Report on investing in Equity Focused Mutual Funds versus Flexi Cap PMS schemes of the same category.

An equity-focused mutual fund is a mutual fund that invests into a restricted number of highly researched stocks. The SEBI guidelines limit these to a maximum of 30 stocks in a focused fund. These funds provide a precise market exposure rather than a diverse portfolio and are meant for long-term investors with high-risk appetites investing for 5-7 years.

Advantages

1. High returns and avoid limitations of general mutual funds- With equity-focused mutual funds, investors can maximize their capital gains more effectively. This can be done by negating the limitation of general mutual funds wherein we can limit the returns from investing in stocks that do not perform well since mutual funds do not segregate between companies and sectors.
2. Lower investment amount- Focused funds required a significantly lesser initial investment amount as compared to Portfolio Management Services(PMS) schemes. This can appeal to a broad range of investors.
3. High Liquidity- The ease of money transfer can be a critical factor when choosing between PMS schemes and focused mutual funds and can allow for financial flexibility with quick access to funds to take advantage of other investment opportunities. Meanwhile, PMS scheme investments are illiquid due to which it can be difficult to sell them quickly on the market.

4. Some level of diversification- Even with a focused strategy, these funds allow a greater level of diversification than PMS schemes, spreading risk across an array of stocks and decreasing the probability of incurring losses.
5. Passive involvement- These offer a more hands-off investment approach with minimal interaction between the investor and fund managers without the need for fund modification
6. Low volatility- The regulatory constraints and diversification help in reducing the volatility which is often preferred by long term investors as it ensures a balanced approach to investments by incremental and steady gains over time.
7. Higher Tax efficiency- Mutual funds and PMS schemes have capital gains tax on profits in the long term of 10% plus supercharge and 15% in the short term. Since the initial investment amount is Rs.50 lakhs in PMS schemes, HNI investors are in the highest tax slab of 30%. Mutual funds are more tax efficient since in the growth investment option, for a holding of more than a year, a MF receives dividends from the underlying stocks but does not pay out anything to investors and rather reinvests it to avoid tax liability in the growth option unlike PMS schemes which have immediate tax implications on investors. Furthermore, mutual funds use Net of Expenses(NAV) while PMS schemes deduct charges against a single value. In mutual funds the value of your investment is already adjusted for all expenses, like management fees and you pay tax on the increase in NAV from when you bought the fund to when you sell it making it tax efficient while PMS schemes pay tax from the initial value to the final value before expenses are deducted. This makes MFs marginally more tax efficient as less tax is paid. Another aspect is that at higher investments of Rs 50 lakh, 2 crore or 5 crore in PMS schemes

investors are pushed into a higher surcharge bracket paying a higher base rate in taxes than mutual funds making them less tax efficient

Disadvantages

1. Limited customization- Mutual funds offer a standard investment approach ignoring individual investor's financial objectives and needs. Investors also have little control over the fund's portfolio composition and investment strategy
2. Less active management- There is less active engagement in the decision-making process of the fund as compared to PMS schemes
3. Performance dilution- To ensure liquidity of funds, fund managers may hold a small portion of the investor portfolio in liquid assets which may not contribute to returns, hence diluting overall performance

Portfolio Management Services(PMS) are services offered by fund managers to handle investment portfolios of high net-worth individuals based on their investment objectives, risk profile and financial goals. These schemes are generally targeted at high net worth individuals with high risk tolerance

Advantages

1. Customization and flexibility- Flexi Cap PMS schemes allow for a higher degree of customization than mutual funds allowing investors to tailor their investment strategies to their specific financial goals and risk appetite. PMS managers also have the flexibility to

manage and modify the portfolio as a response to market changes and changes in investor goals and are not tied to rigid investments.

