A DEFINITIVE GUIDE TO SYSTEMATIC METHODS: SIP, SWP & STP

Chapter 9

In a world that appears random and chaotic, having systems in place can be refreshing. This applies to investments too. The good news is, there are some distinct 'systematic' ways to invest your money and help seek reap benefits.

What is SIP (Systematic Investment Plan)?

A Systematic Investment Plan (SIP) is a disciplined investment approach. Through the SIP route, you invest a fixed amount of money in mutual funds at regular intervals, monthly, quarterly or even semi-annual basis. For example, if you decide to invest Rs. 2,000 per month in a mutual fund through SIP, you should try and ensure that you transfer the amount into the fund every month.

You can select the auto-debit feature to ensure that the amount is transferred to the fund directly from your bank account on the allocated date. This way, you don't have to worry about missing the monthly payment.

The aim of investing in mutual funds through SIP is to create wealth in the long run. Since it is a recurring investment process and not a one-off investment, it can help you inculcate the habit of saving and investing. SIP investments can also limit your exposure to the volatilities of the financial market.

What are the types of SIP?

1. **Top-Up** SIP In a top-up SIP, you can change the amount of SIP instalment by a fixed amount at pre-defined intervals.For example, if you have been investing Rs. 1,000 in an equity fund every month, you can increase your investment to Rs. 1,500 through the top-up option. This is an easy way to contribute a higher amount towards your goals as your income rises over the years.

2. **Flexible** SIP Until now, you have seen that SIP means investing a fixed amount in a mutual fund in a systematic manner. But, what if it may not be possible to invest the same amount each month? In such a scenario, you can consider investing through a flexible SIP. Here, you can alter your monthly investments as per your cash flows. In case of a financial crunch, you can reduce the SIP amount. And when you have a high cash flow, you can invest a more significant amount. This is a suitable option for entrepreneurs who don't earn a fixed amount each month.

3. **Perpetual** SIP Investors generally opt to invest in a mutual fund for a fixed period. This can be for six months, three years, five years or even ten years. But what if you don't want to set an end date to your SIP investment? This is possible when you choose the perpetual option. Here, you can continue investing in the fund through SIP for as long as you wish, until you provide specific instructions to the AMC to cease it. And when you have created an adequate corpus to reach your financial goals, you can redeem the amount.

Benefits of investing in SIP, and why should you invest in SIP?

There are several financial benefits for investors when they choose to invest in mutual funds online through SIPs. Here are a few important ones:

1. **Rupee cost averaging**
   When you invest through SIP, you don't have to worry about timing the market. SIP investments ensure that you purchase more fund units when the market is low and lesser units when the market is high; this is known as rupee cost averaging. It helps investors generate relatively reasonable returns without worrying about market volatility.

2. **Power of compounding**
   Compounding is the process of earning income on your principal investment plus the income earned. For instance, if you invest Rs. 10,000 in a mutual fund (at 10% interest rate per annum), you gain an interest of Rs. 1,000 at the end of the year. Now, you start making interest not just on the original Rs. 10,000 you invested but also on the Rs. 1,000 you have received as interest. Over time, this can grow into a large corpus of money. Consider a situation where you invest Rs. 5,000 in a mutual fund offering annual returns of 12%. If you invest in this fund for 15 years, you will earn a sum of Rs. 25 lakhs. Continue investing for five more years, and you are likely to achieve a corpus of Rs. 50 lakhs. Another five years and your corpus increase to Rs. 95 lakhs! This is the power of compounding. The longer you invest, the better could be your returns.

3. **Simple to invest**
   Investing in mutual funds through SIPs can be easy. When you decide the amount you wish to invest, merely provide an auto-debit instruction to your bank account. This transfers the investment amount directly to the fund. They are also easy to monitor because the AMC provides you with all the necessary details of your investment clearly and concisely.

4. **Ideal tool for financial planning**
   You may have various goals you wish to achieve in life. For instance, you may have short-term goals like travelling to all the eight wonders of the world in a single tour. On the other hand, you could also have longer financial goals like buying a house or starting your own business 10 years down the line. When you invest steadily in different mutual funds, you can hope to achieve all your financial goals at the right time in life.

How to invest in SIP?

If you are wondering how to start SIP, here are three simple steps for you:

1. Identify a mutual fund for your investment
   You can choose from several mutual funds in the market. Select a fund based on your investment goals and risk appetite. Complete the KYC process and submit an application form online or offline to the AMC to begin your investment journey.
2. Choose the investment duration
   Once you select a fund, you need to decide how long you wish to remain invested. The duration could range anywhere between 6 months to 10 years, based on your investment goals.
3. Invest regularly
   Select a date you wish to invest every month. Investing through SIPs is a convenient and straightforward method to create long-term wealth. That's why it is important to stay invested for the entire investment duration.

