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A STUDY OF MAJOR MUTUAL FUNDS IN INDIA

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Abstract:-Now-a-days the concept of mutual funds is very popular in India. Globally, mutual funds have become popular as an effective investment intermediary to mobilize savings into the financial markets. The Indian mutual fund industry has grown immensely in the past couple of decades and has emerged as one of the most dynamic segment in Indian financial system. The present study is an attempt to evaluate the performance of Growth, Income, Balanced and Tax saving funds in terms of risk and return and contrast with market Benchmark. The judgment has been made with benchmark portfolio during the period April 7, 2012 to March 30, 2013. Performance measures applied are, Sharpe ratio, Treynor ratio, Jensen alpha and coefficient values. It is found that majority of the schemes under selected funds have acquired handsome return and less systematic risk than the market portfolio. Tax saving fund have performed well in market and got first rank whereas Balanced and Equity fund have acquired second and third rank respectively. At last Income fund schemes were found worst among all due to less return.

Keywords: Sharpe & Treynor Effect on Funds.

1. INTRODUCTION

The process of economic liberalization and globalization of Indian capital market have elevated the concept of mutual funds and make it very popular among the Indian investor. It mobilizes savings, particularly from the small and household sectors, for investments in stock and money market. It has emerged as one of the vital destinations for investment. Basically, professional fund managers manage funds of those individuals and institutions may not have such high degree of proficiency or sufficient time to cope-up with complexities of different investment avenues, legal provisions associated with and vagaries and vicissitudes of capital markets. Mutual Funds, thus, provide an alternative to the investors who instead of making direct investments in shares or bonds through public issues or through secondary market, subscribe to the corpus of mutual funds. Investors can reap all the benefits of good investing through mutual funds like enjoying growth in scrip in which they could not have otherwise invested, holding a balanced and well-diversified portfolio, getting tax exemptions, better returns due to specialized and professional management of funds etc. Therefore, a mutual fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

Presently in India, there is a greater scope of development of mutual fund investment programmes and also there are wide variety of mutual fund schemes that cater to the needs of various class of investors according to their age, risk tolerance, return expectations which aim to provide both capital appreciation income by periodical distribution of dividend as per the choice of investor. The future of mutual funds is also bright as it has seen a great upward trend in its first phase of operation and is set to grow manifold in near future. The increasing popularity of mutual funds worldwide and especially in India has necessitated research in this field. Hence, the need arises to study the performance of mutual funds in India.

2. REVIEW OF LITERATURE

The concept mutual fund is a fairly new one to the Indian capital market but not to the international capital world. By the 1930's a large number of close-ended mutual funds have been formed in the United States of America consequently, more studies have been conducted in other countries.

The study by Mc Donald (1974) examined the performance of 123 mutual funds in relation to the stated objectives of each fund. The results showed positive relationship between fund objectives and risk measures. This implied that a funds risk

