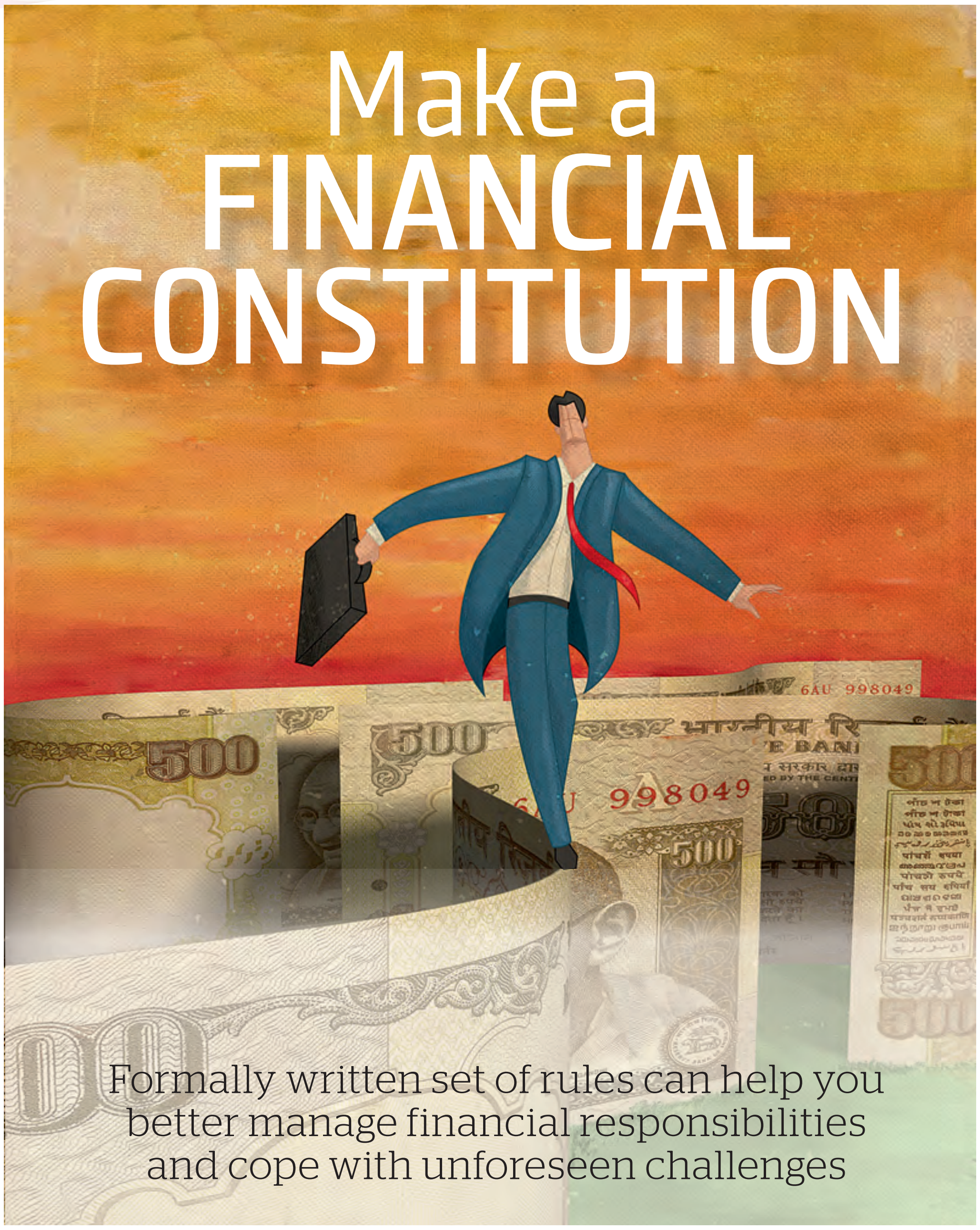
Make a FINANCIAL CONSTITUTION



Formally written set of rules can help you better manage financial responsibilities and cope with unforeseen challenges

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On January 26, 1950, India became a republic and instated its constitution — a document that has since been a guiding light to the government and its people. For the people of India, it reminds them of their rights and obligations, and to the government, its duties.

Such is the power of a formally written document. As the country celebrates its 66th Republic Day, we thought of helping you draw out a financial constitution that would direct you and your dependants through life effortlessly.

