Enrichmentors Wealth Builder Advisory

The application of concepts for building wealth

Which asset class to invest today? Which to exit? How?

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What is in this Issue

From The Editor's Desk

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Dear Reader,

We talked about the basic principles of building wealth in the last two issues- Buy low and sell high-and I shared my learnings over the years about how to buy and sell right the various asset classes.

With the basic clearly laid out, hopefully, your may like to know the most suitable asset class to invest your hard earned money today. With this we start applying the concepts learned in last two issues and help you build your wealth.

You may also now like get into the details of most suitable methods and schemes to invest into the right asset class along with the reason.

As advised in last issue, you also need to know which asset class should you exit these days, why and how.

Equally important is to know which asset classes to hold and how to do that effectively

If you can do this every month and keep your portfolio of investment in tune with the situation, you are surly on the way to building your wealth!

The application of concepts for building wealth

Which asset class to invest today? Which to exit? How?

This wealth builder advisory attempts to answer the following questions.

- *What should be your strategy today for building wealth?*
- *What asset classes should you invest now? Why? How?*
- *What assets classes should you exit? Why? How?*
- *What asset classes should you hold? Why? How?*

What should be your strategy for building wealth today?

As at end of May 2013, the Gold has dropped from its high by 20% while Equity market has reached its previous highs. The Debt market is poised for increase in bond prices as the interest rates fall on account of reduction in inflation and current account deficit. Property market is still sluggish though the rates have not dropped in general. In fact the property prices have appreciated in last few years in spite of sluggish demand on account of high interest rates. Indian economy is also poised to recover with the new Finance Minister working seriously on cutting the current account deficit, making FIIs invest in India along with continued financial reforms. The local political environment and the world economy continues to pose some challenges.

Given the above situation today what should be your overall Wealth Building Strategy

- What should to invest into
- What should you exit and
- What should you hold

Invest	Exit	Hold
Gold, Commodities	Equity	Debt, Property, Insurance

As we noted in the last two issues, most of us are underinvested in Gold which has appreciated well in the long term. The current drop of 20% in the Gold Prices is a good opportunity for investment. I would not predict in the short term if the Gold Prices will further fall or they will rise from here. I would rather use this fall of 20% to invest in Gold with an option to be ready to invest more if it falls further. You can set aside your target investment in Gold as 20% of your total wealth and invest in steps of 4% of total wealth max at a time. You can always choose a lower sum. This way you will be ready to keep investing in Gold even if it further drops by 50%.

Another area of investment is into commodities financing. This will be able to generate a return of 11-14% return on your investment pretax. This investment is good for you if your marginal rate of taxation is at the lower slabs of 10 or 20%. With a very less risk, this provides better yield than the Debt markets.

Given the Equities reaching their previous high, it is a good time to partially exit equities and take the profits. Equity Holdings exposure should be reduced to 10-20% of total wealth, whether in the form of shares or Mutual Funds.

Your investments in Debt, Property and Insurance need to held as it is expected that these will appreciate as we go along.

So the overall strategy will be to switch from Equity to Gold as the Equity Market keep going up.

With this overall wealth building strategy, let us now look at how best to execute this strategy.

How to best invest in Gold & Commodities now?

You have many options to invest in Gold including the following

- Jewelry
- Gold Coins, bars etc.
- Demat Gold
- Gold ETF (Exchange Traded Funds)
- Gold Funds

I prefer to invest in Gold Funds for the investment purpose due to following reasons

- ✓ Does not attract wealth tax as Physical and Demat Gold will
- ✓ No risk of theft or quality like Physical Gold
- ✓ No need to keep track of the price of Gold Units like Gold ETF for taking profits

Gold Jewelry is right way to invest in gold if you are buying it to wear it for various occasions or would like to give to your children on their marriage. This is the costliest way to invest in Gold as you will need to pay the making charges and you can never to sure of its quality unless you buy from very reputed Jewelers like Tanishq etc.

The less costly and more surer route to buy Gold is in Gold Coins and bars etc. from the banks. The issue with such investment in Gold is the safety of keeping gold, especially if the quantity is large. For small amounts, they can surely be kept in Bank Lockers.

Demat Gold is a good way to invest in Gold if you don't want the delivery now and would be happy investing with the knowledge that the Gold you bought would be kept in the safe vaults of the company. The Key thing is to select the right company who would be keeping your gold.

Gold ETFs are also a good way to invest in Gold for investment purposes when you are willing and able to keep track of the Gold Unit Prices and actively get involved in buying and selling these units. In many ways, it is like buying and selling shares.

There are many ways to invest in other commodities like Silver, Copper, Spices etc.

- Physical purchase
- Forward Contracts
- Spot Buying

I recommend investing in commodities through Spot Buying for general investors like you. This method can provide a pre tax return of 11-14% with practically no risk. You buy a lot of any suitable commodity available on National Spot Exchange with an forward contract to sale at an agreed rate. This way you are really financing the commodity deal with surety of sales while buying itself.

Forward contract in commodities through National Commodities Exchange are more risky along with potentially higher profit or loss as the sale prices are not agreed at the time of purchase. You have to sell the contract within a time limit at the prices best you can get which can also be lower than your purchase price. It is like the Derivatives Trading in Shares. This method is suitable for more experienced and knowledge traders in commodities

The traditional mode of investing in commodities has been over centuries in physically buying and selling. This form of investment in commodities has its risks and issue of storage, pilferage, spoilage etc. This is suitable for traders in commodities who have the storage and handling facilities along with knowledge of the commodities.

