Guaranteed Insurance Products Provide Diversification & Stability to Your Portfolio

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There is a saying – "Don't put all your eggs in one basket". Similarly, in your investments too there is a need for diversification through investment in different product categories. One of the key lessons learnt from the market volatility during the recent Covid-19 pandemic and past market downturns has been to diversify risk and have a more balanced portfolio--to help achieve your long-term investment goals.

A mix of guaranteed and market-linked products may provide more stability in your portfolio

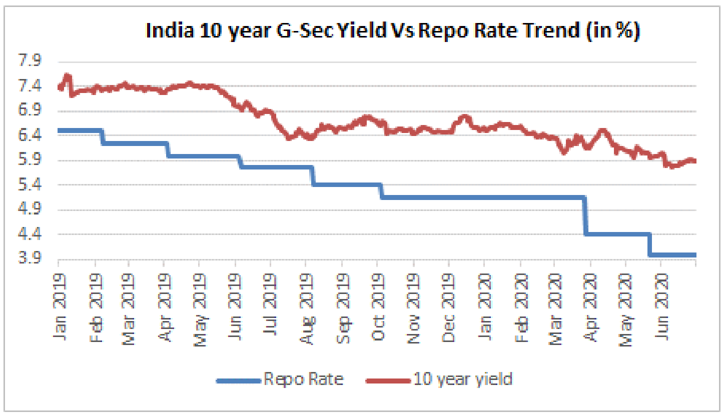
A guaranteed insurance product is a fixed income-oriented product, that provides a guaranteed fixed rate of return throughout the tenure of the product (irrespective of it being a single premium or regular premium product), besides also providing an investor with insurance cover. Therefore, there is a predictability of return from the product, unlike market-linked products—where returns vary depending on market movements. Market linked products may be more rewarding for customers over the long term, but they also come with intermittent volatility due to the inherent nature of the product. Therefore, a combination of guaranteed return products and market-linked products may help to construct a balanced portfolio, by diversifying risk, and helping to reduce volatility in the overall portfolio, especially during periods of market correction/downturns. This could make the investment journey more stable for the investor, and help to achieve their investment goal, by providing some buffer.

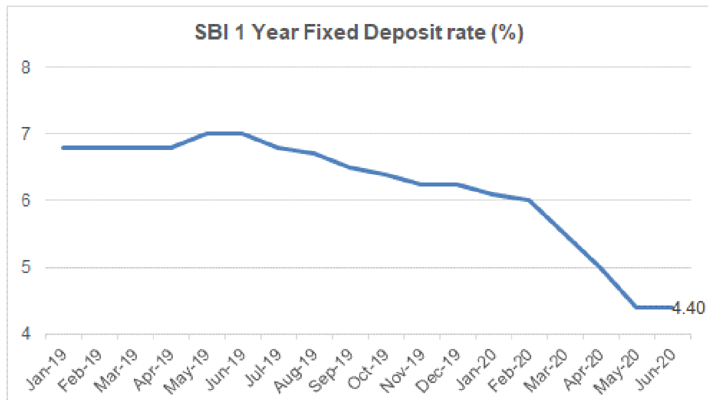
Let's assume an investor makes an investment into an equity market-linked product to help achieve their son's education goal after a 10-year period. His/her equity portfolio has performed well and compounded the investment, but in the 9th year a large market downturn happens like that seen during the global financial crisis in 2008 or the recent Covid-19 pandemic market correction. This would reduce the portfolio value and may jeopardize in achieving the investor's goal as he/she may not be willing to exit the investment then and wait for the markets to recover. However, the investor also had some foresight and purchased a guaranteed insurance product, where he/she is assured of a fixed rate of return, and the predictable cashflow from that helps to provide buffer to the portfolio—and may help him/her to achieve the investment goal, amidst the market volatility.

Guaranteed insurance products enjoy various tax advantages and may provide attractive post-tax returns

Due to their long-term nature and insurance cover provided, guaranteed insurance products provide various tax advantages to an investor. Under Section 10(10)D of the Income Tax Act, 1961, the maturity proceeds or sum assured of an insurance policy is tax free, provided the sum assured is 10X (or more) of the annual premium. Also, you can get exemption up to Rs. 1.5 lakhs under section 80C of the Income Tax Act. Meanwhile, other popular fixed income products (like bank fixed deposits with fixed returns) are taxed at the marginal income tax rate (highest income tax slab is 30% plus cess & surcharge, if applicable), plus TDS is deducted on the interest paid out. With guaranteed insurance products, maturity proceeds are exempt from tax, and therefore the post-tax returns in the hands of investors tends to be more attractive/higher. *For tax related matters please check with your tax adviser.*

Also, interest rates or bond yields in India have fallen significantly, and the recent Covid-19 pandemic has further accentuated the fall. This fall in yields or interest rates have resulted in downward revision in rates of various fixed income products. The RBI has cut the key policy rate (repo rate) by a cumulative 250 bps (2.5%) in a series of rate cuts since early 2019, with 115 bps of rate cut being seen post Covid-19 pandemic. Fixed deposit rates have also fallen sharply, with the benchmark 1-year SBI fixed deposit rate falling from 7% in 2019 to 4.4% recently (a fall of 260 bps, of which 160 bps was post the Covid-19 outbreak) (as indicated in SBI 1 Year Fixed Deposit Rate graph below). In the debt markets, the 10-year benchmark G-Sec yield in India has fallen by more than 180 bps since early 2019 to around 5.8% presently. However, long term rates (as indicated 10 year G-Sec yield graph below) have fallen relatively less than short term rates and also 1-year Fixed Deposit rates, thus allowing guaranteed insurance products to offer better yields presently (as they more closely track long term rates).





Source: Bloomberg

Conclusion:

To conclude, some allocation to guaranteed products can help to provide stability in your overall investment portfolio, and aid to diversify risk. Their attractive post-tax returns also make them a suitable investment product for risk-averse investors who want more stable returns, along with insurance cover. Investors should note that guaranteed insurance products are long-term in nature, as they have high surrender charges. Also, investors should try to go in for those guaranteed insurance products where the expense structure is relatively lower. It is worth noting that over the long term, as the economy matures, interest rates or bond yields are generally expected to moderate (as we have seen in various developed economies). Therefore, investors can lock-into current yields, with rates expected to soften further in the short to medium term (if RBI cuts rates further), and interest rates are also gradually headed lower over the long term in India, as the economy matures/develops.

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