increases when it becomes more aggressive. Salvi (1991) evaluated money market mutual funds and found the average rate of return provided by MMMF's in the United States, which was in the range of 8 percent to 9 percent. Brown, Stephen (1992) analyzed the relationship between volatility and returns in a sample that was truncated by survivorship and showed that this relationship gave rise to the appearance of predictability. Jayadev (1998) examined the performance of 62 mutual funds schemes using monthly NAV data for the period of April 1987 to March 1995. He explored superior performance of bulk (30 out of 44) of the sample schemes when total risk was considered. Only 24 out of 44 schemes outperformed the benchmark portfolio. Gupta (2000) evaluated 73 mutual fund schemes based on weekly NAV data for the five year period i.e. from April 1, 1994 to March 31, 1999. The empirical results reported a mixed performance of sample schemes during the study period. No conclusive evidence scheme was available which warranted their performance to be superior to the relevant benchmark. Smith (2001) examined the degree of performance persistency between the two classes to discern if closed end funds are able to maximize their liquidity advantages and thereby display a greater performance persistency than that of open end funds. The empirical analysis included the spearman rank correlation coefficient to examine relative performance persistency. Singh and Vanita (2002) conducted a study, based on a survey of 150 respondents in Delhi. Their results showed that investor in general, did not perceive the risk inherent in mutual fund investment and used it primarily as a task saving instrument. However, open ended schemes and balanced funds were most preferred by the investor. Alexander (2003) found a significant and negative relationship between the volatility of daily fund flows and cross-sectional differences in performance. Monthly analysis indicated that this relationship applies only to current monthly returns and that flow volatility does not influence the returns of future months. Similarly, Mehru (2004) observed that mutual funds failed to provide safety, liquidity and returns on investments to the small investors, facing several problems in our country like the structural, investors related and performance related. He concluded that the greater transparency, increased innovations, better services to the investor, liquidity and higher returns will make mutual fund schemes more popular and investor friendly. Henri and Peter (2005) studied the size of mutual fund industry in 56 countries. It was larger in countries with stronger rules, laws, and regulations and specifically where mutual fund investors' rights were better protected. The industry was smaller in countries where barriers to entry were higher. Thus, the results indicated that laws and regulations, supply-side and demand-side factors simultaneously affected the size of the fund industry. D.N Rao (2006) classified 419 open-ended equity mutual fund schemes into six distinct investment styles and analyzed the financial performance of open-ended equity mutual fund schemes for the period 1st April 2005 - 31st March 2006. His analysis indicated that Growth plans have generated higher returns than that of Dividend plans but at a higher risk. Further, Acharya and Gajendra (2007) attempted a study to classify hundred mutual funds employing cluster analysis by using a criteria like the 1 year total return, 2 year annualized return, 3 year annualized return, 5 year annualized return, alpha, beta, R-squared, Sharpe ratio, mean and standard deviation etc. Their study found evidences of inconsistencies between the investment style/objective classification and the return obtained by the fund. Jaksa and Wang (2008) studied the effects of Sharpe ratio which demonstrated that if manager's focus on the short horizon, it will be detrimental to the long-horizon investor. When the returns were low, the performance drop its significant, even when horizons were not very different. When the returns were mean reverting, the performance was exacerbated. Anshuman (2009) found that top-performing funds receive net inflow of new money. However, funds that perform unwell did not lose many assets. A high correlation between the rating and the subsequent cash inflow into the fund was one such standard that investors consider while making investments. The study also compared the funds' performance in the out-of-sample period (different period) with the in-the-sample period (sample data period) ratings. Ravi and Aditi (2010) examined the performance of mutual funds which was a great deal of attention from both practitioners and academics. Their idea behind evaluation was to find the returns provided by the individual schemes especially growth funds and the risk levels at which they were delivered in comparison with the market and the risk free rates.

3. SCOPE AND OBJECTIVES OF THE STUDY

The present study is an attempt to evaluate the performance of major mutual funds on the basis of weekly returns compared with risk free security returns and BSE index during the period April 2012 to March 2013. It analyzed 120 different open-ended schemes (30 from each category) floated by the different institutions in India.

3.1 Objectives

On the basis of the relevance and scope of the study following objectives are framed:

1. To evaluate the investment performance of major funds in terms of risk and returns.
2. To study the impact of stock market fluctuations by applying Sharpe and Treynor measure.

3.2 Data Coverage

The sample consists of 120 different open-ended mutual fund schemes from public sector financial institutions, banks, private sector organizations and unit trust of India for the period of 52 weeks. The selection of the schemes was based on the condition that they have an exposure of at least three years and their details are available. Broad 100 share based BSE national index has been used as proxy to find out the performance of the schemes in market.

The collection of data is based upon secondary information which has been collected through various books, studies, annual reports of various institutions and websites. In addition, various Journals, magazines, articles, books, published and unpublished document have also been considered.

