Mirae Asset Knowledge Academy
Profit from Knowledge

Use quartile ranking to determine funds' consistency

Consistency does not mean a fund should be a top performer all the time, rather it should be onsistently better than peers and the benchmark across market phases. Consistent funds should give higher risk-adjusted returns vis-à-vis peers. While there are many ways of finding a consistent performer, quartile ranking analysis over a long term is a good measure.

Recent performance can be an illusion

Performance analysis of 2015's top five funds shows that at least two out of five funds have underperformed the category average and the benchmark in all equity funds categories in the succeeding year (2016). Even if an investor had chosen all top five funds of 2015 and invested equally among them, returns would have been lesser than the whole category average returns or the benchmark in 2016 in two out of the three categories analysed. While this is a primary analysis, it does point out the perils of investing based on recent performance.

Performance of 2015's top five funds in 2016

		Large cap funds	Diversified equity funds	Small & mid-cap funds
Number of funds underperformed versus	Peers	2	3	2
	Benchmark	2	3	4
Returns (%)	Average of top 5 funds	2.5%	5.1%	4.7%
	Peers average	4.9%	4.3%	4.9%
	Benchmark	3.8%	3.0%	7.1%

Past Performance may or may not sustain in future. Category as per CRISIL classification.
Benchmark for largecap, diversified equity and small and midcap funds represented by Nifty 50, Nifty 500 and Nifty Free Float Midcap 100 respectively

Consistency is key

Consistency does not mean a fund should be a top performer all the time, rather it should be consistently better than peers and the benchmark across market phases. Consistent funds should give higher risk-adjusted returns vis-à-vis peers. While there are many ways of finding a consistent performer, quartile ranking analysis over a long term is a good measure.

Quartile ranking

It is used to measure a fund's performance vis-à-vis peers in a given time frame. Funds are sorted on the basis of returns and ranking is assigned from 1 to 4. Funds in top 25% (funds A and B) are assigned quartile ranking 1, next 25% (funds C & D) are assigned 2nd ranking and so forth as illustrated:

Fund	One-year returns	Quartile Ranking
A	15%	1
B	12%	1
C	9%	2
D	7%	2
E	3%	3
F	0%	3
G	-2%	4
H	-5%	4

Past Performance may or may not sustain in future. For representation purpose only

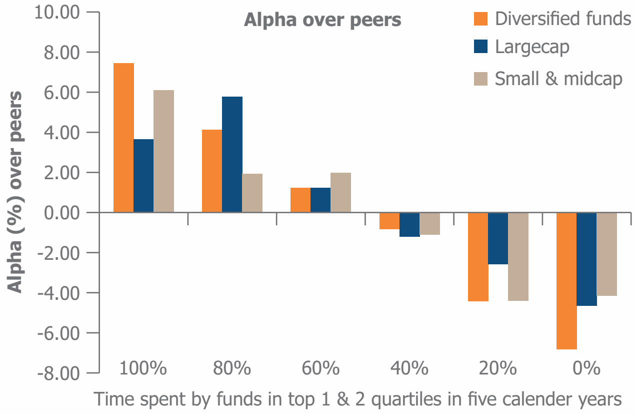
Case study

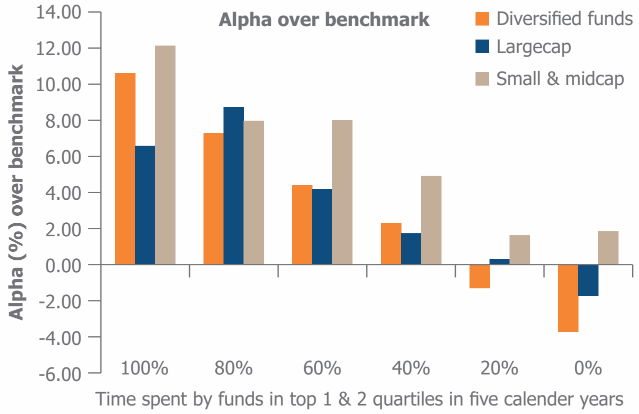
Consistent funds create higher alpha vis-à-vis peers and benchmark over long term.

In order to determine consistency in a fund's performance, the quartile ranking of each calendar year (2011, 2012, 2013, 2015 and 2016) was related with long-term performance during the five years. The objective of the analysis was to see whether funds which have consistently fallen in top quartiles in all five calendar years have generated higher alpha in the long term.

Based on each calendar year quartile ranking, funds were categorised on the basis of time spent in top quartiles (either quartile 1 or 2). If the time spent is 100%, it denotes fund is in top quartile in all five calendar years, 80% denotes four out of five calendar years and so forth. Consistency is determined by the time a fund spends in the top quartiles. More the time spent, higher the consistency. Based on this, average five-year annualised returns of each segment were compared with peers and benchmarks for different equity funds.

Consistent funds create higher alpha vis-à-vis peers and benchmark over long term.



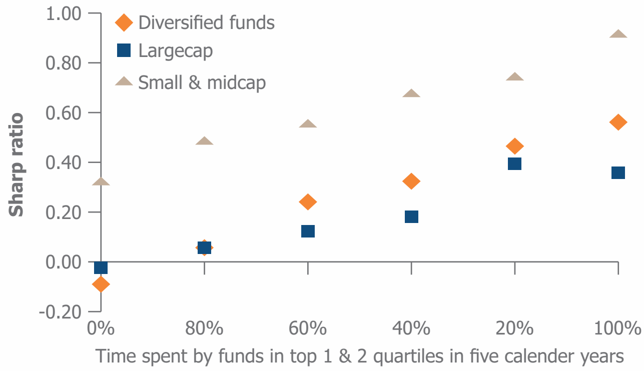


Notes: **Past Performance may or may not sustain in future.** Funds having history of five years and above are considered for analysis. Alpha is difference between average returns of each segment vis-à-vis peers and the benchmark. Quartile ranking is based on calendar year returns of 2012, 2013, 2014, 2015, 2016. Five-year annualised returns for period ended December 2016 are considered. Category as per CRISIL classification. Benchmark for largecap, diversified equity and small and midcap funds represented by Nifty 50, Nifty 500 and Nifty Free Float Midcap 100 respectively.

Superior risk-adjusted returns

Non-consistent funds may show spurt in returns in bouts which may tempt investors to invest. But that performance can be because of higher risk taken by the fund manager, as already mentioned. On the other hand, consistent funds typically give higher risk-adjusted returns over a longer time frame. For instance, funds which have consistently fallen in top quartiles (either 1 or 2) in the past five calendar years, have given superior risk-adjusted returns in five years represented by Sharpe ratio compared with less consistent funds.

Consistent funds give higher risk-adjusted returns



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Look for consistency

To gauge consistency in a fund's performance, investors can use quartile rankings along with various other performance parameters such as analysis based on rolling returns and market-phase performance. Consistent funds may fall short sporadically but in the long term they could outperform peers and the benchmark. Investors should also note that in fund evaluation, weightage should be given to other parameters such as portfolio attributes, expense, liquidity and safety among others. To accentuate, fund selection should be based on investor risk-profile.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully

Email Us
customercare@miraeasset.com

Call Us
1800-2090-777 (Toll Free)
Mon-Fri: 9.30am to 5.30pm

Internet
www.miraeassetmf.co.in

Contact your financial advisor for details

Mirae Asset Global Investments (India) Pvt. Ltd.
CIN - U65593MH2006FTC165663
Unit No. 606, 6th Floor, Windsor Building, Off C.S.T. Road, Kalina, Santacruz (E), Mumbai - 400 098.