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WEALTH CREATION

HOW TO CREATE WEALTH?

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SEBI RIA

Chapter 1- Networth

In this Chapter, we see the very basic of WEALTH CREATION. Let's start from what we are today. Our Networth.

Believe me, if you keep this figure positive and increasing, you will reach all your goals. This is just like your personal balance sheet.

You can create personal wealth. It's possible to meet your financial goals. By choosing to budget, save and invest, you can pay off debt, send your child to college, buy a comfortable home, start a business, save for retirement and put money away for a rainy day. Through **budgeting, saving and investing, and by limiting the amount of debt you incur, all these goals are within your reach.**

Create one today and keep reviewing it every year. Below are the explanation and Template for you to start today.

Some people consider themselves wealthy because they live in a very expensive house and travel around the globe. Others believe they are wealthy simply because they're able to pay their bills on time. What we are talking about here is financial wealth and what it means to you.

Building wealth requires having the right information, planning and making good choices. This article provides basic information and a systematic approach to building wealth. It is based on **time-honored principles** you probably have heard many times before—**budget to save; save and invest; control debt; and protect the wealth you accumulate.**

"Accumulating wealth—as distinct from just making a big income—is the key

to your financial independence. It gives you control over assets, power to help

shape the corporate and political Landscape, and the ability to ensure a prosperous

future for your children and their heirs...."

Rev. Jesse L. Jackson, Sr. and Jesse L. Jackson, Jr.,In their book *It's About the Money!*

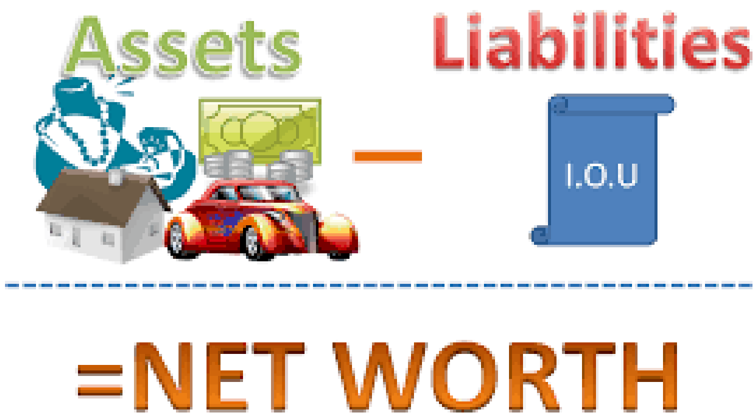
The first Step to Wealth Creation: Know your Networth

You want to create personal wealth, right? So does Aman.

Aman is 35 and works for a software company. He looked at his finances and realized that at the rate he was going, there wouldn't be enough money to meet his family's financial goals.

So he chose to embark on a personal wealth-creation strategy. His first major step was to learn the language of wealth creation. The **first lesson was to understand the meaning of assets, liabilities, and net worth**.

They make up this very important formula:



A wealth-creating ***asset*** is a possession that generally increases in value or provides a return, such as:

- A savings account.
- A Mutual Fund investment.
- Investment in PPF.
- A retirement contribution like EPF or NPS.
- Stocks.
- A house.

Some possessions (like your car, big-screen TV, and clothes) are assets, but they aren't wealth-creating assets because they don't earn money or rise in value. And we spend a major portion of earnings on these so called assets. A new car drops in value the second it's driven off the lot. Your car is a tool that takes you to work, but it's not a wealth-creating asset.

A ***liability***, also called debt, is money you owe, such as:

- A home loan.
- Credit card balances.
- Loan from a friend.
- A car loan.
- Hospital and other medical bills.
- Student loans.

Net worth **is the difference between your assets (what you own) and your liabilities (what you owe).**

Your net worth is your wealth.

