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PORTFOLIO MANAGEMENT OF INDIAN MUTUAL FUNDS: A STUDY ON DIVERSIFIED EQUITY FUNDS PERFORMANCE

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ABSTRACT

Actively managed fund aims at outperforming its corresponding benchmark index. Equity diversified mutual fund's performance in comparison with broad based index like S&P CNX 500 definitely investigates the activism shown in the fund management. In this paper attempt has been made to find out whether actively managed equity diversified funds in India have achieved superior performance through their stock selection and timing abilities. It is observed that one third of the sample funds delivered positive alpha and remaining funds were satisfied with zero Alphas. However these positive alpha funds failed to time the market movement.

KEYWORDS

Active returns, Alpha, Market phases, Market timing,

I. INTRODUCTION

Mutual funds are professionally managed investment companies, offering efficient service and a flexible product range to create wealth for individual and institutional investors. The size and Growth of Mutual Fund industry in India has changed enormously over the last decade. The Industry now has 42 players with assets under management of Rs. 673,176cr as on June 30, 2011. Assets under Management have achieved a record compounded growth of 28% in the period between the years 2006-2010. Industry is growing at the annual growth rate of 27.25 % in terms of net sales. It is one of the steady and fast growing segments of the Indian economy.

In fund management Active and Passive investing are the two basic investment approaches in equity investments of mutual funds. While Active investing relies on the ability of managed funds to outperform the market, the passive investing relies on the long-term success of market indexes. The idea behind the active management is to deliver superior returns over the market. Equity diversified funds follow active investment approach and seek to beat the market.

Indian stock market observed two bull phases and one bear phase during the period of 31st March 2005 to 31st March 2011. S&P CNX 500 index increased from 1772.85 points on 31st March 2005 to 5354.70 on 31st December 2007 with the CAGR of 33.46%. From 31st December 2007 to 30th November 2008 it earned CAGR of -60.91% and from 30th November 2008 to 31st March 2011 achieved CAGR of 38.85%. Actively managed portfolios are expected to exhibit the superior performance over its benchmark portfolio in any phase of the market. This study uses a broad based index S&P CNX 500 as common benchmark to compare the performance of sample funds.

II OBJECTIVES OF THE STUDY

The following objectives are identified to study the active returns of Indian mutual fund industry.

1. To identify and analyze the excess returns (over the 91 days T-Bills returns) of select equity diversified funds in the different phases of market i.e., bull and bear phases.
2. To identify and analyze the level of alpha generated by the funds and classify the funds into positive, zero and negative Alpha funds.

III DATA

Published Data is collected for the past 72 months i.e. the period of April 2005 to March 2011 related to NAVs of funds, 91 days T-Bills and NSE 500.

1. Monthly returns of 30 growth option equity diversified funds which are surviving from March 2005 are calculated based on NAVs from ICRA Online Mutualfundsindia.com
2. Monthly risk free returns are calculated from Implicit Yield at Cut off Price of 91 days T-bills Actions from RBI.
3. Monthly Market returns from S&P CNX 500 index of National Stock Exchange.

DESCRIPTIVE STATISTICS: MONTHLY RETURNS OF SAMPLE FUNDS AND S&P CNX 500

portfolio	N	Minimum	Maximum	Mean	Std. Deviation	Skewness	Kurtosis
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic
Fund average (30 funds)	72	-0.24	0.31	0.0136	0.08313	-0.203	2.27
S&P CNX 500	72	-0.28	0.34	0.0126	0.09043	-0.21	2.864

IV METHODOLOGY

Jenson (1968) measure of portfolio performance is used to calculate the Portfolio Alpha. Fund excess returns are regressed with excess market returns to obtain the Alpha. A positive value of Alpha indicates superior performance. Linear Regression Method with the help of SPSS package is used to calculate the intercept and its significance. The regression equation is

$$R_{pt}-R_{ft}=\alpha+\beta R_{mt}-R_{ft}+e_t$$

Where $R_{pt}-R_{ft}$ and $R_{mt}-R_{ft}$ are excess portfolio and market returns.

