

Learn with DNA...

## Is your confidence 'conning' you?

"Before I was Pope, I believed in papal infallibility. Now that I am Pope, I can feel it." - Joke told of Pope Pius IX

A colleague of mine has become a minor celebrity these days, at least in the office. Having made a killing on a few stocks, he has been handing out tips to others. He gives them a specific price at which to enter and a price at which to exit the stock and seems supremely confident about the advice. The confidence has emerged in the last few months when most of his tips have been right.

Most people rate themselves high on most of their positive personal traits and many are overconfident about their ability to make accurate estimates. They generally tend to be over-optimistic when they are directly involved and have had no negative experience from the over-optimism. This seems to be the case with my colleague as well.

Jason Zweig has this to say of such people in his book, *Your Money and Your Brain - How the New Science of Neuroeconomics Can Help Make You Rich*: "Inside each one of us, there lurks a con artist who is forever cajoling us into an inflated sense of our own powers. The less skilled or experienced you are at something, the harder your inner con man works at convincing you that you are brilliant at it."

So, what makes someone who has made a few gains from the market recently feel like an expert? The winning streak, Zweig writes, "makes the future feel more predictable. Like many kinds of repeating patterns, a financial hot streak can make your brain automatically expect more of the same... The upshot: An early run of success makes people feel they suddenly have power over a purely random process. Instead of attributing the results to an abstract force like 'chance,' they now believe in 'luck,' a personal force that watches over them (at least temporarily) like a guardian angel. So long as luck seems to be lingering in the air, people feel compelled to make the most of it - and that can lead investors to take reckless amount of risk."

Also, "a streak of gains makes you feel that you are 'playing with the house of money'." That's the term gamblers use when they mentally divide the bucks into different buckets: the cash they started out with (which remains their "own money") and any winning they've made on top of that ("the house money"). Let's say you put \$1000 into a stock that triples; now that it is priced at \$3,000, you've got \$2,000 of "house money". So long as any of that \$2,000 gain is left, you may shrug off any losses as a reduction of the house money - rather than a depletion of your own. Somehow, losing the house money hurts less than losing your "own" - even though, strictly speaking, all the dollars are the same," writes Zweig.

## Invest wisely even for tax planning

Investing for the sake of saving taxes is a losing proposition

Swati Kedia



Investing to save tax is something most of us do as an obligation. But, what we do not realise is that many a times we are investing only to save tax, when a lot more can be accomplished with the same amount of money.

Let's see how this is possible.

At the start of your career, when you are still 'care free' and the near-term needs are limited, you should consider taking maximum risk to grow your money. Every rupee you invest wisely today is worth more than the rupee you invest tomorrow. So, when you are planning your taxes, allocate a higher proportion to risky assets like tax-saving mutual funds, which invest all their money in the stock markets. Of course, you need to take care to select the right fund, because the fund management styles of various tax saving funds are different. Some are aggressively managed, while some others are quite conservative.

So, you need to pick up a fund that suits your risk-taking ability.

## Taxation planning

Tax-planning amounts to making investments or contributions in line with prescribed guidelines that lead to a reduction in tax liability. Investors must note that while planning for saving taxes, one can assume many forms (u/s 80C, u/s 80D, u/s 24(b)), though we have considered the most important and popular sections - sec 80C and sec 80D. As we all know, sec 80C allows for a deduction of up to Rs1,00,000 from the gross total income, whereas sec 80D allows Rs15,000 towards health insurance.

Investment avenues that aid in tax-planning u/s 80C include Employee Provident Fund, Public Provident Fund, tax-saving mutual funds, National Savings Certificate, tax-saving fixed deposits (at least for five years with a scheduled bank) and infrastructure bonds. Other contributions that aid in tax-planning u/s 80C include life insurance premium, repayment of principal amount on housing loan and payment of tuition fees.

Let's take the case of 32-year-old Raj Sharma to understand the possibilities better. Sharma earns a gross salary of Rs7 lakh p.a. His family includes his wife (30) and son (3). The tax payable on his salary is Rs1.59 lakh without considering any tax benefit, which would leave Rs5.41 lakh in his



hand. His current expenditure is Rs3 lakh p.a., which would leave him with a surplus income after tax of Rs2.41 lakh.

## Analysis

It is observed that Sharma is not utilising the deductions available u/s 80C and 80D, which would allow him to not only save tax, but also utilize the surplus created for wealth creation.

