Growth And Profitability: The Right Mix Earns Outstanding Returns In The Indian Stock Market

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ABSTRACT

This paper is an exercise in style investment for the Indian stock market. We carefully construct a class of portfolios using the stocks of the NIFTY500 index based on two firm characteristics: 1) gross profit over book value of assets (GPA) and; 2) book-to-market (BM) ratio of stocks, over a broad sample period of 22 years ranging from December 1996 to December 2018 and a sub-period of 11 years ranging from December 1996 to December 2007. Value-investing strategies suggest that stocks with high BM ratios (value stocks) yield higher average returns than stocks with low BM ratios (growth stocks). However, for the Indian equities market, we observe the opposite relation. Our study strengthens evidence in favour of a BM anomaly within the Indian stock market as we show quintile portfolios comprising stocks of lower BM ratios earn better average and risk-adjusted returns historically than those with higher BM values. Further, we observe that the portfolio combining stocks of the highest profitability and least BM quintile earns superior average and risk-adjusted returns than comparison portfolios in different market states and investment periods.