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Fixed Deposit and Sensex Returns in Deregulated Regime

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ABSTRACT

In deregulated regime since 1991, the rate of inflation is high enough to reduce the real return. Throughout the deregulated regime shows positive difference between fixed deposit and sensex return suggesting FD scheme to be opted.

KEYWORDS : Equity, fixed deposit, inflation, return, deregulated

Introduction

Investors have options either to invest in fixed income scheme or floating income scheme. Debt fund, fixed deposit, saving deposit, recurring deposit are parts of fixed income scheme while equity, real estate and gold are parts of floating income scheme. The present study makes an effort to compare fixed deposit and sensex returns.

Literature review

Equity mutual fund is risk adjusted return in which individual fund does not earn higher returns from following the momentum strategy in stock (Carhart, 1997) because of investment constraints (Almazan, 2004). Restriction on competing products is the reason of the development of money market and short term bond funds (Klapper, 2000). Therefore, an investor should invest in small equity fund whose trading activity is high (Dahlquist, 2000) or whose expense ratio is low (Malkiel, 1995) . Funds that heavily underperform have very high expense ratio, while funds that are successful do not increase revenues by raising their fees but benefit from increased size of their funds (Elton 1996, Carhat 1997). Actively managed equity funds charge higher fees than index tracking funds or bond and money market funds, reflecting the higher costs of employing investment management staff to achieve diversification and strategy (James et al. 1999). Funds charge lower fees when they have smaller boards and a large proportion of independent directors (Tufano and Sevick, 1997). Larger and more mature funds as well as no load funds have lower expense ratio (Malhotra and Mcleod, 1997). Aggressive growth funds charge higher entry and exit fees to discourage redemption because they hold more of the smaller, less liquid stocks (Chordia, 1996). However, despite the basic academic advice offered to investors to prefer low expense index funds, actively managed funds continue to be popular (Gruber, 1996). To decrease the risk it is advised to use derivative. Bond mutual fund uses derivatives more than equity mutual funds. Use of derivative is negatively correlated with fund age and positively correlated with fund size (Johnson and Yu 2004) and it is positively correlated with asset turnover (Koski and Pontiff, 1999). Derivatives are used for trading rather than hedging (Minton et al. 2009).

Methodology

Index formula of (P1 /P0 *100) has been followed to get the value of the invested money. It has been adjusted with inflation by depreciation the inflated value.

Analysis

Table-1 and figure-1 clearly strengthens the view that return on fixed income scheme is better than that of on floating income scheme.

Table-1: Inflation adjusted return from Fixed deposit and Sensex

Year	Inflation (%)	Fixed Deposit Rate (%)	Sensex	Value of Rs. 100000 in FD Scheme (Inflation adjusted)	Value of Rs. 100000 in sensex Scheme (Inflation adjusted)	Difference between FD and Sensex return
1991-92	13.74	12.00	4285	96611.2	86260	10351.2
1992-93	10.06	11.00	2281	111813.4	47877.05	63936.36
1993-94	8.35	10.00	3779	125333.2	80827.39	44505.82
1994-95	12.60	11.00	3261	132668.6	66513.75	66154.84
1995-96	7.99	12.00	3367	156426.3	72298.17	84128.11
1996-97	4.61	11.00-12.00	3361	180822.5	74820.49	106002
1997-98	4.40	10.50-11.00	3893	200701.8	86854.33	113847.4
1998-99	5.95	9.00-11.00	3740	217192.5	82087.98	135104.5
1999-2000	3.27	8.50-9.50	5001	243485.8	112893.1	130592.8
2000-01	7.16	8.50-9.50	3604	254726.5	78085.26	176641.2
2001-02	3.60	7.50-8.50	3469	285653.6	78042.38	207611.3
2002-03	3.41	4.25-6.00	3049	300870.9	68728.8	232142.1
2003-04	5.46	4.00-5.25	5591	307772.5	123354.3	184418.2
2004-05	6.48	5.25-5.50	6493	320816.2	141709.5	179106.7
2005-06	4.36	6.00-6.50	11280	348594.3	251766.4	96827.9
2006-07	6.60	7.50-9.00	13072	368515.3	284929.9	83585.38
2007-08	4.62	8.25-8.75	15644	410197	348220.5	61976.53
2008-09	8.06	8.00-8.75	9702	428517.7	208168.5	220349.2
2009-10	3.81	6.00-7.00	17527	477467.5	393447.4	84020.09
2010-11	9.56	8.25-9.00	19455	487623.1	410620.8	77002.25
2011-12	9.00	9.00	17404	534800.2	369606.5	165193.7

Source: RBI, BSE

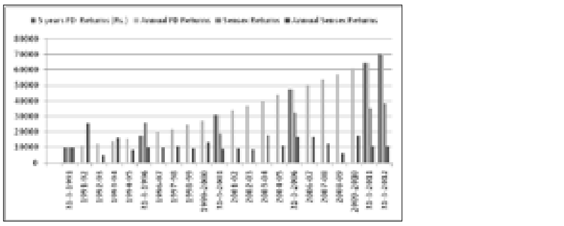

Figure-1: Fixed Deposit and Sensex (Rs.) of Rs. Ten thousand

There are various reasons to choose fixed deposit scheme in the place of equity. First, the risk in equity can not be eliminated completely. Second, sensex market does not give uniform return on yearly basis. Third, investors must have cash ready to be deployed according to market value. Fourth, right timing of sensex is unknown to be invested. Therefore, whenever there is market euphoria, equity allocation of the fund should be reduced. Fifth, if fund is allocated at over extended valuation in sensex, the return will suffer for a longer period. Sixth, if P-E ratio rises, better to sell and if P-E ratio falls ,better to buy equity. However, one should buy stock only when its value is lower than its price.

Conclusion

In deregulated regime since 1991, the rate of inflation is high enough to reduce the real return. Throughout the deregulated regime shows positive difference between fixed deposit and sensex return suggesting FD scheme to be opted.

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