4. METHODOLOGY

The analysis and interpretation is based upon following methodology as under:

$$\text{Portfolio return: } R_p = \frac{\text{NAV}_t - \text{NAV}_{t-1}}{\text{NAV}_{t-1}}$$

Where, R_p is a difference between net asset values for two consecutive days divided by the NAV of preceding week.

$$\text{Market Return: } R_m = \frac{\text{M. Ind}_t - \text{M. Ind}_{t-1}}{\text{M. Ind}_{t-1}}$$

Where, R_m is the difference between Market Indexes (M. Ind) of two consecutive days, divided by the market index for the preceding week.

Average return:

$$AR_p = \sum_{t=1}^n \frac{R_p}{T}$$

Where, AR_p is Average returns on portfolio

$$AR_m = \sum_{t=1}^n \frac{R_m}{T}$$

AR_m = Market Average Return

4.1 Measuring Risk return relationship

To measure the relationship between risk and return precisely, following tools have been used.

4.1.1 Standard Deviation ()

Standard deviation is a measure of dispersion in return. It quantifies the degree to which returns fluctuate around their average. A Higher value of standard deviation means high risk.

$$\sigma_p = \sum_{t=1}^n \left[\frac{(R_p - AR_p)^2}{t-1} \right]^{1/2}$$

Where,

σ_p is total risk of the scheme portfolio. The total risk on the market portfolio is computed as follows:

$$\sigma_m = \sum_{t=1}^n \left[\frac{(R_m - AR_m)^2}{t-1} \right]^{1/2}$$

Where, σ_m is Total risk of the market portfolio and σ_p is Total risk of the scheme portfolio.

4.1.2 Beta (β)

Beta reflects the sensitivity of the fund's return to fluctuate in the market index. The beta for the average well-diversified portfolio equals to 1.0. Betas greater than 1.0 indicate above-average volatility as the higher the beta, the greater the risk. Betas less than 1.0 reflect below-average volatility.

$$\beta_p = \frac{(T \sum_{t=1}^n er_{mt} \cdot er_{pt}) - (\sum_{t=1}^n er_{mt} \sum_{t=1}^n er_{pt})}{(T \sum_{t=1}^n er_{mt}^2) - (\sum_{t=1}^n er_{mt})^2}$$

Where,

er_{mt} is Excess return on market index

er_{pt} is Excess return on portfolio

Such sense can also be conveyed by certain CAPM based measures of portfolio performance.

4.1.3 Risk free rate

Risk free rate of return refers to that minimum return on investment that has no risk of losing the investment over which it is earned. In the present study, 91-day Treasury bills (T-bills) has been used as proxy for risk free rate which is the standard practice under empirical research in finance world over.

4.2 Measures of Performance Evaluation

The performance of selected mutual fund schemes has been evaluated by most significant and widely used measures. A brief description of these measures is given below.

4.2.1 Sharpe ratio

This reward to variability ratio is developed by William F. Sharpe in 1966. Sharpe index indicates returns generated by mutual fund over and above risk free rate of return and the total risk associated with it. Symbolically, it can be written as:

$$Sr = \frac{AR_p - AR_f}{\sigma_p}$$

Where,

Sr is Sharpe Ratio

AR_p is Average return on portfolio

AR_f is Average risk free return

σ_p is Standard deviation of return on portfolio

A positive and high Sharpe ratio shows a superior risk adjusted performance of fund whereas; a low and negative Sharpe is an indication of unfavourable performance.

4.2.2 Treynor Index

This volatility measure is introduced by Jack.L.Treynor in 1965 which indicates about the relationship between additional returns and systematic risk. A comparison can also be made with the benchmark taking systematic risk of market portfolio.

$$Tr = \frac{AR_p - AR_f}{\beta_p}$$

Where,

Tr is Treynor's Ratio

AR_p is Average return on portfolio

AR_f is Average risk-free rate of return

β_p is Sensitivity of fund return to market return

It measures portfolio risk in terms of beta, and the ratio is relevant to the investors. The higher the ratio better is the performance.

