Sharekhan's top equity fund picks

The market maintained its upward momentum in January 2007. Fuelled by strong corporate results along with sustained buying by foreign institutional investors (FIIs), the Sensex and the Nifty both posted gains of around 2.5% during the month. More importantly, January has been a milestone month, with the Sensex having comfortably vaulted over the 14,000 mark. Even its rival index, the Nifty, seems to have successfully crossed the 4,000 level, after exhibiting considerable volatility in the early part of the month.

The long-term outlook for the Indian economy continues to remain bright. The Central Statistical Organisation (CSO) revised the country's economic growth rate for FY2006 to 9% from 8.5% projected earlier. The government too has just released its first official growth estimate for FY2007 and the same stands at 9.2%! Futuristically, if the sustained double-digit growth in every other key economic indicator is any indication, the economy is poised to move on to an even higher growth plane. Growth in almost all the key economic indicators has accelerated in recent months. Even industrial production, an important component of the gross domestic product (GDP), has moved onto the double-digit growth zone fuelled by the growth in the capacities of Indian companies in the past few years. The growth rate of the Index of Industrial Production (IIP) has shifted from 7% in FY2003 to double digits in this fiscal. The index grew by 10.6% during the April-November 2006 period vs 8.3% in the corresponding period of FY2006.

The buoyancy in the economy is translating into growth for the corporate sector, whose earnings have been growing at over 20% for the past couple of quarters. Also, the earnings are growing in spite of rising input costs and hardening interest rates. India Inc reported absolutely stellar numbers for the third quarter of FY2007, beating all expectations. Surpassing market expectations of a strong 26% growth, the earnings of the Sensex companies grew by a handsome 40% year on year. The brilliant performance of Q3FY2007 has resulted in a 1-2% upgrade in the earnings estimates of the Sensex companies for FY2007 and FY2008. The earnings of the Sensex blue chips excluding Reliance Communications are now expected to grow by 27.8% in FY2007 and by 14.6% in FY2008. Going forward also, the high growth rate in corporate earnings is expected to sustain on the back of the ongoing capex drive and the surging internal consumption.

The government's fiscal position too has progressively improved of late. The government's net tax collections rose by 37.6% for the April-December 2006 period, which resulted in a 28.8% growth in its total receipts. The higher receipts combined with a comparatively lower total expenditure, which grew by only 15.4%, helped bring down the fiscal deficit by 12.4% to Rs94,854 crore during the nine-month period. The surging tax revenues and the strong 9.1% GDP growth in H1FY2007 are expected to help the government reduce the fiscal deficit below the targeted 3.8% of the GDP in FY2007. Also, considering the buoyant tax collections and lower expenditure, we do not expect any significant tax measures in the forthcoming Union Budget for 2007-08 and expect the budget to be positive.

On the flip side, the rising inflation continues to give us sleepless nights. It has crossed 6% recently owing to a rise in the prices of primary food articles. To keep inflation within its targeted range of 5.0-5.5% the central bank, in its January review of the credit policy, has hiked the repo rate by another 25 basis points to 7.5%. The government has also reduced customs and import duties on several items. We feel that the recent policy measures, the softening crude prices, the impending better than expected *rabi* harvest and a large-scale import of food grains will moderate inflation in the days to come.

Crude and the US economy, the other two concerns of last year, are however expected to remain benign this year. Crude oil has fallen to levels below $60 per barrel and the probability that current levels would be maintained is high. There is more clarity regarding the US economy too. Driven by consumer spending, the economy grew by 3.5% in the fourth quarter, up from 2% in the third quarter. Moreover, recent data has suggested some signs of stabilisation in the housing market. The core inflation continues to be moderate. The US Federal Reserve has left the interest rates unchanged in its January 31 meeting, for the fifth time in a row after raising them 17 times at a measured pace from 2.5% in June 2004 to June 2006.

Net-net, the climate continues to remain conducive to investment in the stock market. If anything it may get more pleasant in the long term. In the short term, the market may take its cue from the Union Budget announcements due at the end of the month. In the long term, the favourable global cues, along with the growing corporate earnings, would continue to drive the market.

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).

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.

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.

