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Building an optimal Portfolio Exploring Investment Opportunities in a Specific Sector

[1]Chaitanya J, [2] DR. Madhavi R

[1]Jain Deemed to be University, Bengaluru

[2]Faculty of Management Studies (CMS Business School), Jain Deemed to be University, Bengaluru

ABSTRACT

This master's thesis explores the dynamics of portfolio management in three important industries: pharmaceuticals, automobiles, and fast-moving consumer goods (FMCG). The study, which covers the years 2013 to 2023, uses a methodical research methodology to carefully analyse market trends and company performances. Companies in each sector are examined using simple random sampling to assess risk and return profiles using recognised criteria such as the Treynor Measure, which helps to create market portfolios that are well-balanced. The research improves understanding of portfolio creation by combining empirical data with finance and economic theories. It provides investors with practical insights on how to manage risk effectively across sectors and maximise profits.

Keywords: Risk and Return, Sector Analysis, Treynor Measure, Simple Random Sampling, Market Portfolio, Investment Strategy, Financial Markets, Risk Management, Return Optimisation, and Portfolio Management

I. INTRODUCTION

This study explores the complexities of modern financial markets, emphasizing the challenges investors face in balancing risk and reward. Understanding industry-specific dynamics is crucial for effective portfolio management in today's volatile economic landscape. Sectors like information technology, banking, and automobiles each present unique risks and growth prospects, requiring nuanced portfolio construction strategies.

The research employs sophisticated quantitative methods like the Treynor Measure to delve into risk-adjusted returns within these sectors, aiding in the identification of optimal investment opportunities. By integrating sectoral analysis with portfolio optimization techniques, the study bridges theoretical concepts with practical investment realities, offering valuable insights to investors and financial professionals.

The findings not only enrich academic discourse but also inform tangible investment decisions, empowering stakeholders to navigate financial market complexities confidently. Ultimately, the study aims to equip stakeholders with the knowledge and tools necessary to enhance portfolio performance amid increasing economic uncertainty, fostering continuous evolution and resilience in investment strategies.

II. NEED FOR THE STUDY

This study delves into the intricate dynamics of risk and return within specific sectors—: pharmaceuticals, Fast-moving consumer goods (FMCG), and Automobile—highlighting the vital role of sectoral analysis in portfolio management. Despite its acknowledged importance, a significant gap exists in the literature regarding the integration of sectoral insights into portfolio optimization methodologies.

The research seeks to address this gap by investigating how the application of the Treynor Measure, a widely recognized metric for assessing risk-adjusted returns, can facilitate the construction of balanced portfolios across these diverse sectors. Through meticulous examination, it aims to uncover insights into the underlying factors driving performance variations within each industry, including technological advancements, regulatory frameworks, market trends, and broader macroeconomic influences.

Furthermore, the study aims to elucidate the challenges and opportunities inherent in sectoral diversification, providing investors and financial practitioners with actionable insights to navigate these complexities effectively. Ultimately, this research strives to advance portfolio management practices, offering practical guidance for constructing resilient portfolios tailored to individual risk preferences and investment objectives.

III. OBJECTIVES OF THE RESEARCH

- Calculating both risk and return metrics and estimating the beta coefficient for a range of stocks.
- Selecting 15 stocks across three distinct sectors and conducting an analysis of their respective beta values.
- Crafting a diversified investment portfolio by selecting shares with lower beta coefficients, aiming to minimize overall portfolio risk.

IV. LITERATURE REVIEW

The literature review covers a wide range of research topics related to portfolio management and risk assessment, particularly focusing on the Indian market context:

1. Sector-Specific Risk Factors: Studies by Gupta et al. (2018) and Singh and Singh (2019) examine sector-specific risk factors impacting Indian industries, such as government policies and market dynamics.
2. Treynor Measure in Portfolio Optimization: Mishra and Shukla (2014) and Jain and Chakraborty (2017) demonstrate the use of the Treynor Measure for constructing optimized portfolios in India, considering unique market factors.
3. Automobile Industry Risk Exposure: Chakrabarti et al. (2017) and Kumar and Malhotra (2020) explore risk factors affecting the Indian automobile industry, such as consumer preferences and government policies.
4. Macroeconomic Indicators and Sectoral Performance: Sharma and Vasishta (2015) and Khan and Khan (2018) investigate the relationship between macroeconomic indicators and sectoral performance in India.
5. Risk Management Strategies: Sharma and Sharma (2019) and Singh and Kumar (2021) study risk management techniques and strategies tailored for sectoral investments in India.
6. Diversification and Portfolio Performance: Patel and Shah (2016) and Gupta and Singh (2019) evaluate the performance of diversified portfolios across different sectors in the Indian market.
7. Dynamic Asset Allocation and Sector Rotation: Verma and Sharma (2017) and Mehta and Bansal (2020) explore dynamic asset allocation and sector rotation strategies optimized for the Indian market.

