Are your SIP returns helping you meet your goals?

The first thing that you would look at before purchasing a product is the price of the product. Similarly, the first thing that most investors look at before making an investment is the potential returns on an investment. There are various reasons why calculating the returns on your Systematic Investment Plan (SIP) investments is very important.

- First, the only way that you can measure the success of your investment is by comparing expected returns with actual returns.
- Second, if the investment is not generating the desired return then you are at risk of not achieving your goals. Thus, evaluating returns gives you a chance to ensure that you are on the right path or need to course correct.
- Third, if the returns are above your expectations, then you might consider increasing your SIP investment.

SIP has become a popular investment facility to invest in mutual funds. Through SIP, you can invest a pre-determined amount at regular intervals, be it fortnightly, monthly, or even quarterly, in a fund of your choice. Whether easy or not, at the end of the day, you would want your investments to generate the desired returns. This makes it very important to calculate the returns on your SIP investments. These will depend on various factors such as the category of the mutual fund, the performance of the market, and the investment time-frame.

While knowing the sources of returns is important, what is even more important is to be able to calculate the returns on your SIP.

Understanding the concept of returns

It is possible that most of you would know the basics of calculating returns. However, the first thing to note is that calculating SIP returns is very different from calculating the return on your lumpsum investments. To calculate the SIP returns, you need to calculate the annualised return on the invested amount. Most investors add the total SIP investment in a year and calculate the returns.

Let us assume that you have an SIP of Rs.10,000 that it is running for over two years and has generated 10%. Here, the first SIP instalment will get the entire 10% returns i.e., 1000. In the succeeding months of SIP investment, the return will

change for two reasons:
1) the amount invested keeps increasing as you invest more every month
2) the time period for which you generate the return also changes.

Methods to calculate SIP returns

Now that we know that the method to calculate SIP returns differs, let's explore further.

Method 1: Simple Annualised Return

When the investment period is less than 12 months, you might want to annualise the returns, i.e., understand the returns generated in a year. It provides a return estimate if the investments stayed invested for a year. Before we learn how to calculate simple annualised return, let us first calculate the absolute rate of return.

Absolute return is the one of the simplest and easiest ways to calculate returns. You can use the absolute returns to calculate the annualised returns. Here, you need the initial and present unit price (NAV) of the mutual fund to calculate the returns.

Absolute return = (Present NAV – Initial NAV) / Initial NAV x 100
Let us assume that the NAV of a fund increased from 20 to 35 in 7 months or 210 days.
The absolute rate of return in this case is 75%.

However, calculating absolute returns for SIP investment is flawed. This is because SIP entails investing a fixed amount of money at regular intervals - it is not a one-time lumpsum investment. The entire amount that you invest through an SIP is not invested at the same time. So, it is important to calculate the SIP returns as per their investment time period.

Simple Annualised Return: ((1 + Absolute Rate of Return) ^ (365/number of days)) – 1
Continuing with the earlier example where the absolute return was 75% and total number of invested days were 210 days, the annualised returns will be:
= {(1 + 75%) ^ (365/210)} – 1 = 164%

Method 2: XIRR

XIRR is the most commonly used method to calculate SIP returns as it calculates the internal rate of return (IRR) or annualised yield by considering every cash flow.

You will receive a certain number of units based on the NAV of the fund. The NAV at which units are allotted will vary from time to time. On redemption, the withdrawal amount will depend on the NAV of that day multiplied by the total number of units that you are redeeming.

To find out the SIP returns through the XIRR method, you can use the XIRR formula available in excel.

SIP Calculator

SIP calculators have made it easy to check the returns on your SIP investments. To calculate the SIP returns, you need to provide the amount that you have invested through SIP, the frequency of investment, the day you started investing and the end date. After you add these details, the SIP calculator will give you an 'indicative' return of your SIP investment portfolio.

If investing is the start of your financial journey then generating the desired returns is the end-game. This means that it is important for you to understand how you can calculate the returns on your SIP and accordingly make the right investment decisions.

An investor education initiative by Edelweiss Mutual Fund

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