SIP — A Powerful Tool to Create Wealth Over Time

With the Indian economic success story continuing unabated, more and more investors are on the lookout for investment avenues in the country. The Indian equity market, together with mutual funds, has emerged as a hot favourite over the past few years. This article discusses the pros and cons associated with a Systematic Investment Plan (SIP).

A Mutual Fund (MF) is a special type of investment institution that pools the savings of the community and invests large funds in a well-diversified portfolio of sound investments. It employs professionally qualified and well-experienced investment consultants and fund managers to take the pooled money and invest it in a wide range of industries with the objective of minimising risk and maximising return on investment.

An MF is set up in the form of a trust, which has a sponsor, trustees, an Asset Management Company and a custodian. The Mutual Fund industry in India started way back in 1963 with the formation of the Unit Trust of India. However, a new era of this industry began with the entry of public sector banks, private financial companies and foreign institutions.

A variety of schemes are available to investors, including Debt-Oriented schemes, Equity Schemes, Balanced Schemes, Equity-Linked Savings Schemes, Money Market Schemes, Sector-Specific Fund, Index fund, etc. An investor in MFs generally chooses the scheme as per his investment objective, risk profile, time horizon, etc. If the investor invests a sum of Rs 10,000 at a Net Asset Value (NAV) of Rs 10, he receives 1,000 units of the fund. The timing of the investment in such a case may turn out to be favourable or unfavourable to the investor. Thinking on this line, it may be a wiser decision for an investor to go in for a Systematic Investment Plan (SIP) rather than a regular MF investment.

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Unlike MF investments, in which all his money is invested at one go, SIPs allow the investor to invest a specified amount at predetermined specific intervals. It works the same way as a Recurring Deposit. For example, an investment of Rs 10,000 can be spread over 10 months, with Rs 1,000 invested every month. The number of units accruing in the SIP is dependent on the NAV of the scheme prevailing at the time of purchase of the fund.

Advantages of SIP

- The biggest difficulty in investing is in deciding when to invest. SIP helps us to overcome this problem. It is a disciplined investment irrespective of the state of the market. It makes the market timing totally irrelevant. And especially with the next 2-3 years looking good from the economy point of view, one can expect good returns through regular investing.
- MF allows us to invest amounts as small as Rs 500–1000 in SIP. This makes investing easier, as it does not strain monthly finances. It is therefore an ideal investment option for a small investor who would otherwise not be able to enjoy the benefits of investing in the equity market.
- In SIP, an investor invests a fixed sum of money regularly for a pre-determined

period. Therefore, the investor ends up buying more units when the market is down and NAV is low, and fewer units when the market is up and the NAV is high. This is called rupee-cost averaging.

For example, if the investor opts for SIP, investing Rs 1000 per month in a scheme that has an NAV of Rs 10 initially, let us see what will be his position in a rising, falling as well as volatile market:

Month	Amount Invested (Rs.)	Rising Market		Falling Market		Volatile Market	
		NAV(Rs.)	Units Allotted	NAV (Rs.)	Units Allotted	NAV (Rs.)	Units Allotted
1	1,000	10	100	10	100	10	100
2	1,000	10.5	95.24	9.75	102.56	10.5	95.24
3	1,000	12	83.3	9	111.11	9	111.11
4	1,000	14	71.43	7	142.86	11	90.9
5	1,000	17	58.82	6.5	153.86	13	76.92
6	1,000	18	55.56	6	166.67	11.5	86.96
Total	6,000	81.5	464.38	48.55	777.05	65	561.13
Avg. Purchase NAV (Total of NAVs / number of investments)		13.58		8.04		10.83	
Avg. cost per unit (Total investment / No. of units held)		12.92		7.72		10.69	

Thus, one can see that the average unit cost under SIP will always be less than the average purchase price per unit, irrespective of whether the market rises, falls or fluctuates. To substantiate this with empirical evidence, let us consider an investment of Rs 10,000 every month in a Mutual Fund's SIP from October 2002 to September 2005 (Refer to table on next page).

- Investments are ultimately made for some purpose such as children's higher education, marriage, construction of house etc. that require a huge sum of money. Since it is not possible to raise such a large amount at short notice, regular investment through SIP will help raise funds over a longer period of time.
- To make SIPs more attractive, a number of Mutual Funds have also come out with innovative features (such as insurance cover) added to the scheme.
- When time horizon for investment is 3-4 years, one could choose to opt for an equity-linked savings scheme (ELSS) over a purely diversified equity fund schemes so that tax benefits can be enjoyed as well.
- In most SIP schemes the entry load is Nil and in a few schemes it is as low as 1%. If one exits before a specified period, exit load will be applicable.

How to start with SIP

- Fill up single SIP form and a single application form.
- Draw a few post-dated cheques or give instructions to automatically debit the specified bank account.
- In case of discontinuance of the scheme, the remaining cheques will be returned by the fund house without any penalty imposed. The fund house will settle the account on the day of exit at the prevailing NAV for the accumulated units.

Downsides of SIP

SIP has a lot of merit. At the same time the demerits of the scheme cannot be ignored. For instance, when the market has a continuous

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MONTH	Rs.	NAV	UNITS	MONTH	Rs.	NAV	UNITS
Oct-02	10000	12.48	801.2821	Aug-04	10000	21.83	458.085204
Nov-02	10000	14.47	691.085	Sep-04	10000	23.26	429.922614
Dec-02	10000	15.07	663.57	Oct-04	10000	24.72	404.530744
Jan-03	10000	13.46	742.9421	Nov-04	10000	27.32	366.032211
Feb-03	10000	13.83	723.0658	Dec-04	10000	26.97	370.782351
Mar-03	10000	12.51	799.3605	Jan-05	10000	26.32	379.93921
Apr-03	10000	10.58	945.1796	Feb-05	10000	27.75	360.36036
May-03	10000	10.39	962.4639	Mar-05	10000	27.88	358.680057
Jun-03	10000	11.79	848.1764	Apr-05	10000	24.69	405.022276
Jul-03	10000	12.43	804.5052	5-May	10000	28.49	351.000351
Aug-03	10000	13.59	735.8352	5-Jun	10000	29.92	334.224599
Sep-03	10000	15.33	652.3157	5-Jul	10000	29.43	339.789331
Oct-03	10000	16.31	613.1208	5-Aug	10000	31.61	316.355584
Nov-03	10000	18.04	554.3237	5-Sep	10000	33.03	302.755071
Dec-03	10000	20.71	482.8585	TOTAL	3,60,000		19,855.53
Jan-04	10000	19.39	515.7298	Total no. of units			19,855.53
Feb-04	10000	19.27	518.9414	Present Market Value (Rs.)			6,55,828.16
Mar-04	10000	17.58	568.8282	Amount invested (Rs.)			3,60,000
Apr-04	10000	18.78	532.4814	Average investment (Rs.)			1,85,000
May-04	10000	18.82	531.3496	Total Gains (Rs.)			2,95,828.16
Jun-04	10000	19.43	514.668	Yield (%)			159.91
Jul-04	10000	21.01	475.9638	Annualised Yield (%)			53.3

rising trend, a security risk is involved. Investing in a sector fund such as IT through SIP during boom-time would not give the investor much benefit, since the number of units accumulated would keep decreasing. Secondly, in a falling market, SIPs do not ensure profit but only protect you from losses.

Conclusion

Though the SIP has its pros and cons, the benefits far outweigh the downsides. If the investor is able to take wise decisions and make the best of the Indian volatile market, SIP is definitely a powerful tool to create wealth over time. ❐