What is SIP Calculator?

A Systematic Investment Plan (SIP) calculator is an online financial tool that can help to calculate the returns you would earn on your SIP investments. The calculator also tells you how much you would need to invest every month to earn a target corpus. Simply put, it provides a roadmap to achieve your various financial goals.

The calculator can be highly effective in automatically computing complex financial calculations, without the need for a pen and paper. You merely need to provide a few inputs, and the calculator arrives at the result in a matter of seconds.

How to calculate SIP investments? That is the big question for many investors. The answer is a mutual fund SIP calculator online.

A SIP return calculator for mutual funds generally has three input boxes. They are:

1. Monthly investment amount
2. Investment period
3. Expected annual returns

You need to enter the amount you wish to invest in a fund every month. For instance, it can be as little as Rs. 500 or as high as Rs. 10,000 (or more), depending on the amount you wish to invest.

Next, you should input the tenure of investment. You need to decide the time for which you want to invest in the fund through the SIP. Generally, fund houses require investors to stay invested in the SIP for at least six months. However, you may want to stay invested for a more extended period (say three years or more) that could help you achieve reasonable returns.

After that, you need to enter the rate of return you expect on the investment. This value is generally based on the fund's past performance.

Once you input these values, hit on the 'calculate' button to find out the corpus you could earn in the specified period. You can adjust the values to find out what works best based on your budget and goals.

Here is an example to show how SIP calculator works:

Imagine you wish to invest Rs. 4,000 per month for 10 years. The expected rate of return is 10%. You need to input these values in the specified boxes, and the calculator gives you the corpus you would earn.

In this case, you would earn a total corpus of Rs. 8.3 lakhs. If you were to increase the investment amount to Rs. 5,000, you would earn Rs. 10.3 lakhs. This is how you can tweak the values to see how your investments would turn out.

Some calculators include an additional input known as the 'Adjust for Inflation' button. You can use this option if you don't know the future value of your goal after taking inflation into consideration. You can choose either 'yes' or 'no'. If you select yes, the calculator incorporates the inflation rise into the calculations. If you choose no, you get the estimates without inflation.
It is always better to incorporate inflation into the calculations because it gives you a more realistic value of the earnings. Some calculators also give you a graphical view of how your earnings would grow over the investment tenure.

Note – SIP does not any assure a profit or guarantee protection against loss in a declining market.

What is SWP (Systematic Withdrawal Plan)?

Systematic Withdrawal Plan (Or SWP) is a redemption plan that allows you to withdraw a fixed amount from your fund at regular intervals. You can consider this as a complete opposite of SIP because if SIP is an investment plan, SWP is a withdrawal plan.

How SWP works

In SIP, you invest small amounts periodically and could end up with a large corpus at a later date. But in SWP, you invest a large corpus initially. After that, you can redeem a certain amount from the fund on a regular basis.

For example, imagine you invest Rs. 10 lakhs in a debt mutual fund. You give an instruction to withdraw Rs. 10,000 every month. The fund transfers this amount regularly until the value becomes zero. This is a convenient way to earn a regular income. Anybody can opt for SWP; it is regarded as a good option for retired people who want to invest their corpus and also receive a fixed income every month.

Based on your requirements, you have the option of redeeming a fixed amount, fixed number of units or all returns above a certain base level.

What is STP (Systematic Transfer Plan)?

A Systematic Transfer Plan (or STP) gives you the option to shift your investments from one mutual fund scheme to another. This is possible for schemes of the same fund house. If you break it down, STP is actually another form of SIP. But instead of transferring money from your bank account to the mutual fund, you transfer from one fund to another regularly.

How STP works

To initiate an STP, you need to select two funds:

1. The fund from which the money is transferred
2. The fund to which the money is to be transferred

Subsequently, you can choose whether you want the transfers to occur monthly or quarterly etc..

Systematic Transfer Plans are generally of three types:

1. Fixed STP: You can transfer a fixed amount from one fund to another.

2. Capital Appreciation plan: You can move only the profit of one fund into another.
3. Flexible plan: You can transfer a variable amount. This includes a fixed amount that is the minimum amount to be transferred, and a variable amount that depends on market volatility.

STP can be a good investment strategy if you have a large amount to invest in equities but want to do it gradually. So, instead of putting a lump sum in an equity fund, you can invest the amount first in a liquid fund. This can be a safer option as liquid funds come with low risk.

Following this, you can transfer a fixed amount into the equity fund just like a SIP. Here, you can earn potential returns on the liquid fund as well.

NEXT TO COME: TYPES OF MUTUAL FUND IN INDIA