PGIM India Mutual Fund

"In case of Emergency, contact xxxxx"

Ajit Menon
CEO

April 2022

Dear Investors and Partners,

If any of your loved ones writes your name for the above question while filling out a form, then you have a responsibility that you must fulfil. This month's letter is on the behaviour biases that exist while dealing with emergencies and how we can overcome them and be as prepared as we possibly can.

Emergencies are a fact of life. However, the most common reaction when we see someone else in an emergency situation is to reassure ourselves that "this can't happen to me" and walk away. Many emergencies also end up being a financial crunch for someone who has not planned for it. In India, people are now insured to a greater extent on life and on medical insurance too though penetration levels are still low compared to other markets. However, in general, they are not really prepared for non-medical emergencies (layoffs for instance).

While there is enough literature on how to actually build an emergency corpus, as well as financial advisors who can help create a customized plan, the impact that it has on other areas is not fully understood. The benefit of an emergency fund is not for its end use only (which I pray never occurs in your life) but for the many intangible benefits. The first and obvious benefit is the confidence and self-respect that you gain, knowing that you have taken the right steps to protect your loved ones, and thus lead a less stress-free life. The second and third order benefit is that this prevents you from overspending on a whim, as your disposable cash is stashed away and it saves you from getting trapped into borrowings (which invariably comes at a high cost during emergencies). Additionally, the non-intuitive benefit according to me, is that an emergency corpus, invested in safer assets, lets an investor stay invested in equity markets during volatile times, as he is not worried about his basic requirements. Let me explain this further with the help of an illustration below:

Consider two investors A and B who are invested in the equity market and have monthly expenses of Rs. 50,000. Investor A also has an emergency corpus worth 12 months of expenses, which she can draw down during tough times. On the other hand, investor B doesn't have such a corpus and is fully invested in equities. An emergency event such as a layoff can happen at any time but may happen to more people during an economic shock and is likely to be accompanied by a fall in markets. This may impact the financial outcomes for investors. Let us see this with the example of a real-life scenario in 2020, the first year of the covid pandemic.

Consider that A starts with investments of Rs. 10 lakh and an emergency corpus of Rs. 6 lakh, while B invests Rs. 16 lakh entirely in the equity markets. If both A and B lose their jobs in March 2020, A can draw down her emergency corpus for a year and leave her equity investments untouched. On the other hand, B may have to redeem Rs. 6 lakh worth of her investments to meet her monthly expenses for the same period. Worse, she may develop financial anxiety and sell her investments at an inappropriate time. If B would have redeemed her investments in panic on (yes, we are exaggerating to make a point), March 23, 2020, her financial outcomes would be starkly different than A over the following year (see table below). Having an emergency corpus would make investor A better off by nearly Rs. 4.5 lakh in a short span of a year. The bigger benefit being that A will have far less financial anxiety than B and that's worth a lot more than just the 4.5 lakh difference.

Date	Nifty 50	Investor A			Investor B		
		Emergency corpus (Rs.)	Investment Value (Rs.)	Withdrawal (Rs.)	Emergency corpus (Rs.)	Investment Value (Rs.)	Withdrawal (Rs.)
01-Jan-20	12,183	6,00,000	10,00,000	–	–	16,00,000	–
23-Mar-20	7,610	6,00,000	6,24,687	–	–	3,99,499	6,00,000
01-Apr-21	14,867	0	**12,20,386**	–	–	**7,80,460**	–

(Source: Nifty 50 data from MFI Explorer. The above table is for illustration purposes only. Emergency corpus of Rs 6 lakhs goes to zero by April 21 since the expenses of Rs 50,000 is withdrawn every month for a year's time period.)

In conclusion, when you make your child or spouse or dependent parent etc. to save your mobile number in their emergency contact list, it is your responsibility to also first set up a Plan to deal with any financial emergencies. The easiest solution is to have an emergency corpus tucked away. As a thumb rule you can put away six months of your monthly expenses or to be more conservative, a year's expenses in a safe and liquid investment. Since every individual and, by extension, household is unique, a good financial advisor can help you with what's best for you.

Stay safe & happy investing.