Chapter 1

A BEGINNER'S GUIDE TO MUTUAL FUNDS

Just saving money is not enough; you need to invest it wisely to ensure that inflation does not eat it away.

According to the dictionary, income that is not spent is saving. For instance, if you do not spend 10% of your monthly income and just keep the cash in a box, then you are saving money. It is a simple concept, but by itself, it does not get you very far.

The basic reason for that is that money does not retain its value. Meaning, what was worth a hundred rupees last year is probably worth ten or twenty rupees more this year. This rise in prices is called Inflation which eats away at your savings, bit by bit. Historically, inflation in India has always been at a far higher level than in developed countries. Over the last thirty years, it has varied over a wide range, but has rarely fallen below 4% per year for a sustained period. The long-term average over this entire period is about 8%^.

Eight per cent does not sound all that harmful. It just means that something worth Rs.100 becomes Rs.108. However, that is only the annual rate for one year. Over multiple years, there is a compounding effect, meaning, the inflation rate of one-year feeds into that of the next year, and so on. This means that if you had saved Rs.1 lakh in 1982 and just kept it in a drawer as cash all long, then it would be worth less than Rs.9000 today, about 1/10th of its original value, at an inflation rate of 8%!

That is why we need to not just save, but also invest our savings. Investing means putting our money into some form whereby it will yield some gains. Typical forms of investment are property, gold, bank deposits, postal savings, shares and mutual funds. Thus, anything into which we can put in money and have it grow can be called an investment.
Of course, just matching inflation should not be the goal of any smart investor. Anyone who takes the trouble to learn the basics and applies them, should be able to earn more than enough to retain the value of their money. Investments can then become an independent source of income. If you let this sum accumulate instead of using it as income, then it can grow into a substantial amount of wealth.

Take the above example. Suppose that the same Rs.1 lakh had been invested in 1982 in the shares of a group of leading companies so that their value grew along the same rate as the S&P BSE Sensex. The money would have grown to Rs.1 crore as of July 31, 2014, a growth rate of 15.26%! This is far more than the rate of inflation, meaning, this sum of Rs.1 crore can buy you a lot more today than what Rs.1 lakh could have bought you in 1982. Investing over long periods of time will not just save you from inflation- it can also make you wealthy. But investing can be as risky as it can be rewarding. Newcomers who start investing with over-optimistic expectations and lack of knowledge or caution may face problems.

SUMMARY

Income that is not spent is saving. But rising prices (inflation) will mean that your money is actually worth less and less as time goes by. A good investment will not just match inflation but exceed it, thus becoming a second source of income in the long-term. Investment can be risky, but if done with some care and knowledge, can reward you handsomely.

^*Source - www.ination.eu/ination-rates/india/historic-ination/cpi-ination-india-1984.aspx*

NEXT TO COME: SAVINGS ARE NOT INVESTMENTS