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Five high alpha stocks you can buy right now

Alpha, the first Greek alphabet, describes, among other things, stocks that give better-than-expected returns. The expected return is calculated on the basis of the stock's sensitivity to the benchmark (this is called beta).

These stocks are arrived at after a complex statistical calculation that lay investors cannot do on their own. So, one way to locate these stocks is to follow the National Stock Exchange's (NSE's) CNX Alpha index. The index measures the performance of high alpha stocks listed on the NSE.

Past data show that investing in stocks that are part of this index can help you outperform the broader market by a good margin. For instance, the Alpha index rose 137% to 9,042 in four years on March 31. It was at 3,816 on 1 April 2011. The CNX Nifty rose 46% during the period.

For a lay investor, alpha is the difference between expected returns based on the stock's beta and actual returns. Beta measures the sensitivity of a stock's returns with market returns. For instance, if a stock's beta is 1.5, this means it is 50% more volatile than the market.

Alpha is an important tool for investors to figure out if their stock is doing well compared to the benchmark. "The stocks in the index are growth stocks. To get good returns, investors can buy those that have generated the highest alpha in the previous one year. Higher returns from the index indicate that investors are more bullish on stocks in the index given good prospect of these companies," says, Sumeet Bagadia, associate director, Choice Broking.

DK Aggarwal, chairman and managing director, SMC Investments and Advisors, says, "Alpha investing enhances portfolio returns."

Out of 50 stocks in the index, 45 gave over 100% returns in two years till March 25. Aurobindo Pharma, Ceat, TVS Motor Company, BEML and Bharat Forge rose 762%, 752%, 707%, 622% and 528%, respectively.

CNX Alpha

The stocks are selected from the top 300 companies on the basis of average free-float market capitalisation and turnover for the last six months. The market capitalisation of these stocks was Rs 1,660-72,900 crore on March 31.

The index is revised every quarter. Stocks with the highest alpha get the highest weight. Alpha of eligible securities is calculated using one-year trailing prices. The index was launched in November 2012.

What's in it for investors?

Positive alpha indicates that the stock performed better than was expected based on its risk (as measured by its beta) A negative alpha means the stock did worse than expected.

For example, if a stock's beta is 1.5, and the benchmark rises 2%, it is expected to gain 3% (2% x 1.5). But if it gains 4%, the alpha comes to one percentage point (4% minus 3%).

Take one more example. A stock with a beta of 1.5 returns 12% in a year as the benchmark, Sensex, rises 10%. Is this a good investment? Let's see. A beta of 1.5 implies 50% greater volatility than the benchmark. Therefore, the stock should have returned 15% (1.5 x 10%) to compensate for the additional risk. In such a case, the alpha is -3.

Alok C Churiwala, managing director, Churiwala Securities, says, "A stock with negative alpha is not considered a good investment even though it returned more than the benchmark."

Advantages & Shortcomings

Alpha can be used as a parameter for selecting stocks. However, as alpha is calculated on the basis of a stock's past performance, it cannot be the sole criteria.

Apart from that, alpha does not take into account the market risk of a stock.

Sahil Kapoor, assistant vice president, retail capital market research, Edelweiss Financial Services, says, "Alpha fails to take into consideration inherent market risk and hence does not provide a holistic image of the risk attributable to the investment. It does not safeguard the portfolio when the broader market moves against the favoured direction."

Aggarwal of SMC says, "Alpha depends upon the legitimacy of the stock's beta figure. It also fails to distinguish between underperformance caused by incompetence and underperformance."

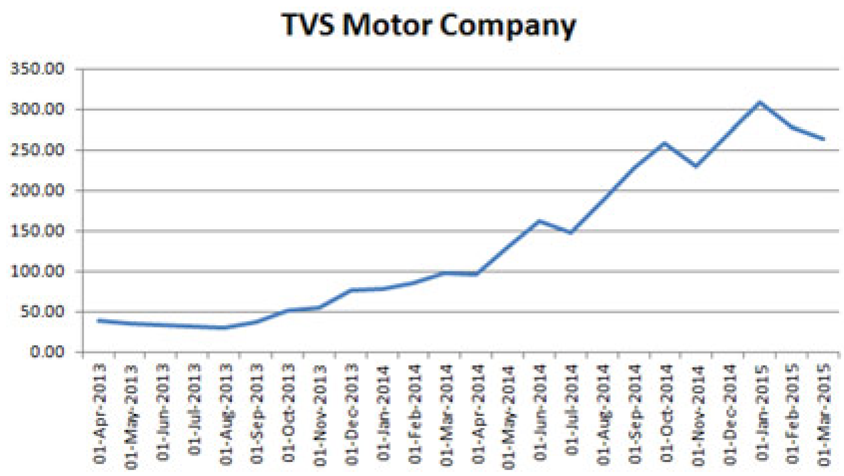
There is no guarantee that stocks in the index will always give lucrative returns. The index is just a medium to identify high-return stocks. Some experts believe investing in high alpha stocks for the long term is not a good strategy.

