



FINANCIAL ANALYSIS

How fund managers pick stocks

Top-down and bottom-up: two starting points for choosing shares, and the rules that fence the choice

Industry figures as on 30 September 2026

For training and education only. Not investment advice.

A fund manager can start from the economy and work down, or from one company and work up.

The first route is called top-down. The second is called bottom-up. Many managers use some of each, inside limits set by the scheme's category and by SEBI.

Two starting points, often mixed



Top-down

Start with the big picture: growth, interest rates, policy. Decide which sectors may gain or lose. Then choose companies inside those sectors.



Bottom-up

Start with one company: what it sells, its profits, its debt, its management and its share price. The sector and the economy come in later.



A blend

Many managers use both. A view on sectors sets rough weights, and company study decides which shares fill them. The mix differs from scheme to scheme.

A sector is a group of companies in the same line of business, such as banks or cement makers.

How a sector view shows in a portfolio

AN INVENTED FUND

A fund holds ₹2,000 crore of shares.

Its benchmark index has 30% in Sector A. The fund has 36%.

Every other sector's price stays unchanged.

- 1 Extra weight in Sector A: $36\% - 30\% = 6$ percentage points. On ₹2,000 crore, that is ₹120 crore more than the benchmark would hold.
- 2 If Sector A rises 10%: the fund gains $36\% \times 10\% = 3.6\%$ from it. The benchmark gains $30\% \times 10\% = 3.0\%$.
- 3 The fund is ahead by 0.6 percentage points: $6 \text{ points} \times 10\%$.
- 4 If Sector A falls 10% instead, the same sum runs the other way. The fund is behind by 0.6 percentage points.

A top-down view appears as a sector weight different from the benchmark's. It can help or hurt.

Illustration with an invented fund and assumed figures. Not a forecast and not a view on any sector.

The two routes side by side

	Top-down	Bottom-up
First question	Where is the economy heading, and which sectors does that touch?	Is this a sound business, and what is being paid for it?
What is studied first	Growth, inflation, interest rates, the Budget, global trade.	Annual reports, profits, cash flow, debt, the people who run it.
How it shows in the fund	Sector weights that differ from the benchmark's.	Company weights that differ from the benchmark's, across many sectors.
Where it can go wrong	The view on the economy is wrong, or right but too early.	The company is sound but its whole sector falls out of favour.

A general description of two approaches. Neither is defined in SEBI's rules, and a scheme may use both.

From an idea to a holding

The usual stages in an actively managed equity scheme. Details differ from one fund house to another.

1	Narrow the field	Screen the listed companies down to those that fit the scheme's category and pass basic tests.
2	Study the company	Read its accounts, meet management, compare it with rivals, estimate its worth.
3	Write down the reason	SEBI's code makes the manager record each buy or sell decision in writing, with detailed reasons.
4	Decide the size	Set how much of the scheme goes into the share, within SEBI's and the scheme's limits.
5	Keep reviewing	Check results and news against the original reason. Add, hold or sell as the facts change.

Source for step 3: SEBI (Mutual Funds) Regulations, 2026, Fourth Schedule, Part B (Code of Conduct for Fund Managers and Dealers), clause 3(a).

The fences round the choice

A manager's freedom is limited by the scheme's category and by SEBI's investment limits.



The category

A sectoral or thematic fund keeps at least 80% of total assets in its sector or theme. A focused fund may hold 30 stocks at most.

10%

One company

A scheme may put up to 10% of its net asset value in the shares of one company. Index funds, ETFs, sector and thematic schemes are exempt.



The record

Each scheme's full portfolio, as on the last day of the month, is published within 10 calendar days.

Source: SEBI Master Circular for Mutual Funds, 20 March 2026: para 3.8.1 (categories), para 13.1 (10% limit), para 6.1.1 (portfolio disclosure).

Where things stand

Open-ended equity-oriented mutual fund schemes in India as on 30 September 2026.

EQUITY-ORIENTED SCHEMES

583

Across SEBI's equity categories.
Of these, 60 are sectoral funds
and 194 are thematic funds.

NET ASSETS, ₹ LAKH CRORE

37.54

₹37.54 lakh crore, out of ₹82.64
lakh crore for the whole mutual
fund industry that day.

FOLIOS, IN CRORE

19.10

19.10 crore investor accounts
(folios) in these schemes. One
investor can hold several.

Source: AMFI Monthly Report, September 2026 (equity sub-total: 583 schemes, 19,09,90,944 folios, net AUM ₹37,54,274.57 crore; grand total ₹82,64,116.63 crore).

If you learnt this from older material

The two ideas are unchanged. The rules and disclosures around them are not.

What a 2013-15 deck assumes

- Top-down and bottom-up are two kinds of manager, and a fund is one or the other.
- A label such as 'focused' or 'thematic' means whatever the fund house says.
- No information ratio against the benchmark is published daily.

What holds in October 2026

- Many schemes blend the two. The scheme's category sets much of the frame.
- SEBI set standard categories on 6 Oct 2017 and revised them on 26 Feb 2026.
- Equity schemes publish an information ratio daily (SEBI circular, 17 Jan 2025).

Source: SEBI Master Circular for Mutual Funds, 20 March 2026, para 3.8.1 and footnote 22 (categorisation circulars), para 6.10 and footnote 125 (information ratio).

Four things people get wrong



'The two approaches are rivals.'

They are starting points, not camps. Many managers form a sector view and then study each company inside it.



'Sound company, sound holding.'

The price paid matters too. A sound business bought at a very high price can still give a poor result.



'The manager can buy anything.'

The scheme's category, SEBI's limits and the fund house's own rules narrow the choice before any share is picked.



'A careful process assures returns.'

A process gives discipline, not certainty. Returns from equity schemes are not assured under any approach.

Four questions to ask about any scheme

1

Which category is it in?

The category sets what the scheme must hold. It is the first limit on the manager's choice.

2

What does the SID say?

The Scheme Information Document (SID) describes the investment strategy in the fund house's words.

3

What does it hold?

The monthly portfolio shows the sectors and companies. Compare the weights with the benchmark's.

4

How has it differed?

Look at returns against the benchmark over several periods, and at the information ratio.

We explain how a scheme is run. We do not tell a client which approach or which scheme to choose.

Check yourself

Q1

A manager first decides that falling interest rates may help lenders, then chooses three banks. Which approach is this, and where does it show in the portfolio?

Q2

A benchmark has 20% in a sector and a fund has 25%. The sector rises 8% and every other sector is unchanged. How far ahead is the fund?

Q3

A client says: 'This manager is bottom-up, so the scheme will do well.' What would you say?

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Equity categories; sectoral and thematic 80%; focused fund maximum 30 stocks: SEBI Master Circular for Mutual Funds, 20 March 2026, para 3.8.1.
- 10% of NAV limit on equity of one entity and its exemptions: same Master Circular, para 13.1. Monthly portfolio within 10 calendar days: para 6.1.1.
- Information ratio disclosed daily for equity schemes: same Master Circular, para 6.10 (SEBI circular dated 17 January 2025).
- Written record of buy and sell decisions: SEBI (Mutual Funds) Regulations, 2026, Fourth Schedule, Part B, clause 3(a).
- Scheme counts, folios and net assets on 30 September 2026: AMFI Monthly Report for September 2026.
- The fund, Sector A and all figures in the worked example and quiz are invented for illustration.

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