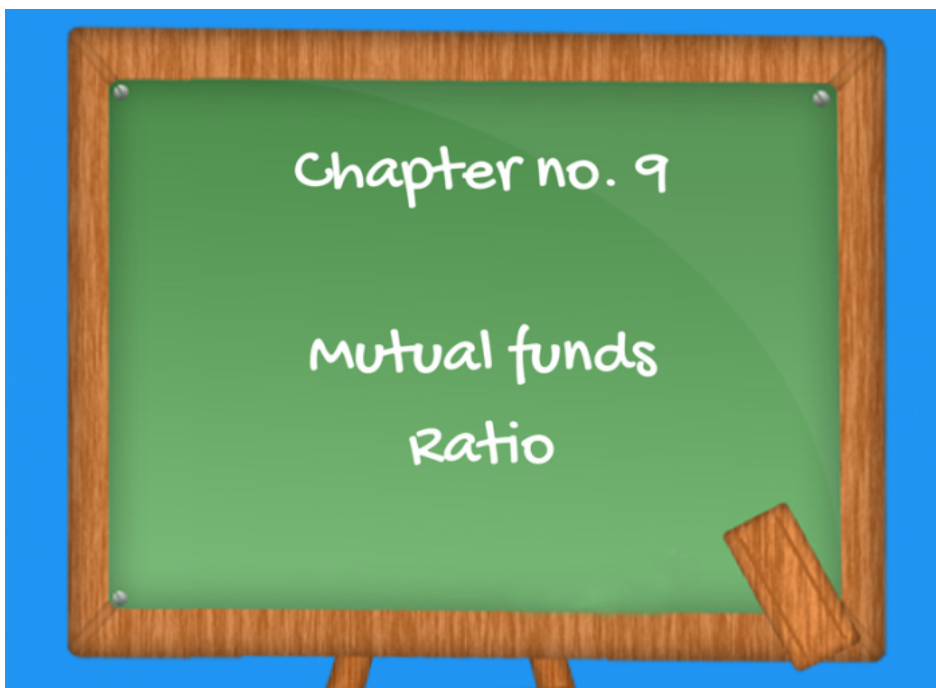




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Mutual Funds Ratio

By WealthTrust (<https://www.wealthtrust.in/blog/author/wealthtrust/>) / June 22, 2017 (<https://www.wealthtrust.in/blog/mutual-funds-ratio/>)



Chapter 9 – Mutual Funds Ratio

India hosts more than 2000 mutual fund schemes with sub varieties in its plan. As an investor how do we pick the best fund that would suit our needs from such a huge chunk? We evaluate any performance by using certain metrics, for bike its mileage, pick up, durability are the major metrics that we consider while evaluating. Similarly for mutual funds we have a set of metrics through which we would be able to differentiate between what is good for us and what is not. Here are the key metrics that we consider while evaluating a mutual fund.

1. Beta

Beta is a measure of mutual fund schemes volatility compared to its benchmark. This ratio would help us to judge how much a fund's performance can move upside/downside compared to its benchmark.

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Formula

$$\text{Beta} = (\text{Standard deviation of mutual fund scheme} / \text{Standard Deviation of Benchmark}) * R\text{-Square}$$

Significance

A fund with beta value more than 1 would move more volatile than the market. i.e. if market moves up 100% a fund with beta value of 1.5 would move up by 150% and if market comes down by 20% the fund will come down by 30%.

If beta value is less than 1 it means fund will be less volatile than the benchmark. i.e. if market moves up 100% a fund with beta value of 0.75 would move up by 75% and if market comes down by 20% the fund will come down by 15%.

2. Alpha

Alpha is a measure of mutual funds' performance after adjusting the risk. This ratio helps to measure the fund manager performance

Formula

Alpha = Mutual fund scheme return - (Risk free rate of return + beta*(Benchmark return - Risk free rate of return))

*Risk free return is the return that would be obtained if invested in a govt bond for the same duration as mutual fund.

