

<p>Investment MEANING AND DEFINITION Investments refer to the employment of funds with an objective of earning a favourable return on it. Investment is sacrificing present consumption for future gains. It is a planned decision to put money in financial assets with a risk-return trade-off. "Sacrifice of certain present value for some uncertain future value" – WILLIAM F. SHARPE</p> <p>FEATURES OF INVESTMENT</p> <ol style="list-style-type: none"> 1. Return: Investors buy or sell financial instruments in order to earn return on them. The return on investment is the reward to the investors. 2. Risk: Risk is inherent in any investment. Risk may relate to loss of capital, delay in repayment of capital, non-payment of return or variability of returns. Theoretically, the higher the risk, higher is the expected return. The higher return is a compensation expected by investors for their willingness to bear the higher risk. 3. Safety: Safety refers to the protection of investor principal amount and expected rate of return. The safety of investment is identified with the certainty of return of capital without loss of time or money. 4. Liquidity: An investment that is easily saleable without loss of money or time is said to be liquid. 5. Tax Considerations: There are certain investments which provide tax exemption to the investor. Interest, dividends, capital gains and capital losses are all treated differently for tax purposes. Some type of investment enjoys special tax incentives. The tax saving investments increases the return on investment. <p>INVESTMENT OBJECTIVES</p> <ol style="list-style-type: none"> a) Short term high priority objectives: Investors have a high priority towards achieving certain objectives in a short time. For example, a young couple will give high priority to buy a house. b) Long term high priority objectives: investment is done on the basis of objectives of long term needs. They want to achieve financial independence in long period. For example, investing for post retirement period or education of a child etc. c) Low priority objectives: These objectives are not painful. After investing in high priority assets, investors can invest in these low priority assets. For example, provision for tour, purchasing domestic appliances etc. d) Money making objectives: Investors may invest their surplus money just to make more money. Their objective is to maximize wealth. Usually, the investors invest in shares of companies which provide capital appreciation apart from regular income from dividend. Other objectives <ol style="list-style-type: none"> a. Lifestyle - Investors want to ensure that their assets can meet their financial needs over their lifetimes. b. Financial security - Investors want to protect their financial needs against financial risks at all times. c. Return - Investors want a balance of risk and return that is suitable to their personal risk preferences. d. Value for money - Investors want to minimise the costs of managing their assets and their financial needs. e. Peace of mind - Investors do not want to worry about the day to day movements of markets and their present and future financial security. <p>NEED AND BENEFITS OF INVESTMENTS</p> <ol style="list-style-type: none"> 1. Income: The main benefit from investment is income which comes in form of dividends on shares or interest on bonds. 2. Capital Appreciation: Investments not only gives regular income but it also provides long-term price appreciation leads to growth in capital, and wealth for investors. 3. Highly Regulated: Investment in the capital market is highly regulated through the statutory agency like SEBI. Any investor that is wronged can have his case taken up by the market regulators. 4. Tax Advantages: Tax on dividends and bonds is very low when compared to alternative investments. 5. Collateral: Securities represent stocks of wealth, and can be used as collateral to secure financing such as loans from lending 	<p>institutions. It will interest investors that they can use their share certificates as collateral to obtain bank loans for individual use or business development.</p> <ol style="list-style-type: none"> 6. Confidentiality: Investing in securities provides confidentiality in the management of wealth, as financial securities are intangible in nature. 7. Flexibility: Shares are traded in units and lots that are affordable by investors of different income levels. Bonds are also fairly affordable when compared to alternative investments such as real estate. As such, investment in securities can be customised to the specific incomes of investors. 8. Operating Convenience: As investing in securities represents the separation of ownership from management, it therefore does not require the personal commitment of the investor for it to give a return. 9. Liquidity: Shares and bonds are easily transferable at low transaction cost as compared to other assets such as real estate. Therefore an investor can buy and sell at considerable convenience. 10. Hedge against inflation: Securities prices over the long term tend to outperform inflation, therefore investment in securities can be a reliable hedge against inflation in the long term. <p>FACTORS AFFECTING INVESTMENT DECISIONS</p> <ol style="list-style-type: none"> 1. Return: The investment should earn reasonable and expected return on the investments. Certain investments yield fixed income, while others do not yield fixed income. Based on investors' expectations, he will decide where to invest. 2. Form of return: Investments in securities yield two types of return. They are periodic cash receipts and capital gain. Some investors want periodical cash receipts in the form of interest and dividend. Some investors are interested in capital gain in the form of increase in the price of investment. While selecting the investment, the investor is required to consider the form of return. 3. Risk appetite: The ability to tolerate risk differs from person to person. The level of risk depends on the objective of investment. An investor who expects greater returns should also be prepared to take higher risk. 4. Objectives of investment: Some investors may prefer safety of their principal amount (low risk) and may be satisfied with lower rate of return. An aggressive investor, on the other hand, may be willing to take a high risk in order to have high capital appreciation. 5. Capital appreciation: If the goal of the investor is to achieve conservative growth, he would make an investment portfolio that will yield money over the long term by capital appreciation knows as wealth building overtime. Those investors who want short term and long term capital gains shall opt for aggressive growth in stocks. There are some others whose aim is to maximise returns by buying and selling securities solely to make profit from short-term price fluctuations (i.e. speculators). 