mutual gains

Sharekhan's top equity fund picks

Even though the market has recovered some of the lost ground in the past few trading sessions, it yet lacks a clear direction and is characterised by intense volatility. In addition to the global uncertainties the market now has to deal with certain local risks as well. Till yesterday, every time the market stumbled and fell on global concerns, such as the possibility of recession in the USA, higher crude prices or unwinding of yen carry trades, it was the promise of India's long-term growth story that helped it get back on its feet. However, with the recent volatility, investors are questioning the basic fundamentals of India's growth story. Foreign investors, the main drivers of the market so far, were net sellers to the tune of Rs1,082 crore in March, while the domestic mutual funds were buyers to the extent of Rs5.8 crore.

Inflation has raised its ugly head again. After stubbornly remaining well above 6% for four weeks in a row it has relented and dropped to 5.7% levels. This inflation is driven by supply-side constraints and abundance of liquidity. The government is trying its best to increase the supply of the items that are driving inflation, viz food articles like wheat and pulses. It has also taken some forced measures as in the case of cement. Notwithstanding its unsuccessful attempts to tame inflation, the government is likely to attempt some more, drastic, measures to curb inflation.

Alongside the Reserve Bank of India (RBI) has been using every conventional trick in its bag to control money supply, which has been growing at a healthy rate of 22%. The RBI has raised the repo rate six times since January 2006 and increased the cash reserve ratio (CRR) three times in the past three months. Most of these measures have been unscheduled and hence have caught the market on the wrong foot. We feel the aggressive stance of the RBI is likely to continue for some more time due to political exigencies. The central bank is slated to announce its annual monetary policy statement for FY2008 on April 24 and another rate hike could be in the offing.

As a result of the CRR hike, liquidity conditions are expected to tighten further, resulting in higher deposit and lending rates. The rising interest rates can make retail credit and, in the process, working capital finance that much costlier. The hardening of interest rates has already begun to hurt rate-sensitive sectors like housing and automobiles.

The rupee too may grow stronger because of the persisting liquidity crunch. The local currency has already appreciated by 9.5% in the past eight months, it touched its eight-year high at 42.925/935 against the dollar on April 4, 2007. A rising rupee could be bad news for our export industry. Besides adversely affecting the financial performance of the software companies, the unexpected sharp rise in the rupee is feared to influence their annual growth guidance for FY2008.

In its war against inflation the government may find an ally in the monsoon. It was initially feared that *El Nino* conditions might affect the south-west monsoon in 2007. However the latest NOAA estimate suggests that *El Nino* indicators have visibly weakened in recent weeks, implying that the 2006-07 *El Nino* events have ended. Thus we may have a normal monsoon this year, which may help moderate inflation in the economy.

To add to the market's woes, the spectre of recession still hovers over the world's largest economy, which is currently reeling under a housing slump. The US gross domestic product expanded at an annual rate of 2.5% in the last quarter and at 2% in the previous quarter. But even as the US economy is slowing down, inflation remains at 2.4%, above the US Federal Reserve's (Fed) comfort zone of 1% to 2%. Hence it is still uncertain whether the Fed's next move would be a rate hike or a rate cut.

In the medium term, India Inc's fourth quarter results, the outcome of the state elections, the RBI's monetary policy announcement and the initial monsoon forecast will act as triggers for the market. The early results are likely to be a fair indicator of the shape of things to come with respect to the financial performances of the corporate sector as a whole. Reports of good earnings growth would no doubt boost market sentiment; on the other hand, any lower than expected guidance for FY2008 may dampen mood and result in more volatility.

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

We have identified the best equity-oriented schemes available in the market today based on the following 3 parameters: the past performance as indicated by the returns, the Sharpe ratio and Fama (net selectivity).

The past performance is measured by the 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 3 parameters and then calculated the mean value of each of the 3 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 3 parameters vis a vis their respective mean values.

For our final selection of schemes, we have generated a total score for each scheme giving 50% weightage to the relative performance as indicated by the returns, 25% weightage to the relative performance as indicated by the Sharpe ratio and the remaining 25% to the relative performance as indicated by the FAMA of the scheme.

