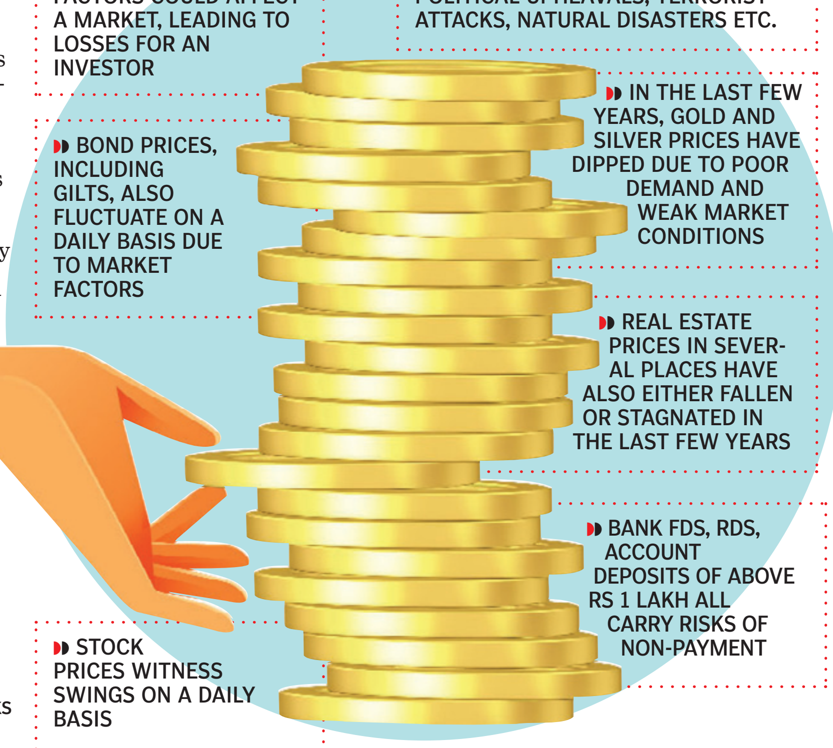
UTI SWATANTRA

An investor education initiative | Powered by THE TIMES OF INDIA

All Investments Carry Market Risks

It's not only mutual funds, but most savings and investments through financial and real assets carry risks which could lead to losses for investors

Last week, India's largest bank cut the rate of interest on savings deposits to 3.5% from 4%. Other banks followed. For over six years interest rate on SB deposits was at 4% or above. The decision was based on two market factors: Low inflation and high real interest rate. This sent shock waves among investors. This cut in SB deposit rate is another example that it's not only mutual funds, even the safest of the deposits carry market risks.

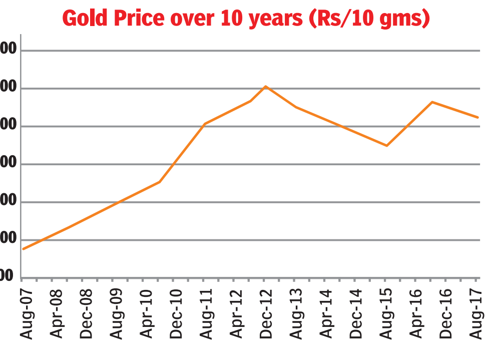


- MARKET RISKS REFER TO THE POSSIBILITY THAT NUMEROUS FACTORS COULD AFFECT A MARKET, LEADING TO LOSSES FOR AN INVESTOR
- MARKET RISKS INCLUDE CHANGES IN INTEREST RATES, INFLATION AND EXCHANGE RATES, RECESSION, POLITICAL UPHEAVALS, TERRORIST ATTACKS, NATURAL DISASTERS ETC.
- BOND PRICES, INCLUDING GILTS, ALSO FLUCTUATE ON A DAILY BASIS DUE TO MARKET FACTORS
- IN THE LAST FEW YEARS, GOLD AND SILVER PRICES HAVE DIPPED DUE TO POOR DEMAND AND WEAK MARKET CONDITIONS
- REAL ESTATE PRICES IN SEVERAL PLACES HAVE ALSO EITHER FALLEN OR STAGNATED IN THE LAST FEW YEARS
- BANK FDS, RDS, ACCOUNT DEPOSITS OF ABOVE RS 1 LAKH ALL CARRY RISKS OF NON-PAYMENT
- STOCK PRICES WITNESS SWINGS ON A DAILY BASIS