This is how Aman Calculated his Networth. Also on the right side, <u>the Template is BLANK</u>... for you to do the same exercise:

Aman's Balance Sheet	Amount	Your Balance Sheet	Amount
Wealth-building assets	In Lakh Rs	Wealth-building assets	In Lakh Rs
Cash	14000	*Cash*	
Savings account	110,000	*Savings account*	
Fixed Deposit/Bond	230,000	*Fixed Deposit/Bond*	
Retirement plan EPF/GPF	1,100,000	*Retirement plan EPF/GPF*	
Market value of home	7200000	*Market value of home*	
Any Other Real Estate	800000	*Any Other Real Estate*	
Gold/Silver/Metals	200000	*Gold/Silver/Metals*	
Mutual Funds	900000	*Mutual Funds*	
Equity	25000	*Equity*	
ESOP, Vintage Articles, Arts Etc	-	*ESOP, Vintage Articles, Arts Etc*	
Others	-	*Others*	
Non-Wealth-building assets		Non-Wealth-building assets	
Market value of Car/Vehicles	900,000	*Market value of Car/Vehicles*	
Others	-	*Others*	
Total assets	11479000	Total assets	
Liabilities	**Amount**	**Liabilities**	**Amount**
Home Loan	600000	*Home Loan*	
Car loan balance	275,000	*Car loan balance*	
Credit card balance	24,000	*Credit card balance*	
Student loan	-	*Student loan*	
Amount due to friends	2,000	*Amount due to friends*	
Miscellaneous liabilities	18,000	*Miscellaneous liabilities*	
Total liabilities	919000	Total liabilities	
Net worth	**10560000**	**Net worth**	

With this is the end of this chapter, with the assurance that subsequent chapters will make you ready to understand more about creating wealth and strategies that make your financial goals achieve.

CHAPTER 2 - BUDGETING

In this Chapter we shall focus on taking it forward and get to know more pillars of **Wealth Creation**. This time, we cover **Budgeting**. Budgeting is important because it takes you to Savings. So, with a budget, you can know your saving potential.

Obviously, you need to increase your Net worth. And the best way is to invest your savings. But how to arrive or know what we save? Is the current savings ok? Or you can increase it?

Budgeting will answer all these important questions. So let's start learning **Budgeting**.

When it comes to finances, people generally fall into the following groups. **Where do you fit in**?

- **Planners** control their financial affairs. They know what they are earning and spending. They budget to save.
- **Strugglers** have trouble keeping their heads above rough financial waters. They find it difficult to budget to save.
- **Deniers** refuse to see that they're in financial trouble. So they don't see a need to budget to save.
- **Impulsive** seek immediate gratification. They spend today and let tomorrow take care of itself. They couldn't care less about budgeting to save.

Knowing what kind of financial manager you are will help determine what changes to make. To maximize your wealth-creating ability, you want to be a planner, like Gauri.

Gauri is a single parent with one child. "I have to budget in order to live on my modest income. I have a small notebook I use to track where every dime goes. Saving is very important to me. When my son was born, I started investing every month in a mutual fund for his college education. I am proud to say that I control my future. I have bought my own home and provided for my son, and I've never bounced a check. You must have common sense regarding money!" A proud mother and a saver.

Manu, by contrast, is impulsive. Manu has a good job, makes good money and lives a pretty comfortable life, but her bank statement tells a different story. She has no savings or investments, owns no property and has no plans for retirement. Plus, she's got a lot of credit card debt, lives from paycheck to paycheck and doesn't budget. A happy go lucky spender.

You can choose to be like Manu, or you can follow Gauri's road to wealth creation by learning to budget and save.

A budget allows you to:

1. Understand where your money goes.
2. Ensure you don't spend more than you make.
3. Find uses for your money that will increase your wealth.

