mutual gains

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Sharekhan's top equity fund picks

Every year before the annual budget event the market draws up a long list of wishes. This year too it had built up expectations, only this time its expectations were very high, given the decisive victory of the Congress Party that had not only resulted in a stable government but also got rid of the anti-reformist Left parties from the ruling alliance. The market was hoping that to justify the strong decisive election mandate the government would announce some bold measures including a roadmap for structural reforms in banking, insurance and energy sectors, aggressive push to disinvestments and abolition of the securities transaction tax.

However, the Union Budget for FY2010 failed to impress the market as it did not make any major announcement on the subjects close to the market's heart. As a result, in a knee-jerk reaction the market tanked by nearly 900 points on the budget day itself after having surged by 23% in the aftermath of the election outcome. But then, the market's budget expectations were lofty and unrealistic in the first place, as was indicated by us in our pre-budget note.

Another factor that spooked the markets was the fiscal deficit estimate of 6.8% of the gross domestic product for FY2010—the same is much ahead of the market's expectations and the highest in 16 years. The government would resort to market borrowings of around Rs400,000 crore this year to fill in the gap. The further hike in the borrowing programme (10% higher than the already steep figure indicated in the interim budget) can potentially result in the crowding out of the private sector borrowers and put upward pressure on the interest rates. The yield on the ten-year government bonds surged by 19 basis points on the budget day itself to cross the 7% mark.

Meanwhile, now that the much hyped event of budget is behind us, reality is likely to return to the market. The reality is that the market is trading at 14,000 levels and has already risen by 83% (till July 3, 2009) since March 2009. It is fairly valued at 16.5x one-year forward earnings estimate and is enjoying a premium of over 10% on the mean average multiple of the past few years. To justify any further rise, the market would need the support of further earnings upgrades. The earnings downgrade cycle has largely bottomed out but clear signals of an upward revision in the earnings cycle are still not visible. Moreover, the possible hardening of the interest rates on the back of the huge government borrowing programme could potentially delay the earnings upgrade cycle.

Besides the earnings performance, the other crucial factor that could affect the market in the near term is the southwest monsoon. The summer monsoon, so important for the wellbeing of the country's economy, has played truant this year. On the positive side, the latest forecast expects reasonably good monsoon in the two key months of July and August. However, we keep our fingers crossed as a good monsoon is pivotal to continued buoyancy in demand from rural India.

Any unfavourable development in the global economy could also spook the markets in the days ahead. Despite the signs of green shoots across the global economy, it is difficult to say at this juncture whether this recovery is sustainable. Moreover, the recent unemployment data from the USA shows that the recovery process cannot be linearly positive and disappointments would continue to keep the market volatile. The unemployment rate in the USA rose from 9.4% in May 2009 to 9.5% in June 2009. Though the unemployment rate was lower than the consensus estimate of 9.6% for the month, but it was the highest since 1983.

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 Jun 30, 09 (%)		
		3 Months	1 Year	2 Years
Birla Sun Life Mid Cap	73.42	73.28	11.21	-0.68
IDFC Premier Equity	19.60	54.53	8.20	5.90
Reliance Growth	325.69	59.71	7.95	2.91
Sundaram BNP Paribas Select Midcap	97.01	77.38	11.12	-1.24
Indices				
BSE Sensex	14493.84	51.48	7.67	-0.53

Opportunities category

Scheme Name	NAV	Returns as on Jun 30, 09 (%)		
		3 Months	1 Year	2 Years
IDFC Imperial Equity	14.94	39.07	16.08	8.10
Kotak Opportunities	33.59	52.61	4.01	2.13
UTI Opportunities	18.94	50.32	23.15	10.02
Indices				
BSE Sensex	14493.84	51.48	7.67	-0.53

