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NSC *vs* PPF: The better bet

Returns: Investments into NSC (National Savings Certificate) VIII give an interest of 8% per annum. But as the interest is compounded half yearly, they give an interest of 8.16% per annum. PPF (public provident fund), on the other hand, gives an interest of 8% per annum, but the interest is compounded annually. The rate of interest in the case of NSC VIII is locked in at the time of investment. This is not the case with the public provident fund (PPF) where interest rates can and have been changed and are applicable even on the corpus that has been built over the years.

PPF was started way back in 1969. Back then, it offered an interest of 4.8% per annum. After that the government increased the interest rates on it till it reached a high of 12% in 1986-97. This is where the interest rate stayed put till January 15, 2000. Thereafter, the interest rate has been slowly decreased, and from March 1, 2003, it is at 8%.

What is common to both the NSC and PPF schemes is that interest accumulates and is not paid out every year.

Investment amount, maturity: The minimum investment that can be made in case of NSC VIII is Rs 100. There is no upper limit. Certificates are available in denominations of Rs 100, Rs 500, Rs 1000, Rs 5000 and Rs 10000. The investment tenure is 6 years.

In case of PPF the minimum investment is Rs 500 and a maximum contribution is Rs 70,000 per annum. The PPF account matures in 15 years after the end of the financial year in which the investor first invests. Let's say an investor starts a new PPF account on January 15, 2006. Now, we add 15 years to the financial year end, 2006+15= 2021. Hence the account will mature at the end of the year 2020-21 i.e. April 1, 2021.

NSC VIII requires a one-time investment whereas, in case of PPF, investments have to be regularly made. PPF requires an investment of a minimum of Rs 500 every year to keep the account active. The NSC VIII matures in 6 years and withdrawals from the PPF account are permitted 6 years after the year in which the account is opened.

Tax benefit: Under Section 80 'C' of the Income Tax Act, individuals can make an aggregate deduction of up to Rs 100,000 from their gross income for certain kinds of investments. NSC is one investment avenue for which deductions are allowed. Even though, there is no upper limit for investments into NSC, only investments up to Rs 100,000 are tax deductible because that's the limit under Section 80 'C'. Since the maximum investment allowed into PPF in a given year is Rs 70,000 only, the maximum deduction that can be taken for tax purposes is limited to that amount.

The interest on the investment into NSC, except in the sixth year, is not paid but credited to the investor's account. So the interest that accumulates is treated as invested in NSC. Hence the accumulated interest also qualifies for an exemption under Section 80 'C' for the first five years. In the last year, the interest is handed over to the investor and hence does not qualify for a deduction. In case of PPF the interest that accumulates is tax free through out the period till the maturity of the account.

Conclusion: Given these details, NSC works well as a medium term investment option, whereas PPF works better as a long term investment option.

Post office deposit rates and features

Kisan Vikas Patra	
Interest	Doubles in 8 yrs 7 mnth
Effective interest rate	8.41%
Min. amount	Rs 100
Max. amount	No limit
Tax breaks	None
Monthly Income Scheme	
Interest	8%
Tenure	6 yrs
Min. amount	Rs 1,000
Max. amount	Rs 3 lakh for single a/c Rs 6 lakh for joint a/c
Tax breaks	None
National Savings Certificate	
Interest	8%
Effective Interest Rate	8.16% (semi annual compounding)
Tenure	6 yrs
Min. amount	Rs 100
Max. amount	No limit
Tax breaks	Section 80C deduction
Public Provident Fund	
Interest	8%
Tenure	15 -16 yrs
Min. amount	Rs 500
Max. amount	Rs 70,000 p.a.
Tax breaks	Section 80C deduction
Recurring Deposit	
Interest	7.5%
Tenure	5 yrs
Min. amount	Rs 10
Max. amount	No limit
Tax breaks	None
Senior Citizens Savings Scheme	
Interest	9%
Tenure	5 yrs
Min. amount	Rs 1,000
Max. amount	Rs 15 lakh
Tax breaks	None
Min. age	60 years
Time Deposit	
Interest	6.25-7.5%
Tenure	1,2,3,5 yrs
Min. amount	Rs 200
Max. amount	No limit
Tax breaks	None

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MY FINANCES

Planning on the verge of retirement

Though delayed, Ashwani might still realise her goals if she sticks to the plan

Balvir Chawla

Ashwani (58) is working in a private firm. Her husband (73) has retired. One of their two daughters is married and the marriage of the second daughter is expected to take place this year. They live in their own flat in Mumbai. However, the rising cost of living has left Ashwani worried and she is keen to plan her retirement. Though the time span is quite short, we feel she would be able to achieve her near term goals.

