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Systematic Transfer Plan (STP): An Alternative Investment Strategy to reduce Risk of Market Timing

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Abstract: ***Systematic Transfer Plan (STP) is a plan where an investor moves from one scheme to another a fixed amount of money, typically from debt funds to equity funds. STP is similar to SIPs or systematic investment plans, where money is moved from bank account to mutual equity funds. In STP, money is transferred in a few installments from a debt mutual fund to a mutual equity fund, so that the total purchase price is weighted suppose investor have earned 20 lakh from an asset sale and want to invest over 24 months in an equity fund through STP. Investor must first pick a debt fund that gives STP choice to invest in an equity fund. Then, choose an equity fund. Invest Rs 20 lakh in the debt fund and then determine the balance from the debt fund to the equity fund and the duration. In the alternative investment plan, the Systematic Transfer Plan (STP) has emerged for a large number of investors interested in high returns but less risk with lump sum investments. The purpose of the study is to know how to put money into STP reduces the risk of market timing and also helps investors to gain more from their source corpus by investing in debt funds. Results of the study found that awareness and operational framework, on the other hand, is one of the key barriers that investors face. The strategy of rupee cost average is an approach that motivates the investor to invest in a systematic transfer plan to gain from market timing risk. This research is also beneficial. The present study also allows investors to analyze the decisions and determine whether or not to invest in them and provides advice to protect their financial goals.***

Key words: Systematic Transfer Plan (STP), Investment, Lump sum, Investor and Rupee Cost Averaging.

I. INTRODUCTION

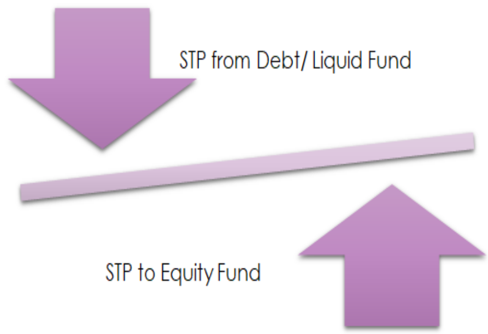
Systematic Transfer Plan (STP) is the mechanism in which investors can transfer from one mutual fund plan to another automatically. The process of switching from one fund to another occurs through STP in cases where the money is already invested in units of mutual funds.

For STPs it is usually recommended to implement lump-sum business financing. In the same fund house, an individual can invest a sum within liquid or ultra-short funds and move a periodic amount to an equity fund ".

This helps to reduce the risk of market timing, according to experts. STP reduces the risk of market timing, and also allows investors to gain more from their source pool by investing in debt funds. Nevertheless, an STP can also be used effectively to move income from equity to book or adjust the distribution of assets (especially in situations where the target time is close). In such situations, the transfer from the equity fund to the liquid fund has the same benefit as the transfer of STP to an equity fund that avoids the risk of market timing. This can be used to influence a structural withdrawal strategy that is more effective.

Investors may seek help from a financial planner if they are not sure how to use STP effectively. STP represents the average investment cost given that investors have a lump sum to invest in equity. For example, if investors have Rs. 10 lakh to invest in equity, invest it in the liquid fund and report it to equity funds for monthly Rs. 1 lakh STP. Thus, in 10 months, the amount will be invested in equity, averaging the cost. It is possible to determine the volume and length based on the market situation. When investors are not sure how to do this, a planner will help. STPs can carry exit loads per scheme of the respective AMC.

Picture-1: STP from Debt/Liquid Fund to Equity Fund



Source:https://www.moneycontrol.com/news/business/markets/technical-classroom-what-is-a-systematic-transfer-plan-and-how-does-it-work-3819931.html

Picture-2: How STP Works

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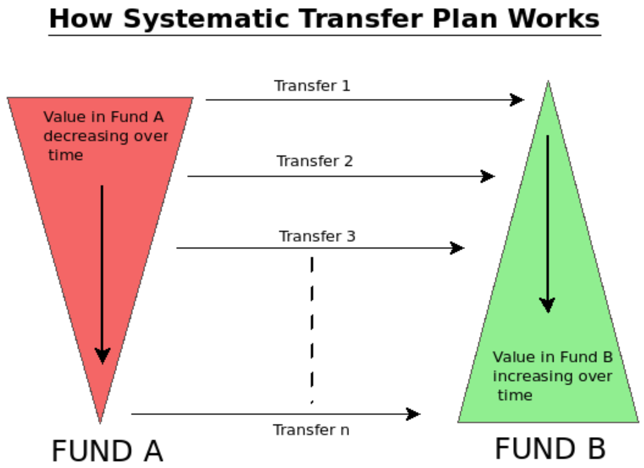

Source:https://www.jagoinvestor.com/2010/03/what-is-systematic-transfer-plan-stp.html

II. OBJECTIVES OF THE STUDY

1. To assess the overall view of the STP.
2. To show how rupee cost averaging is benefitted by comparison between lump sum & STP.
3. To provide suggestions to investors how to reach their financial goals through STP.

