PERSONAL FINANCE 2.01
simple. interactive. independent

Most people phase out when money/ savings/ investing/ tax/ stocks/ insurance/ funds are discussed. After tackling them over the last one year on my blog and website , I hope to construct an easy-to-digest, friendly e-book on personal finance that people would like to read and understand!

This e-book is only 21 pages and will not take more than an hour to go through. No matter who you are and what you earn, my feeling is that this one hour can help you understand money and change a lot of things for you, for the better!

Personal Finance is about managing your own money. There are scores of books and courses to manage the finance of your business or a Company. Then there are books on finances of the Government (Monetary, Fiscal Economics). But are there enough for managing your own finances? Which is equally, if not more, important for all of us. And moreover it's simple and not rocket science!

Lest you begin to think that here comes another preachy "expert" , allow me to share my own dismal track record of handling my finances!

Last year, I took out Rs 3000 from an ATM using my credit card. I had setup the auto debit thing in my savings account so that the amount gets debited when it's due, no interest. I thought I was smart to be using a credit card which I could pay off after a month ahead and use the interest free period to my advantage. However, the next month credit card statement had a nasty surprise for me. They charged me Rs 300 for the transaction, Rs 38.04 as finance charges and another Rs 40 for service tax! Firing up my excel sheet, I found out that my cost of that transaction was 12% monthly. Annualised interest cost would be 144%!!

It's February already and my Office payroll guys were after me since December to show all receipts for tax exemption. I kept postponing my tax calculations and finally when I got the last warning, I began picking up my papers last week. Oops, I discovered that I had not paid the premium due in December for getting the full 80C benefit that I had committed at the beginning of the year. Another Rs 250 spent on late fees charged by the Insurer.

The biggest blow to my ego happened when I was trying to compare my **actual** networth and the **ideal** networth. The assumption for the **ideal networth** was saving and investing roughly 15% of my income with an annualised return of 10%. Not very ambitious or unrealistic assumptions, I would say. The results have totally deflated my ego. The ideal networth is three times more than my current networth. There is a 200% variation between the two figures. Time to pull up my socks and get started along with you.

In fact I've tried to run away from finance myself. Maybe because I was not able to understand the jargon and the maths. But I guess ignoring personal finance worsens the situation. And the only way to get maximum out of your personal finance is to look it into its eye and grapple with it. You will come out stronger. Let's take the journey to a better personal finance together!

The purpose of this eBook is to get you started. What do we have here in this e-book? 🙂

1. Monday is Money day!
2. Basics of Financial Planning
3. Investing Basics: Which financial products to choose from and why?
4. Seven deadly sins of Investing.
5. Asset Allocation:
6. What is Exchange Traded Fund (ETF)?
7. Toolbox and Resources

The Magic of Compounding

- You can get the **magic of compounding** work for you if you start early, invest regularly and aim for the long term, the power of compounding helps your money grow exponentially.
- **Example:** If you start at age 25, invest Rs 5000 every month and get a return of 10% annually, the corpus at 60 years of age would be Rs 1.62 crore. However if you start at 40, with the same amount and return, the corpus is only Rs 34.5 lacs! A difference of 1425%!! To match Rs 1.62 crore, the guy at 40 would need to invest Rs 45000 per month instead of Rs 5000!!

Check out this Spreadsheet and play with your numbers

Monday is Money day!

I have always been smug with my assumption that a sophisticated finance professional will take care of all my wealth creation needs. But the day my over friendly and over smart advisor came, I was more confused when he left than when he had entered!! He talked about sophisticated jargon, terms, options, technology, software, analysis and at the end of it asked me to decide on my own risk appetite. Damn it, if I have to do my own analysis what the heck was he doing, sitting smugly on my sofa while I looked like a sheep in my own house.

To be fair to my financial advisor, he helped me understand that one must take responsibility for oneself. And he logged me on to the fascinating world of finance and investing.

It's easy to be overwhelmed with the investment options. 650 odd Mutual Funds, More than 2000 scrips to choose from, options, futures, commodities, real estate, deposits, insurance, tax saving schemes and bonds like PF, NSC, KVP, Infrastructure bonds, et al....... At times I feel the importance of the proverb: " Ignorance is bliss"
Apart from the overwhelming options, you are faced with finance jargon, terminologies, irrational behaviour of the stock markets and smug finance professionals.

