SWATANTRA

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Use Bonus Money To Pay Off High-Interest Debt

You could also consider to beef up emergency corpus or part-pay home loan

Partha Sinha | TNN

April is the month when a large number of salaried people receive their annual bonuses. These are one-time lump sum payment that employees receive mainly for good performance during the previous year and there is no guarantee that such payments would be repeated.

Often people receiving bonus resort to binge spending. Some, however, prefer to invest wisely for gains in future.

Financial planners and advisors say that rather than spending the lump sum bonus money and exhaust the whole sum, it's always better to invest, at least a large part of the bonus amount with your eyes on the future.

ILLUSTRATIONS: DEBASISH SARMA

Pay off high-interest bearing loans/debt

According to Satyam Pati, head of content at Scripbox, although the issue about how to use such lump sum receipts like bonus amount should be dealt with at a very individual level, still there are some rules that investors could keep in mind. For one, one should consider using the bonus money to pay off high-interest debt.

A search on the net for the annual rate of interest on personal loans throws up results which show this rate could start at about 11.5% and can go to as high as 24%. On the other hand, outstanding dues on credit cards could attract rate of interest as high as 2.5% per month, which when compounded comes to an annual rate of nearly 35%. So instead of keeping your bonus money in bank FDs which can give you around 7.5%-8% annually, financial advisors say it makes sense to pay back such loans which come with a high rate of interest.

Emergency fund

Secondly, an investor could consider building an emergency fund to meet unforeseen exigencies in life. "If one already has an emergency corpus in place__which ideally should be equal to six times the monthly expenses__then he could consider padding up the corpus,"Pati said.

Usually people keep a part of their total portfolio in low-risk investment products like bank FDs or liquid funds so that, in case of an emergency, the money could be taken out within a day or two.

Short/Medium/Long term investment

The third option could be to invest in short, medium or long term investment products, as per one's individual needs. "For example is one is planning to buy a car in 3-5 years, then he could put this money in a fund which is suitable for similar investment horizon. If one wants to invest the money for the long term, he could invest in equity funds or directly into equities," Pati said.

INTELLIGENT WAYS OF USING BONUS MONEY

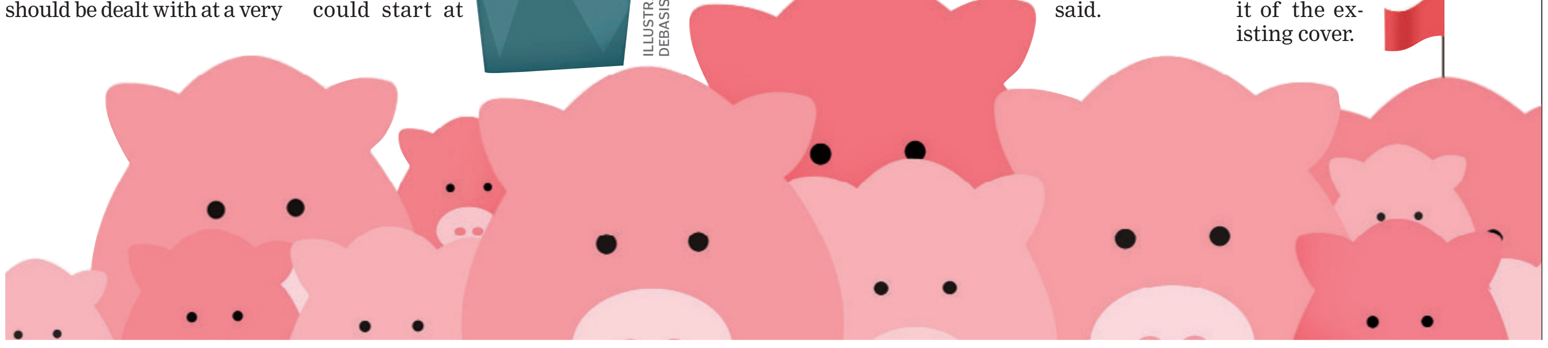
1. Consider paying off high-cost loans or debt like personal loan, credit card dues
2. Create an emergency fund. If you have one, consider topping it up
3. Short/medium/long term investments
4. Part-pay outstanding home loan
5. Top-up your insurance plan

Top-up health plans

A regular policy reimburses hospital bills up to the sum insured while a top-up plan covers costs after a certain threshold is reached.

