Building an Equity Portfolio using Mutual Funds

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The present paper makes an attempt to decipher the methodologies widely adopted by Fund Managers in developing an Equity portfolio. An equity portfolio comprises of equity securities from different sectors of the economy depicting varied characteristics. As stated by classical theory of finance, a well-diversified portfolio seeks to give higher returns with reduced risk as compared to a non-diversified portfolio where higher returns are derived only with higher risks.

In the present study, the author makes an attempt to understand the factors considered by Fund managers in developing an equity portfolio. In order to carry out the task, the author has confined to a sample of 15 securities to develop an equity portfolio. Given that these 15 securities command high market capitalization, the sample looks justifiable capable of reflecting similar traits observed in a portfolio comprising higher sample.

The study focuses on the twin approaches of Fundamental and Technical analysis to select the securities for forming the portfolio. Fundamental analysis seeks to identify the characteristics unique to a company that distinguishes it from others as reflected by various financial parameters. Technical analysis on the other hand focuses on tracing the patterns formed by securities as reflected by the movement in prices and quantity of securities traded over a period of time.

The present study is highly relevant and meaningful in the realm of current practices in the world of security analysis and portfolio management as it identifies useful techniques applied by practicing fund managers keeping the fundamental concepts in mind.

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Introduction

Many investors in stock market invest in equity shares based on their hunch or intuition. To understand and analyze how fund managers of each mutual fund have invested the money, the summer internship study was done on the top performing mutual funds.

The main **objectives** of the study are as following:

- To identify top 15 equity share based on mutual fund performance.

- To validate the investments in identified equities.

- To do the fundamental and technical analysis of the selected set of equity shares

- To identify most profitable sectors based on top 15 equity shares in which mutual fund companies have invested the most.

- To suggest an equity portfolio comprising of those top 15 equity shares obtained after analyzing top 50 mutual funds.

The research was done to identify top 15 equity shares so that the investor can invest for a long term return. The research includes fundamental and technical analysis. The stock scripts were shortlisted at every stage of study. The companies were shortlisted on the basis of top performing sectors, then the companies were studied on the basis of fundamental analysis and technical analysis of the top performing 15 shares that were identified.

Company Profile:

Basket Option Pvt. Ltd. was founded by Mr. Abdul Gaffar Sait, currently CEO of the company. Basket Option Pvt. ltd is a Wealth Management company incubated by Jain Group of Institutions & has been in existence for 6 years. They are into managing corporate portfolios comprising of Assets Management, Insurance, and liability products too. They are considered as one of the best corporate risk managers in the industry due to the value they bring to the table. They manage around 150 corporate clients from various industries, starting from Hospitality Industry, Real estate, Software, Developers, Educational Institutions, Telecommunication, Manufacturing industry and few MNCs.

Methodology

The study has been conducted on the basis different parameters which include percentage investment of net asset in different stocks, Sector Analysis, Fundamental analysis along with Technical analysis to understand the different aspects of fund evaluation.

Sources of Data Collection:

➢ Secondary Data: The secondary data for this study has been sourced from published records, reports and websites and books.

The secondary data includes:

◆ Fact sheets and reports of the various Asset Management Companies

◆ Information through websites such as valueresearch.com and indiainfoline.com

◆ Balance sheet and ratio analysis from the company's websites

Analysis and Interpretation[2] :

Fundamental Analysis:

ITC:

1. Price to Earnings Ratio- P/E Ratio:

Table 1

2012	31.34
2011	31.72
2010;	29.30

Price to Earnings ratio shows how much investor is willing to pay per rupee of earnings. In the year 2012 the P/E ratio was Rs.31.34. It means that an investor is willing to pay Rs. 31.34. for Rs.1 of current earnings.

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[2] In the original report technical and fundamental analysis of 15 companies was done.

2. Debt to Equity Ratio:

Table 2

2011	0.01%
2010	0.01%
2009	0.01%

In case of ITC, we can see that the Debt/Equity ratio in the last 3 years was around 0.0%. A debt-equity ratio of 0.0% indicates that company has been financing its capital only through equity.

3. Return on Capital Employed:

Table 3

2011	48.8%
2010	43.7%
2009	37.4%

In the year 2011 this ratio was around 49%, indicating that 49% of its profit was gained through assets after paying for current liabilities. This ratio has risen significantly from the year 2009. This ratio is very high, signifying that this share is very good for the investors to invest.

4. Price to Book ratio:

Table 4

2012	11.49
2011	8.83
2010	7.17

During the above mentioned years, the price to book ratio was more than 1, it means that the; company's earning is really good and it is not overvalued. In the year 2012 this ratio was the highest, indicating higher returns from the share.