6. Safety of funds: The important consideration in making investment is that the funds so invested should be safe and secure. The investor should get back his investment without loss. He will generally select only those investments or securities which are safe. 7. Liquidity: Before making investment, the investor should keep in mind the degree of liquidity required. Some securities can be sold very easily. Such investments are said to be liquid. Some investments are illiquid. 8. Tax considerations: Before selecting the securities for investment, the investor will take into consideration the provisions of income tax, capital gain tax, wealth tax etc. He wants to minimise his tax burden and avail all tax exemptions available to him. 9. Investment period: The investment decisions may also depend on the period of investment. The longer the time-horizon, the greater are the returns that investors should expect. Further, the risk element reduces with time. 10. Investible surplus: The investible surplus plays 	<p>a vital role in making investment decisions. The money available for investment determines the selection of various asset classes and so do the risks and returns.</p> <ol style="list-style-type: none"> 11. Investment need: The amount investor need at the time of maturity is factor deciding investment. This helps him determine the amount of money he needs to invest every month or year to reach the required figure. 12. Past market trends: Sometimes history repeats itself; sometimes markets learn from their mistakes. We need to understand how various asset classes have performed in the past before planning finances. <p>INVESTMENT AND SPECULATION</p> <p>Speculation means buying and selling assets or securities with the expectation of getting profit from the price fluctuations. It means undertaking the risk involved in buying and selling assets or securities in the hope of getting short term gain. Investment is based on valuation of the business while speculation rests completely on the price. investment is distinguished from speculation with respect to the following factors.</p> <ol style="list-style-type: none"> 1. Risk: An investor prefers low risk investments, whereas a speculator is prepared to take higher risks for higher returns. The investment tends to be speculative investment when the investor does not make adequate analysis. 2. Price Change: speculation is associated with buying low and selling high with the hope of making large capital gains. Investors are careful while selecting securities for trading. 3. Holding Period: Investment is long term in nature. An investor commits funds for a longer period in the expectation of holding period gains. However, a speculator trades frequently, hence, the holding period of securities is very short. <p>INVESTMENT</p> <ol style="list-style-type: none"> 1. Investment is made for a long period (one year to few years) 2. The investment involves moderate risks. 3. The main motive of investment is to earn return (income). <p>SPECULATION</p> <ol style="list-style-type: none"> 1. Speculation is made for a short (few days to months). 2. Speculation involves high risks. 3. The main motive of speculation is earn profit (capital gain). 4. Investor uses his own funds and avoids borrowed funds. 4. Speculator uses own funds as well as borrowed funds <p>INVESTMENT AND GAMBLING</p> <p>Gambling is a combination of pleasure and pain. It can be described as easy money for lazy people. Gambling is a very short-term investment in a game or chance. Investing is any activity in which money is put at risk for the purpose of making a profit.</p> <p>GAMBLING</p> <ol style="list-style-type: none"> 1. It is for very short period 2. Its aim is return along with enjoyment. 3. It involves artificial risks. 4. There is no analysis of risk and return <p>INVESTMENT</p> <ol style="list-style-type: none"> 1. It is for a long period. 2. Its aim is return 3. It involves commercial risks. 4. There is an analysis on risk and return <p>STEPS IN INVESTMENT PROCESS</p> <ol style="list-style-type: none"> 1. Defining Investment Objective: This is the first step of the investment decision process that involves specification of investment objectives, investment constraints, fund available for investment, identification of potential investment assets and tax status of the investor. Investment objectives should be stated in terms of both risk and return. 2. Analysing securities: There are two approaches used for analysing securities; Technical analysis and Fundamental analysis. Technical analysis involves studying the trends of stock prices movements. fundamental analysis is a method of evaluating a security in terms of its intrinsic value by examining related economic, financial and other qualitative and quantitative factors. 3. Portfolio Construction: A portfolio is a combination of securities. It is constructed in a manner so as to meet the investor's goals and objectives. The investor should decide how best to reach the goals with the securities available 4. Performance Evaluation: it is essential to monitor the 	<p>performance of these investments to see how they are working together in your portfolio to help you progress toward your goals.</p> <ol style="list-style-type: none"> 5. Portfolio Revision: Having built a portfolio, an investor must consider when and how to revise it. Portfolio revision involves the periodic repetition of the above steps. <p>INVESTMENT POLICY</p> <p>An investment policy describes the parameters for investing funds and identifies the investment objectives, preferences or tolerance for risk, constraints on the investment portfolio, and how the investment program will be managed and monitored. investment policy statement (IPS): it is a document which is signed between an individual investor and financial advisor or portfolio manager. IPS describes the client's overall investment objectives and long-term goal. This statement specifies the strategies that the fund manager will implement to achieve the desired results</p> <p>Features of the Investment Policy Statement</p> <ol style="list-style-type: none"> 1. Investment Goal: It contains the financial goals they wish to achieve. It also mentions their time horizon for investment, the returns they expect as per their goals. 2. Return and Risk: Investment policy includes the risk tolerance levels of investors. It provides a guide to the portfolio manager while choosing particular asset classes to invest. 3. Asset Selection: the investors mention the type of asset which seems closer to their investment goal. This is where the investors say which variety of asset classes they wish to invest. 