4.2.3 Jensen's Measure

In 1968, Jensen confined his attention to the problem of evaluating a portfolio manager's ability of successfully predicting security prices which yield higher returns. His measure suggests explicit account of the effects of risk on returns of the portfolio. It is regression of excess fund return with excess market return. It is expressed as:

$$R_p - R_f = \alpha + \beta(R_m - R_f) + e_i$$

Where:

- Alpha (α) is the intercept term
- β is Systematic risk
- R_m is Market return
- R_p is Return on portfolio
- R_f is Return on risk-free asset

4.2.4. Coefficient values

Coefficient of variation is applied to measure the variability of return in terms of risk. Higher value shows greater variability in returns of a particular scheme. The coefficient of determination represents the proportion of variation in the excess return on scheme that is related to the variation in the excess return on the market index. R^2 indicates the degree of diversification. Coefficient of non-determination represents the proportion of movement in the excess return on scheme which is not due to the market. The Sharpe differential returns computed by subtracting the expected fund return from the observed fund return. This measure takes into consideration both the manager's stock selection ability as well as his ability to provide diversification.

5. RESULTS AND DISCUSSION

An overall performance of sample schemes, whether they were superior or not is evaluated with the help of various performance measures. Risk- return relationship has been studied in Equity fund, Income fund, balanced fund and Tax saving fund. Figure 1 categorized the performance in terms of risk and return. The results indicate that all schemes have earned positive return which is a healthy sign as stock with progressive return can perform better in market.

As per Figure (i) equity fund schemes have high average risk (2.2150) than other mutual funds whereas it is low in income schemes (0.2408). It is moderate in balanced fund schemes (1.7271) and high in tax saving schemes (2.1659) which results that mutual funds performed with their stated investment objectives. Equity fund schemes come under high risk category as there are more fluctuations in returns than other funds. Hence, neither fund had risk more than the market on an average.

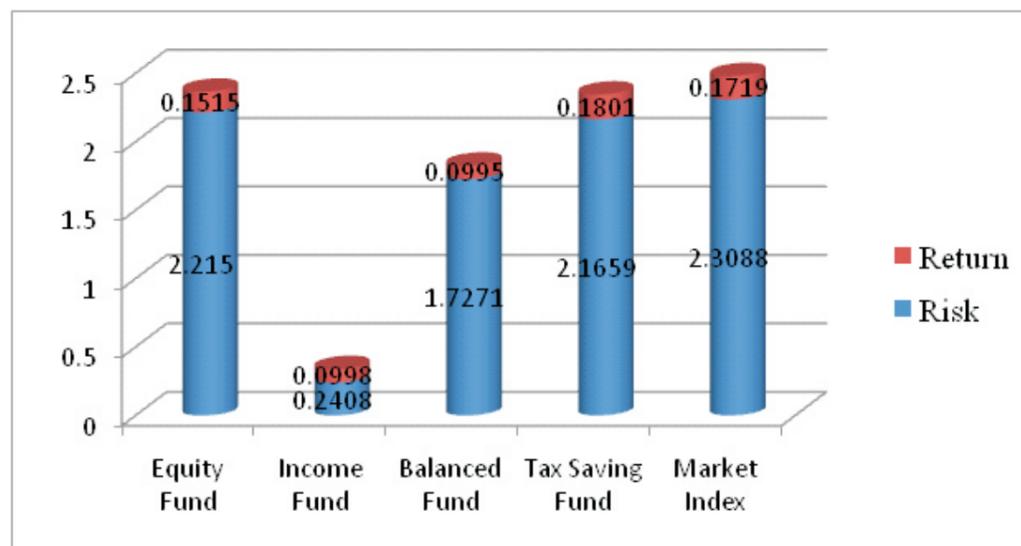


Figure (i): Risk and return are expressed on average basis
Source: compiled from website www.mutualfundsindia.com

Further, while examine systematic risk under various funds, it is found that tax saving fund has high systematic risk (0.8859) whereas equity fund schemes have (0.8733) lower beta than tax saving fund. Balanced fund has moderate risk (0.5565) as per its objective and income schemes shows low risk than all categories (0.0635). It is observed that, JM basis fund and Taurus discovery fund from equity fund schemes, Tata young citizen fund from balanced fund schemes and BP ELSS96, Birla sun life relief 96 from tax saving fund were found more volatile whereas Franklin Pharma fund, Kotak bond regular plan, Kotak bond deposit fund, UTI Mahila unit scheme and ICICI prudential child care plan-SP were found least risky. Thus, majority of sample schemes acquired less systematic risk than the market.