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

We present below our recommendations in the equity-oriented mutual fund category.

Aggressive Funds

Mid-cap Category

Scheme Name	NAV	Returns as on Mar 31, 07(%)		
		3 Months	1 Year	2 Years
Sundaram BNP Paribas Select Midcap	86.16	-6.92	15.10	52.04
Reliance Growth	259.54	-2.70	14.11	49.25
Prudential ICICI Emerging STAR	26.61	-6.34	7.86	51.72
Kotak Midcap	19.25	-2.22	-1.63	38.85
Birla Mid Cap	60.03	-6.80	7.25	37.22
HDFC Capital Builder	60.30	-4.54	1.35	30.85
Indices				
BSE Sensex	13072.10	-5.18	15.61	43.12

Opportunities category

Scheme Name	NAV	Returns as on Mar 31, 07(%)		
		3 Months	1 Year	2 Years
Prudential ICICI Dynamic Plan	63.02	-4.24	18.75	54.51
Reliance Equity Opportunities	20.35	-6.20	11.51	43.15
Franklin India Opportunity	24.10	-8.75	14.65	49.52
ING Vysya Domestic Opportunities	25.99	-5.04	11.74	42.49
HSBC India Opportunities	26.74	-8.95	17.57	44.52
Birla India Opportunities	50.06	-4.10	11.89	36.19
Indices				
BSE Sensex	13072.10	-5.18	15.61	43.12

Equity diversified/conservative funds

Scheme Name	NAV	Returns as on Mar 31, 07(%)		
		3 Months	1 Year	2 Years
SBI Magnum Global Fund 94	41.21	-6.93	17.76	55.93
SBI Magnum Multiplier Plus 93	50.68	-6.20	10.38	53.68
HDFC Equity Fund	142.60	-1.91	12.24	47.69
Birla SunLife Frontline Equity	49.42	-1.42	22.94	45.42
Birla SunLife Equity	174.25	-3.58	13.06	48.95
Prudential ICICI Power	77.49	-5.12	12.63	47.33
Franklin India Prima Plus	132.81	-3.43	18.03	46.31
DSP ML Top 100 Equity	55.21	-3.61	14.93	45.16
DSP ML Equity	37.38	-4.81	13.27	45.71
Indices				
BSE Sensex	13072.10	-5.18	15.61	43.12

Thematic/emerging trend funds

Scheme Name	NAV	Returns as on Mar 31, 07(%)		
		3 Months	1 Year	2 Years
Prudential ICICI Service Industries	14.96	-3.11	27.43	--
Prudential ICICI Infrastructure	17.65	-4.59	19.82	--
Kotak Lifestyle	11.64	1.85	13.17	--
DSP ML India Tiger	31.54	-3.76	16.17	52.45
Birla India GenNext	15.54	1.30	12.12	--
SBI Magnum Sector Umbrella	35.55	-5.20	12.39	50.91
Tata Infrastructure	22.02	-8.27	10.58	44.88
Indices				
BSE Sensex	13072.10	-5.18	15.61	43.12

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.

Balanced funds

Scheme Name	NAV	Returns as on Mar 31, 07(%)		
		3 Months	1 Year	2 Years
HDFC Prudence	110.13	-3.19	15.82	37.33
FT India Balanced	32.12	-1.57	15.26	30.48
Franklin India Balanced	34.69	-1.59	15.24	30.47
Birla SunLife 95	172.56	-0.84	12.42	32.04
JM Balanced	22.18	-4.81	11.57	32.31
Prudential ICICI Balanced	33.56	-3.09	10.00	31.12
Birla Balance	27.33	-2.25	10.11	25.40
Indices				
Crisil Balanced Fund Index	2377.77	-2.41	10.37	23.83

Tax planning funds

Scheme Name	NAV	Returns as on Mar 31, 07(%)		
		3 Months	1 Year	2 Years
SBI Magnum Tax Gain Scheme 93	42.42	-4.07	17.20	55.45
Birla SunLife Tax Relief 96	87.96	-4.29	11.64	42.71
HDFC Taxsaver	133.88	-8.62	3.55	41.70
PRINCIPAL Tax Savings	72.75	-4.13	8.25	42.45
Sundaram BNP Paribas Taxsaver	26.16	-6.05	5.41	41.65
Principal Personal Taxsaver	122.34	-2.86	8.21	34.15
Indices				
BSE Sensex	13072.10	-5.18	15.61	43.12

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.

