



Sharekhan's top equity fund picks

The year 2006 was the fifth consecutive year of positive returns for the Indian capital markets. While the Sensex moved in a wide range of 8,900-14,000, it rose 47% during the year to close at 13,787.

The Indian capital markets have been attracting strong inflows from both the foreign and local investors. Despite the market's not so cheap valuations, as many as 170 new FII registered with the SEBI in 2006, taking the total number of registered FIIs to more than 1,000. FIIs have invested funds to the tune of \$7.9 billion into the Indian equity markets in 2006. The domestic mutual funds too have made significant contributions to the market rally, having made investments to the tune of \$3.4 billion into the equity markets in 2006, as compared with \$3 billion in 2005. What's more, brimming with the funds mobilised from the recent new fund offerings, the domestic mutual funds are also sitting on a war chest of over Rs12,000 crore and would continue to provide stability to the market.

The long-term outlook for the Indian economy continues to remain bright. The gross domestic product (GDP) grew by an impressive 9.1% in H1FY2007 as compared with 8.5% for H1FY2006. India's corporate sector is a beehive of activity, with every company going on an expansion binge. Flush with funds after quarters of healthy earnings growth, companies are building capacities and aggressively participating in the global merger and acquisition (M&A) wave.

However, the rising inflation rate remains a key risk to the economy. Though it is within the government's targeted range of 5.0-5.5%, the same has risen too high for comfort in the recent times. The inflation rate was 5.43% in the Indian economy for the week ended December 16, 2006 caused by a surge in the prices of food items. The good news is that the seasonal drop in the prices of agricultural produce after the harvest season and the large-scale imports of food grains are expected to moderate inflation in the months to come.

Crude oil prices and the US economy were the two other main worries of the market in 2006 and both these global factors are expected to remain benign in 2007. Expectations of increased supplies and a milder than expected winter in the USA has brought crude prices down below the \$60 per barrel levels. The US economy, on the other hand, is expected to achieve a soft landing. The latest US data, such as consumer confidence, jobs added and retail sales, show that the

economy is growing at a modest rate. The softening crude prices have already contained inflation in the USA, fuelling expectations of a Fed rate cut in mid 2007.

With a strong growth story for India, Inc, a comfortable liquidity situation and favourable global cues, we remain bullish on the market in the long term. For the short-term, a favourable Union Budget and impressive third quarter results of Indian companies may act as strong catalysts in the market's upward rally.

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 December 29, 2006 (%)				
		3 months	6 months	1 year	2 years	3 years
Sundaram BNP Paribas Select Midcap	92.56	11.68	24.95	60.98	61.27	52.19
Prudential ICICI Emerging STAR Fund	28.41	19.17	36.85	40.43	54.50	--
Reliance Growth	266.74	13.60	33.69	41.27	54.43	50.31
Indices						
BSE Sensex	13786.91	10.70	29.95	46.86	44.65	33.20

Opportunities Category

Scheme Name	NAV	Returns as on December 29, 2006 (%)				
		3 months	6 months	1 year	2 years	3 years
Prudential ICICI Dynamic Plan	65.81	17.89	38.90	58.51	58.61	42.71
DSP ML Opportunities Fund	56.23	13.74	30.50	44.11	47.05	41.21
Kotak Opportunities Fund	28.37	11.28	25.43	38.83	48.54	--
Indices						
BSE Sensex	13786.91	10.70	29.95	46.86	44.65	33.20

Equity Diversified/Conservative Funds

Scheme Name	NAV	Returns as on December 29, 2006 (%)				
		3 months	6 months	1 year	2 years	3 years
SBI Magnum Global Fund 94	44.28	21.82	43.21	56.83	67.22	67.60
SBI Magnum Multiplier Plus 93	54.03	16.80	36.03	50.00	59.89	49.67
HDFC Equity Fund	145.39	8.65	27.73	35.98	48.84	41.31
DSP ML Equity Fund	46.03	15.24	34.22	47.25	50.15	43.10
Birla SunLife Equity Fund	180.72	14.06	38.34	42.98	48.62	47.05
Indices						
BSE Sensex	13786.91	10.70	29.95	46.86	44.65	33.20

