THE EQUITY COMPASS | EDITION 14

WHAT IS

UPSIDE CAPTURE, DOWNSIDE CAPTURE AND CAPTURE RATIO?

How much a fund participates when markets rise, and how much it falls when markets decline.

Imagine two hikers on a mountain trail.

On the easier stretches, both walk at a similar pace. But when the trail turns steep, rocky and uneven, one hiker carefully navigates the difficult terrain, losing little ground, while the other slips more often and falls further behind.

A fund's performance relative to its benchmark can be viewed in a similar way. During bullish periods, the benchmark may rise, while during bearish periods, it may decline. What matters is not only how much of the benchmark's upside the fund captures, but also how much of its downside it experiences. Upside Capture, Downside Capture and Capture Ratio provide a useful framework for evaluating this behaviour, helping investors understand whether a fund has historically participated well in market rallies while limiting losses during downturns.

WHAT IS UPSIDE CAPTURE?

Upside Capture Ratio measures how much of the benchmark's gains a fund captured during bullish periods, when the benchmark delivered positive returns, based on a predefined frequency such as daily, monthly or quarterly.

Formula:

$$\textbf{Upside Capture Ratio} = \frac{\text{Fund Return During Up Markets}}{\text{Benchmark Return During Up Markets}} \times 100$$

An Upside Capture Ratio above 100 indicates that the fund has outperformed its benchmark during rising market periods.

Example:

If the benchmark gains 10% during up markets and the fund gains 12%, the fund's Upside Capture Ratio is 120%. This means the fund captured 120% of the benchmark's upside, outperforming it during favourable market conditions.

WHAT IS DOWNSIDE CAPTURE?

Downside Capture Ratio measures how much of the benchmark's decline a fund experienced during bearish periods, when the benchmark delivered negative returns, based on the same predefined frequency.

Formula:

$$\textbf{Downside Capture Ratio} = \frac{\text{Fund Return During Down Markets}}{\text{Benchmark Return During Down Markets}} \times 100$$

Here, lower is generally better, as it indicates that the fund declined less than its benchmark during market downturns.

Example:

If the benchmark falls 10% during down markets and the fund falls 7%, the fund's Downside Capture Ratio is 70%. This means the fund captured only 70% of the benchmark's downside, demonstrating relatively better downside protection.

WHAT IS CAPTURE RATIO?

Capture Ratio combines both Upside Capture and Downside Capture into a single measure, helping investors assess how effectively a fund has participated in rising markets relative to how much it has declined in falling markets.

Formula:

$$\textbf{Capture Ratio} = \frac{\text{Upside Capture Ratio}}{\text{Downside Capture Ratio}}$$

A Capture Ratio above 1 generally indicates that the fund has historically captured more upside than downside relative to its benchmark. The higher the ratio, the more favourable the balance between participating in market gains and limiting losses.

HYPOTHETICAL EXAMPLE

Three Flexi Cap Funds are compared against the same benchmark over a period covering both bullish and bearish benchmark phases.

	FUND A	FUND B	FUND C
Upside Capture	110%	95%	105%
Downside Capture	80%	75%	115%
Capture Ratio	1.38	1.27	0.91
Interpretation	Captured more than the benchmark's upside during bullish periods while experiencing less of its downside during bearish periods.	Captured slightly less than the benchmark's upside, but also experienced lower downside participation.	Captured more than the benchmark's upside, but experienced even higher downside participation, resulting in a Capture Ratio below 1.

Overall, Fund A shows the most favourable balance between upside participation and downside containment, followed by Fund B, while Fund C's higher downside participation weakens its overall capture profile.

WHY DO THESE RATIOS MATTER?

Markets rarely move in a straight line. They go through phases of gains and declines, making it important to understand how a fund has behaved across different market environments.

Upside Capture indicates how effectively a fund has historically participated in market rallies.

Downside Capture shows how much of the benchmark's decline the fund has historically experienced during market corrections.

Capture Ratio brings these measures together, helping investors assess whether a fund has historically participated more in rising markets than in falling ones.

When used together, these ratios provide a more complete picture of a fund's historical behaviour than looking at returns alone.

POINTS TO KEEP IN MIND

- These are historical measures and do not predict future performance.
- They are most meaningful when evaluated over a full market cycle that includes both rising and falling markets.
- A high Upside Capture Ratio should always be assessed alongside the Downside Capture Ratio.
- A very low Downside Capture Ratio may sometimes be accompanied by lower participation during market rallies.
- These ratios are most useful when comparing funds within the same category and against the same or comparable benchmark.
- They should be used alongside other measures such as returns, risk metrics, portfolio characteristics and consistency before making an investment decision.

Past performance may or may not be sustained in future.