Sharekhan's top equity fund picks

The global financial crisis assumed unprecedented proportions over the last few weeks. Governments across the world had to intervene and bail out many large and leading financial institutions, and the entire financial system was on the brink of collapse in the USA and Europe. Not surprisingly, the equity markets globally have turned extremely edgy. The ruthless carnage has taken our markets to the 10,000 levels—that's a correction of over 50% from the highs of 21,000 in January 2008. Clearly, these are difficult times and equity markets are truly sailing in uncharted waters.

In the past few weeks, all the major stand-alone US investment banks have either fallen (Lehman Brothers Holdings), sold out (Merrill Lynch) or turned themselves into old-fashioned retail banks (Goldman Sachs and Morgan Stanley), thereby bringing to an end the era of stand-alone investment banking institutions in the USA. The US Federal Reserve (Fed) has had to bail out mortgage giants Fannie Mae and Freddie Mac as well as the nation's largest insurer, American International Group. Commercial banks like Washington Mutual Inc and Wachovia have also fallen pray to the contagion, which has spread to the other sections of the financial sector. The ripples of the crisis are beginning to show up in the other global economies too. In Europe, several financial institutions had to be bailed out and required fresh infusion of capital. Halifax Bank of Scotland, Bradford & Bingley Plc, Fortis, Dexia SA...the list goes on.

In light of all these events, the probability of a global recession has increased, which has forced regulators worldwide to roll out unprecedented measures to check further deterioration in the situation. In the USA, the US Congress has approved the US government's $700-billion bail-out package whereas the German government has unveiled a •500-billion rescue package for banks. The UK government is infusing $80 million as fresh equity capital into its major banks. Apart from this, there are other initiatives such as extending guarantee on bank deposits and/or debt taken by banks. However, some of the smaller European countries do not have the required resources to extend the helping hand to their banks, resulting in virtual bankruptcy of Iceland.

The fears of the contagion spreading to the Indian banking space, which is already reeling under tight liquidity conditions, led the Reserve Bank of India (RBI) to lower the cash reserve ratio by 250 basis points to 6.5%. This has released over Rs100,000 crore into the banking system. In addition, the RBI has taken steps to help mutual funds meet their redemption obligations, increase capital inflows on raising deposit rates on NRI accounts etc.

On the positive side, the dip in the prices of crude oil below $75 per barrel, the collapse of the commodity rally would ease the pressure on the ballooning current account deficit. Further, domestic inflation has declined well below the 12% levels and the central bank is clearly showing the change in its preference to "avoiding slowdown in growth" from an "anti-inflation" stance taken earlier. The continued downturn in the commodities market would remain the key to the RBI's target of reducing inflation to 7% by the end of FY2009. The tighter liquidity conditions along with cooling off in growth of key monitorables (M3, credit, deposit) builds up a case for earlier reversal in interest rate cycle than previously expected.

The Indian markets have been battered by the rising risk aversion globally that has resulted in capital flight from emerging markets including India. The foreign institution investors (FIIs) have been net sellers to the tune of over $10 billion in 2008. Apart from the global mayhem, some negative data points have emerged in the Indian economy. The shocking industrial output growth of 1.3% announced for August 2008 added to the weakness in sentiments. Owing to the relentless selling in the stock market and the heavy demand for dollars from the oil refiners and importers, the rupee too has plunged to a five-year low of ~Rs49 against the dollar, further adding to the concerns of global investors.

Given the situation, the Indian equity market could remain jittery in the days ahead resulting in high volatility. Apart from the global cues, the stock-specific movements would be influenced by the second quarter results. The growth expectations are relatively modest with estimates of around a 10% growth in the Sensex' earnings (ex-oil) in Q2FY2009. Another factor to watch out for is the review of the RBI's credit policy by its new chief at the end of the month. Another rate cut could boost market sentiments as could the announcement of financial sector reforms in the monsoon session of the Parliament slated to reconvene from October 17. On the global front, investors would be keenly watching the impact of the recent coordinated efforts taken by central banks across the world to infuse liquidity and unfreeze the credit markets.