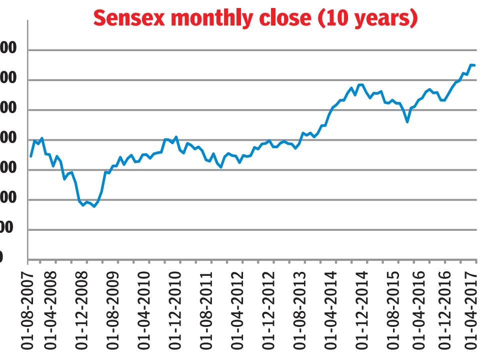
Prices of stocks, bonds, gold, silver, real estate, commodities fluctuate on a daily basis. So naturally mutual funds which invest in some of these assets also witness fluctuations in their NAVs on a daily basis. The risks in mutual funds are risks derived from actual risks which are inherent in assets they buy in the portfolio.

Savings banks, fixed deposits, recurring deposits also carry market risks. In India, each of these accounts is insured for up to Rs 1 lakh. So if you have Rs 2 lakh in a bank account (SB, FD or RD) and the bank is unable to pay, there is a guarantee that you will get half of the money in that account. But the balance half, you may get or it may be lost forever. In effect each SB, FD and RD account of above Rs 1 lakh also carries market risks.

Gold Price over 10 years (Rs/10 gms)



Sensex monthly close (10 years)



ILLUSTRATIONS: SACHIN VARADKAR

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CASE STUDY

'Take the MF route to market, not direct equity'

I am 31 years old, getting married this December. My monthly take home is Rs 50,000. I have cash outflows of Rs 12,000 towards loan EMI and Rs 10,000 in RD. I have a personal mediclaim of Rs 3 lakh and a cover from employer for Rs 5 lakh. I pay monthly rent of Rs 5,500 and get Rs 3,000 as rental income from my home. My monthly expenses are Rs 5,000. I want to invest in share market and in mutual fund. What would be the best way for me to invest and when? Is there any better option to invest?

- Srikant Satpathy

Mohan Lal Sharma *replies*

Given the cashflow figures, you should go for SIPs in mutual funds. As you are young, it is advisable he should do SIP in midcap and diversified equity funds. Given that you are 31, if you continue the SIPs for 20 years or more, you will be able to build a huge corpus when you would possibly need the money. As we know that most of our liabilities (child's education, child's marriage etc.) arise after the age of 50, you will be financially comfortable at that age.

In mutual fund, since equity schemes usually invest in several stocks, diversification is easy. However, if you want to go for direct equity, diversification becomes difficult since that requires substantial amount of money. But by investing through the mutual fund route, you are able to participate in a large number of stocks with a small amount as well. Also due to the professional knowledge of the fund manager, you will probably be able to beat the benchmark also easily. In addition, mutual funds offer high level of liquid and tax free returns. And all these come at a low cost.

I would not advice you to invest directly in stocks since you have no experience of such investments.

Have a look at the expected returns from MF SIPs and how much you could make over 20 years:

Monthly SIP amount	Tenure	Expected annual return	Total corpus
Rs 15,000	20 years	15%	Rs 2.27 cr

Historically, equity investments have multiplied money manifold compared to other investment avenues. If you start investing early and continue for a long time, there is every likelihood you would achieve your financial goals.

You could build your portfolio with these types of funds: Midcap fund (35%), large cap fund (35%) and the balance equally divided into two sector funds (banking and transport & logistics). With this combination, given the current market scenario, you stand to make good returns in the long run. Also if you invest through the mutual fund route, in case of an emergency, you can withdraw your money without any hassle.

To summarise: If you want to invest in equity and you don't have much knowledge of the same, you should take the mutual fund route rather than investing directly into equities.

***Mohan Lal Sharma** runs Baba Investments & Consultants, Jaipur*

GURU SPEAK

By the time any view becomes a majority view, it is no longer the best view: somebody will already have advanced beyond the point which the majority have reached. — **Friedrich Hayek**, *Economist*

Yours Behaviourally

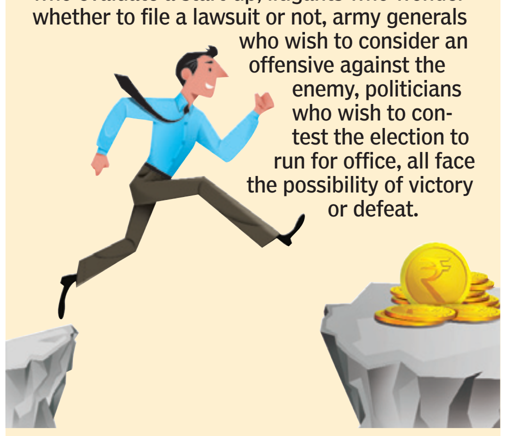
WHAT'S YOUR GAIN-LOSS RATIO?