4. Asset Allocation: a diversified portfolio will reduce the volatility of the investment portfolio. As a result, one asset's positive performance offsets a negative performance of another asset. 5. Review: one should control and check the performance of the portfolio, either monthly, quarterly, half-yearly or even on an annual basis. This helps the investors to rebalance their portfolio at the same time based on current market conditions. <p>INVESTMENT AVENUES</p> <ol style="list-style-type: none"> 1. REAL INVESTMENTS Real assets are physical investments which would include real estate, gold and silver, precious stones rare coins and stamps, and art objects. <ol style="list-style-type: none"> a. Real estate: It is investments in land and house or property. Real estate investment has seen a lot of capital appreciation over the last few years b. Bullion: Gold and Silver is still a traditional investment avenue. Investing in gold and precious stones always has a guaranteed return. c. Commodities: Commodities are simply raw materials that we use to make some of the essential products we employ daily. An individual can estimate the commodity price and the fluctuation by the trends in export and import. d. Art: Art and antiques as investments have caught the fancy of many. Today, investment in art is catching on and people are making a lot of gains through it. 2. FINANCIAL INVESTMENTS These investments are freely tradable and negotiable. <ol style="list-style-type: none"> a. Debts: These are instruments, which give a fixed rate of interest for a fixed period of maturity. Hence they are low risk, low return investments. b. Equities: These investments carry more risk than investing in debt instruments. There is no assured return but when we invest in a share of a company, we become an owner of the company to the extent of the capital invested. c. Mutual Funds: A mutual fund pools money from investors and invests in different securities. A professional fund manager decides the investment strategies and securities, where one can purchase units of a fund. 3. NON-SECURITIZED FINANCIAL SECURITIES These investment instruments are not tradable, transferable nor negotiable and would include bank deposits, post office deposits, company fixed deposits, provident fund schemes, national saving schemes and life insurance. 4. Fixed Deposit: Investors deposit a certain amount for a specified period. He can earn a
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<p>predetermined interest rate on that amount from the bank or any other financial institution. An individual can also help with loan services based on the fixed deposit. b. Public Provident Fund (PPF): The impact of compounding of tax free interest is hefty, especially in the later years. It is a safe investment as the interest earned and the principal invested is backed by sovereign guarantee. c. National Pension System (NPS): It is a long term retirement focused investment product managed by the Pension Fund Regulatory and Development Authority (PFRDA). It is a mix of equity, fixed deposits, corporate bonds, liquid funds and government funds. d. Life Insurance: Insurance plans sold as life insurance shall not be considered as investment options as they provide risk coverage in case of any mishap. However, many Indians consider insurance as an investment. It is an instrument for the security of life CHAPTER 2 Investment Analysis TIME VALUE OF MONEY This means that a rupee received now is worth more than a rupee to be received in future. An individual would be ready to invest a rupee only if he receives more than a rupee in exchange in the future. There will be a fall in the value of money tomorrow due to inflation and similar reasons. The time value of money concept states that earlier receipts are worth more than later receipts because earlier receipts can be reinvested to bring additional returns before the later receipts are generated. RETURN Return is the reward of making investment. General definition of return is the benefit associated with an investment. Meaning of Risk Risk is the quantifiable likelihood of loss or less-than-expected returns. Risk includes the possibility of losing some or all of the original investment. risk can be defined as the measurable possibility of loss on an investment. There is risk involved if the outcome of an investment is uncertain at the time the investment is made. TYPES OF INVESTMENT RISKS The general market component of risk is called systematic risk and a specific (issuer) component of the risk is called unsystematic risk. Thus; Total risk = Systematic risk + Unsystematic risk 1. SYSTEMATIC RISK Occurrence of certain events can affect all firms at the same time. Events such as inflation, war and fluctuating interest rates influence the entire economy and not just a specific firm or industry. This is known as systematic risk. Diversification cannot eliminate this type of risk. Therefore, it is considered a non-diversifiable risk. 2. UNSYSTEMATIC OR DIVERSIFIABLE RISK Unsystematic risk (also called diversifiable risk) is risk that is specific to a company. This type of risk could include dramatic events such as a strike, a natural disaster like a fire or something as simple as falling sales. Two common sources of unsystematic risk are business risk and financial risk. Diversification can help eliminate unsystematic risk from a portfolio. SOURCES OF RISK 1. Market Risk: The variability in a security's returns resulting from fluctuations in the aggregate market is known as market risk. All securities are exposed to market risk including recessions, wars, structural changes in the economy, tax law changes, even changes in consumer preferences. Market risk occurs due to the reaction of investors in the stock market. 2. Interest Rate Risk: The variability in a security's return resulting from changes in the level of interest rates is referred to as interest rate risk. Such changes generally affect securities inversely 3. Purchasing Power Risk: A Factor affecting all securities is purchasing power risk, also known as inflation risk. It is arising from decline in purchasing power on account of inflation. There is the chance that the purchasing power of invested amount will decline. 4. Regulation Risk: Some investments can be relatively attractive to other</p>	<p>investments because of certain regulations or tax laws that give them an advantage of some kind. The risk of a regulatory change that could adversely affect the stature of an investment is a real danger. 