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Major Parameters for Effective Wealth Management

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Abstract: *In the present scenario of Investment World where there are diverse investment options available for an investor, choosing the right options is not an easy task. The importance of wealth management has grown by manifolds and is continuing to grow with the growth in economies and also with the growth of cross border investments. Apart from the major investment products available in the market, there are some basic pillars which acts a major foundation for managing one's wealth effectively.*

The paper deals with the most important parameters for have a proper wealth management considering the present status of the investors as well as his future plans such as retirement, wealth planning for child etc.

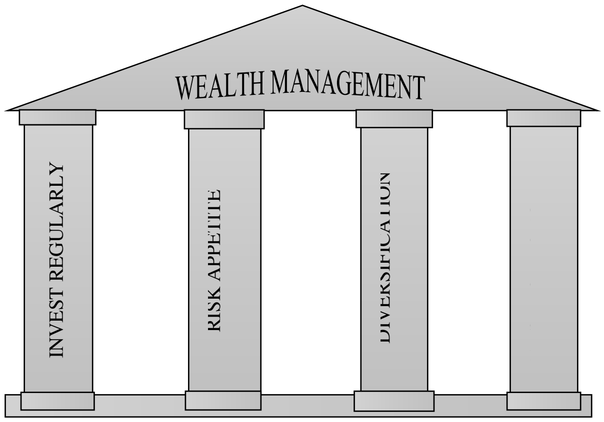
Key words*: Wealth Management, Diversification, Mutual Funds, Risk Appetite, Volatility, Mutual Funds, Portfolio*

1. Introduction

It is rightly said that the when the real strength of a tree lies in its roots which are at the base. The analogy is very much applicable in all stages of life as well the same holds true in wealth management.

While doing a proper planning of one's wealth, it very important to follow some grounds rules which have framed in the form of "Pillars of Wealth Management"

These Pillars forms the basic foundations which need to be considered while drafting the investment strategy for the investor's wealth management



2. Invest Regularly

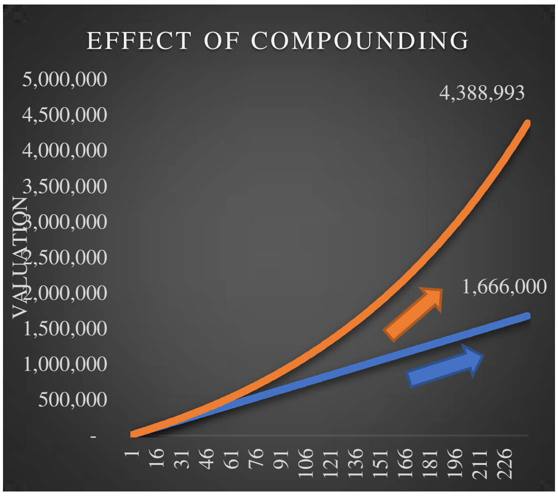
Regularly saving from your funds not only helps in doing compulsory savings and investments, but also it helps to build a significant corpus especially which is important as and when the age of the investor advances.

Another major factor which is the outcome of regular investments in the compounding effect on the investment. As the compounding effect basically deals with the interest on interest concept, the more regularly an investment is made, higher is the compounding effect and more is growth in the valuation of the investment in future years.

To elaborate the effect of compounding, let's consider the following scenario:

Investment Amount per month (INR)	7000
Interest Rate	8.5% per annum
Investment Duration	20 years
Total Number of Instalments	240

The total Investment value for a duration of 20 years with 7000 amount per month, comes to INR 16,66,000 and the maturity value at the end of 20 years, considering an interest rate of 8.5% comes to INR 43,88,993.



As it is evident from the graph, the rate at which the Maturity Investment value increases is like that of a chain reaction and at a much faster rate than the Initial Investment value. This incremental growth in the Investment value is because of the compounding effect.

3. Risk Appetite

Risk Appetite is basically termed as the risk-taking ability of the Investor which is considered for strategizing his portfolio of investments. Broadly, it is classified among three types:

- Aggressive
- Moderate
- Conservative

An Investor with Aggressive risk appetite will have a major portion of his portfolio in high risk products especially equity and related products and/or interest rate sensitive fixed income products. Investor with Moderate risk appetite will have a fairly balance portfolio of high risk and low risk investment products. Investor with a Conservative Risk appetite will try to have comparatively less risky product portfolio with products such as Fixed Deposits, Bonds etc. in his portfolio

An Investor should always understand his/her own risk appetite while doing an investment. The prime motive behind understanding an investor's risk appetite is that different people have different risk taking ability and their investment strategy is based on their risk appetite.

