

A STUDY OF THE PERFORMANCE OF MUTUAL FUNDS IN INDIA

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Abstract

Mutual funds are investment instruments that pool the investments from small investors and invest the same in the capital markets on their behalf. From the landmark papers of [Sharpe \(1966\)](#) and [Treynor \(1966\)](#) to measure the performance of fund managers to [Choiet al. \(2016\)](#) who analyse how investors try to study fund managers from the records of their performance, mutual funds have been the subject of many studies in the developed markets. This study proposes to contribute to the mutual fund literature in the developing market by conducting a comprehensive study of mutual funds in the Indian capital market. The first chapter provides the introduction while the second chapter describes the data used in the study. The main research questions are explored in chapters 3, 4 and 5. The sixth chapter provides the conclusion for the study. The 3 research questions are (a) Does the mutual funds generate superior returns for their investors? (b) What are the sources of the mutual funds' superior (or inferior performance) and (c) Do the mutual funds provide an insurance to their investors and if yes what is the value of this insurance? One of the major problems that plague mutual fund research is the issue of survivorship bias. Survivorship bias occurs when many mutual funds are closed thus leaving only surviving funds for observation ([Rohleder et al. \(2011\)](#)). This leads to over-estimation of the funds' returns and distorts any empirical observation that are made in the study. In the third chapter a comprehensive analysis of the performance of equity mutual funds in India is conducted. The dataset used for this study is unique as it is one of the largest survivorship-bias free dataset of equity mutual funds in India. The dataset consists of 438 unique mutual funds over a period of 14 years from January, 2001 to December, 2014. This dataset includes both existing as well as dead funds thus reducing the effect of survivorship bias. Various risk-adjusted measures of performance are used in the study to assess whether the mutual funds have reported excess market adjusted return and whether such returns are persistent. A preliminary analysis using the Capital Asset Pricing Model shows both positive and negative alphas generated by the fund managers. Out of 438 funds, 94 have a positive alpha while the rest are negative. This motivates the study of the source of the superior performance of fund managers. The fourth chapter tries to ascertain the source of superior performance of the fund managers in India. There are three possible sources for superior performance. One, the fund managers should have been good in stock selection. Two, the fund managers may have timed the market correctly. Finally, the fund managers may have 'drifted' from the stated objective of the fund and picked stocks that are not consistent with the fund objective. Various models are used to study both the market timing and stock selection abilities of the fund managers. In addition the phenomenon of 'drift' in mutual funds is thoroughly studied. It is found that funds do drift but the magnitude of drift is not too large. The funds do not tend to deviate a lot from their benchmarks. [Glode \(2011\)](#) observe that though mutual funds might not provide a better return in times when the market is performing well (i.e, in general mutual funds might not be able to beat the market in good times), they provide an insurance against losses in bad times (i.e., in general the mutual fund returns exceed

market returns in bad times). In the fifth chapter the returns of the funds and the indices in the times of recession are observed to test the [Glode\(2011\)](#) hypothesis. The study looks at both economic business cycles as well as market upturns and downturns to analyse the performance of funds when there is a bad phase. It is found that the fund performs better than the market when the market is falling and therefore provides an insurance value to the investors. The study uses the defensive score proposed by [Narasimhan and Balasubramanian \(1998\)](#) and the [Black and Scholes \(1973\)](#) option pricing methodology to calculate the monetary value of the insurance provided by the funds. It is found that the funds provide a positive insurance value to the investors in a falling market.