We have identified the best equity-oriented schemes available in the market today based on the following three parameters: the past performance as indicated by the one and two year returns, the Sharpe ratio and Fama (net selectivity).

The past performance is measured by the one- and -two year returns generated by the scheme. Sharpe indicates risk-adjusted returns, giving the returns earned in excess of the risk-free rate for each unit of the risk taken. The Sharpe ratio is also indicative of the consistency of the returns as it takes into account the volatility in the returns as measured by the standard deviation.

FAMA measures the returns generated through selectivity, ie the returns generated because of the fund manager's ability to pick the right stocks. A higher value of net selectivity is always preferred as it reflects the stock picking ability of the fund manager.

We have selected the top 10 schemes upon ranking on each of the above four parameters and then calculated the mean value of each of the four parameters for the top 10 schemes. Thereafter, we have calculated the percentage underperformance or over performance of each scheme (relative performance) in each of the four parameters vis a vis their respective mean values.

For our final selection of schemes, we have generated a total score for each scheme giving 30% weightage each to the relative performance as indicated by the one and two year returns, 30% weightage to the relative performance as indicated by the Sharpe ratio and the remaining 10% to the relative performance as indicated by the FAMA of the scheme.

All the returns stated on next page, for less than one year are absolute and for more than one year, the returns are annualised.

Aggressive Funds

Mid-cap Category

Scheme Name	NAV	Returns as on Sep30, 08 (%)		
		3 Months	1 Year	2 Years
Birla Sun Life Mid Cap	61.42	-6.97	-29.02	2.88
HDFC Capital Builder	63.37	-1.25	-23.57	5.17
IDFC Premier Equity	16.73	-7.66	-14.88	21.43
Reliance Growth	281.06	-6.85	-19.06	9.38
Indices				
BSE Sensex	12860.43	-4.47	-25.44	1.61

Opportunities category

Scheme Name	NAV	Returns as on Sep30, 08 (%)		
		3 Months	1 Year	2 Years
DWS Investment Opportunity	26.73	-8.43	-18.25	12.86
Fidelity Equity	20.49	-2.08	-23.97	5.64
ICICI Prudential Dynamic Plan	63.29	-2.23	-18.13	6.46
IDFC Imperial Equity	12.93	0.45	-14.63	8.27
Kotak Opportunities	29.81	-7.69	-20.97	8.12
Indices				
BSE Sensex	12860.43	-4.47	-25.44	1.61

Equity diversified/conservative funds

Scheme Name	NAV	Returns as on Sep30, 08 (%)		
		3 Months	1 Year	2 Years
Birla Sun Life Frontline Eq	51.70	-2.23	-21.11	7.31
DSP Merrill Lynch Top 100 Eq	63.14	-1.12	-15.62	11.59
DWS Alpha Equity	55.49	-4.18	-16.90	8.66
Franklin India Prima Plus	139.72	1.90	-21.03	8.12
HDFC Growth	54.54	1.99	-14.43	12.00
HDFC Top 200	118.75	2.89	-15.36	8.49
HSBC Equity	74.45	-6.92	-16.18	8.67
Kotak 30	72.69	-2.01	-17.04	9.02
Sundaram BNP Paribas Select Focus	65.33	-5.29	-18.44	10.82
Indices				
BSE Sensex	12860.43	-4.47	-25.44	1.61

Thematic/Emerging trend funds

Scheme Name	NAV	Returns as on Sep30, 08 (%)		
		3 Months	1 Year	2 Years
DSP Merrill Lynch India Tiger	31.96	-4.31	-30.10	6.33
ICICI Prudential Infra	22.17	-0.45	-13.90	16.97
SBI Magnum COMMA	16.53	-10.02	-24.31	6.83
Tata Equity P/E	27.21	-9.00	-23.74	9.48
Tata Infrastructure	25.09	-6.49	-23.64	9.96
Templeton India Eq income	12.06	-14.14	-22.41	6.86
Templeton India Growth	68.16	-11.53	-21.35	6.29
UTI Dividend Yield	17.49	-0.91	-15.31	7.60
Indices				
BSE Sensex	12860.43	-4.47	-25.44	1.61