But as I said earlier, personal finance is no rocket science. The surefire way of getting it all right is **"Getting Started".** ***Start with a Money day !***

Choose a Monday (any day will do when banks and business are open) and get things done. Don't worry that you're using a day for "nothing" important, this day will repay you many times over!

Gather all the account information you can find. Eliminate distractions. Commit to spending the entire day taking control of your personal finances. It's time to do all the things you've been putting off!
Here are some tasks you might consider for your Money Day. These may sound dull, but the money you'll save by taking the time to do these can be very exciting:

- **Begin tracking every Rupee you spend**: This sounds very boring but once you get started, it will throw up very interesting insights on how you spend and what you can save. The fact is that you can't change your finance habits unless you know where your money is going! You can set up your budget in your diary and here's a sample spreadsheet which you can create on MS Excel/ Zoho Sheet/ Google Docs which will eventually help you take better decisions with your money.

- **Review & Optimize your Financial accounts**: Financial accounts would include your Bank accounts, Fixed deposits, Demat accounts, Online trading accounts, Credit Cards, Mutual funds portfolio, Insurance policies and other investments.

- **Have you paid up the bills:** Personal finance is also about your expenses and not just your investments

- **Check out with the best offers and deals**: Stay in touch with your current service providers and ask around for better deals they can offer. Do some research and ask them if they can match the best offer. You are an important customer to them and they have a slogan in their office that "Customer is God"! Give them a reason to please you!!

- **Brush up your knowledge of personal finance**: Read, Discuss, Research, Ask. It's as simple as that!

- **Plan your financial goals**: Most young people putter through life with no idea what they're supposed to be doing. You don't need to be one of them. Are you carrying credit card debt? Do you have an emergency fund? Would you like to buy a house? A car? Would you like to start a business? Take some time to decide where you want to be ten years from now. Create some money goals to act as a road map to your future. Goals keep you on course. They give you something to work toward.

- **Create a money file.**
  This can be an actual paper file, or it can be on your desktop/laptop (not shared ones, though). It simply needs to be an easy-to-access location in which you keep all of your important financial information. By financial information, I mean your account numbers, folio/policy numbers, service providers, phone numbers, email ids, etc. This final step ties together all the work you've done on Money Day.

These are just a few tasks you can get done on Money Day. Only you can say which tasks are most important, which tasks you've been putting off. Make a list. Gather information. **Don't just talk about improving your financial situation — do it!** Make a commitment to your financial future and schedule a personal Money Day. Is Monday the Money day for you?

Basics of Financial Planning

Financial planning is a dynamic process that requires regular monitoring and reevaluation. In general, it has five steps:

1. **Assessment:** One's personal financial situation can be assessed by compiling simplified versions of financial balance sheets and income statements. A personal balance sheet lists the values of personal assets (e.g., car, house, clothes, stocks, bank account), along with personal liabilities (e.g., credit card debt, bank loan, home loan). A personal cash flow statement lists personal income and expenses.

2. **Setting goals:** Setting financial goals helps direct financial planning. Examples of financial goals are: "To retire at age 50 with a personal net worth of Rs 5000000", or "To buy a house in 3 years paying a monthly mortgage servicing cost that is no more than 25% of my gross income". It is not uncommon to have several goals, some short term, and some long term.

3. **Creating a plan**: The financial plan details how to accomplish your goals. It could include for example, doing an asset allocation plan, reducing unnecessary expenses, increasing your employment income, and investing in the stock market.

4. **Execution:** Execution of one's personal financial plan often requires discipline and perseverance, and many people obtain assistance from professionals such as accountants, financial planners, investment advisers, and lawyers.

5. **Monitoring and reassessment:** As time passes, one's personal financial plan must be monitored for possible adjustments or reassessments.

Here is a more action oriented financial planning checklist for you. It may seem very elementary but I doubt how many people are scoring more than 5/10. Here it goes along with my own reality checks.

1. Get Paid What You're Worth and Spend Less Than You Earn : Hey, I get less than what I deserve and so do you!! And I've not done any budgeting so that I may not be sure of the second part. But can you think of ways to maximize your income? Spend a little time on this one.