2. No behavioral flows- With a high initial investment ticket, portfolio managers gain advantage in the form of long term rational capital flows. In contrast, high number of retail investors and a pooled portfolio concept in focused mutual funds lead to more frequent behaviorally driven inflows and outflow. As retail flows rise, MF managers are forced to buy more at higher market levels along with rising markets. In PMS schemes each investor owns individual shares in their demat accounts. This ownership structure ensures that one investor's market reactions and movements do not impact the portfolios of other investors leading to potentially better long-term investment outcomes

3. Transparency- PMS schemes provide a comprehensive reporting and regular communication to clients including detailed portfolio statements, capital gain statements and performance reporting enabling clients to stay informed about their investments and the rationale behind decisions.
4. Highly concentrated- PMS portfolios are more concentrated than focused mutual funds reducing the stock level uncertainty through thorough research and active management. While a level of diversification can help mutual funds by reducing volatility it increases the risk of buying the less known

5. Potential for high returns- PMS schemes, being highly customizable to individual investor goals and often more concentrated, have a greater potential to generate

significant profits. This personalized approach allows portfolio managers to focus on high-conviction investments and take advantage of specific market opportunities, tailoring strategies to maximize returns based on the investor's risk tolerance and financial objectives.

Disadvantages

1. Liquidity risks- PMS investments tend to be illiquid, meaning they can be challenging to sell quickly in the market. This lack of liquidity can be problematic for investors who need to access their funds promptly to meet financial needs or take advantage of other investment opportunities. The difficulty in selling PMS investments quickly could lead to delays and potential losses due to which these schemes are a high risk high-reward playing field.
2. High Volatility- The concentration increases the portfolio's volatility, causing significant fluctuation and leading to potential losses if the stocks perform badly.
3. Higher expense ratio- PMS schemes often have high expense ratios with high costs associated with research, administration and distribution fees due to a smaller pool. The administrative charges are higher in these schemes and billed separately to investors consisting of management and performance fees which are higher than mutual fund fees. In contrast, equity-focused mutual funds have lower expense ratios as costs are spread over a larger pool of assets wherein returns are inclusive of all taxes and charges. These have management and sometimes exit load fees which are lower than those of PMS schemes

4. Concentration risk and lack of diversification- PMS schemes are more concentrated than focused mutual funds wherein this concentration increases the risk as the performance of a few stocks can significantly impact the entire portfolio.
5. High Investment amount- These schemes have a minimal investment ticket of Rs 50 Lakhs which might not be affordable for many investors

Comparison

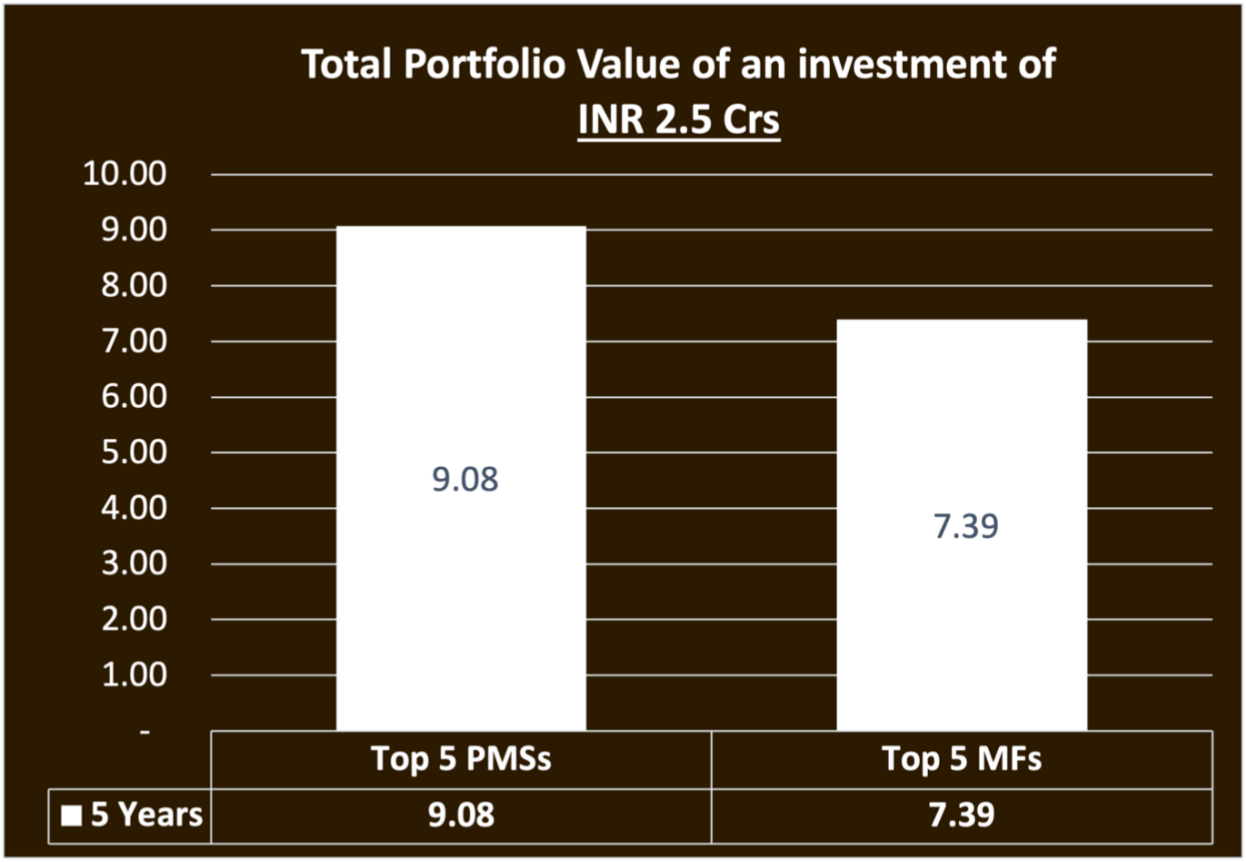
Assuming an investor wishes to invest in the long term over a period of 5 years. According to a report published by AIF World the following table shows a comparison of the returns received by the investors in an equity-focused mutual fund and in a portfolio management service of the same category:

