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Disguised To Mislead

Some stocks skyrocket in the short run. But before you add them to your portfolio, remember that these have a propensity to crash land from those dizzying heights. Here are six such stocks which defy fundamental reasoning in their rise and are driven more by the speculative tendencies in the markets.

SPECIAL OFFER
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Repay Home Loan Or Invest In Open-Ended Debt Funds?

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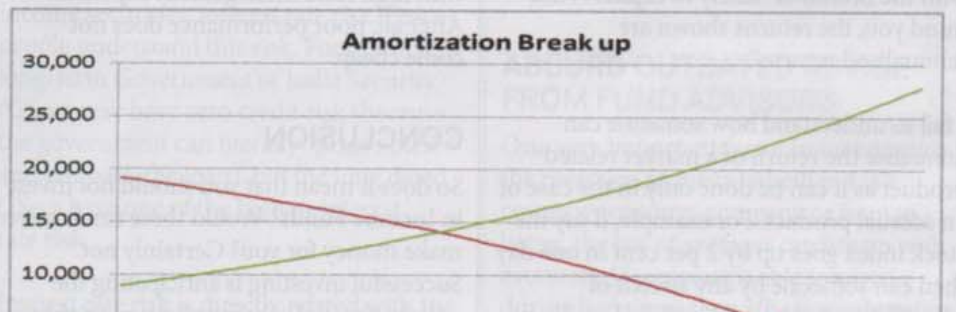
I took a 10-year home loan of Rs 20 lakh 9 years ago. As per my bank records, my total outstanding as of today is Rs 337428. My bank manager informed me that the outstanding principal is Rs 317341 and the outstanding interest is Rs 20087. I am currently paying interest at 11.5 per cent (floating). Over the next 15 days, I expect to receive Rs 3 lakh. Should I repay the loan now (I can raise the remaining Rs 40000) or invest this money in open-ended debt funds for a year? I pay tax at 10 per cent.

- Abhijeet Pawar

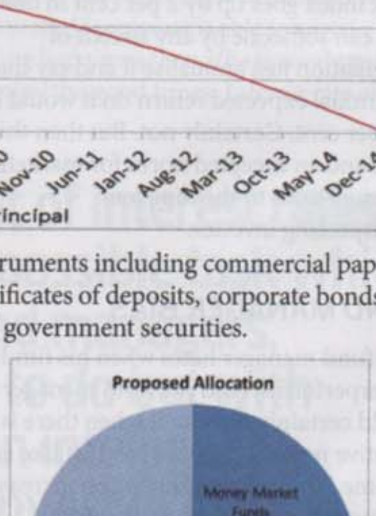
As your loan is close to maturity, the majority of your monthly payment will contribute towards principal rather than the interest. Generally, most banks charge a relatively higher interest rate during the initial period of the loan. Interest (as a proportion of your monthly EMI) diminishes over time. At this stage, you are effectively repaying most of your principal.

This phenomenon is highlighted in the chart. The data in the chart is based on an amortisation table which was calculated based on your interest rate. (I have assumed that your first EMI was made in January 2005).



Your effective absolute rate of interest is about 6 per cent (this is calculated by dividing the outstanding interest by the outstanding principal amount). Consequently, you may be better off investing the lump-sum of Rs 3 lakh in open-ended debt funds rather than repaying your loan.

You should invest in a mix of short-term and money market funds. These funds usually invest in a variety of debt instruments including commercial papers, certificates of deposits, corporate bonds, and government securities.



Currently, the yields offered by money market funds are around 9 per cent, while the yields offered by short-term funds are around 10 per cent. Long-term debt funds offer slightly higher yields but these funds are not very suitable as your investment horizon is relatively short.

Investments in short-term and money market funds are likely to generate returns higher than the effective cost of your loan. You should invest the bulk of your corpus in short-term funds. A small portion can be invested in money market funds such as Kotak Floater Fund-Long-Term Plan for liquidity. Your proposed allocation is shown in the chart on the left.

cap the upside in oil prices. This will be beneficial for India as the country is a net oil importer. Furthermore, the current account may not be an obstacle to monetary easing if exports continue to grow faster than imports. In the last policy review, the Governor hinted that further rate hikes are not imminent and even suggested that the central bank may be able to focus on growth if inflation declines faster than expected.

As you plan to invest in debt funds for a year, you should invest in the Growth options of debt funds as these will be more tax efficient than Dividend options as shown below. You will incur Long-Term Capital Gains tax.

Scheme Name	Annualised Returns as on 25th February 2014				As on 31st January 2014	
	3 Months	6 Months	9 Months	1 Year	Yield to Maturity	Modification Duration
Money Market Fund						
Kotak Floater Fund-Long Term Plan	8.71	10.38	8.23	8.98	9.30%	0.29 years
Shrot Term Funds						
Templeton Low Duration Fund	9.27	10.64	9.03	9.67	9.86%	0.19 years
Templeton Short Term Income Plan	8.68	11.7	6.87	9.36	10.88%	1.58 years
Uti Short term Income Fund	8.73	11.02	5.7	8.2	9.90%	1.50 years

The funds shown in the table above are amongst the best performers in their respective categories. You can invest around 75 per cent of your portfolio in short-term funds and invest the remainder in Kotak Floater Fund-Long-Term Plan.

You may also benefit from capital appreciation by investing in short-term funds if interest rates decline over the next year.

Over the next few months, interest rates are unlikely to rise as inflation appears to have peaked. In January, consumer price inflation slowed to a two-year low of 8.79 per cent, while wholesale price inflation fell to an eight-month low of 5.05 per cent.

The slump in growth and consumption may limit upside pressures to inflation as corporate pricing power is muted. The recent US deal with Iran may reduce geopolitical tensions in the Middle East and

Option	Type of tax	Tax Rate
Dividend	Dividend Distribu-tion Tax	28.33%
Growth (Units held for > 1 year)	Long-term Capital Gains Tax	Lower of 10.3% (Without Indexation) and Lower of 20.6% (With Indexation)

In conclusion, you can continue with EMIs until your loan is fully paid and invest the Rs 3 lakh that you will receive in money market and short-term funds. Investments in these funds should enable you to earn a return which will be higher than the effective cost of your loan.
Furthermore, the short-funds in your portfolio may also generate higher returns if interest rates fall.

KEY POINTS

Currently, the yields offered by money market funds are around 9 per cent, while the yields offered by short-term funds are around 10 per cent.

You may benefit from capital appreciation by investing in short-term funds if interest rates decline over the next year.

As you plan to invest in debt funds for a year, you should invest in the Growth options of debt funds as these will be more tax efficient than Dividend options

Invest in a mix of short-term and money market funds. These funds usually invest in a variety of debt instruments including commercial papers, certificates of deposits, corporate bonds, and government securities.