α and β are the intercept and slope coefficients.

e_t is an error term.

Treynor and Mazuy(1966) market timing measure is used to identify timing ability of the funds. Actively managed portfolio has a relatively high beta when the market rises and a relatively low beta when market drops is expected. The following regression method is used to identify the market timing.

$$R_{pt}-R_{ft}=\alpha+\beta R_{mt}-R_{ft}+c(R_{mt}-R_{ft})^2+e_t$$

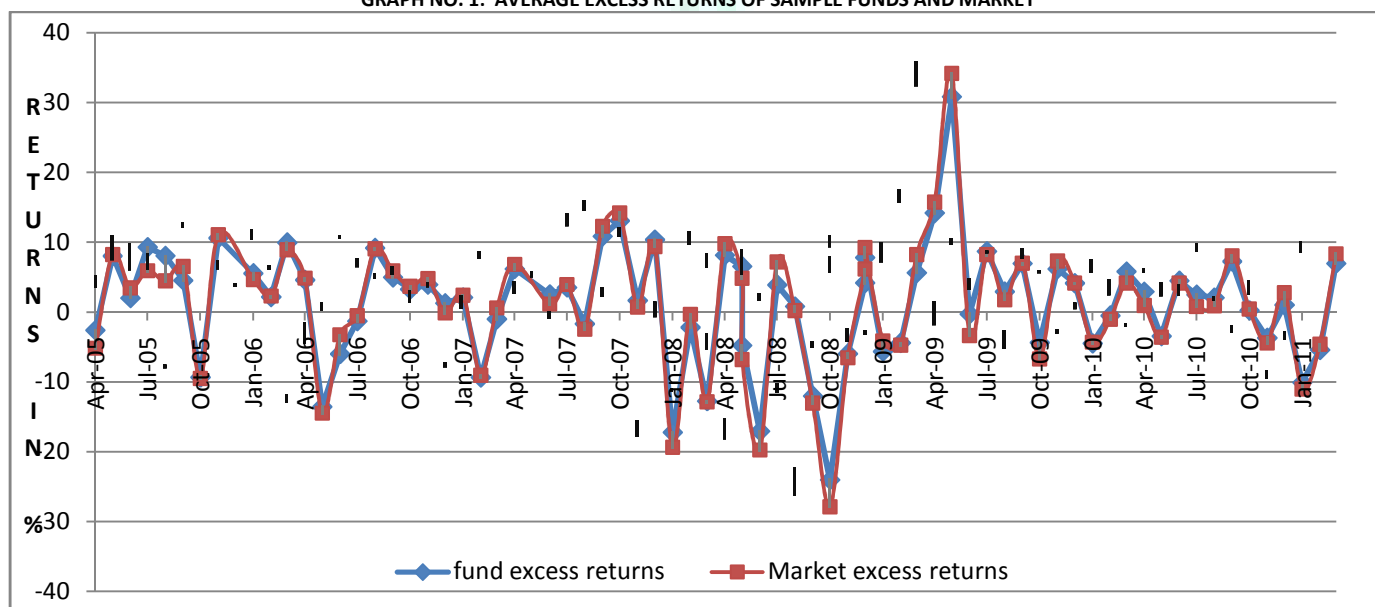
Where $R_{pt}-R_{ft}$ and $R_{mt}-R_{ft}$ are excess portfolio and market returns at that time . C is a measure of timing ability. If the estimated value of c is positive, it indicates that the portfolio successfully timed the market.

