets should help us reach our goals.

1. *Stop fantasising*

The biggest enemy of any goal is excessive positive fantasising. [Research on fantasising](#) in goal-setting shows that positive fantasies are associated with failure to get a job, find a partner, pass an exam or get through surgery. Those whose fantasies were more negative did better. Don't experience the future positively before you achieve it.

2. *Start committing*

The reason we don't achieve our goals is lack of commitment.

One powerful psychological technique to increase commitment is [mental contrasting](#). This involves entertaining a positive fantasy but then pouring a bucket of cold reality over it (follow [this link](#) for the details). It's hard, but research shows people really respond to it.

3. *Start starting*

You can use the [Zeigarnik effect](#) to drag you on towards your goal. A Russian psychologist, Bluma Zeigarnik, noticed that waiters seemed only to remember orders which were in the process of being served. When completed, the orders evaporated from their memory.

What the Zeigarnik effect teaches is that one weapon for beating procrastination is starting

somewhere...anywhere. Just taking that first step could be the difference between failure and success. Once you've started, the goal will get lodged in your mind.

4. Visualise process NOT outcome

We're all susceptible to the planning fallacy: that's thinking all will go smoothly when it won't (and hardly ever does). Visualising the [process of reaching your goal](#), helps focus attention on the steps you need to take. It also helps reduce anxiety.

5. Avoid the what-the-hell effect

When we miss our target, we can fall foul of the what-the-hell-effect. It's best known to dieters who go over their daily calorie limit. Reasoning the target is now gone, they think 'what-the-hell', and start eating too much of all the wrong food.

Goals that are vulnerable to the what-the-hell-effect are generally short-term and inhibitional (when you're trying to stop doing something). The effect can be avoided by setting goals that are long-term and acquisitional. Find out more about the [what-the-hell effect](#).

6. Sidestep procrastination

When goals are difficult and we wonder whether it's really worth it, procrastination can creep up on us. Under these circumstances the key is to forget about the goal and bury yourself in the details. Keep your head down and use self-imposed deadlines (read more on [how to avoid procrastination](#)).

7. Shifting focus

You can't keep your head down all the way or you'll get lost. In the long-term, the key to reaching a goal is switching between a focus on the ultimate goal and the task you are currently completing. Research suggests, when evaluating progress, especially on difficult tasks, it's best to stay task-focused. But when tasks are easy or the end is in site, it's better to focus on the ultimate goal (read more on [how to shift focus](#)).

8. Reject robotic behaviour

Often our behaviour is robotic. We do things not because we've really thought about it, but because it's a habit or we're unconsciously copying other people (e.g. [Bargh et al., 2001](#)). This type of behaviour can be an enemy of goal striving. Ask yourself whether what you are doing is really getting you closer to your goal.

9. Forget the goal, what's the aim?

Goals should always be set in the service of our overall aims. But there's a [dark side to goal setting](#). When goals are too specific, it's easy to get stuck; when they are too many goals, unimportant, easy ones get prioritised over vital, difficult ones; when they are too short-term, they encourage short-term thinking. Badly set goals reduce motivation and may increase unethical behaviour.

Remember to keep in mind the whole point of the goal in the first place.

10. Know when to stop

Sometimes the problem isn't getting started, it's knowing when to stop. Psychologists have found that sunk costs make us do weird things ([Arkes & Blumer, 1985](#)). 'Sunk costs' refer to the effort or money we've already expended in trying to reach our goal. So, even when our plan is failing, we keep pushing on.

Research shows that the more people invest in a goal, the more they think it will succeed; irrespective of whether it actually will succeed. Know when to change tack or you'll end up flogging a dead horse.

11. If-then plans

What all these studies show is the importance of self-regulation in achieving a goal. Unfortunately, as we all know to our cost, controlling the self can be very hard.

One strategy with plenty of research to back it up is forming 'if-then' plans ([Gollwitzer et al., 2006](#)). You simply work out in advance what you're going to do in a particular situation. Although it sounds simple, we often prefer to wing it, rather than plan. With a little ingenuity, though, if-then plans can be used to surmount the obstacles described above.