When should you break some financial rules? Find out

By Chandralekha Mukerji, ET Bureau • Last Updated: Jul 04, 2016, 03:33 PM IST

Synopsis
A rulebook guides the inexperienced to make rational decisions. This is true for money management too. Money rules help you keep your finances on track.


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BENGALURU: A rulebook guides the inexperienced to make rational decisions. This is true for money management too. Money rules help you keep your finances on track. But rule of thumb that do not fit your situation can be a waste of time, or worse, actually worsen your finances. They may be oversimplifying a complex issue which can harm long-term prospects and be a poor substitute for analysis. Here are five **personal finance** rules that based on your circumstances, you can consider breaking.

Rule 1: Young should have equity-heavy portfolio
Risk appetite is independent of age. A young person usually has higher risk tolerance and a longer investment horizon and therefore saved keep a heavier chunk of portfolio in equities. However, historical data shows that equity investment requires a commitment of four to five years for good returns. Even if you are 20-something, equities are not for you if you have a lot of debt and many dependents or are saving for short-term (read: 2-3 years) goals.

If there is an ailing family member and a medical emergency can arise unannounced, you should have your savings in debt as chances of capital corrosion are less while the penalty for early exit is not high. On the other hand, you may be 60 and retired, but have enough liquidity to manage your short-term expenses. Then, you must consider allocating a portion towards equities. "The first step to asset allocation is therefore knowing your risk appetite through a risk profiling exercise, step two is understanding the constraints in life and decide your equity-debt investment ratio," says Vivek Rege, CEO, VR **Wealth** Advisors.

Rule 2: The key to financial success is cutting expenses
The key to financial success is not in cutting your expenses. It is in creating a surplus that can be invested, which can be done by reducing your costs or increasing your income.

While budgeting is a must, however, some costs can't be snipped beyond a point. Your financial planner may then advise you to either reduce your goals or push back the target dates or re-prioritise your financial needs. However, what if the financial need can't be compromised. Take the case of 35-year-old Pravin Kumar, who works for an IT company.

"Although his **earnings** were enough to meet his present needs, he wanted an overseas **education** for his 10-year-old daughter, which was not possible considering he had already taken a huge home loan," says Mimi Partha Sarathy, MD, Sinhasi Consultants and Kumar's financial planner. One of the constraints for Kumar to earn more was his qualification, so he decided to take up an executive MBA in marketing from a top B-school. "With this new addition to his resume, he negotiated not only a promotion but a 40% increase in his salary with an increased role," Partha Sarathy. It was then easy to allocate the necessary funds for the child's future needs.

Rule 3: Debt is bad. Try to avoid debt at all cost
Debt is not always bad but you shouldn't borrow beyond your repayment limits. Loans can help you lead a **lifestyle** that you desire by drawing from current and future income. "While in the previous generation, our parents had to wait till they saved up enough to buy a house, we are able to do that easily today through a home loan. Loans give us a lot of flexibility to enjoy a lifestyle today rather than in the future," says Priya Sunder, director, PeakAlpha Investment Services. However, in case of financial distress, you lose all flexibility since EMIs will have to be paid, with very adverse consequences in case of default.

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"Hence it is prudent to create a Plan B in case of a loan default such as hrough **insurance** covers or collaterals," adds Sunder. Having an open **credit card** limit with sufficient insurances is a great emergency planning. "It is a much better idea than building huge emergency corpus,"adds Bhuvana Shreeram, a Mumbai-based Certified Financial Planner. If you are a good borrower, even **credit cards** are not bad. "Apart from using credit wisely, you can use debt to create appreciating assets like a home not only to gain through appreciation but also tax savings," says Manish Shah, CEO, Bigdecisions.com.

Rule 4: Realty is the best asset
Too much of anything is bad, especially an unpredictable and illiquid asset like real estate. However, most Indians have a portfolio terribly skewed towards real estate. "They overestimate the returns **real estate** gives. If they did the math, they would know better," says says Shreeram. "Even when real estate had a good bull run in the last 10-12 years (2002 to 2014), most investors have made about 9% to 10% after accounting for interest repayment on loans, tax benefit, cost of maintenance etc., which may be better than bank deposit but not worth taking 20-year loans at 10%,"adds Shreeram. Also, the bull run does not last long. So, the investment is not as safe or liquid as bank deposits. The time during 2011 to mid-2014 was a very challenging time for those who had invested in the stock **markets**. "Many HNIs moved to real estate during this time and at high levels which is now close to impossible to liquidate," says Partha Sarathy. Sunder of PeakAlpha **Investments** doesn't recommend holding more than 60% of portfolio in real estate.

Rule 5: Re-evaluate your portfolio regularly Yes, there is a need to regularly rebalance and evaluate your portfolio. However, too much tinkering is not good either. "There are **people** who have long-term goals but have a habit of tracking their investments on a daily basis and get carried away by the emotions of the market," says Anil Rego, CEO, Right Horizons. Tinkering is either motivated by the need to earn more (greed) or by the need to save whatever is there (fear). "Jumping in and out of investments is the single-most wealth destroyer, followed by waiting in the sidelines and losing precious time," says the expert. Every investment has a time horizon for it to achieve its expected returns and this must be respected and adhered to.

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