Sharma's prioritised needs are as follows:

1. **Life protection through term insurance:** One must have adequate insurance cover, particularly if he is the family's breadwinner. Term insurance is a pure risk cover that takes care of the risk to one's life. It is the cheapest insurance cover one can have, and the younger one is, the lower is the premium. So, it makes more sense to buy a term cover early in life and get the maximum coverage.

2. **Equity-linked savings scheme (ELSS):** ELSS is an equity mutual fund that offers a tax benefit u/s 80C. ELSS returns have averaged 30% in the last few years and their dividends are tax-free, too. There is a three-year lock-in period, which enables the fund managers to take sector and stock bets they are not able to do in the regular equity schemes.

3. **Public Provident Fund (PPF):** The PPF scheme runs over 15 years and deposits into the account earn a return of 8% p.a. The minimum

and the maximum investment amounts per annum have been pegged at Rs500 and Rs70,000 respectively.

4. **Coverage u/s 80D:** This section provides a deduction of Rs15,000 for premium paid towards health insurance, which includes mediclaim and critical illness cover. Health insurance takes care of the expensive medical treatment incurred during hospitalisation resulting from a serious accident or illness and also covers pre- and post-hospitalisation expenses.

## Recommendations

Based on the insurance calculation, Sharma should insure his life to the tune of Rs32 lakh. A pure term insurance plan is recommended for the same, as it allows a large coverage at a low premium. The premium can be paid monthly, quarterly, semi-annually or annually.

To achieve his other financial goals Sharma should invest in equity and equity mutual funds to beat the inflation. As per the Income Tax Act, dividend earned on these instruments is totally tax-free. Moreover, long-term capital gains (greater than 12 months) on mutual funds are tax-free higher returns.

Along with life cover, Sharma should also be covered under health insurance, for which premium paid to the extent of Rs15,000 can be availed as deduction.

The percentage of equity investment allowed may be calculated as 100 less the age of the individual. So, based on Sharma's age, which is 32, the allocation to equity should be 68% and that to debt 32%. At the same time, we should not forget that insurance does play an integral part in asset allocation for tax planning.

Considering Sharma's age and risk appetite, the ideal asset allocation in tax planning u/s 80C should be as follows:

Particulars	Amount	Asset class	Allocation (%)
ELSS	Rs62,000	Equity	62%
PPF	Rs20,000	Debt	20%
Life insurance	Rs18,000	Insurance	18%
<b>Total</b>	<b>Rs1,00,000</b>	<b>-</b>	<b>100%</b>

Under 80D, he invests Rs 15,100 towards mediclaim and critical illness cover for himself, his wife and his son. On this investment, as much as Rs15,000 would be tax deductible.

The net result is a tax saving of Rs34,500, not to forget a life cover of Rs32 lakh and a health cover for the family.

## Comparing the benefits

	Before investments	After investments
Salary	7,00,000	7,00,000
Investments into 80C	-	1,00,000
Investments into 80D	-	15,000
Tax payable	1,59,000	1,24,500
Post-tax salary	5,41,000	5,75,500
Household expenses	3,00,000	3,00,000
<b>Net surplus</b>	<b>2,41,000</b>	<b>2,75,500</b>

## Conclusion

The case study stresses the fact that asset allocation is a very important component under tax planning and not just for the sake of investment. Also, tax planning must start from beginning of the financial year and not towards the end, because the sooner you start investing, the better will be the effect of compounding on your investments.

The writer is a certified financial planner working with Mumbai-based SRE Financial Planners. Views are personal and are not necessarily those of FSPB India. Feedback may be mailed to myplan@fspbndia.org.

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## '20% corporate growth still possible'

Religare equity head sees Sensex at 25,000 by end-2008

Sanat Vallikappen, Mumbai

Amitabh Chakraborty is a true-blue Bengali. Talk to him about the markets, and he uses 'fishy' metaphors to convey his point of view.

"Companies were raising money like fish soaking up oil when it's cooking," says the president of equity at Religare Securities, referring to the initial public offers that helped companies raise obscene sums last year. He is especially critical of the 15-odd real estate companies that have hit the market since January 2007.