V ANALYSIS OF RESULTS

A. THE OVERALL ACTIVE RETURNS SCENARIO IN THE INDUSTRY

Difference among the average risk free returns of funds and market in the bull and bear phases is clearly observed in the graph no.1. The average fund's risk adjusted returns in the bear phase appears superior compared to the market. During this phase funds managed to fall less than the market. In this period i.e., 31st December 2007 to 30th November 2008 market had suffered with -8.13% monthly excess returns while average funds monthly excess returns were only -7.57%. In the bull phase i.e., 31st march 2005 to 31st December 2007 the average fund returns were 3.13% and market returns were 3.08%. In another bull phase from 30th November 2008 to 31st March 2011 funds average monthly returns 2.78% while market returns were 2.80%.

GRAPH NO. 1: AVERAGE EXCESS RETURNS OF SAMPLE FUNDS AND MARKET



B. ANALYSIS OF SELECTIVITY AND TIMING TESTS

Active returns by outperforming the market are possible with the superior stock selection and timing the movement in the market. These stock selection and timing abilities are measured with the level of alpha generated. Performance is categorized with the alpha at a 10% significance level, into positive Alpha, zero Alpha and negative Alpha. This study uses the t-statistic threshold -1.66 to 1.66 which is based on the degree of freedom to categorize the funds. Funds with which t-value lies within this region as zero Alpha, above the 1.65 t-value into positive alpha and remaining are termed as negative Alpha funds. Selectivity tests shows that Out of 30 funds 10 funds have delivered positive significant alpha. These funds had shown an average Alpha 0.0055. The remaining funds had shown either zero or non significant positive alphas whose t-values lies in the zero Alpha category.

TABLE: 1 TEST OF SELECTIVITY

+ve significant Alphas	Mean Alpha	-ve Alphas	Mean Alpha	zero Alphas	mean Alpha
10	0.0055	0	0	20	0.00045

Timing ability tests evidences that majority of the funds failed to time the market movement. Only 3 funds out of observed 30 funds had shown positive and significant timing coefficient with average of 0.602. However these observed 3 funds have not shown any significant positive alpha. The overall average timing coefficient is -0.00387.

TABLE: 2 TEST OF TIMING

Mean timing coefficient	+ve significant timing coefficients
-0.00387	3

SUMMARY AND CONCLUSION

To study the Active portfolio management of Indian mutual funds, 30 Equity diversified funds have been selected after examining their investment objective and their survival till the end of study period. Jensen measure of portfolio performance and Treynor and Mazuy market timing measures are used to test the stock selection and timing abilities of the fund management in generating the active returns. This study finds the evidence that one third sample funds delivered positive alpha and remaining funds were satisfied with zero Alphas. These funds had generated positive active returns through the stock selection abilities but they failed to time the market movement.