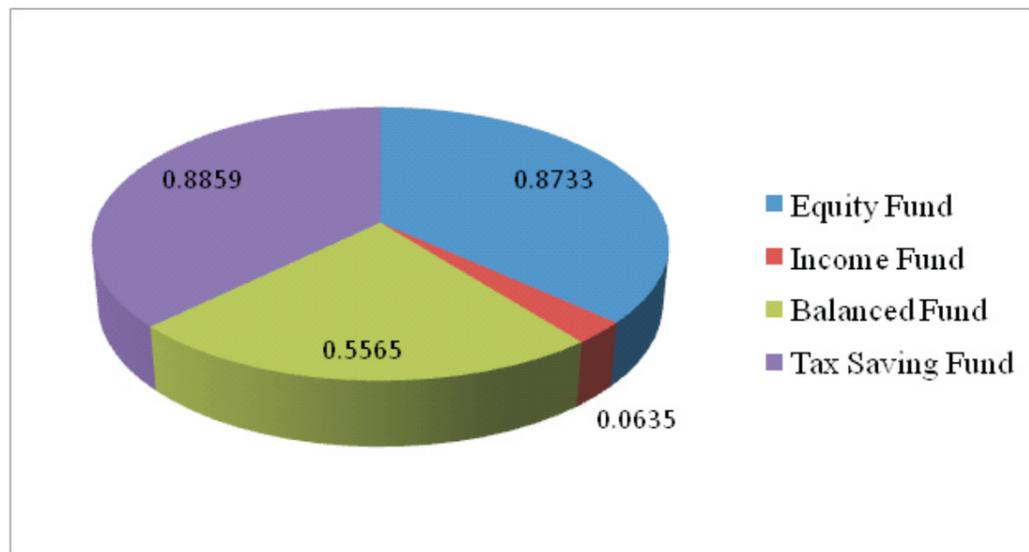


Figure (ii): Investment objective Vs. Systematic Risk

Thus, distributing systematic risk according to the average analysis of 30 selected mutual fund schemes from each category of fund it is found that Beta is higher (.8895) in tax saving schemes instead of equity schemes which is (.8733). Other two funds (balanced and income) have beta according to their investment objective which is moderate (.5565) and low (.0635) respectively.

5.1 Performance in terms of various measures

After computing systematic risk, the various sample schemes have been tested by Sharpe and Treynor measure. It has been found from Figure (iii) that majority of schemes showed positive return out of which some had outperformed and some had failed to perform well in market.

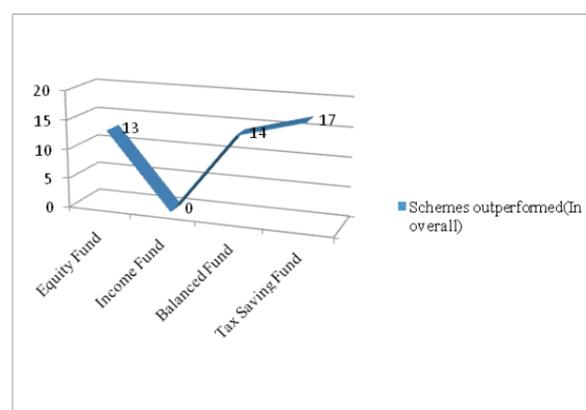


Figure (iii): Overall Results by Risk Adjusted Measures.

