Empirical Economics Letters, 24 (12): pp. 257-267, (December 2025) *ISSN 1681 8997*
https://doi.org/10.5281/zenodo.18154703

Profitability-Adjusted Volatility and the Low-Risk Effect: Insights from Indian Markets

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Abstract: This paper examines whether profitability-adjusted volatility can explain the low-risk anomaly in Indian equities. Using Nifty 500 data from March 2003 to March 2022, decile portfolios are constructed based on scaled volatility, defined as the standard deviation divided by (1 + net profit margin). The results show a strong and persistent inverse relationship between scaled volatility and returns. Incorporating profitability into the volatility metric improves risk ranking but does not eliminate the return differential between low- and high-risk portfolios. Overall, scaled volatility refines but does not replace the low-risk anomaly, highlighting its robustness in the context of Indian markets.

Keywords: Low-risk Anomaly, Scaled Volatility, Profitability, Indian Stock Market, Factor Regression

JEL Classification Number: G12, G11, C58