Thematic/Emerging Trend Funds

Scheme Name	NAV	Returns as on December 29, 2006 (%)				
		3 months	6 months	1 year	2 years	3 years
Prudential ICICI Infrastructure Fund	18.50	14.27	42.97	58.73	--	--
Tata Infrastructure Fund	24.00	15.75	35.74	60.53	--	--
DSP ML Tiger Fund	32.77	15.97	38.34	52.61	53.18	--
Sundaram BNP Paribas CAPEX Opportunities	17.42	16.85	35.51	56.34	--	--
SBI Magnum Sector Umbrella - Contra	37.50	12.17	29.35	50.65	60.58	61.81
Indices						
BSE Sensex	13786.91	10.70	29.95	46.86	44.65	33.20

Balanced Funds

Scheme Name	NAV	Returns as on December 29, 2006 (%)				
		3 months	6 months	1 year	2 years	3 years
Tata Balanced Fund	49.33	11.28	22.64	35.06	33.21	28.24
Kotak Balance	23.59	7.25	15.21	30.54	36.78	32.65
Franklin India Balanced Fund	35.25	9.13	26.30	32.97	31.68	26.03
FT India Balanced Fund	32.64	9.12	26.31	32.93	31.68	25.96
SBI Magnum Balanced Fund	35.37	10.98	22.94	34.03	40.74	38.53
Indices						
BSE Sensex	13786.91	10.70	29.95	46.86	44.65	33.20

Tax Planning Funds

Scheme Name	NAV	Returns as on December 29, 2006 (%)				
		3 months	6 months	1 year	2 years	3 years
SBI Magnum Tax Gain Scheme 93	55.65	17.75	37.04	45.10	68.82	63.62
HDFC Tax saver	146.51	11.26	27.18	34.23	53.31	51.93
HDFC Long Term Advantage Fund	91.72	7.73	23.72	23.07	38.48	41.06
Sundaram BNP Paribas Tax saver	27.85	16.66	32.90	32.07	45.28	44.73
PRINCIPAL Tax Savings Fund	80.71	17.88	34.40	43.50	44.80	41.87
Indices						
BSE Sensex	13786.91	10.70	29.95	46.86	44.65	33.20

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.

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 the peers albeit at a higher risk.

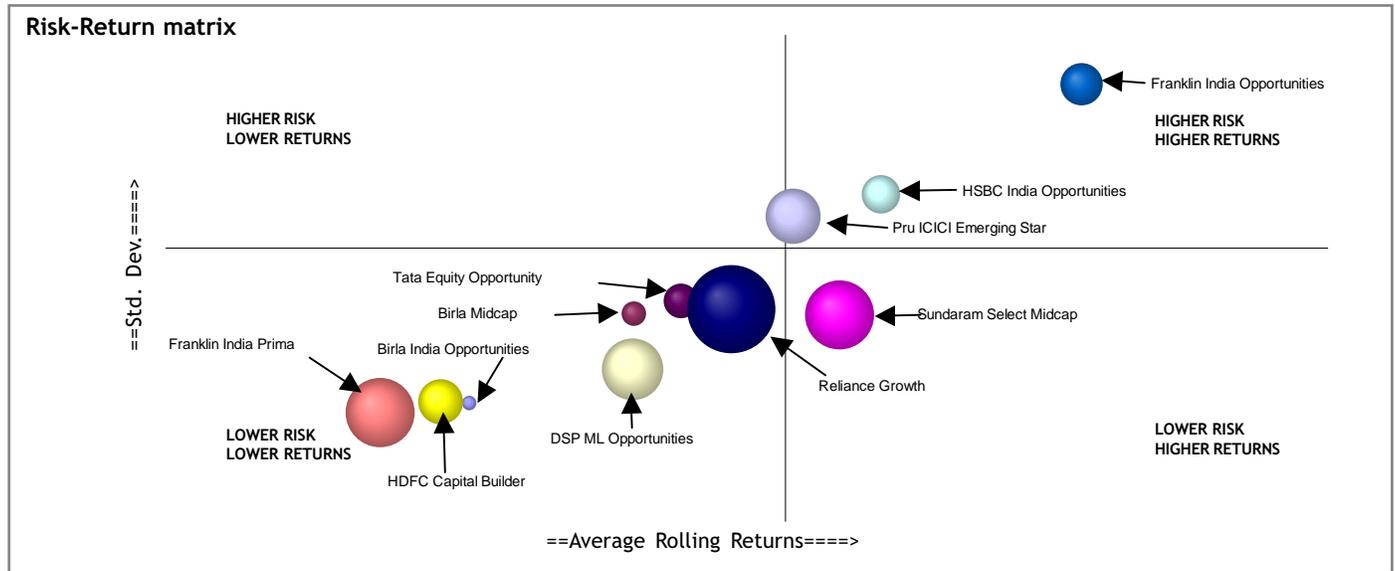
The funds in the **low-risk high returns** quadrant outperform the peer group on the risk-adjusted returns basis as they deliver higher returns compared to the peers without exposing the portfolio to very high risk.