To develop a budget, you need to:

1. Track your daily expenses.
2. Calculate your monthly income.
3. Determine how much you spend on monthly bills.

One day, Manu, the impulsive, realized that to create wealth she had to become more like Gauri and plan her financial future. To start, Manu analyzed her finances to see how much money she made and how she was spending it. Gauri chipped in to help and shared her **daily expense sheet** that she makes to note down daily expenses:

Gauri's's Day-to-Day Spending		In Rs	In Rs
Date	Expense	Cash/Bank/cheque	Credit Card
2-Jan	Lunch with coworkers		889
2-Jan	Coffee with Amrita		218
2-Jan	Building Monthly Maintenance	2000	
2-Jan	Petrol for car	1500	
2-Jan	Drinks with friends		1398
2-Jan	Groceries	1654	
2-Jan	Life Insurance Premium	6555	
2-Jan	Newspaper	180	
3-Jan	Vegetables & Fruits	780	
3-Jan	Books	399	
3-Jan	Medicine	170	
3-Jan	Milk Expenses	2010	
3-Jan	Auto	150	
3-Jan	Snacks at office	200	
3-Jan	Telephone Bill		899
3-Jan	Trip to the movie	900	
4-Jan	Dress Shopping		2400
4-Jan	Purchased Gift for Lata		600
4-Jan	Lunch		310
4-Jan	Cookin Class Fee	2000	
4-Jan	Sofa Dryclean	1200	
4-Jan	Birthday present		890
4-Jan	Donation to Cry		500
5-Jan	Cosmetics	350	
5-Jan	Car EMI	7700	
5-Jan	Home Loan EMI	12553	
5-Jan	RD	2000	
5-Jan	Magazine	100	
6-Jan	Breakfast	110	
6-Jan	Electrician	200	
6-Jan	Housemaid Salary		
6-Jan	Lunch		390
6-Jan	Cab Uber	135	
6-Jan	Internet Recharge	1179	
6-Jan	Tata Sky		715

She also shared the **monthly budget sheet** that she makes after adding the figures of daily expense sheet. This looks like this:

Gauri's Monthly Budget	In Rs
Month Jan 2016	Income
Take-home pay	78000
Overtime pay	3300
Investment earning	1400
Interest on savings accounts	255
Alimony/child support	10000
Other income	0
Total income	92955
Expenses	Spending
Charitable donations	500
Insurance (life, disability)	6555
Electricity	2544
Petrol	2500
Water	200
Telephone	1600
Cable TV/Internet service	1614
Credit card interet payment	14190
Grocerie	2800
Clothing	3000
Day care/tuition	800
Car loan	7700
Home Loan	12553
Car insurance	0
Meals out & entertainment	4330
Miscellaneous daily epense	100
Total expenses	60986
Monthly net (income - expense)	31969
Available to save or invest	**31969**

Budgeting is a simple tool to know and works on increasing the disposal income.

I highly recommend that you start making a budget for your household and you will feel the difference in your life.

Chapter 3 - Investing the Savings

This Chapter takes you one more step ahead, which is **Investing the Savings**. You have budgeted and identified an amount to save monthly.

Where are you going to put your savings? By investing, you put the money you save to work making more money and increasing your wealth. An investment is anything you acquire for future income or benefit. Investments increase by generating income (interest or dividends) or by growing (appreciating) in value. Income earned from your investments and any appreciation in the value of your investments increase your wealth.

There is an art to choosing ways to invest your savings. Good investments will make money; bad investments will cost money. Do your homework. Gather as much information as you can. Seek advice from personnel at your bank or other trained financial experts. Read newspapers, magazines and other publications. Identify credible information sources on the Internet.

Some facts to know before you start investing

- **Compound interest** helps you build wealth faster. Interest is paid on previously earned interest as well as on the original deposit or investment. For example, Rs 5,000 deposited in a bank at 6 percent interest for a year earns Rs 308 if the interest is compounded monthly. In just 5 years, the Rs 5,000 will grow to Rs 6,744.

Rate of Return p.a.	8%	10%	12%	15%
Lump sum Amount Invested	**1,00,000**	**1,00,000**	**1,00,000**	**1,00,000**
Initial Amount + Simple Interest	3,40,000	4,00,000	4,60,000	5,50,000
Initial Amount + Compound Interest	10,10,000	17,40,000	30,00,000	66,20,000
Difference in Wealth	**6,70,000**	**13,40,000**	**25,40,000**	**60,70,000**
Number of times Rs.1 lakh has grown in 30 years by compounding	10.1	17.4	30.0	66.2

> *Compound interest is the eighth wonder of the world.*
> *He who understands it, earns it ... he who doesn't ... pays it.*
>
> *– Albert Einstein*

- **Time horizon** -How long can you leave your money invested? If you will need your money in one year, you may want to take less risk than you would if you won't need your money for 20 years.

