Choose the right investment instrument to fulfill long term milestones

We never realize the true power of regular investments until we actually look at the results. And we are dumbfounded; no doubt. It is hard to imagine one's investments grow manifold into a mammoth corpus by just following the discipline of systematic investing. Systematic investing has many advantages – it does not pinch your pocket too much and moreover; it does not time the markets and reduces market risk by spreading your investments over time period.

Every individual sets some milestones to ensure a bright future for himself and his family. To fulfill his dreams, he saves every penny he can and invests the same to multiply his corpus to achieve his milestones. Unfortunately, when it comes to investing, the choice of instrument can often render the saving efforts ineffective. Since the products on which the distributors make maximum commissions are pushed most aggressively, more often than not, the choice of instrument for long term milestone driven investments is a costly product. A typical example is the aggressively advertised Unit Linked Insurance Plans or ULIPs.

For most investors, it takes a while to realize what a mess such complex products are. Not only can one not get out easily, one faces the unhappy prospect of losing part of the invested capital itself. This brings us to one of the basic thumb rules of investing i.e. the need to keep ones insurance separate from investments. Often ULIPs are positioned as instruments for truly long term investments while investors tend to think of mutual funds as more actively managed short term funds. Hence investors often might not feel comfortable with the idea of investing in mutual funds for long term goals. They often want fire-and-forget type of options for long term investing.

Well, index funds are precisely that! What's more, they come at a very low cost, are extremely liquid and face little risk of underperforming the market. The inherent simplicity of index funds makes them the ideal choice for long term goal based investing.

Comparison between ULIPs and Index Funds as instruments for long term milestones

		Index Funds	ULIPs
Allocation Charges	1st year	Nil	20.0% - 60.0%
	Subsequent years	Nil	1.0% - 8.0%
Surrender Value		Equal to fund value throughout the life of investments	Zero for first three years, slowly grows close to fund value over time
Expense Ratio		1.5%	1.5% - 3.0%
Liquidity		Very high	Very low
Market underperformance risk		Close to nil	High
Insurance cover		Needs to be taken over and above	Incorporated in the product
Ability to switch in case of underperformance		Very high	Non-existent

To be fair, ULIPs do provide the additional life insurance cover; but practically speaking, these products are so complex that it even leaves a finance wizard dumbstruck. There is a general understanding amongst finance professionals that "more complex the product, more costly it likely to be!" True to this belief, ULIPs typically have high premium allocation costs and various other charges like annual management fees, expense ratios etc. which eats into your premium before it gets invested into equity markets.

If Index Funds are so much better, why have you not heard of them before? Simple, low commissions! Index funds typically have low cost structures associated with them. They do not have any entry load and have less exit loads; applicable if only redeemed before one year. Their expense ratios too are on the lower side as compared to ULIPs or other diversified equity mutual funds. Being passively managed, they closely track the stocks of a benchmark index and invest in the stocks in similar proportion to their weights in the benchmark index. Such funds are not affected by fund manager performance and do not under perform the index they are tracking. The no/low entry loads in index funds means all your investments go to build your milestone corpus.

Unlike ULIPs, index funds are highly liquid and can be redeemed anytime. There is no concept of a surrender value and one gets one's corpus back with the capital appreciation right from the first investment date. If you want to avail a life insurance benefit, the best option would be to take a term cover equal to the milestone target amount. In this type of cover, the associated premium costs are quite low. All in all, index funds with sufficient term insurance cover work out way cheaper and significantly more effective than ULIPs in saving for life's major milestones.

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