



Why are investors shying away from ELSS funds?

- Poor performance and confusion over deduction benefits may have hit net inflows
- The average three-year SIP returns of ELSS funds for 2017 and 2018 were around 14%, and only 6% in 2019

ELSS fund, equity exposure, ELSS inflows, tax-saving investments, Mutual Funds, Amfi, SIPs, financial planning

Equity-linked saving schemes (ELSS) are popular among those looking to save taxes as well as getting some equity exposure. Typically, ELSS inflows are higher during the last three to four months of the financial year as investors rush to make tax-saving investments before the 31 March deadline. This year, however, the inflows during this period have dwindled.

According to data released by the Association of Mutual Funds in India (Amfi) on 9 April, net ELSS inflows between December 2019 and March 2020 ₹3,834 crore, 36% lower than the net inflows during the same period in FY19, and 55% lower than the number in FY18. The net inflows in ELSS in this four-month period in FY19 was ₹6,001 crore and ₹8,440 crore in FY18. It may be noted that the deadline for making tax-saving investments has been extended to June 2020. So what explains the fall in ELSS net inflows in FY20?

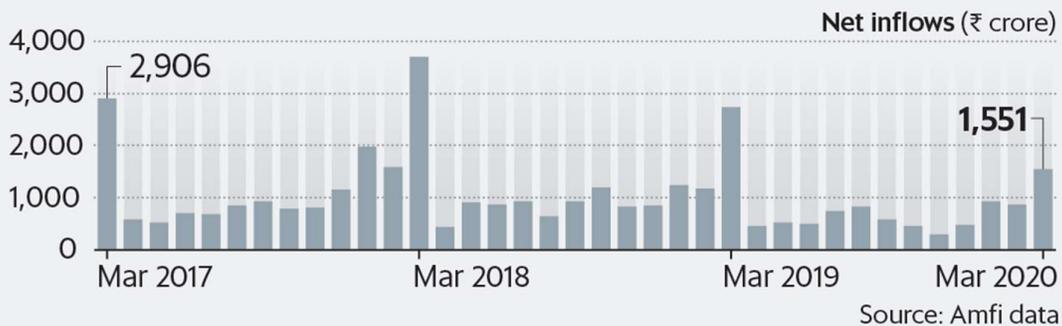
Lower net inflows

“It is likely that with increasing awareness about systematic investment plans (SIPs), investors are starting SIPs at the beginning of the new FY instead of investing a lump sum at the end of the FY. This could account for the slower sales in the ELSS category this year,” said Rajat Jain, chief investment officer, Principal Mutual Fund. However, this is unlikely. Net inflow in ELSS in whole of FY20 was lower than FY19— ₹8,187 crore in FY20 compared with ₹12,771 crore in FY19.

Market volatility may be another reasons for investors to stay away from ELSS as they have the equity component. But net inflows in equity funds jumped 52% to ₹24,343 crore between December 2019 and March 2020 compared to the previous year. So what else?

Waning popularity

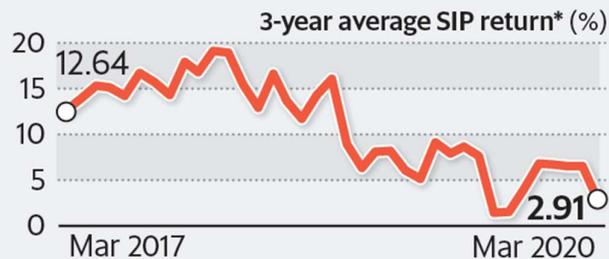
The spike in net ELSS inflows during December-March FY20 is not as significant as the inflows in the same period in the previous years.



The three-year SIP returns of the ELSS category have gone down substantially compared to previous years.

Assumptions: SIP amount of ₹5,000 invested on the 5th of every month for 3 years

*As on 1st of every month



Waning popularity

Confusion over tax regime: The year-end popularity may have reduced due to the budget announcement, said experts. Budget 2020 introduced a new optional tax regime which does away with most of the tax deductions, including the one available on ELSS investment under Section 80C of the Income-tax Act.

