EDELWEISS MUTUAL FUND

Rupee cost averaging - Meaning and how it works?

Remember those crane games at gaming zones? You had to press the button at the right time in order to lift the gift. You may think that mutual funds also work in a similar way wherein you must enter the market at the right time to make profits. However, this is not always true. You need not worry about timing the market because you can invest in mutual funds regularly through Systematic Investment Plans (SIPs) and gain from rupee cost averaging.

Let's decode SIPs and rupee cost averaging.

First, what are SIPs?

An SIP is one of the two modes of investing in mutual funds. As against a lumpsum investment, you get to invest in parts through SIPs. Once you start an SIP, a fixed predetermined amount gets deducted from your bank account at regular intervals and gets invested in the mutual fund scheme of your choice.

SIPs offer several benefits, such as they help you become financially disciplined, or they allow you to invest a small amount. But rupee cost averaging is one of the major benefits of SIPs.

Understanding rupee cost averaging

You know that markets are volatile. Sometimes the price of the mutual fund unit (Net Asset Value or NAV) is high, sometimes it is low. Perfectly timing the market demands time as well as market knowledge. This is where SIPs come to your rescue.
When you start an SIP, you invest a fixed sum of money at regular intervals, say every month. Since the price of the mutual fund units keeps changing, you get to own a different number of units every month with your SIP amount. Thus, you get to buy more units when the price is low and fewer units when the price is high. This eventually helps you average out your cost of mutual fund investment over time, which is known as rupee cost averaging.

Let's see how rupee cost averaging works in your favour.

Suppose you have Rs. 50,000 at your disposal and you start a monthly SIP of Rs. 10,000 in January instead of making a lumpsum investment then.

Month	NAV (Rs.)	No. of units purchased (SIP amount/NAV)
January	100	100
February	110	90.9
March	90	111.11
April	98	102
May	100	100
Total	**498**	**504.01**

Are you wondering what this means? The table below shows how this rupee cost averaging impacts your investment.

SIP vs lump sum – Know the math behind your investment

Particulars	SIP	Lumpsum
Purchase NAV	Rs. 99.6 (498/5)	Rs. 100
Units owned	504.01	500
Investment value in May (Total units*NAV in May)	Rs. 50,401	Rs. 50,000

The difference in the value of your investment in both cases may not be a lot because the investment was for a short term. Rupee cost averaging may be particularly beneficial in the long run. Though it does not guarantee profits, it is a systematic way of investing to build wealth over time. Thus, it can become an integral part of your retirement plan. You can even use an SIP calculator to estimate your returns and plan your golden years better.

Let's look at some other advantages of rupee cost averaging.

Benefits of rupee cost averaging

1. You can avoid emotional investing
2. You can avoid making impulsive investment decisions
3. You can spare yourself the time and effort of tracking and timing the market
4. You can stay stress-free in the ever-volatile markets
5. You can get enough flexibility through SIPs that helps you create wealth in the long run
6. You can invest with an amount as low as Rs. 500/month

To sum it up

Market volatility is part and parcel of mutual fund investments, especially equity funds. Your profits depend on how well you tackle market fluctuations. Rupee cost averaging through SIPs tends to be an effective way of sailing through such ups and downs. Thus, it is prudent to make SIPs a part of your financial plan.