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Don't Park All Your Retirement Funds In FDs

Diversify portfolio to ensure returns are higher than inflation, tax-efficient

Vishal Dhawan

Recently-retired Vijay Parekh lives in Mumbai with his wife Megha, a home-maker (all names changed). They have two children, both are married and are well-settled.

Post-retirement, the couple had the following queries and goals:

- Are their savings are sufficient for their post-retirement life?
- After five years, they want to gift an international holiday to their children and grandchildren, which currently costs Rs 6 lakh.
- Ensuring a corpus to meet any medical emergency.

KEY NUMBERS

Basic expenses: Rs 7.5 lakh/year

Net worth: Rs 1.45 crore (excluding value of primary residential home)

EXISTING INVESTMENTS

Equity mutual funds: Rs 11 lakh

Bank FDs: Rs 1 crore

PPF: Rs 30 lakh

Savings accounts: Rs 4 lakh

GOALS

RETIREMENT PLANNING (2015)

Current annual expenses: Rs 7.5 lakh

At an assumed annual rate of inflation of 8%, the required retirement corpus is Rs 1.5 crore (Life expectancy 80 years, Post retirement inflation 8%, yearly growth of corpus at 8%)

MEDICAL CORPUS (2015)

Current value: Rs 5 lakh for each, total Rs 10 lakh

FOREIGN HOLIDAY (2020)

Current value: Rs 6 lakh; future value: Rs. 8.8 lakh

Illustration: Mahesh Benkar

Recommendations

Retirement corpus: The current level of net worth is insufficient to cover their retirement. With most of their funds in bank FDs, they will need to consider how to make the portfolio more efficient from both the taxation perspective as well as to enable them to beat inflation. They could look at moving a part of their funds into debt-oriented mutual funds so as to achieve tax-efficiency at a portfolio level. Due to indexation benefits, investments in debt funds for over three years would be more tax efficient as compared to FDs.

There are two critical items to note for their retirement portfolio. Firstly, fixed income investments should be laddered to reduce reinvestment risks. That is they should be invested in such a way that they mature at different times. Secondly, a portion of the portfolio should be allocated to inflation-beating assets such as equity or balanced mutual funds as well so that it can beat inflation over the long term. Mutual funds allow you the flexibility to set up Systematic Withdrawal Plans (SWPs) that can give you a fixed amount each month and are more efficient than dividend options for investors in a higher tax bracket due to the higher level of dividend distribution tax on debt oriented mutual funds.

Medical emergency corpus: Although there is adequate liquidity in the form of bank FDs, there is a need to separately earmark Rs 10 lakh as a medical emergency fund. It could either remain in a fixed deposit or be parked into a liquid fund. With SMS registration on liquid mutual funds available today, access to these funds could be very smooth.

Fund for international holiday: For the holiday that they want to gift to their children and grandchildren, they could park a lump sum of Rs 5 lakh or start an SIP into an equity-oriented balanced fund as they have a five-year horizon to grow this corpus to the required Rs 8.8 lakh.

CASE STUDY I

Conclusion

The Parekhs are recommended to diversify and rebalance their portfolio to ensure regular cash flows from investments in a more tax efficient manner. In addition to the milestones which are five years away or cash flow needs that are not immediate, they could consider some equity exposure to their investments to fund those goals as well as to beat inflation.

The writer is founder, Plan Ahead Wealth Advisors

SWATANTRA INITIATIVE ON ETNOW

UTI MF Swatantra initiative will soon be launched on ETNow as well. In the next few weeks, the following topics will be covered over several episodes: senior students joining workspace, young working professionals, single working professionals (female) and married professionals without children. If you belong to any of these groups and have queries related to financial planning, you could post them on **www.indiainvestkaro.com** and some of the most relevant ones would be answered by experts and professionals from the field.