Active or passive ELSS? No clear winner yet

Advisors see potential in the newly introduced passive option, promise in active ones

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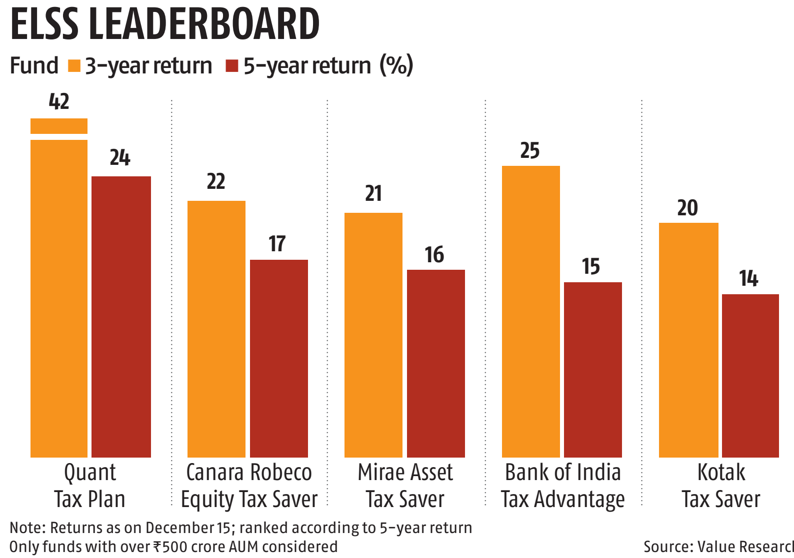

Investment advisors seem to be divided on their preference in the mutual fund (MF) tax-saver space.

While some see the newly-introduced passive equity-linked savings scheme (ELSS) as a better option, given that they are free of underperformance risk, others recommend active ELSS funds. They believe that the three-year lock-in provides ample leeway to fund managers to deliver superior returns.

Advisors see promise in the passive option due to the absence of fund manager risk, low cost, consistency in investment strategy and transparency.

"On the active side, you don't really know what you are getting into. Today, the fund might be completely large-cap but can later turn into a large & midcap fund. On the passive side, there's more clarity. A large-cap index fund will remain a large cap forever," said Suresh Sadagopan, chief financial planner, Ladder7 Wealth Planners. They also cite active ELSS schemes' inability to consistently outperform their benchmark for their preference for passive.

"The SPIVA (S&P Indices Versus Active Funds) report indicates that actively-managed ELSS schemes do not consistently outperform. Passive may be a better alternative also because people get into ELSS for tax savings. They are likely to be happy with the index returns," said Vishal Dhawan, chief executive officer (CEO) of Plan Ahead Wealth Advisors.

According to the SPIVA report on active funds' performance in HI, almost 88 per cent of active ELSS funds failed to beat their benchmarks in the five years ending June 2022.

However, some advisors believe that the active option should not be shunned based on the past few years' performance. They feel that the ELSS structure gives fund managers a good amount of flexibility to generate alpha (outperformance over the benchmark).

"In a category like ELSS, active is a better alternative as there is a clear value-addition potential for the fund manager, given the three-year lock-in," said Lakshmi Iyer, CEO, investment advisory, Kotak Investment Advisors.

"ELSS is by design a long-term investing option. Hence, I believe that one should go for an active strategy, which can generate alpha. ELSS fund managers have the flexibility to invest across market capitalisation.

The three-year lock-in allows them to take a broader view of the market," said Tarun Birani, founder & director, TBNG Capital Advisors.

"However, passive ELSS is a good addition to the bouquet of MF offerings. They can be used by new investors or people who are not seeking high alpha from their investment to build a core long-term portfolio," he added.

Advisors also pointed out that since there is only one passive ELSS option (IIFL ELSS Nifty 50) right now, it may not fit into every portfolio. This is because most portfolios already have substantial allocation to large caps.