

COMPARATIVE PERFORMANCE ANALYSIS OF LARGE-CAP EQUITY MUTUAL FUNDS: A CASE STUDY OF KOTAK SECURITIES

P Hema naga Janaki Lakshmi¹

¹Department of Business and Management Studies, SR Gudlavalleru Engineering College, Gudlavalleru, India.

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ABSTRACT

Mutual funds have emerged as popular investment vehicles for individuals seeking exposure to the equity market with a diversified approach. This study aims to conduct a comprehensive comparative analysis of large-cap mutual funds offered by Kotak Securities. The research begins by exploring the theoretical underpinnings of large-cap funds, discussing their characteristics, investment strategies, and objectives. The study delves into historical market data to analyse the performance of these funds over the past five years, assessing their risk-adjusted returns and volatility levels. Sharpe ratio and standard deviation are used as key performance indicators to measure and compare the performance of these funds. The research concludes by providing investors with actionable insights based on the findings. The goal is to empower investors at Kotak Securities to make informed decisions regarding their investment preferences, risk tolerance, and long-term financial goals. The study's findings can serve as a valuable reference for financial advisors, individual investors, and market participants interested in gaining a deeper understanding of large-cap funds.

Keywords: Mutual Funds, Large-Cap Funds, Sharpe Ratio, Standard Deviation, Risk-Adjusted Returns, Investment Strategies.

1. INTRODUCTION

A mutual fund is a professionally managed type of collective investment scheme that pools money from many investors and invests it in stocks, bonds, short-term money market instruments, and other securities.

Mutual funds have a fund manager who invests the money on behalf of the investors by buying and selling stocks, bonds, etc. Currently, the worldwide value of all mutual funds totals more than USD 26 trillion. Mutual funds provide a convenient investment avenue for investors who prefer a diversified, professionally managed basket of securities at a relatively low cost.

The Securities and Exchange Board of India (SEBI) regulations define a mutual fund as a fund established in the form of a trust by a sponsor to raise monies by the trustees through the sale of units to the public under one or more schemes for investing in securities in accordance with these regulations. These regulations have since been replaced by the SEBI regulations, 1996. A mutual fund comprises four separate entities: sponsor, mutual fund trust, Asset Management Company, and custodian. The sponsor establishes the mutual fund and gets it registered with SEBI. Thus, a mutual fund is a trust that pools the savings of several investors who share a common financial goal. The money collected is then invested in capital market instruments such as shares, debentures, and other securities. The income earned through this investment and the capital appreciation realized is shared by its unit holders in proportion to the number of units owned by them.

In the context of large-cap equity mutual funds, these funds specifically invest in companies with a large market capitalization, typically those that are well-established and financially stable. Large-cap funds are known for their relatively lower risk compared to mid-cap and small-cap funds, as they invest in blue-chip companies that have a proven track record of performance.

This makes them an attractive option for investors seeking steady growth and income.

Kotak Securities, a prominent player in the Indian financial market, offers a range of large-cap equity mutual funds. This case study aims to conduct a comparative performance analysis of these funds, evaluating their returns, risk-adjusted performance, and overall effectiveness in meeting investor expectations. By analyzing various performance metrics such as the Sharpe ratio, Treynor ratio, and Jensen's alpha, this study seeks to provide a comprehensive understanding of how Kotak Securities' large-cap equity mutual funds perform relative to their benchmarks and peers.

The significance of this study lies in its potential to guide investors in making informed decisions about their investments in large-cap equity mutual funds.

By comparing the performance of Kotak Securities' funds with other similar funds in the market, investors can gain insights into the strengths and weaknesses of these funds, helping them to align their investment choices with their financial goals and risk tolerance.

2. LITERATURE REVIEW

Mutual funds have garnered extensive scholarly attention due to their pivotal role in financial markets and widespread appeal among individual investors. Researchers have scrutinized various facets of mutual fund performance, including risk-adjusted returns, volatility, and management practices. Gruber (1996) underscores the influence of skilled management on fund outcomes, positing that manager expertise significantly shapes performance trajectories. Similarly, Sharpe (1994) introduced the Sharpe Ratio as a critical gauge for assessing risk-adjusted returns, where higher ratios denote superior performance.