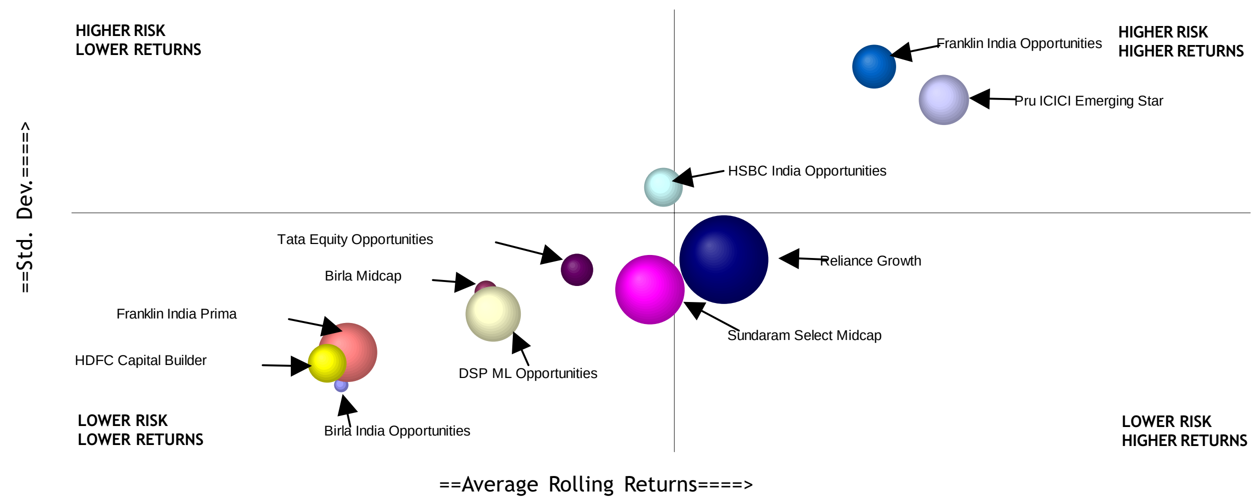
The funds in the **low-risk low returns** quadrant are not very aggressive and provide lower absolute returns, taking lower risks.

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 March 31, 2007. 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 March 31, 2007.

