A Performance Study on Sectoral and Diversified Mutual Fund Among Selective AMC's

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Abstract

This study examines the performance of sectoral and diversified mutual funds managed by selected Asset Management Companies (AMCs) in order to determine their risk-return profiles and investor preferences. Sectoral funds, which focus on certain industries, produce better returns but are more volatile, whereas diversified funds provide consistent returns by investing across numerous sectors. Statistical approaches such as Sharpe Ratio, t-tests, and regression analysis were used to analyze primary data from 80 investors as well as secondary data from 2013-2024. The findings show that sectoral funds produce better long-term gains but are more risky, whereas diversified funds provide consistent performance with lower volatility. The study focuses on the impact of AMCs, fee ratios, and market circumstances on mutual fund performance, providing significant insights for investors, analysts, and policymakers looking to optimize investing strategies.

Keywords

Mutual Funds, Sectoral Funds, Diversified Funds, Asset Management Companies, Investment Performance, Risk-Return Analysis, Investor Preferences.

Introduction

Mutual funds play an important role in investment portfolios by providing diversification and management expertise. This study, titled "A Performance Study on Sectoral and Diversified Mutual Funds among Selective AMCs," compares sectoral and diversified mutual funds, examining their risk-return profiles and market returns. Sectoral funds concentrate their assets in specific industries, resulting in great growth potential but increased volatility, whereas diversified funds distribute their interests throughout sectors to provide steady returns. Using primary data from 80 investors and secondary data from 2013-2024, the study assesses performance using statistical tools like as Sharpe Ratio, t-tests, and correlation analysis. The findings will assist investors in aligning their investments with their financial goals and risk tolerance, as well as investigating the influence of asset management companies, expense ratios, and market movements in mutual fund performance.

Objectives:

The major goal of this research is to evaluate and contrast the performance of sectoral and diversified mutual funds managed by a select group of Asset Management Companies (AMCs) in order to better understand their risk-return profiles and investment potential. Its goal is to use statistical methods like the Sharpe Ratio, correlation analysis, and regression analysis to assess the influence of market circumstances, economic factors, and volatility on the funds. Additionally, the study investigates investor preferences and decision-making characteristics that influence the choice between sectoral and diversified funds. It also evaluates the impact of AMCs, expense ratios, and fund management practices on mutual fund performance. Finally, the study offers insights and recommendations to assist investors connect their mutual fund choices with their financial objectives and risk tolerance, resulting in better informed and strategic investment decisions.

Diversified Funds vs Sectoral Funds

Mutual funds are classified according to their investing strategies, with diversified funds and sectoral funds illustrating two separate strategies. Understanding the differences between them is critical for investors when choosing the appropriate fund based on risk tolerance, return expectations, and market conditions.

1. Diversified Mutual Funds

Diversified mutual funds invest in many different kinds of industries and sectors, limiting exposure to sector-specific risks. These funds strive to generate stable and consistent returns by balancing risk and reward across a diverse asset portfolio.

Key Features:

- **Lower Risk:** As investments are diversified across multiple sectors, the risk of underperformance in any one sector is reduced.
- **Stable Returns:** Diversified funds often provide stable returns over time, making them ideal for conservative investors.
- **Market Resilience:** These funds outperform amid economic swings because losses in one sector can be offset by gains in another.
- **Ideal for long-term investors:** Ideal for investors seeking consistent wealth building with moderate risk exposure.

2. Sectoral Mutual Funds

Sectoral mutual funds focus their investments on a certain industry, such as banking, IT, healthcare, or infrastructure. These funds seek to capitalize on a specific sector's growth potential, but they carry a higher risk due to a lack of diversification.

Key Features:

- **High Growth Potential:** When a sector does well, sectoral funds outperform diversified funds.
- **Higher volatility:** These funds are more vulnerable to industry-specific risks, regulatory changes, and economic fluctuations.
- **Market timing is critical:** To optimize gains, investors must have extensive sector knowledge and enter/exit at the appropriate times.
- **Best For Aggressive Investors:** Suitable for investors with a high risk tolerance and a thorough understanding of their selected area.

Analysis

1. Performance Analysis of Diversified vs Sectoral Mutual Funds

The study utilizes return analysis to examine the performance of sectoral and diversified mutual funds over various time periods. The findings show that sectoral funds provide better long-term returns but are more volatile, whereas diversified funds provide consistent and stable returns. For example, the Kotak Emerging Equity Fund (Diversified) returned an average of 22.89% over five years, whereas the ICICI Prudential Technology Fund (Sectoral) returned 27.09%, indicating sectoral funds' strong return potential. However, the Sharpe Ratio research revealed that diversified funds have higher risk-adjusted returns, making them a safer investment alternative for moderate-risk investors.