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ANNEXURE

ANNEXURE I: ALPHA AND BETA VALUES

sno		alpha	t value	p value	beta	t value	pvalue
1	Birla Buy india fund	0.003	0.969	0.369	0.826	22.27	0
2	Birla dividend yield fund	0.003	1.004	0.319	0.808	21.866	0
3	Canreboco equity diversified fund	0.003	1.072	0.287	0.932	29.847	0
4	Fidelity equity fund	0.006**	2.879	0.005	0.823	36.365	0
5	Franklin india flexi cap fund	0.005*	2.361	0.021	0.89	40.335	0
6	Franklin india tax shield	0.004**	1.687	0.096	0.834	35.63	0
7	Hdfc equity fund	0.007*	3.423	0.001	0.905	37.976	0
8	Principal dividend yield fund	-0.002	-0.668	0.506	0.846	24.484	0
9	Franklin india prima fund	-0.001	-0.192	0.848	0.959	22.118	0
10	Can reboco emerging equity fund	-0.002	-0.444	0.658	1.11	25.394	0
11	DWS equity fund	0.003	0.962	0.339	0.835	21.753	0
12	Escorts growth plan	0	0.026	0.979	0.965	16.611	0
13	Baroda pioneer ELSS96	-0.011	-1.589	0.117	0.96	13.093	0
14	Baroda pioneer growth fund	0.005**	1.848	0.069	0.885	30.76	0
15	Reliance vision	0.003	1.315	0.193	0.906	34.786	0
16	DSP Blackrock opportunities fund	0.004*	2.071	0.042	0.865	40.459	0
17	Tata pure equity fund	0.004**	1.723	0.089	0.865	38.513	0
18	HSBC equity fund	0.003	1.145	0.256	0.784	28.042	0
19	HSBC india opportunities fund	0.002	0.644	0.522	0.836	26.072	0
20	SBI Magnum equity fund	0.002	0.765	0.447	0.93	27.197	0
21	Taurus tax shield	-0.001	-0.189	0.851	1.019	16.67	0
22	Taurus discovery	-0.008	-1.412	0.162	1.186	19.829	0
23	Sundaram growth fund	0.001	0.464	0.644	0.978	36.63	0
24	Sundaram tax saver	0.004	1.252	0.215	0.909	27.013	0
25	Sundaram select focus	0.003	1.123	0.265	0.946	27.867	0
26	Icici pru dynamic plan	0.008*	2.569	0.012	0.802	24.512	0
27	Icici pru discovery	0.005	1.317	0.192	0.949	21.402	0
28	Idfc premier equity fund plan	0.008**	1.753	0.084	0.895	19.253	0
29	Sahara growth	0.004*	1.939	0.056	0.813	32.581	0
30	Tata growth	-0.001	-0.44	0.661	0.949	25.617	0

*Alpha Significant at 5% level

** Alpha significant at 10% level

ANNEXURE 2: TIMING COEFFICIENTS OF SAMPLE FUNDS

Sno		Timing coefficient	t val	P val
1	Birla buy india fund	-0.206	-1.064	0.291
2	Birla dividend yield fund	0.059	0.302	0.763
3	canreboco equity diversified fund	0.115	0.704	0.484
4	fidelity equity fund	-0.198	-1.71	0.092
5	Franklin india flexi cap fund	-0.008	-0.068	0.946
6	Franklin india tax shield	-0.123	-1.008	0.317
7	Hdfc equity fund	0.12	0.962	0.34
8	Principal dividend yield fund	-0.248	-1.382	0.171
9	Franklin india prima fund	0.046	0.201	0.842
10	Can reboco emerging equity fund	0.231	1.014	0.314
11	Dws equity fund	-0.549	-2.876	0.005
12	Escorts growth plan	0.996*	3.541	0.001
13	Baroda pioneer ELSS96	-0.048	-0.124	0.902
14	Baroda pioneer growth fund	-0.006	-0.039	0.969
15	Reliance vision	0.085	0.622	0.536
16	DSP Blackrock opportunities fund	-0.234	-2.146	0.035
17	Tata pure equity fund	0.001	0.013	0.99
18	HSBC equity fund	-0.368	-2.622	0.011
19	HSBC india opportunities fund	-0.45	-2.815	0.006
20	SBI Magnum equity fund	0.007	0.041	0.968
21	Taurus tax shield	0.372	1.168	0.247
22	Taurus discovery	0.152	0.482	0.631
23	Sundaram growth fund	-0.055	-0.389	0.698
24	Sundaram tax saver	0.45*	2.673	0.009
25	Sundaram select focus	0.359*	2.068	0.042
26	Icici pru dynamic plan	-0.56	-3.534	0.001
27	Icici pru discovery	-0.01	-0.042	0.967
28	Idfc premier equity fund plan	-0.255	-1.06	0.293
29	Sahara growth	-0.083	-0.633	0.529
30	Tata growth	0.292	1.523	0.132