Equity diversified/conservative funds

Scheme Name	NAV	Returns as on Jun 30, 09 (%)		
		3 Months	1 Year	2 Years
Birla Sun Life Frontline	62.44	52.67	18.08	5.02
Canara Robeco Equity Diversified	36.99	58.96	20.57	4.48
DSP BlackRock Top 100	72.71	41.79	13.85	5.61
Franklin India Bluechip	151.46	51.48	20.92	3.11
HDFC Top 200	143.76	58.20	24.55	9.27
Sundaram BNP Paribas SMILE	22.38	72.37	11.58	5.28
Indices				
BSE Sensex	14493.84	51.48	7.67	-0.53

Thematic/Emerging trend funds

Scheme Name	NAV	Returns as on Jun 30, 09 (%)		
		3 Months	1 Year	2 Years
Birla Sun Life Dividend Yield Plus	51.57	45.39	27.40	4.59
ICICI Prudential Infra	24.20	40.78	8.67	6.67
Templeton India Growth	80.09	50.36	3.96	3.98
UTI Contra	10.94	43.57	21.42	4.74
UTI Dividend Yield	20.51	37.28	16.20	6.90
Indices				
BSE Sensex	14493.84	51.48	7.67	-0.53

Balanced funds

Scheme Name	NAV	Returns as on Jun 30, 09 (%)		
		3 Months	1 Year	2 Years
Birla Sun Life 95	221.52	44.94	23.33	5.23
Canara Robeco Balance	44.07	41.48	19.46	5.35
HDFC Balanced Fund	36.00	40.82	14.58	5.54
Reliance RSF - Balanced	16.01	51.20	27.36	14.49
Indices				
Crisil Balanced Fund Index		28.66	11.08	4.68

Tax planning funds

Scheme Name	NAV	Returns as on Jun 30, 09 (%)		
		3 Months	1 Year	2 Years
DSP BlackRock Tax Saver	11.63	50.73	2.92	-0.34
Franklin India Taxshield	143.16	49.12	14.24	1.27
Religare Tax Plan	11.41	45.35	15.49	2.78
Sundaram BNP Paribas Taxsaver	32.96	47.68	10.06	6.18
Indices				
BSE Sensex	14493.84	51.48	7.67	-0.53

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.

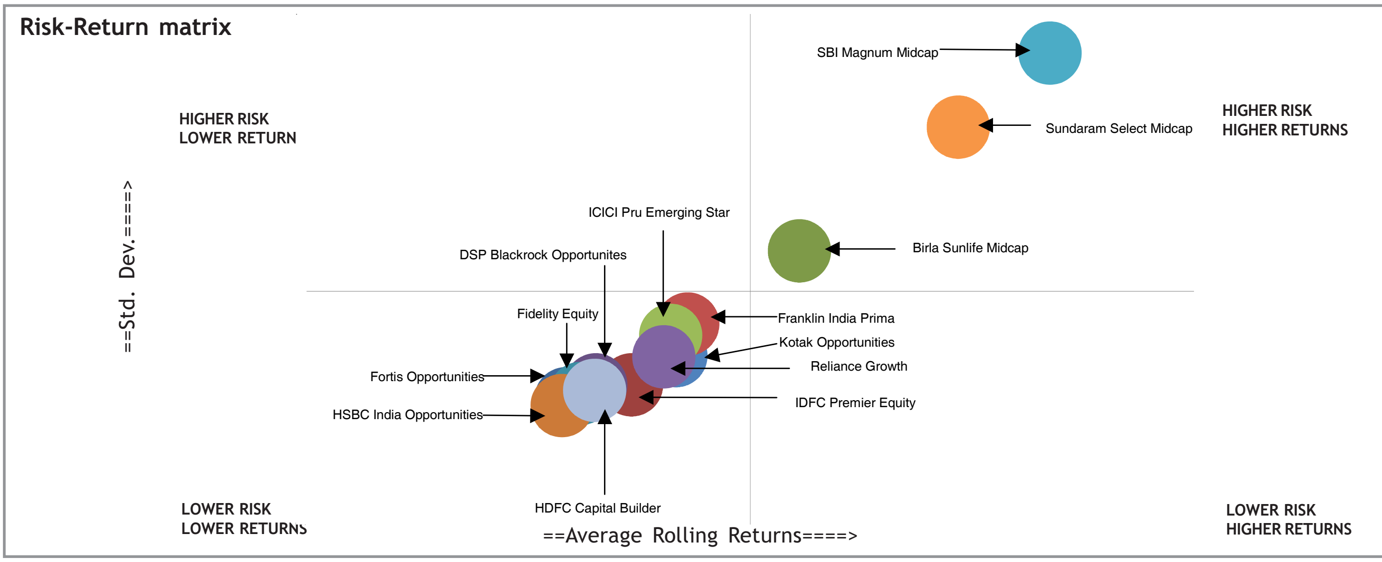
The funds in the **low-risk low returns** quadrant are not very aggressive and provide lower absolute returns, taking lower risks.

