Be Empowered

Have separate bags of money for your goals

Treating your savings and investments as one big lump of money can leave you struggling to meet your financial goals in the future.

It’s not uncommon to find people who have saved and invested enough but are still struggling to meet their fi-nancial goals. Often, the reason is that they were not really investing, instead they were just putting money away in some instrument or the other. This may sound like the most obvious thing in the world, but the real point of investing is not to put money aside, but to eventually use the corpus. The problem is that this is hard to do in an organised manner, unless the investment was tailored to match that particular expense. You don't have to be able to foresee the future to do this. All you need to do is make reasonable guesses about the obvious financial goals of your life. So what exactly is a financial goal for your investments? It's not something as general as 'Make lots of money'. It's more precise, and involves concrete financial plans for things you would like to do in the future. Only when we have the goals set out can we answer questions about the kind of investments we need. Here are some instances: you'll need money for your daughter's higher education after six years; you will be retiring in 18 years and would like to maintain your lifestyle afterwards.

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Without this kind of clear understanding of your needs, it's hard to make good investment choices. It's easy to make a random statement like, "I need `1 crore after five years." But suppose you can't invest the sum required to reach that target in five years. Then what? Without an exact goal, you can always backtrack. Would `90 lakh be enough? How about seven years instead of five? How about starting next year instead of now? How about forgetting all about it and buying a new iPhone? But, with a precise goal, the choice is obvious. If you can't reach a goal, it generally becomes quite evident, as does what you need to do next. When the goals are very precise, the returns you need, and the variability you can afford in each case becomes clear. Most importantly, it also becomes amply clear that each of these goals must have a set of investments that are chosen specifically to meet them. In other words, we must have separate portfolios for separate goals. The word 'portfolio' is generally used to signify all the investments and assets that an individual or a family possesses. This is problematic. It makes far more sense to have separate portfolios for separate goals-a set of investments that are aimed at meeting one specific financial goal. If you think it would be difficult to keep track of multiple portfolios, there are portfolio managing tools available online which can help. This method of having separate portfolios is actually quite similar to what many housewives have always done. I had an elderly relative who ran her family's finances this way. She had a number of hand-stitched drawstring pouches. Each one was a separate `budgetary head'. When her husband brought home his salary, she would put away the exact amount of money for a particular expense in the designated pouch. There was a pouch for groceries, one for the salaries of the help, one for the dhobi’s charges, and so on. The system worked very well. That's all I'm asking you to do with your savings and investments. Have a separate financial plan for each of your goals. There are just three inputs needed to start organising the bags. The first is the amount, the second is when it's needed, and the third is whether there is any leeway possible in that target date or the target amount. The time period can range from immediate, which is the emergency bag, to up to 20 or 30 years for retirement funds. There is a simple sliding scale of volatility versus potential returns across time. Broadly, one can classify time scale into immediate to one year, one to five years, and five years and above. Each needs a different approach and mix of investments. The shorter investment period, the more you should lean towards asset types that have lower variability, but at the cost of lower returns. For longer periods, it would be the opposite. As for deciding in greater detail on how to structure these portfolios, we'll tackle that in the coming weeks.

Source & Courtesy: Dhirendra Kumar, CEO, Value Research, ET Wealth.