Rule of 72: We wrote about About Rule of 72 in detail here - Simplifying the Rule of 72

- **Inflation** is that kills your wealth silently. Thank god the extent of kill can be limited by earning more than the rate of inflation. While investing you should focus on Real Returns and not the Nominal Returns.

- Real return = Return from investment – Inflation rate
- For instance, if my return from investment is 8% and my inflation is 7%, then my real rate of return is 1%. Because, what I can buy with Rs.100 today, is likely to cost Rs.107 in the next year

Value of Rs.100,000/- invested in today's worth				
Years	Real Rate of Return			
	0%	2%	4%	6%
10	1,00,000	1,21,899	1,48,024	1,79,085
20	1,00,000	1,48,595	2,19,112	3,20,714
30	1,00,000	1,81,136	3,24,340	5,74,349

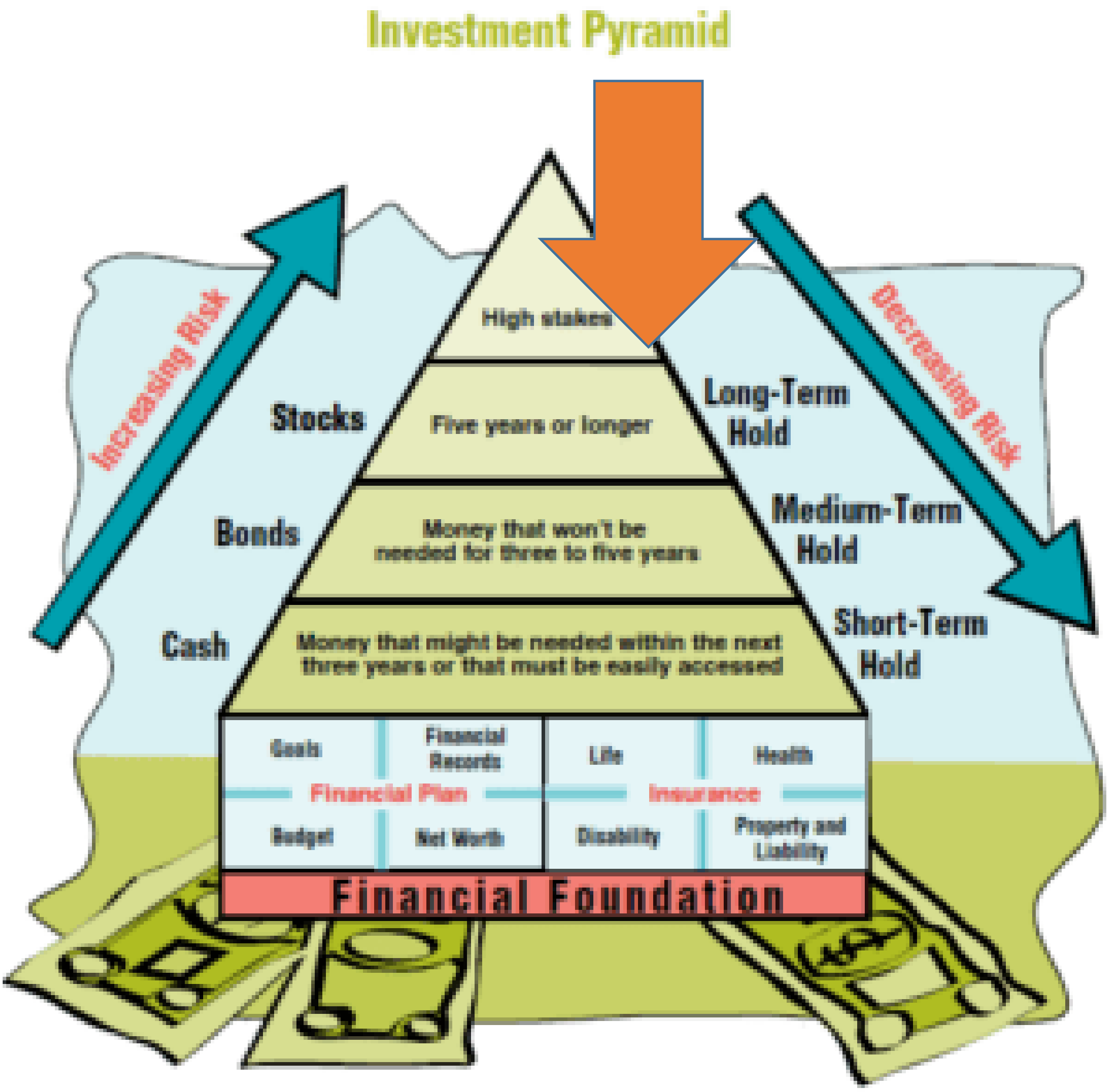
- **Financial goals -** How much money do you want to accumulate over a certain period of time? Your Investment decisions should reflect your wealth-creation goals. We wrote about Goals in Detail Here.

