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The Smart Investor

Equity funds lag on risk-adjusted basis during 5-yr period

30% of equity schemes beat their benchmarks, show information ratios

ABHISHEK KUMAR
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One in three equity mutual fund (MF) schemes has beaten its benchmark on a risk-adjusted basis during the five-year period (2020-25), going by their information ratios (IRs), a performance metric fund houses have started publishing only lately.

An IR shows how effectively an investment manager generates excess returns relative to a benchmark, considering the risk taken.

The IR generally ranges between 1.5 and -1.5. The higher the IR, the better is the fund manager's performance.

"A higher IR indicates that the fund manager is more consistent in generating returns relative to the benchmark, and a lower IR shows that the fund is underperforming against the benchmark," said Feroze Azeez, joint chief executive officer, Anand Rathi Wealth.

During the past five-year period, only 62 of the 208 active equity schemes, excluding sectoral and thematic funds, have had a positive IR.

Smallcap funds have the worst performance among equity funds with only three of the 21 schemes outperforming.

Largecap and midcap funds also have a poor record with less than 20 per cent of the schemes reporting a positive IR.

However, the three-year and one-year data paints a better picture. During the one-year period, a majority of the schemes have outperformed in all the categories expect largecaps. In the three-year period, a majority of the largecap and multicap schemes have delivered higher returns than the benchmark.

According to investment advisors, a higher IR is an outcome of fund managers' stock selection abilities and timely sectoral shifts.

"The fund manager's stock selection and allocation skills are probably the drivers of a higher IR and this is helped by a higher upside capture and a lower down capture ratio. In most cases, there is a meaningful difference between funds in the first and fourth quartile in terms of capturing upside and protecting downside," said Vishal Dhawan, founder and chief executive officer, Plan Ahead Wealth Advisors.

The IR is calculated by taking the difference between the portfolio return and the benchmark return, then dividing that by the standard deviation of the excess returns.

Investment experts say while the IR is a key performance metric, investors should consider other factors when selecting schemes.

"Investors should consider evaluating other parameters such as the Sharpe ratio, alpha, and beta of the funds to get more insights about the fund's ability to perform across different market cycles and the ability to deliver consistently over the long-term," said Azeez.

Meghna Luthra, analyst at InCred Research Services, said the long-term average IR could give a better fund performance picture.

"Risk-adjusted returns give a deeper insight into active management of the funds, which aid in fund selection, though a better way to look at it is on a long-term average basis," she said. The industry has started disclosing the IR data on the direction of the Securities of Exchange Board of India (Sebi).

ILLUSTRATION: AJAYA MOHANTY

LONG-TERM STRUGGLE

All categories, except smallcaps, have gloomy showing in the long-term

% of schemes with positive information ratio

Category	1-year	3-year	5-year	10-year
Largecap	45.2	60.7	16.0	17.4
Large & mid	62.1	38.5	20.0	15.8
Flexicap	68.4	48.3	21.7	36.8
Multicap	68.0	73.3	33.3	16.7
Midcap	51.7	32.0	16.7	0.0
Smallcap	74.1	39.1	14.3	69.2

All data are of regular plan, as of April 17
Source: Amfi

Schemes with highest IR*

Largecap	IR
Nippon India Largecap Fund	0.51
ICICI Pru Bluechip Fund	0.45
Midcap	
Motilal Oswal Midcap Fund	0.19
Quant Midcap Fund	0.09
Smallcap	
Quant Smallcap Fund	0.83
Nippon India Smallcap Fund	0.36

Schemes with lowest IR*

Largecap	IR
Axis Bluechip Fund	-1.12
LIC Largecap Fund	-0.84
Midcap	
DSP Midcap Fund	-1.37
Taurus Midcap Fund	-0.95
Smallcap	
ABSL Smallcap Fund	-0.68
ITI Smallcap Fund	-0.61

*in 5-year period