Investors shun dividend option in hybrid mutual funds, opt for SWP

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Many investors are moving out of the dividend option in aggressive hybrid mutual fund schemes against the backdrop of dwindling dividends, say mutual fund advisors.

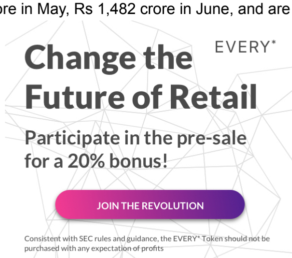
"Many investors are moving away from the dividend option in hybrid equity schemes. This trend has been there since the beginning of this year. This trend started getting bigger with every passing month due to bad returns and taxation and then re-categorisation," says Vishal Dhawan, founder & CEO, Plan Ahead Wealth Advisors.

In the past two years, many investors, especially retirees, had bet on the dividend option in these schemes (known as equity-oriented hybrid schemes or balanced schemes before Sebi re-categorisation), to draw a regular income. However, many of them are getting out of these schemes in the face of meager dividends and introduction of dividend distribution tax and long-term capital gains tax on equity schemes.

Re-categorisation of mutual funds is also compounding the problem. After re-categorisation, these schemes are called aggressive hybrid schemes and they can invest up to 65-80 per cent of their corpus in equity and 20-35 per cent in debt. Earlier, most of these schemes used to invest around 65-75 per cent in equity. Though the new investment guideline is not drastically different, the creation of a new balanced fund category and marking them as aggressive hybrid schemes are changing the investor perception of these schemes.

Advisors believe that the main reason for the trend is the poor returns and piddly dividends offered by these schemes. The aggressive hybrid schemes have given 7.75 per cent returns in the last one year and 1.59 per cent in the last three months. Secondly, the DDT (Dividend Distribution Tax) of 10 per cent, which was introduced in the Budget 2018, has further hit the income from these schemes.

The inflows in the hybrid fund category have been falling every month in this financial year and are on its lowest in July. The net inflows in the balanced category stood at Rs 2,666 crore in May, Rs 1,482 crore in June, and are at the lowest Rs 287 crore in July.



"DDT or Dividend Distribution Tax has sure deterred many investors to move away from these schemes. The returns from the hybrid schemes are low because of the volatility in both equity and debt markets. A 10 per cent tax makes the dividends even lower," says Karthik Swaminathan, a certified financial planner based in Mumbai.

The re-categorisation process has designated these schemes under the risky aggressive hybrid category. It was a surprise for some mutual fund investors who used to view these schemes as a safe investment. Many mutual fund advisors used to promote these schemes to investors looking for risk-free regular income. "Categorising the schemes as aggressive hybrid didn't make much of a difference, as these schemes were already investing aggressively. While some mutual fund investors noticed this only after re-categorisation, most investors are still unaware of the change," says Vishal Dhawan.

Mutual fund advisors have never been in favour of dividends from equity schemes for regular income. They say aggressive hybrid schemes may not be suitable to draw a regular income. Equity is volatile in nature - so these scheme may or may not declare dividends regularly. As per Sebi regulations, mutual funds can declare dividends only from their profits.

This may be the reason why many investors have started looking at SWPs (Systematic Withdrawal Plans) as an alternative to dividends in aggressive hybrid schemes. “Many investors are switching to SWPs and it is good if you look at it from regular flows perspective. You will have a control on the money that you take out every month to manage your regular cash needs but it will not let your money grow in the longer time horizon,” says Karthik Swaminathan.

An SWP allows investors to withdraw a fixed amount regularly from their investments in a mutual fund scheme at predetermined intervals (daily, weekly, monthly, quarterly or yearly). Mutual fund advisors say an SWP is ideal for investors looking for a regular income, as it offers more control to investors. Investors can set the amount and frequency to draw the money via SWPs. However, those who are okay with a periodic income may opt for the dividend plan, advisors add.

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