For our selection of funds, we have given 50% weightage to the past performance as indicated by the returns, 25% weightage to the Sharpe ratio of the fund and the remaining 25% to the FAMA of the fund.

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 Jan 31, 07(%)		
		3 Months	1 Year	2 Years
Sundaram BNP Paribas Select Midcap	94.48	8.61	51.25	61.69
Prudential ICICI Emerging STAR	29.92	18.17	37.50	61.72
Reliance Growth	276.61	11.38	36.31	57.24
Birla Mid Cap	66.80	8.79	32.07	47.29
Franklin India Prima	216.32	10.25	20.06	40.93
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

Opportunities category

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
Prudential ICICI Dynamic Plan	67.80	14.58	52.31	63.33
DSP ML Opportunities	56.48	8.84	35.02	47.95
ING Vysya Domestic Opportunities Fund	27.69	8.67	34.42	46.57
Kotak Opportunities	29.35	10.85	33.29	51.92
Franklin India Opportunity	26.97	10.85	50.59	55.04
HSBC India Opportunities	29.34	13.17	43.92	48.67
Tata Equity Opportunities	59.55	10.83	30.21	46.72
Birla India Opportunities	54.19	11.78	31.98	40.38
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

Equity diversified/conservative funds

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
SBI Magnum Global Fund 94	45.82	17.16	49.45	71.38
SBI Magnum Multiplier Plus 93	55.19	13.91	39.58	62.38
HDFC Equity	151.39	8.58	33.90	53.97
Franklin India Prima Plus	142.93	12.11	45.02	52.98
Birla SunLife Equity	186.87	12.34	38.44	53.28
Prudential ICICI Power	83.32	9.32	39.47	51.73
Prudential ICICI Growth Plan	94.95	7.30	34.83	49.36
Sundaram BNP Paribas Select Focus	61.63	9.46	40.57	49.04
SBI Magnum Equity	28.53	12.28	46.39	50.80
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

Thematic/emerging trend funds

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
Prudential ICICI Infrastructure	19.19	12.62	50.39	--
Prudential ICICI Service Industries	15.94	21.31	47.32	--
Tata Infrastructure	24.24	10.61	44.35	55.15
DSP ML India Tiger	34.10	14.43	44.36	56.91
SBI Magnum Sector Umbrella - Contra	38.78	10.45	43.21	63.59
Sundaram BNP Paribas CAPEX Opportunities	17.90	11.97	41.71	--
Kotak Global India	27.23	12.27	26.95	42.01
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

Balanced funds

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
HDFC Prudence	117.00	9.56	33.22	43.59
FT India Balanced	33.51	6.91	31.00	34.15
DSP ML Balanced	39.09	7.00	28.15	33.57
SBI Magnum Balanced	36.15	8.95	29.25	42.27
Birla SunLife 95	179.78	5.80	28.95	33.34
Tata Balanced	50.55	9.27	29.12	34.86
Prudential ICICI Balanced	35.63	8.50	24.97	36.87
Indices				
Crisil Balanced Index	2482.27	5.77	23.21	25.63

Tax planning funds

Scheme Name	NAV	Returns as on Jan 31, 07(%)		
		3 Months	1 Year	2 Years
PRINCIPAL Tax Savings	79.69	15.21	39.40	49.62
SBI Magnum Tax Gain Scheme 93	57.87	15.44	42.95	71.42
HDFC Taxsaver	146.13	4.46	25.37	51.80
Sundaram BNP Paribas Taxsaver	28.57	13.02	24.32	46.13
Birla SunLife Tax Relief 96	150.37	8.96	37.70	43.37
HDFC Long Term Advantage Fund	95.22	8.07	21.88	42.46
Franklin India Taxshield	130.01	5.75	22.28	40.91
Prudential ICICI Taxplan	93.75	2.76	22.92	45.87
Indices				
BSE Sensex	14090.92	8.71	42.05	46.61

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.

