PGIM
India Mutual Fund

Thumb Rules that help you make asset allocation decisions simple

August, 2019

Ajit Menon
CEO

Till the recent past, all of us had a family doctor who had this amazing ability to predict how long a fever would last, that too without conducting any medical test. Similarly, an experienced cook is able to tell the quantity of ingredients required to cook food for an entire event. A tailor can tell the length of cloth required to stitch a suit by just looking at the body structure. Even before google maps came into existence, an experienced cabbie on the streets of Mumbai could have given you a fair estimation of time required to reach a particular destination, that too for different hours of the day. And a good fielder is able to take a running catch without first calculating the trajectory, speed and direction of the cricket ball. Ever wondered how they do it?

All these are based on practical experiences. Over the years these professionals developed insights into their trade taking away the need for scientific measurements that are accurate to the last digit. These roughly correct measurements are often referred to as thumb rules. There are wide ranging debates on the origin of Rules of Thumb or what is commonly known as Thumb Rule. As per the Merriam Webster Dictionary, it is a general principle regarded as roughly correct but not intended to be scientifically accurate. They are a layman’s guide to practical problems.

Like all other professions, the world of investments also has a fairly long list of useful thumb rules. Rules of thumb are a great starting point to help you manage your investments and portfolio.

One of the key challenges faced by investors and advisors alike is to decide the basic asset allocation for their investments. Many studies have proved that more than 90% returns generated can be attributed to the asset allocation decision alone. Asset allocation becomes challenging to arrive at due to a host of factors like investors age, risk appetite, life stage, nature of job, market cycles, etc. The underlying principle of asset allocation is to manage risk. In the case of most investors, there will be an earnings’ phase where they will have an opportunity to save and build a retirement corpus. Post retirement, the corpus created through savings earns an income for them. So early in life, the priority is about growing the retirement kitty as much as possible. It naturally means that the allocation should be more towards assets that can generate higher returns, though with a commensurate volatility, like equity. As retirement comes close, the focus has to shift towards safeguarding this corpus from volatility through low volatility assets like low risk debt funds. The logical question would be, what should be equity allocation at various ages. Here too, a rule of thumb comes handy. Experts say that (100 - age) of the investors should be the allocation to equity. For example, if an investor is 30 years old, equity allocation in the portfolio should be 100-30 = 70 percent. Same investor at the age of 50 should have 100-50 = 50 percent equity allocation.

Arriving at a basic asset allocation is easier than sticking to it through various cycles. To stick to the decided plan it may need an active rule-based switching of money from one asset class to another. Psychologically, it is difficult to shift investments from equities to debt in a rising equity market. Similarly, it is equally difficult to shift money from debt to equity when equity market is falling. To help our advisors and investors to overcome this problem, we have launched an Age Linked Asset Allocation Facility based on the 100-age formula. It manages allocation on an ongoing basis between a selected equity fund and a debt fund based on the age of the investor. The investor can choose any one equity scheme and one debt fund from our offerings. The facility would rebalance the portfolio based on the age of the investor on his/her birth date. Investors can also decide the frequency of rebalancing. It can be done every 1/3/5/7 years for investors above the age of 30. Below the age of 30, the allocation to equity will be 100%. It is a very simple facility based on a thumb rule. Investors should consult their advisors before opting for the Age Linked Asset Allocation facility.

More on other financial thumb-rules in our future communication. I have deliberately not touched upon any of the highly debated topics like slowing down of domestic and international economy, trade war, negative interest rates in some economies, etc. All these events will have an impact on the markets in short-to-medium term. But a decade from now, they all will be irrelevant. What will remain relevant would be the asset allocation decision that you make today and how you remain steadfast to the financial plan.

We, at PGIM India, will constantly try to create simple solutions to make the investment journey simpler. I sincerely hope that you make the most of these unique solutions for your wealth creation.

Connect with us on: in f 🐦 ▶ www.pgimindiamf.com ☎ 1800 2667 446

This Document is for information purpose only. This Document and the information do not constitute a distribution, an endorsement, an offer to buy or sell or the solicitation of an offer to buy or sell any securities or mutual fund schemes (collectively “Products”). PGIM India Asset Management Private Limited (erstwhile DHFL Pramerica Asset Managers Private Limited) and/or its affiliates/associates undertake no obligation to update forward-looking statements to reflect events or circumstances after the date therefore. PGIm India Asset Management Pvt. Ltd. and/or its affiliates/associates, their directors, employees, representatives or agents shall not be liable or responsible, in any manner whatsoever, to any Investor/Recipient or any other person/entity, for the performance of the products. The distribution of this Document in certain jurisdictions may be restricted or totally prohibited and accordingly no persons receiving this Document in any such jurisdiction may treat this Document as constituting an invitation to them to subscribe for units of funds of PGIM India Mutual Fund.

© 2019 Prudential Financial, Inc. (PFI) and its related entities. PFI of the United States is not affiliated with Prudential plc, a company incorporated in the United Kingdom. The PGIM logo and the Rock symbol are service marks of PFI and its related entities, registered in many jurisdictions worldwide.

Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.