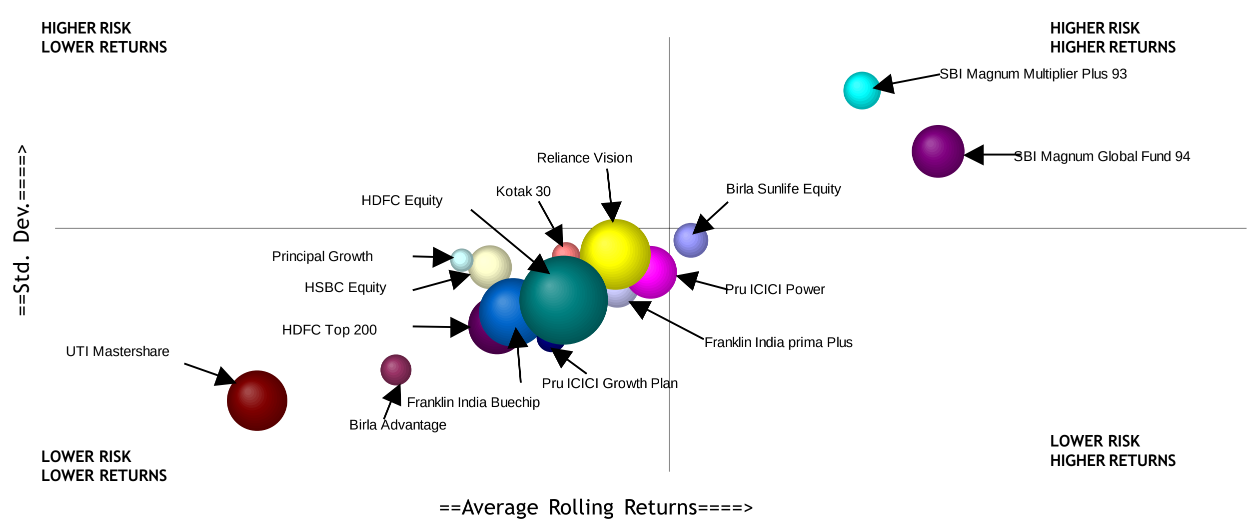
Aggressive Funds

Risk-Return matrix



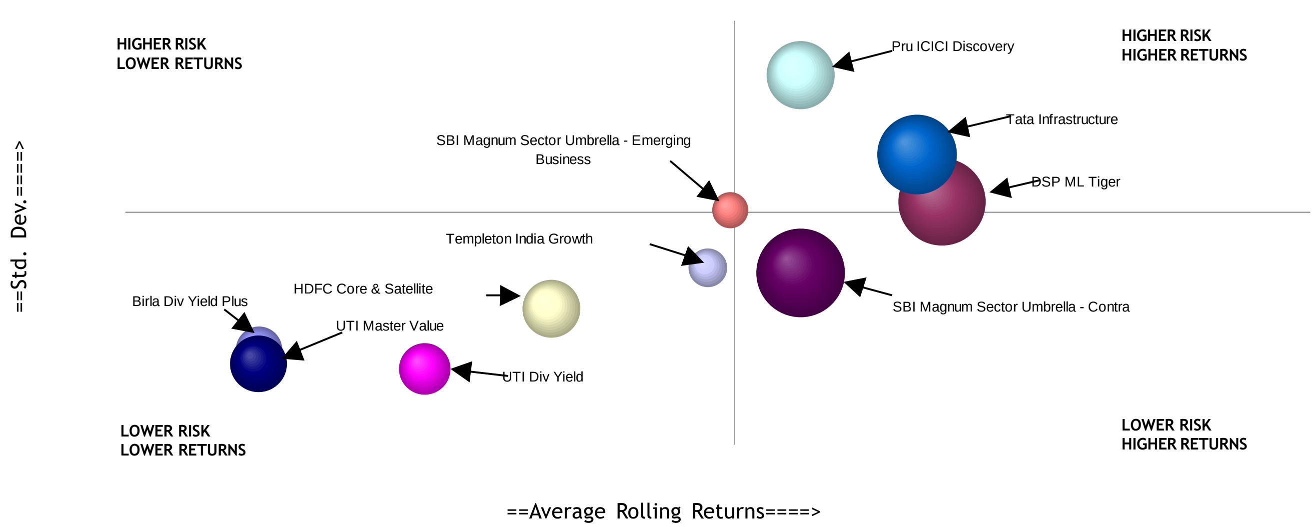
Equity Diversified/Conservative Funds

Risk-Return matrix

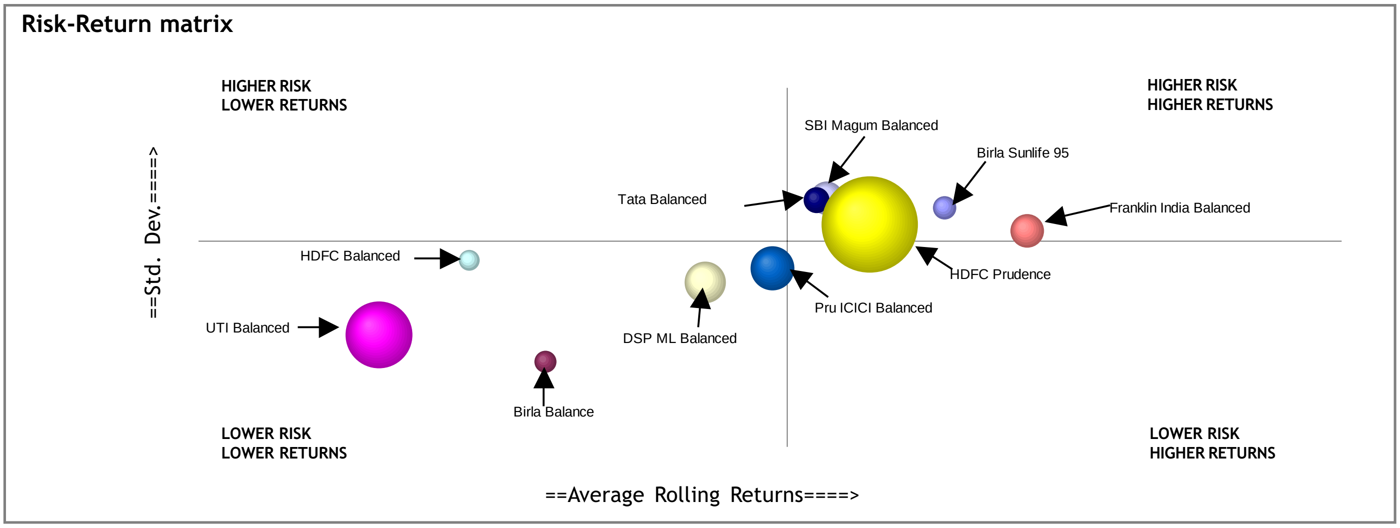