Out of 30 schemes from each category 17 tax saving schemes had outperformed in market by Sharpe and Treynor measures. Some of these were Fidelity Tax Advantage Fund, HDFC Tax Plan 2000, Sahara Tax Gain, ING Tax Saving Fund, and Franklin India Tax Shield. This fund had performed sound in market. Balanced fund comes under second rank as 14 schemes had predicted better performance in market such as Birla sun life 95, HDFC Balanced Fund, ICICI Prudential Balanced, UTI Balanced, FT India Balanced, HDFC Prudence, ICICI Prudential Child Care Plan-SP. Similarly, Equity Fund has acquired third rank as 13 had given better results. Some of these were namely, HDFC Equity, ICICI Prudential Dynamic, UTI Equity Fund, Kotak 50-G, Fidelity Equity Fund, UTI Master Value, HDFC Top 200, ICICI Top 100 fund. At last income fund schemes such as, Birla Sun Life Cash Manager, L&T Freedom Income, Sahara Classic Fund, Kodak Bond Regular Plan and Kodak bond deposit are found worse than all schemes. However, Income Fund had low risk but the main reason behind their loose performance was low returns. Thus, the majority of sample mutual funds resulted into good performance. Most of the underperformed schemes belong to the income fund due to low return than risk free asset. Finally it can be concluded that risk component is useful while taking decision of investment but proportion of return is must for better results.

5.2 Performance Indication by Alpha and Differential Return

Figure (iv) predicts the values of Alpha and differential return of various mutual funds. A positive value of Alpha for the fund would indicate that the portfolio had generated an average return greater than the benchmark return thereby implying a superior performance. There was a combination of positive and negative values of Alpha under each category of sample fund but only tax saving fund has found positive value by taking average of 30 schemes. Its differential return also found positive which results good overall performance. Further, Tax saving fund has low Sharpe differential return (0.0099) than Alpha value (0.0115). Fidelity Tax Advantage Fund, ING Tax Saving Fund, HDFC Tax Plan 2000 had high differential returns whereas JM Tax Fund, Escort Tax plan, Principal Tax Saving Fund had negative returns. It clearly reflects that schemes under this category need little more diversification for best performance and better return. For well diversified portfolio these two measures should indicate same differential returns. However if portfolio is not fully diversified, the Sharpe differential return would be small in magnitude. This would indicate a decline in fund performance owing to lack of diversification. Thus, few schemes under tax saving fund need more diversification. Equity fund has negative value of alpha (-0.0165) and differential return (-0.0193) based on the average of 30 schemes. The results also indicates that alpha values were highest in these schemes namely, HDFC Equity Fund, UTI Master Value, HDFC Top 200, Fidelity Equity which indicates that their fund manager were efficient to forecast future security prices in time. Similarly income fund has also least value of average alpha (-0.0451) which is nearly equal to its differential return (-0.0463). The highest negative alpha values were found in these schemes namely, Principal MIP-G, Fidelity Flexi Bond Fund whereas it had found lowest in HDFC Multiple Yield. Note that alpha and differential return value under equity and income fund schemes are almost equal to each other. In other words, their negative results were due to low return than risk free asset and market index or inefficiency of fund managers during the period of study.