For instance, when you are hospitalised, the insurance company will pay up to the set sum insured limit. The top-up, on the other hand, will come in picture after a certain amount, has been crossed. It'll pay for the claim amount over and above it.

It is the additional coverage for people who have an existing individual plan or a mediclaim from the employer. It is for reimbursement of expenditure which arises out of single illness beyond the limit of the existing cover.



Continue Your Equity SIP, Emergency Funds In Short Term Saving Schemes

Finance & investment details of Vijay Shukla *(30 year/Male)* **CASE STUDY**

- **Annual salary:** Rs 14 lakh
- **Existing investments:** Insurance of Rs 1 crore with an annual premium of Rs 12,000
- **SIPs:** Five SIPs of Rs 2,000 each;
- **ULIP:** Current value of Rs 1.97 lakh, annual premium of Rs 35,000;
- **PPF:** Rs 60,000;
- **Family floater health insurance:** Rs 3 lakh with Rs 5 lakh top-up (Provided by employer)
- **Liability:** A 20-year home loan of Rs 40 lakh, EMI Rs 40,000.
- **Planning to take a health insurance policy for parents:** Rs 5 lakh
- **Goals:** Child's education & marriage, Retirement fund for self & wife

Anand Zinzuvadia replies

MONTHLY CASH FLOW (IN RS)

Inflows		Outflows	
Salary	117000	Household Expenses	20000
		SIP	10000
		ULIP	3000
		Insurance	1000
		EMI	40000
Total	117000	Total	74000
		Surplus	43000

>> **Emergency (contingency fund):** Surrender the ULIP and invest the corpus in liquid fund in an emergency fund.

>> **Retirement fund:** Considering current monthly house hold expenses of Rs 20,000, expected monthly expenses would be Rs 1.53 lakh when you retire. To meet this monthly need you must have a retirement kitty of Rs 3.65 crore (Assumptions: Retirement at 60, life expectancy: 85 years, Inflation: 7%, Expected returns: (Pre-retirement) 12% and post-retirement on corpus 8%) To build this fund you should invest monthly Rs 11,800 in diversified mid-cap, small-cap and multi-cap funds.

>> **Child's education:** Child's current age: 6 months, Time to go for higher studies: about 18 years. Considering current education cost of Rs 20 lakh and education cost inflation at 10%, future value would be Rs 1.12 crore. To accumulate this fund you start monthly SIP of Rs 15,600 in diversified large-cap, mid-cap and multi-cap funds.

>> **Child's marriage:** Time to marriage: 25 years. Considering current marriage cost of Rs 10 lakh and cost inflation at 12%, the future value would be Rs 1.08 crore. To accumulate this fund you start monthly SIP of Rs 6,400 in diversified large-cap, mid-cap and multi-cap funds

>> **Term plan:** Take an additional term insurance policy of at least Rs 1 crore with permanent disability rider. Approximate

annual premium may vary from Rs 12,000 to Rs 15,000.

>> **Mediclaim for self & spouse:** It's suggested you have a separate mediclaim family floater policy of at least Rs 7 lakh as your current mediclaim is provided by employee till you are in the current job. Hence you should have a separate mediclaim policy. Approximate premium could vary from Rs 10,000 to Rs 16,000.

>> **Conclusion:** You should continue your SIP of equity funds. To save taxes you should invest up to 50,000 in NPS. Also check the interest component in your EMI and insurance amount. In case of any shortfall, that can be bridged by using ELSS investments. The remaining surplus of approximately Rs 7,700 should be invested in ultra short term fund that will fulfill your contingency fund.

Anand Zinzuvadia runs N J Securities, Amreli, Gujarat

GURU SPEAK

In investing, what is comfortable is rarely profitable"

Robert Arnott, *author, investor, entrepreneur*

INVESTOR QUERY

I AM 26 YEAR OLD AND WORK IN A PRIVATE FIRM WITH ANNUAL INCOME OF RS 3 LAKH. I DON'T HAVE MUCH KNOWLEDGE ABOUT THE VARIOUS SCHEMES IN THE MUTUAL FUND SPACE BUT I KNOW A BIT ABOUT FUNDS AND SYSTEMATIC INVESTMENT PLANS (SIPS). I WAS TO START INVESTING FOR THE SHORT TERM. I NEED TO KNOW WHICH SCHEMES TO INVEST IN WHICH WOULD BE SUITABLE FOR ME, FROM THE POINT OF VIEW OF LOWER RISKS. IN NEED YOUR HELP ON THIS.

