

AN IDEA ON INVESTMENT

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Everyone saves and invests for different reasons. One person may save for financial security in retirement and another may choose to save for a trip around the world. People have different needs, wants and values that will determine how much they need to save or invest. We invest in order to improve our future welfare. If we are making investment decisions today that will directly affect our future wealth, it would make sense that we utilize a plan to help guide our decisions. Surprisingly, the majority of people do not have in place any type of formalized investment plan. Taking some time to put together a financial plan can reap tremendous benefits.

Financial planning is the process of meeting your life goals through the proper management of your finances. Life goals can include buying a home, saving for your child's education or planning for retirement.

The term investment is used to describe the process of investing (or divesting) money in shares, debentures, fixed deposits, gold, real assets, life policies, etc. These outlets where the money is invested are known as investment assets. Analysis, decision making and processes involved in allocation of funds to these different assets and more specifically, selection of one or the other asset is known as investment management. An investor hopes to be compensated for (i) forgoing present consumption, (ii) for the effects of inflation, and (iii) for taking a risk. Investments may take form of real assets, financial assets or even antiques.

Real assets and financial assets can be classified in different categories:

In the context of investment, the term **investment process** is used to refer to decisions making process employed by an investor to decide about what assets to invest in and when to make investment. It includes several steps as follows:

- (a) Setting investors objectives and amount of investible wealth.
- (b) Analysis of different assets securities to identify those which are suitable for investment.
- (c) Constructing a portfolio of investments and determining the proportion of wealth to be invested in each one.

(d) Periodic repetition of the above three steps to revise and improve the portfolio in view of changing situations. This may entail the evaluation of performance of the portfolio in terms of the risk and return of the portfolio.

The combination of investments is known as **portfolio** and the practice of including several investment alternatives in the portfolio is known as **diversification**. Following are some of the features which an investor looks into an investment:

1. Liquidity: Liquidity, with reference to investments, means that the investment is saleable or convertible into cash without delay.

2. Risk of an Investment: Another equally important factor that must be considered in the investment process is the degree of risk an investor is ready to assume. Risk of an investment is to be analysed from two different angles.

(a) Safety of Principal: An investor should take care that the amount of investment (principal) is safe.

(b) Stability of Return: An investment is considered a good investment if it offers stable returns.

3. Capital Appreciation: Some investments such as land, buildings, equity shares provide opportunities of capital appreciation.

4. Tax Aspects of Investments: Investments differ with respect to tax treatment of initial investment, return from investment and redemption proceeds.

5. Investment Horizon: Investment horizon refers to the planned liquidation date of the investment. The maturity period of an investment makes it more attractive if it coincides with the date when funds would be needed.

Saving and investing mean different things to different people. A savings to one person may be considered an investment to another. Generally, saving refers to putting aside a sum of capital or cash that remains constant while earning a low, guaranteed rate of interest. Investing refers to putting capital where it can increase or decrease in value, but where neither interest nor dividends are guaranteed. An Investor should follow the following technique to avoid losses or decrease the value of capital.

Hedging. Hedging is a technique to cover losses. Options can be used to build up different hedging strategies to cover the risk of holding investment in securities.

Arbitrage. Arbitrage refers to a situation where an investor undertakes two simultaneous actions in an attempt to make risk-less profit.

Diversification. Diversification refers to the process of spreading away the total investible funds over different investment assets. This stems from the English proverb '*Never put all the eggs in the same basket*'. If an investor invests all of his funds in just one type of asset or one security, there is a greater risk that he may incur losses if that asset or security fails poorly.

Here are few tips that investors may want to look at while investing in such uncertain times:

Firstly, investors often find it difficult to decide on the right time to invest, There is a tendency to invest when everyone else is investing. However, the danger here is that investors may enter the market late and at higher prices. Mutual funds have devised a very sensible solution for investors to deal with the issue of timing – The Systematic Investment Plan (SIP). In a SIP, the investor buys units every month for a specific amount. As a result, his investments accumulate over time, and he is able to participate in the market regularly without worrying about the right timing.

Secondly, every investor must seek to practice asset allocation whether equity or debt is determined after taking into account factors like investment horizon, individual financial goals, age, risk appetite etc. It would be a good idea to be in both and investors who can't determine the ideal asset mix, may want to see a financial planner.

Thirdly, Investors should try to keep a balance. It is a good idea to have a core investment in a well diversified equity and debt fund and then add to it, the other flavours like sectoral funds, specialized funds and the like. Equity funds focusing on different sectors and styles have different levels of risk and return. It is important to have a balance in the choice of products. Among debt funds, the short-term funds would be less risky, but will have low returns. The long-term funds are more likely however they have the potential to earn higher returns.

Fourthly, another important investment decision is how many funds should one invest in? Too little is risky, and too many is unwieldy. It is a good approach to spread investments across 3-4 fund houses, and buy the products of large, well known funds, with a reputation of good management and sound investment processes.

Finally, investors have also to decide upon how often they should review a mutual fund portfolio. Most mutual funds publish their portfolios every month. A review one every six months should be adequate for the investor. Investors can check for returns and performance of a fund

in comparison with its benchmark (published in the report itself) to judge how well a fund is doing.

At this point I would like to stress, that any of these parameters could only be a guiding star and not a guarantee for the future.

Choosing an investment avenue is like getting into a marriage, so do it wisely. Happy Investing!

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