What are the best equity mutual fund categories for SIPs

Equity MFs or mutual funds have established themselves as a popular category featuring in the portfolios of several investors. Suitable for the long-term, these funds can be used for goals like retirement, a child's higher education expenses, home ownership, and more. However, this mutual fund category offers several types. So, if you are looking for the best options when investing in equity through Systematic Investment Plans (SIPs), here's what you should know.

Best equity mutual funds for SIP

There are many equity mutual funds in the market. However, you must understand every mutual fund category and what they offer to select the best option for your risk preference and goals. Here are the options you can consider:

1. **Options based on market capitalisation**

Market capitalisation is the total market value of a business's outstanding stocks. It helps you understand the company's position in the stock market. Given below is the equity mutual fund classification based on market capitalisation:

- **Large-cap equity mutual funds:** Large-cap companies are businesses that have been in the market for some time and have established themselves well. These companies rank among the top 100 in the stock market based on market capitalisation. Large-cap equity mutual funds invest at least 80% of their capital in these companies. Since these companies are well-established, they offer better financial stability against market volatility and pose a lower risk compared to other segments.
- **Mid-cap equity mutual funds:** Mid-cap companies are relatively less established than large-cap firms. They rank from 101 to 250 on the list of companies based on market capitalisation. Mid-cap equity mutual funds invest at least 65% of their capital in these businesses. Although these companies are less stable than large-cap businesses, they are more established than small-cap companies and have a medium risk profile.
- **Small-cap equity mutual funds:** Small-cap companies are ranked from 251st onward and often include newer, less-established businesses. Small-cap equity mutual funds invest at least 65% in these companies. Due to their relatively new and less-established nature, small-cap companies may be more volatile, resulting in higher risk.

2. **Options for tax-efficiency**

If you are looking for tax benefits from your equity funds, you can consider the following option:

- **ELSS mutual funds:** Short for Equity-Linked Savings Schemes, ELSS invests at least 80% in equity and equity-linked securities as per the Equity Linked Saving Scheme, 2005, by the Ministry of Finance. ELSS stands out as the sole mutual fund category eligible for tax deductions under Section 80C. Section 80C includes a list of investments and saving options that offer a deduction on your overall taxable income for a given financial year. Any investments made in ELSS qualify for a tax deduction of up to Rs 1.5 lakh per annum under the section.

However, it is important to note that the ELSS has a lock-in period of three years. When you invest through SIPs, this lock-in period applies to every new investment you make through the SIP. For example, an investment made on Jan 1, 2024, will have a lock-in period until Jan 1, 2027. Likewise, an investment made on Feb 1, 2024, will have a lock-in period until Feb 1, 2027.

3. **Options for diversification**

If you want to invest in equity funds but also want to diversify your portfolio to include other asset classes and lower your risk, you can consider hybrid funds.

- **Hybrid funds:** Hybrid funds follow a hybrid investment model and invest in a mix of equities and debt. The exact allocation can depend on the type of hybrid fund. The Securities and Exchange Board of India (SEBI) classifies hybrid funds into the following types:

    - **Aggressive hybrid funds:** These invest anywhere between 65% and 80% in equity and equity-related instruments, and 20% and 35% in debt instruments.
    - **Balanced hybrid funds:** These allocate 40% to 60% to both equity and debt instruments.
    - **Conservative hybrid funds:** These invest 10% to 25% in equity and equity-related instruments and 75% to 90% in debt instruments.
    - **Dynamic asset allocation or balanced advantage funds:** These have a dynamic allocation in equity and debt based on market conditions.
    - **Arbitrage funds:** These follow an arbitrage strategy with at least 65% investment in equity and equity-related instruments.
    - **Multi asset allocation funds:** These invest in at least three different asset classes with a minimum of 10% allocated to each.
    - **Equity savings funds:** These funds allocate a minimum of 65% to equity and equity-related instruments, with at least 10% allocated to debt instruments. Additionally, they use derivatives for hedging as specified in the Scheme Information Document (SID).

The risk profile can vary in each of these funds, depending on their precise allocation.

Conclusion

It is important to note that the risk profile can make a significant difference when looking for the best equity fund for SIPs. While equity funds are inherently risky, each type carries unique features that can further alter their risk levels. Therefore, it is crucial to evaluate each mutual fund category carefully before making a decision.