- **The Risk-Return Relationship**- When you are saving and investing, the amount of expected return is based on the amount of risk you take with your money. Generally, the higher the risk of losing money, the higher the expected return. For less risk, an investor will expect a smaller return.

For example, a savings account at a financial institution is fully insured by the Deposit and Credit Guarantee Corporation (RBI Subsidiary) up to Rs 100,000. The return—or interest paid on your savings—will generally be less than the expected return on other types of investments.

On the other hand, an investment in a stock or bond is not insured. The money you invest may be lost or the value reduced if the investment doesn't perform as expected.

After deciding how much risk you are able to take, you can use the investment pyramid to help balance your savings and investments. You should move up the pyramid only after you have built a strong foundation.



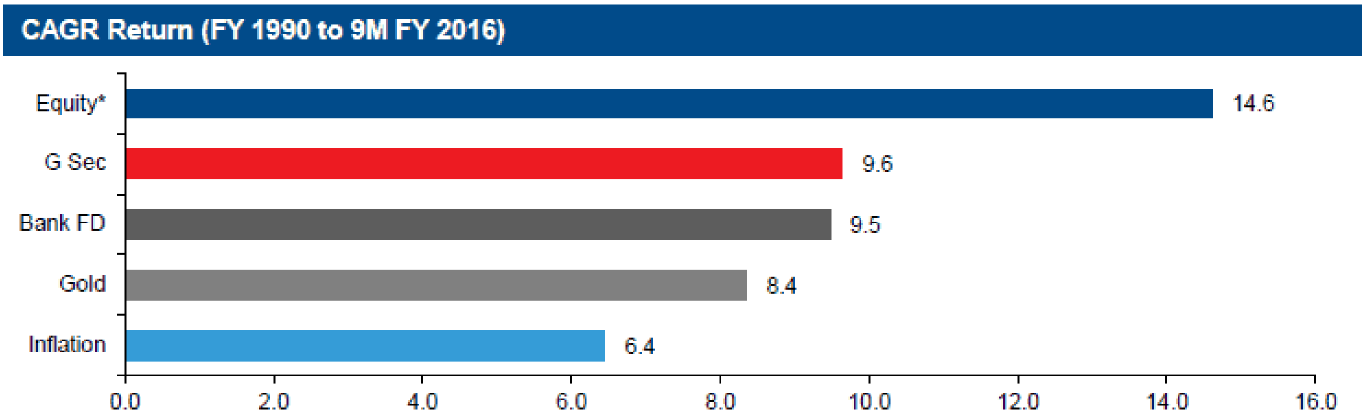
Tools for Savings

Once you have a good savings foundation, you may want to diversify your assets among different types of investments. Diversification can help smooth out potential ups and downs of your investment returns. Investing is not a get-rich-quick scheme. Smart investors take a long-term view, putting money into investments regularly and keeping it invested for five, 10, 15, 20 or more years.

