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ILLUSTRATION: SACHIN VARADKAR

ELSS Could Be The Accelerator To An Equity Portfolio

For long term wealth creation, investors should look for the best tax saving product after deciding asset allocation

Times News Network

Salaried people who come within the applicable tax brackets for their tax obligations to the government, are required to pay a large part of their taxes before the end of the financial year in March. However, to lessen their tax burdens and to promote certain types of investments, the government also allows them to invest in some notified tax savings investments and financial products.

For every tax payer, the ideal situation should be to plan their tax savings options at the start of the financial year and continue through the next 12 months. However, a large number wait till the last few months of the year to select and start investing in tax saving products. This, in turn, may have negative implications in the tax payer's portfolio in the long run, financial planners say.

Of the several tax saving plans which are available in the market, financial planners and advisors say that the ones offered by mutual funds, which are also called equity linked savings schemes (ELSS), ranks among the top in terms of flexibility, the chances of higher returns and lock-ins (All tax saving products come with some lock-in time and in an investor wants to withdraw the invested amount within the lock-in period, he/she loses the tax benefits that had accrued).

At present fund houses offer two types of ELSS. One is an open ended structure within which investors can enter and exit as and when they want. The lock-in clause, however, holds. The other structure is where the initial investors are locked-in for three years and post the end of lock-in, they are allowed to redeem their investments. But again, fresh investments, even if the scheme continues to give superior returns, is now allowed.

> *If tax savings is your primary objective while investing in an investment product, the returns may suffer in the long run*

In the second option, the investor remains invested in the scheme for the whole period of lock-in duration. The fund manager, on the other hand, gets a free hand to invest in stocks of his/her choice which he/she thinks could give superior returns over the three year period. In this way, the fund manager is much relieved by not thinking about which all stocks to sell in case there is any redemption pressure.

OBJECTIVE TO INVEST IN ELSS

According to fund managers and financial advisors, the prime motive for investing should be to grow one's wealth. "For this, one should look at asset allocation. Tax saving should be the accelerator," said a top official at a large domestic fund house.

It works this way: Suppose as an investor your asset allocation plan allows you to invest in an equity fund. On top of that you also have the option to invest in tax saving products to save some taxes. Now the equity fund you select is an ELSS which is expected to give an annual return of 15% over the long run. On top of this, by investing in this fund you can get an additional benefit of say 3% (because of lower tax outgo). So the total long term return could add up to 18% per annum on an average, explained the fund house official.

"If tax savings is your primary objective while investing in an investment product, the returns may suffer. For example, bank FDs which qualify for tax savings given lower returns than equities can offer in the long run," the official said.

CASE STUDY

'Portfolio to remain in growth mode till retirement'

I am 37, working with a private firm at an Rs 16.5 lakh annual package. My investments are: Rs 30 lakh in FDs, Rs 6 lakh in PPF, three monthly SIPs of Rs 5,000 each (current value Rs 2.5 lakh), life insurance with a yearly premium of Rs 25,000 (to close in 2021), a debt ULIP with a yearly premium of Rs 1.2 lakh, Rs 6 lakh health plan and a Rs 1 crore term plan. Monthly expenses: Rs 45,000. Goals: A land worth Rs 35 lakh in one year, Rs 30 lakh for child's education in 2030 and retirement corpus of Rs 5 crore. Kindly advice about reaching my financial goals

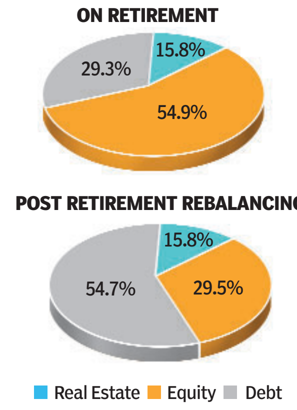
—*Gourav*

Samrat Banerjee *replies*

Given your gross income, after applicable deductions, about Rs 13.7 lakh should be available to you. After your expenses, insurance premiums and PPF contribution, you should have about Rs 44,333 per month for investments. This could be invested in the following manner:

1. Rs. 43,000 in new SIPs into funds with a debt-equity asset allocation ratio of 30:70 with a target of 9.5% compounded annual growth rate for the portfolio. Assuming you would retire in 2040, the total corpus is estimated at about Rs 4.3 crore.
2. The Rs 1,333 monthly surplus may be used to pay for additional health insurance cover (of Rs 10 lakh) and also a term cover (Rs 1.5 crore). The additional term plan would come at a premium of about Rs 20,000/year, a portion of which will incrementally be needed to be funded from your overall income.
3. As your life insurance premium payment stops in 2021, this surplus till 2039 can be used to invest into fresh SIPs at the rate of Rs 2,000 per month into schemes with a targeted growth rate of 9.5%. In 2040, this corpus would be about Rs 11.4 lakh.

Now, to specifically address your goals, we need to make some assumptions. Firstly, increase in your expenditure over the years and lifestyle needs will be balanced by the increase in your income. Secondly, PPF will be paid till retirement and the interest rate on it shall not change significantly over the years.



To buy the plot of land in 2018, your FDs worth Rs 32 lakhs (assumed value at the end of 2017) and Rs 4.8 lakh corpus obtained from your ongoing SIPs (assuming an annual rate of return of 14%) should be sufficient. Rs 30 lakh for the child's education fund in 2031 can be fulfiled by your ULIP at 7.5% annual return. The retirement fund of Rs 5 crore could be fulfiled by the PPF maturity corpus of Rs 1.3 crore, Rs 4.3 crore generated from new SIPs and Rs 11.4 lakh from additional SIPs started in 2021.

