The emergence of a new breed

Equity-income funds are like balanced funds but they are also low on risk as well as taxes. This makes them worth exploring

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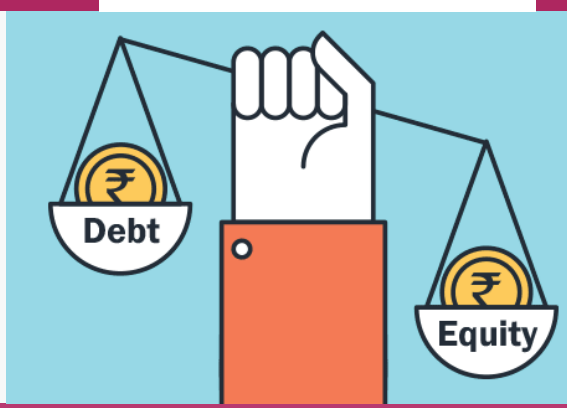

Driven by India's tax rules, balanced funds have become too equity-heavy and risky. But, there's another type of balanced fund that combines tax efficiency with a more conservative, safer exposure to equities.

This lesser known breed in the mutual fund universe goes under the rather odd name of 'equity-income fund'. Experienced investors would find the name a little puzzling because all hybrid funds, like balanced funds or MIPs, have both equity and income parts and could justifiably be called by this name. Let's see what's so different about these so-called equity-income funds, and how they deliver lower risk while having the same lower tax liability as regular balanced funds or equity funds.

Experienced investors know that under our tax laws, capital gains from equity investments are zero if you stay invested for more than one year. To qualify as an equity investment, a mutual fund must invest more than 65 per cent of its assets in equity. If the equity exposure drops below this level, then the risk will be lower, but investors will have a heavier tax liability, as is for any income fund.

Low risk, low taxation

That's where the equity-income fund comes in and delivers lower equity exposure, combined with the lower taxation of equity funds. They do this by utilising equity derivatives in such a way that the returns are predictable and safe, while the investment is still classified as equity for tax purposes. Therefore, if one creates a balanced fund where some of the equity exposure is in the form of arbitrage trades, then one gets the very useful combination of lower risk and lower tax.

Proof of the pudding

There are now twelve such funds. Most of those are less than two years old. The highest 1-year return from an equity-income fund is a decent 14.59 per cent. The median of the worst one-week performance is -3.05 per cent. The median of the worst one-month performance is -4.14 per cent. Compare these numbers with the worst one-week and the worst one-month performance of balanced funds. The median of the worst one-week performance of balanced funds is -6.07 per cent and that of the worst one-month performance is -8.54 per cent.

Loophole

Of course, investors should be aware that by investing in these funds, they are exploiting what is basically a loophole in tax rules. It may continue like this for years. But the risk that tax authorities may address it at some point is always there.

Scheme Name	1 Month Return	1 Year Return	Worst 1 Month Return	Worst 1 Week Return	Unhedged equity (%)	Hedged equity (%)	AUM (Rs Cr)
Axis Equity Saver Fund - Regular Plan	-2.44	4.83	-4.04	-3.15	45.14	20.31	936.37
Birla Sun Life Equity Savings Fund - Regular Plan	-3.04	10.48	-6.21	-3.75	-	-	371.87
DHFL Pramerica Equity Income Fund	-1.28	6.91	-4.23	-3.36	27.77	38.69	36.24
DSP BlackRock Equity Savings Fund - Regular Plan	-2.35	-	-4.27	-2.57	37.3	28	385.89
HDFC Equity Savings Fund	-0.74	14.59	-5.95	-3.09	-	-	319.7
ICICI Prudential Equity Income Fund	0.6	12.58	-3.39	-3.3	33.39	31.93	664.73
Edelweiss Equity Savings Advantage Fund - Regular Plan	-1.68	5.18	-2.89	-2.33	31.08	36.1	221.2
Kotak Equity Savings Fund - Regular Plan	-0.73	7.28	-2.29	-1.89	22.76	38.71	851.72
L&T Equity Savings Fund	-1.37	5.67	-3.59	-2.43	28.84	38.94	57.89
Reliance Equity Savings Fund	-1.59	5.19	-4.51	-3.28	-	-	651.67
SBI Equity Savings Fund - Regular Plan	-2.61	7.85	-4.86	-3.02	-	-	316.59
Tata Regular Saving Equity Fund - Regular Plan	-0.49	8.76	-3.83	-2.35	17.5	52.18	91.83

Returns as on 30th November 2016
Others as on 31st October 2016

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