You can invest in many assets like Shares, Mutual Funds, Commodities, Fixed Deposits, Government Securities, Bonds, Gold, Real Estate and many derivatives of these broad categories.

The ground rule is to understand your needs, your risk profile makes a portfolio in line with your goals, by minimizing risk through proper diversification as per the asset allocation. Than Reviewing the portfolio to match asset allocation and incorporate changes.

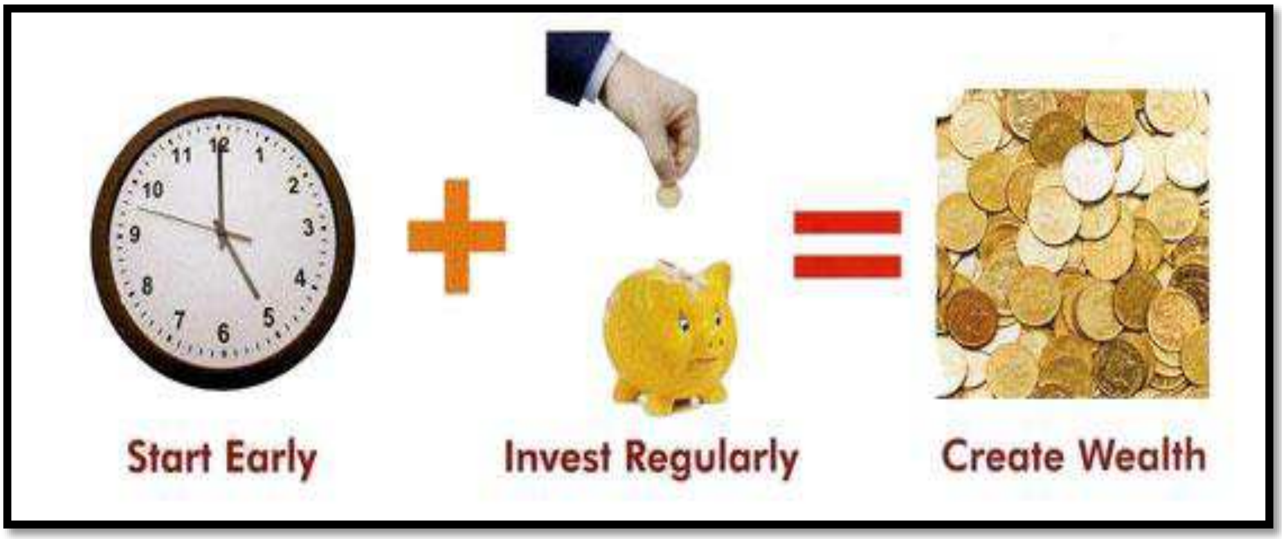
Historically this has been the picture:



Source: CLSA

As mentioned, **the picture is not to advocate investing in equities.** You need to take a scientific approach to investments which is Financial Planning.

With this, we end this chapter. In the next chapter, we will learn about Debt, its forms, its problems and controlling debt.



Chapter 4 – Debt

Now, we move to the villain of the story- **Debt.** Debt is considered a dirty word but still world has to live with it. If Debt Management is lacking in one's life, he may spoil what he has and his future. Budgeting, Savings, Investments and Financial Planning all depends on how a person manages his debt situation.

Here we go. Remember the definition of net worth (wealth)?

Assets - Liabilities = Net Worth

Liabilities are your debts. Debt reduces net worth. Plus, the interest you pay on the debt, including credit card debt, is money that cannot be saved or invested—**it's just gone**. Debt is a tool to be used wisely for such things as buying a house. If not used wisely, debt can easily get out of hand. For example, putting day-to-day expenses—like groceries or utility bills—on a credit card and not paying off the balance monthly can lead to debt overload.

Lots of people are mired in debt. In some cases, they could not control the causes of their debt.

People get into serious debt because they:

- Experienced financial stresses caused by unemployment, medical bills or divorce.
- Could not control spending, did not plan for the future and did not save money.
- Lacked knowledge of financial and credit matters.