ANNEXURE 3: AVERAGE RETURNS OF SAMPLE FUNDS, CNX500 AND 91 DAYS T.BILLS

month	fund avg	CNX500	avg risk free	month	fund avg	CNX500	avg risk free
Apr-05	-2.19%	-4.75%	0.42%	Apr-08	8.72%	10.36%	0.59%
May-05	8.45%	8.66%	0.42%	May-08	-4.20%	-6.22%	0.60%
Jun-05	2.44%	3.89%	0.43%	Jun-08	-16.41%	-19.10%	0.64%
Jul-05	9.72%	6.36%	0.44%	Jul-08	4.61%	7.91%	0.72%
Aug-05	8.46%	4.88%	0.43%	Aug-08	1.53%	0.94%	0.74%
Sep-05	4.95%	6.94%	0.43%	Sep-08	-11.32%	-12.34%	0.70%
Oct-05	-8.90%	-9.07%	0.45%	Oct-08	-23.37%	-27.23%	0.65%
Nov-05	11.06%	11.53%	0.47%	Nov-08	-5.37%	-5.96%	0.59%
Dec-05	4.65%	6.64%	0.48%	Dec-08	8.26%	9.68%	0.46%
Jan-06	6.05%	5.15%	0.51%	Jan-09	-5.27%	-3.78%	0.38%
Feb-06	2.70%	2.82%	0.54%	Feb-09	-4.02%	-4.35%	0.39%
Mar-06	10.47%	9.45%	0.53%	Mar-09	6.01%	8.61%	0.39%
Apr-06	5.03%	5.30%	0.45%	Apr-09	14.48%	16.04%	0.31%
May-06	-13.10%	-14.01%	0.46%	May-09	31.09%	34.43%	0.27%
Jun-06	-5.51%	-2.76%	0.49%	Jun-09	-0.02%	-3.08%	0.27%
Jul-06	-0.79%	0.00%	0.52%	Jul-09	8.94%	8.48%	0.26%
Aug-06	9.69%	9.58%	0.52%	Aug-09	3.20%	2.02%	0.27%
Sep-06	5.49%	6.42%	0.53%	Sep-09	7.21%	7.25%	0.27%
Oct-06	3.80%	4.23%	0.54%	Oct-09	-4.09%	-6.45%	0.27%
Nov-06	4.46%	5.33%	0.54%	Nov-09	6.43%	7.59%	0.27%
Dec-06	1.83%	0.45%	0.56%	Dec-09	4.42%	4.43%	0.29%
Jan-07	2.66%	2.98%	0.58%	Jan-10	-4.18%	-4.00%	0.31%
Feb-07	-8.74%	-8.41%	0.62%	Feb-10	-0.17%	-0.69%	0.34%
Mar-07	-0.39%	1.21%	0.62%	Mar-10	6.15%	4.50%	0.36%
Apr-07	6.77%	7.43%	0.61%	Apr-10	3.24%	1.27%	0.34%
May-07	7.16%	5.46%	0.62%	May-10	-3.10%	-3.24%	0.36%
Jun-07	3.12%	1.74%	0.60%	Jun-10	4.91%	4.59%	0.43%
Jul-07	3.92%	4.36%	0.41%	Jul-10	2.93%	1.23%	0.45%
Aug-07	-1.15%	-1.91%	0.54%	Aug-10	2.55%	1.39%	0.50%
Sep-07	11.41%	12.85%	0.57%	Sep-10	7.74%	8.55%	0.50%
Oct-07	13.64%	14.76%	0.57%	Oct-10	0.76%	0.97%	0.53%
Nov-07	2.25%	1.30%	0.60%	Nov-10	-3.13%	-3.85%	0.58%
Dec-07	10.96%	9.96%	0.60%	Dec-10	1.58%	3.34%	0.58%
Jan-08	-16.66%	-18.78%	0.57%	Jan-11	-9.53%	-10.45%	0.58%
Feb-08	-1.61%	0.27%	0.59%	Feb-11	-4.86%	-4.01%	0.58%
Mar-08	-12.16%	-12.27%	0.59%	Mar-11	7.54%	8.93%	0.58%

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