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The two most common ways financial advice can misguide you, reveals Devina Mehra

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Contrary to popular advice, at retirement, you should be invested in equities and have substantial global exposure.

FIRST THE BACKGROUND. Managing your investment portfolio can appear daunting at one level but is actually quite simple once you cut out the irrelevant stuff.

As much as 85-90% of your portfolio returns come from asset allocation rather than security selection. Again, not as complicated as it sounds. Asset categories are simply financial instruments that have similar characteristics. These can be both financial assets (like shares or bonds) or real assets (like land or gold).

Thus, equity will include direct stock holdings plus equity holdings via mutual funds or PMS schemes. Fixed income will include fixed deposits, bonds, fixed income mutual funds, etc. Then there are assets such as gold, silver (held directly or indirectly), other commodities, real estate, alternative assets that can range from crypto to art, and so on.

Getting this right is the most important thing you can do about your portfolio. Specific stock selection, which eats up most of your, or your adviser's, waking hours, contributes only 10-15% of the returns.

What this means is that the proportion you invest in equities, fixed deposits/other debt, gold, etc., matters more than which specific stocks you pick.

Within equities, it matters more whether you are in bank and consumer stocks against, say, steel and industrial machinery, at any point in time — rather than which specific stocks you have picked in each sector.

Now, when planning for your future goals there are two major areas where the advice you are likely to get won't be right.

One is related to your asset allocation based on age. I hear all sorts of 'experts' saying that when you are young and in a good job you should invest entirely in equity because that gives the maximum return over time.

On the other hand, if you are say retiring at 60, from age 55 you start moving whatever is in equity towards fixed income, so that when you retire, you have almost everything in fixed income.

Why isn't this great advice?

Because equity returns are highly risky which means they are not predictable for two or sometimes even five years. For instance, over the nine years from 1994 to 2003, the Indian stock market gave zero returns. Then over the next five years it went up six times. The 12-15% annual compounding that is often spoken about is extremely uneven, to say the least.

Even a young person needs money for contingencies: they may lose a job, want to study further, pay downpayment on a house, have a medical emergency, etc. Money that can be possibly needed for any of these should not be invested in the stock markets directly or indirectly.

Conversely, when you are retiring at 58 or 62, given the rising life expectancy, you need to budget for a minimum of 30 more years. You definitely do not want to run out of money at 82 if you are going to live till 90.

Therefore, even when you retire, a significant portion of your investment should be in equity.

Of course, what you require to withdraw within the next few years should be in more predictable investments like fixed income. Otherwise, you will take a hit on your capital if in the first few years post-retirement, the equity markets go down. Nevertheless, you must still have a substantial portion in equity because it has to last you another 30 years. Else you will not be able to beat inflation and maintain your living costs.

Which brings me to the second big mistake, that is not having global diversification or not having enough global diversification.

When you are budgeting for financial goals 10 or 30 years hence, you cannot forget the fact that the rupee depreciates.

When I started working in the 1980s, the dollar was at ₹12. Now it is at ₹90 — there has been a 90% depreciation (in the ₹) in the course of less than a career. You cannot forget this when budgeting for the long term, besides the fact that you should not put all your eggs in one basket.

However, do not diversify globally as a reaction to events, say, since India didn't do well in the last one year, let me put something in the global markets. Put a proper plan in place where over a period of time, 30-40% of your portfolio is global. And global does not mean only the American market. You should look at investing beyond the U.S.

Remember, these are the two areas where you are likely to be advised incorrectly. One, having too much in equity when you are young and having too little in equity when you're around retirement age. And two, not having significant, truly global, diversification.

(Mehra is founder, MD, and chairperson of First Global, and author of the bestselling Money, Myths and Mantras: The Ultimate Investment Guide. *Views are personal.)*