All you need to know about SYSTEMATIC INVESTMENT PLAN (SIP)

SIP is a word used many times by Mutual Fund Houses and Advisors to clients as the best form of investing in Equities through Mutual Funds. This form of investing is best understood in these difficult times (read volatile markets) Given below is a ready reference guide to SIP – Systematic Investment Plan

An SIP entails making regular investments (generally) in smaller denominations as opposed to making a one-time lump sum investment. The intention is to capitalize on the volatility in equity markets by lowering the average purchase cost. While few would dispute the utility that an SIP can offer, there is a flipside to the same as well. Given below are the pros and cons of SIP investing.

How an SIP helps…

1. Lowers the average purchase cost (RUPEE COST AVERAGING)

Perhaps the single most important advantage offered by an SIP is the opportunity to lower the average purchase cost. This is achieved in periods when equity markets experience a turbulent patch. Since the investment amount for each installment is fixed, the investor gains by receiving a higher number of units.

Date	Amount	NAV	Units	Total
Jan-07	1000	10	100.00	100.00
Feb-07	1000	20	50.00	150.00
Mar-07	1000	30	33.33	183.33
Apr-07	1000	50	20.00	203.33
May-07	1000	40	25.00	228.33
Jun-07	1000	20	50.00	278.33
Jul-07	1000	70	14.29	292.62
Aug-07	1000	80	12.50	305.12
Sep-07	1000	65	15.38	320.50
Oct-07	1000	55	18.18	338.69
Nov-07	1000	50	20.00	358.69
Dec-07	1000	40	25.00	383.69

Total Invested	12000
Total units accumulated	383.69
Average Cost Per unit	**31.28**
Average Price during the year	**44.17**

Average Price per unit is significantly lower than the average Price during the year

2. Induces disciplined investing

Lack of disciplined investing is one of the major reasons for investors not achieving their financial goals. Often monies kept aside for investment purpose end up getting used for extraneous purposes. As a result, the investor is even further divorced from his goals. An SIP ensures that the investor continues to be invested in a disciplined manner and thereby stays on course to achieve his financial goals.

3. Lighter on the wallet

An often-heard excuse for not investing is lack of funds. SIP takes care of this problem by lowering the minimum investment amount. While the minimum investment amount for a lump sum investment in a diversified equity fund could typically be Rs 5,000, for an SIP it can be as low as Rs 500. As a result, investing via the SIP route becomes lighter on the wallet.

4. Makes market timing irrelevant

Timing the market ranks as a popular pastime. Investors have an inexplicable urge for timing markets and trying to get invested when markets have bottomed out. It's a different matter that timing markets to perfection and doing so consistently is beyond most investors. An investment via the SIP route makes market timing irrelevant.

When an SIP won't deliver…

1. In rising markets

An SIP could fail to deliver on its proposition of lowering the average purchase cost, if equity markets rise in a secular manner. Such a scenario is fairly possible over shorter time periods. As a result, investing via an SIP could prove to be more expensive vis-à-vis a lump sum investment. Hence, the solution lies in opting for an SIP that runs over an appropriate time frame, say at least 12-24 months.

2. A directionless SIP

Here we are referring to an SIP that is not a part of an investment plan or an aimless SIP. It should be understood that an SIP is not an 'end'; instead, it is the 'means' to achieve an end. Hence, the SIP should form part of an investment plan aimed at achieving a predetermined objective.

3. An SIP in the wrong fund

Investing via the SIP mode doesn't improve the prospects of a wrong fund. A poorly managed fund stays that irrespective of the investment mode. An SIP will not eliminate its shortcomings. Hence the key lies in first selecting a well-managed fund that is right for the investor and then investing in it via an SIP.

As can be seen, the SIP mode of investing has a fair number of advantages to offer; conversely, there can be instances when it may not deliver as expected. Investors on their part should make well-informed investment decisions after acquainting themselves of both the pros and cons.

(inputs from www.personalfn.com)