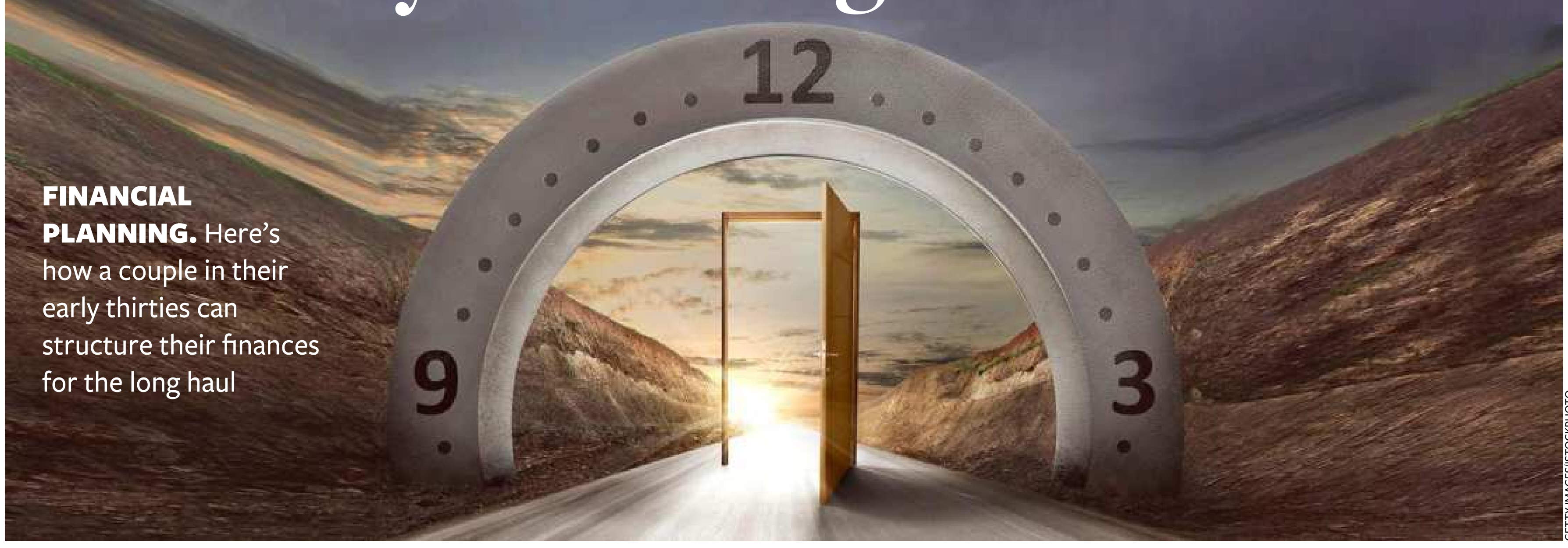
‘Five-year plans’ for a 25-year savings horizon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FINANCIAL PLANNING. Here's how a couple in their early thirties can structure their finances for the long haul

Sridevi V

Young couple Sandeep and Kamini approached us for financial planning. They are in their early thirties.

They did not have clarity about their financial goals. A simple savings and investment plan without worrying too much about an increase in future income with reasonable returns was their expectation. They were not sure if a financial planner can work that way. They both agreed to invest ₹10 lakh per year for the next 25 years out of which 50 per cent will be committed for the long term and the balance for the short to medium term.

They both are from affluent family backgrounds. Their interests vary — from travel to building legacy to support social causes. Kamini is a very enterprising person and runs a family business. Sandeep is working with a consulting firm, in a mid-management role.

Sandeep is concerned about job security in his mid-40s. They have a daughter aged 3. They both have adequate life and health insurance for themselves and their parents and all are leading a healthy lifestyle. They spend ₹12 lakh per year on living expenses.

RECOMMENDATIONS

Based on the discussion, they would like to have two years of expenses in safe avenues at any point of time. This will provide the flexibility to opt for a change in career or handle job loss for Sandeep. Kamini wants to build an equivalent amount to support her business or for its expansionafter 5-7 years. It was also suggested to focus on the daughter's education expenses and their own retirement.. This will also provide them with guidance on selecting the investments.

1. Their requirements were divided into 5 baskets:
   a. Protection
   b. Stability
   c. Responsibility
   d. Retirement
   e. Legacy
2. It was suggested to look at the investment period as 5 blocks of 5 years, equally dividing the 25-year time horizon. For the first five years, they will be investing 50 per cent of the investible surplus towards protection need. This will help them build approximately 2 years of living expenses in the first 5 years. This investment basket will be in safe avenues with high liquidity. The balance of 50 per cent will be directed towards daughter's education in the Responsibility Basket at an expected return of 12 per cent CAGR.
3. In the next block of 5 years, 50 per cent of the investible surplus will be directed towards building the Stability basket for a sum of ₹25 lakh at current cost. The stability basket may have exposure to moderately higher risk than Protection Basket based on their risk position in that block of years. The balance of 50 per cent will be directed towards their retirement with an expected return of 12 per cent CAGR.
4. By the end of the 10th year, they will have ₹25 lakh in Protection basket adjusted for interest and taxes and ₹25 lakh adjusted for moderate growth in the Stability Basket with mostly fixed income investments. The first 5 years of investment in Responsible basket at an expected return of 12 per cent will be at ₹56 lakh and Retirement Basket may have ₹31.76 lakh.
5. In the third block of 5 years, they will be spending from Responsibility basket towards daughter's education, and they will also be redirecting 50 per cent of investible surplus towards this requirement. Hence, in total, they will be having ₹56 lakh plus the additional allocation of ₹25 lakh in that block of 5 years towards their daughter's college education. This is equivalent to ₹29 lakh at the current cost of college education at 10 per cent expected inflation for the next 10 years.