5. Business Risk: The risk of doing business in a particular industry or environment is called business risk. For example, as one of the largest steel producers, Tata Steel faces unique problems. Similarly, General Motors faces unique problems as a result of such developments as the global oil situation and Japanese imports. 6. Reinvestment Risk: The YTM (The Yield To Maturity) calculation assumes that the investor reinvests all coupons received from a bond at a rate equal to the computed YTM on that bond, thereby earning interest on interest over the life of the bond at the computed YTM rate. In effect, this calculation assumes that the reinvestment rate is the yield to maturity. 7. International Risk: International Risk can include both Country risk and Exchange Rate Risk. Exchange Rate Risk: the variability in returns on securities caused by currency fluctuations. Exchange rate risk is sometimes called currency risk. Country Risk: With more investors investing internationally, both directly and indirectly, the political, and therefore economic, stability and viability of a country's economy need to be considered. 8. Liquidity Risk: Liquidity risk is the risk associated with the particular secondary market in which a security trades. An investment that can be bought or sold quickly and without significant price concession is considered liquid MEASUREMENT OF RISK 1. Standard Deviation The standard deviation measures how much returns change over a period. This is also known as the volatility of returns. The standard deviation measures the typical deviation from the mean return. The mean return is the average return of the asset over a specified period. The square root of the variance is the standard deviation, which is simply the average deviation from the expected return. Greater the standard deviation, greater the risk of an investment. 2. Coefficient of variation The coefficient of variation is a better measure of risk, quantifying the dispersion of an asset's returns in relation to the expected return, and, thus, the relative risk of the investment. Hence, the coefficient of variation allows the comparison of different investments. This can be calculated as follows. Measurement of Systematic risk The systematic risk causes variability in returns due to changes in the economy or the market. Such changes may affect all securities in the market in a greater or lesser degree. Hence an investor cannot avoid such risks. The Meaning of Beta The systematic risk of a security is measured by a statistical measure called beta. The data required for the calculation of beta are the historical data of returns of the individual security and the returns of a representative stock market index. Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. In other words, beta gives a sense of a stock's market risk compared to the greater market. Beta > 1- Aggressive securities. A beta of greater than 1 indicates that the security's price will be more volatile than the market. Beta < 1- Defensive securities. A beta of less than 1 means that the security will be less volatile than the market. Beta = 1- Neutral securities. A beta of 1 indicates that the security's price will move with the market. CHAPTER 3 Approaches to Security Analysis Fundamental analysis fundamental analysis is a method used to determine the value of stock by analyzing the financial data that is 'fundamental to the company. fundamental analysis is the analysis, wherein the investment decisions are taken on the basis of the financial strength of the company.</p>	<p>Fundamental analysis is a method of evaluating the intrinsic value of an asset and analysing the factors that could influence its price in the future.. IMPORTANCE OF FUNDAMENTAL ANALYSIS 1. Predicting future price movement Fundamental analysis scans the industry and the overall economy, hence forecasts the movement of the price of the security. Based on certain parameters, fundamental analyst tries to predict the future price. 2. Determining fair value With the help of fundamental analysis, one can easily determine the fair value of a company by carefully analysing the past and present performance of the company. Fair value helps in deciding whether the company is overvalued or undervalued. 3. Management evaluation fundamental analysis helps in evaluating management and also to make internal business decisions. Fundamental analysis helps in understanding the structure of the management and how it has been performing over the years. 4. Determining company's ability to beat Fundamental analysis helps to understand whether the company is able to beat its competitors. If it is not able to outperform its competitors, it will not be able to survive in the long run. 5. Analysing company's financial strength Fundamental analyst helps to determine company's financial strength and its ability to repay debts. RATIONALE OF FUNDAMENTAL ANALYSIS 1) It allows the investor to identify companies with durable or long-term competitive advantages; 2) It is easy to implement; 3) It is a structured and consistent process performed on the basis of the available financial reports; 4) It is useful to select potential stocks to acquire, thus, facilitating the make-up of an investment portfolio; 5) It allows the estimation of the intrinsic value or "real" value of the stocks. In fact, as stock markets are not perfectly efficient, there is always an opportunity to find undervalued stock TOP-DOWN AND BOTTOM-UP APPROACH 1. Top down approach: This is also known as the Economy-Industry-Company or the EIC approach wherein the analyst starts analysing the economy at large and extend it further into the relevant industry and then the company in particular. 2. Bottom up approach: Bottom-up approach is just the opposite of top-down approach. In this approach, the company is analyzed first and then it is extended to economy and industry. In this, we study the details about the companies such as the financial statements, ratios, management and estimate its investment potential. E-I-C ANALYSIS 1. E - Economic (macroeconomic) analysis: This describes the macroeconomic situation in the particular country and its potential influence on the profitability of stocks. 2. I- Industry analysis: This evaluates the situation in the particular industry/ economic sector and its potential influence on the profitability of stocks. 3. C - Company analysis: This involves financial analysis of the individual companies from the shareholder approach. STEPS IN FUNDAMENTAL ANALYSIS Fundamental Analysis can be broken down into the three broad steps mentioned below. 1. Analysing the overall economy. 2. Analysing the industry in which the company operates. 3. Analysing the company. 