FinShiksha

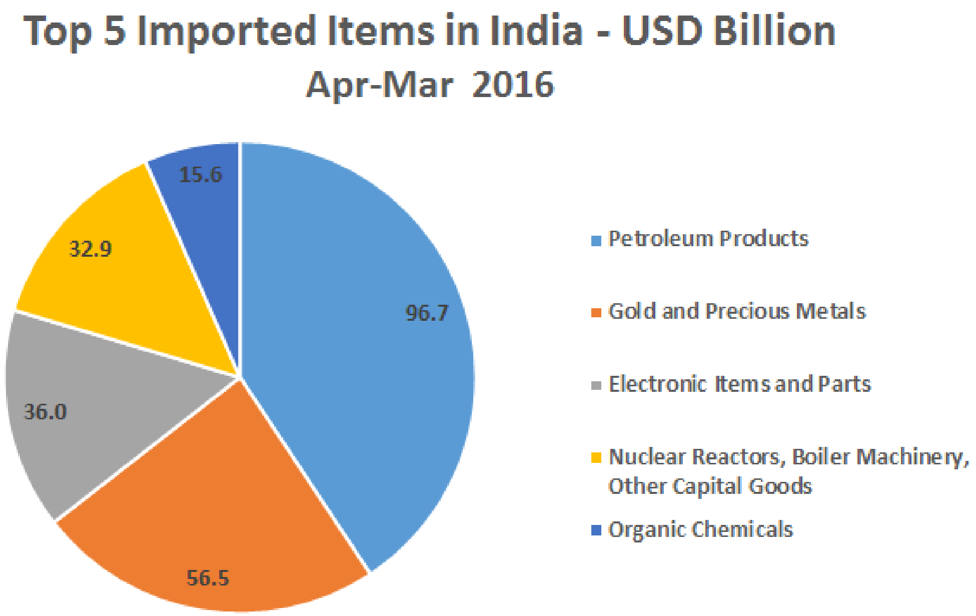
Monthly Update – June 2016

Every month, we will come out with a collection of articles that are also available on our blog, as well as some of the good articles that we come across the web. These may help you put the global events in perspective, as well as add to your skill set when it comes to the financial services industry.

Contents

1- Why India should focus on boosting manufacturing of electronic goods?

We all love the latest versions of electronic goods. For long, India has been an importer of electronic goods. Most of the manufacturing that happens in electronic goods such as televisions, refrigerators, washing machines and others is largely assembling. Major companies selling in India usually import most components. In fact, electronics imports in India are the 3rd largest import in terms of bill value. We imported nearly 36 billion dollars' worth of electronics last year (as shown in the chart here). This is also nearly 8-9% of our overall import bill.



Now penetration of Consumer Electronics in India, with the exception of televisions is quite low. Refrigerators, Washing Machines are both below 20% penetration, as per some surveys. Air conditioner in only in 3-4% of households. Many issues result in this low penetration – such as lack of infrastructure, to be able to give last mile connectivity on logistics, arbitrary taxation structure – with so many state taxes, low affordability and also lack of power supply. We have electrified most of India, but consistent power supply is still a pipe dream.

A lot of activity is happening on this front though – giving us hope. GST should enable simpler taxation. Rural infrastructure should get upgraded in the next few years, with road building high on the government's agenda. Power situation is looking up – with new power projects coming up, focus on electricity for all by 2020 and focus on revitalizing State Electricity Boards. Finally, affordability is going to improve, as the demographic boom of India continues. All this should result in a significant jump in demand for all electronic appliances, which could result in a sharp jump in imports. Some estimates suggest that imports of electronics may jump 2-2.5 times in the next few years. That would mean an additional USD 40-50 billion imports (making it probably the second largest import group for India), and a consequent pressure on India's trade balance. And the situation is unavoidable, since prosperity to India's middle class would result in this demand. It is thus necessary that the country boosts its investment in manufacturing of electronic goods, and also woo investors to focus on exporting this out of India. No reason we cannot do it, if the government decides, and focuses on the bigger picture. Else, we would again be grappling to someone save our currency in the next few years.