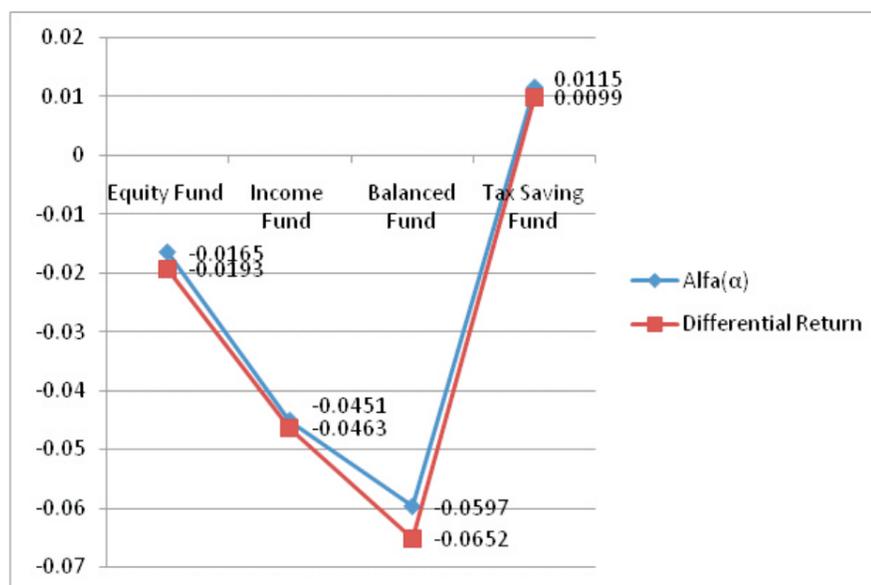


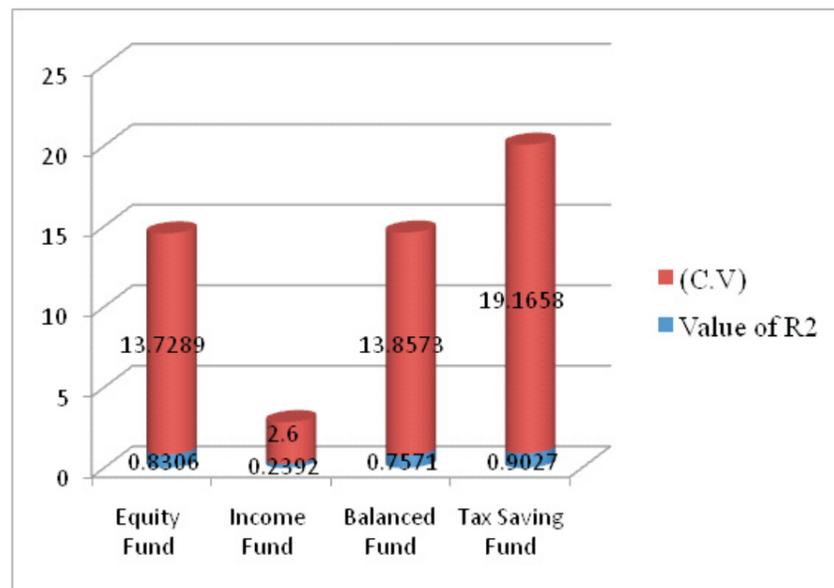
Figure (iv): Majority under Alpha and Differential Return.

As stated in Figure (iv) that there is a majority between Jensen's value of alpha and Sharpe differential return as they have been plotted near to each other. Equity fund schemes, income schemes and tax saving schemes have a little difference in values whereas balanced fund has little more difference among alpha (-0.0597) and Sharpe differential return (-0.0652) than

other funds. The analysis of balanced schemes explains that in overall 14 schemes had positive differential return and they were fully diversified in nature whereas UTI Mahila Unit scheme, Tata Young Citizen Fund, Birla Sunlife Freedom fund were the worst performers under this measure.

5.3 Performance based on Determination and Variation in Returns

Figure (v) shows how much the movement in sample mutual fund schemes excess return can be explained by the movements in the excess return on BSE National Index. Tax saving schemes has gained high value of R2(0.9027) and leading mutual funds schemes under R2 measure were Franklin India Index Tax Fund, UTI Equity Tax Saving Plan, JP Morgan India tax advantage fund whereas it was low in JM Tax Gain Fund, IDFC Tax Advantage Fund and Reliance Tax Saver. In terms of variation again tax saving fund has high average value (19.1658) than other funds. Higher variability shows less reliability in returns. In overall, all tax plan schemes had positive variation in returns which results average performance of these schemes.