Ashwani is drawing a salary of Rs 25,000 per month and the expenses are around Rs 24,000 per month.

Family goals

The major expenses lined up for Ashwani in the near future are her second daughter's wedding and her husband's knee operation. The wedding is expected to take place in the next six months and Rs 3.50 lakh is the estimated expense. Her husband's knee replacement operation will also have to be done in the near future, depending on the call taken by the doctor. This is expected to cost around Rs 2 lakh. Ashwani will be retiring in July 2009. She expects her monthly expenses to remain at the same level even after retirement.

Current investments

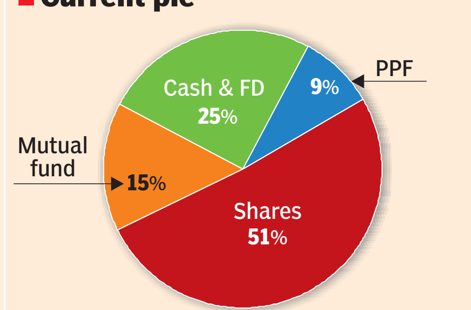
Mutual funds	Rs 1,75,000 (invested amount)
Shares	Rs 6,00,000 (market value as of July 1, '07)
Cash	Rs 1,00,000
Fixed deposits	Rs 2,00,000 (maturing in 2009)
Provident fund	Rs 4,000 p.m. (existing corpus of Rs 18 lakh)
PPF account	Rs 5,000 p.a. (existing corpus of Rs 1,12,000)

The investment in shares was done around 15 years back and the mutual fund investments have been done in the last one year. There has been a shift in the investment pattern in the last two years wherein she has been taking the aggressive route in terms of mutual funds and ULIPs.

Analysing investments

The major investment done by Ashwani is in shares amounting to Rs 6 lakh and this is in a single share. This accounts for 51% of the asset allocation. Since the major expenses are in the near future, it is advisable to partially book some profits from the shares and keep it in a debt instrument in the interest of liquidity and protection from equity market volatility. A debt fund or an fixed maturity plan for a shorter tenure can be considered for this purpose. Also, since the exposure is in a single stock, the returns on the holdings have not been attractive. Our recommendation would be to convert 70% of the holding into cash and in the remaining 30%, the exposure of a single stock should not be more 10% of the portfolio size.

Current pie



The value of 70% of the existing equity holding would be Rs 4,20,000 and the balance equity portfolio should be reshuffled to have an exposure of around 80% in large-cap stocks and 20% in the mid-cap segment.

The mutual fund portfolio is around Rs 1,75,000, which is well diversified and could remain so.

Insurance

The total risk cover enjoyed by Ashwani is around Rs 4 lakh from LIC (including the single premium policies done in the form of ULIP).

Hence, we do not recommend any new insurance policy for her.

However, she can keep the Ulips in the growth option to gain maximum benefit till the time she retires. This will boost her corpus.

Since she is covered for medical insurance by her company, she could check if there is a provision to continue the cover even after retirement. We would recommend continuing to pay the premiums for the same and ensuring that medical insurance is in place.

Achieving the goals

a. **Daughter's marriage:** The amount realised through sale of shares can be kept aside for the daughter's marriage.

b. **Husband's knee operation:** The amount realised through sale of shares and the cash available can be used for the husband's operation. The fixed deposit amount can be used for any emergency later.

c. **Retirement:** Since the monthly expenses are around Rs 25,000 per month (including the annual expenses) and we feel these expenses would remain at these levels even after retirement, Ashwani should plan for her retirement immediately.

To maintain the same level of expenses even after retirement, the corpus needed for Ashwani will be around Rs 40 lakh, assuming a life expectancy till the age of 80. This corpus is excluding the pension she will receive from her employer and LIC, which will be around Rs 7,500 p.m.

She will receive Rs 25 lakh approximately from the PF account and Rs 1,50,000 from her PPF account, considering her payments to those accounts till 2009. Also, the LIC policy maturing in 2009 will give her Rs 1,44,000. Her fixed deposit of around Rs 2,00,000 is maturing in 2009. So, her corpus will be around Rs 30 lakh.

The funds received from PF and PPF can form the initial corpus and the amounts in shares, mutual funds and Ulips can be utilised later.

We do not foresee any major shortfall in the retirement fund. However, it would be recommended that the funds received on retirement are invested judiciously to get the best returns.