TOP 5 PMSs- 5Y Returns (Multi Cap Fund)		
Scheme Name	Assets Under Management	Annualized returns
ValueQuest Platinum Scheme PMS	1529.00	30.16%

Sameeksha Capital Equity PMS	1202.00	29.90%
Stallion Asset Core PMS	1407.00	29.89%
Globe Capital Value PMS	817.14	25.97%
Globe Capital Arbitrage PMS	269.23	24.00%

TOP 5 MFs- 5Y Returns (Regular Plan, Multi/Flexi Cap Fund)

Scheme Name	Assets Under Management	Annualized returns
Quant Flexi Cap Fund	4154.65	28.65%
Quant Active Fund	8466.76	27.33%
Parag Parikh Flexi Cap Fund	60559.43	22.71%
Axis Growth Opportunities Fund	11310.89	21.04%
ICICI Prudential Large & Mid Cap Fund	11333.37	20.48%



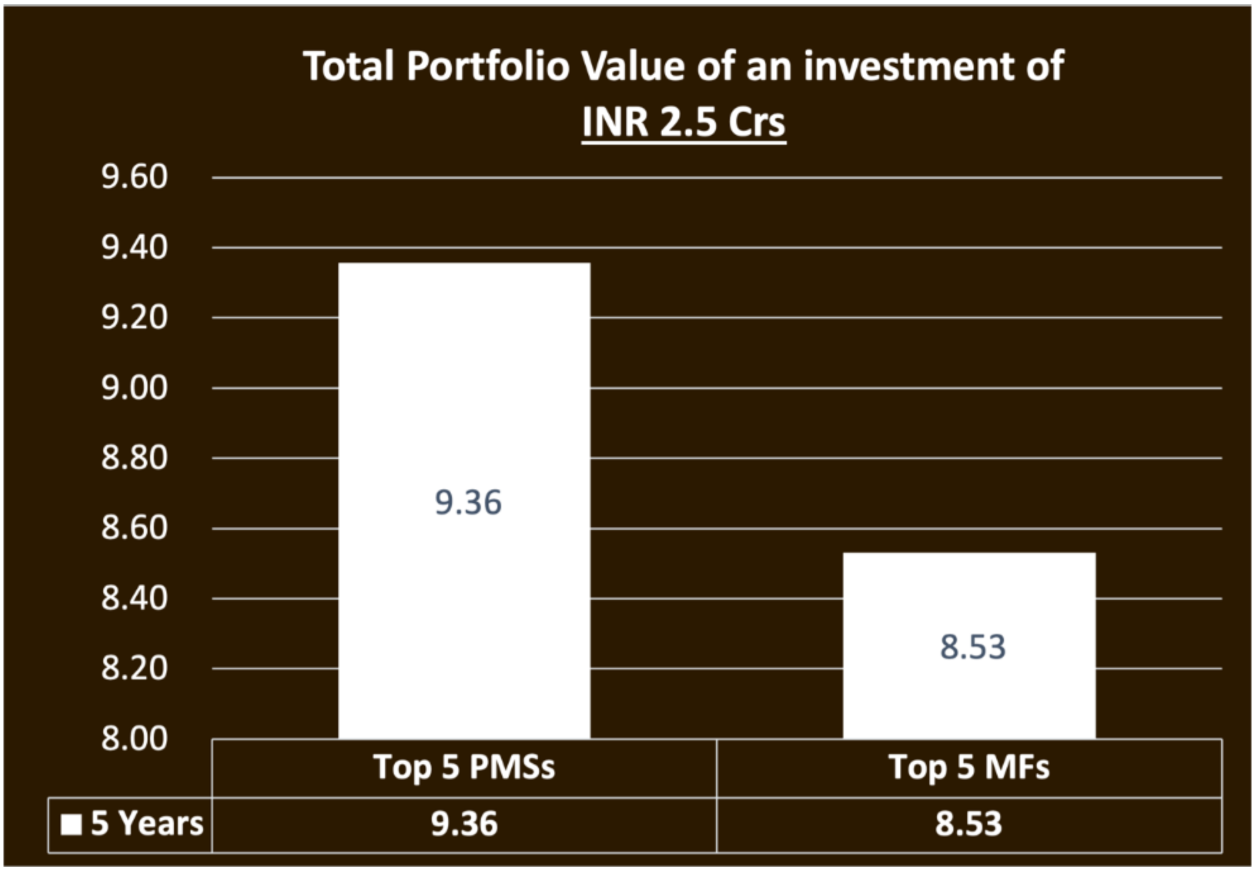
Over the past 10 years PMS schemes have generated up to 37% annual returns. If an HNI client invested Rs. 2.5 Crs in these top 5 PMSs on 1st April 2019, rather than in the top 5 equity focused mutual funds of the same category over a period of 5 years, it would have generated Rs. 1.68 crs more. The 2.5 crs would have earned investors 9.08 crs from PMS schemes and 7.39 from mutual funds.

TOP 5 PMSs- 5Y Returns (Mid and Small cap Fund)		
Scheme Name	Assets Under Management	Annualized returns

Green Lantern Capital LLP Growth PMS	406.49	37.87%
UNIFI APJ 20 PMS	620.50	29.03%
Aequitas Investment India Opportunities PMS	3149.16	28.88%
Equirus Long Horizon PMS	851.87	27.11%
UNIFI Blended Fund-Rangoli PMS	12857.00	26.83%

TOP 5 MFs- 5Y Returns (Mid and Small Cap Fund)

Scheme Name	Assets Under Management	Annualized returns
Quant Small Cap Fund	17193.09	34.60%
Nippon India Small Cap Fund	46044.13	28.27%
