Business Standard

Ignore bitcoin mania: Five personal finance lessons from 2017

Rebalance your investment portfolio, diversify beyond fixed deposits, and don't fall prey to the bitcoin mania

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For those who had an allocation to equities, 2017 was a very good year. But with interest rates on fixed-income products falling, fixed-income investors took a beating. Here are five key lessons you can draw from the year that has just gone by.

Rebalance from outperformers to underperformers: The equity markets turned in a very good performance this year. While the Nifty 50 is up 30.71 per cent, the Nifty Free Float Midcap 100 Index is up 50.09 per cent, and the Nifty Free Float Small cap 100 Index is up 60.41 per cent over the past year. Meanwhile, valuations have also climbed, making this a very expensive market. While the Nifty 50 is at a trailing price-to-earnings ratio of 26.51 per cent, the Nifty Free Float Midcap 100 Index is at 51.37, and the Nifty Free Float Small cap 100 Index is at 100.77.

Investors need to strike a balance. On the one hand, they should not become so euphoric about equities that their allocation to this asset class exceeds the pre-assigned level. At the same time, they should not get scared by the high valuations in the markets that they quit the equity markets altogether. The need of the hour is regular rebalancing. "Sell equities and put that money in underperforming asset classes like fixed income and gold," said Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors. In particular, your investment in mid- and small-cap funds should not exceed 25-30 per cent of your portfolio.

Stick largely to shorter-duration debt funds: In the last quarter of the year, the 10-year G-Sec yield started firming up (it is currently at 7.37 per cent). Funds that had a very high average duration got caught on the wrong foot and their returns have come down. The rate rally seems to be nearly over. Hence, it would be prudent to have around 60-70 per cent of your debt fund portfolio in short-duration funds. You may also invest in accrual oriented corporate bond funds. Only a small portion of your debt fund portfolio should go into riskier classes of funds like longer-duration funds (income and dynamic bonds funds), if you have a horizon of three years or more. Similarly, only a small portion should be allocated to credit opportunity funds.

Diversify beyond fixed deposits: This was not a good year for investors investing primarily in fixed deposits and post office small saving schemes, with returns offered by these instruments coming down. With the decline in interest rates having stopped for the moment, fixed-income investors can heave a sigh of relief, at least for the moment. But the relief may not last long. If the RBI manages to keep inflation on a tight leash, the structural movement in interest rates may be downward. Hence, fixed-income investors need to do two things. One, within the fixed-income category, they should hunt for better returns. Some smaller banks, for instance, give higher returns on their fixed deposits than others. Returns from some post office small saving instruments (Senior Citizens Saving Scheme, Sukanya Samriddhi, etc) are still attractive. Look at the maturity of these products, consider your own investment horizon, and if the post-tax return in them appears attractive, go for them. But you may in future also have to move to market-linked instruments. Begin with shorter-duration debt funds. Due to the more attractive tax treatment after three years, they tend to outperform fixed deposits. If time is on your side (seven years or more), make a small start in equities also.

Opt for ready-to-move-in properties: In real estate, this was a landmark year when many states set up the Real Estate Regulatory Authority. But implementation is still patchy. If you belong to one of those states where the regulator is not functional, pay a higher price and buy a ready-to-move-in property.

Don't fall prey to the bitcoin mania: Bitcoin has been perpetually in the news this year: up one day, down the next. Enrollments on Indian bitcoin exchanges have been on the upswing as many retail investors climb on to the bandwagon. There is also talk of the government coming out with regulations for bitcoin.

Bitcoin doesn't pay dividends, nor does it generate any cash flow, so it has no intrinsic value. "This is an exotic asset class. Don't put more than 10 per cent of your portfolio in it," said Arvind A. Rao, financial planner and founder, Arvind Rao & Associates. In fact, only put that money whose loss won't affect you greatly. Book profits regularly. And do pay tax on your gains in this asset class, since four-five lakh tax notices have already gone out to HNIs investing in bitcoin.

Get a Sebi registered investment advisor: Finally, if you are doing well in your career and your income is on the upswing, get a Sebi registered investment advisor. Handling personal finances is becoming increasingly complicated, and most of us are not up to it, given our job and other pressures. By helping you avoid costly mistakes and keeping your finances on track, he will not only justify his fee but also help you build long-term wealth.

Happy investing in 2018.