Balanced funds

Scheme Name	NAV	Returns as on Sep30, 08 (%)		
		3 Months	1 Year	2 Years
DSP Merrill Lynch Balanced	42.36	-2.18	-11.89	9.67
FT India Balanced	33.89	0.96	-16.74	6.44
Sundaram BNP Paribas Balanced	32.82	-1.26	-18.08	5.10
Tata Balanced	49.99	-4.00	-19.91	6.18
Indices				
Crisil Balanced Fund Index	2530.12	-1.11	-12.45	5.28

Tax planning funds

Scheme Name	NAV	Returns as on Sep30, 08 (%)		
		3 Months	1 Year	2 Years
Fidelity Tax Advantage	12.41	-2.08	-22.54	5.63
Principal Personal Taxsaver	68.23	-8.45	-29.17	9.41
Sundaram BNP Paribas Taxsaver	28.96	-3.30	-17.45	10.11
Indices				
BSE Sensex	12860.43	-4.47	-25.44	1.61

Risk-return analysis

The charts on the following pages give you a snapshot of how the mutual funds have performed on the risk-return parameters in the past. We have used the bubble analysis method to measure their performances on three parameters viz risk, return and fund size. The risk is measured by standard deviation, which measures the average deviation of the returns generated by a scheme from its mean returns. We have tried to explain the same with the help of a diagram, which is divided into four quadrants, with each quadrant containing funds of a particular risk-return profile. The size of the bubble indicates the size of the fund.

The funds in the **high-risk high returns** quadrant follow a very aggressive approach and deliver high absolute returns compared to its peers albeit at a higher risk.

The funds in the **low-risk high returns** quadrant outperform the peer group on the risk-adjusted returns basis as they deliver higher returns compared to its peers without exposing the portfolio to very high risk.

The funds in the **low-risk low returns** quadrant are not very aggressive and provide lower absolute returns, taking lower risks.

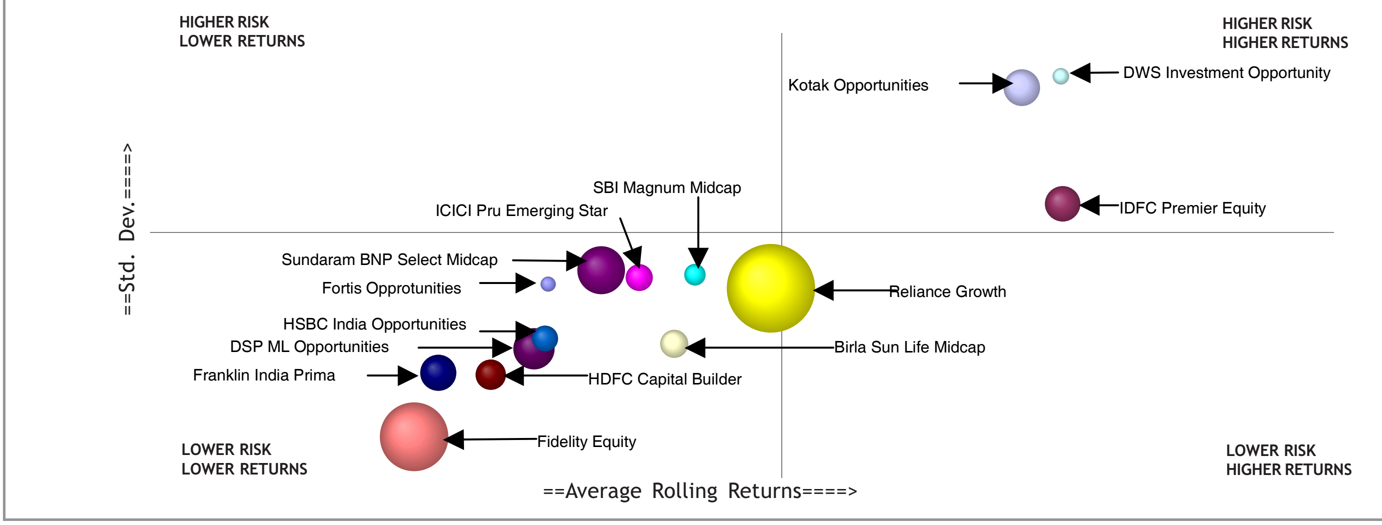
The funds in the **high-risk low returns** quadrant underperform the peers on the risk adjusted returns basis as they adopt a high-risk strategy but the returns fail to compensate the risk taken by the fund.