Significance

Higher the alpha, it's better for investor. Positive alpha numbers indicate positive returns compared to benchmark and negative alpha value indicates negative returns to benchmark.

For example if alpha is 8 it means scheme would outperform benchmark by 8% and if alpha -8 the scheme will underperform by 8% compared to benchmark.

3. R Squared

It's a measure of co-relation between mutual fund schemes performance and its benchmark. It ranges between 1 and 100.

Formula

R – Squared = (covariance between benchmark and mutual fund scheme / (Standard deviation of mutual fund scheme* standard deviation of benchmark))²

Significance

A high R-squared, between 85% and 100%, indicates the fund's performance patterns have been in line with the index. A fund with a low R-squared, at 70% or less, indicates the security does not act much like the index.

4. Standard deviation

Standard deviation (SD) measures the volatility the fund's returns in relation to its average returns. It tells you how much the fund's return can deviate from the historical mean return of the scheme. If a fund has a 10% average rate of return and a standard deviation of 4%, its return will range from 6%-14%.

Formula**When you take more than 3 years data**

Variance = (Sum of squared difference between each monthly return and its mean / number of monthly return data)

Or

When you take less than 3 years data

Variance = (Sum of squared difference between each monthly return and its mean / number of monthly return data – 1)

Standard deviation = square root of variance;

Significance

The higher the standard deviation, the more volatile is the fund's returns. Prefer funds with lower volatility.

5. Sharpe Ratio

Sharpe ratio helps the investor tell if a mutual fund delivers the returns with respect to the risk taken by it on comparing a fund with risk free rate of return.

Formula

Sharpe ratio= (Mutual fund returns – Risk free rate of return)/ Standard deviation of mutual fund

Significance

Higher the better, if this value is negative it should be understood as mutual fund underperforms when compared to risk free rate of return (Govt. bonds or even a simple FD).

6. Information Ratio or appraisal ratio

Information ratio helps the investor tell if a mutual fund delivers the returns with respect to the risk taken by it on comparing with benchmark.

Formula

Information ratio = (Mutual fund returns – benchmark return)/SD (Standard deviation of mutual fund – Standard deviation of benchmark)

Significance

Higher the better and signifies the fund manager is doing a good job.

7. Treynor Ratio or reward to volatility ratio

This ratio is developed by Jack Treynor to measure a fund's performance against the risk taken.

Formula

Treynor ratio = (Mutual fund return – risk free rate of return)/ Beta of mutual fund.

Significance

Higher the ratio, higher the returns against volatility.

8. Sortino Ratio

Sortino ratio measures the mutual fund performance against the downside deviation. This ratio is similar to Sharpe ratio

Formula

Sharpe ratio= (Mutual fund returns – Risk free rate of return)/downside deviation of mutual fund

Significance

Higher the Sortino ratio, lesser the probability of huge loss.

9. Upside Capture Ratio

Upside capture ratio is a measure of funds' performance to its benchmark index during bull market (where market is rising up)

Formula

Upside capture ratio = (Mutual fund returns in bull market/ benchmark index returns in bull market)* 100

Significance

If the value is more than 100 it means the fund has performed better than benchmark during bull market (up market).

10. Downside Capture Ratio

Downside capture ratio is a measure of funds' performance to its benchmark index during bear market (where market is falling down)

Formula

Downside capture ratio = (Mutual fund returns in bear market/ benchmark index returns in bear market)* 100

Significance

If the value is less than 100 it means the fund has performed better than benchmark during bear market (bear market).

Back to [Chapter 8](https://www.wealthtrust.in/blog/mutual-funds-taxation/) (https://www.wealthtrust.in/blog/mutual-funds-taxation/) – Mutual funds Taxation.

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N harikrishna

April 9, 2018 at 8:55 PM (<https://www.wealthtrust.in/blog/mutual-funds-ratio/#comment-70455>)

Very nice..... From where i can get expense ratio of various mutual funds...and list of stocks in a fund...

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April 10, 2018 at 3:35 PM (<https://www.wealthtrust.in/blog/mutual-funds-ratio/#comment-70570>)

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