5. Dividend Yield:

Table 5

2012	1.9%
2011	1.9%
2010	1.9%

During the above mentioned years this ratio was above 1%, signifying that an investor can earn around Rs.2 for every Rs.1 invested. So it is a very good share for the investment. This share has been giving good dividends to its investors.

6. Earnings Per Share (EPS):

Table 6

2012	7.5
2011	5.7
2010	9.0

This ratio serves as an indicator of a company's profitability. In the year 2012, the EPS ratio is 7.5:1; it means that the earning is Rs.7.5 per share. However this ratio was much lower in the year 2011. This ratio was the highest in the year 2010.

7. Market Capitalization:

Market capitalization represents the total dollar market value of all of a company's outstanding shares. It is calculated by multiplying the price of the stock by the number of stocks issued. The current market capitalization of the company in 2012 is Rs.182,794.76 Crore. Market capitalization is the consensus opinion of what the market thinks the company is worth.

Tata Consultancy Services (TCS):

1. Price to Earnings Ratio- P/E Ratio:

Table 7

2012	21.96
2011	22.51
2010	32.56

In the year 2012 the P/E ratio was 21.96:1. It means that an investor is willing to pay Rs.21.96 for Rs.1 of current earnings. This ratio was higher in the previous two years. It was the highest in the year 2010.

2. Debt to Equity Ratio:

Table 8

2011	0.01%
2010	0.01%
2009	0.01%

A debt/equity ratio of greater than 1, generally means that a company has been aggressive in financing its growth with debt. This can result in volatile earnings as a result of the additional interest expense. In case of TCS, we can see that the Debt/Equity ratio in the last 3 years was almost zero. It means that the company has been using only equity to finance its operations.

3. Return on Capital Employed:

Table 9

2011	59.3%
2010	49.9%
2009	44.6%

In the year 2011 this ratio was around 60%, indicating that 60% of its profit was gained through assets after paying for current liabilities. In the year 2009 this ratio was lower indicating that around 45% of its profits have been gained through assets. This ratio is very high, signifying that this share is very good for the investment.

4. Price to Book ratio:

Table 10

2012	9.23
2011	11.88
2010	10.18

During these years, the price to book ratio was more than 1, it means that the company's earning is really good and it is not overvalued. In all these years this share was close to 10, signifying higher returns from the share.

5. Dividend Yield:

Table 11

2012	2%
2011	2%
2010	2%

In the absence of any capital gains, the dividend yield is the return on investment for a stock. In all these years this ratio was 2%, signifying that an investor can earn Rs.2 for every Rs.1 invested. So it is a very good share for investment.

6. Earnings per Share (EPS):

Table 12

2012	51.9
2011	36.3
2010	25.3

This ratio shows that portion of a company's profit which is allocated to each outstanding share of common stock. This ratio serves as an indicator of a company's profitability. In the year 2012, the EPS ratio is 52:1; it means that per share company is earning Rs.52. However this ratio was much lower in previous 2 years. Huge increase in the EPS value shows that the company's profit has increased a lot in the current year 2012.

7. Market Capitalization:

Market capitalization represents the public consensus on the value of a company's equity. It is calculated by multiplying the price of the stock by the number of stocks issued. The current market capitalization of the company in 2012 is Rs. 241,031.77 Crore. Market capitalization is the consensus opinion of what the market thinks the company is worth.

Technical Analysis (Candlestick Approach)

ITC

Figure 1 : Last 3 years performance analysis

The general trend for the share has been upward. In the month of June in 2009, the share price was around the price level of 100 and in the month of May in 2012, the share price went above the price level of 220. So there was an increase of 120% in the share price. So the investors who are looking for long term profit can keep ITC in their portfolio.

In the month of May in 2009, the share was trading around the price level of 100. The share continued to trade around this price level in the month of June also. From this level the share price went up to the price level of 105 in the month of July. In the month of August in 2009, the share price went up to the price level of 120, where the share found its resistance level around this price level. After reaching this price level of 120, the share was able to stick around this price level of 120 in the month of September but the share was not able to break the price level of 120. In the beginning of the month of February, the share fluctuated between the price level of 120 to 130 and the share was almost stable around this price level. But in the month of March the share broke its previous resistance level of 130 and the share went up to the price level of 140, where the share reached its new resistance level in the month of April.