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.

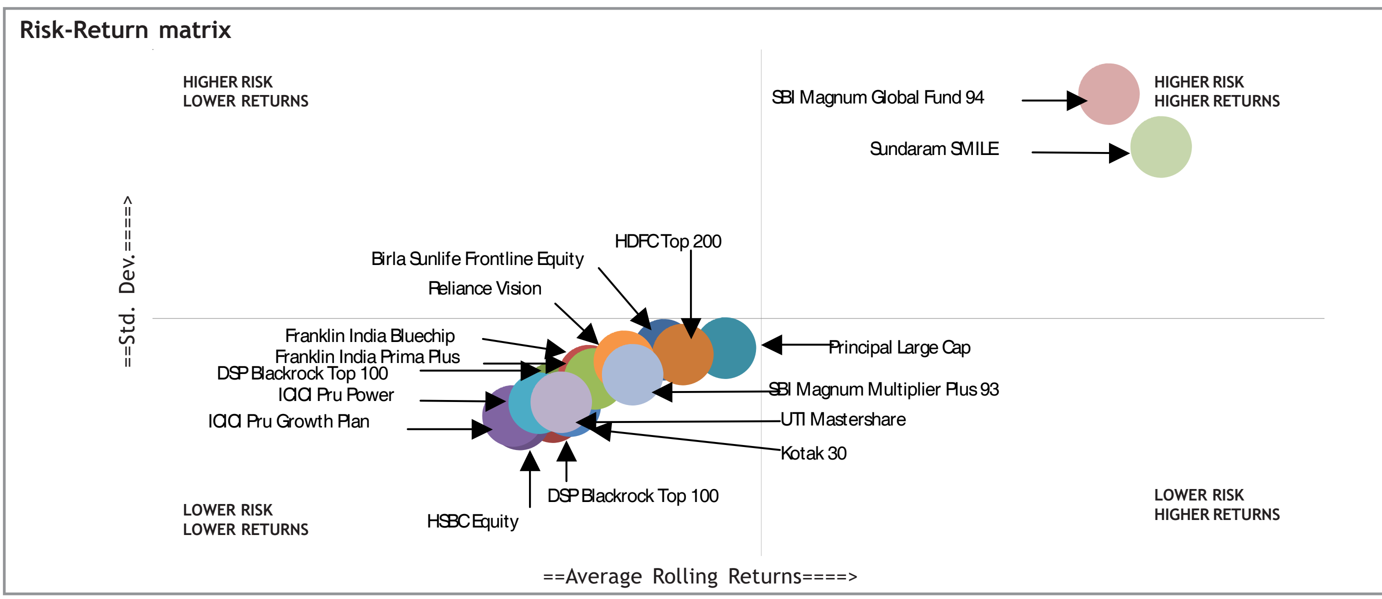
For aggressive, conservative and tax planning funds, risk is measured in terms of two years' volatility while returns are measured as two years' average rolling returns as on June 30, 2009. For thematic and balanced funds, risk is measured in terms of one year's volatility while returns are measured as one year's average rolling returns as on June 30, 2009.

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.

