Are focused & ELSS mutual funds making a comeback? Here's how to invest

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Two equity mutual fund categories which saw waning interest from investors from the start of the current financial year are making a comeback due to tax benefits, renewed confidence in the equity markets, and changing market dynamics.

ELSS and focused mutual funds saw continuous outflows for six straight months and have now started to receive inflows since October, according to the monthly data released by Association of Mutual Funds in India (AMFI).

In the first six months of this financial year, ELSS funds saw an outflow of Rs 2,030 crore and received an inflow of Rs 383 crore in October. The focused funds in the first six months saw an outflow of Rs 1,897 crore and then received an inflow of Rs 693 crore in October.

Are you wondering what is helping these categories gain investors' interest back? What factors are working in their favour?

According to the expert, as the second half of the financial year tends to see tax related declarations and with expectations from the equity market, these categories are an option for investors to consider.

"The second half of the financial year tends to see rekindled interest in tax related instruments as companies start to seek declarations for tax purposes. This would have kindled interest in ELSS funds. Focussed funds are benefiting from an expectation that equity markets could be range bound and since they tend to be larger cap oriented, are an option for investors to consider," said Vishal Dhawan, CEO, Plan Ahead Wealth Advisors, a wealth management firm in Mumbai.

The introduction of the new income tax regime has impacted the appeal of Equity Linked Savings Schemes (ELSS) or tax-saving schemes. Under the new tax regime, investors don't have the tax-saving benefit previously offered under Section 80C and has reduced the investors' interest to invest in ELSS mutual funds.

The new tax regime does not allow deduction of common deductions such as Section 80C deduction up to Rs 1.5 lakh for specified investments and expenditures. Any individual opting for the new tax regime, can now claim only two deductions – Standard deduction of Rs 50,000 from salary/pension income and Section 80CCD (2) for employer's contribution to the employee's NPS account.

Should an investor make allocation in these funds? Do ELSS funds look attractive after the introduction of the new tax regime?

The expert recommends that If the investors are opting for the old tax regime, ELSS funds can be considered.

"ELSS funds can be considered through a SIP/STP till the end of the year provided investors are opting for the old tax regime wherein this benefit under ELSS can still be taken advantage of," said Dhawan.

In this financial year so far, ELSS mutual funds have offered an average return of around 10.71%. Motilal Oswal ELSS Tax Saver Fund gave the highest return of around 22.99% in this financial year, followed by HSBC Tax Saver Equity 18.04% return in the same period. Quant ELSS Tax Saver Fund gave the lowest return of around 0.54% in the said period.

Focused mutual funds gave an average return of around 10.33% in this financial year so far. Invesco India Focused Fund gave the highest return of around 19.33%, followed by Bandhan Focused Equity Fund which gave 17.74% return in this financial year so far. Quant Focused Fund gave the lowest return of around 0.87% in the same period.

Will these categories continue to perform in a similar fashion? What is the way forward for them?

The experts say that aggressive investors can go for focused funds with a long-term perspective.

"Focussed funds can be a good option for more aggressive investors to consider with a 5–7-year perspective, due to their concentrated holdings," advises Dhawan.

ELSSs or tax saving schemes help investors to save income tax under Section 80C of the IT Act. One can invest a maximum of Rs 1.5 lakh in a financial year and claim deductions on investments in a financial year. ELSS funds invest in stocks and carry high risk. These schemes have a mandatory lock-in period of three years. Other investment options under Section 80C have longer holding periods.

Focused fund schemes are recommended for investors who are ready to take more risk of a concentrated portfolio and have an investment horizon of around seven years. As per Sebi norms, focused equity mutual fund schemes must invest in a portfolio of maximum 30 stocks. These schemes have no other restrictions when it comes to investing- like flexi cap schemes they can invest in any market capitalisations and sectors. These schemes can be extremely risky because of their concentrated portfolio. If the fund manager makes wrong calls, schemes will suffer greatly. They may also gain a lot if the fund manager makes the right calls.