In the month of November in 2011 the share was trading around the price level of 180 which is its resistance level. In the month of December the share was stable around the price level of 170 and the share fluctuated

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between the price level of 160 to 170 in the months of February and March. In the month of December in 2011 the share again reached its new resistance level of 210 and it fell to the rice level of 200 which became new support level for the share. In the months of January and February in 2012 the share was stable around the price level of 200 and the share again reached its previous resistance level of 210 with a strong support around the price level of 200. In the month of April the share started to gain momentum and the share broke its previous resistance level of 210 and the share reached above the price level of 220 which became new support level for the share. From this support level the share moved above the price level of 240 which became new resistance level for the share and the share fell to its previous strong support around the price level of 220.

Figure 2 : Last 6 months performance analysis

In the beginning of the month of November we can see a Bearish Engulfing pattern. This pattern gives strong signals of the arrival of the sellers in the market and heavy sell-off could happen in the market. Soon after this pattern we can see a red Spinning Top pattern. This pattern indicates toward confusion or indecision in the mind of investors. After the appearance of this kind of pattern the trend can become downward. That's why we can see a sharp fall in the price from the price level of 210 to the price level of 190 in the 3rd week of December. But in the 3rd week we can again see a green Spinning Top pattern. After the appearance of this pattern the trend can become upward with heavy buying in the market.

In the beginning of the month of December, we can see a Bearish Harami pattern. This pattern indicates that the share has opened and closed below

the previous day's price. This pattern gives low to moderate signals of reversal in the trend. This pattern signifies that the sellers can again come into the market. In the 2nd week we can see couple of Doji pattern, indicating towards possible change in trend. In the last week of December we can see lot of Spinning Top patterns, indicating towards the confusion or indecision among investors. This pattern gives signals of uncertainty in the market regarding whether to buy or sell the share. These patterns of Spinning Top can be seen up to the 1st week of January in 2012. In the 2nd week of January we can see a Bearish Harami pattern, giving low to moderate signals of the arrival of buyers in the market.

In the 1st week of March, we can see a Doji pattern. This pattern signifies that the share price opened and closed at the same price level. This pattern indicates towards the possible change in trend. From this point the trend can become either upward or downward. That's why in the 3rd week we can see a big green candle. It signifies towards the arrival of buyers to the market. In the 3rd week again we can see a Doji pattern, indicating toward the possible change in trend. In the last week in the month of March and in the beginning of the month of April we can again see lot of Spinning Top patterns. This pattern indicates towards the confusion or indecision in the mind of investors. In this month share price reached the price level above 240. In the 3rd week we can see a Bullish Harami, giving low to moderate signals of the arrival of buyers in the market. In the last week of April we can see couple of Doji patterns, signifying towards the possible change in trend. That's why in the month of May, we can see that the share price went below the price level of 230. This fall indicates towards sell-off in the market.

Tata Consultancy Services (TCS)

Figure 3 :Last 3 years performance analysis

The general trend of the share is upward. In the chart we can see that the share is bullish and the bulls are buying the shares with bears selling the share and making short term profits causing little fluctuations in the share price. In the month of February the share found a new support around the price level of 800. But due to short term sell the share price broke the previous level of 800 and came down to around the price level of 700. From here the share fluctuated between the price level of 700 to 800 and again the share price came up to around the price level of 850 to meet its previous resistance point in the month of August in 2010.

In the month of February in 2011, the share reached the new peak around the price level of 1200. At this point the share found its new resistance point around the price level of 1200. But at this peak the share was not able to sustain for long and the share fell to around the price level of 1100 in the month of March in 2011. The share than again went up to the price level of 1150 in the month of March. From this price level of 1150 the share fell to its previous support level of around the price level of 1100.

In the month of August in 2011 the share price fell from the price level of 1100 and broke its previous strong support of around 1000 price level and came down to the price level of 900. This price level of 900 offered a strong support to the share and helped it not to go below this price level. And the share again went above the price level of 1000. In this month of September the share was fairly stable around this price level of 1000. At this price level of 1000 the share also found a strong support in the month of September. From this strong support the share started to move up with fluctuations in the month of October and the share came around the price level of 1100. In the month of May in 2012 the share again started move up and it again went up to its previous resistance point of 1300. But at this price level of 1300 the share was not able to sustain and it fell to the price level of 1200 where the share found its new support.

Figure 4 : Last 6 months performance analysis

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change. It shows that the share opened and closed at the same price. It indicates that all confidence built up by the bulls from the 1st day is destroyed when the next day's gap closes near its open. That only has happened in the share and we can see a fall in the share price from 1110 to 1060 price level. In the 3rd week of November, we can see a Bullish Harami. It indicates low to moderate reversal signals. Since Bullish Harami reflects that the price opened lower and then closing higher, it connotes that buyers are coming in control of the market.

