Unit V — Active Portfolio Management & Mutual Funds

Investment and Portfolio Management | BMB FM 01 / KMBN FM 01

Unit V: Active Portfolio Management, Performance Evaluation and Mutual Funds

Syllabus: Portfolio management and performance evaluation — performance evaluation of an existing portfolio; Sharpe, Treynor and Jensen measures; finding alternatives and revision of portfolio; portfolio management and the mutual fund industry.

Exam Blueprint (2022–2025 papers)

Topic	Years asked	Marks
Portfolio evaluation — purpose and measures	2024, 2025	2 & 7
Mutual funds — growth in India, types	2022, 2024	2 & 10
Portfolio revision	2022	2
Debt fund vs Equity fund	2022	10
Close-ended mutual fund	2022	2
What is a portfolio	2025	2

YE QUESTION BAAR-BAAR AAYA HAI

Sharpe, Treynor aur Jensen — teeno formulas ratt lo, kyunki numerical bhi aa sakta hai aur theory bhi. Aur **mutual funds** ka 10-marker do baar aa chuka hai.

1. Portfolio and Portfolio Management

DEFINITION - RATTA MAARO

A **portfolio** is a **combination of two or more securities or assets** held by an investor, constructed so as to obtain the **best possible combination of return and risk** in line with the investor's objectives.

(A 2-mark question in 2025-26.)

DEFINITION - RATTA MAARO

Portfolio management is the **art and science of selecting, combining, monitoring and revising** a group of investments so as to meet the investor's long-term financial objectives and risk tolerance.

1.1 Objectives of Portfolio Management

Primary: maximise return for a given risk; **minimise risk** through diversification; ensure **capital appreciation** and **safety of principal**; and maintain adequate **liquidity**. **Secondary:** provide **regular income**; hedge against **inflation**; achieve **tax efficiency**; and maintain **marketability** of the holdings.

1.2 The Portfolio Management Process — five steps

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1. SPECIFICATION OF         2. SECURITY /        3. PORTFOLIO
   OBJECTIVES AND     -->      ASSET        -->     CONSTRUCTION
   CONSTRAINTS              ANALYSIS              (selection & weights)
   (return, risk,           (fundamental,                |
    liquidity, tax,          technical)                  v
    horizon)                                     4. PORTFOLIO
         ^                                          REVISION
         |                                            |
         |                                            v
         +----------- 5. PORTFOLIO EVALUATION <---------+
                         (Sharpe, Treynor, Jensen)
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1. **Specification of investment objectives and constraints** — return requirement, risk tolerance, liquidity needs, time horizon, tax position, legal and unique constraints
2. **Selection of asset mix / asset allocation** — how much in equity, debt, gold, cash. *Research shows asset allocation explains the large majority of portfolio return variation — more than individual stock selection*
3. **Formulation of portfolio strategy** — **active** (attempt to beat the market) or **passive** (track an index)
4. **Selection of securities** — using fundamental and technical analysis
5. **Portfolio execution, revision and evaluation** — implement, monitor, rebalance and measure performance

1.3 Active vs Passive Portfolio Management

Basis	Active management	Passive management
Objective	**Beat** the benchmark index	**Match** the index
Belief about markets	Markets are **not fully efficient**; mispricing exists	Markets are **efficient** (EMH)
Method	Stock picking, market timing, sector rotation	Buy and hold an index portfolio
Turnover and cost	**High** — brokerage, taxes, research	**Very low**
Expense ratio	High (1–2.5%)	Very low (0.05–0.5%)
Risk	Manager/selection risk added	Only market risk
Evidence	Most active managers **underperform** the index after fees	Delivers the market return reliably

2. Portfolio Revision

> DEFINITION - RATTA MAARO
>
> **Portfolio revision** is the process of **periodically reviewing and altering the composition of an existing portfolio** — by buying, selling or changing the weights of securities — so that it continues to meet the investor's objectives as market conditions, security prospects and personal circumstances change.

(A 2-mark question in 2022-23.)