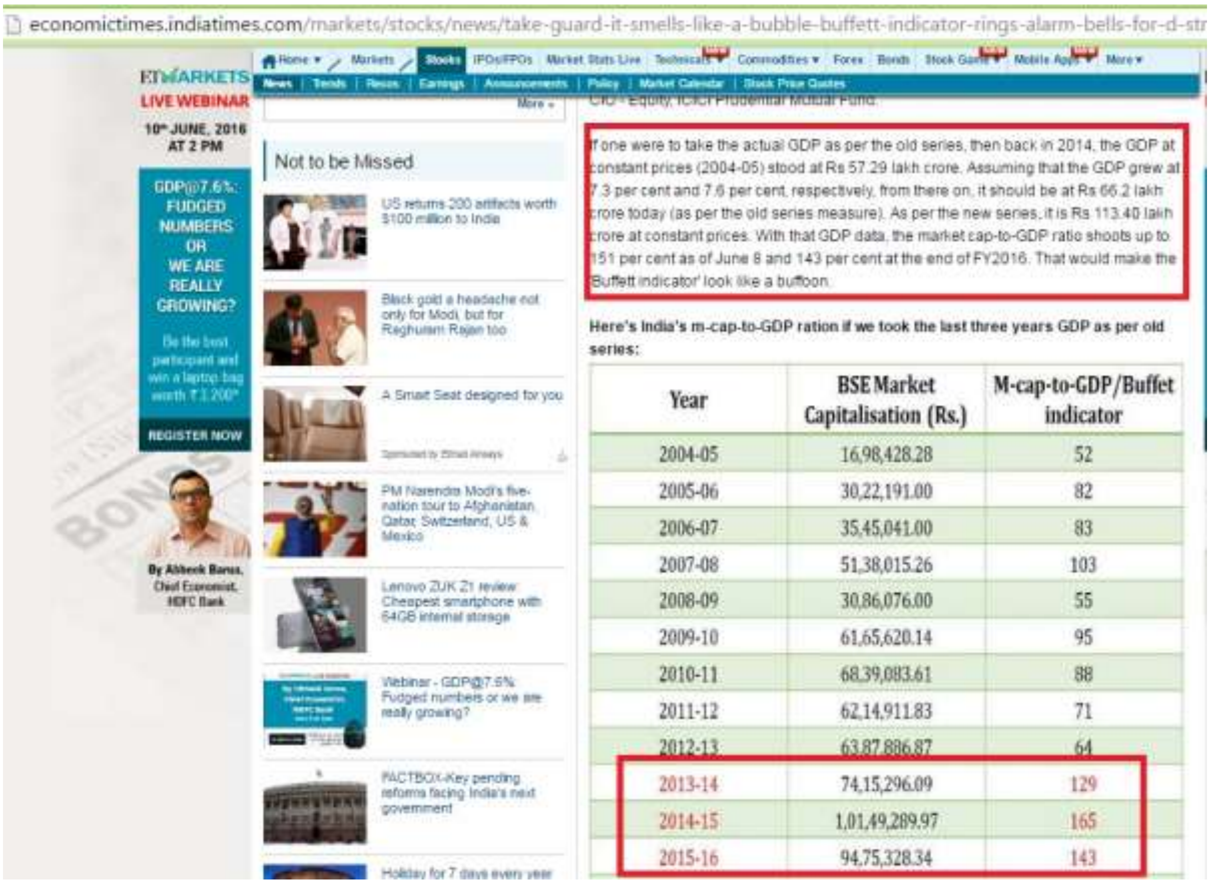
2- What is wrong with the argument in this article?

This note reviews an article that appeared in the ET a few days ago.

Refer to the mentioned article here http://goo.gl/swF0rA . Try and find out if there is something wrong with the argument in this article?

We outline what is wrong with the argument this article uses about the overvaluation on Indian markets. **This is a classic case of incorrect usage of real and nominal numbers**. Whenever we calculate a ratio in finance – both the numerator and denominator should ideally point to nominal numbers, or to real numbers. By definition, Market Capitalization is a Nominal number. When we calculate the Market Cap to GDP ratio, it is thus imperative that we use GDP at current prices, and not GDP at constant prices.

Look at the image below from the article



economictimes.indiatimes.com/markets/stocks/news/take-guard-it-smells-like-a-bubble-buffett-indicator-rings-alarm-bells-for-d-str

If one were to take the actual GDP as per the old series, then back in 2014, the GDP at constant prices (2004-05) stood at Rs 57.29 lakh crore. Assuming that the GDP grew at 7.3 per cent and 7.6 per cent, respectively, from there on, it should be at Rs 66.2 lakh crore today (as per the old series measure). As per the new series, it is Rs 113.40 lakh crore at constant prices. With that GDP data, the market cap-to-GDP ratio shoots up to 151 per cent as of June 8 and 143 per cent at the end of FY2016. That would make the 'Buffett indicator' look like a buffoon.