PART 1

R Raja

The bias that we will discuss today has wide implications on investment decisions which we take to achieve our financial goals. It's called 'loss aversion' bias.

This bias also encompasses all options and choices we face in life whenever there is a possibility of 'mixed' results: There is a risk of loss and also an opportunity to gain. Entrepreneurs who evaluate a start-up, litigants who wonder whether to file a lawsuit or not, army generals who wish to consider an offensive against the enemy, politicians who wish to contest the election to run for office, all face the possibility of victory or defeat.



Suppose you are evaluating a decision to invest 100. Here the upside is that it can appreciate to Rs 110, if conditions favour. Under unfavourable conditions, however, it may depreciate to Rs 92. Will you invest when the probable gain is Rs 10 and the probable loss is Rs 8? One should balance the psychological benefit of gaining Rs 10 against that of losing Rs 8. Although the expected value of the gamble is obviously positive__you stand to gain more than you can lose__most people dislike the former. The fear of losing Rs 8 is more intense than the hope of gaining Rs 10. Losses loom larger than gains as the pain of losing Re 1 is much more than the pleasure of gaining Re 1. This is loss aversion bias which refers to the smallest gain that I needs to balance an equal chance to lose Rs 100. For many, the answer is about Rs 200, twice as much as the loss.

Several experiments have estimated the loss aversion ratio, which usually comes in the range of 1.5-2.5. This is an average and could differ depending on individual traits. Some people are more risk averse than others. Risk takers in the financial markets are more tolerant of losses and they may not respond emotionally to every fluctuation in the market.

***Yours Behaviourally** is a monthly column on psychology that impacts our investment decisions. **R Raja** is with a leading domestic fund house.*

GLOBAL FINANCIAL CRISIS SHOWED US ALL INVESTMENTS CARRIED RISKS

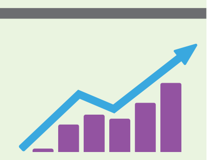
Here is what happened between 2007 and 2009 due to reckless home loans practices in the US in the preceding years

REAL ESTATE
Real estate prices witnessed severe crash in the US and many other parts of the world after the sub-prime bubble burst and plunged global markets into a financial crisis not seen since the days of Great Depression in 1929

GOLD
As global financial crisis spread, Gold being a hedge against risks, its price jumped from a low of about $830 per troy ounce in Aug 2008, to an all-time record high near $2,000. Then it crashed again to $1,100 by December 2015

CRUDE OIL
From a high near the $150 per barrel mark in June 2008, crude prices dipped to below $30 level by early 2016.

STOCKS
Globally Stocks plunged by up to 70%. In about 13 months, the sensex crashed from above 21,000 to below 8,000 while Dow Jones Index in the US nearly halved from close to 14,000 to just above the 7,000 mark.



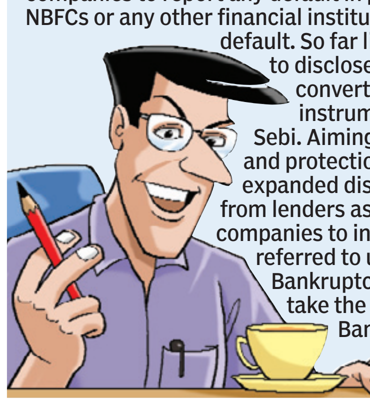
NEXT EDITION

For every person, a little extra cash is always welcome. In our next edition we will discuss how investors can invest in a variety of mutual fund schemes that can earn them some extra income.

DEMYSTIFIER

WHAT'S SEBI'S NEW RULE FOR LISTED COMPANIES DEFAULTING ON LOANS?

Swatantra Kumar explains: Last week Sebi asked all listed companies to report any default in payment on loans to banks, NBFCs or any other financial institution within a day of such a default. So far listed companies were required to disclose only the defaults on non-convertible debentures and other listed instruments which are regulated by Sebi. Aiming towards more transparency and protection of investors, the regulator has expanded disclosure requirement for loans from lenders as well. Sebi also wants listed companies to inform investors if a company is referred to under the Insolvency and Bankruptcy Code, which allows lenders to take the company to the Insolvency and Bankruptcy Commission within a day of the default.



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