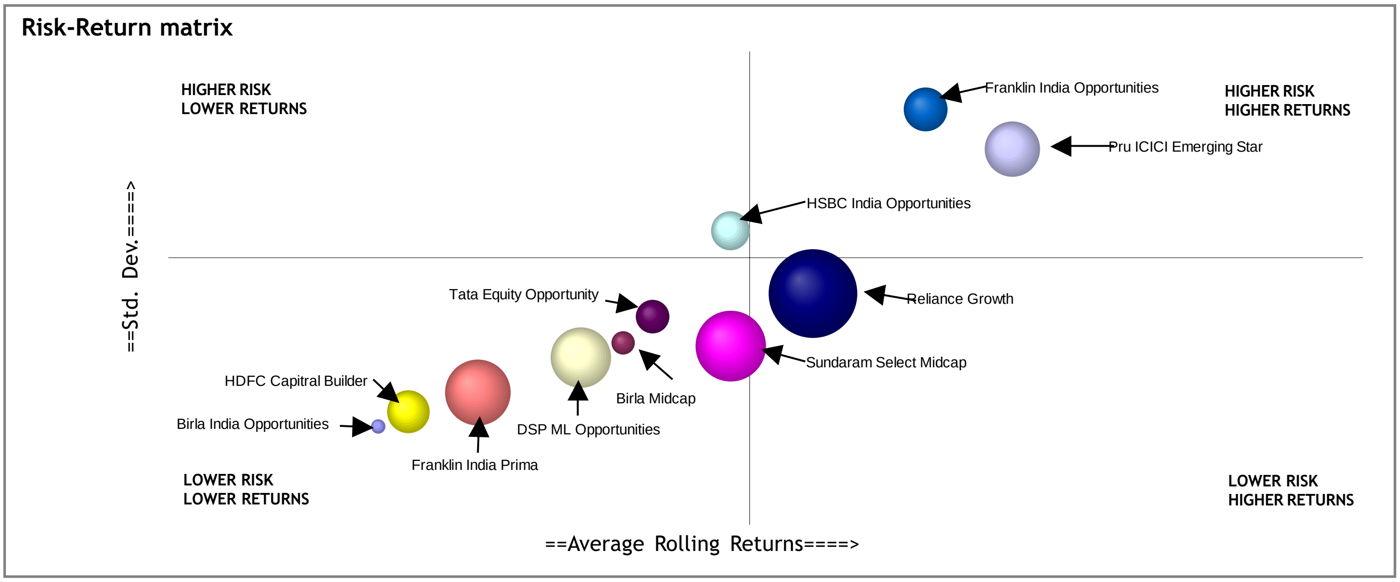
The funds in the **low-risk low returns** quadrant are not very aggressive and provide lower absolute returns, taking lower risks.

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.

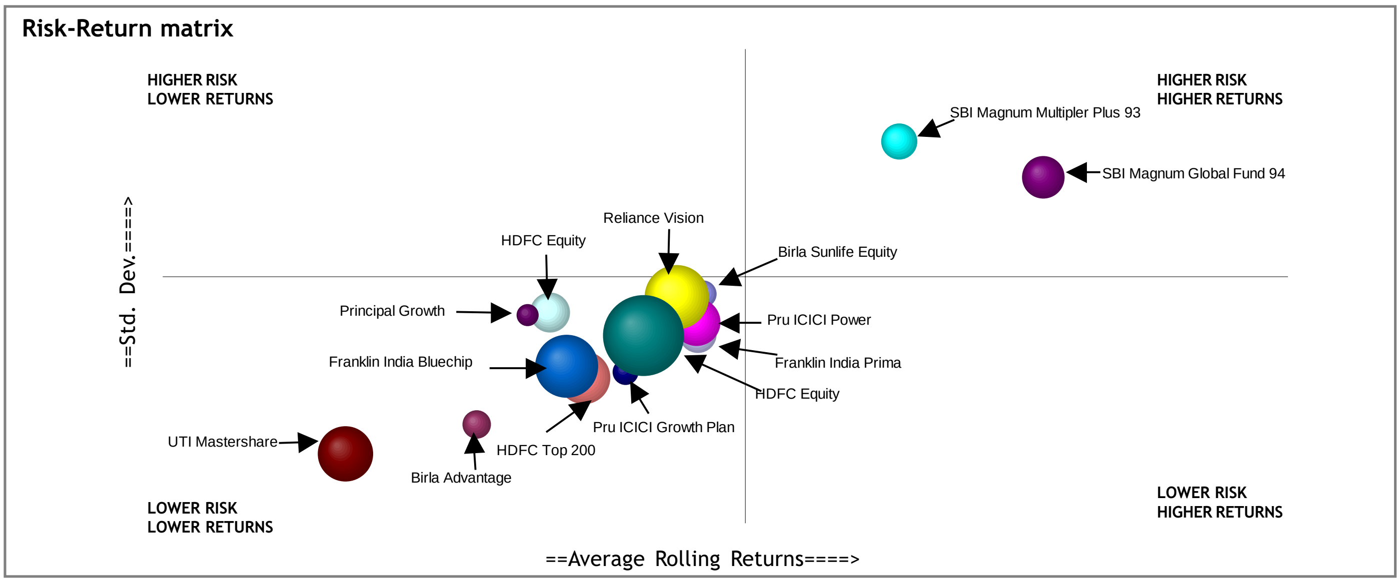
For aggressive, conservative and tax planning funds, risk is measured in terms of two years' volatility while returns are measured as two years' average rolling returns as on January 31, 2007. For thematic and balanced funds, risk is measured in terms of one year's volatility while returns are measured as one year's average rolling returns as on January 31, 2007.

