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8 biggest investment mistakes: planner survey

Here are eight of the most common mistakes that investors make, according to financial planners. Time to take corrective action

Kayezad E. Adajania

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When most of the top 19 financial planners of India point to some common investor mistakes, it's a good idea to listen. The same planners had alerted us earlier about the mistakes investors make with mutual funds. You can read it here: *bit.ly/2p2Va8U*. Here are six investing mistakes people commonly make. These are money traps that you would do well to avoid.

1. Mixing insurance and investment

Mixing life insurance and investment is not a smart way to manage risk and money. Twelve of 19 financial planners said most investors mix the two. Investors use both unit-linked insurance plans (Ulips) and traditional policies or endowment plans to do this. With benefits and costs unclear in traditional plans, the logic of these plans appeals only to the agents who get high upfront commissions. Worse, investors are confused. "Many do not even understand whether what they have bought is a traditional policy or a Ulip, the features and benefits, suitability, and whether there are better products in insurance or outside that can work more effectively for that goal, and so on. The fact is that insurance is a really long-term contract and one needs to give it proper thought before committing," said Suresh Sadagopan, founder, Ladder7 Financial Advisories.

2. Being underinsured

Eight of 19 financial planners said they find plenty of life insurance policies in portfolios but very little cover. Shyam Sekhar, founder, ithought, a mutual fund advisory, gave the example of a client who had five life insurance policies with a total annual premium of Rs75,000 and sum assured of Rs25 lakh. The person actually needed a cover of Rs2.50 crore. "The sole purpose of life insurance is to provide for your family in your absence," said Sekhar. How much cover you need must be calculated taking into account the dent in your household income if you are not there. "Many investors are under-insured or overly allocate funds to insurance. For example, we often see a bread-earner and spouse both insured for similar amounts. These decisions are often made emotionally rather than pragmatically," said Roopali Prabhu, head-investment products, Sanctum Wealth, a boutique advisory.

Advisers recommend a cover equal to 12-15 times your annual expenses or 8-10 times your annual income. And stick to buying a term plan.

3. Excessive or expensive loans

Often people take loans when their income levels or existing investments are not sufficient to fund a so-called unavoidable expense. Banks are only too happy to help. And with most of us carrying at least one credit card—financial planners swear some clients have half a dozen credit cards—you don't really need to go through the process of visiting a bank to borrow money. Many of those who use credit cards tend to pay not the full amount that is due but only the minimum amount and simply roll over the rest. "The stigma associated with borrowing has reduced significantly in our generation. Such borrowing helps in consumption by spending tomorrow's income, today," said Shyam Sunder, managing director, PeakAlpha Investment Services Pvt. Ltd. Eight of the 19 financial planners said that most first-time clients have excessive and expensive loans.

Deepak Chhabria, chief executive officer and director, Axiom Financial Services Ltd., a Bengaluru-based distributor of financial products, cited the example of a young couple that was paying equated monthly instalments (EMI) for personal loans they had taken over years to fund overseas holidays. Their state was such that they were unable to meet monthly expenses. "Loan for creating an asset is acceptable, but to fund consumption is best avoided," he said.

According to an EMi calculator of loan portal Bankbazaar.com, the EMI for a personal loan of Rs5 lakh would be around Rs12,100 if you wish to repay in 5 years. But just the total interest outgo would be Rs2.29 lakh, which would be in addition to the Rs5 lakh principal.

4. Excessive property and physical investments

Real estate and gold are dominant in of investors' portfolios, said eight out of 19 planners. Amol Joshi, founder, PlanRupee Investment Services, said one reason behind why many people buy real estate is they feel the rent is guaranteed yield. "But rental yield in India is 2-3%. This is far below what other assets can generate," he said, adding that rent income is taxable unlike equities.

Budget 2017 has further limited the level of set-off of losses to Rs2 lakh under the 'income from property' head. This can be set off against other sources of income, but only till Rs2 lakh. Additional losses can be carried forward for 8 consecutive years, but can be set-off only against income from house property to the extent of mentioned limit. Earlier, there was no limit, which incentivised many to buy a second or even a third house and pay for loans. Now, if you take a home loan to buy a second house for the purpose of renting it out, watch out. "Calculate the required appreciation to break even with post-tax interest paid, before jumping into such a decision," said Bharat Phatak, founder and director of distribution firm Wealth Managers (India) Pvt. Ltd.

Gold is another favourite in the Indian household. But too much of gold—especially bought from an investment point of view—is not a good strategy. In fact, over the past 5-year period, gold has lost 5% in value, while equity has given a return of 11.90%.

5. Poor savings and tax management

Seven of 19 financial advisors told us that investors often have poor savings and investments in tax inefficient instruments. From not having an emergency fund, according to D. Muthukrishnan, a Chennai-based certified financial planner, to having "too many bank accounts", according to Vishal Dhawan, founder and chief executive officer, Plan Ahead Wealth Advisors, such inefficiencies slow down wealth creation over a long period. "The same people who don't mind investing in a Public Provident Fund with a 15-year lock-in, avoid tax-savings equity mutual funds that come with only a 3-year lock-in," said Valmiki Khatri, partner, Krushna Finserv LLP, one of India's largest mutual fund distributors.

Further, many of us invest just to "save tax". But there's more to investments and financial planning than tax-planning.

6. Exotic products, ordinary returns

There is no dearth of investment products but should you own them all? And more importantly, should you invest in them despite their complexity? Five of 19 advisers told us that toxic products are a part of many portfolios. From investing in private equity funds, capital protection oriented funds or structured products, these avenues can create havoc if you don't understand the risks they carry.

Exotic products sometimes fail because of strategies that didn't work. According to data from News Corp VCCEdge, private equity funds invested around $137,758 million between 2005 and so far in 2017, and have exited (sold shares of underlying companies) of around $53,600 million. To be sure, this is not a like to like comparison since investments made according to a strategy, say, 2 years ago, may not be up for redemption now. But the wide chasm between overall investments made and exited from in the past 10 years point to the fact that not everything worked out as planned.

7. Lure of IPOs

While direct investment in equity is good for those who can read balance sheets, we recommend going through equity mutual funds if you don't have the wherewithal to make sense of annual reports and cash flow statements of companies. Four of 19 financial advisers said many investors' portfolios have a large portion of equity shares they had bought during initial public offers (IPOs). Investing in direct equities is not bad, but if you invest in IPOs blindly, and without understanding the company's business and the segments in which it operates, the strategy could backfire. According to Prime Database, of the 24 IPOs launched in 2015-16, the share prices of seven companies are still lower than their issue prices, as on 28 April 2017. Of the 49 companies whose IPOs got listed since April 2016, 11 companies' share prices are below their issue prices.

8. No estate planning

Three of the 19 financial advisers said investors don't make Wills or plan their estate. Before you make a Will, we suggest you ensure that your investments are held in joint names so that it's easier for the second holders to take over. "Often, we notice that investments have no nominations," said Dhawan. While nominees are merely trustees of investments till the rightful heir comes along (unless there's no legal heir or claim, in which case the money could go to your nominee), nominations ensure that the transfer becomes a smooth process. A Will, though, ensures that your assets are rightfully bequeathed to legal heirs. If you have multiple heirs, a Will helps avoid any future conflict.

"Succession planning is perceived as important only for the wealthy. However, it is equally important for any individual, irrespective of income strata, to ensure that the wealth they have built is transferred to the next generation. This would include making Wills, having joint holdings, and organizing the information, to ensure their successors don't spend years getting possession of the wealth," said Prabhu.

Take note of these mistakes and take corrective action to stay financially fit.