In terms of cost efficiency, Bogle (1999) highlights mutual funds' advantages due to economies of scale, which translate into lower expense ratios compared to individual stock investments. Diversification, emphasized by Ippolito (1992), emerges as another cornerstone, reducing portfolio risk by spreading investments across multiple securities.

Large-cap mutual funds have been a focal point in several studies. Carhart (1997) reveals that these funds typically exhibit lower volatility than small-cap counterparts, appealing particularly to risk-averse investors. Analyzing specific large-cap funds from Kotak Securities, recent research has used historical data to evaluate their performance over the past five years, contributing nuanced insights into their market behavior.

Further research delves into intricate dimensions of mutual fund performance. Fama and French (1993) pioneered a comprehensive three-factor model explaining fund returns through market risk, size, and value factors, shedding light on the underlying drivers of fund performance. Jensen (1968) introduced Jensen's Alpha, a pivotal metric assessing managers' ability to exceed expected returns adjusted for risk, while subsequent studies by Elton, Gruber, and Blake (1996) affirm the persistence of superior fund performance, suggesting certain managers consistently add value.

Conversely, Malkiel (1995) challenges the predictability of mutual fund performance, arguing it often adheres to random patterns. Kacperczyk, Sialm, and Zheng (2005) explored how industry concentration influences fund performance, highlighting sectors where specialized knowledge offers strategic advantages. Chen et al. (2004) revealed that larger fund sizes can lead to underperformance due to operational inefficiencies, contrasting with findings on the detrimental effects of high turnover rates identified by Wermers (2000).

Lastly, Barber, Odean, and Zheng (2005) investigated investor behavior's impact on mutual fund outcomes, revealing tendencies among individuals to chase past performance, thereby underscoring the critical role of informed decision-making and professional management in achieving optimal results. These studies collectively underscore the complexity of mutual fund dynamics, urging a balanced approach that integrates empirical research with practical insights to navigate investment choices effectively.

3. OBJECTIVES OF THE STUDY

- To provide a detailed overview of the regulatory framework, historical development, and key characteristics of mutual funds in India.
- To categorize and describe the different types of mutual funds available in the Indian market, with a focus on equity mutual funds.
- To explain the methodology for calculating Net Asset Values (NAVs) of mutual funds and their significance in performance evaluation.
- To compare the performance of selected large-cap equity mutual funds offered by Kotak Securities, using specific performance metrics such as Sharpe ratio and standard deviation.
- To analyse the volatility and fluctuation patterns of NAVs of selected large-cap equity mutual funds over the past five years.

4. METHODOLOGY

4.1 Data Collection:

Historical performance data for selected large-cap mutual funds offered by Kotak Securities over the past five years were meticulously gathered and analyzed. This comprehensive data set encompassed monthly Net Asset Values (NAVs), total returns, and expense ratios, essential metrics for evaluating fund performance and cost efficiency. The primary source of this data was Kotak Securities' official reports, renowned for their reliability and transparency in financial disclosures. To ensure accuracy and completeness, the data was cross verified using secondary sources, including reputable financial databases and market analysis platforms, as detailed in Kumar's (2017) research methodology.

By collating and analyzing this extensive dataset, researchers gained valuable insights into the financial performance trends of these large-cap mutual funds. The monthly NAVs provided a clear snapshot of how fund values fluctuated

over time, reflecting market conditions and investment strategies employed by fund managers. Total returns, encompassing both capital gains and dividends, offered a comprehensive measure of the funds' profitability relative to their investment objectives and benchmark indices. Additionally, the assessment of expense ratios shed light on the cost-effectiveness of these funds compared to industry standards, crucial for investors seeking optimal returns net of expenses.

This robust approach to data collection and analysis not only ensured the reliability of findings but also facilitated informed decision-making for potential investors and financial analysts alike. By leveraging both primary and secondary data sources, the study-maintained rigor and objectivity in evaluating the performance and operational efficiency of Kotak Securities' large-cap mutual funds, contributing to a deeper understanding of their competitive positioning within the market.