Naveen Chandra Paneru, *via email*

Ashish Modani

Ashish Modani replies

You are on track to become a good investor as you know what you want. You are very clear with your requirements that you need money in the short term. When you have a short term tenure, you should look for portfolio which are not in equity. Debt funds are good for such short term investment tenures. If you have an investment horizon less than one year, then you may choose schemes from the liquid plus category of schemes. If you are looking for more than one year but for short term only, then you can look at credit opportunities funds. You may start savings per month in these funds. Remember that SIPs are about regular savings and not about investing in equities. So go for SIP in these funds and withdraw the money when your goal arrives. This will also help you control your urge to spend the money.

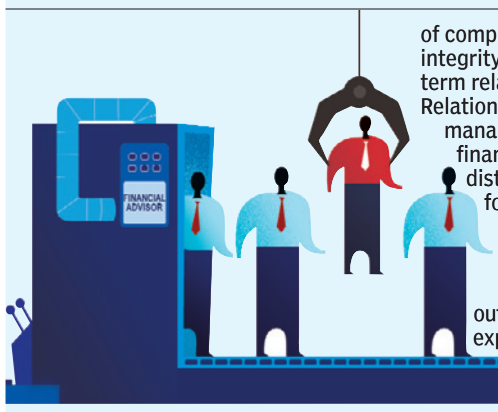
Ashish Modani runs SLA Investments, Jaipur

WHAT ARE SIPS AND HOW TO SET UP ONE?

A systematic investment plan or SIP is similar to bank recurring deposit for investing in mutual funds of various types, equity, debt, gold etc. Here every month/quarter a fixed amount is invested in the fund of your choice. Unlike in RDs, in SIPs, however, there is no guarantee of return but the chances are that the return could be higher than in RDs.

HOW DO I SELECT A FINANCIAL ADVISOR?

Having a good financial advisor on your side, for several decades of planning and investing, could make one's life easier. Here are a few pointers how you can select a good financial advisor



JOBS AND RESPONSIBILITIES OF A FINANCIAL ADVISOR

Understand your needs, put a financial plan, select right investments, help execute the plan, review and if needed rebalance, educate

BE CLEAR ABOUT WHAT TYPE OF FINANCIAL ADVISOR YOU WANT

Independent Financial Advisors/Planners work on their own and come with a varying level of competence, sophistication and integrity. Expect to develop a long term relationship with them. Relationship managers and wealth managers work for banks, financial houses, large distributors etc. and are usually for rich people.

MEET AND EVALUATE

Meet the person and check out his level of competence, experience, advisory processes including for investing, reviewing and rebalancing. Check if both of your thinking about finance and investment matches.

ASK QUESTIONS

Ask all relevant question about advising, planning, track record, fees etc.

TAKE REFERENCES

Ask for references from the person and do a proper due diligence if you are satisfied on all the points given above.

NEXT EDITION

In our next edition we will delve into the basic of index fund investing.

DEMYSTIFIER

What are repo and reverse repo rates?

Swatantra Kumar answers: Earlier this month the RBI cut repo rate by 25 basis points (100 basis points = 1 percentage point) to 6.50%, mainly aimed at influencing lenders to reduce their lending rate of interest. Repo rate is the interest rate at which the banks borrow money from the RBI. Like repo rate, the RBI also has another tool, the reverse repo rate, to influence the market rate of interest. Reverse repo rate is the interest rate that RBI pays when banks keep their excess money with the central bank. Since banks fix their rates of interest for their customers based on the rate of interest banks pay to get money, so by changing the repo rate the RBI is able to influence the rate of interest that commercial banks fix for their customers. In case there is high inflation, RBI increases repo rate. On the other hand in case of a situation when people are not borrowing, forcing banks to keep money with the RBI, the central bank cuts reverse repo rate, prompting banks to lower rate which may attract customers to borrow more and spend.

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Mutual Fund investments are subject to market risks, read all scheme-related documents carefully