Don't stop or lower investment in SIPs

GET PERSONAL

Vishal Dhawan

SYSTEMATIC INVESTMENT Plans (SIPs) have become extremely popular over the last few years to invest in stock markets. They allow investors to take a gradual exposure to stocks by investing small amounts every month in mutual funds or in stocks.

One of the biggest advantages of investing in an SIP is the benefit of 'rupee cost averaging'. Essentially, what rupee cost averaging achieves is that a fixed amount of money is invested each month on a fixed date, irrespective of the market level.

When the markets are at a higher level, less units will be purchased with the same amount, while when markets are at a lower level, the number of units purchased will be higher. Over a period of time, an average price is achieved which is a result of purchases at the lower and higher prices at multiple levels of the stock market.

With the outlook for the stock markets having turned negative over the last few weeks, driven by both domestic and international factors, people have started wondering if they should invest or suspend the investment plan for a while.

In our view, if you stop our investment, it will defeat the very purpose of using the SIP strategy. With the markets in the bearish trend, this is actually a good time for you to invest in SIP as you can continue to get a higher number of units at lower prices over the next few months.

Mr Warren Buffet, arguably the most successful investor of our times in his letter to his shareholders in 1997 put this very aptly in the form of a short quiz: "If you plan to eat hamburgers throughout your life and are not a cattle producer, should you wish for higher or lower prices for beef? Likewise, if you are going to buy a car from time to time but are not an auto manufacturer, should you prefer higher or lower car prices?" These questions, of course, answer themselves.

But now for the final exam: If you expect to be a net saver during the next five years, should you hope for a higher or lower stock market during that period? Many investors get this one wrong. Even though they are going to be net buyers of stocks for many years to come, they are elated when stock prices rise and depressed when they fall. In effect, they rejoice because prices have risen for the "hamburgers", they will soon be buying. This reaction makes no sense. Only those who will be sellers of equities in the near future should be happy at seeing stocks rise. Prospective purchasers should much prefer sinking prices."

We ran a simulation for investors who invest in SIPs during the period of Jan 2008 to June 2011 when the markets peaked, subsequently crashed and then recovered significantly. We found that even though the BSE Sensex is currently down eight per cent from those levels, SIP investors in a cross-section of funds would have returns ranging from 12 per cent to 25 per cent per annum assuming that they continued with their SIPs through this period of three and a half years ago.

Considering this empirical data, we strongly recommend that investors use this opportunity to enhance their SIPs, rather than stop or lower them. In fact, we would recommend that wealthy investors who have traditionally stayed away from SIP strategies and actively try to time the market, should also use this opportunity to do SIPs or systematic transfer plans.

(The writer is a certified financial planner by profession and founder of Plan Ahead Wealth Advisors.)

INVESTOR'S CALL

- If you stop or lower your investment in systematic investment plans (SIPs), it will defeat the very purpose of staggered investment strategy.
- With the markets in the bearish trend, this is actually a good time for you to invest in SIP as you can to get a higher number of units at lower prices over the next few months.