Then from the 2nd week of December, we can see a lot of Spinning tops indicating indecision among the investors regarding whether to buy or sell the share. So sell-off happens and the share price falls from 1180 to 1130 price level. In the first week of January in 2012, we can see a bearish engulfing pattern, it is indicating future bearish trend in the share. It is a kind of reversal pattern indicating that the bears can become active and sell-off could happen in the market. Then from the 4th week of January we can see sharp increase from 1070 price level to 1230 price level in just 2-3 weeks a lot of buying happens which again lifts the share to a new and high price level. Then from here we can again see a lot of small fluctuations and Spinning Tops in the share trend indicating confusion and indecision among investors regarding whether to buy or sell the share.

From 2nd week to 3rd week of February the share was fairly stable and fluctuated between the price level of 1130 to 1170. Then in the 3rd week of March we again see a Doji appearing indicating trend can again change. This exactly happens and profit takers appeared in the market and the share fell heavily to its previous low in the past 5 months to around 1050 price level in the 3rd week of April. From here the share moved up sharply and broke again the 1200 price level in the 4th week of April due to the excellent quarterly result of TCS. At this point we can see a couple of patterns i.e. Bearish Harami and Bullish Engulfing. The first pattern of Bearish Harami has low to moderate strength. But bullish engulfing is a reversal pattern and is giving strong signal regarding the arrival of more buyers in the market. This only happens and the share reached a new peak of around1280 price level in the first week of May.

Result

The result of this analysis is a mutual fund which is equity type. This mutual fund is a portfolio of equity shares and it consists of those top 15 equity shares which have been arrived by analyzing top 50 mutual funds. Any

investor who wishes to invest for long term i.e. for 2-3 years can invest in this mutual fund or in any of these shares and can gain a lot. The equity shares have been assigned specific percentage of NAV based on their profitability in last 3 years. The Net Asset Value (NAV) of this mutual fund is 26 Crores.

Table 13

Name of Holding	Instrument	%Net Assets	Value (Rs.)
Tata Consultancy Services	Equity	20%	52,000,000
Lupin	Equity	15%	39,000,000
ITC	Equity	12%	31,200,000
ING Vysya Bank	Equity	12%	31,200,000
Hindustan UniLever	Equity	8%	20,800,000
HDFC Bank	Equity	6%	15,600,000
HDFC Equity	Equity	5%	13,000,000
Divi's Laboratory	Equity	5%	13,000,000
Bank Of Baroda	Equity	5%	13,000,000
Nestle India	Equity	3%	7,800,000
Infosys	Equity	3%	7,800,000
ICICI Bank	Equity	2%	5,200,000
State Bank of India	Equity	2%	5,200,000
Bharti Airtel	Equity	1%	2,600,000
Reliance Industries	Equity	1%	2,600,000
			NAV= 260000000

Findings

1. The top 15 equity shares after analyzing the top 50 mutual funds based on their profitability in the last 3 years are as follows:

Table 14

Name of the equity share
1. Tata Consultancy Services
2. Lupin
3. ITC
4. ING Vysya Bank
5. Hindustan Uni Lever
6. HDFC Bank
7. Housing Development Finance Corporation (HDFC)
8. Divi's Laboratory
9. Bank Of Baroda (BOB)
10. Nestle India
11. Infosys
12. ICICI Bank
13. State Bank of India (SBI)
14. Bharti Airtel
15. Reliance Industries Ltd. (RIL)

2. The top two sectors which were favourite among top 50 mutual funds are Banking and Fast-Moving-Consumer-Goods (FMCG) sector. Among top 15 equity shares all the shares which come under each of these sectors are listed below:

Table 15

Sectors	
Banking	**FMCG**
1. ING Vysya Bank	1. ITC
2. HDFC Bank	2. Hindustan Uni Lever
3. Bank Of Baroda	3. Nestle India
4. ICICI Bank	
5. State Bank of India	

4. The top 3 equity shares among these 15 equity shares based on their profitability in these last 3 years i.e. from 2009 to 2012 are as follows:

Table 16

Name of the Stock	Profitability (%)
1. Tata Consultancy Services (TCS)	300%
2. Lupin	233%
3. ITC	200%

Conclusion

Equity investment is a type of investment which requires a lot of planning. But many investors in stock market just invest in equity shares based on their hunch or intuition. They do not know in which equity shares to invest.

An investor can be categorized on the basis of his/her horizon of investment i.e. short & long term. An investor whose investment horizon is short is investing for short period based on market rumours. On the other hand an investor whose investment horizon is long term thinks that he will get high returns from any equity share. Both types of investors before investing in any equity share should analyze the share both fundamentally and technically.

This project is a guide to both types of investors who wish to invest in equity shares but are confused in which company to invest. This study provides investors with 15 equity shares where they can invest for both short and long term.

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