Here's India's m-cap-to-GDP ration if we took the last three years GDP as per old series:

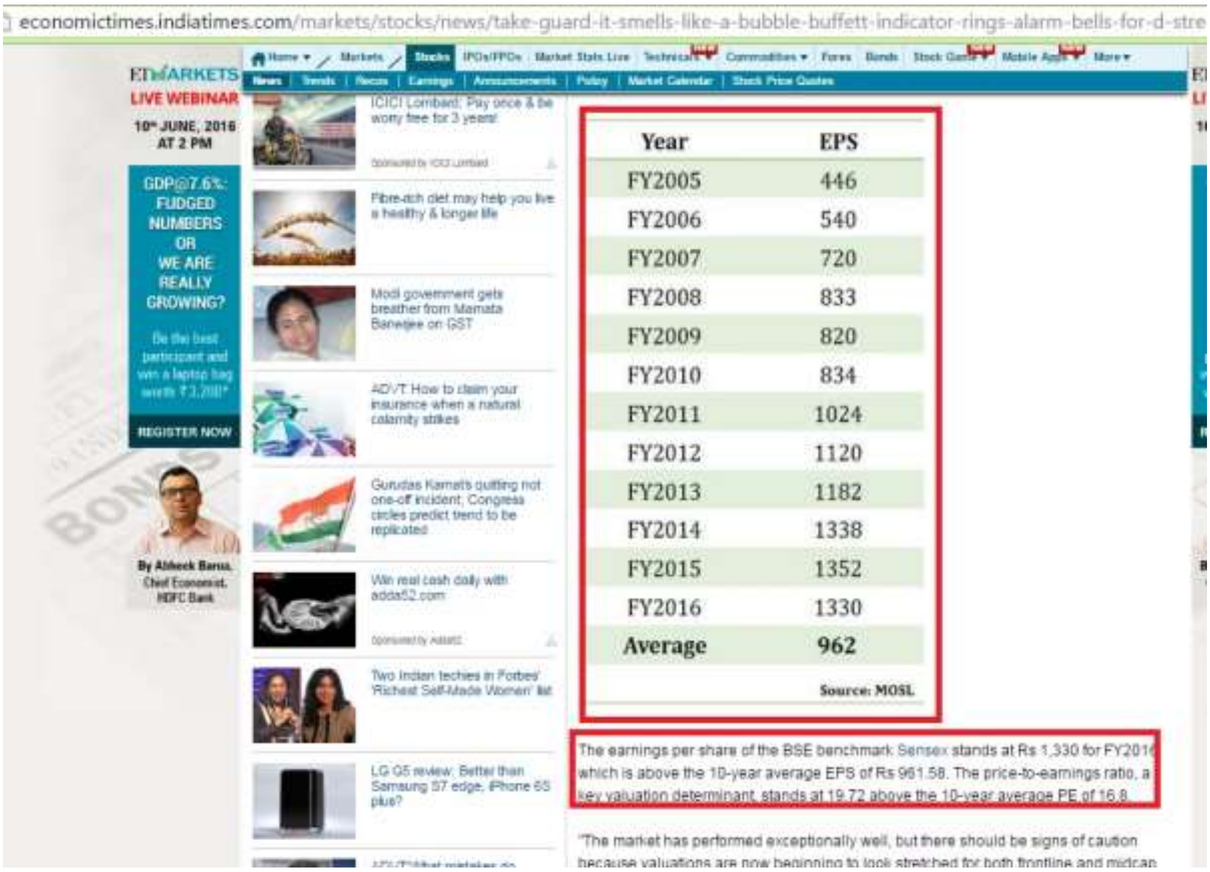
Year	BSE Market Capitalisation (Rs.)	M-cap-to-GDP/Buffet indicator
2004-05	16,98,428.28	52
2005-06	30,22,191.00	82
2006-07	35,45,041.00	83
2007-08	51,38,015.26	103
2008-09	30,86,076.00	55
2009-10	61,65,620.14	95
2010-11	68,39,083.61	88
2011-12	62,14,911.83	71
2012-13	63,87,886.87	64
2013-14	74,15,296.09	129
2014-15	1,01,49,289.97	165
2015-16	94,75,328.34	143

That is the first major mistake this article does, amongst many others.

