Why Should I consider Investing?

Financial Planning

Financial planning is essential for everyone for meeting life goals. Financial planning goes beyond savings and requires proper management of your finances so that you can identify your financial goals and then make investments accordingly to meet those goals. Your goals may include buying a house, savings for a child's education or planning for your retirement. For financial planning you need to consider short and long term savings and a portion of your savings can be invested in assets.

In today's world we come across many people who live beyond their means, piling up debt or investing in products they have very little knowledge about. Therefore, it is necessary to engage in financial planning and to do so you must have a sound understanding of the various investment options. These options can be in the form of assets such as bank deposits, shares, unit trusts, bonds etc.

If your income is more than your expenses, you are planning your finances adequately. But if your balance is negative, you need to start planning your finances right away.

Let us consider the steps involved in the financial planing process.

1. Determine your current fiancial situation – your income, debt levels, commitments etc
2. Develop your financial goals – define your investment objectives. Then you can plan how much you need to save today and how much you will receive as returns to achieve your future plans
3. Identify any financial issues - not only is the source of income important, but you should also know your liabilities
4. Prepare a Financial Plan - you should prepare your financial plan depending upon various factors like your income, risk taking ability, age group and investment objective
5. Implement your financial plan -After preparing your financial plan you need to review and revise your plan to stay up-to-date and relevant to the economic climate and your changing lifestyle.

Savings and Investments

People save usually to meet their short term goals and in order to access their money at any time and to ensure that the money is safe. Most people put their money in savings accounts that generate low interest but typically have no risk.

When you are planning your investment, it is critical that you take into account the effects of inflation on your investments. Inflation at its most basic level, is simply a rise in prices. This means that, over time, as the cost of goods and services increase, the value of a rupee is going to go down because you won't be able to purchase as much with those rupees as you could have in the last month or last year.

This is why many people put some of their money in savings but look for investing that can earn more over longer periods of times.

Though there is no guarantee that the money you invest will grow, in the long run investments can generate a lot more returns usually than a savings account. When you invest, your money is making money for you and you will be able to achieve your financial goals faster. But you must keep in mind that all investments contain taking on risk. It's important that you go into any investment in shares, bonds or unit trusts with a full understanding that you could lose some or all of your money in any one investment.

Power of Compounding

Albert Einstein has stated that compound interest is the most powerful force in the universe. He also said, "Compound interest is the 8th wonder of the world. He who understands it, earns it; he who doesn't, pays it."

The power of compounding is the single most important reason for you to start investing right now. Remember, every day that your money is invested, is a day that your money is working for you. Allowing your principal and accumulated interest to grow over time is an important part of building wealth. More precisely, compound interest is earned on both the initial deposit (principal) and the interest accumulated from previous periods.
Now let us see how simple interest and compound interest works:

Assume that Soma invests Rs.100,000 this year in a scheme with compounded interest and earn an interest of 10% per annum. At the end of 1st year, she would have earned interest of Rs. 10,000. However, in the 2nd year, her investment increases to Rs. 110,000 and her interest earned increases to Rs.11,000. As the years increase, the income for Soma also increases proportionately. This is the power of compounding, essentially useful for meeting long term financial goals.

Risk and Return

Risk and investing go hand in hand. Risk can be loosely defined as the chance one takes that all or part of the money put into an investment can be lost. On the other hand, the good news is that investing risk comes with the potential for investing reward – which is what makes the whole process worthwhile. Low levels of risk are associated with low potential returns, whereas high levels of risk are associated with high potential returns. When choosing investments for your portfolio, you must be aware of your personal risk tolerance. It is not possible to cut out all risk and taking on some risk is the price of achieving returns if you want to make money. Instead what can be done is to find an appropriate balance - one that generates some returns, but still allows you reasonable safety of your investment.

Investment Options

Personal circumstances as well as overall market conditions will influence the best investing selections. Liquidity refers to the ease with which investments can be converted into cash. You need to choose a product or the best combination of products to meet your preference and objectives. Your choice generally take three factors into consideration, namely, Liquidity, Safety and Return depending on the stage of life There are several short-term and long-term financial investment options available, some of which are given below.

Savings Related products
Bank deposits are generally safe since banks have high capital requirements and are regulated by the Central Bank of Sri Lanka. They offer various types of deposits, depending on the needs of the customer. Bank deposits are preferred more for their liquidity and safety than for their returns.

Investment Related products
The capital market offers products like equity, debt and various unit trust schemes. Each of this investment class carries different risk-return profiles.

Equity Shares
Equity shares represent ownership in the company and they are listed and traded on a stock exchanges which facilitate buying and selling. The Colombo Stock Exchange facilitates coming together of buyers and sellers, and provides liquidity and price discovery. Investing in equities is riskier than and require more time and skill than other investments but this risk also carries good rewards. In the long run, equities outperform other modes of investment. Stocks are probably the best bet against inflation too. Investments in equity can be made in two ways:
Shareholders are entitled to voting rights as well as dividends based on corporate earnings and capital gains by selling shares at a profit.

• Through the primary market (by applying for shares that are offered to the public)
• Through the secondary market (by buying shares that are already listed on the stock exchange)

Bonds
Bonds are instrument issued by companies, financial institutions, or even the Government to raise debt capital. As an investor, you lend you money to the company, in return for its promise to pay you interest at a fixed rate The buyer receives interest income from the seller and the par value of the bond is receivable by the buyer on the maturity date which is specified.

Unit Trusts

A Unit Trust is a pool of funds collected from a number of investors who share a common financial goal. Funds collected from the investors are invested in various financial assets such as shares, treasury bills, treasury bonds, debentures and other securities. The income earned from these investments and the capital appreciation is shared by its unit holders in proportion to the number of units owned by them.

They are a useful tool of investment for those who are not well-versed with the securities markets. They are professionally managed by fund managers who are well trained.

Factors to consider prior to investing

- Evaluate risk of every investment
- Have clarity on your short term and long term needs
- Decide the investment based on the needs
- Invest only in schemes that you understand
- Take into account tax implication of every income
- Do not blindly follow market tips and rumours
- Anything that appears unnaturally high or low will have some hidden catch
- Do not invest in schemes where you may protect the interest but lose the principal
- Equity investment are subject to market risk. study your investment options well before investing.
- Before investing in share market, study financials of the company, history, background of the promoters and objectives of the issue and its future prospects.
- Read and properly understand risk associated with investing in securities.
- Assess the risk return profile of the investment as well as liquidity and safety aspects before investment