

HIGH BETA AND RETURNS

Does High Beta Really Mean High Returns or Just High Risk?

Prepared by: Divya Reddy



HIGH BETA AND RETURNS: DOES HIGH BETA REALLY MEAN HIGH RETURNS OR JUST HIGH RISK?

Market Cycle	Time Periods
Bear Market - Covid Pandemic	20/02/2020 to 24/03/2020
Bull Market - Global Liquidity and Fiscal Stimulus	04/04/2020 to 23/03/2021
Consolidation Phase - Supply Chain Issues and Inflation	18/10/2021 to 26/06/2023
Bull Market - Economic Growth	03/07/2023 to 18/09/2024

To better understand the relationship between Beta and returns, Beta for different market cycles within the small-cap fund category was calculated, as small-cap funds are generally more volatile. Benchmark considered for the calculations – Nifty Small cap 250 Index

Typically, low-beta funds are expected to perform better in bear markets due to their lower sensitivity to downturns, providing relative stability when broader markets decline. While high-beta funds are often seen as better positioned for bull markets, as they have the potential to capture most of the returns when markets rise. To test these expectations, we analyzed the last five years across four distinct market cycles: one bear market, a consolidation phase, and two bull markets. With two bull rallies in the period, high-beta funds would theoretically be expected to outperform. However, our analysis revealed that low-beta funds outperformed high-beta funds in 50% of these cycles, including one of the bull markets.

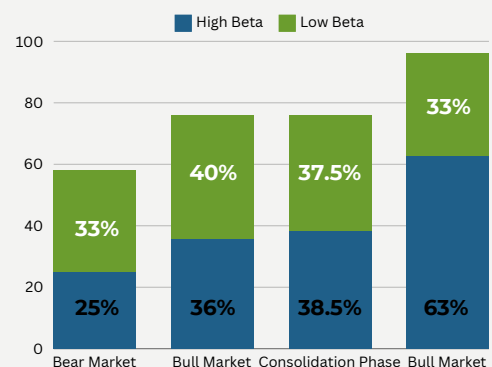
While high-beta funds are generally expected to do better in bull markets, this pattern did not hold during the post-COVID bull rally. This period was driven largely by fiscal stimulus and high liquidity, with the rally concentrated in defensive and growth-oriented sectors like technology and healthcare. Investors focused on these sectors due to their perceived resilience and potential for steady returns, amidst economic uncertainties. Consequently, quality, low-beta stocks gained Favour as they were seen as safer investments during the uneven economic recovery, limiting the performance of high-beta small-cap stocks.

OUTPERFORMANCE STATS

	Bear market	Bull Market	Consolidation	Bull Market
High Beta	25%	36%	38.5%	63%
Low Beta	33%	40%	37.5%	33%

The table above illustrates the percentage of times high-beta and low-beta funds outperformed the category average.

	Outperformance with the Category Average
High Beta Funds	27%
Low Beta Funds	50%



When we look at the overall picture, low-beta funds have delivered significantly better returns than high-beta funds in absolute terms from January 2020 to September 18, 2024. This is largely due to the volatility associated with high-beta funds. Their returns fluctuate more widely, making it challenging to sustain consistent returns over longer periods. While this trend may not apply to every fund, it holds true for the majority. This consistency in performance further underscores the appeal of low-beta funds for investors seeking stable, reliable returns across various market conditions.

UNDERSTANDING BETA AND ITS IMPLICATIONS

A beta above 1 is considered high, while a beta below 1 signifies low beta. The assumption that high beta leads to higher returns is based on the risk-return trade-off in finance, which suggests that achieving higher returns requires accepting greater risks. High-beta funds tend to experience more significant price fluctuations, meaning they are likely to outperform in rising markets but can suffer larger losses during downturns.

However, it is essential to note that beta measures volatility, not risk. Renowned investors like Peter Lynch and Warren Buffett have criticized beta as a standalone indicator of risk. Lynch famously stated, “Beta is a measure of volatility, and volatility is not the same as risk.” This underscores the notion that while beta captures price fluctuations, it does not reflect the true risk of an investment.



WHY BETA ALONE DOESN'T DRIVE RETURNS?

1. **Market Conditions Matter:** Beta helps measure how much a fund's price might move compared to the market, but it doesn't capture what's actually happening in the broader economy. In bear markets, high-beta funds—those that tend to move more than the market—often face sharper drops. For example, during downturns, low-beta funds outperformed high-beta funds 33% of the time versus 25% for high-beta funds. This shows that, during challenging market periods, low-beta funds can provide better stability.
2. **Quality of Companies Matters:** Beta measures volatility but doesn't reflect the quality of the companies within a fund. A high-beta fund might include companies with high debt or in riskier industries, which can lead to more unpredictable price swings. Without looking at the fundamentals of these companies, high-beta funds could end up being riskier investments. Thus, it's important to also consider the financial strength of the companies, not just beta, to avoid taking on excessive risk.
3. **Investor Risk Tolerance and Investment Horizon:** High-beta funds may be more suitable for those who are comfortable with risk and willing to hold their investments through market ups and downs. While high-beta funds have the potential to outperform in bull markets, they don't always do so; in fact, low-beta funds outperformed in some bull markets, with 40% outperformance for low-beta funds compared to 36% for high-beta. This suggests that even for growth-focused investors, low-beta funds can sometimes provide similar returns without the extreme fluctuations.
4. **Performance in Consolidation Phases:** During consolidation phases, where markets are steady or only slightly fluctuating, high-beta funds can have a slight edge. Here, high-beta funds showed a small outperformance of 38.5% versus 37.5% for low-beta funds, indicating they capture minor gains in stable periods. However, the difference is minor, suggesting that during uncertain times, high-beta funds may not significantly outperform low-beta ones.