2. Pay Off Credit Card Debt: Thank God, I finally get a score on this one. I've managed to stay clear though I've had to suffer with the agonising interest calculations earlier. I have setup the auto debit facility and every month on the due date, my bills are cleared without me having to remember the payment dates.

3. Contribute to a Retirement Plan: Do you have a pension plan? Have you ever cared to figure out whether it is sufficient!

4. Have an Asset Allocation Plan: Depending on your risk appetite which can be low, moderate or high, think up on your asset allocation plan. There is a detailed article in this ebook.

5. Invest! : Pretty straight forward. But few people manage to find an hour for that in a week. They'll rather keep the money in their savings account or fixed deposits. They'll rather watch TV(Hip Hopper on Youtube is the craze these days!)

6. Review Your Insurance Coverages: Putting a finger on that is important from the family point of view. Those of you without that responsibility can breathe easy on that count. But I get full marks here! Check how much Insurance you need by clicking on this link

7. Update Your Will: Never thought about that up till now. Did you?

8. Keep Good Records: Yet to get started on that? *Next Monday*, promise!

9. Plan your Tax: I have spread out my tax saving payouts so that I am not burdened in a particular month. Spread the tax deductions evenly so that you don't feel the pinch.

Rupee Cost Averaging

Rupee Cost Averaging is investing fixed amount at regular intervals and not worrying about timing the market. The beauty of the concept is that the average unit cost will always be less than the average sale price per unit, irrespective of the market rising, falling or fluctuating!!

Example: If the cost of the stock/fund goes down during the period of investment, it's easy to figure out that you get more for the same price. However If the cost of a stock increases, say by Rs 1 every month and you invest Rs 1000 every month; the average cost of the stock is Rs 15.5 [(Rs 10+11+12+...21)/12]. But still the average unit cost is Rs 14.70 (Rs 12000/ 816.39) where 816.39 is the number of shares of the stock available at each price points.

So even with increasing price, the average unit cost (Rs 14.70) is less than the average sale price (Rs 15.50)

Investing Basics: Which financial products to choose from and why?

Some of you ask me a simple question, where to invest? If I am writing a personal finance blog/website, I need to answer that. I have been guarded with my answers and start with the observation that since everyone has different financial goals and risk appetite, my recommendation may not work for him or her. And Personal Finance is a wider thing and investing is just a part of the package deal.

But when my elder brother asked me this question, I did not have an escape route anymore. And I had a responsibility too. After all I can't vanish from him after a year or so!

Let's take a look at some of the popular options available which are Bonds, Stocks, Real Estate, Mutual Funds (MFs), Unit Linked Insurance Policies (ULIP) and Exchange Traded Funds (ETF). Now I'll try to rate them on four parameters of investing. i.e. *1) Growth, 2) Liquidity, 3) Security and 4) Expenses*

Growth: Stocks, MFs and ETFs top the rankings here. Over a period of over 5 years, the Compounded Annual Growth Rate (CAGR) is above 15% in comparison to 8% in Bonds. ULIPs begin to give a good growth only after 5 years or so because initially they are very expensive. Real estate is on a fairytale run these days too.

Liquidity: Again, Stocks, MFs and ETFs score heavily while Bonds and ULIPs have a lock-in period or have substantial surrender charges. Real estate scores low here (You have to be lucky to get good buyers at the right time).

Security: I would rate all of them at par over a long-term of over 5 years. But you may get into a bad stock or real estate which are unsecured. Otherwise also, stocks and real estate are very volatile and can affect your blood pressure too!

Expenses: ETF is the least expensive with charges of around 0.5% compared to 2% from MFs and much more in ULIPs (especially in the initial years). Stocks too, are the least expensive, provided you get into the right stocks at the right time.

Based on the short analysis, I would recommend ETFs. Read more about ETFs here. But as I said earlier, one man's meat could be another man's poison. Moreover, the diversification rule says that one should not keep all our eggs/ apples (for the vegetarians) in one basket. So let us take a look at the various options, one at a time.

Shares: Investing in the equity market directly is exciting and sexy. You are in the thick of things and learn a lot in the process. Though the volatility and the information overload makes it a daunting task, investing in stocks is not rocket science. One should start with identifying a list of 10-15 companies out of 3-5 sectors which you know about and interests you. You can then keep a tab on their management team, financials, and future outlook and over a period of time, and will be able to take a call on them.