1. ECONOMIC ANALYSIS The first step in fundamental analysis involves analysing the overall economy. Macroeconomic factors are given importance in this phase of analysis. It aims to evaluate the economic climate of a country which is suitable for the growth of the business sector, especially the capital market. Macro Economic Factors The macro economy is the study of all the firms operates in economic environment. The key variables to describe the state of economy are explained as below: 1. Agricultural Growth: Agriculture is directly and indirectly linked with the</p>	<p>industries. Hence increase or decrease in agricultural production has a significant impact on the industrial production and corporate performance. Companies using agricultural raw materials as inputs or supplying inputs to agriculture are directly affected by change in agriculture production. 2. Industrial Growth: The industrial growth is a major contributor to the national income of a country. Industrial growth helps the overall development of different industrial sectors and that finally reflects in the return and price of securities. The GDP growth rate represents the average of the growth rate of agricultural sector, industrial sector and the service sector. 3. Type of Economy: India follows a pattern of mixed economy where both public and private sector receives equal importance. Government is major investor in industries. The industrial and fiscal policy of the government also plays a very important role for the performance of the Indian economy. 4. Business Cycle: In all capitalist economies we find business cycle. Such economies pass through different phases of prosperity. The different stages of business cycle are depression, recovery, boom and recession. These different stages of business cycle will have a direct connection on the performance of industries and companies. 5. Gross Domestic Product (GDP): Investors have to consider the rate of growth of the economy. An important variable to know the rate of growth of the economy is GDP. It is the aggregate value of goods and services produced in the economy for the specific period. The increase of GDP has the favourable impact on the stock market and the decrease of it weakens the financial market. 6. Savings and Investment: Growth of an economy requires proper amount of investments which in turn is dependent upon amount of domestic savings. The amount of savings is favourably related to investment in a country. The small savings of the investors are mobilised and made available to business firms through capital market. 7. Interest Rates: Interest rates are a good indicator of economic growth. A lower rate of interest means a lower cost of financing and thereby gives more profit to companies. Higher rate of interest will lead to higher cost of finance and reduces the profits. 8. Price level and Inflation: The inflation rate is defined as the rate of change in the price level. Most economies face positive rates of inflation year after year. The price level, in turn, is measured by a price index, which measures the level of prices of goods and services at a given time. 9. Unemployment: Unemployment rate reflects the percentage of the currently unemployed persons in the labour market. Since wages will end up as household income, a high unemployment rate may point to a dip in consumer spending 10. The tax structure: The business community eagerly awaits the government announcements regarding the tax policy in March every year. The type of tax exemption has impact on the profitability of the industries. Concession and incentives given to certain industry encourages investment in that industry and have favourable impact on stock market. 2. INDUSTRY ANALYSIS Another important aspect of fundamental analysis is industry analysis. An industry is generally described as a homogenous group of companies. Industry as a group of firms produces similar products which serves the same needs of common set of buyers. Certain industries are likely to benefit more than others when the economy is expanding. Therefore an investor can narrow the analysis from general economy to those industries that are best suited to benefit from the current or future economic environment. To assess an industry group's potential, an investor would consider the</p>
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<p>overall growth rate, market size, and importance to the economy. factors that influence the performance of industry groups.</p> <p>1. Product or Service: While conducting fundamental analysis there is a need to concentrate on product or services offered by industry. Success or failure of companies greatly depends on the products offered by them to its customers. 2. Estimating Growth: It is also necessary to study an industry's volume of sales and revenues over the last several years, preferably over more than one business cycle. By extending this approach to all companies in the same industry, it is possible to assess competitive capability of a company. 3. Industry life cycle: All industries exhibit a life cycle characterised by pioneering stage, growth, maturity and decline. However, the length of each stage varies from industry to industry and from company to company. 4. Raw material and other inputs: Another important factor which decides the prosperity of industries is the availability of raw materials and other inputs required for production. Easy availability of raw material is highly necessary for an uninterrupted flow of production activities. 5. Production Cost and Profit: The lowest cost producer in an industry is best able to withstand intense price competition, either by pricing its product to maximize profits or setting prices at low levels to keep potential competitors from entering the business. 6. Competitive Forces: Many competitive forces determine the attractiveness of an industry and that can drastically change the future growth and valuation of companies within the industry. 7. Cyclical Industries: cyclical industries are sensitive to global economic conditions and swings in the prices of international commodities markets. When business conditions are improving, earnings tend to rise dramatically. 8. Capacity utilisation: If the products offered by an industry are good, there will be great demand for such products and consequently industry would be able to achieve high growth and prosperity. In such a case industry can function at its full capacity. 9. Nature of Demand: The prosperity of an industry cannot be estimated accurately if the demand is a fluctuating in nature. On the other hand, industry with stable demand can achieve better growth. 10. Govt. Policy: The policy announced by the government will also affect the industry as a whole such as industrial policy and fiscal policies of the government have a direct connection on the performance of industries. Likewise, relief, rebate and concessions declared by the government to certain class of industries also influence the functioning of organisations.