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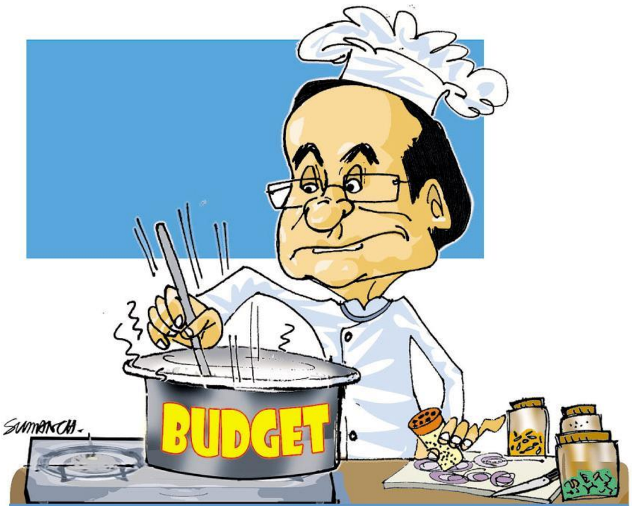
PERSONAL FINANCE

Ajay Srinivasan finds out what Arun Jaitley dished out for retail investors in the budget



What's on the menu

The Union budget is a statement of the government's finances, but this time the expectations were high as this was the first full budget of the new government. The government used the space created by falling oil prices and some increase in taxes to create a fiscal stimulus aimed at getting India back on the growth trajectory it desires.

Now, what does the budget mean for the retail investor? Soon after the budget, the RBI cut the repo rate, given the fall in inflation locally and interest rates globally We should expect another 75-100 basis-point fall in interest rates in the next financial year.

Fixed on FDs

The fall in interest rates will boost demand for both fixed-income products and equities.

Fixed deposits have fixed rates and do not offer the benefit of capital appreciation that a typical fixed-return bond or a debt mutual fund gives. Open-ended debt mutual funds capture the favourable interest rate movements by way of higher returns.

The more the duration of a portfolio, the greater the returns when interest rates fall. Investors looking to benefit from falling interest rates should look at fixed-income funds with a portfolio duration of at least 5 years. Those wanting to play a bit safer can look at medium-term funds, which have a slightly lower duration. Another way to gain from falling interest rates and rising equity markets is through balanced funds or the more conservative monthly income plans.

The surcharge on dividend distribution tax has been hiked by 2 per cent. This means investors should prefer the growth schemes of mutual funds over the dividend schemes.

New options

Retail investors have a few interesting investment options after the budget proposals. One can expect the launch of Real Estate Investment Trusts (REITs) and gold bonds that will see money move from physical to financial assets.

Investors in REITS will be able to invest smaller sums and yet get the yields of the underlying property with some tax advantages.

Gold bonds should provide investors regular return and the option of converting a financial instrument into gold if desired.

The key will be the return — if that is attractive, those buying gold as an investment may look at bonds favourably.

We should also expect to see several tax-free bond issues in infrastructure. Depending on the rate offered, this could be a good avenue for those in the higher tax paying brackets.

Pension push

The budget provides incentives to protect oneself from the uncertainties of the future. Contributions up to Rs 50,000 under the New Pension Scheme will be exempt from tax.

This is a good route for individuals to start accumulating money for retirement. With families becoming nuclear and inflation hovering in the 5-6 per cent range, it is very essential that we set aside money for retirement. This is the only way we will be able to maintain our standard of living after retirement.

The tax benefit on health insurance has been raised to Rs 25,000, which is a step in the right direction. With the rising cost of healthcare, it is important for individuals to protect themselves through insurance.

Stocks to watch

The divestment programme announced in the budget has two important implications — one it helps the government to raise resources and two it provides investors an opportunity to acquire these shares at a discount to the market.

One can expect a large number of equity issues with the government setting a divestment target of around Rs 70,000 crore for 2015-16.

Falling inflation, the fiscal push for growth and lower interest rates would ultimately boost corporate earnings. This makes equities an attractive choice for the long term.

We must not only look at the market by comparing it to its past performance but also relative to others globally since foreign capital has the choice of going to many markets.

Mood upbeat

Given the surfeit of global liquidity and the search for attractive investment options, India is well placed to attract a lot more money and this could push markets higher. Appreciation from here though would more likely come from earnings growth than multiple expansion.

Assuming a corporate earnings growth of 17-18 per cent, the Sensex can double in four years. This will offer huge opportunities across sectors.

However, the markets will be marked by volatility on account of global cues, including US interest rate outlook, eurozone debt, slowdown in China, geopolitical risks in Russia and uncertainty on account of oil.

Equity will probably be the best asset class over a 3-4 year time frame, assuming India grows as we all expect it to and inflation stays benign.

The mood is bullish on good financials and the manufacturing sector, especially cement, auto ancilliary and commercial vehicles.

The push to infrastructure should benefit companies in the road, rail, ports, power and construction sectors.

The government has also set out the basis of a social security programme in the budget with the provisions of low-cost accident insurance, life insurance and pension.

There is a message in this to all investors: Take your financial future in your own hands and begin to provide for your financial needs.

Protect yourself first with health and life insurance. Build some wealth through assets such as equity, fixed income, gold, REITS or tax-free bonds and plan for your retirement while you are earning. It is high time Indians make their money work as hard as they do!

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