Canara Robeco Small Cap Fund	9594.98	25.43%
Tata Small Cap Fund	6289.22	24.93%
Invesco India Smallcap Fund	3705.37	24.77%



If an HNI client invested Rs. 2.5 Crs in these top 5 PMSs on 1st April 2019, rather than in the top 5 equity focused mutual funds of the small and mid cap category over a period of 5 years, it would have generated Rs. 0.83 crs more with 9.36 crs from PMS schemes and 8.53 from mutual funds.

These results showcase that **investing in PMS schemes has generated more wealth for HNI clients than investing in equity-focused mutual fund**s

There are around 1.35 lakh investors in the PMS segment as opposed to over 10 crore portfolios in the MF industry and about 3 crore unique investors. Both PMS schemes and mutual funds follow the same tax structure with capital gains tax on profits in the long term of 10% plus supercharge and 15% in the short term which is stocks traded within a year. According to a portal PMS bazaar, 79% of PMS schemes outperformed their benchmarks over a 10-year period, while only 49% of mutual funds improved the returns generated by their benchmarks. As a result, the number of clients opting for PMS schemes has increased from around 106,000 to about 147,000 in just the last five years since 2019. Additionally, at least 22 schemes made HNI investors richer last month with double-digit returns going up to 17%.

Therefore, HNI investors should choose flexi cap PMS schemes over equity focused mutual funds, as they offer the advantage of a customizable portfolio tailored to individual financial goals, potentially yielding higher returns as seen by the data given above.