This comprehensive review of literature provides valuable insights for portfolio managers and investors operating within the Indian market, helping them understand sector-specific risks, optimize portfolio construction, and implement effective risk management and diversification strategies.

V. INDUSTRY AND COMPANY ANALYSIS FOR BETA CALCULATIONS

The researchers developed their own criterion for selecting sectors and related Companies in order to build the best diversified portfolio with the lowest betas. The following conditions were carefully examined for the selection of Industries and Companies, as listed below:

1) Sector specific fundamental analysis for the selection of stocks from various sectors.
2) Historical returns, Standard Deviation, Beta of the concerned companies (Automobile, FMCG and Pharmaceuticals) eight companies taken from each sector
3) 10 years companies return and Index return (SENSEX)

PARTICULARS	**DESCRIPTION**
Sample Size	**Sectors: 3 Sectors chosen from the Index i.e., Information Automobile, FMCG and Pharmaceuticals** **Companies: - 15 Companies selected**
Data Collection	**Chosen sectors and companies underwent rigorous evaluations, with a decade-long dataset for thorough analysis.**
Research Design	**Descriptive and Quantitative**
Sources of Data	**The secondary data has been collected though BSE India (10 Years data from 2013 - 2023 is taken for the research)**
Method of Calculating Beta	**Beta has been calculated using Risk Free Rate of Return and Treynor Ratio.**

VI. RESEARCH METHODOLOGY

This report offers a thorough analysis of risk and return across different sectors, specifically Information Automobile, FMCG and Pharmaceuticals. By exploring these sectors, we aim to uncover the relationship between risk and return within each one. Through historical data, statistical measures, and portfolio simulations, we provide insights into the advantages and challenges of diversifying across industries. Our research focuses on identifying optimal equity portfolios in the Indian capital markets as of June 31, 2023, considering various objectives and constraints. Using ten years of return and risk data, we aim to confirm the correlation between risk and return for these portfolios, providing rationale for our findings.

VII. ANALYSIS AND INTERPRETATION

COMPANIES (x)

COMPANIES (X)								
Stocks	Mean	Varients	Standard Deviation	Covarient	Beta	Total Risk	Sytematic Risk	Unsystematic Risk
Tata Motors	0.18	0.38	0.61	0.03	2.05	61%	24%	38%
Maruti	0.23	0.13	0.37	0.02	1.63	37%	19%	18%
TVS Motors	0.49	0.69	0.83	0.06	4.62	83%	53%	30%
Ashok Leyland	0.36	0.40	0.64	0.04	2.66	64%	31%	33%
Eicher Motors	0.20	0.55	0.74	0.04	2.79	74%	32%	42%
Hero Motocorp	0.07	0.06	0.24	0.01	0.97	24%	11%	13%
Bajaj Auto	0.11	0.03	0.16	0.01	0.58	16%	7%	9%
M & M	0.08	0.08	0.28	0.00	-0.25	28%	-3%	31%
Hindustan Unilever	0.18	0.05	0.22	0.01	0.98	22%	11%	10%
Nestle India	0.17	0.03	0.16	0.01	0.68	16%	8%	8%
Britannia	0.24	0.15	0.39	0.02	1.49	39%	17%	22%
Marico	0.12	0.05	0.22	0.02	1.50	22%	17%	5%
Colgate	0.07	0.05	0.23	0.02	1.22	23%	14%	9%
P&G	0.32	0.22	0.47	0.00	0.07	47%	1%	46%
Tata Consumer	0.27	0.32	0.57	0.04	2.78	57%	32%	25%
Zydus Wellness	0.12	0.05	0.21	0.01	0.96	21%	11%	10%
Sun Pharma	0.10	0.07	0.26	0.02	1.20	26%	14%	12%
Lupin	0.05	0.09	0.30	0.00	0.20	30%	2%	28%
Cipla	0.14	0.08	0.28	0.02	1.22	28%	14%	14%
Dr. Reddy	0.11	0.09	0.30	0.00	0.37	30%	4%	25%
Abbott India	0.35	0.16	0.40	0.02	1.51	40%	17%	23%
Aurobindo Pharma	0.25	0.59	0.77	0.04	3.37	77%	39%	38%
Biocon	0.03	0.20	0.44	-0.02	-1.75	44%	-20%	64%
Glenmark	0.12	0.18	0.42	0.00	-0.20	42%	-2%	44%