III. RESEARCH METHODOLOGY

The research design is conceptual in nature. The study is based on the secondary information. Secondary information was collected from various published and unpublished sources, which include magazines, reports, books, articles, and websites.

IV. TYPES OF SYSTAMATIC TRANSFER PLAN

A Systematic Transfer Plan has three kinds: Fixed STP, Capital Appreciation STP, and Flexi STP.

- **Fixed STP -** The investor collects a fixed amount of cash from one investment to another in Fixed STP.
- **Capital Appreciation STP -** The investor takes the profit portion from one investment in Capital Appreciation STP and invests in the other.
- **Flexi STP -** The investor has the option to transfer a variable sum in Flexi STP. The minimum quantity will be the sum set, and the variable quantity will depend on the fluctuations of the market.

STP is, therefore, particularly appropriate for investors who have lump sum cash and want to invest in equity funds but are cautious about timing the market. Then they can choose to park the lump sum money in a liquid or debt fund and use the STP option to transfer a fixed amount of money into the target equity fund at regular intervals.

If the target fund's NAV decreases, investment can be raised to take advantage of falling prices and if the market moves up, the minimum transfer sum is invested to take advantage of rising prices. The transfer facility is available at regular, monthly and quarterly intervals on a weekly basis.

V. ADVANTAGES OF SYSTAMATIC TRANSFER PLAN

- **Consistent returns:** Investing in a debt or liquid fund through STP, investor can move their money to a target equity fund. Therefore, investor will receive the returns from the equity fund that investor transfers to and at the same moment remain shielded as a portion of their investment stays in debt.
- **Cost average:** Like SIP, a set amount of money is also invested in the target fund in STP at regular intervals. Since it is comparable to SIP, STP helps to average the price for investors by buying more units at a reduced NAV and vice-versa.
- **Portfolio Rebalancing:** STP allows the re-balancing of the portfolio by allocating debt-to-equity or vice- versa. If their investment in debt increases, money can be reallocated through an STP to equity funds and if their equity investment increases, money can be moved from equity to a debt fund.

VI. TAXATION ON SYSTAMATIC TRANSFER PLAN

The applicable tax on an STP relies on two variables – the type of fund investor transfer from and the duration of their holding period. This is because a transfer from a STP is regarded as redemption and taxed accordingly.

For equity funds, transfers will be taxed at 15 percent within 1 year of acquisition under the Short Term Capital Gains Tax (STCG). Transfers after one year will be taxed at 10 percent over Rs 1 lakh under the Long Term Capital Gains Tax (LTCG).

In the case of debt funds, transfers will be taxed according to their slab within 3 years of purchase and transfers after 3 years will be taxed at 20 percent after giving investor the indexation benefit. Indexation to account for inflation decreases their tax liability.

Most STPs typically come from liquid assets and are therefore taxed as per their income slab. The returns/earnings in these funds are also about 6-8 percent, however, and hence the actual tax payable by STPs is not high. Each STP transfer is taken as part capital and part income as per the First-in-First-Out (FIFO) accounting system.

VII. CHALLENGES OF LUM SUM INVESTING

- If investor plans to invest this lump sum money in an equity mutual fund, there are three key challenges that investor will face.
- Investor will have to get their timing of buying the equity fund right. For example, if investor had bought equity funds at the peak of the 2007 Bull Run, then it may have taken investor at least 8 years to break even. Finding the tops and bottoms are a big challenge.
- Market volatility will work against investor since once the money is invested it idles in the equity fund. If there are corrections in between, investors are not able to take the full advantage of these corrections.
- In case investors are waiting for opportunities, where does investor park their money? If investor leaves their money in their savings bank accounts then investor just earn 4% return and that is an extremely uneconomical usage of their funds.
- Is there a method to address all the above three problems. A Systematic Transfer Plan (STP) could provide the response.