4.2 Performance Metrics Calculation:

- **Standard Deviation (SD):** Standard Deviation is a statistical measure used to quantify the amount of variation or dispersion of a set of values. In the context of mutual funds, it is employed to assess the volatility or risk associated with the fund's returns over a specific period. Specifically, it measures how much the returns of a fund deviate from its historical average return. A higher standard deviation indicates that the fund's returns have been more volatile, meaning they have fluctuated widely from the mean return. Conversely, a lower standard deviation suggests more stable and predictable returns. Investors use standard deviation as a tool to gauge the level of risk they are exposed to when investing in a particular mutual fund. It helps investors understand the potential range of returns and make informed decisions based on their risk tolerance and investment goals.
- **Sharpe Ratio:** The Sharpe Ratio is a widely used measure of risk-adjusted return. It was developed by Nobel laureate William F. Sharpe and is calculated by subtracting the risk-free rate (such as the yield on government bonds) from the average return of the mutual fund, and then dividing that result by the standard deviation of the fund's returns. Essentially, the Sharpe Ratio indicates how much excess return a mutual fund generates for each unit of risk taken, relative to a risk-free investment. A higher Sharpe Ratio suggests that the fund has achieved superior returns relative to its risk level. This metric is crucial for investors as it allows them to compare the risk-adjusted performance of different mutual funds. Funds with higher Sharpe Ratios are generally perceived as more attractive because they offer better risk-adjusted returns. However, it's important to note that the Sharpe Ratio should be considered alongside other factors, such as investment objectives and time horizon, to make well-rounded investment decisions.

In summary, while Standard Deviation quantifies the volatility of a mutual fund's returns relative to its average, the Sharpe Ratio provides a measure of how effectively a fund has compensated investors for the risk they have taken. Together, these metrics offer valuable insights into both the risk and return aspects of mutual fund investments, aiding investors in making informed choices aligned with their financial goals and risk tolerance.

4.3 Comparative Analysis:

The performance analysis of selected mutual funds focused on evaluating which fund offered superior risk-adjusted returns and exhibited lower volatility over a specified period. This comparative assessment involved analyzing two key metrics: Standard Deviation and the Sharpe Ratio. Standard Deviation was employed to measure the volatility of each fund's returns relative to its historical average return.

A higher Standard Deviation indicated greater variability in returns, suggesting higher risk associated with the fund. Conversely, a lower Standard Deviation implied more stable returns.

The Sharpe Ratio, on the other hand, served as a critical measure of risk-adjusted return. Developed by William F. Sharpe, this metric compares the average return of a fund to the risk-free rate (such as government bond yields), adjusted for the fund's volatility as measured by its Standard Deviation. A higher Sharpe Ratio signifies that a fund has delivered better returns for each unit of risk taken, making it more attractive to investors seeking optimal risk-adjusted performance.

Rao and Tummalapalli's (2020) analysis leveraged these metrics to compare the performance of the selected mutual funds. By evaluating both the Standard Deviation and Sharpe Ratio over the specified period, their study provided insights into which fund managed to achieve better risk-adjusted returns while maintaining lower volatility.

This approach not only facilitated a quantitative comparison of fund performances but also helped investors identify potential investment opportunities aligned with their risk tolerance and financial objectives. Such comprehensive analyses are crucial for making informed investment decisions in the dynamic landscape of mutual fund investments.

5. RESULTS AND DISCUSSION

From Table 1, it is evident that each fund exhibits varying levels of risk and return characteristics over the past five years. The Kotak Large Cap Fund stands out with the highest Sharpe Ratio of 1.3, indicating it offers the best risk-adjusted return relative to the other funds analysed. This metric suggests that investors in this fund have been compensated more effectively for the level of risk taken compared to the other two funds.

In terms of volatility, the Kotak Blue-chip Fund shows the lowest Standard Deviation at 15.2%, suggesting it has been the least volatile among the selected funds. Lower volatility typically indicates more stable returns over time, which may appeal to risk-averse investors seeking steadier performance.

Table 1: Summary of Standard Deviation and Sharpe Ratio for Selected Funds Over the Past Five Years		
Fund Name	Standard Deviation (%)	Sharpe Ratio
Kotak Blue-chip Fund	15.2	1.2
Kotak Equity Fund	14.5	1.1
Kotak Large Cap Fund	16	1.3

Overall, these metrics from Table 1 provide valuable insights for investors evaluating mutual funds. The Sharpe Ratio helps assess how well each fund has performed relative to the risk it has undertaken, while Standard Deviation offers a measure of the variability of returns. Investors can use this information to align fund selections with their risk tolerance and investment objectives, ensuring informed decision-making in their financial planning endeavours.

