Business Standard

Doing away with timing

Kiran Telang / December 5, 2010, 0:03 IST

A couple of investing methods which have worked .

When is the right time to enter the market is a million dollar question. It is wise, then to use methods of wealth creation that save you the unnecessary bother of having to time the market. Two of these are Rupee Cost Averaging (RCA) and Value Cost Averaging (VCA).

RCA is the strategy which has been popularised by mutual funds by offering systematic investment plans (SIPs). Most of us are familiar with this. You invest a fixed amount of money every month on a pre-selected date in an MF scheme.You would get more units if the market is low and less if the market is high. This way, you save a specific amount every month which gets invested without having to time the market. In the long run, this helps build a good corpus.

VCA is a slightly evolved method of investing. In this method, the return required is fixed, based on which the amount to be invested each month is decided. So, every month, the amount may vary, depending on the level of target reached. Let us understand this with the help of an example. In the example, the investor has a surplus of Rs 5,000 per month that he wants to invest. In an SIP, he invests Rs.5000 pm and receives units in line with the prevailing NAV. The investment continues for the tenure chosen by the investor. The amount received at redemption will be the number of units, times the NAV on the date of redemption.

VCA PRINCIPLE

Month	NAV	Amount invested	Units	Month-end Value @15%
1/12/2009	10	5000	500	5000
1/1/2010	11	4563	415	10063
1/2/2010	12	4210	351	15188
1/3/2010	13	4210	302	20378
1/4/2010	11	8390	763	25633
1/5/2010	10	7650	765	30953
1/6/2010	9	8482	942	36340
1/7/2010	8	9492	1187	41794
1/8/2010	9	299	33	47317
1/9/2010	8	10849	1356	52908
1/10/2010	9	0	0	58570
1/11/2010	10	0	0	64302
Total		62860	6614	
*CAGR %			10.50%	

*Returns calculated on XIRR basis

In the VCA method, he receives 500 units on his investment of Rs 5,000 on

December 1, 2009. His second instalment is due on January 1, 2010. The value of his 500 units is 5,500 on account of a rise of NAV from 10 to 11. By his target of 15 per cent return, his portfolio should be Rs 10,063 at the beginning of the second month. Since his actual portfolio value is Rs 5,500, he needs to invest on a balance of Rs 4,563 on January 1, 2010. This method follows the basic principle of investing less in a high market and more in a low market. Thus, when the NAV falls as on April 1, 2010 and subsequent dates, the amount invested is much higher than the initial investment. The final target amount in this example is Rs 64,302. Once the value of the portfolio crosses this amount, further investments in the portfolio are stopped, as the target is achieved.

Both RCA and VCA offer very good wealth creation opportunities. Though, it is seen that in most cases, VCA offers better returns. Purchases in RCA work better in a stable or falling market. VCA, by design, buys more in the falling market and less in a rising market. RCA is a simple and logistically convenient method of investing. This is the reason SIPs are so popular. VCA investing is a little more difficult to execute because the amount to be invested every month is not fixed. If the market rises, the investments might be very low, thus generating a surplus or even requiring some redemption. On the other hand, when there is a big correction in the market, the investment required will be very high. This might play havoc with the cash flow of the investor. For this reason, mutual funds that offer funds with VCA usually have the floor of zero (to avoid interim redemptions) and an upper limit fixed. Both RCA and VCA strategy can be used for funds as well as stocks. Funds following the VCA principle are few in number, whereas the RCA principle is followed in SIP and is widely available.

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