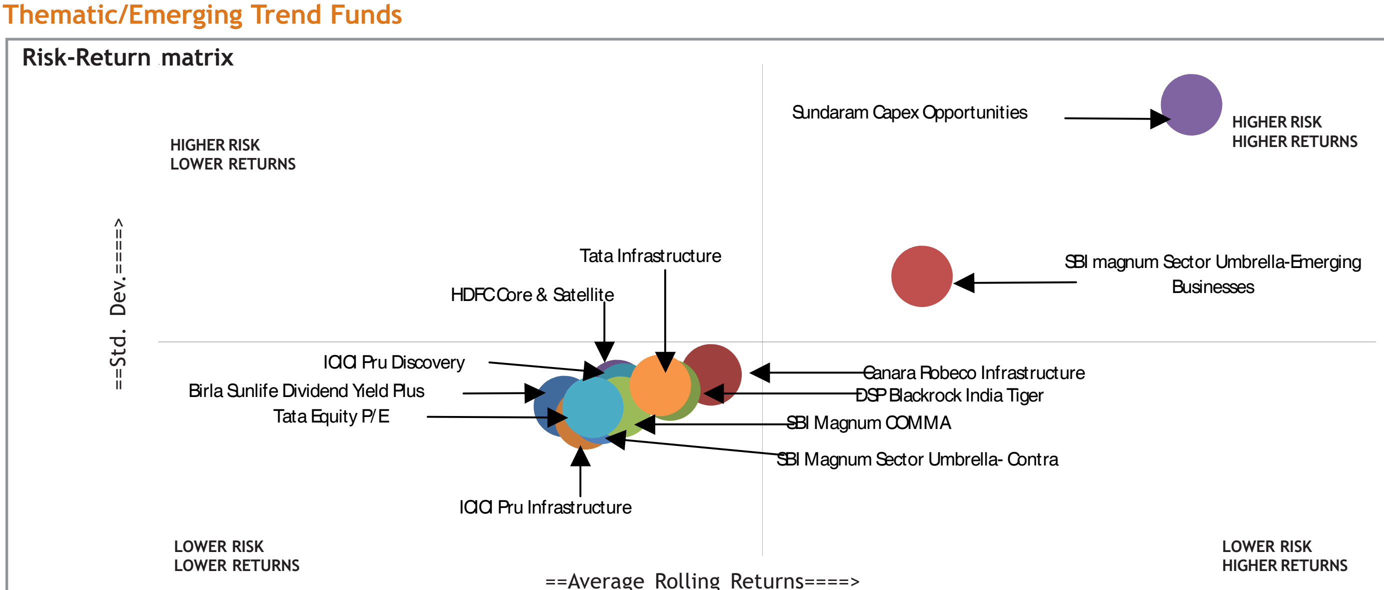
Aggressive Funds



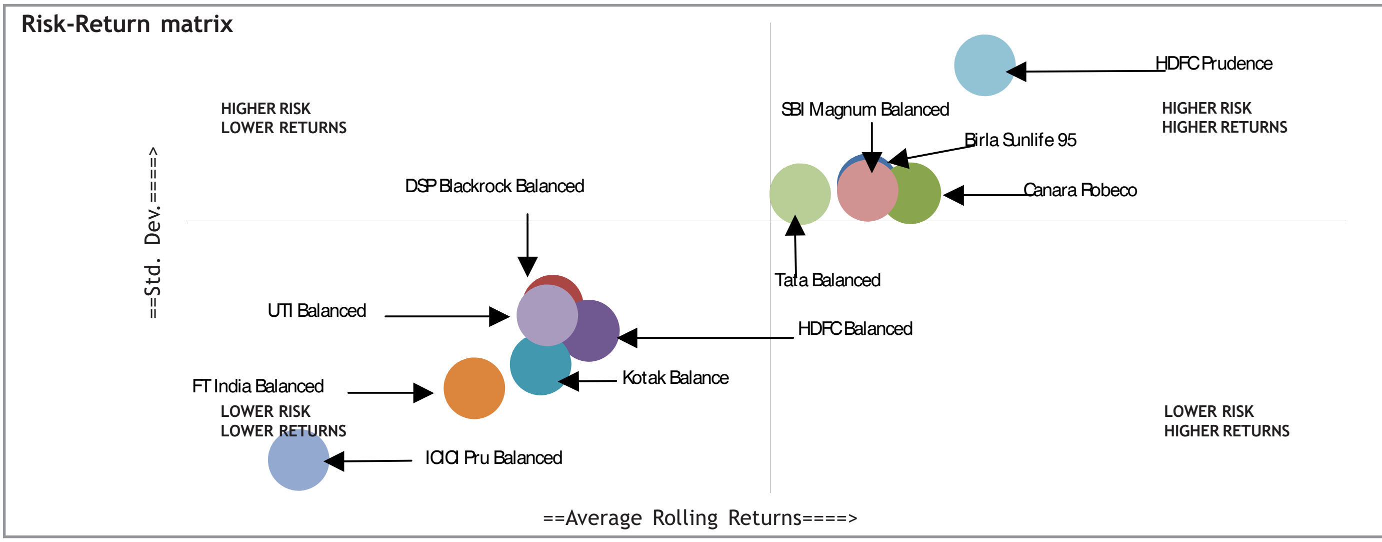
Equity Diversified/Conservative Funds



