How many ELSS funds should you have in your MF portfolio?

BY SHIVANI BAZAZ, ET ONLINE | JAN 07, 2019, 11.34 AM IST

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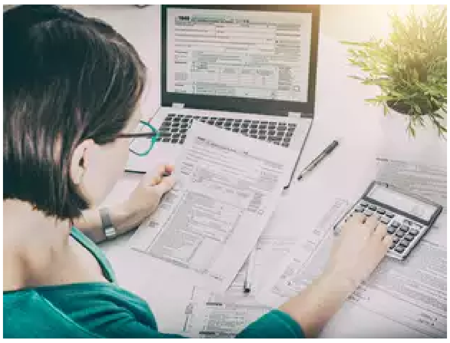

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Many mutual fund investors opt for equity linked saving schemes to save taxes under Section 80C of the Income Tax Act. However, many new investors are generally confused about how many tax-saving mutual fund schemes or ELSSs they should invest to diversify their investments. Even some seasoned investors worry about a large number of ELSSs they have amassed over the years in their mutual fund portfolio. So, how many mutual funds should ideally be in your mutual fund portfolio?

“Generally, the answer is simple. Since you can save only up to Rs 1.5 lakh in a year, one scheme is fine,” says P Srinivasan, Founder of Ace Financial Advisories. Many mutual fund advisors second the opinion. They believe that investors should not invest in more than two ELSS funds in a year.

Investments in ELSS or tax saving mutual fund schemes qualify for tax deduction of up to Rs 1.5 lakh under Section 80C of the Income Tax Act. These schemes come with a mandatory lock-in period of three years, which is the shortest lock-in period among tax-saving investments permitted under Section 80C. However, mutual fund advisors ask investors to invest in ELSSs with an investment horizon of at least seven years.

Mutual fund advisors point out that too many tax saving mutual funds in the mutual fund portfolio may make it tough to keep track of them, and also defeat the purpose of diversification because of the overlapping of portfolios of different schemes. “Having many ELSSs in the portfolio leads to over diversification as most of these schemes hold similar stocks,” says P Srinivasan.

What about investors, who have collected too many ELSS funds over a period? Many investors choose a new ELSS when their old tax saving scheme is not performing well for a year or two. This may result in several schemes in a mutual fund portfolio. In fact, many mutual fund investors eventually own more than half a dozen ELSS funds in their portfolio.

“It happens many a times that investors have to invest in multiple schemes because of their scheme’s underperformance or to claim tax benefits in consecutive years. In such cases the investors have no other choice but redeeming the funds,” says Vishal Dhawan, Founder, Plan Ahead Weal Advisors.

So, what should do you if you have too many ELSS funds in your portfolio? “If your schemes are not in the top quartile, you should move out of those schemes and invest in diversified equity schemes or any other scheme according to your risk profile,” says P Srinivasan.

Vishal Dhawan says that historically the diversified equity fund category has outperformed the ELSS category. Hence it is better to invest in a diversified mutual fund scheme than to have multiple ELSSs in your portfolio.

Finally, after the reintroduction of LTCG tax in equities, there might be an extra 10 per cent tax when you redeem your ELSSs. “The tax shouldn’t be a reason why you have multiple ELSSs in your portfolio. You can withdraw your gains in two instalments in March and April to get away from the tax. Even if you pay a tax of 10 per cent at this point, you will catch up with the better returns in the long term,” says Vishal Dhawan.