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

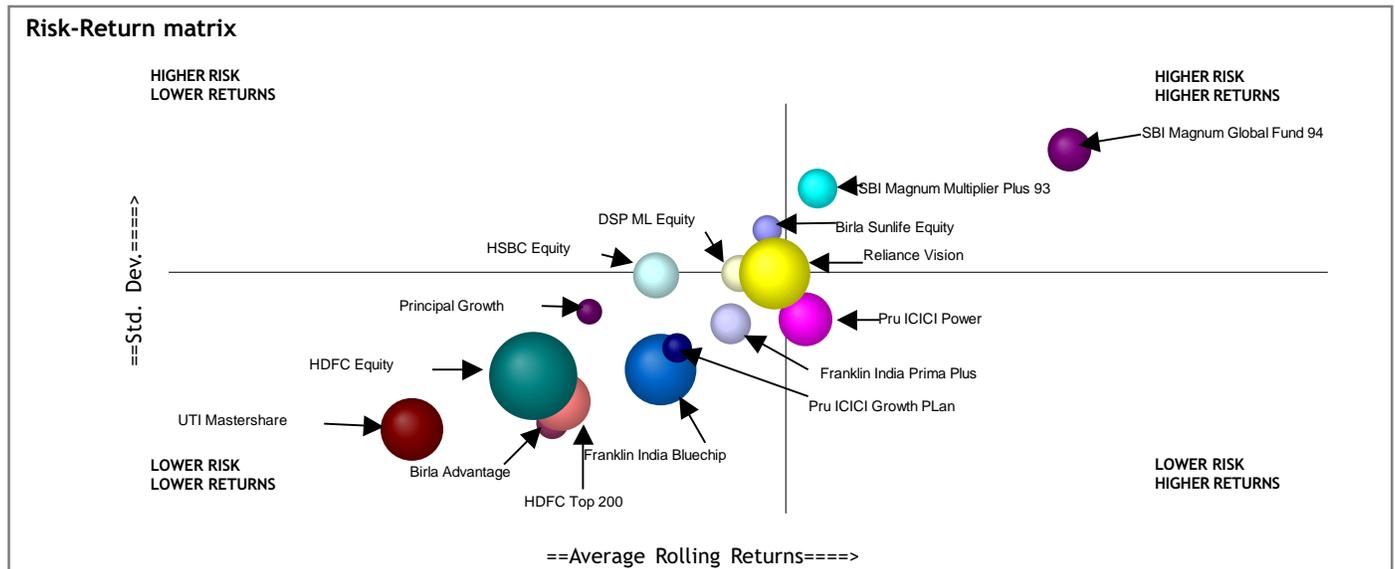
The funds in the **high-risk low returns** quadrant underperform the peers on the risk adjusted returns basis as they adopt a high-risk strategy but the returns fail to compensate the risk taken by the fund.