Market (y)	
Mean	0.13
Varients	0.01
Standard Deviation	0.11

Interpretation

Companies with comparatively higher mean returns include TVS Motors, Eicher Motors, and Aurobindo Pharma, but they also have higher standard deviations, indicating greater volatility. Companies such as M&M, Biocon, and Glenmark appear to have negative mean returns, signalling possible losses. Beta numbers indicate how volatile a stock is relative to the market. A beta larger than 1 suggests higher volatility than the market, whereas a beta less than 1 indicates lesser volatility. Total risk is the sum of systematic and unsystematic risks. Systematic risk appears to dominate for the majority of organisations, indicating that market forces play an important role in their risk profiles. Unsystematic risk fluctuates between organisations, indicating that company-specific factors influence risk.

Overall, investors may use this information to evaluate the risk-reward profiles of various companies and make informed investment decisions depending on their risk tolerance and investment goals.

BALANCED MARKET PORTFOLIO

Balanced Market Portfolio								
	SL No.	Companies	Rp	Rf	(Rp-Rf)	Beta	Treynor = (Rp-Rf)/Beta	Rank
AUTOMOBILE	1	MARUTI SUZUKI INDIA LTD	231%	6%	225%	1.63	1.37	6
	2	HERO MOTOCORP LTD	67%	6%	60%	0.97	0.62	2
	3	BAJAJ AUTO LTD	109%	6%	102%	0.58	1.76	8
FMCG	4	HINDUSTAN UNILEVER	179%	6%	172%	0.98	1.76	7
	5	COLGATE-PALMOLIVE (INDIA) LTD	67%	6%	61%	1.22	0.50	1
	6	ZYDUS WELLNESS LTD	124%	6%	117%	0.96	1.22	5
PHARMACEUTICAL	7	SUN PHARMACEUTICAL INDUSTRIES LTD	99%	6%	92%	1.20	0.77	3
	8	CIPLA LTD	141%	6%	135%	1.22	1.10	4
	9	ABBOTT INDIA LTD	349%	6%	342%	1.51	2.26	9

Interpretation

The detailed analysis of various companies within the balanced market portfolio underscores the importance of considering both return potential and risk characteristics when making investment decisions. Maruti Suzuki India Ltd stands out with a remarkable ROI of 231% despite higher volatility (beta of 1.63). Hindustan Unilever offers stability with an ROI of 179% and a lower beta of 0.98, suggesting steadier stock price movements. Hero MotoCorp Ltd and Colgate-Palmolive (India) Ltd have more modest ROIs and less efficient risk-adjusted returns.

Zydus Health Care, Inc. and Abbott India Ltd present attractive investment opportunities, with both expected to deliver solid returns and efficient risk-adjusted performance. Each company's Treynor ratio provides a valuable metric for assessing risk-adjusted returns relative to market risk. Ultimately, investors should carefully consider these factors to construct a diversified portfolio aligned with their investment objectives and risk tolerance.

AGGRESSIVE GROWTH PORTFOLIO

Aggressive Growth Portfolio								
	SL No.	Companies	Rp	Rf	(Rp-Rf)	Beta	Treynor = (Rp-Rf)/Beta	Rank
AUTOMOBILE	1	TVS MOTOR COMPANY LTD	487%	6%	480%	4.62	1.04	6
	2	ASHOK LEYLAND LTD	365%	6%	358%	2.66	1.34	7
	3	EICHER MOTORS LTD	199%	6%	193%	2.79	0.69	2
FMCG	4	BRITANNIA INDUSTRIES LTD	236%	6%	229%	1.49	1.54	8
	5	MARICO LTD	119%	6%	113%	1.50	0.75	4
	6	TATA CONSUMER PRODUCTS LTD	273%	6%	266%	2.78	0.96	5
PHARMACEUTICAL	7	AUROBINDO PHARMA LTD	246%	6%	239%	3.37	0.71	3
	8	BIOCON LTD	25%	6%	19%	-1.75	-0.11	1
	9	ABBOTT INDIA LTD	349%	6%	342%	1.51	2.26	9

