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Private Wealth Management
we know your investment needs

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**Dear Patrons,**

**Merry Christmas!**

We are pleased to share our monthly newsletter **"Knowledge Initiative"** for December 2018.

The year is coming to an end. We would like to take this opportunity to thank our readers for acknowledging our newsletter every month. Knowledge Initiative Team is committed to bring to you more educative and informative articles.

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**Reasons to invest in tax saving mutual funds:** As we are approaching the part of the year where tax planning is on the minds of every individual, the article is the first today. ELSS is the most liquid and convenient investment options under Section 80C considering the SIP route. Let's understand why and how.

2

**Home Loans - Do borrowers only pay interest cost:** An individual takes into account the interest cost that he needs to pay every month as a part of the Equated Monthly Instalment. Educate yourself on the different types of costs, besides interest cost, one incurs during the period of home loan.

3

**Myths about mid-cap and small-cap funds:** Mid cap and small have recently seen a rapid growth in AUM (Assets under management), but sadly are considered a highly risky product. Let's understand the reality now, by removing the general myths from our minds.

4

**SIP Returns:** Check the best performing funds in their respective categories.

# Reasons To Invest In Tax Saving Mutual Funds

As we are approaching the part of the year where tax planning is on the minds of every individual, the article is the first on our newsletter today. Section 80C of Income Tax Act 1961, allows investors to claim deductions from their taxable incomes by investing in certain eligible schemes.

There are number of benefits of investing in tax saving mutual funds and they are mentioned here below in the most simplistic language possible:

## REDUCE TAXES FROM GROSS INCOME

The main reason to invest in tax mutual funds is to save tax under Section 80C. You can claim up to Rs. 150,000 deduction from your gross taxable income by investing an equivalent amount in ELSS or other eligible 80C schemes.
SIP is the best disciplined format of investing to create log term wealth along the benefit of saving taxes.

## WEALTH CREATION IN LONG TERM

Under Section 80C, Equity Linked Saving Scheme (ELSS) are the best performing schemes in the long term. They are managed by skilled and professional fund managers, who are in close watch with the funds/schemes and market scenarios. These schemes are essentially diversified equity mutual funds, which invest in equity and equity related securities.

## MAXIMUM LIQUIDITY

ELSS offers maximum and easiest liquidity, as compared to other schemes under Section 80C. PPF has a lock-in of 15 years and Fixed Deposits has a minimum lock-in of 5 years. ELSS tax saving mutual funds have a lock-in of only 3 years.

## TAX EFFICIENT OPTION

Schemes under 80C such as PPF are tax free, but interest paid by some other 80C investments are taxed as per the income tax rate of the investor. Capital gains of up to Rs 1 Lakh in ELSS mutual funds will be tax exempt. Capital gains in excess of Rs 1 Lakh will be taxed at 10%. Incidence of tax in ELSS investments arises only at the time of redemption and not during the term of the investment. Even with the introduction of the capital gains tax, ELSS remains one of the most tax efficient 80C investment options.

## CONVENIENCE AND FLEXIBILITY

ELSS offers immense flexibility and convenience, as one can invest a particular amount dedicated every month. This disciplined approach helps in maintaining sufficient cash balance and a continuity. Also, there are no penalties or punishments in case of missed payments. In case of 3 missed payments, one needs to restart the SIP by applying fresh.

An individual takes into account the interest cost that he needs to pay every month as a part of the Equated Monthly Instalment. But, it adds to his worries when he realises that it is much more than interest cost that gets paid to the financial institution.

Here are some other costs that we discuss:

# Home Loans: Do borrowers only pay interest cost

## PROCESSING CHARGES

This is typically 0.25% - 0.50% of the loan amount and is usually capped with fixed amount for loans of higher amount. For instance, HDFC limited charges 0.50% of the loan amount up to Rs 20 lacs. Loans above Rs 20 lacs will have a fixed charge of Rs 10000 + 18% GST that comes to Rs 11800.

Processing fee is usually non-refundable. In some cases, the financial institution may refund 50% of the fees, depending on the considerations and case elements. Also, in cases where the loan has been rejected due to property issues, the processing fee is chargeable.

## MISCELLANEOUS COSTS

An individual may have to pay some other costs besides the ones mentioned above. These include lawyer fees for inspection of property and checking the authenticity of the property documents, registration of the mortgage deed and so on.

## COMMITMENT FEES

This is levied by the financial institution on the borrower for unused credit. In case of a construction linked plan, the loan disbursal is according to the completion of stages of construction agreed upon. The borrower may need to pay a charge to access the loan in the future from the lender. Kotak Mahindra Bank Limited charges 2% commitment fees on loan amount sanctioned less the amount disbursed.

## PREPAYMENT PENALTY

A Prepayment charge is an amount paid by the borrower to the financial institution in case of repaying a part or full loan amount, before due date. By doing this, the lender is trying to cover a part of his loss, as he loses out on the opportunity of earning interest on the loan amount further. The prepayment charge may vary across financial institutions. However, on 5th June 2012, the Reserve Bank of India directed all the lending institutions not to charge any prepayment penalty on floating interest rate home loans. For fixed rate home loan products, the prepayment penalty is still valid and is generally 2% of the loan amount outstanding.

## WHAT SHOULD A COMMON MAN DO?

Before applying for a home loan, one must visit the lending institution or the channel partner personally. He/she should understand all aspects of applying for a home loan, procedures and various costs involved. Once there is clarity in the mind of an individual, he/she has agreed to the costs and procedure, then should they go ahead with the home loan sanction process.