Assumptions

The recommendations suggested are based on the information available with us. Inflation is assumed at 5% per annum and post-tax returns have been assumed at 8% p.a. Pension is assumed at Rs 7,500 per month from the employer and the LIC. Life expectancy is 80 years.

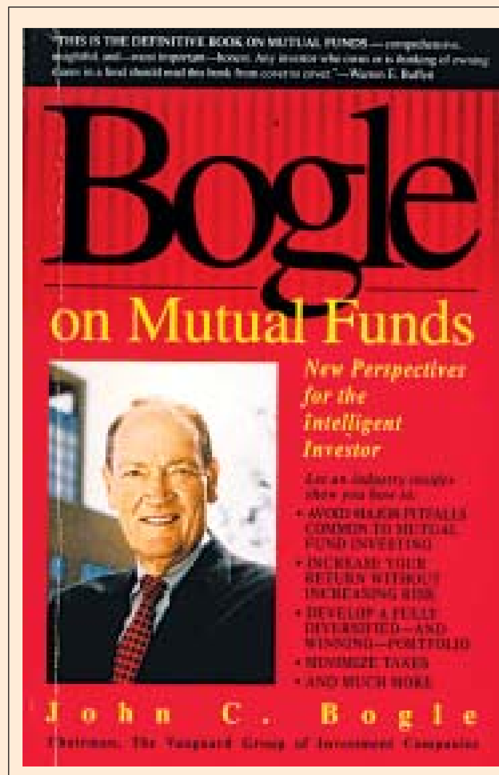
Disclaimer: *The writer is a practicing certified financial planner. This plan has been prepared on the basis of the information and data provided. Constant monitoring and review of the financial plan is required to achieve the goals. The views expressed are those of the planner and do not necessarily represent that of FPSB India. Feedback may be mailed at my-plan@fpsbindia.org*

If you would like to be featured and need a financial plan made by a qualified planner, mail to: mymoney@dnaindia.net

How to select a mutual fund

Past performance shouldn't be the sole criterion for choosing a fund, writes John C Bogle

Vivek Kaul
Mumbai



"Reports by the financial press typically lionise the portfolio managers who had the 'best' records during the previous quarter or year or even longer. This myopic focus on past performance is not helpful. It is a flawed and a counter-productive way to select a mutual fund"

Not everyone believes in retail investors investing in stocks directly to make more money. As John C. Bogle writes in the book, Bogle on Mutual Funds - New Perspectives for the Intelligent Investor, "In my view, attempting to build a life time investment programme around the selection of a handful of individual securities is, for all but the most exception investors, a fool's errand. To be sure, by owning individual equities, some active investors will enjoy spectacular results. But others perforce will lose much of their capital. Earning extraordinary returns from the ownership of individual stocks is a high-risk, long-shot bet for most investors. Specific stock bets should be made, if at all, in small portions, and more for the excitement of the game than for the profit. Serious money belongs elsewhere; it belongs in a widely diversified investment programme."

Coming from Bogle, the man who set up Vanguard group of investment companies and is a pioneer of index funds, it needs some attention. So if not stocks, what is the way out? "For nearly all investors, mutual funds are the most efficient method of achieving this diversification," writes Bogle.

Having advocated the need of investing in mutual funds, Bogle feels that investors need to be careful, when investing. "In my view, too many fund complexes have put the business need for asset gathering, the better to enhance the profits earned by fund managers, ahead of the fiduciary duty to provide efficient asset management at the lowest reasonable price," writes Bogle.

Given this and the fact that there are so many mutual funds available in the market, how does one get around to identifying the right kind of mutual fund to invest in?

The first thing an investor can easily take a look at is the immediate past performance of the mutual fund. Data relating to this is easily available these days either on websites or business magazines and newspapers. But this may not be always the best way to go about it. As Bogle writes "Reports by the financial press typically lionise the portfolio managers who had the "best" records (i.e., achieved the largest gains) during the previous quarter or year or even longer. This myopic focus on past performance is not helpful. It is a flawed and a counterproductive way to select a mutual fund".

Having said that it always makes sense to look at the performance of the fund over a longer period of time. As Bogle writes "In most cases, a fund should prove its merit over a period of at least five to ten years." Chances are that a fund which has performed well for this period of time has seen various phases of the market and performed well across these various periods. In an Indian context, there wouldn't be many schemes which have proved their performance over a period of ten years. But there certainly are enough schemes which have proved their performance over a period of three to five years.