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 December 29, 2006. 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 December 29, 2006.

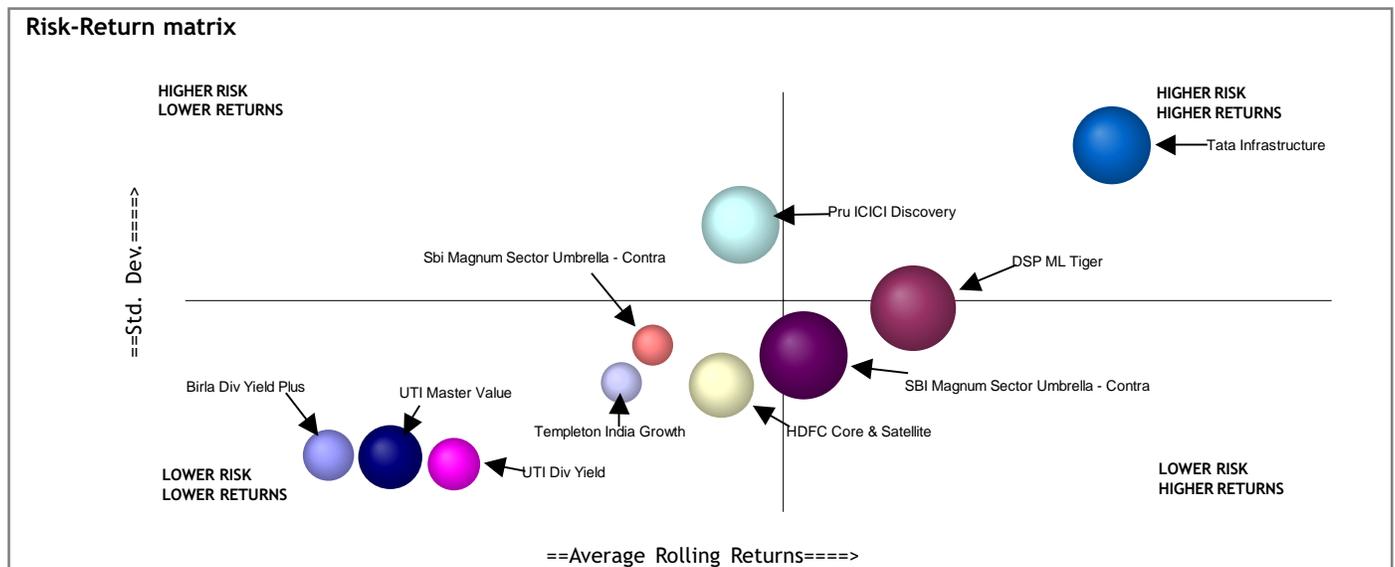
Aggressive Funds



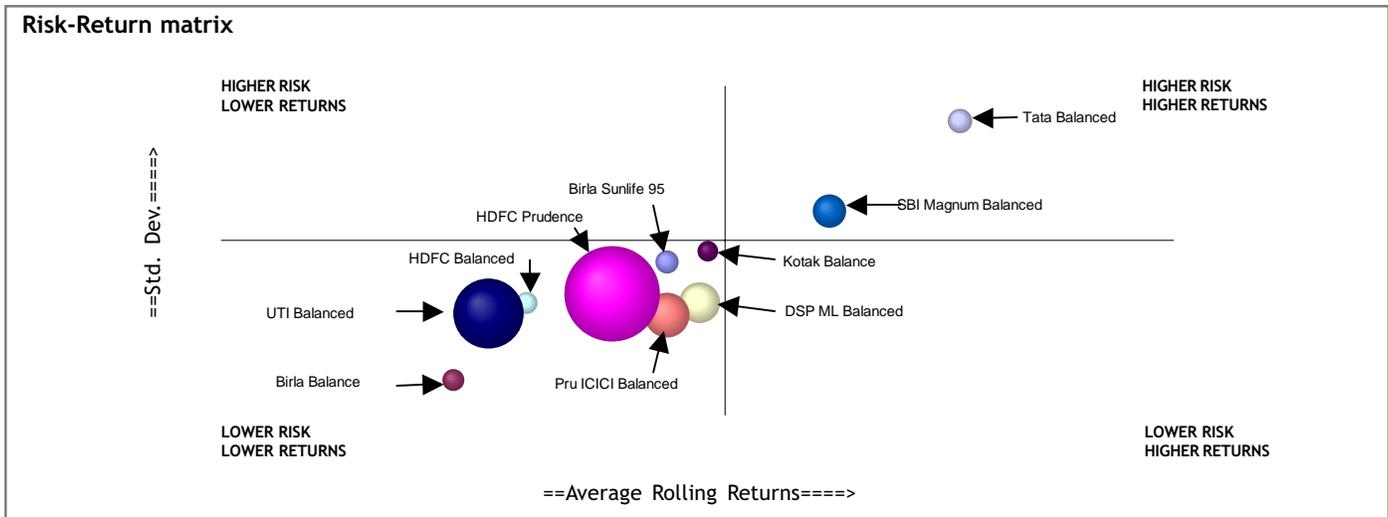