Interpretation

The Aggressive Growth Portfolio encompasses a range of companies offering diverse expected returns and volatility levels. TVS Motor Company Ltd and Tata Consumer Products Ltd stand out with high expected returns but significant volatility. ASHOK LEYLAND LTD and Britannia Industries Ltd offer strong growth potential with more moderate volatility, making them attractive options for investors seeking growth with a balanced risk profile.

EICHER MOTORS LTD and AUROBINDO PHARMA LTD present increased volatility, resulting in less efficient risk-adjusted returns, which may pose higher risk relative to potential returns. BIOCON LTD, with the lowest expected return and poor risk-adjusted returns, highlights the importance of comprehensive risk evaluation in portfolio construction.

Abbott India Ltd is noteworthy for its high expected return and efficient risk-adjusted returns, making it an appealing choice for investors pursuing aggressive growth opportunities while managing risk effectively.

Investors should carefully assess the risk-return profiles of these companies, considering individual risk tolerance and investment goals, to construct a well-balanced Aggressive Growth Portfolio aligned with their objectives for aggressive growth strategies in the market.

VIII. FINDINGS

The research findings shed light on effective portfolio management methods tailored to the fast-moving consumer goods (FMCG), pharmaceutical, and automobile industries. The study's diligent data analysis highlights key insights shaping portfolio construction and risk management within these sectors. In the fast-moving consumer goods industry, Hindustan Unilever and Britannia Industries Ltd exhibit resilient performance with consistent returns and low exposure to systematic risk. Including these industry leaders in portfolios offers stability and growth potential while diversifying risk.

Within pharmaceuticals, Sun Pharmaceutical Industries Ltd. and Cipla Ltd. demonstrate strong returns and lower systematic risk, reflecting robust business models and market performance. Incorporating these firms enhances portfolio growth potential while diversifying across industry leaders. In the automobile sector, Maruti Suzuki India Ltd. and Bajaj Auto Ltd. stand out for their market positions and consistent performance despite regulatory changes and technological disruptions. Including them provides a foundation for portfolio growth while mitigating industry-specific

risks. Sectoral diversity emerges as a critical risk mitigation strategy across FMCG, pharmaceuticals, and automobiles. The study's systematic approach ensures comprehensive sector-specific analysis, reducing concentrated portfolio risks and providing balanced exposure.

The research underscores the effectiveness of the Treynor Measure in evaluating risk-adjusted returns and guiding portfolio optimization within these sectors. This quantitative framework measures return against systematic risk, aiding informed portfolio allocation decisions aligned with risk tolerance and return targets.

In conclusion, the research offers actionable insights empowering practitioners to navigate portfolio management intricacies in FMCG, pharmaceuticals, and automobiles. By leveraging sectoral diversification, prudent risk management, and quantitative metrics like the Treynor Measure, investors can optimize wealth accumulation while mitigating downside risks amid dynamic market environments in each sector.

IX. CONCLUSION

The present study highlights the transformative potential of sectoral diversification, sophisticated risk-adjusted metrics such as the Treynor Measure, and dynamic risk management techniques. The research covers portfolio management across FMCG, pharmaceuticals, and cars. Investing in firms such as Hindustan Unilever, Sun Pharmaceutical Industries, and Maruti Suzuki allows investors to strategically diversify across industries, thereby mitigating sector-specific volatility and creating growth potential. By implementing risk-adjusted criteria, one can discover assets with favourable risk-return profiles, such as Britannia Industries, Aurobindo Pharma, and Ashok Leyland, and make well-informed investment decisions. Furthermore, dynamic risk management guarantees portfolio robustness and long-term performance by enabling investors to adjust to market swings and sector-specific difficulties. By embracing these insights, investors can comfortably traverse the complexities of their portfolios and continuously improve their strategies to maximise returns and efficiently weather market fluctuations.

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