"It will work in a bull market, but not now," he says. And why? Because of all that uncertainty and lack of clear direction in the market, which scuttled Emaar MGF's attempt to raise over Rs 7,000 crore earlier this month. Indeed, wasn't the company forced to pull out of the market owing to investor apathy and unreasonable pricing? "The land bank that real estate companies tout as their biggest strength can be compared to the 'eyeball' selling proposition that internet companies used in the pre-2000 era. How much of that land bank has been paid for?" asks Chakraborty, who has been through the cycle of the internet boom and bust during his days as director and research head of the Indian operations of Cazenove, a British investment bank.



Amitabh Chakraborty

"In this market, the successful equity manager will be one who is nimble, and can move in and out of sectors and stocks to generate his alpha."

Cazenove wound up its Indian operations in 2001, and Chakraborty moved to head the institutional equity desk at IDBI Capital. In 2004, he quit to head the private client research desk at Kotak Securities and went on to hold the same position at Bric Securities. That's when he was called by the Ranbaxy-promoted Religare, tasked with the mandate to transform Religare's image from a discount broking house to a research and advisory-based broking outfit - a job he thinks he has accomplished.

Having tracked the equity markets for over 14 years now, Chakraborty calls on his experience

to draw his inferences: "There definitely is a deceleration in the traction of companies, but we feel that a 20% growth rate in corporate numbers is still possible," he says.

Taking that measure forward, he says the Sensex can scale 25,000 in 2008. That's a rather optimistic call given that most other market analysts predict a high that is not much higher than the Sensex's peak so far.

However, Chakraborty agrees that this is a volatile market and not a trending market, and as such, a buy and hold strategy will not work. "In this market, the most successful equity manager will be someone who is nimble, and can

move in and out of sectors and stocks to generate his alpha (a term used for extra returns generated by taking extra risk, over and above the benchmark returns)," he says.

According to him, the Union Budget will be important as far as foreign flows are concerned. "The government needs to give clear signals on whether it's on its way to meet its fiscal targets, and whether it has chalked out a path to move towards a goods and services tax," he says.

The finance minister had indicated earlier that the government aims to reduce fiscal deficit to 3% and completely wipe out revenue deficit by March 2009. Further, the goods and services tax will be in place by 2010.

"Only if he shows the path to move towards this will foreign institutional investors make their allocation for India," said Chakraborty. "Otherwise, why should they risk their capital here when the S&P 500 and the Dow Jones Industrial Average are available at 12 times the PE (price-to-earnings) multiple and 14 times PE, respectively," he asks.

For the record, FIIs have net sold Indian equity worth over Rs11,500 crore so far in 2008. The sectors he is bullish on? "Agri-commodities for sure; globally, prices have been increasing. Mining companies, because of the scarcity value of depleting assets, and banking stocks, especially public sector banks and some smaller private sector banks like City Union Bank and Catholic Syrian Bank."

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## Nifty hourly resistances for February 25, 2008

Time AM/PM	Resistances Upon surpassing (1)	Resistances exhausts at (2)	Rally at (3)
09.55 - 10.30	5177	5214	5250
10.30 - 11.30	5168	5207	5245
11.30 - 12.30	5159	5200	5240
12.30 - 13.30	5150	5193	5235
13.30 - 14.30	5141	5186	5230
14.30 - 15.30	5132	5179	5225

## NOTES

Trading derivatives is a risky activity. These studies do not assure profits. Please consult a certified financial analyst before trading.

-Vijay Bhambhani

## Post office deposit rates and features

<b>Kisan Vikas Patra</b>	
Interest	Doubles in 8 yrs 7mth
Effective interest rate	8.41%
Min. amount	Rs 100
Max. amount	No limit
Tax breaks	None
<b>Monthly Income Scheme</b>	
Interest	8%+ 5% bonus at maturity
Tenure	6 yrs
Min. amount	Rs 1,000
Max. amount	Rs 4.5 lakh for single a/c Rs 9 lakh for joint a/c
Tax breaks	Section 80C deduction
<b>National Savings Certificate</b>	
Interest	8%
Effective Interest Rate	8.16% (semi annual compounding)
Tenure	6 yrs
Min. amount	Rs 100
Max. amount	No limit
Tax breaks	Section 80C deduction
<b>Public Provident Fund</b>	
Interest	8%
Tenure	15 -16 yrs
Min. amount	Rs 500
Max. amount	Rs 70,000 p.a.
Tax breaks	Section 80C deduction
<b>Recurring Deposit</b>	
Interest	7.5%
Tenure	5 yrs
Min. amount	Rs 10
Max. amount	No limit
Tax breaks	None
<b>Senior Citizens Savings Scheme</b>	
Interest	9%
Tenure	5 yrs
Min. amount	Rs 1,000
Max. amount	Rs 15 lakh
Tax breaks	Section 80C deduction
Min. age	60 years
<b>Time Deposit</b>	
Interest	6.25-7.5%
Tenure	1.2,3,5 yrs
Min. amount	Rs 200
Max. amount	No limit
Tax breaks	None

