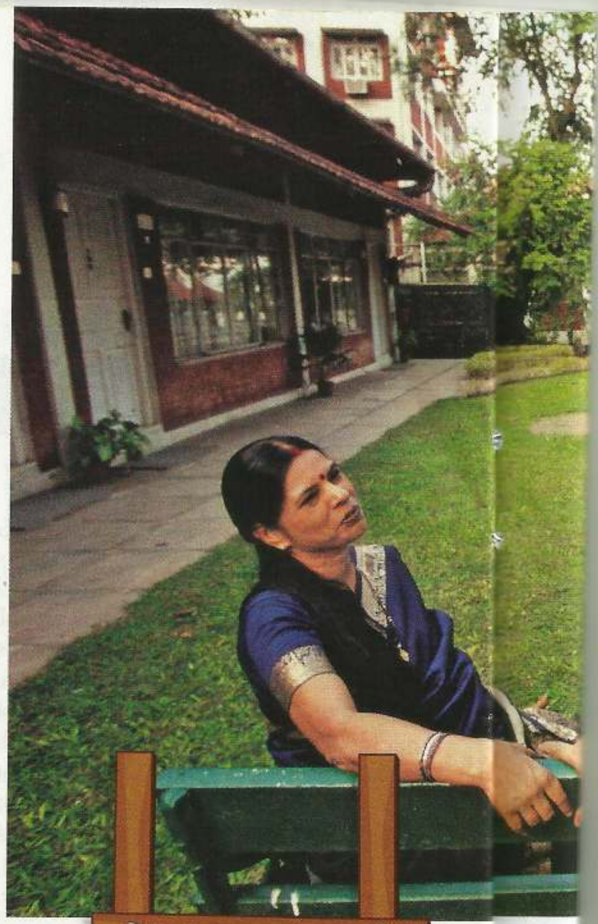
Life Goals

BY KAVYA BALAJI

RETIREMENT

A LADDER OF SECURITY



Regular investments in NSCs and bank FDs can create another income stream to supplement pension

Did your ever shudder at the thought of making ends meet during your visits to the neighbourhood grocer in the last one year? For those, who have retirement in sight, i.e., 10 years or less away from retirement, this would surely be a niggling worry. When you retire, you have to make do with a fixed income, unlike your worklife, where annual pay hikes are the way life. In retirement, people tend to invest in fixed income instruments, such as post office options and bank fixed deposits, but the income from them gets dented by inflation. Even if you reinvest the proceeds at higher rates, in times of rising interest rates, the returns also trail inflation. As a result, there is often little cushion to meet periodic large needs, such as social events, besides other large expenses such as home renovations.

Income ladder to the rescue. One way to solve this conundrum is to create separate periodic income flows that will supplement your regular retirement income, be it from pensions or payouts from retirement income schemes, such as Senior Citizens Savings Scheme. Since you need to derisk your investments that you started early on in life, and align them to meet your requirements in the last 5-6 years to retirement, this is the time you can invest at regular intervals—every month or quarter—in fixed income options such as National Savings Certificates (NSC) to create an income "ladder" where predictable sums keep accruing at regular intervals. Says Amit Kukreja, founder, WealthBeing Advisors: "The ladder can be used to create an income stream lasting for 10-15 years by timing the NSC maturity and reinvestment." For example, if you invest ₹1,000 in October 2012 in the 5-year NSC for a year, you would be receiving ₹1,523 in October 2017, when your retired life commences. As you keep investing every month, now, for the next 11 months, you would have created an income stream that would start after five years and would last for a year. In our example, you would earn a steady income flow every month from October 2017 and that would last till September 2018. This could be extended further to the number of years you want. Laddering can be used to create regular income in other situations as well, such as meeting your child's regu-

ONE STEP AT A TIME

Here's how a mix of NSCs and bank fixed deposits can create additional retirement income for you

Assuming: Interest rates on both are same and there is no reinvestment risk

Graphic: ANIL PANWAR

OUTLOOK MONEY PHOTO

lar expenses during his or her years of higher education. Here, of course, we will stick to its use during retirement. When you are creating a ladder, you can increase the denominations of the NSCs progressively for larger maturity amounts to counter the future impact of inflation.

Mix NSC with bank FDs. Apart from NSCs, you may also look at bank fixed deposits and, especially, the 5-year notified tax savers, if you are looking to save tax on your investment. The current interest rate for the 5-year NSC is 8.6 per cent, while the rate is 9.25-9.5 per cent for a tax-saving bank FD. While the interest rates of NSC are reset each year based on the G-sec rates, the FD rates of banks are driven more dynamically and can change much frequently. Take these fluctuations into consideration while laddering. There isn't any tax deducted at source (TDS) for NSCs, but FDs are exposed to TDS if the annual interest exceeds ₹10,000. While both come with tax savings on the investment made, the overall returns of FDs may score high. Adds Manikaran Singal, chief financial planner, Marvel Investments: "FDs are compounded quarterly so they score over NSCs." Also, there is a need for higher liquidity in your laddering process. FDs provide that liquidity at zero or less penalty than NSCs. Says Sumeet Vaid, founder, Ffreedom Financial Planners: "FD laddering gives you flexibility in terms of liquidity of the capital. You need not invest the entire capital in one go, thus protecting you against interest rate vagaries." This not only maximises returns, but enhances the liquidity of your investment.

Extend your ladder. It is quite possible that you will not need the additional income flows you create through laddering. This income can be reinvested to create a ladder once again with investments in a mix of NSCs and bank FDs or similar instruments, with the mix being determined more in favour of the option providing higher returns. If your retirement finances are comfortable, you could even regularly invest in an index or balanced fund, so that the money is useful for your later retirement years. One of the virtues of laddering is that it creates a second stream of income that keeps you ready to counter inflation and protects your standard of living. Often that is more than handy in retirement. ❐

kavya.balaji@outlookindia.com

Up next Enterprise: Get The Funding Right pg 48

KIDS' FUTURE

ENDURING BONDS

While you need to invest in equity-related products, such as equity mutual funds, growth unit-linked insurance plans and stocks, to get inflation-beating growth while investing for your childrens' future, to manage investment risks through diversification, you need fixed income investments as well. That's where bonds can be a viable alternative.

Bond advantage. The advantage with bonds is that you can invest in a way that would match the timing of your goal. For instance, if your child's higher education begins in 2022, you could invest in a 10-year Rural Electrification Corporation tax-free bond that matures at the same time. Many of them, such as tax-free bonds, capital gains saving bonds and Government of India bonds, also come with sovereign guarantee that limits your risk. Investing in them at regular intervals can create regular cash accruals to meet your regular expenses.

IN BRIEF

- Invest in bonds with tenures matching the goal's timing
- Consider government-backed bonds for lower risk
- Check out credit rating

Mandatory checks. Check the credit rating and the existence of a call option, as the latter allows the issuing company to buy back the bonds. This means you could face a reinvestment risk for the money mid-way, something that investors had experienced in the 1990s. While high growth investments, such as stocks, equity mutual funds and growth Ulips appear more appealing, bonds lend solidity to your childrens' portfolio. It holds you in good stead if markets are choppy in the lead up to the time when you have to tap the money. ❐

kavya.balaji@outlookindia.com

If you would like us to feature certain topics on children or retirement, write in to us with your contact number at letters@outlookmoney.com