Tips for Controlling Debt

- Develop a budget and stick to it.
- Save money so you're prepared for unforeseen circumstances. You should have at least three to six months of living expenses stashed in your rainy day savings account or the Emergency Fund.
- When faced with a choice of financing a purchase, it may be a better financial decision to choose a less expensive model of the same product and save or invest the difference.
- Pay off credit card balances monthly.
- If you must borrow, learn everything about the loan, including interest rate, fees, and penalties for late payments or early repayment.

When you take out a loan, you repay the ***principal***, which is the amount borrowed, plus ***interest***, the amount charged for lending you the money.

Remember the discussion about earning compound interest in Chapter 3? The interest on your monthly balance is a good example of compound interest that you pay. The interest is added to your bill, and the next month interest is charged on that amount *and* on the outstanding balance.

"The bottom line on interest is that those who know about interest earn it; those who don't, pay it."

People who go by planning, **rarely use [credit cards]**. When they do, they **pay off their balances every month**. When a credit card balance is not paid off monthly, it means paying interest—often 35 percent or more a year—on everything purchased. So think of **credit card debt as a high-interest loan**.

Do you need to reduce your credit card debt?

Here are some suggestions:

- Pay cash.
- Set a monthly limit on charging, and keep a written record so you don't exceed that amount. (Remember your daily expense sheet from Chapter 2? Use it to keep track.)
- Limit the number of credit cards you have. Cut up all or surrender except one of our cards. Stash that one out of sight, and use it only in an emergency.
- Choose the card with the lowest interest rate. But beware of low introductory interest rates offered by mail. These rates often skyrocket after the first few months.
- Don't apply for credit cards to get a free gift or a discount on a purchase.
- Steer clear of blank cheques offers like loans without security, zero processing fees or loans without documents that financial services companies send you. These are cash advances and loans that may carry a higher interest rate than typical charges.
- Pay bills on time to avoid late charges or increased interest rates.

Predatory lenders often target seniors and low-income people they contact by phone, mail or in person. After her husband died, 73-year-old Mrs. Sharda got plenty of solicitations from finance companies. She was struggling to make ends meet on her fixed income. To pay off her bills, she took out a 500,000 home equity loan that carried a high-interest rate and excessive fees. Soon she found she was even deeper in debt, so she refinanced the loan once, then again, and again, paying fees each time.

Mrs. Sharda's children discovered her situation and paid off the loan. The lessons here are:

- Don't borrow from Ram to pay Shyam.

- Never respond to a solicitation that makes borrowing sound easy and cheap.
- Always read the fine print on any loan application.
- Seek assistance from family members, local credit counseling services or others to make sure a loan is right for you.

Those who have used credit will have a **credit report** **(CIBIL Report)** that shows everything about their payment history, including late payments.

The information in your credit report is used to create your credit score. A credit score is a number generated by a statistical model that objectively predicts the likelihood that you will repay on time. Banks, insurance companies, potential landlords and other lenders use credit scores.

Credit scores range from under 300 to 900 and above and are determined by payment history, the amount of outstanding debt, the length of your credit history, recent inquiries on your credit report and the types of credit in use. Factors not considered in a credit score include age, race or ethnicity, income, job, marital status, education, the length of time at your current address, and whether you own or rent your home.

A credit report that includes late payments, delinquencies or defaults will result in a low credit score and could mean not getting a loan or having to pay a much higher interest rate. The higher your score, the less risk you represent to the lender. A score above 700 is considered healthy.

Review your credit report at least once a year to make sure all information is accurate. If you find an error, the RBI guidelines require credit reporting companies and those reporting information to them to correct the mistake.

If you believe you are too deep in debt:

- Discuss your options with your creditors **BEFORE** you miss a pay.
- Seek expert help, such as Financial Planner or Debt Counseling.
- Avoid “credit repair” companies that charge a fee. Many of these are scams.

Debt is very crucial to manage, as investors get very easily temp to fall into it. The reason is **DEBT IS A BUSINESS** for few. Your bank, loan companies, credit card companies or home loan provider etc all **make money off what you pay as interest.** But it helps financing or funding dreams and causes. So one has to be vigilant of quality and quantity- Both.