All the above methods of investment in commodities make you liable to pay the Income tax as per the tax slab applicable

So most suitable means for you as general investor would be to invest in Gold through Gold Funds and in commodities through NSEL.

How to best exit from Equity?

As mentioned earlier, this is the time to partially exit from Equity whether held in the form of shares or Mutual Funds, through the modus operandi of exit will differ.

If your are holding equity in the forms of shares of many companies, you need to keep exiting these company shares in full one by one as and when they peak.

How can you know if these company shares are peaking?

The company shares are peaking for you to exit if

- ✓ Share prices have moved up recently more than by 10% and
- ✓ There are more buyers in the market than sellers pushing the prices up and
- ✓ The share prices is establish new high and
- ✓ You are making a decent return on your holdings.

If all these conditions are satisfied you can sell all the shares of that company and convert your paper profits into cash for reinvestment appropriately.

Can you be sure that you have got the best prices? No!

There is no way to know if this was "the peak" price. You can however be sure that it was one of the peaks and if you are making a decent return, it is worth converting your paper profits into hard cash.

Another confirmatory sign for exiting a shares is when you feel greedy to keep it in spite of making a decent return.

Some of these principles can also be applied in determining your exit from the Mutual Funds.

If you are holding many Mutual Funds, you can exit now the mutual funds that are giving you good returns but are inherently either risky or of "not so good" quality.

What is a risky or "not so good" mutual fund, let me elaborate.

There are several type of Equity Mutual Funds in reducing risk levels

1. Sectoral Equity Mutual Funds where the Funds invest into a specific sector like Banking, FMCG, Pharma, Infrastructure etc.
2. Small Cap Mutual Funds which invest into companies with smaller capitalization
3. Mid Cap Mutual Funds which invest in Mid Size companies
4. Large Cap Mutual Funds which invest into Large companies
5. Diversified Mutual Funds which invest into a portfolio across sectors and capitalization

As the market moves up, the risk of fall in share prices keeps going up. At such a time like now, you should reduce this risk by profitably exiting from high risk mutual funds like Sectoral, Small and Medium Caps.

You should also profitably exit now from "not so good" mutual funds even of Large caps or diversified nature.

The performance of each Mutual Funds is determined by some parameter like Sharpe Ration and Alpha. These are measurements of the past returns for a unit of risk. You should get this information for last 3-5 years for all your equity mutual funds and exit from bottom 50% now. The obvious assumption is that you are holding about 20% of your wealth in equity as of now. The Goal should to reduce this to about 10% now and be ready to invest back as and when the equity market falls by 10% of more later

If you over come the greed of keeping more than 10% in equity now, you are on the way of building your wealth!

How to hold Debt, Property and Insurance?

You might ask what is there so great in holding Debt, Property and Insurance investments! There is a pressure or temptation in each of these to exit at the wrong time. Let me talk about each of these staring with Insurance.

Most Unit Linked Insurance Plans (ULIP) do not give your any return during the first 5 years while having been promised incorrectly of a good return after 3 years. Given this outcome, a large number of ULIP holders get frustrated and what to exit from these Plans. It requires some understanding and some patience not to discontinue from these insurance plans.

Most of insurance companies take money from you in the first 5 years in the form of various charges and that is the main reason for your not making a return in first 5 years. These insurance companies start giving back you bonuses from the 6th year to full term.

So if you exit from a ULIP in first 5 years, you loose a lot in the form of charges paid as well as exit charges.

Know this and you will do well to wait patiently for your full term of insurance to be over to get some decent return on your investment in such plans.

There is challenge in holding your debt investments as it is very tempting in the rising market to switch your debt funds to equity funds. It requires a strong resistance to this temptation in a rising market not to invest in equity as on today. The best way is to ask your self how much will the equity market go up further in a year if you shift your funds from debt to equity. Since you make a 10% annual return after tax in debt funds, it will be only worth shifting to equity if you make more than 12% returns through appreciating in equity. Also ask your self the question about the risk in equity vs debt. With significantly higher risks in equity markets, any shift would be justified only if it make double the return in equity- 25%. So will the market appreciate by 25% is next one year? Very unlikely. Wait for it to fall by 10% and then your investment is equity will be justified.

Holding your property investments is relatively easy. As I leaned from one of my cousins while holidaying in Udaipur, just setup a price double that of market for sale.

Let me summarize here now.

Given the current market situation in India and the world, Gold and commodities are worthy of fresh investment if you hold less than 20% of your total wealth in Gold. Best way to invest in gold is through Gold Mutual Funds and in commodities through National Spot Exchange.

If you hold more than 10% of your wealth in equity either through shares of mutual funds, it is good time to encash these excess equity holdings profitably. This is best done by selectively selling the shares when they reach one of the peaks or exiting risky or "not so good" mutual funds

Holding on to Debt funds, insurance and property investments is critical to your building wealth. This is best achieved by setting high profitable exit barriers for each of these.

If you stay rational and avoid emotional buying and selling driven by Greed and panic, you will build wealth. Stay tuned, more update next month!