Few of the factors which can help the investors to analyse his / her risk appetite are:

- Age: An investor can afford to take risk at an early stage of his life. As and when the age advances, the risk-taking ability of the investor generally moves from aggressive to moderate or conservative
- Job security: An investor with a secured job can afford to take more risk than an investor with a less secured job
- Multiple Income Source: Investors having multiple income source can afford to invest in high risk products than an Investor with a single income source

Apart from these, there are multiple other factors which help investor to understand his / her risk appetite. At times consulting a financial advisor also helps the investor to have a proper understanding of his / her risk appetite.

Another major point to be highlighted here is the Risk – Return trade-off, which says that higher the risk, higher the return and vice-versa.

4. Diversification

One of the most important factor which should be applied while drafting an investment strategy is the process of diversification.

As the old saying goes "Never put all the eggs in one basket", same is the concept applicable in diversification. In terms of Wealth Management, diversification is basically scattering the investment amount in more than one asset class, rather than investing the whole amount in just one asset class.

The prime motive of diversification is investing in more than one asset class thereby reducing the risk associated with investing in a single asset class. Diversification reduces the risk as the unexpected fluctuations in one asset class can be balanced by the returns from the other asset class.

In the current investment market, the best example of diversification is the Mutual funds market. Mutual Fund investments invest the funds in a pool of asset classes which helps to diversify the investment systematically in more than one asset classes.

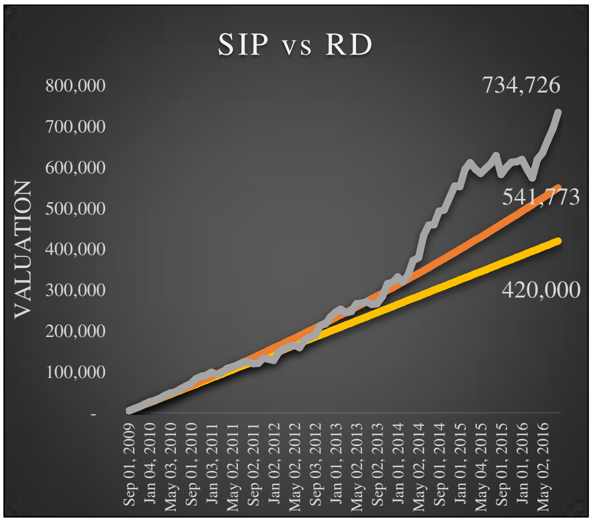
5. Invest for Long Term

The real benefits of any investment lie in staying invested in it for long term. As discussed in the previous chapters, that for any kind of investment there is always a risk return trade – off, i.e. Higher the risk higher the return, the best way to understand this trade-off is by having a long term sustained investment.

In fact, the previous graph shows that the effecting of compounding is also best visible when the investment is kept for long term duration.

Most of volatile instruments in the market especially equity products and interest rate sensitive products, generally show their advantages when kept for long term.

The following graph shows the advantage of having a long-term investment. The graph shown is a comparative analysis of a Systematic Investment Plan (SIP) in an equity mutual fund and a Recurring Deposit (RD) of the same amount per month. The amount considered is Rs. 1500 per month in both cases.



***Source**: moneycontrol.com, www.bankbazaar.com*

The CAGR obtained from RD with investment of INR 1500 / month for 7 yrs.- 7.34%. The CAGR obtained from Equity Fund SIP with monthly investment of INR 1500 / month for 7 yrs.- 14.67%.

Though the equity mutual fund has high volatility but it is because of this volatility that there lies significant potential in these instruments which help them to generate high returns in future.

Thus, the most effective way to cater the market volatility and to generate potential high return is to have a long-term vision for investment.

6. Conclusion

In order to have a proper and well diversified portfolio of investments, the factors mentioned in the paper in the form of pillars of wealth management should be considered collectively for strategizing one's wealth.

Though each factor has its own impact on the investment planning, some of the outcome of the factors result in a common event. Such as long term investment and regular investment both result in the generation of Compounding effect.

The historical data obtained from the sources has been considered for analysis purpose in order to plot the graphs.

An effective wealth management is the collective outcome of the due consideration to each of the mentioned pillars of wealth management viz. Regular Investment, Risk Appetite, Diversification, Invest for Long Term.

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