Thematic/Emerging Trend Funds

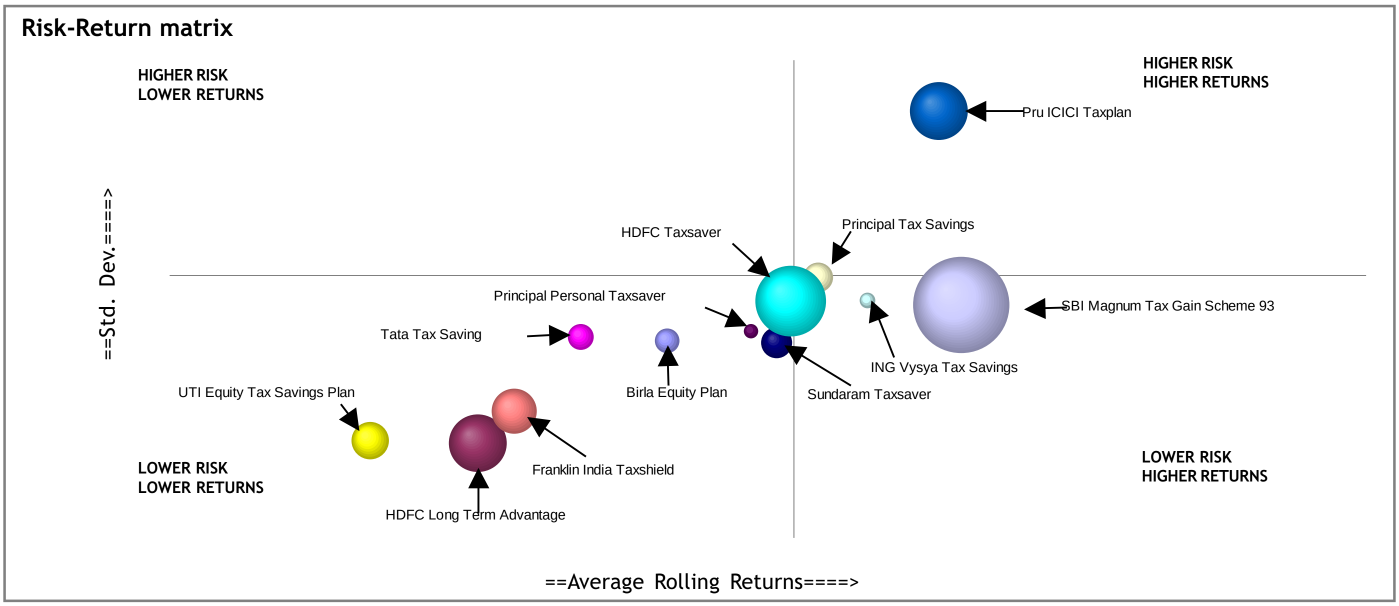
Risk-Return matrix



Balanced Funds



Tax Planning Funds



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.

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