1. The only use of Real GDP (GDP at constant prices) is for finding the Real GDP growth rate. So the number itself is not important – it is the change in number that is important. Why is that so? Let us see how we calculate the Real GDP number. We take today's output, and then multiply it with a base year price. Now it does not matter it the base price is of 2005 or 2012 – since we are going to multiply the output of each year with that price. We are only concerned about output changes when using Real Data, and that is why, Real GDP (GDP at constant prices) will be dependent on the base year we use. In this article, the author suggests using the previous estimates of Real GDP, which were at 2004-05 base price. The number

obviously appears much lower since the prices were much lower. That is basic economics, which has been overlooked here. And since you divide by a much lower number, you get a much higher multiple. On the contrary, India's market cap should be around USD 1.5 trillion, which when divided by the Nominal GDP of USD 2.2 trillion, gives a ratio of about 70%. This is close to the lowest we have seen on this number in the last many years, which was around 60%. The highest was around 140% in 2008. Contrary to what the article says, we seem to be undervalued based on this metric.

2. At another place, the article looks at 10 year average EPS. That is incorrect as well, since for a growing economy, the EPS will rise every year. To say we are today greater than 10 year average is a meaningless statement. Image here for reference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Year	EPS
FY2005	446
FY2006	540
FY2007	720
FY2008	833
FY2009	820
FY2010	834
FY2011	1024
FY2012	1120
FY2013	1182
FY2014	1338
FY2015	1352
FY2016	1330
Average	**962**

Source: MOSL

The earnings per share of the BSE benchmark Sensex stands at Rs 1,330 for FY2016 which is above the 10-year average EPS of Rs 961.58. The price-to-earnings ratio, a key valuation determinant stands at 19.72 above the 10-year average PE of 16.8.

"The market has performed exceptionally well, but there should be signs of caution because valuations are now beginning to look stretched for both frontline and midcap

There are some other errors as well, but those are minor in comparison to what the above ones are. The article tries to use the confusion around the GDP numbers released (which is more on account of inflation calculations) and link that to this calculation, which is clearly incorrect. In all, a poorly researched and worded article, which makes incorrect observations based on incorrect metrics. That it appears on a widely read website is even more amazing!

3- Career Guidance: Financial Modeling vs Equity Valuation – The difference

How do we differentiate between financial modeling and valuation? Under common parlance, both these terms are used interchangeably, but a careful analysis would show the difference. It is necessary for someone trying to learn the two to understand the difference between the two.

Valuation of a company is a way to find out its intrinsic value. There are various ways we can analyse a firm, and we usually end up using Excel to speed up the process.

Financial Modeling on the other hand is effectively creating a model to solve a problem related to the field of finance. Once again the tool used extensively is Excel, and that is probably what mixes up the two terms. Financial Modeling should spread across the breadth of financial services. Any problem that can be solved using a model fits under financial modeling – be it financial planning, project finance, M&A analysis, valuation or risk management.

Valuation is one of the applications of financial management. If you intend to learn how to do valuation, the focus should be on what is important to the valuation process. Building a model, while important, is not the most important part of valuation of a business. Understanding the business, and figuring out what method to use to value it is the most important part.

Financial Modeling on the other hand should help you use Excel to Model any problem in financial services. The focus here should be on primarily learning Excel, and not just learning it, but applying it to solve any problem in financial services.

So if you want to learn Financial Modeling, you should search for something that allows you to Learn and Apply Excel. On the other hand, if you want to learn Valuation, you should be focusing on learning the in-depth analysis of a business and company, reading its annual reports, doing financial statement analysis on it, and finding its value. Excel is just a tool here to support the entire process.

4-Articles we read: Robo-advisory: which one is for you?

There are 4 categories. Once you know the extent of help you need, you can choose the one that works best for you

Source Article here: http://www.livemint.com/Money/MGNQT2wi0XEza7v93ykLwM/Roboadvisory-which-one-is-for-you.html

What is robo-advisory? Press a key and your investment is done? Or is it pre-programmed personal financial advice? A robo-advisor is essentially an automated service that gives you advice on managing investments and even helps you buy some financial products. The advice is generated with the help of algorithms. From registration to execution, little human intervention is needed.

Though all robo-advisory platforms give multiple choices for quick, clear and scientific investment advice, there is a difference in the final recommendation. The basic premise, however, remains the same; for your long-term goals, of more than, say, five years, it works best to allocate to equity, and into fixed income investments for near-term needs.

To choose a robo-advisor that suits you, assess what is available out there. Here's what one can expect from robo-advisors.

What do you get?