</p> <p>3. COMPANY ANALYSIS Company analysis is the study of various characteristics of a company regarding its operating and financial performance and future prospects. Once an investor decides to invest in a particular industry on the basis of economic and industry analysis, it is important to select the company in which investment is to be made. The main points of analysis at this stage are:</p> <p>1. Business Model: The business model is the basis upon which all other things are built. If model is not good, there is little hope for the success of the business. Even before an investor looks at a company's financial statements or does any research, one of the most important questions that should be asked is: What exactly does the company do? This is referred to as a company's business model. Investors can get a good overview of a company's business model by checking out its website. Sometimes business models are easy to understand. Take McDonalds, for instance, which sells hamburgers, fries, soft drinks, salads and whatever other new special they are promoting at the time. It is a simple model, easy enough for anybody to understand. Unless investors understand a</p>	<p>company's business model, they don't know what the drivers are for future growth. 2. Market Share: It is necessary to consider the market share of the company in which investors are going to invest. If the market share is high, the company would be able to meet the competition successfully. While analysing the market share, the size of the company should also be considered because it is difficult for small companies to survive in the future. It is also wise to make a comparison with similar companies, for example, an IT company can be compared with another IT company to assess the viability to invest. 3. Customers: Some companies serve only a handful of customers, while others serve millions. In general, it is not desirable if a business relies on a small number of customers for a large portion of its sales because the loss of each customer could dramatically affect revenues. For example, think of a military supplier who has 100% of its sales with the Government of India. One change in government policy could potentially wipe out all of its sales. 4. Growth of Sales: An investor must also see the growth of sales before taking an investment decision. A leading company of today may turn out to be a bad company in future unless there is a steady growth in the sales. The investors normally would not prefer to invest in the stocks of a big company with inadequate growth. Not only the growth of sales, but also the stability in the growth of sales should also be considered. If firm has stable revenue from sales, it will likely to make stable earning also. 5. Competitive Advantage: Another business consideration for investors is competitive advantage. A company's long-term success is driven largely by its ability to maintain a competitive advantage. Every industry is composed of many individual firms and each individual firm is producing similar goods and services. Naturally competition will be high between these companies. A company which offers greater satisfaction to customers will eventually become market leaders. Powerful competitive advantages, such as Coca Cola's brand name and Microsoft's domination of the personal computer operating system enjoy growth and profits. 6. Management: A company requires top-quality management to drive it towards financial success. Some investors believe that management is the most important aspect for investing in a company. This is true because even the best business model fail if the leaders of the company are not capable to properly execute the plan. Therefore, investors might look at management to assess their capabilities, strengths and weaknesses. A good way to understand management capability is to check and see how executives have done at other companies in the past. We can normally find biographies of top executives on company web sites. Identify the companies they worked at in the past and do a search on those companies and their performance. 7. Labour and other industrial problems: A cordial relationship between management and employees is necessary for the smooth functioning of organisations. A company with skilled and expertise labour and high labour productivity can achieve prosperity within a short period. On the other hand, frequent labour problems like strike may worsen the relation between management and employees. Companies with acute labour problems are not popular for investment. 8. Financial Analysis: The final step to the fundamental analysis process would be to evaluate the financial statements to determine the value. Many techniques such as financial ratios like current ratio, acid test ratio, gross profit ratio etc., can be used for financial analysis. Tools for Company Analysis- Balance sheet- Income statement- Cash flow statement- Notes to financial statements-</p>	<p>Auditor's report- Social and sustainability reports, if any- Corporate governance reports Financial Ratios 1. Profitability ratios: which measure the earning power of the firm. 2. Liquidity ratios: which measure the ability of the firm to pay its immediate liabilities. 3. Debt ratios: which measure the firm's ability to pay the debt obligations over the time. 4. Asset utilization ratios: which measure the firm's ability to use its assets efficiently. 5. Market value ratios: are an additional group of ratios which reflect the market value of the stock and the firm. ADVANTAGES OF FUNDAMENTAL ANALYSIS 1. Suitable for Long-term Investments: Fundamental analysis is good for long-term investments based on long-term trends. The ability to identify and predict long-term economic, demographic, technological or consumer trends can benefit patient investors who pick the right industry groups or companies. 2. Identification of Value: Long term investors believe in value investing, fundamental analysis looks out for best in companies and help investors in identifying those with a good value. Fundamental analysis can help investors to assess and know companies with valuable assets, a strong balance sheet, stable earnings, and staying power. 