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.

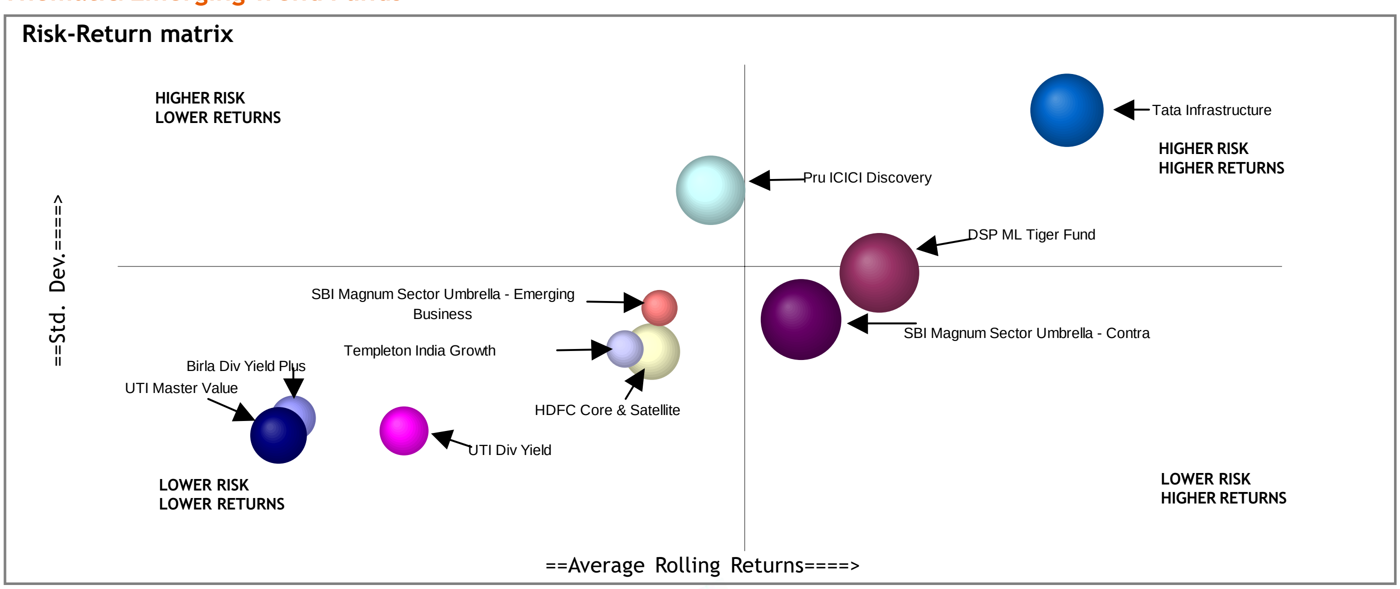
Aggressive Funds



Equity Diversified/Conservative Funds