Real Estate: I feel that one has to be plain lucky to get into a good deal and be able to get the right buyer at the right price and time. I can't think of any other factor other than luck. So if you feel you are blessed and have the right tip, go for it. Otherwise, it's a no-no.

Mutual Funds: One should allocate their time to investment decisions in proportion to their income generation goals. Also, convenience and hassle free investing should be a major factor. Mutual Funds fit the bill where Fund Managers are into it full time. If you van identify fund managers who have consistently performed over last 3-5 years, nothing like it. The fund manager also has the muscle power of crores of Rupees and is able to take entry and exit decisions impartially. MFs continuously churn their portfolio. When MFs buy and sell stocks, they don't have to pay capital gains as you would do when you churn. With Systematic Investment plans (SIP), you can start investing with as low as Rs 500 per month. But MFs have its own loading and administrative charges and the fund managers make merry on your hard earned money.

Exchange Traded Funds: While the index fund has given a one-year return of 42% last year, diversified equity schemes (MF) could only come up with 34% returns. Diversified equity funds usually have large expense ratios compared to index funds. For example, the expense ratio of Banking BeES, an index fund, is only 0.45, while it is anywhere between 2-2.50% for diversified equity schemes. **That's why I recommend ETFs.**

ULIPs: Unit linked insurance policies combine two products, i.e. Insurance and Mutual Funds. In the initial few years, ULIPs are very expensive. But in case you don't want any hassles of investing, and you have a tried and tested Insurance agent who is almost part of your family, then ULIPs are for you.

Bonds: For those of you who are risk averse.

Remember the seven deadly sins of Investing

Kartik Jhaveri, an expert at Financial Planning, has written an article which is being reproduced here.

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

Asset Allocation

Asset Allocation (AA) sounds sophisticated, no? It assumes you have an asset to allocate and gives a boost to your ego, eh! Looks like a smart and sexy word for a thing as drab and dreary as planning your personal finance. And AA also gives you a feeling that you are holding some aces (AA) rolled up in your sleeves. It specially applies to the Financial Planners or Advisors.

But seriously, asset allocation is a useful concept to know. Simple too. And once you get your fundamentals clear about AA, you can use it to your advantage. It is the first step of adding value to your money or putting your money to good use.

Over 91% of long-term portfolio performance is derived from the decisions made regarding asset allocation, and not market timing or security selection

Asset allocation is the percentage distribution of your money into equity, debt and liquid instruments. Equity, as you know, gives the highest growth but comes with the highest risk. Debt instruments are more or less guaranteed but give you a lesser return. Liquid money is your money in your savings account.

Let's start with the **thumb rule** of AA. Your allocation to debt should be equal to your age. And as you age, the percentage in debt should increase too. In other words, your investments in equity should be (100- your age).

But AA should be much more dynamic than the above thumb rule. I feel that it should depend on your age and your risk appetite. Guys at 20-25 years of age may want to invest everything into equities and I think that is the right strategy.

And before you set off to do some AA for yourself, I would like you to ask the following questions to yourself:

1. What is your risk appetite?
2. What are your financial goals?
3. When do you need the money?

And if you love ready made formulas, here's some from allocation strategies:

- Older investor : 50% equity; 50% debt
- Young investor : 80% equity; 20% debt

You already know this, a recapitulation of the three basic principles of Investing

1. **Don't put all your eggs in one basket.** (Diversify in different asset classes.)

2. **There is no such thing as a free lunch** (Capture the entire return of each basket, or asset class, through low cost index funds).

3. **Save for a rainy day.** (Develop a long term financial plan)

Some cool definitions about Financial markets!!

Bull Market - A random market movement causing an investor to mistake himself for a financial genius

Market Correction - The day after you buy stocks.

What are Exchange Traded Funds?

Despite giving the *highest returns* last year and also being the *least costly*, Exchange Traded Funds or ETFs are hardly known to the general public. Most ETF managers don't give commission for their products, which other regular mutual funds do very aggressively, hence there is no one pushing it.

But internationally what has happened that over a period of time people have found out that ETFs are ideal instruments and it has become very popular.

