Use goal-based investing to achieve your lifetime goals

Most of us make investments with a single-minded focus on maximising returns. This often leads to investment mistakes like trying to time the market. Fear and greed become the driving forces so that when markets turn volatile, investors tend to pull out their money or they typically increase their investments when the markets are already over-heated. This results in ill-planned and directionless investing.
Investors should, instead, follow the path of goal-based investing by first identifying and quantifying their short-, medium- and long-term financial goals and then tailoring their investments to meet these goals, based on their risk appetite and asset allocation.

Goals based investing

Every individual has multiple goals that he works towards in life such as taking a vacation abroad, or buying a car or house, or saving for a child's education or building a retirement fund. However, in order to fulfill these needs and aspirations, he needs to make his money work in sync with these goals. This is possible by adopting goal-based investing.

Instead of following the traditional approach of first creating an investment portfolio and then using the returns from it to meet goals as they arise, it is more effective to first identify an investor's goals at different stages of his life and to then fund and invest for each goal separately based on the time horizon and risk profile.

By setting tangible targets instead of saving blindly, goal-based investing motivates individuals to invest for their goals. It empowers them to realistically assess their current financial situation and plan their investments more precisely so that they start saving early, avoid debt and also match their asset allocation to the goal's time horizon and therefore, take the optimum amount of risk.

Goal investing process

Investors can follow a six-step process for goal-based investing.

Step 1: The first step is to list out all the individual's financial goals.

Step 2: He must then classify them in terms of the timeframe in which he wishes to achieve them besides identifying which goals are priorities and which, aspirations. Buying an iPhone may be an aspiration but funding a child's education, a priority.

Step 3: The third step is to quantify the future cost of each goal while evaluating his existing financial status. For instance, a house that costs Rs 50 lakh today may cost the investor Rs 70 lakh after five years (assuming a 7% increase in home values a year). Accordingly, he will have to invest enough money keeping this future cost in mind to build a sufficient corpus for the down payment on a housing loan after five years. The important thing is to never underestimate inflation.

By classifying his goals into short-, medium- and long-term ones and by determining their future cost and also preparing a cash flow statement of his income, expenses and savings, the investor can determine how much time he needs to achieve each goal and hence, how much he needs to invest and how much risk he can afford to take.

Step 4: This takes him to the fourth step of measuring his risk profile, which will vary based on each goal. For instance, if a young marketing executive needs to save money to fund an MBA degree after two years, he will follow a conservative approach. His priority will be to ensure the safety of his capital by investing into the debt asset class and not take undue risks. On the other hand, if a worker only retires after 30 years, he can afford to take some risks by investing in equities for the long-term to build his retirement kitty. In addition, his risk-taking capacity will also depend on factors like his age, income, expenses and financial responsibilities.

Step 5: Based on his risk profile comes the fifth step or action plan of identifying the investment avenues and allocating his disposable income to different asset classes. Investors can turn to mutual funds here and choose from a variety of debt, equity and hybrid mutual fund options to create goal-specific portfolios with appropriately conservative, moderately conservative, moderate, moderately aggressive or aggressive investment styles. They must take a realistic view on the returns expectation from each asset class. And they can also step-up their investments each year in line with the growth in their income.

Step 6: As a sixth step, the investor must also regularly monitor his investments to ensure he is on track to achieve his financial goals. This will also help him make any corrections, if required. He must also realise that just beating the benchmark on returns will not ensure he meets his goals but that he has to invest the right amount and ensure it makes appropriate returns to reach his target.

Case study

Arun is 30 years old and works in a manufacturing company. He has identified his goals (see below) and has a monthly savings of Rs ~36000 today which he is planning to invest to achieve those goals. He can accordingly bucket his savings into four goal-specific portfolios based on his time horizon and risk appetite, as below.

Goal	Time period to achieve the goal	Amount required at end of the period	Asset allocation (■ Debt ■ Equity)	Action plan
Car	3 years Short-term	₹ 5 lakhs	100%	Monthly SIP of ~₹ 11200 with annual top-up of 10%
Foreign vacation	7 years Medium-term	₹ 10 lakhs	25% 75%	Monthly SIP of ~₹ 6300 with annual top-up of 10%
Home	12 years Medum to long term	₹ 75 lakhs	50% 50%	Monthly SIP of ~₹ 15500 with annual top-up of 10%
Retirement	30 years Long-term	₹ 3 crore	25% 75%	Monthly SIP of ~₹ 2750 with annual top-up of 10%

For illustration purposes only.
100% debt represented by CRISIL Short-Term Debt Fund Index. 75% debt and 25% equity represented by CRISIL Hybrid 75+25-Conservative Index. 50% debt and 50% equity represented by CRISIL Hybrid 50+50-Moderate Index. 25% debt & 75% equity represented by CRISIL Hybrid 25+75-Aggressive Index. Returns considered for the above calculation are based on five year returns as of January 2018 of all the above indices; CRISIL Short-Term Debt Fund Index (8.50% CAGR), CRISIL Hybrid 75+25-Conservative Index (10.50% CAGR), CRISIL Hybrid 50+50-Moderate Index (12% CAGR) & CRISIL Hybrid 75+25-Aggressive Index (14% CAGR).

Common mistakes in goal planning

There's many a slip between the cup and lip, and Arun must also beware of some common mistakes. For instance, it would be risky for Arun to pick the wrong asset class and invest in equities to buy his car since the market may be in a bear phase after three years. In this case, he may have to forego or postpone his goal.

On the other hand, he has 30 years to build his retirement fund. So, he can take significant risks as the portfolio above shows. Had he picked the wrong asset class and conservatively invested in only, say, debt funds, his retirement corpus would have only grown to Rs 1.35 crore in 30 years instead of Rs 3 crore with an aggressive portfolio (equity 75% and debt 25%).

Arun may also think he has enough time to retire and postpone his retirement planning. But this will reduce the power of compounding. A delay of even five years means that he will have to start with a monthly SIP of Rs 6,000 five year later as compared with an SIP of Rs 2,750 a month today (assuming an annual top-up of 10% with the rise in income).

He also needs to continuously monitor his progress to ensure he reaches his target. This also means following a glide path towards his target. So, as he nears retirement, he should ensure the safety of his corpus by switching his investments to safer assets.

To sum up

Goal-based investing helps investors to achieve their financial goals by mapping their investments to their goals keeping in mind their time horizon, risk profile, inflation and other factors such as their income, age and financial responsibilities. Investors can bucket their savings in goal-specific portfolios and regularly monitor their progress to ensure they meet their financial targets and fulfill their needs and aspirations. Mutual funds offer a variety of funds across asset classes that investors can use to achieve their financial goals.

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