Taxpayers have the choice of continuing with the old regime. Experts said that the confusion about whether to opt for the new tax regime may have resulted in lower inflows this year. In March 2020, the net inflows in ELSS funds were 43% lower at ₹1,551 crore compared with ₹2,742 crore in March 2019.

“We do see higher flows in ELSS funds in the last few months of the financial year but maybe people are unsure of investing because if they opt for the new tax

regime, they will not get the deduction benefit," said Rupesh Patel, senior fund manager, Tata Asset Management Ltd. The new tax regime will be applicable from FY21.

Poor performance: This may be one of the major reasons why people are shying away from ELSS funds. Data from ICRA Research shows that ELSS funds were delivering double-digit returns on systematic investment plans (SIPs) in 2017 and 2018, but returns came down to single digit in 2019.

The average three-year SIP returns of ELSS funds for 2017 and 2018 were around 14%, and only 6% in 2019. Many funds yielded negative three-year SIP returns in 2019 and 2020. "Lower returns from ELSS funds over the last few years and the polarization of returns from only a few stocks in 2018 and 2019 may have contributed to the poor performance. As investors look at past returns, which aren't very attractive for ELSS funds, the inflows may have been lower," said Vishal Dhawan, founder, Plan Ahead Wealth Advisors, a financial planning firm.

Allocation plays a role

"Because of the lock-in (of three years), fund managers in ELSS funds generally take high exposure to mid- and small-cap stocks, which performed badly in the past two-three years. This has resulted in the poor performance of these funds," said Santosh Joseph, founder and managing partner, Germinate Wealth Solutions LLP.

As of February 2020, the average large-cap allocation in tax-saving funds was around 65%, while the rest was allocated to mid- and small-cap stocks, according to data provided by Value Research, an investment research company. Some ELSS funds have an even higher exposure to mid- and small-cap companies. As of February 2020, seven out of 42 ELSS funds had over 50% exposure to mid- and small-cap stocks, according to Value Research.

Patel said the returns of ELSS funds are in line with that of multi-cap funds. The 10-year category average return from multi-cap funds is 7.78% compared with 7.83% from ELSS funds, as per Value Research data.

Some of the funds also change the allocation of stocks of different market capitalizations, as per the fund manager's view of the market. For example, Tata Tax Saving Fund had increased its allocation to large-cap stocks from 52% in February 2017 to 80.31% in February 2020. "I follow a bottom-up strategy. So, the increase in allocation is because of the respective stock picks. However, I also ensure that the large-cap exposure doesn't go below 50%," said Patel.

On the other hand, the exposure of PGIM India Long Term Equity Fund to large-cap stocks has gone down from 82% in February 2017 to 70% in February 2020. "It was a deliberate move to lower the large-cap allocation. After the correction in mid- and small-cap stocks that started in February 2019, they looked attractive and we decided to increase the exposure," said Srinivas Rao Ravuri, chief investment officer, equities, PGIM India Mutual Fund, who started managing the fund from September 2019.

These funds are among those that significantly changed their market cap allocation between February 2017 and February 2019.

What you should do

ELSS funds are just like other equity funds but come with a lock-in and provide tax deduction benefit. If you are exhausting your Section 80C deduction limit with other products and think you have the discipline to stay invested in equities for the long term, you may not need an ELSS fund. However, if you have the required risk appetite and are looking for a tax-saving option with equity exposure, ELSS funds with a good track record can be a good option for wealth creation.

"The lock-in has an advantage as well as a disadvantage. The advantage is it instills discipline of staying invested for at least three years, while the disadvantage is that if the fund doesn't perform well, investors can't exit before three years. So, if the investor is not looking for a tax-saving option, we don't recommend ELSS funds," said Dhiraj Mittal, CEO, Prime Capital Services Pvt. Ltd, a Delhi-based financial planning firm. Remember that when you start an SIP in an ELSS fund, the lock-in of three years will apply on each SIP separately.

If you already have an ELSS and the lock-in is over, stay invested if you are satisfied with the performance. If you are a new investor, go for an ELSS whose

portfolio matches your risk profile. The risk profile of an ELSS could be different depending on the allocation to different market caps. Funds with higher exposure to mid- and small-caps will be riskier than the ones with higher large-cap allocation.