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SELECTIVE DIVERSIFICATION: DOES THE CAPITAL ASSET PRICING MODEL CAPTURE EFFECTS?

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ABSTRACT

The modern finance theory has indisputably strong pillars due to the years of diverse and adapting research that has taken place and still continues till date. But the basic structure of this theory, that has been taken and improved time and again, is owed to the very first contributors i.e., Harry Markowitz in 1952 and William F. Sharpe in 1964. Though been subjected to ample criticism, the original Capital Asset Pricing model, that is the simplest of its form today, still holds relevance for numerous investors and researchers. Sharpe's theory had multiple assumptions that are considered unrealistic when the real process of investing is considered, and having a very well-diversified portfolio spanning over industries is one of them. Selective diversification has fast become the norm of investing and in unprecedented times, when only a handful of industries perform favourably, it has also become an essential practice. This paper attempts to use the original Capital Asset Pricing Model to compare three portfolios compiled from India's NIFTY 500, with varying levels of diversification. Covid-19 and its impact on the share market and all businesses has been undeniably strong like the 2007-09 recession but has in an unlikely way, resulted in facilitating growth in very specific industries like pharmaceuticals and healthcare, a typical K-type growth scenario. This paper investigates whether CAPM is able to capture such a change in growth across portfolios.

KEYWORDS: *Capital Asset Pricing Model, Diversification, Pharmaceutical Industry, Anomalies*

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Selective Diversification: *Does The Capital Asset Pricing Model Capture Effects?*

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