The next thing to take a look at is the fund manager who is managing the scheme. As Bogle writes "Find out whether the portfolio manager has run the fund for a few months, a few years, or a few decades, and give this information whatever weight you deem appropriate."

Having said that this should not be the only reason while deciding whether or not to invest in a scheme. As Bogle writes "Even when funds have individual fund managers, performance in a particular period can be due to much more- or less - than the manager's skill. For instance, a manager may be less important than the research and the analytical support he receives. Or a manager may grow or shrink, in capability. It is not unknown for a new manager to do better than a successful predecessor.

A market environment in which a manager has been able to shine brightly may be replaced by a very different environment that does not favour the manager's investment style. Finally, good luck (always a factor in shaping fund returns) may turn to bad and vice versa. And if the fund manager has changed recently for that Bogle's advice is "when managers change, a wait-and-see policy is usually appropriate."

The next thing to look at is portfolio concentration. "It is not enough to know how many stocks a fund owns, because many of them may represent a small percentage of the net assets and have little impact on the fund's overall performance. The better test is the proportion of total assets the fund holds in its largest positions. One good measure is to check the fund's ten largest holdings. In the more concentrated funds, the ten largest holdings may comprise up to 50% of the portfolio; in the less concentrated funds, they may comprise as little as 15%. As a general rule, the greater the portfolio concentration, the greater is the opportunity for the fund to provide differentiated performance," writes Bogle. What this means is that a greater amount of scheme's investment is in fewer stocks, the better is its chance to perform better than others or worse than others."

BOOKS & IDEAS

Another thing to look at is the size of the mutual fund. Investing in schemes with very small assets under management (AUM) is not advisable, as Bogle writes "simply because of the relatively higher expenses associated with small funds."

But what if you are a lazy investor and neither have the time nor the inclination to go looking for all the above information, while deciding to invest in a mutual fund. For these investors, the best way of investing is to invest in index funds.

Index fund is a mutual fund which collects money from investors and invests money in stocks that make up a stock market index in the same proportion as their proportion in the index.

As Bogle points out in Eric J Weiner's book "What goes up - The Uncensored History of Wall Street - As told by the Bankers, Brokers, CEOs, and Scoundrels who made it happen", "The germ of the idea for index funds was in my thesis at Princeton, which was about mutual funds. In 1951, in that ancient thesis, I wrote, "Mutual funds can make no claims of superiority over the market averages."

I didn't do any exhaustive statistical test, just looked at a dozen or so funds, but it was quite clear that beating the market wasn't something this industry was about to do". The Vanguard group started Vanguard 500, the first index fund in the world.

Stock queries

Arun Kejriwal

Is it the right time to buy DLF shares? *–Baiju Parikshith, Sanpada*

DLF Ltd announced its first ever quarterly results after going public for the quarter ended June 2007. They were a good set of numbers with total income on a stand alone basis being Rs 1207.11 crore and the net profit Rs 579.27 crore.

The company follows a unique practice where it does not construct anything by itself. It is all contracted on cost plus 10% basis and the company therefore has the best of contractors working for it and ensuring timely and quality construction. In real estate business the cost of construction on a thumb rule basis is about 20% of the total which means the profit paid to the contractor is 2%. DLF is able to recover more than the amount paid to the contractor because of their global sourcing and the fact that they have a huge set up in China for procurement.

DLF has yet another first where all the commercial property built by them is owned by them. They do not sell commercial space but lease the same. This ensures that they have a steady rental stream which continues and more important the appreciation in property prices remains with them.

DLF
Share price on BSE (Rs)

Jul 5, 07	570.05
Aug 3	602.30

It is with this objective and to give a flavour of the same they had sold some real estate properties to a group company DAL where the yield from such lease rentals would be in the region of 9% per annum. This sale was done in the run up to the IPO. This kind of sale is the norm in Singapore and Hong Kong where real estate prices are extremely expensive.

Going forward, the yield on such deals would reduce to around 7% which in other words means that the prices of such properties would rise.

The recent high and low of the share have been Rs 685.30 and Rs 568.40. The share closed for trading at Rs 602.30 and has gained RS 77.30 or 14.7% since issue. On the day of listing the share did touch a low of Rs 505.60 but that may be ignored as a one off. If one were to look at various estimates, the same can be narrowed down to anywhere between Rs 535 and Rs 565. The share looks attractive and investors should look at buying the share on dips closer to the NAV.

Sebi disclaimer: The author has no investments in the stock mentioned above. He invites comments at kejriwalarun@rediffmail.com