Diversify portfolio to maximise your gains

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EMERGING SIGNALS

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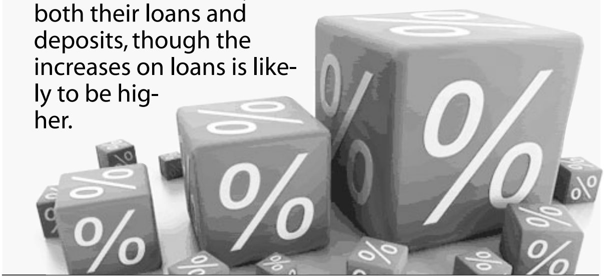
- **Prepay your loans:** With the RBI continuing to hike rates, banks are likely to up rates on both their loans and deposits, though the increases on loans is likely to be higher.



THE RESERVE Bank of India (RBI) surprised the financial markets earlier this week by raising repo rates by 0.5 per cent against the broadly expected rate increase of 0.25 per cent.

This was driven by significant concerns on inflation and a willingness to compromise on growth, even as inflation continues to be on the upside. This was very different from the view expressed by the chairman of the US Federal Reserve last week wherein he indicated that any increase in inflation are unlikely to be sustained and are temporary in nature. The US Fed therefore decided to focus on growth rather than worry about inflation. Even as the financial markets get more integrated, the actions by the two very powerful central banks could not have been more different.

With such conflicting signals emerging from different directions, what should investors do in this environment?

■ **Stick to your asset allocation:** There is a wealth of empirical data available indicating that long term portfolio returns are driven largely by asset allocation decisions rather than market timing and security selection.

Unfortunately, most investors tend to give undue importance to market timing and the choice of security, rather than the asset class selection itself.

For example, investors tend to spend a disproportionate time deciding on which mutual funds/stocks to buy, and what level of the Sensex to buy or sell at, rather than the decision on how much money from the portfolio should be allocated to equities itself. If you are unable to do so yourself, please take the help of a financial planner. Once the decision on asset allocation has been taken, it is critical to stick to it and rebalance on a predefined basis, irrespective of shorter term financial market movements.

■ **Prepay your loans:** With the RBI continuing to hike rates, banks are likely to raise interest rates on both their loans and deposits, though the quantum of increases on loans is likely to be higher. It is therefore important to measure the post tax returns on your fixed income investments against the overall cost of your loans, and take a decision on prepayment accordingly. A large number of investors tend to rush to park monies in deposits when rates go up, and continue to pay out high interest rates on their loans at the same time. This is especially important as most loans have been on floating rates for the last couple of years.

■ **Diversify your portfolio globally:** Whilst investing in domestic financial markets are preferred by all investors, differing actions by central banks could cause differing returns at different points. For example, there has been a wide variance in returns between US stock markets and Indian stock markets over the last year. It is therefore important to allocate between 10-20 per cent of the portfolios to international markets as well.

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