2. Volatility and Risk Analysis

A standard deviation analysis was used to examine the volatility of sectoral and diversified funds. Results demonstrate that sectoral funds have a higher standard deviation (6.30%) than diversified funds (3.07%), implying greater price volatility. Correlation study backs up this finding, indicating that diversified funds have more consistent long-term performance trends, whereas sectoral funds face dramatic variations due to industry movements. These findings imply that risk-averse investors should focus on diversified funds, whilst aggressive investors with a great market understanding may gain from sectoral funds.

3. Investor Behaviour and Fund Selection Preferences

The study surveyed 80 investors to discover about their investment preferences. The results suggest that 53.75% prefer diversified mutual funds, while only 27.5% invest in sectoral funds, indicating a preference for stability over high-risk, high-reward strategies. Furthermore, 40% of investors prioritize long-term wealth accumulation, with 38.8% investing for better returns, indicating a fair mix of investment incentives. The study also finds that 95.1% of investors believe Asset Management Companies (AMCs) have an important impact in fund performance, underlining the significance of fund management skills in mutual fund selection.

4. Statistical Comparison Using Independent t-Test

An independent t-test was used to examine whether there is a significant difference in the returns of sectoral and diversified funds. The findings revealed that the p-values for 1-year and 3-year returns were greater than 0.05, indicating no statistically significant difference in short-term performance. However, for 5-year returns, the p-value was less than 0.05, indicating a significant difference between the two groups. This means that sectoral funds outperform diversified funds in the long run, but with higher risks. These findings support the notion that short-term investors should favour diversified funds for stability, whilst long-term investors with a higher risk tolerance might consider sectoral funds for potential high returns.

5. Sharpe Ratio Analysis for Risk-Adjusted Performance

The Sharpe Ratio was used to evaluate the risk-adjusted performance of sectoral and diversified mutual funds. According to the findings, diversified funds typically provide higher risk-adjusted returns, making them a more solid investment option. For example, the Sharpe Ratio of the Kotak Emerging Equity Fund (Diversified) was 1.90, while that of the SBI Technology Opportunities Fund (Sectoral) was 1.79. The higher the Sharpe Ratio, the greater the risk-adjusted return. This shows that, while sectoral funds can provide strong absolute returns, they also carry more risk, making diversified funds a more balanced investing alternative.

Findings & Suggestions

Findings

1. Performance Comparison:

- Sectoral mutual funds have higher long-term returns but are more volatile. For example, the ICICI Prudential Technology Fund (Sectoral) returned 27.09% over five years, whereas the Kotak Emerging Equity Fund (Diversified) returned 22.89%.

- Diversified mutual funds generate regular and predictable returns, making them excellent for risk-averse investors.

2. Risk and Volatility Analysis:

- Sectoral funds have a higher standard deviation (6.30%) than diversified funds (3.07%), indicating increased risk exposure.
- Diversified funds are less affected by sector-specific downturns and provide a more balanced investment approach.

3. Investor Behaviour and Preferences:

- 53.75% of investors prefer diversified funds, while just 27.5% choose sectoral funds, indicating a preference for stability over high-risk, high-reward strategies.
- 40% of respondents prioritize long-term wealth accumulation, while 38.8% invest for bigger returns, demonstrating the conflicting motivations that drive investing decisions.

Suggestions

1. For Investors:

- Investors that are risk-averse should prioritize diversified funds in order to achieve stable returns with lesser risk.
- High-risk investors wanting higher growth can select sectoral funds, particularly those in high-growth industries such as technology and pharmaceuticals.
- Long-term investors should commit a percentage of their portfolio to sectoral funds, which often outperform diversified funds over time.

2. For Asset Management Companies (AMCs):

- Reduce volatility by improving sectoral funds' risk management strategies.
- Improve investor education on expenditure ratios and risk-return trade-offs.
- Create hybrid mutual fund solutions that combine sectoral and diversified investment strategies to cater to a variety of risk profiles.

Conclusion

This study compares sectoral and diversified mutual funds, finding that sectoral funds produce higher long-term returns but are more volatile, whereas diversified funds deliver stable and consistent returns with lower risk. Statistical analysis reveals that sectoral funds are appropriate for high-risk investors, whilst diversified funds are good for risk-averse investors seeking consistent growth. Investor behavior data reveals a preference for diversified funds (53.75%), with AMCs, fee ratios, and market trends all influencing performance. The study underlines that mutual fund selection should be based on an investor's risk tolerance and financial objectives, with diversity serving as a significant risk-mitigation method. Future research can delve into global market patterns, economic cycles, and regulatory changes to gain a better understanding of investment opportunities.

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