3. Understanding about Business: Fundamental analysis provides a thorough understanding of the business to an investor. Investors can discover earning potential and expectation of a company and identify those companies that are expected to deliver desired return on the investments and avoid companies that have many shortcomings 4. Stock groups: Stocks move as a group. By understanding a company's business, investors can better position themselves to categorize stocks within their relevant industry group. Business can change rapidly and with it the revenue mix of a company. LIMITATIONS OF FUNDAMENTAL ANALYSIS 1. Defective Practice: Critics of fundamental analysis often charge that the practice is either irrelevant or that it is inherently defective. it is impossible to learn anything new about a company, by analyzing its fundamentals. 2. Unscientific Process: The other major argument against fundamental analysis is that it is more practical than theoretical. These critics charge that fundamental analysis is an unscientific process, and that it is difficult to get a clear picture of a company's value when there are so many qualitative factors such as a company's management and its competitive environment. 3. Time Consuming: Fundamental analysis may provide excellent insights, but it can be extraordinarily time-consuming. 4. Industry/Company Specific: As each industry group and company vary, different valuation techniques need to be adopted while evaluating specific companies. An investor would need to adopt different technique and model for different industries and companies which may create hassle and often lead to a time-consuming method 5. Subjectivity: Fair value is based on assumptions. Any changes to growth or multiplier assumptions can greatly alter the ultimate valuation. 6. False or Biased Information: Since all information during fundamental analysis come from the direct source of companies itself, it may be hampered or biased to attract investors. Companies are capable of manipulating figures in financial statements that can mislead the investors. SOURCES OF INVESTMENT INFORMATION Sources of Company Data 1. Annual Reports 2. Prospectus 3. Stock exchange official directory 4. Investment Guides 5. Newspapers and Journals Sources of International Economic Data 1. International financial statistics 2. Manuals by rating companies 3. Capital International Perspective 4. International Journals 4 Technical Analysis</p>	<p>CHAPTER 4 TECHNICAL ANALYSIS Technical analysis Technical analysis seeks to predict price movements by examining historical data, mainly price and volume. Technical analysis is the study of chart patterns and statistical figures to understand market trends and pick stocks accordingly. ASSUMPTIONS OF TECHNICAL ANALYSIS 1. Price Discounts Everything Technical analysts believe that the current price fully reflects all information. Because all information is already reflected in the price, it represents the fair value and should form the basis for analysis and hence only a study of the price movement is enough. 2. Prices Move in Trends Technical analysis assumes that prices create trend. Prices move in trends and those trends tend to remain for relatively long periods of time. Technical analysts also believes that price changes are not random. Instead, they follow a given trend, which can be either bullish/long or bearish/short, following identifiable patterns that tend to repeat over time. Whenever a trend is established, the underlying asset is likely to continue moving in a given direction until a new trend is established. 3. History Tends to Repeat The basic idea in technical analysis is that history will always repeat itself, be it in the short term or long term. For this reason, technical analysts spend most of their time trying to understand past price movements to try and accurately predict future price movements. The repetitive nature of price movements makes it possible to predict future price movements. TRADING STRATEGIES 1. Pick a Strategy or Develop a Trading System 2. Identify Securities 3. Find the Right Brokerage 4. Track and Monitor Trades 5. Use Additional Software or Tools: Main considerations in Technical Analysis (a) Price: In fact, price action is the primary measure considered when conducting technical analysis. Changes in price reflect in investor attitudes and demand and supply of securities. (b) Time: The degree of movements in price is a function of time. The longer it takes for a reversal in trend for instance, the greater the price changes that would follow, (c) Volume: The intensity of price changes is reflected in the volume transactions that accompany the changes. Volume increases every time a buyer and seller transact their stock or futures contract. (d) Breadth: Study of Breadth of market indicators, the extent to which the price changes have taken place in the market in accordance with a certain overall limit. PRICE FIELDS Open - This is the price of the first trade for the period (e.g., the first trade of the day). High - This is the highest price that the security traded during the period. It is the point at which there were more sellers than buyers Low - This is the lowest price that the security traded during the period. It is the point at which there were more buyers than sellers Close - This is the last price that the security traded during the period. Due to its availability, the Close is the most often used price for analysis. Volume - This is the number of shares that were traded during the period. Open Interest - This is the total number of outstanding contracts Bid - This is the price a market maker is willing to pay for a security Ask - This is the price a market maker is willing to accept ADVANTAGES OF TECHNICAL ANALYSIS 1. Focus on Price: Technical analysis focuses on price movements. Price movements usually precede fundamental developments. 2. Trend Prediction: The main advantage of technical analysis is that it helps investors and traders predict the trend of the market. Up trend, downtrend, and sideways moves of the market are easy to predict, with the help of chart analysis. 3. Entry and exit recommendations: With the help of technical analysis, traders and investors can predict the right time to enter and exit a trade thereby enabling good returns.. 4. Provides Valuable</p>