The focus is on money management advice. The interactions are digital and around financial goals such as retirement, saving, tax planning and regular investment. You have access to investment management and financial planning. Figure out what you need—just some financial transactions or more in-depth, goal-linked planning. Most robo-advisors at present primarily offer mutual funds as the solution for financial objectives. This might seem restrictive, but in terms of transparency, returns and accessibility, mutual funds are found to be most appropriate to address goal-based asset allocation needs for retail investors. Some offer other products like insurance, deposits and direct stocks.

Types of Robo-advisory

Broadly, the robo-advisory platform can be categorised into four—automated investments, direct plans, goal-based advisory and full service advisory.

Auto-pilot: In this mode, you select among the offered 'packages'. You select what you need, and then stay invested. One such platform is Scripbox, an online MF investment service firm that offers three 'boxes'—equity, fixed income and tax-saving. Sanjiv Singhal, its founder and head of product strategy, said, "The objective is to reach out to the young earners and first-time investors. We want to bridge the gap between awareness about mutual funds and the execution. While linking a goal is important, sometimes it's hard to even think of a goal. So the idea is to get started and build investment discipline." Scripbox recommends a total of eight funds—four equity funds, two fixed income funds and two tax-saving funds, split into the three different boxes you can pick.

Direct plan-based: Companies such as Bharosaclub.com, Orowealth.com and Invezta.com offer a low-cost direct plan option. You can even switch your existing mfs into the direct plan. there could be a nominal advisory or convenience fee attached to transactions. Prasad Janardhanan, product manager, Invezta (Valuefy Solutions Pvt. Ltd.), said, “We have been pained with biased advice, hidden fees, commissions and profits-over-people approach. We are democratising healthy investing with a zero commission platform and institutional quality robo-advice.” These platforms offer both do it yourself option and the choice to invest based on goals.

Goal-based advisory: Such a robo-advisory is structured on asset allocation, which means fund selection is a result of the information you provide. While these websites offer basic advisory on how to approach your long-term investments, the option to only transact, which allows you to simply login and buy the funds you want. FundsIndia.com, for example, helps you invest based on goals. One of the first firms to get started with an online distribution model, it also allows transactions in shares, company deposits and corporate bonds, and now has an advisory service as well. BigDecisions.com, another robo advisory platform, answers your initial questions, but doesn’t offer products.

Full-service: If you need in-depth advice, look towards a full service robo-advisory, which will ask you to answer a detailed questionnaire to assess your risk appetite, financial goals, saving and spending pattern and current asset liability position. The information is analysed to assess how you are managing your monthly liquidity, whether spending is more than earning, what your net worth is, do you have enough surplus, taxation and so on. “We are not just a platform to sell mutual funds. We use precise tools to provide personal financial advice, which we customise. For us risk management is as important and a part of personal finance as wealth creation is. moreover, portfolios are entirely customised to every individual’s risk profile thanks to millions of simulation done of various scenarios to suit each client,” said Nitin Vyakaranam, chief executive officer and founder, ArthaYantra, a full service robo-advisor. The firm, which has been around for six years, helps you connect with partners that can assist with buying insurance or taking a loan as per its recommendations.

Another newly launched full-service robo-advisor is Aditya Birla MyUniverse. This site allows you to link almost all your financial details directly into the account you create here. You can link your bank accounts, credit cards, investments and loans. Based on this information, it gives you analytical reports about your financial health, expense management and net worth, among other things. You can also choose to simply transact. “We provide two types of services—personal finance management and product specific mutual fund investment,” said Rahul Parikh, chief executive officer, My Universe.com.

5nance.com is another platform that allows you access to analytics and also offers execution capability. Dinesh Rohira, founder and chief executive officer, 5nance.com, said, “The analysis of spends and asset details helps in focusing on specific issues. For example, you might find that eating out less often can help you save better to fulfil the long-term goal of child’s education.” The site offers other products as well, including equity shares, gold, credit cards and loans.

What you need to know

To get started on a robo-advisory platform, you will have to create an account. Some platforms, especially if they allow transactions, will ask you to add bank details, Permanent Account Number (PAN) and know-your-client (KYC) details. If buying a mutual fund, you can choose a systematic investment plan or invest a lump sum.

While not every platform is a full-service robo-advisor, all offer automated investment advice.

This essentially means that a selection of mutual fund schemes is recommended as per algorithms designed by each platform. Each service provider may recommend a different set of funds for the same goal. Some recommend four, some eight and some just one. The main aim is to get the long-term asset allocation right.