For aggressive, conservative and tax planning funds, risk is measured in terms of two years' volatility while returns are measured as two years' average rolling returns as on September 30, 2008. For thematic and balanced funds, risk is measured in terms of one year's volatility while returns are measured as one year's average rolling returns as on September 30, 2008.

Every individual has a different investment requirement, which depends on his financial goals and risk-taking capacities. We at Sharekhan first understand the individual's investment objectives and risk-taking capacity, and then recommend a suitable portfolio. So, we suggest that you get in touch with our Mutual Fund Advisor before investing in the best funds.

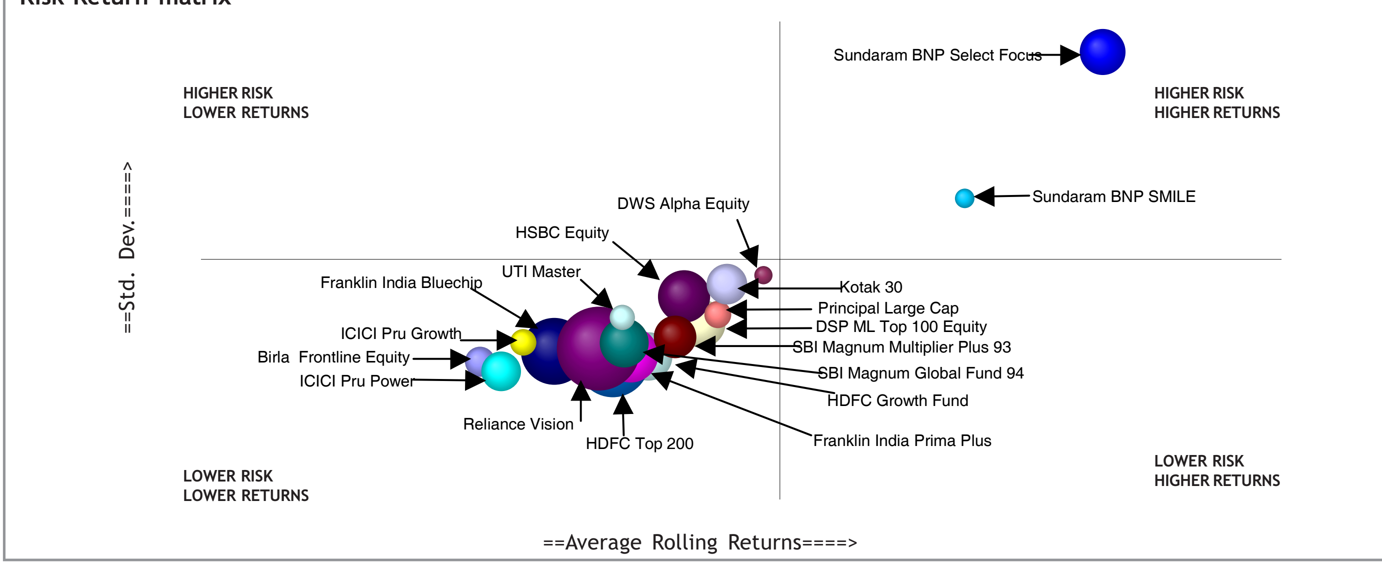
Aggressive Funds

Risk-Return matrix



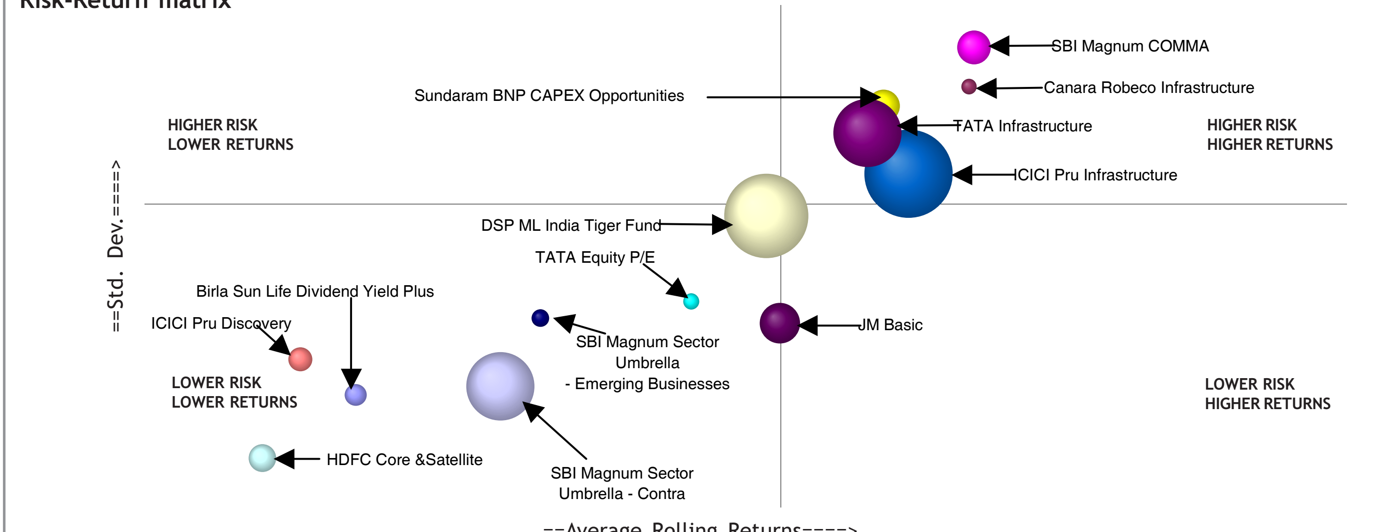
Equity Diversified/Conservative Funds

