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A sequence to guide your saving and investment journey

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Dear Investors and Partners,

Mr. Inv (investor) to Mrs. FA (Financial Advisor): Hi. I have some surplus money right now and I was planning to perhaps invest in this new fund idea.

Mrs. FA: That's a great thought. May I ask what prompted you to take this decision?

Mr. Inv: My colleagues in office have invested in this scheme recently and they were talking about it. This theme has done well in recent times and looks good for the future. I also heard on business channels about the bright prospects of such companies. I want to participate in this future trend.

Mrs. FA: Yes, it seems a worthwhile option for the long-term. However, allow me to say that you might be making a mistake, in terms of overall financial planning.

Mr. Inv: Oh, is that so! But isn't investing in equities, especially such new age stocks for the long-term the right thing to do? Could you please elaborate?

Mrs. FA: Yes, it is. However, what really matters is the sequence of financial planning. The first steps are to evaluate your insurance coverage and emergency corpus based on a solid budgeting exercise before looking to invest.

In the above conversation if you identify with the thoughts of investor Mr. Inv, then let me explain the importance of sequencing in financial planning in this month's letter.

Financial planning is both an art and science in my opinion. While there are well-accepted rules for the same, each individual and his requirements have some unique elements. This makes customization an inherent part of financial planning. Often, there are a range of issues to take care of before one settles for a customized financial plan: taxation, associated costs, flexibility, cash flows, insurance, type of instruments among other things. A seasoned financial planner can help sort out this aspect. However, the onus is on the investor to follow the right sequence of financial planning activities.

Let me illustrate what I mean by right sequencing of planning and its importance. In India, most investors invariably invest in tax saving instruments in the Feb-March period. This often leads to hurried decisions, and they end up buying insurance plans that they don't need, or probably invest in schemes with lock-in clauses that underperform. The impact of such actions on long-term wealth creation may be worse than the tax that they may have saved through such investments. Additionally, there is so much information nowadays cluttering our decision making, including from social media, that it may be tempting to allocate to whatever is the fad of the day.

Following a sequence in financial planning can possibly take care of the above issues to a great extent. The right order or sequence can be to start with a **Household Budgeting** exercise, then buy protection through **Life Insurance**, followed by **Saving** (which includes an emergency corpus) and lastly, **Investing** the remaining corpus (which includes tax optimization). Within the Investing stage, there is a need to prioritize Retirement planning since that's the only financial goal for which one can't get a loan.

Household budgeting is all about balancing one's expenses with one's income. This is important because identifying your sources of income and expenditure pattern on a monthly basis, can itself optimize your financial plan. Budgeting is the building block for the entire financial planning sequence. For example, you need not scamper for funds before the monthly instalment due date of an insurance premium, if you know your income and expenses beforehand. If done properly, household budgeting will let you know if you can afford the insurance plan or not, in the first place. If the answer is yes, it will also help one determine the monthly premium amount that can be realistically allocated. This exercise may also curb non-planned, compulsive shopping and spending. In other words, household budgeting exercise is all about taking control and being in charge.

The next step in the sequence is to buy life and health Insurance for self and family. This needs careful planning as there are various customisations possible depending on your requirements. Cost, policy benefits, associated rider benefits, term etc. can be decided with the help of a financial advisor.

The third important step is to look at Savings. While in the previous step (buying insurance), the intention was to provide a safety net in case of death, the objective of the Savings step, is to provide a safety net for any unforeseen financial crisis or ad-hoc emergency expenses. Something like a pandemic in 2020 which may lead to temporary job loss, or ad-hoc emergency expenses like car breakdown, or any unanticipated bills should ideally be covered by savings. This enables one to avoid dipping into one's long-term investments, thus allowing one's wealth to compound.

If one follows the above sequence, one will likely have some corpus available for investments at the end of each month. A financial advisor can help one invest this corpus as per one's risk appetite and returns expectations, among other factors.

Following this sequence in financial planning ensures that you are not under-insured like in the conversation between Mr. Inv and Mrs. FA mentioned above, even if the long-term investments, needed to support family, in case of an untimely death, have not reached the stage of adequacy.

This, right sequencing can help imbibe financial discipline in investors and help attain financial independence at every stage of life. The above is a simplified version to explain the broader context of things. Since each household is different and has some unique requirements, a good financial advisor can help in customising based on the requirement. The objective however is that while you may find it difficult to anticipate the future and desire flexibility to enjoy your life in the near term, just following the sequence can help avoid mistakes; and avoiding mistakes itself is winning half the game.

Stay safe & happy investing.

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