   This is a reasonable accumulation under the given constraints. In this block of 5 years, they will be investing the balance 50 per cent in their retirement basket. Assuming Protection and Stability Baskets were not withdrawn, these baskets may have the interest and growth added to the respective baskets.
6. In the 4th block of 5 years, the entire 100 per cent of the investible surplus will be invested towards retirement. This will help them reach a target value of ₹2.18 crore at the end of 20 years.
7. In the last block of 5 years, they will be spending or investing in the legacy fund. Without further contribution, their Retirement Basket will grow to ₹3.84 crore by the end of 25 years approximately. They can expect ₹16.9 lakh per year retirement income at then cost for the next 30 years, adjusted for inflation of 5 per cent per year and an expected return of 7 per cent per year. It has to be noted that the retirement income would be equivalent to ₹5 lakh today at 5 per cent inflation per annum.

The family was earlier approached by one of their friends to invest ₹10 lakh per year for 25 years. Kamini and Sandeep realised at that point about their saving potential and wanted to understand the alternatives and their search ended with the financial planner. The holistic approach of financial planning covering their requirements amidst the anticipated constraints provided more clarity to them. There could be alternate strategies if not for those constraints and their personal preferences to reach their milestones.

SAFETY FIRST
Kamini and Sandeep wanted to have two years of expenses in safe avenues at any point of time

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9 timeless lessons from Warren Buffett

INVEST SMART. As the Oracle of Omaha marks his 93rd birthday, we cull insights from his 9 decades of investing

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REUTERS

The Oracle of Omaha, Warren Buffett, celebrated his 93rd birthday recently. By his own sense of humour, since he is a nonagenarian, the candles would have cost more than the cake! In his annual newsletter to shareholders published in 1994, he refers to the 100th birthday celebration of Rose Blumkin, founder of one of Berkshire Hathaway's portfolio of companies, Nebraska Furniture Mart. Blumkin marked her 100th year in 1993, and according to Buffett, given the number of candles required, that was likely the costlier item.

Since Buffett made his first investment at age 11, he comes with an investment experience of 82 years that appears unparalleled. Here are nine words of wisdom from Buffett and some elucidation gathered from his investment career spanning as many decades – that are still relevant as always.

1 “An investor needs to do very few things as long as he avoids big mistakes.”

This advice is very relevant in our age of information overload, wherein the urge to react to the plethora of data flows and views and opinions can be strong. Many times, it can turn out to be counterproductive. One big mistake can outdo many right investing decisions.

2 “A fat wallet is the enemy of superior investment.”

Let not your lack of or limited financial resources constrain your investing journey. The limitation can become a key to judicious and superior investment decision.

3 “As they say in poker – if you have been in the game for 30 minutes and you don't know who the patsy is, *you're* the patsy.”

If you buy a stock without clearly understanding the business and valuations, then you can end up being the patsy.

4 “We do know that the less the prudence with which others conduct their affairs, the greater the prudence with which we should conduct our own affairs.”

Patience is one of the greatest virtues in investing. Often, irrational markets can sustain for long and test the tolerance of value investors. So, as Buffett says, one needs to stay prudent as long as markets reflect less prudence. A good investor will wait for the markets to blink first!

5 “In a finite world, high growth rates must self-destruct. If the base from which the growth is taking place is tiny, this law may not operate for a time. But when the base balloons, the party ends.”

If you are ever tempted to invest in a company where a story of growth is sold to investors (like the new age IPOs of 2021), disregarding other fundamental metrics, this quote should serve as a guide. Growth will taper after a few years, and overlooking other fundamental metrics like profitability and valuation will be costly when the party ends.

6 “In Wall Street all too often, what the wise do in the beginning, fools do in the end.”

”If you ever have the FOMO or fear of missing out feeling, resist it. It is no fun joining the party in the end and footing the whole bill!

7 “It's no sin to miss a great opportunity outside one's area of competence.”

Elon Musk recently took a jibe at Buffett, claiming that Buffett missed an amazing opportunity — by not investing in Tesla when it was trading at well less than one per cent of its current value. However, it appears he is unaware of Buffett's investment principles, as the above quote indicates. So, if you have missed an opportunity, don't waste time on regret; markets keep offering new opportunities.

8 “Inactivity strikes us as intelligent behaviour.”

Stock markets reflect the views of millions of market participants playing out tick by tick. You can never time your investing decisions perfectly. So, if you are convinced about an investment after due research, some level of inactivity is required to let it play out.

9 “Speculation is most dangerous when it looks easiest.”

In an era of “finfluencers” posting fake P&L on social media to mislead all and sundry into derivatives trading by creating the illusion that it is easy to make money by speculating, this quote serves as a profound piece of advice as well as a warning.

SAMPLE THIS
As they say in poker – if you have been in the game for 30 minutes and you don't know who the patsy is, you're the patsy

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Also available on Spotify, Apple Podcasts and Google Podcasts

ALERTS.

Innovative income plan from ICICI Pru Life Insurance

ICICI Prudential Life Insurance has launched an innovative income plan, ICICI Pru GIFT Pro, which provides customers the option to receive either a year-on-year increasing income or a constant regular income. In addition, the life cover component of this non-participating savings product ensures that the family has financial security. ICICI Pru GIFT Pro allows customers to customise the product to their unique needs by providing a choice of income benefits and premium payment terms, among other flexibilities. Along with assured long-term income, the product offers customers the option to receive a lump sum benefit.