Vikas Gupta, executive vice president and fund manager, Arthveda Fund Management, says, "The CNX Alpha is a good way of doing momentum-based short-term trading. However, it is not a great strategy for more value-oriented long-term investors."

Between January 2008 and January 2013, the CNX Alpha index delivered a return of 1.5% a year. The Nifty rose 3% a year over the period.

Stocks You Can Bet On

Here are some investment options from stocks that are part of the CNX Alpha index.



Graph shows share price movement of TVS Motor Company in Rs

TVS Motor Company:

The stock has given stellar returns in the past two financial years (2013-14 and 2014-15). It rose 727% from Rs 31.90 on 1 April 2013 to Rs 263.75 on March 31 this year.

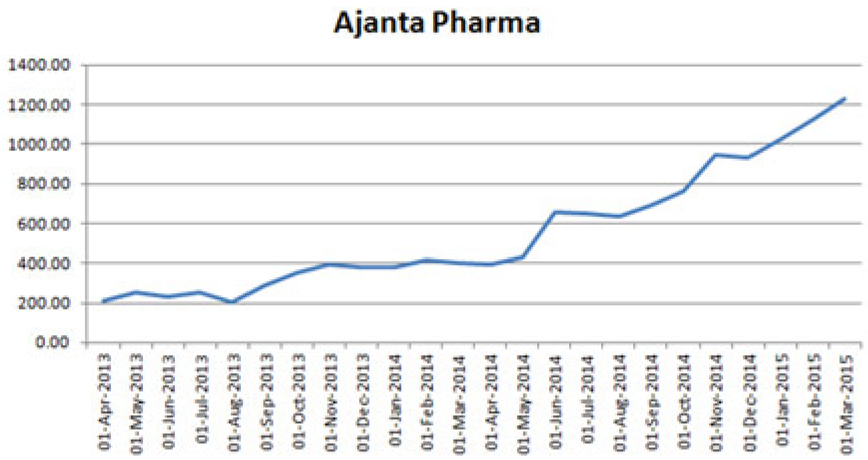
The company is doing well in terms of revenue and profit growth. In the three years till March 2014, top line and bottom line grew at 9% and 13% a year, respectively. Bagadia is bullish on the stock. "At present, the stock is looking strong on charts. We can see a 10-15% rise in the next two-three months." On April 22, it was trading at Rs 238.

Graph shows share price movement of Sintex Industries in Rs

Sintex Industries:

Sintex Industries has posted a good overall performance with healthy growth in revenues and profitability led by better performance from the prefab and custom moulding segments. The revenue zoomed 24.96% to Rs 999.77 crore for the quarter ended December 2014 as compared to Rs 800 crore during the corresponding quarter last year. Net Profit for the quarter ended December 2014 zoomed to 115.34% from Rs 66.69 crore to Rs 143.6 crore. The company reported a good operating profit of Rs 252.84 crore compared to Rs 190.72 crore of corresponding previous quarter.

Sandeep Sharma, equity research analyst, Hem Securities, says, "Robust outlook for prefab and spinning business coupled with improvement in the custom moulding business, we expect the growth momentum to continue with healthy margins. Hence, we give a buy rating with price target of Rs 180 which is 9 times of 2016-17E earnings of Rs 20. During the previous financial year, the share price of the company jumped 173% to Rs 263.75 on March 31 this year against Rs 96.70 on April 1 last year. On April 22 this year, it was trading at Rs 116.50.



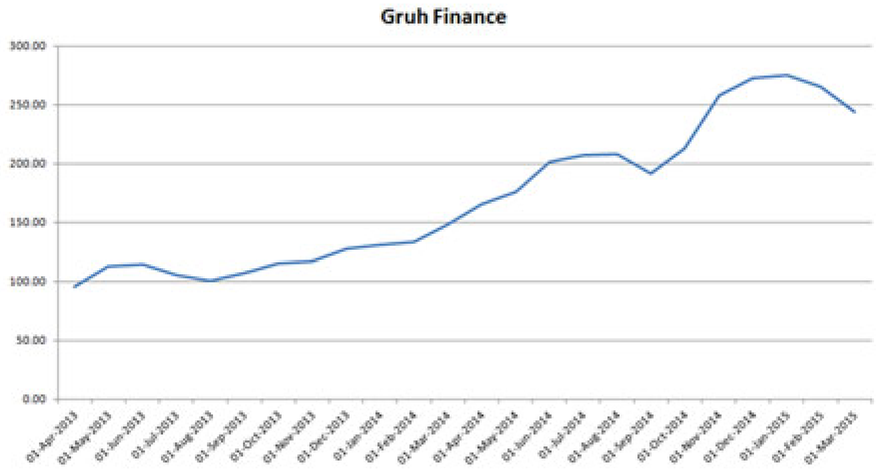
Graph shows share price movement of Ajanta Pharma in Rs