VIII. HOW THE INVESTOR BENEFIT FROM STP APPROACH

STP entails a very intelligent structuring of their lump sum money in such a way that investor get the benefit of SIP, makes the best of the market volatility, does not have to worry about identifying tops and bottoms and also makes productive use of their idle money. Here's how in reality an STP works. The entire lump-sum amount of Rs.20 lakhs is invested in a liquid fund that yields about 6 per cent a year. The reason we picked a liquid fund is because it does not require any exit load which makes it easier to sweep money out of the fund. In fact, the STP is calculated as the principal plus return, so the short-term capital gains tax (STCG) is only payable on the very small return part. A fixed sum of money is swept out of the liquid fund into an equity fund every month.

Table-1: Benefit from STP Approach

Month	Opening Balance	Return on Liquid Fund	Investment Value	STP into an Equity Fund	Closing Balance
1	20,00,000	10,000	20,10,000	88,500	19,21,500
2	19,21,500	9,608	19,31,108	88,500	18,42,608
3	18,42,608	9,213	18,51,821	88,500	17,63,321
4	17,63,321	8,817	17,72,137	88,500	16,83,637
5	16,83,637	8,418	16,92,055	88,500	16,03,555
6	16,03,555	8,018	16,11,573	88,500	15,23,073
7	15,23,073	7,615	15,30,688	88,500	14,42,188
8	14,42,188	7,211	14,49,399	88,500	13,60,899
9	13,60,899	6,804	13,67,704	88,500	12,79,204
10	12,79,204	6,396	12,85,600	88,500	11,97,100
11	11,97,100	5,985	12,03,085	88,500	11,14,585
12	11,14,585	5,573	11,20,158	88,500	10,31,658
13	10,31,658	5,158	10,36,817	88,500	9,48,317
14	9,48,317	4,742	9,53,058	88,500	8,64,558
15	8,64,558	4,323	8,68,881	88,500	7,80,381
16	7,80,381	3,902	7,84,283	88,500	6,95,783
17	6,95,783	3,479	6,99,262	88,500	6,10,762
18	6,10,762	3,054	6,13,816	88,500	5,25,316
19	5,25,316	2,627	5,27,942	88,500	4,39,442
20	4,39,442	2,197	4,41,639	88,500	3,53,139
21	3,53,139	1,766	3,54,905	88,500	2,66,405
22	2,66,405	1,332	2,67,737	88,500	1,79,237
23	1,79,237	896	1,80,133	88,500	91,633
24	91,633	458	92,092	88,500	3,592

Source: https://www.iifl.com/blogs/how-does-systematic-transfer-plan-stp-work

It's rather fascinating how the STP was organized. The entire funds are invested in a liquid fund yielding 6% per annum. Then the entire portfolio is moved into an STP to an equity fund. The balance left in the liquid fund continues to earn returns at 6% per annum and investor get the additional benefit of rupee cost averaging.

- There are a few obvious benefits that flow from this STP approach to investing their lump sum money.
- The idle money that is not invested will stay in a liquid fund and that continues to earn 6% return per annum. With zero exit load and minimal tax on capital gains, this is more efficient than a 4% savings deposit where their interest is taxed at 30.9% (peak rate).
- Since investors are spreading their investment of Rs.20 lakhs over 2 years, investor get the benefit of rupee cost averaging. The volatility over the next 2 years will automatically work in their favor.
- Now let us look at returns. Assume that their equity fund yields returns of 15% annually in the next 2 years. So their equity SIP of Rs.88, 500 per month will grow to Rs.24.90 lakhs at the end of 2 years.
- Effectively, their annual yield on the funds in the last 2 years has been 11.55% CAGR. Now investor have a corpus of Rs.24.90 lakhs invested via STP in the equity fund with the benefits of rupee cost averaging and the benefits of smart usage of idle money combined.
- A STP is essentially like hitting two birds with one stone. It gives their all the benefits of equity SIP and at the same time also makes efficient use of idle funds.

IX. CONCLUSION

Systematic Transfer Plan is considered safer, even though an initial lump-sum investment is required. The main reason is, investor can choose to transfer daily sums to other target funds from your source fund. This is not only a great way to increase your wealth but also boost your investment returns.
Investor will benefit during any market cycle with the versatility of switching out to debt or equity-oriented funds. In fact, the source fund continues to generate yields (at the same time). That means investor investment continuously creates wealth and compounds it.
Those plans give investor the option of rebalancing their portfolio on the basis of their financial goals. When investor need to meet short-term goals and move out to leverage when investor need long-term savings, investor should switch to equity-oriented funds.
We can conclude that the Systematic Transfer Program has its own advantages. However, people need to completely understand the modalities of the scheme before investing or opting for any plans. They should also test whether or not the scheme provides STP choice. Investor can also seek a financial adviser's view. This will make sure people receive full return on their investment.

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