Vijay Kuppa, co-founder ORO Wealth, an online mutual fund investment platform that promotes direct investments, said, "We run an algorithm based on quantitative and qualitative criteria and which recommends the fund. Consistency of performance is important and that is built into the algorithm. The outcome is one recommendation for a large-cap fund, one for a multi-cap fund and one for a mid-cap fund."

Recommended portfolios are reviewed periodically. Let's say, you have recently started with the service and a month later the chosen funds are reviewed and a new one added. Should you sell one of the older funds and buy a new one?

Not necessarily. The robo-advisor will provide relevant reasons for making a change, but it will be your decision to change or not. As a thumb rule, churning schemes often is not efficient. And no one fund can be a top performer year after year. Aim to bring consistency in returns and adhere to your initial allocation, at least for three years (if it is a long-term investment).

Remember that these are automated portals—mostly recommendations are made; handholding is done (in some cases) only in extraordinary situations. Most of the advice is structured around long-term investments.

But what happens during short-term market volatility, or in case of a personal emergency? The automated advisory platform will send reminders stating that you are moving away from the long-term goal, but the exact cash flow and behaviour management suggestions may not come through from those that are not full-service platforms.

Is it for you?

Sadique Neelgund, founder, Network FP, a professional membership organisation for financial planners, said, "An investor who wants to start with a systematic investment plan of a small amount can look towards robo-advisory platforms as they are easy to access and offer elementary planning for free, whereas human financial advisors may not find it commercially viable. It works well till markets are positive. However, support is required when events go sour. As of now, there is no way to know whether these portals will be able to help investors hold on in rough times. Behaviour plays a bigger role when it comes to delivering good returns."

This is where human intervention helps. Comprehensive robo-advisory service providers say many people want some interaction, even if the advice generated is automated. Srikanth Meenakshi, co-founder, FundsIndia.com, said, "It's not enough to be reactive on portfolio queries. There is an expectation of proactive interaction as well."

Keeping this demand in mind, Vyakaranam said they have qualified certified financial planners to help with the explanation of the plan recommendations. The solutions, however, remain automated and don't originate from the human adviser.

If you are well-versed with investment products, robo-advisors can help you make quick, easy and cost-effective transactions. If you don't understand the nuances of investing and need to be shown a target to move ahead, there are robo-advisory platforms that give you the required push in choosing goals and making regular investments. The full-service platforms, in fact, hand hold you through the entire financial journey of understanding your spending habits, cash flows, net worth, helping with the taxation and then building a kitty towards financial goals. ArthaYantra is one such platform which doesn't have the option to just invest yourself; they believe investments have to part of a financial plan so until the appropriate analysis is done products don't get recommended.

If you are starting out with investments, these platforms work well in their ease to use. The analysis is mostly free, but in some cases, if you want to go further with the recommendations, there could be an annual fee. Typically, the fee depends on the adviser and service. For example, ArthaYantra charges Rs.1,000 annually for its premium investment advisory service; Invezta charges Rs.109 per month for its premium service.

As the sector evolves, more innovation beyond simple selling is expected. For do-it-yourself investors, it will ultimately be about costs. Platforms with access to direct plans and recommended portfolios (which means funds have already been selected) are likely to have an edge. Tackling one goal at a time may work with small or first-time investors, but eventually as the portfolio grows and financial needs expand, more in-depth financial planning may be needed, which can come through an offline adviser or through a more comprehensive robo-advisory platform. At present, there are 39 robo- advisory companies in India, according to Tracxn, a data analytics company. Of these, so far 10 have got funding. An early entrant is FundsIndia.com has received $15.41 million so far from Foundation Capital, Inventus Capital Partners and Faering Capital. Other robo-advisory companies who have received funding include MyUniverse ($9.7 million) and Scripbox ($3.22 million).

Ultimately, its portfolio performance that will matter. So, the algorithm has to be accurate and better than others in selecting and reviewing recommendations. It's too early to judge or analyse the existing platforms, but as these firms go through more market cycles and recommendations change, the winners will come through.

For any comments, please feel free to email is at programs@finshiksha.com or contactus@finshiksha.com

Do visit our website www.finshiksha.com for more updates, as well as details on our programs.

About us

FinShiksha is an IIM Calcutta alumnus venture, and specializes in education in the financial services domain. But we are more than just education providers; we help you build a career – and work with you during the process. Our programs help a candidate evaluate his/her strengths and hone them, at the same time spotting weaknesses and eliminate them. We teach, we hand-hold and we guide. And yes – we simplify finance.