Equity Diversified/Conservative Funds



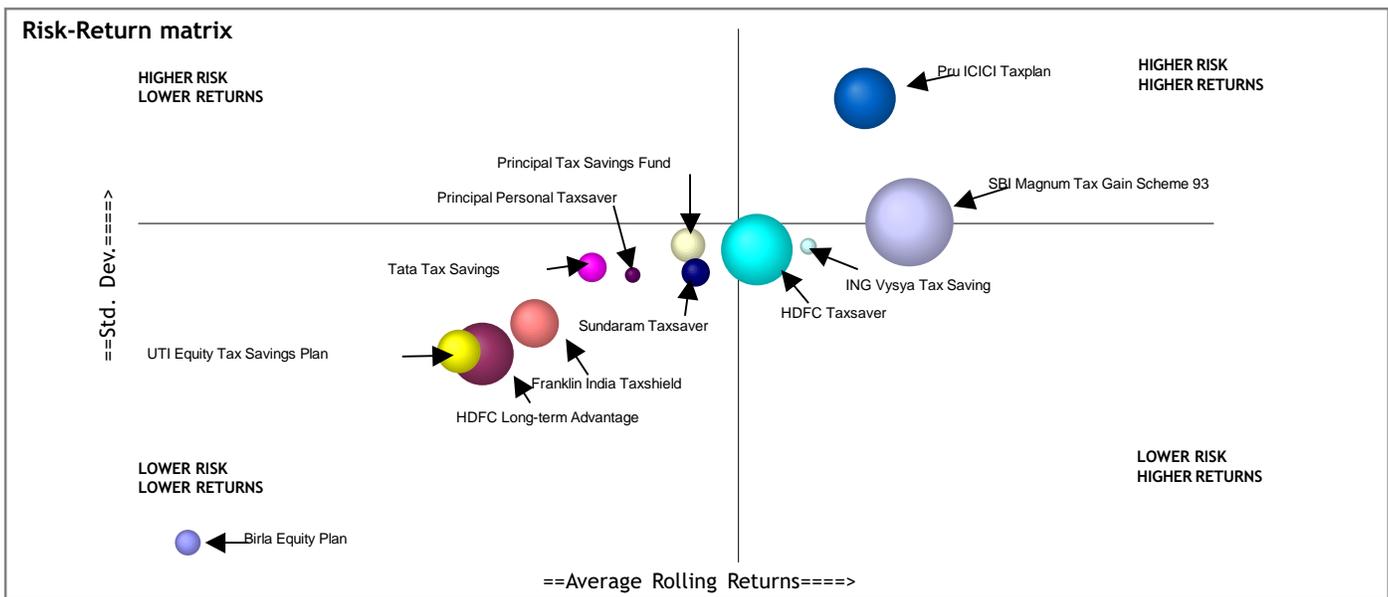
Thematic/Emerging Trend Funds



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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