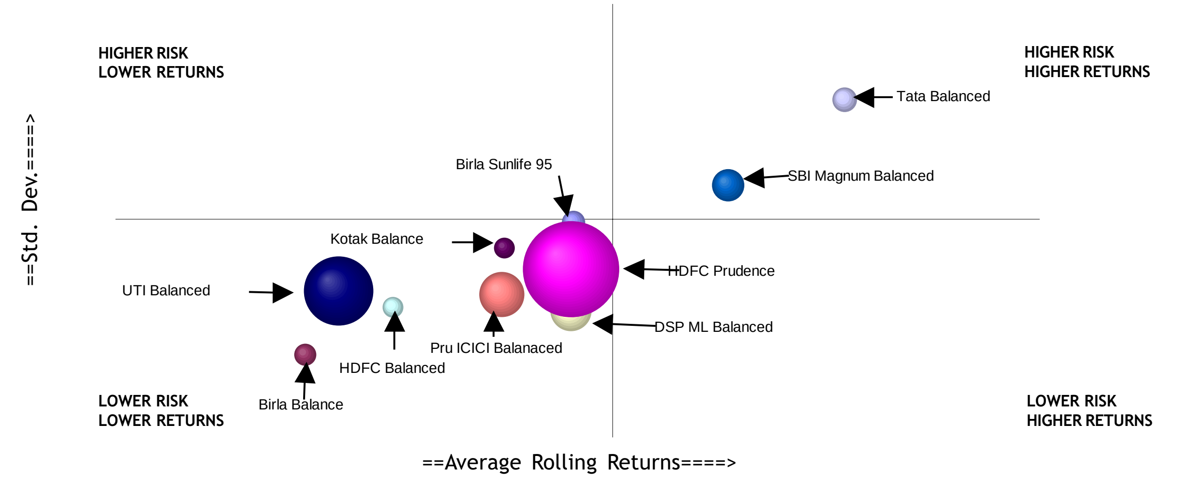


Thematic/Emerging Trend Funds



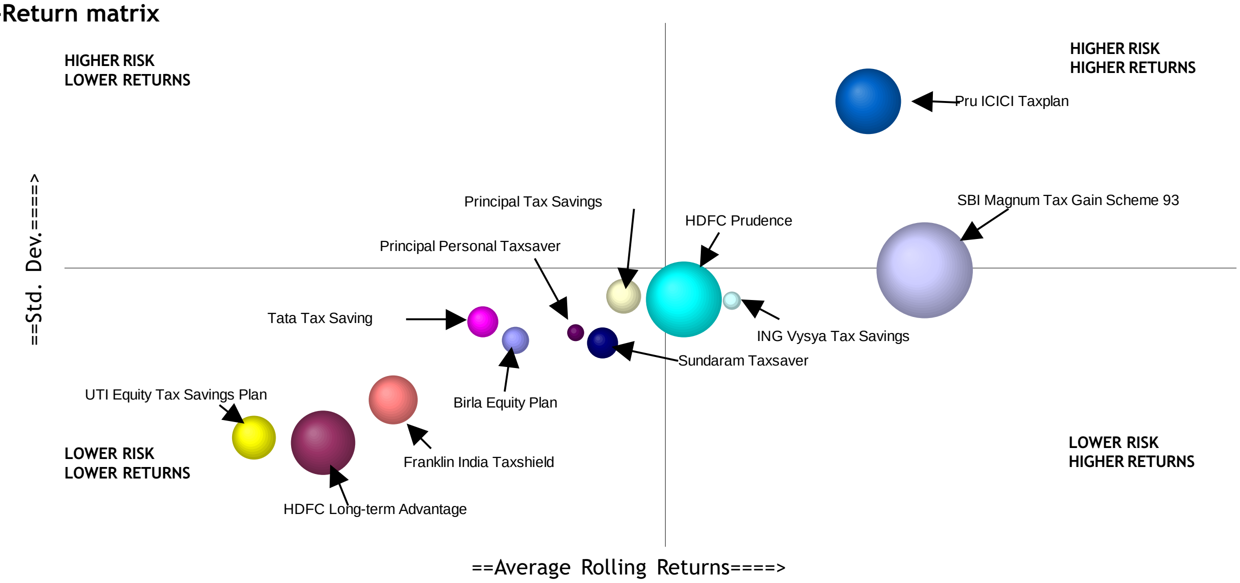
Balanced Funds

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.