Basically, Exchange Traded Funds (ETFs) are open-ended index funds that can also be traded on the stock market. Compared to Mutual funds, there are many advantages of ETFs;

1. The first advantage is real time pricing.
2. Generally long term investors are protected from short term traders. Hence it proves to be an ideal instrument for both long term as well as short term investors and also it is easy to buy and sell from the exchange.
3. **And most importantly, the cost is many times less than a Mutual Fund due to lack of commission to the agent.**

One major disadvantage is that the investor should have a **demat account and a broking account** to invest in an ETF.

There are two types of advantages over index funds -

1. The expense ratio which is currently lower in ETFs as compared to normal index funds.

2. The distribution costs- the other index funds have to pay commission to the broker, while ETFs do not pay the same. So the ETF costs will be lower.
3. In addition to the above-mentioned expenses, there also exist some 'hidden' costs like transaction costs. Such costs do not form a part of the expense ratio like brokerage and STT. The transaction costs however, are incurred by index funds but not by ETFs. This is another area where ETFs score over regular index funds.

Did I tell you that in India the ETFs have outperformed the actively managed funds over the last year (2006-07)?

Even though the actively managed funds have done better on a 3/5 year scale, the net difference would be lower or non existent because of the higher cost. The active funds charge you 2-2.5% while the ETFs charge around 0.5% only. The extra Fund management charges will even out any extra return that Fund managers may claim to generate.

I wonder why a good product like index funds do not sell like hot cakes. Comparatively an expensive product like ULIP is selling like hot cakes even though it is much more expensive than the MFs. There are two reasons that I can think of:

1. Lack of adequate knowledge and information amongst investors and
2. No agents/ advisor pushing it because of lack of commission.

The Scott Adams unified theory says that invest 70% of your money in a **stock index fund** and 30% in a **bond fund** through any discount broker and never touch it until retirement. Let's check out some important data on expenses and return for the ETFs available in India (as on Nov' 2007)

Scheme Name	NAV (23-Nov-2007)	Expense Ratio (30-09-07)	Simple Annualised Return (%)		
			1 Year	3 Years	Since Inception
Bank BeES	899.50	0.55	44.5	69.2	72.9
Gold BeES	1043.49	1	--	--	14.5
ICICI SENSEX Prudential ETF	192.92	0.8	37.4	71.2	97.4
Junior BeES	111.39	1	54.8	63.1	110.2
Nifty BeES	567.06	0.8	40.8	64.5	75.0
UTI's SUNDER	575.53	0.5	43.5	66.3	108.5
UTI Gold ETF	1045.28	--	--	--	6.6
Indices					
S&P Nifty	5608.60		42.1	64.9	
BSE Sensex	18852.87		37.7	70.8	
Crisil Liquid Fund Index	1348.40		7.3	6.3	
BSE PSU	9502.09		51.2	48.2	
CNX Nifty Junior	10949.10		55.0	62.5	

Toolbox and Resources

It is said that if you want to manage something, you must be able to measure it. Similarly to know whether you are doing well with your personal finances or not, you need to have certain measurements for it.

So there are simple spreadsheets and calculators available which can help you with a self analysis and provide a road map for your finance decisions. I would suggest that you start off with the Monthly Budgeting sheet.

We bring to you the following spreadsheets which I have done on Zoho , which has a suite of online web applications.

- Monthly Budgeting Worksheet
- Financial Freedom Calculator
- Networth Template
- Benefit of starting early
- Worksheets for You

The advantage of these sheets is that while you can toggle with your own case figures in the sheet online and they will return with the figures for your case in a jiffy. And you can also download them for free and use them offline !

Resources & References

Blogs and sites that I simply adore!

[Ajay Shah's Blog at http://ajayshahblog.blogspot.com/](http://ajayshahblog.blogspot.com/)

[Deepak Shenoy's Blog at http://blog.investraction.com/](http://blog.investraction.com/)

[PersonalFn at http://personalfn.com](http://personalfn.com)

[Get Rich Slowly at http://getrichslowly.org/](http://getrichslowly.org/)

[Ramit Sethi's Blog at http://www.iwillteachyoutoberich.com/](http://www.iwillteachyoutoberich.com/)

[The Simple Dollar at http://www.thesimpledollar.com/](http://www.thesimpledollar.com/)

Even after reading 21 pages??