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There is no such thing as a perpetually successful company, writes Phil Rosenzweig

## Nothing recedes like success, and that fast

Vivek Kaul, Mumbai

Hundreds of books claiming to have discovered the formula behind a company's success are published every year. The authors typically study successful companies and try to put together stray patterns to arrive at their 'conclusions'.

However, one notices that most of these companies go back to mediocrity sometime after the book is published. So, how come the formula suddenly stops working?

Phil Rosenzweig, a professor at the International Institute for Management Development in Lausanne, Switzerland, comes up with an answer in his book, *The Halo Effect...and the Eight Other Business Delusions That Deceive Managers*. He believes identifying "what makes a company successful is not as simple and straightforward as these books with 'plug and play' solutions make it out to be.

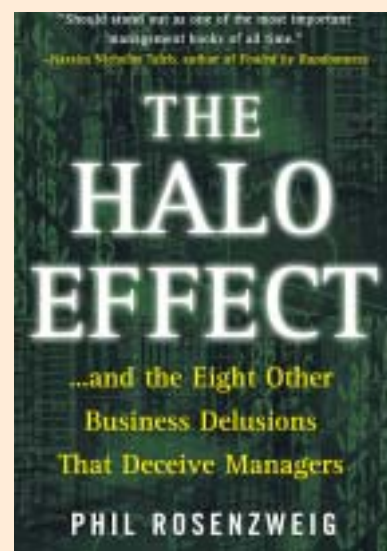
Most such books are victims of what Rosenzweig calls the 'halo effect', which he defines as "a tendency to make inferences about specific traits on the basis of general impression." Since "it's

difficult for most people to independently measure separate features; there's a common tendency to blend them together."

The most reliable data that comes out of any company is its financial performance. "And it's natural that on the basis of this performance data, people make attributions about other things that are less tangible and objective," writes Rosenzweig.

He cites the example of two companies, Cisco and ABB, which were the darlings of the stock market and the business media. "As long as Cisco was growing and profitable, setting records for its share price, managers and journalists and professors inferred it had a wonderful ability to listen to its customers, a cohesive corporate culture, and a brilliant strategy. And when the bubble burst, observers were quick to make the opposite attribution..."

The author feels these books are trying to answer the wrong question. "Lasting business success, it turns out, is largely a delusion," he writes. "Guess how many companies on the S&P 500 in



1957 were still on the S&P 500 in 1997, forty years later? Only 74. The other 426 were gone - nudged aside by other companies, or acquired, or bankrupt. And of the 74 survivors, how many outperformed the S&P 500 over that times pe-

riod? Only 12 out of 74. The other 62 survived, yes, but they didn't thrive... But companies that last longest usually aren't the best performers. Enduring greatness is neither very likely, nor, when we find it, does it tend to be associated with high performance."

Companies that are successful at a point of time are overtaken by other innovative companies. The idea that "companies can follow a blueprint to lasting success may be appealing but it's not supported by the evidence," writes Rosenzweig.

Another reason most such books go

wrong is that they study successful companies in isolation. "Companies are often described as succeeding or failing on the merits of their actions alone, as if the performance were absolute. But in a competitive market economy, the performance of one company is always affected by the performance of other companies," writes Rosenzweig.

"Once we see performance is relative, it becomes obvious that companies can never achieve success simply by following a given set of steps, no matter how well intended; their success will always be affected by what rivals do."

Though a company may be doing well, its rivals might be doing better, as Kmart was to learn. While it improved its performance over 1994-2002, its rivals Wal-Mart and Target improved their performance even more, leading to Kmart declaring bankruptcy in 2002.

Thus, there are no formulas really. As Rosenzweig writes, "The answer to the question 'What really works?' is simple: Nothing really works, at least not all the time. That's not the nature of the business."

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