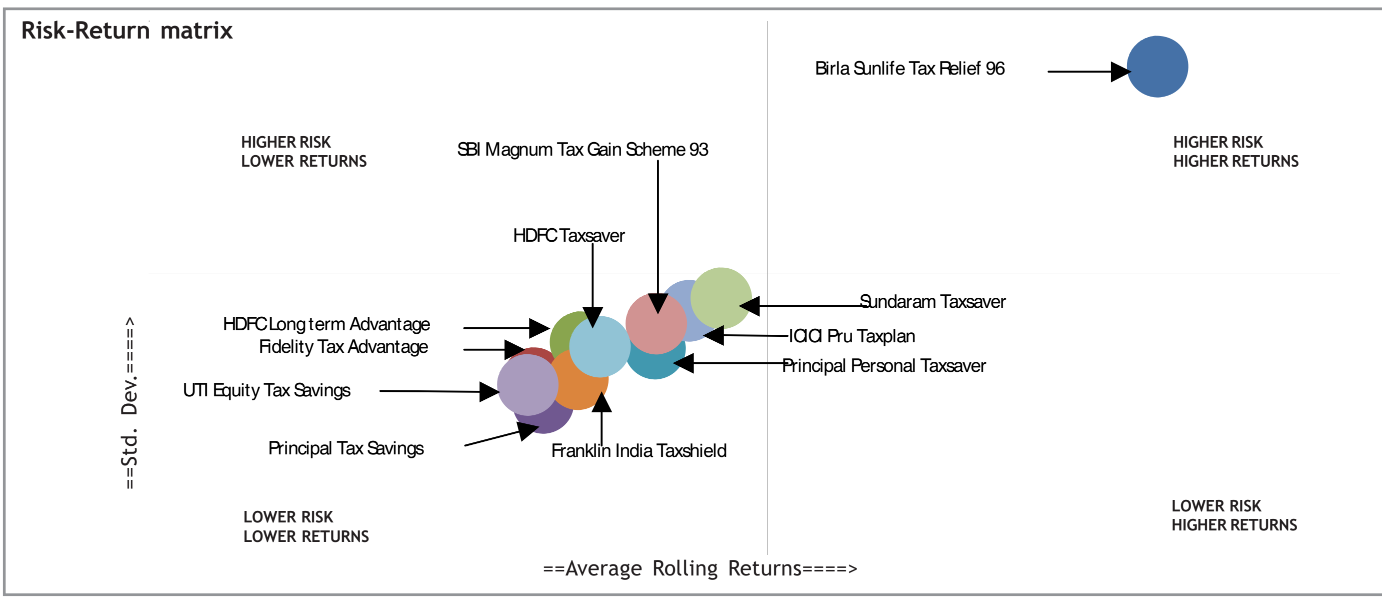
Thematic/Emerging Trend Funds



Balanced Funds



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.