MFs make a dash for hybrid funds before financial year ends

PPFAS, Quantum, Mahindra Manulife launch new products

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The mutual fund (MF) hybrid space is seeing a flurry of product launches under the erstwhile debt taxation framework as the current financial year 2023-24 (FY24) draws to a close. The demand for debt taxation products are higher in the latter part of a financial year as investors look to cash in on an additional year of indexation benefit.

Parag Parikh Financial Advisory Services (PPFAS) MF has launched a balanced advantage fund. Mahindra Manulife and Quantum have also come out with multi-asset allocation funds. All three schemes will maintain around 35-65 per cent equity allocation with the rest in fixed-income instruments.

Multi-asset funds will also have some exposure to gold. PPFAS MF and Quantum MF plan to keep the equity allocation near the lower band of the minimum required to offer a low volatility product. PPFAS MF plans to use arbitrage strategies to lower the equity component further.

"It makes sense to launch debt-focused hybrid funds right now as yields are elevated. Also, the curve is flat and the liquidity is tight. In the next 15-18 months, there is also a possibility of rate cuts and hence scope for capital gains. Given that we are nearing the end of the financial year, there is added benefit on the tax front. The closer you are to the end of the financial year, the higher is the tax benefit," said Lakshmi Iyer, CEO — Investment and Strategy, Kotak Alternate Asset Managers.

Demand for debt taxation products are higher in the latter half of a financial year as investors look to cash in on an additional year of indexation benefits

After the change in debt fund taxation in April 2023, MF schemes investing anywhere between 35-65 per cent in domestic equities qualify for the erstwhile debt fund taxation. Investments held for more than 3 years qualify for long-term capital gains tax (LTCG), wherein the gains are taxed at 20 per cent after accounting for indexation.

In indexation, the gains are adjusted for inflation during the investment period using the Cost Inflation Index. This benefit was available for all non-equity mutual fund schemes prior to April 2023.

According to experts, while the investment holding period is calculated from point to point, the indexation benefit is linked to the number of financial years completed. Hence, even if an investment is made at the end of a financial year, the investor gets the indexation benefit for the investment year.

According to the chief executive officers (CEOs) of Quantum MF and Mahindra Manulife MF, the launch of their products closer to the end of the financial year is only a coincidence and their focus was on bringing a flexible but lower volatility dynamic asset allocation fund.

"We did not take the extra indexation benefit into consideration while planning the launch. This is only a coincidence," said Jimmy Patel, CEO of Quantum MF.

"The added indexation benefit was not a driver. Our focus was on coming out with a fund that has enough flexibility and diversification. The erstwhile debt taxation route is more suited for such an offering. The fund is more focused on returns than the taxation," said Anthony Heradia, Managing Director and CEO of Mahindra Manulife MF.

Fund houses have started coming out with debt taxation offerings in the dynamic asset allocation and balanced advantage space post the change in taxation. Almost all offerings in this space prior to April 2023 were equity-taxation products.

Experts say that while taxation is a factor, investors should primarily focus on the risk-reward dynamic when selecting a fund.

"Post the change in debt fund taxation, the newly created hybrid structures have re-introduced investment options with the erstwhile debt taxation. Investors can look at them if they have a longer investment horizon. However, the investment decision should be based on the requirement and risk profile. The tax efficiency can be an added advantage and not the reason to buy," said Vishal Dhawan, founder of Plan Ahead Wealth Advisors.

	Equity	Debt	Others*
HSBC	65-80	10-25	10-25
Quantum	35-65	25-55	10-20
Mahindra Manulife	35-80	10-55	10-40
Bank of India	35-40	45-55	5-20

* Others include gold, silver and REITs & InvITs

Source: Scheme disclosures