Ajanta Pharmaceuticals:

Ajanta Pharma is engaged in manufacturing pharmaceutical products. The company runs three divisions -- prescription drugs, OTC (over-the counter) and institutional sales. The company has registered a rise of 35.71% in its net profit at Rs 84.71 crore for the quarter ended December 2014 compared to Rs 62.42 crore for the same quarter in the previous year. Total income of the company has increased 20.98 % to Rs 368.84 crore against Rs 304.88 crore during the same period.

Sharma of Hem Securities says, "The third quarter numbers have once again demonstrated Ajanta's consistency in delivering above average numbers both in India as well as abroad. In domestic formulations, the company continues to register robust growth. In the exports space, both the Philippines and Franco-African markets continue to thrive on the back of consistent product launches and base business growth. On the margins front, the company has consistently been improving its margin on the back of improved product mix. We expect revenues, operating profit and net profit to grow at a CAGR of 22%, 23% and 25%, respectively. We believe the share price of the company can touch Rs 1,890 in the next few quarters."

The share price of the company jumped 160% annually (CAGR) in the past four years till 31 March 2015. On the day, it was trading at Rs 1,225 with trailing twelve months price-to-earnings ratios of 36.89 against industry P/E of 32.55 which indicates overvaluation of shares.



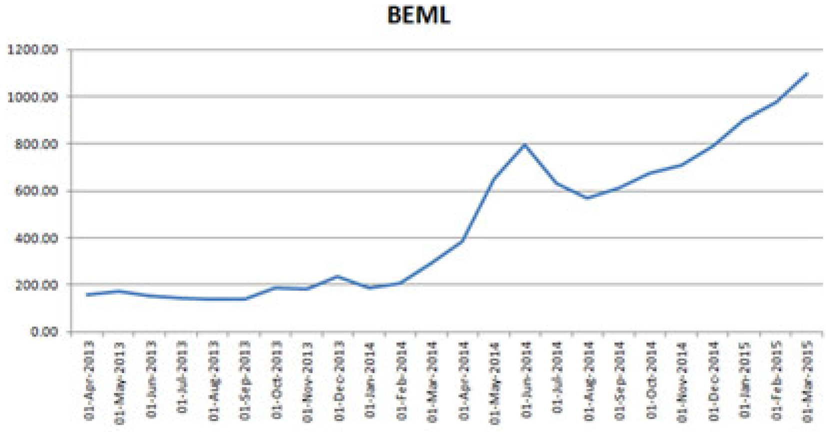
Graph shows share price movement of Gruh Finance in Rs

Gruh Finance:

The share price of the company jumped 68% in the previous financial year. It was trading at Rs 243.10 on March 31 this year against Rs 144.48 on April 1 last year.

Aggarwal is further bullish on the Gruh Finance and says, "The stock is expected to move up further as the central bank of India is in the process of cutting interest rates. Actually, Interest rate is the biggest determinant for home purchases. The company gets 70% of its business from Gujarat and Maharashtra, states which rank high on per capital income. Moreover, the Modi government initiatives regards to land acquisition ordinance and affordable housing, the company is likely to get benefitted." On April 22, it was trading at Rs 249.

On the financial front, for the nine months ended December 2014, Gruh Finance reported 26% rise in income from operations at Rs 770.46 crore. Depreciation declined 82% to Rs 0.33 crore, while provision and write offs increased 46% to Rs 30.54 crore. As a result profit before tax rose 30% to Rs 195.95 crore. The net profit of the company improved 26% to Rs 129.74 crore during the period.



Graph shows share price movement of Gruh Finance in Rs

BEML:

The company is a Public Sector Undertaking for the manufacture of rail coaches and spare parts and mining equipment. It is a multi-technology company offering high-quality products for diverse sectors of the economy such as coal, mining, steel, limestone, power, irrigation, construction, road building, aviation, defence, metro and railways.

During the previous financial year, the share price of the company jumped 279% to Rs 1,092.35 on March 31 from Rs 288.25 on April 1 last year. Kapoor of Edelweiss Financial Services is bullish on the stock and says, "We expect the stock to continue its upside momentum for next few years." Of late, the company has exported a fleet mining and construction equipment worth Rs 70 crore to M/s Hwange Colliery, the largest coal mines owned by the government of Zimbabwe.

For the quarter ended December 2014, the company registered gross sales of Rs 563.15 crore, down 27%, against Rs 772 crore in the corresponding quarter a year ago. Operating profit of BEML plunged 58.67% to Rs 19.92 against Rs 48.20 during the same period.