Just as we have fundamental duties in our constitution, we have formulated six fundamental obligations for your financial life. Pledging and abiding by these rules can set you on a path of prosperity and make sure that all your goals are attained. As Vishal Dhawan, a Mumbai-based financial planner, shares:

a. Plan for contingencies/emergencies: I shall take care of my dependants and myself by planning ahead for contingencies/ emergencies such as unexpected job losses, setbacks in health, and large unexpected expenses.

b. Manage risks: I shall make for provisions and investments that cover my loved ones against sudden loss of life, disability, health challenges or loss of assets like houses, cars, etc. I will take adequate insurance, which is a good way to mitigate these risks.

c. Define goals : I understand that I have to provide for my retirement, education of children, their weddings, asset purchases, vacations, and save for setting up businesses, etc. I shall identify best investment classes and invest regularly.

d. Revisit and review investments: I shall create appropriate asset allocations, and review and rebalance my portfolio on a periodic basis to ensure success.

e. Strategies for wealth distribution: I shall employ financial tools such as nominations, wills, trusts, and charity to help effectively manage and distribute wealth.

f. Sharpen the saw: I shall preserve the greatest asset that I have — myself. I shall allocate a portion of income regularly towards upgrading my skills professionally and developing a balanced programme for self-renewal in four areas of life, which includes physical, social/ emotional, mental and spiritual.

Game plan

Now that we have clearly defined our financial obligations, it is important to identify means and ways to invest. The importance of saving for the rainy day is taught early in childhood. Remember the grasshopper and ant story, or pearls of wisdom of your elders? The idea is to put the teachings into practice and build upon a legacy that creates wealth and inspires others.

Start early: Saving early take into account the effect of compounding and helps in wealth creation, which in turn keeps you away from personal and expensive lines of credit.

Take for instance a person who starts investing Dh2,000 at the age of 25 every month towards his retirement kitty. By the age of 60, he would be able to prepare a nest egg of almost Dh4.5 million. Whereas, if he starts a decade later, at the age of 35, and invests Dh2,000 a month, he will garner just about Dh2 million in 25 years. The calculation takes into account the compounding rate of interest of 8 per cent annually.

Giving your investments time to grow will spell magic for your financial health.

Saving is different from investment: Most of us innately know that saving and investing are not the same, but do we understand the difference? Clarity in this distinction can greatly impact one's financial well-being, explains Cherian John, Zone Chairman — Middle East and Africa, Million Dollar Round Table (MDRT). "Savings is a portion of disposable income that is accumulated and not spent on consumption of consumer goods. The purpose of saving money is to use it for a specific need within a short time frame."

Financial pundits suggest setting aside at least three months of salary as savings or a contingency fund to take care of any emergencies that might try to put a roadblock on your smooth ride.

Investments on the other hand are for wealth creation, and are accumulated gradually over the years. "Investments do involve greater risk, but investments also yield much greater returns when left long enough to ride out the turbulence of the stock market vagaries, or cyclical nature of other investments," explains John.

Identify financial goals: One of the best ways to progress fairly well with financial responsibilities is to start by identifying the goals. Some of the trenchant goals for a family with children can be children's education, funds for annual vacations and retirement planning. "A few questions need to be answered before you start investing for retirement: Is there a safety net in place by the government? Where do you plan to retire? How much money will you require every month? What will your health conditions be like? Do you have health insurance to cushion the medical expenses or your health expenses be accounted from the retirement kitty? Besides, you should also know your risk appetite," explains Taher Fakhri, Regional Head of Strategies and Risk, FP International.

"There is lack of an open architecture in the UAE. Therefore, savings can be done through insurance saving products, which provide a range of platforms. Besides this, NRIs prefer to invest in real estate and gold (within commodities). No matter what asset classes you choose, it is absolutely critical to consider diversification of investment: geographical as well as asset class. If you are planning to invest in other country/ countries, do consider the foreign currency risk. Hedging your investments against this risk is imperative," adds Fakhri.

And lastly, avoid being complacent and standby the side after making investment decisions; revisit the portfolio and make amendments, if needed. "It is important to review the investment portfolio at least once every year, or at least once in two years," notes Dhawan.

Dhawan also advises writing a will as soon as you acquire your first asset and take initial steps towards wealth creation. "It is absolutely critical (to have a will), so that distributions can be done as planned and without excessive effort to get access to the residual wealth. Since succession laws can depend on geography or religion, it is critical to have a good understanding of succession laws before creating this document."

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