Figure(v): Movements & Overall Variability of Sample Schemes with Market

Equity fund comes under second rank in terms of R2 (0.8306). Majority of schemes performed good in terms of this measure which predicts the proportion of movements in growth schemes excess return that is due to the movements in the excess return on BSE Index. DSP Blackrock, Franklin Pharma, Kotak-50, indicated comparatively low value of R2, thereby implying that their systematic risk was low and they performed better under Treynor measure. In overall, more than 80 percent movement on an average are due to the benchmark (market) portfolio as per R2 presented in figure (v). This measure also revealed that Escorts Growth Fund, Principal Growth Fund, Birla Sun Life Growth Equity Fund, Kodak Contra Schemes had high variations in returns as compared to other schemes as their coefficient of variation was more than other selected growth schemes. It is also evident that, the reason behind their underperformance was low consistency in returns. HDFC Equity Fund, ICICI Prudential Dynamic Plan, Kodak 50-G had low variations in returns which showed the better performance under both measures of Sharpe and Treynor index.

Balanced fund has got third rank in terms of average R2 (.7571) and highest in FT India balanced fund, SBI Magnum Balanced fund, ICICI Prudential Balanced Plan whereas it was low in UTI Mahila Unit scheme and UTI Retirement Benefit Pension Plan. Value under coefficient of variation helps to find out the variability in returns of balanced schemes on the basis of total risk and average return. It is clear that 3 balanced schemes had negative variation due to negative returns whereas, rest had positive coefficient of variations which ranked second (13.8573) among sample funds. High volatility had been found in Birla sunlife freedom fund, ICICI prudential child care plan –GP, principal balanced fund on the other hand, ICICI Prudential, HDFC Children Gift fund, Birla Sun Life 95 fund, HDFC Children Gift Fund-SP outperformed due to more consistency in returns. Thus, some balanced schemes require more reliability in returns to get desired results.

The value of R2 (0.2392) is lower in case of Income fund and highest in FT India monthly Income Plan, UTI MIS advantage, LIC MIP-G whereas low in L&T freedom income, Birla Sun Life Income Plus, ING Income Fund. However, R2 found zero under two schemes namely-JM Short Term Fund and Sahara Income Fund. In overall low average value of R2 depicted that income schemes has further scope of diversification. Further, Coefficient of variation indicates that Sahara Classic Fund, Birla Sun Life Cash Manager, L&T Freedom Income had low variation and low risk which indicated more

stability and less deviations in return whereas LIC MIP-G, HSBC MIP regular plan and Principal MIP generated more variability, which indicates these schemes fluctuate frequently, hence these were risky schemes. It can be concluded that income fund gained lowest rank among all mutual funds in terms of variability which is 2.60. Note that there were fewer variations in the returns of income schemes under study.

6. CONCLUSION AND SUGGESTIONS

Finally, Tax Saving Fund performed well in market under selected period of time even with high variations in returns and high risk. Equity and balanced fund performed on an average whereas income fund failed to get desirable return due to less diversification and inefficiency of fund manager. It can be concluded on the basis of above analysis that sample schemes have performed sound as per their investment objectives. Systematic risk and variability were higher in tax saving and equity schemes whereas risk was moderate under balanced and low in income schemes. In terms of market benchmark, Tax saving fund had got first rank while balanced fund and equity fund had acquired second and third rank respectively. In other words, the performance of schemes and funds may be inferior or superior depends upon some uncertain factors. Maximum diversification enhances the chances of better results in market but the fund managers under study were failed to get additional compensation for their diversifiable activities. In short, total risk component was essentially high in case of equity fund schemes as compared to other categories of funds but return and systematic risk was greater in tax saving fund itself and it also performed superior.

Decent returns on Mutual Fund NAV's (net asset values) can be achieved by pursuing an aggressive investment strategy. Investors have to make self-analysis of their needs, risk-bearing capacity, and expected returns across different market environments. If investors prefer to invest in tax saving fund, a closer look is must at other similar schemes of the same mutual fund. This can be useful for the investors, when changes have to be made either due to non-performance or in view of revised investment objective/s as well as time horizon. Investing in tax-saving funds that have rewarded investors more per unit of risk taken by them is suggested. As stock markets turn more volatile, and the choice of funds increases, it will become pertinent to make the right investment decision to start with. Going forward, & opting to invest in a fund that not only provides tax relief to the investors but also good returns is advisable.

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