5.1 Sharpe Ratio Analysis

The analysis of Sharpe ratios reveals that the Kotak Large Cap Fund offers the highest return per unit of risk among the selected funds, making it a particularly attractive option for investors seeking superior risk-adjusted returns. This finding underscores the fund's ability to deliver competitive performance relative to the risk it entails. The higher Sharpe Ratio of 1.3 for the Kotak Large Cap Fund suggests that investors have been rewarded more efficiently for the level of risk taken compared to the other funds analyzed in Table 1.

This observation aligns with the broader understanding in financial markets that large-cap funds, while typically exhibiting lower volatility than small-cap funds, can still generate compelling returns. According to Kamal et al. (2022), large-cap funds are often favored by risk-averse investors for their potential to provide stable performance amidst market fluctuations while offering competitive returns over the long term. The Kotak Large Cap Fund's strong performance in terms of Sharpe Ratio reaffirms its position as a viable choice for investors seeking a balance between risk mitigation and return potential within the large-cap segment of mutual funds.

In summary, the Sharpe Ratio analysis underscores the Kotak Large Cap Fund's attractiveness due to its ability to achieve higher risk-adjusted returns, reflecting its favorable performance relative to risk. This finding provides valuable guidance to investors looking to optimize their portfolio allocations based on risk tolerance and investment objectives, emphasizing the importance of thorough fund analysis in making informed investment decisions.

5.2 Standard Deviation Analysis

The analysis of standard deviation highlights that the Kotak Blue-chip Fund exhibits the lowest volatility among the selected funds, making it a fitting choice for risk-averse investors who prioritize stability over potentially higher returns. With a standard deviation of 15.2%, the fund has demonstrated more stable performance compared to its peers over the past five years, indicating less variability in its returns. This lower volatility characteristic of the Kotak Blue-chip Fund can be attributed to its diversified investment strategy and focus on blue-chip companies with established market positions. According to Leelavati et al. (2022), such funds typically invest in large, well-established companies known for their stable earnings and market leadership. These companies are often perceived as less risky investments due to their resilience to market fluctuations and economic downturns, contributing to a smoother performance trajectory for the fund. For risk-averse investors, the Kotak Blue-chip Fund's ability to maintain lower volatility underscores its appeal as a conservative investment option. While it may not offer the highest potential returns compared to more aggressive funds, its stability provides a sense of security and predictability in investment outcomes. This aligns with the investment strategy of preserving capital and achieving modest, consistent growth over the long term, which is often preferred by investors seeking to mitigate risk in their portfolios.

In conclusion, the analysis of standard deviation highlights the Kotak Blue-chip Fund as a suitable choice for risk-averse investors looking for stability and predictability in their investments. Its lower volatility, supported by a diversified portfolio of blue-chip stocks, reinforces its role in providing steady returns amidst market uncertainties, aligning with the preferences and objectives of conservative investors.

6. CONCLUSION

Mutual funds represent a compelling investment avenue for individuals aiming to diversify their portfolios and benefit from professional management. This study's in-depth comparative analysis of selected large-cap mutual funds offered by Kotak Securities underscores the diverse benefits these funds offer to investors. Specifically, the findings reveal that the Kotak Large Cap Fund stands out for delivering superior risk-adjusted returns, as indicated by its higher Sharpe Ratio compared to other funds analyzed. On the other hand, the Kotak Blue-chip Fund emerges as the least volatile option, appealing particularly to risk-averse investors prioritizing stability in their investment strategies.

These insights are pivotal for investors navigating the complex landscape of mutual fund investments. By understanding the risk-adjusted returns and volatility profiles of these funds, investors can align their investment choices more closely with their individual preferences, risk tolerance levels, and long-term financial objectives. For those seeking a balance between risk and return, the Kotak Large Cap Fund's ability to offer competitive performance relative to its risk level positions it as a strong candidate. Meanwhile, the Kotak Blue-chip Fund's lower volatility makes it an attractive option for conservative investors looking to safeguard their capital while achieving steady, albeit potentially more moderate, returns over time. Ultimately, the decision to invest in mutual funds should be informed by a thorough consideration of these findings alongside personal financial circumstances and investment goals. By leveraging the insights gained from this study, investors can make informed decisions that optimize their investment returns while aligning with their risk preferences and broader financial plans. This approach underscores the importance of research-driven decision-making in navigating the dynamic and diverse mutual fund market, ensuring that investment strategies remain well-suited to individual needs and objectives over the long term.

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