Be Empowered

Simple is best

Why you should stick to simple, time-tested principles when it comes to investing and why complexity in investing is counterproductive

There's a deep belief nowadays that no matter what kind of a product or service you are buying, having more features is better. Whether it's a smartphone app or a pizza or a playschool for your toddler, the longer the list of features, the better it is supposed to be.

The problem is that this lust for features extends to financial products as well. I happen to strongly believe that keeping things simple is the key to making the right investment decisions. Actually, simplicity is probably better for the app, pizza or playschool as well, but that's a separate story.

When it comes to investment products, simplicity is not just a useful characteristic; it is absolutely mandatory. And here is the reason: if an investor does not fully understand a financial product or service, then that's a problem, regardless of how good it may otherwise appear or even actually be. And such understanding can't come with complex products.

The future is uncertain and many things cannot be predicted. Still, the investment process can begin with some sort of estimate about what is needed when. In any case, many things like children's education and retirement are predictable with a fair degree of precision.

Based on these goals, one can work out how much one needs to save to reach them. One good way of saving is to automate and enforce the process as much as possible. For example, all mutual funds offer the so-called systematic investment plans (SIP), under which a fixed sum of money is invested every month either through a post-dated cheque or directly from your bank account.

There are many advantages of SIPs but the most important one is that once begun, they enforce regular investments. Far more people have problems because they don't save at all rather than save in a mediocre mutual fund.

Then comes the issue of deciding which type of fund to invest in. The simplicity mantra is very useful here, too. You should keep all the money you'll need for the coming five to seven years in debt and every-thing else in equity. There exist far more complex approaches to deciding asset allocation but none of them are likely to yield better results than this simple, understandable approach.

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Choose two, perhaps three, general-purpose mutual funds with a good long track record and stick to them, leaving all other thinking to the funds' managers. I've never come across any savings need that required much more than that. If you do this much, everything is simple enough to understand and track. You will have a clear idea of what did well and what didn't. The investments that do well will have a large and clear impact on your investments and the ones that don't will be easy to single out.

When I look at the market for investment products today and see the kind of investment portfolios that people are collecting, I think there's a strong need for a self-conscious and aggressive minimalism in investment planning. The collective impact of marketing messages is to promote the idea that your investment needs are best met by portioning out little bits of your savings into a large number of investments. If you would like to be part of the minority of sensible investors, then you should stick to a minimalist approach.

Simple ideas are best, simply because when they succeed, the reasons are obvious. And when they fail, the reasons are obvious, too.

Source & Courtesy: Dhirendra Kumar, CEO, Value Research, Mutual Fund Insight