Published Date:	19 Jun 2024	Publication:	The Economic Times [Kolkata]
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Circulation:	21,842		

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ET IN THE CLASSROOM

Equity Exposure Using Equity Savings Funds

Amidst high valuations, wealth managers believe conservative investors moving from fixed deposits could consider an investment in equity savings funds that invest 15-25% of their corpus in large-cap stocks and give the benefit of equity taxation.

WHAT ARE EQUITY SAVINGS FUNDS?

Equity savings schemes are funds that belong to the hybrid category. They invest in a mix of equity, debt and arbitrage opportunities. A scheme in this category invests in equity and debt securities, employing a combination of three investment strategies – pure equity (net long equity), arbitrage plays, and debt. The net long equity exposure is generally in large-cap companies, which generates capital appreciation. Allocation to arbitrage opportunities and debt securities provide income and generate stable returns for the portfolio.

WHAT IS THE PORTFOLIO COMPOSITION?

Typically, equity could constitute 65-90% of the portfolio, of which arbitrage opportunities could be 25-75%, unhedged equities at 15-40% based on the fund manager's strategy, and debt and money market instruments making up the remaining 10-35%. If the fund manager is positive on equities, he would generally opt to have a higher allocation in the portfolio. Conservative fund managers typically keep it at 15-25%, with equity comprising primarily large-cap companies. The debt portion, too, is conservatively managed by investing in AAA-rated paper or government securities with low duration.

HOW ARE THESE FUNDS TAXED?

The portfolio of these schemes is structured so that the corpus invested in stocks and arbitrage remains above 65%. Hence, they are classified as equity mutual funds for taxation purposes. Investors pay 15% as short-term capital gains tax if the holding period is less than a year and 10% as long-term capital gains tax for a holding period of more than a year and for gains above ₹1 lakh, making these schemes attractive for investors falling within the 30% tax slab.

HOW HAVE THESE SCHEMES PERFORMED? FOR WHOM ARE THEY SUITABLE?

Over the last three years, as per data from Value Research, this category of funds delivered a return of 9.39%. Financial planners believe these schemes work for investors looking for returns above fixed deposits over three years, first-time mutual fund investors moving from FDs, and investors worried about high volatility in pure equity funds. These funds typically suit investors seeking equity exposure with low volatility and having a short-term time horizon of 1-3 years. The tax advantage is a bonus.

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