# Myths about Mid-cap and Small-cap Funds

Stocks are classified into large cap, mid cap and small cap, based on their market capitalisations. Investors understand the valuations of the company, based on their market capitalisation. Mid cap and small have recently seen a rapid growth in AUM (Asserts under management), but sadly are considered a highly risky product. Let's understand the reality now, by removing the myths from our minds:

## A risky proposition

Risk and volatility are always understood to be the same, by any investor. But, they're not. Volatility is the daily Net Asset Value (NAV) or price fluctuation of a fund. Risk is the probability of making a **loss**. Investors should understand that they will make a loss only if they redeem (sell) – if you are holding your investment, then all profits or losses are notional.

Mid-cap funds are unreasonably taken as a risky and volatile product. But, one cannot generalise it. Some madcap companies have robust business models and strong balance sheets.

## Inferior product

The clear cut difference between large cap and mid-cap/small cap is understood by higher revenues or profits. But that doesn't imply stronger fundamentals.

High operating margins, free cash flows and high return on capital employed (ROCE) drives the EPS growth. There are many mid-cap companies that are often able to generate higher free cash flows and ROCE. Large cap companies are more capital intensive and hence have higher debt equity ratios, that eat away from the profits generated. On the contrary, mid-cap / small cap are less capital intensive, enjoying lower debt equity ratio and hence are able to generate higher profits

## High dividend yield stocks are the better funds

India is a fast growing economy and the equity investors look forward to being a part of the growth story. Mid-cap / small cap have huge potential in context of their growth. Instead of paying large dividends that benefits large shareholders most, why can't the companies reinvest the dividends into growth opportunities, where the investors can gain by way of capital appreciation in the long term. Dividend is not a very tax efficient way of getting returns. The company has to pay dividend distribution tax (@ 15%) before declaring dividends to investors. Further, if dividends exceed Rs 10 lakhs in a year, then the investor has to pay 10% dividend tax. Long term capital gain, on the other hand, is much more tax efficient way of generating returns.

## Multi bagger stocks is the approach

It would not be wise to buy madcap /small cap stocks by way of rumours to gain multi bagger returns. It can backfire the investor, as these stocks need to be bought at the right time and right price. This requires expertise of fund managers and professionals in the field. Hence, mid cap and small cap mutual funds is the best route for investing in these funds.

## Mid-cap / Small cap perform in bull markets only

Mid-cap and small cap outperform in bull markets and underperform in bear markets, is a myth continued for years now. One cannot time the movements in the markets. Hence, these products have be routed through skilled and professional mangers in a SIP approach. This benefits the investors to follow a disciplined approach and he gains from rupee cost averaging in the long run.

## SIP RETURNS IN TOP MUTUAL FUNDS

PLEASE NOTE : Returns over 1 Year are compounded annualised, as on 21st December 2018

| INVESTMENT | | VALUE (3 Year) | | VALUE (5 Year) | | VALUE (10 Year) | |
|---|---|---|---|---|---|---|---|
| Monthly Investment @Rs 10,000 | | 360000 | | 600000 | | 1200000 | |
| *SCHEME NAME* | *CATEGORY* | *RETURN* | *%* | RETURN | *%* | RETURN | % |
| ICICI Prudential Bluechip Equity (G) | *Large Cap* | 422,651 | 10.7 | 792,764 | 11.1 | 2,503,365 | 14.1 |
| Axis Bluechip Fund (G) | *Large Cap* | 441,638 | 13.8 | 812,485 | 12.1 | N/A | N/A |
| Principal Emerging Bluechip Fund (G) | *Large & Midcap* | 415,976 | 9.6 | 861,914 | 14.5 | 3,297,157 | 19.2 |
| Mirae Asset Emerging Bluechip Fund (G) | *Large & Midcap* | 442,710 | 13.9 | 953,003 | 18.6 | N/A | N/A |
| Mirae Asset India Equity Fund (G) | *Multi Cap* | 434,799 | 12.7 | 846,890 | 13.8 | 2,930,662 | 17.0 |
| Kotak Standard Multicap Fund (G) | *Multi Cap* | 423,357 | 10.8 | 832,615 | 13.1 | N/A | N/A |
| L&T Mid Cap Fund (G) | *Mid Cap* | 417,421 | 9.9 | 878,698 | 15.3 | 3,284,769 | 19.1 |
| Kotak Emerging Equity Fund (G) | *Mid Cap* | 402,622 | 7.4 | 844,369 | 13.7 | 3,036,447 | 17.7 |
| HDFC Small Cap Fund (G) | *Small Cap* | 446,104 | 14.5 | 899,028 | 16.2 | 2,9503,365 | 17.1 |
| L&T Emerging Businesses Fund (G) | *Small Cap* | 434,793 | 12.7 | N/A | N/A | N/A | N/A |
| Franklin India Focused Equity Fund (G) | *Focused* | 405,776 | 8.0 | 792,402 | 11.1 | 2,855,677 | 16.5 |
| Axis Focused 25 Fund (G) | *Focused* | 445,711 | 14.4 | 860,536 | 14.4 | N/A | N/A |
| Principal Hybrid Equity Fund (G) | *Hybrid Equity* | 428,601 | 11.7 | 820,768 | 12.5 | 2,407,499 | 13.4 |
| Mirae Asset Hybrid Equity Fund (G) | *Hybrid Equity* | 422,539 | 10.7 | N/A | N/A | N/A | N/A |
| Aditya Birla SL Tax Relief 96 Fund (G) | *ELSS* | 423,687 | 10.9 | 838,032 | 13.3 | 2,728,318 | 15.7 |
| Axis Long Term Equity Fund (G) | *ELSS* | 434,314 | 12.6 | 843,462 | 13.6 | N/A | N/A |

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