Till you retire, the plan will remain largely in a growth mode. After that as per an asset allocation remapping, fixed income will need to be increased to at least 65-70% of the overall portfolio to generate stable income to sustain your expenses.

Samrat Banerjee *is co-founder, Blue Edge India, New Delhi*

GURU SPEAK

> If you hope to have more money tomorrow than you have today, you've got to put a chunk of your assets into stocks. Sooner or later, a portfolio of stocks or stock mutual funds will turn out to be a lot more valuable than a portfolio of bonds or CDs or money-market funds.

Peter Lynch,
one of the most respected fund managers of all time

INVESTOR QUERY

I WANT TO KNOW HOW THE RECENT INCREASE IN CASH RESERVE RATIO (CRR) WOULD HAVE HAD AN IMPACT ON BANKS AND MARKETS?

Rashmi Gulia

CRR is a pre-specified percentage of the total deposits by customers in a bank that the lender has to keep with the RBI or hold in cash, mainly to meet any sudden spurt in cash withdrawals. Since CRR is maintained as hard cash or instruments which are cash equivalent, banks do not earn any interest on this. RBI had specified this percentage at 4%, but then on November 26, had increased it to 100%. But this higher CRR was only for deposits that banks got after September 16 of this year. And not for all the deposits accumulated with them. This 100% incremental CRR has again been reversed from December 10 and now it is back to 4% level.

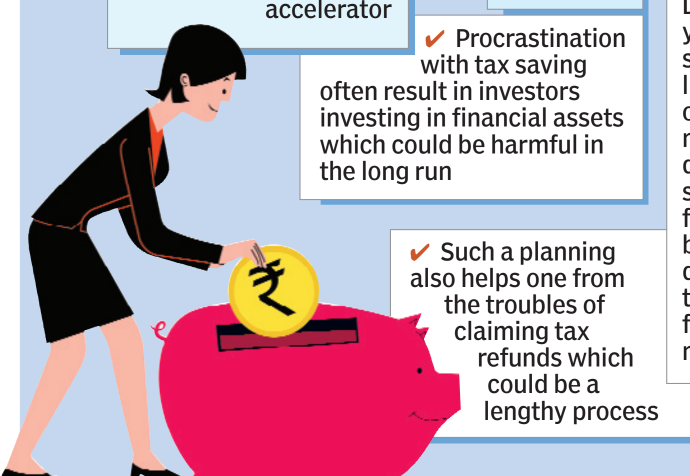
A 4% CRR means for every Rs 100 of bank deposits (savings, FDs, RDs etc) banks have to set aside Rs 4 in cash to meet the CRR requirement. Of this, they also have to compulsorily invest at least Rs 20.75% in government bonds etc to meet another of RBI's requirements, called statutory liquidity ratio (SLR). So what happens is for every Rs 100 worth of deposits that banks get, they are left with Rs 75.25 for onward lending and other operations from which they can generate revenues, pay to their staff, earn profit and so on.

Now when the CRR is hiked, banks have that much less money for onward lending. This in turn could lower their revenues and profits too. For example, if the CRR is hiked to 10%, at 20.75% SLR, banks will be left with Rs 69.25 for onward lending and other operations. This in turn could lead to less money in the banking system for lending operations which can eventually lead to higher interest rate for borrowers (In India, however, the current situation is of ample liquidity). Higher CRR could also lead to lower profit for banks and hence some southward slide for bank stocks.

CRR is a central banking tool to manage liquidity but of late other better tools like repo and reverse repo rates are used for this.

SOME THINGS TO KEEP IN MIND WHILE LOOKING AT TAX SAVING INVESTMENT OPTIONS

- ✔ Your primary objective for investing should be to grow wealth and not saving taxes
- ✔ Don't wait till the last few months of the financial year for investing in tax saving investments
- ✔ Such an approach also helps average out the costs of acquisition over the whole year
- ✔ Tax savings should be an added benefit, which should look more like an accelerator
- ✔ So start early in the financial year and save every month
- ✔ Dividing your tax saving liability over 12 months does not stretch family budget during the last few months
- ✔ Procrastination with tax saving often result in investors investing in financial assets which could be harmful in the long run
- ✔ Such a planning also helps one from the troubles of claiming tax refunds which could be a lengthy process



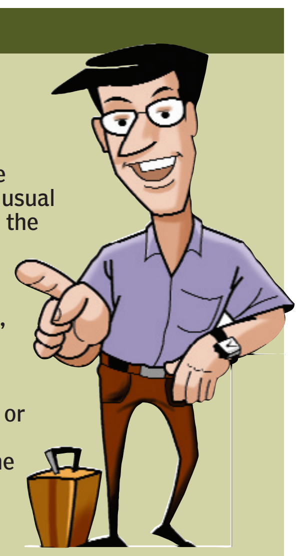
NEXT EDITION

In our next edition we will tell you how in the current situation of demonetisation you can use your money to invest through the mutual fund route for superior future returns.

DEMYSTIFIER

WHAT IS MARKET STABILISATION SCHEME (MSS)?

MSS is a tool to manage availability of funds in the banking system. But this is used only in case of unusual situations. To launch an MSS, the government and the RBI signs an agreement under which the government gives bonds to RBI which the central bank sells in the market to suck out liquidity. The money that RBI gets selling these bonds, however, is not passed on to the government but remain with the central bank in a special account. This is done to ensure that he government does not used this money to reduce fiscal deficits or for planned or non-planned expenses. Till two weeks ago, the RBI's MSS limit was at Rs 20,000 crore. But after the recent sharp increase in deposits in the banking system, to suck out the excess liquidity, this limit has been enhanced to Rs 6 lakh crore.



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