Chapter 5 – Insurance

Here is the Last and Finale of this Series**- Wealth Protection**

After working hard to create personal wealth, you need to protect it. People acquire insurance to protect themselves from major financial loss. **Insurance is simply a promise of Reimbursement for a loss in return for a premium paid**. When shopping for insurance products, consumers should **match their needs** with what the product offers and seek out the best deal. You can buy insurance to cover all kinds of risks, but basic needs can be met with the property, health and life insurance.

PROPERTY INSURANCE

Auto Insurance

State law requires that all motor vehicles have ***liability*** insurance to cover injury to other people or damage to their property. If you have a loan on your vehicle, your lender will also require physical damage coverage on it. The best thing is to cover the vehicle with a Comprehensive Cover.

Home Insurance

Home insurance covers your home and possessions. The personal liability coverage in a home policy protects you from loss resulting from any injuries that may occur on your property. Your mortgage lender will require you to carry a certain amount of insurance coverage as long as the mortgage is in place. Standard home coverage insures your home and its contents against loss from such risks as fire and theft. You may require special insurance for flood, earthquake or other risks specific to your area.

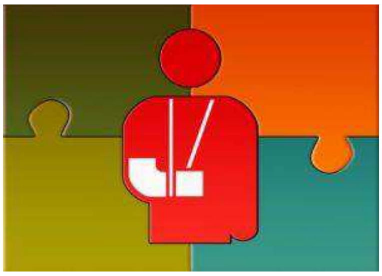
HEALTH INSURANCE

Medical Insurance

Medical insurance pays for some, but not all, of your doctor, hospital, procedural and prescription drug costs. Many people have significant levels of debt because they didn't have medical insurance or they didn't have savings to pay the expenses that weren't covered by their health plan.

Premiums are lower on employer-provided health insurance because the risk is spread over a larger group of people. Take advantage of the lower costs that employer-sponsored health plans offer, but expect to pay part of the premium out of your paycheck. In addition to medical insurance, many employers offer dental and vision plans, often at low cost.

Disability Insurance



Statistics show that you have a higher risk of becoming disabled than of dying before age 65. Disability insurance helps you pay living expenses if you are sick or injured and unable to work for a long time. Your employer may offer this insurance in its benefits plan. If you are self-employed buy it and maintain it till your retirement.

LIFE INSURANCE

The need for life insurance depends on a person's circumstances. In the event of your death, life insurance pays money to the person you choose (your beneficiary). Life insurance helps give financial protection to your children, spouse, parents or even your business.

While some types of life insurance offer savings and investment components to keep the future cost of premiums lower or to increase the death benefit, they are not a substitute for a savings or investment plan. Low-cost term insurance, often available through online portals or through agents, can offer protection for young families.

Buy only Term-Insurance for your insurance needs. The market is full of ULIPs (Unit-linked Insurance Plans), Whole-life, Money-Back and other policies which make returns less than inflation and have huge costs. Refrain from these and invest on low-cost term plans availing high coverage.

Personal accident insurance may also offer a cushion to families if a member dies or is seriously injured in an accident. This kind of insurance is often available through your employer or another provider at relatively low cost.

Tips for Protecting Your Wealth

There are many types of property, health and life insurance, so do your research and seek good advice.

1. Take advantage of group insurance through your employer or other associations you may have.
2. Study the needs of your family and decide how much you can afford to pay.
3. Shop around and get at least two quotes. The website can help a lot.

4. Ask about other discounts that may be available (for a good healthy record, safety equipment, multiple policies with the same provider, etc.) to reduce your cost of coverage.
5. Review your insurance coverage annually to make sure you have appropriate coverage as your situation changes.
6. Like all investments, be sure to get all the facts before parting with your hard-earned money.

With this, the series end but I hope it will be a new beginning for the readers. We often lack basic things and hence the entire financial life becomes stressful and messy. But learning and applying few easy but important things can make the financial life strong and happier.

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