CONCLUSION

This analysis challenges the traditional assumption that high-beta funds will always outperform in bull markets. While high-beta funds are structured to capture larger gains in rising markets, real-world factors such as investor sentiment, sector-specific dynamics, and broader economic conditions can alter this outcome. In times of heightened uncertainty—even in bull markets—investors may prioritize stability and quality, favouring low-beta stocks for their defensive attributes. Beta, is a useful tool for understanding a fund's volatility but not a definitive measure of risk or return potential. For a more robust investment strategy, it's essential to consider beta alongside factors like market conditions, the quality of underlying assets, and the investor's risk tolerance.

This table contains the data for the small-cap funds used to reach the conclusion. The beta values marked in red indicate high-beta funds, while the returns marked in green show the funds that outperformed the category average for both high-beta and low-beta groups.

Fund Name	Bear	Bull	Consolidation	Bull	Bear (Returns)	Bull (Returns)	Consolidation (Returns)	Bull- (Returns)
DSP Small Cap Fund Regular Plan Growth	1.09	1.05	1.08	1.24	-36.6655	105.0484	8.1947	44.345
HSBC Small Cap Fund Regular Growth	0.98	1.05	0.99	1.16	-40.4514	102.4159	10.1842	49.7448
Quant Small Cap Fund Growth	0.82	0.88	1.11	1.13	-36.9789	177.384	8.1521	57.5374
Bandhan Small Cap Fund Regular Growth	0.45	0.73	1.07	1.11	-12.49	87.5726	-0.8783	76.2588
Aditya Birla Sun Life Small Cap Fund Growth	1.03	1.08	1.07	1.10	-40.5835	115.6164	-0.5524	42.8646
Franklin India Smaller Companies Fund Growth	0.97	1.07	0.94	1.08	-38.0001	105.1503	9.805	50.9568
LIC MF Small Cap Fund Regular Growth	0.98	0.90	1.00	1.04	-37.5916	94.462	8.6466	50.6629
Edelweiss Small Cap Fund Regular Growth	0.99	0.94	1.04	1.04	-36.8787	115.5504	8.0799	46.9111
HDFC Small Cap Fund Growth	0.98	1.17	1.05	1.00	-39.0081	107.2314	10.8103	40.0623
Bank of India Small Cap Fund Regular Growth	1.08	0.94	1.06	1.00	-32.3457	109.8964	5.7575	52.6632
Kotak Small Cap Growth	1.06	1.04	0.89	1.00	-38.2276	133.4573	3.9501	42.8003
Nippon India Small Cap Fund - Growth	1.02	1.21	1.08	0.99	-40.3408	122.7024	13.8349	51.6095
Tata Small Cap Fund Regular Growth	0.81	0.96	0.87	0.97	-34.77	94.9577	11.8739	47.4835
ICICI Prudential Smallcap Fund Growth	1.11	1.04	0.86	0.96	-39.9207	110.5719	9.0657	38.3722
Union Small Cap Fund Regular Growth	1.00	0.88	1.02	0.93	-36.5201	101.5311	6.292	42.7896
Sundaram Small Cap Fund - Regular Plan - Growth Option	1.27	1.08	1.05	0.91	-41.1196	101.7756	5.27	45.2891
Canara Robeco Small Cap Fund Regular Growth	1.07	0.86	0.99	0.90	-36.022	113.8889	7.5763	42.7188
Invesco India Smallcap Fund Regular Growth	1.12	0.99	1.03	0.88	-37.6729	92.0299	5.8974	57.1116
ITI Small Cap Fund Regular Growth	1.13	1.23	1.01	0.85	-39.9199	100.3532	-1.0305	60.2688
Axis Small Cap Fund Regular Growth	1.14	0.83	0.87	0.84	-34.4671	85.3899	8.9619	41.0775
SBI Small Cap Fund Regular Plan Growth	0.90	1.09	0.81	0.84	-33.9212	98.1327	8.4378	40.6287
Category Average					-36.4	108.3	7.1	48.7

This table contains the point-to-point absolute returns comparison, the benchmark chosen for Beta calculation here is Nifty 100 TR INR

Fund Name	Beta	Returns
ITI Small Cap Reg Gr	1.13	123.19
Sundaram Small Cap Reg Gr	1.09	141.81
ABSL Small Cap Gr	1.09	124.32
HDFC Small Cap Reg Gr	1.07	147.18
Nippon India Small Cap Gr Gr	1.07	170.18
Quant Small Cap Gr	1.05	214.38
Franklin India Smaller Companies Gr	1.04	146.87
Kotak -Small Cap Gr	1.04	149.83
HSBC Small Cap Fund Reg Growth	1.02	150.63
ICICI Pru Small Cap Gr	1.02	141.79
DSP Small Cap Reg Gr	1.01	148.9
Edelweiss Small Cap Reg Gr	0.99	154.76
LIC MF Small Cap Fund Reg Gr	0.98	144.69
Canara Robeco Small Cap Reg Gr	0.96	160.08
Invesco India Small Cap Reg Gr	0.96	148.61
Tata Small Cap Reg Gr	0.91	152.54
SBI Small Cap Reg Gr	0.91	135.66
Axis Small Cap Reg Gr	0.90	131.21
BANK OF INDIA Small Cap Reg Gr	0.88	168.45
Union Small Cap Reg Gr	0.87	141.61
Bandhan Small Cap Reg Gr	0.69	165.61
Category Average	0.98	150.59



**For more such information
stay connected!**

THANK YOU!

Phone :

+91 9380358305

Website :

www.armstrong-cap.com

Address :

605, 5th Floor, Oxford House,
RustamBaug, Old Airport Road,
Bangalore

Email address :

ashish@armstrong-cap.com