Risk-Return matrix



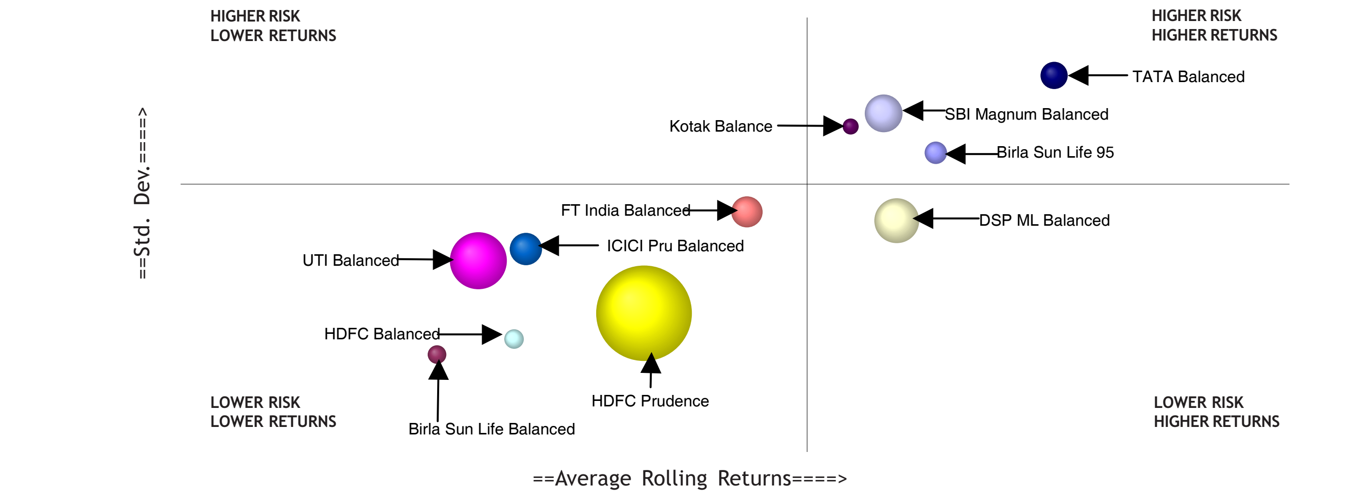
Thematic/Emerging Trend Funds

Risk-Return matrix



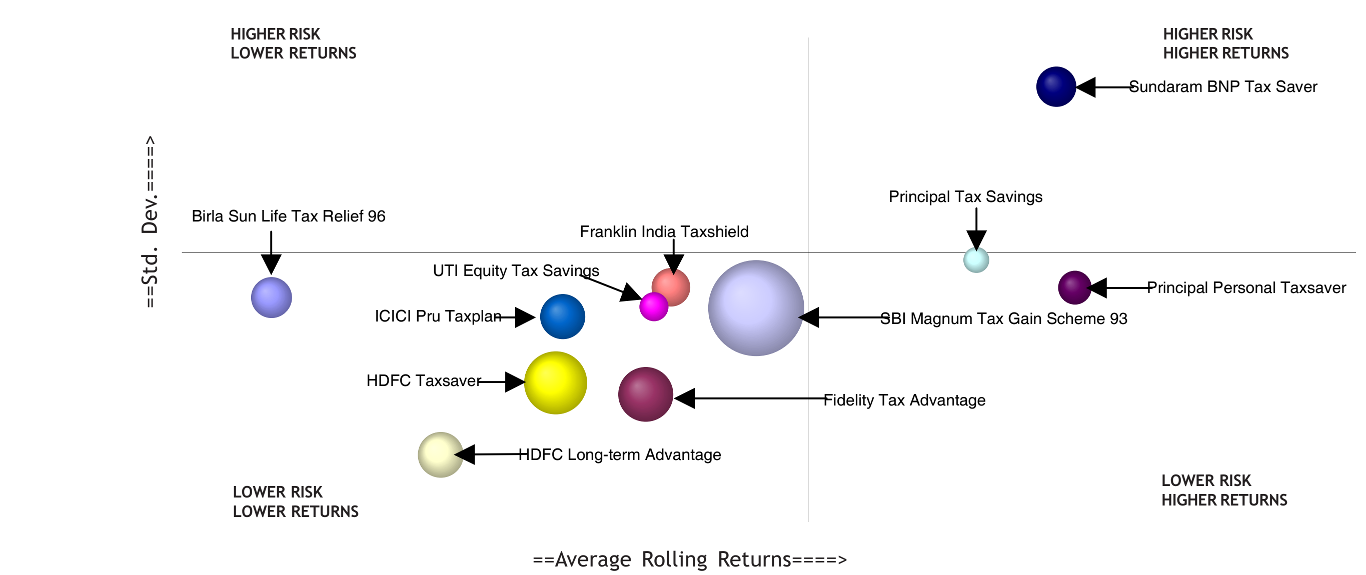
Balanced Funds

Risk-Return matrix



Tax Planning Funds

Risk-Return matrix



Disclaimer: Mutual fund investments are subject to market risk. Please read the offer document carefully before investing. Past performance may or may not be sustained in the future.