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<p>Information: A price chart can offer plenty of valuable information. Information like support, resistance, chart pattern, momentum of the market, volatility, and trader's psychology are some examples of types of information provided by technical analysis and used by traders. 5. Provides Early Signal: Technical analysis gives early signals and also exhibits the psychology of investors and traders. Price-volume analysis indicates the movement of market makers and their activities related to a particular market. 6. Quick and Less Expensive: Technical analysis is less expensive as compared to the fundamental analysis. LIMITATIONS OF TECHNICAL ANALYSIS 1. Lack of Accuracy: Technical analysis is used to forecast stocks. All of the technical indicators give possible entry and exit points. However, we cannot expect cent percent forecasting accuracy in technical analysis. 2. Bias of Analysts: Just as with fundamental analysis, technical analysis is subjective and analysts personal biases can be reflected in the analysis. One technical analyst's opinion may contradict another analyst's opinion for the same stock. 3. Based on past price: All technical indicators are based on price, which always reflects what has already happened in the market. 4. Many Interpretations: Even though there are standards, many times two technicians will look at the same chart and give two different versions or see different patterns. 5. Ignore Fundamental: Technical analysis does not take into account the underlying fundamentals of a company which for longer timeframes may be a risk that needs to be considered. 6. Lateness: Technical analysis has been criticized for being too late. By the time the trend is identified, a substantial portion of the move has already taken place. After such a large move, the reward to risk ratio is not great. 7. Mixed signals: On some occasions you can get mixed signals, two different indicators will show contradictory information; meaning one indicator could show a Buy signal while the other one would be showing a Sell signal Differences between Fundamental Analysis and Technical Analysis FUNDAMENTAL ANALYSIS 1. Recommended for long term investment 2. Best suited for investment 3. For long term trading 4. Utilises both past and present data 5. Performed on economic reports, news and statistics 6. Identify undervalued or overvalued stocks TECHNICAL ANALYSIS 1. Recommended for short term investment 2. Best Suited for trading 3. For swing and short term day trading 4. Relies only on past data 5. Performed through chart analysis 6. Determines right time to buy or sell stock DOW THEORY Charles Dow developed Dow Theory The theory identified three types of price movements or trends namely. 1. Primary trend: The Primary trend is the largest trend and once the primary trend has been identified, it will remain in effect until proved otherwise. The Primary trend usually lasts more than one year and may last for several years. 2. Secondary (reaction) trend: Secondary trends are intermediate, corrective reactions to the Primary trend. These reactions typically last from one to three months. Secondary movements run counter to the primary trend and are reactionary in nature. A secondary trend moves in the opposite direction of the primary trend, or as a correction to the primary trend. 3. Minor trend or Daily fluctuations: Minor trends are simply the daily price fluctuations. Minor trends are short-term movements lasting from one day to three weeks. The minor trend is generally the corrective moves within a secondary move, or those moves that go against the direction of the secondary trend. Three Stages of Primary Trend 1. Primary Bull Market: A primary bull market consists of three stages namely Accumulation, Public</p>	<p>participation and Excess. Stage 1 - Accumulation: The first stage of a bull market is called the accumulation phase, which is the starting point of the upward trend. The accumulation phase starts at the end of a downtrend, when whole condition in the market remains at its worst. Stage 2 - Public Participation or Big move: The second stage of a primary bull market is usually the longest, and sees the largest advance in prices. As the good news starts to spread the market, more and more investors come back into the market; resulting higher prices. Stage 3 - Excess: At this point, the market is attractive again for all investors. The excess phase, is the one in which the smart investors starts to sell their holdings to those now entering the market. This is usually the time when the last of the buyers start to enter the market after large gains have been achieved by smart investors. The late entrants hope that recent returns will continue. Unfortunately for them, they are buying at top prices. 2. Primary Bear Market A primary bear market is defined as a long sustained decline marked by deteriorating business conditions and subsequent decrease in demand for stocks. Stage 1 - Distribution: The first phase in a bear market is known as the distribution phase and marks the beginning of a bear market. This is a period in which informed buyers start to sell (distribute) their stocks. Stage 2 - Public Participation or Big move: During this phase it is clear that the business conditions in the market are getting worse and the sentiment is becoming more negative as time goes on. As business conditions worsen, the sell-off continues Stage 3 - Panic or Despair: The last phase of the primary downward market tends to be filled with market panic and can lead to very large sell-offs in a very short period of time. During this phase many investors selling off their stocks in panic. 2. SECONDARY (REACTION) TRENDS Secondary (or reaction) trends last from three weeks to three months. This can be called as Wave. Secondary movements run counter to the primary trend and are reactionary in nature. In a bull market a secondary move is considered a correction. In a bear market, secondary moves are sometimes called reaction rallies. 3. MINOR TRENDS It is a market movement lasting less than three weeks. The minor trend is generally the corrective moves within a secondary move, or those moves that go against the direction of the secondary trend. They are simply the daily price fluctuations. It tries to correct the secondary movements. This can be compared with Ripple. Criticisms of Dow Theory 1. The first criticism of the Dow Theory is that it is really not a theory. He never wrote proper academic papers outlining the theory and testing the theorems. 2. Dow theory can only identify the trend but cannot forecast the price movement for intraday or other short term trading. 3. One of the criticisms is that following the theory will result in an investors acting after rather than before or at market tops and bottoms. 4. A second criticism of Dow Theory is that the different trends are not strictly defined. Often the interpretation of price swings is difficult to assign to a specific trend type. 5. Dow theory provides only directional indication and only for the longer duration and does not indicate the shorter reflections in the market. 6. Dow Theory is criticized as being outdated and no longer an accurate reflection of the economy METHODS AND TOOLS USED IN TECHNICAL ANALYSIS STOCK CHARTS This uses charts to identify recognisable trends and patterns in the formation of stock price. Stock charts, like all other charts, have two axis—the vertical axis and the horizontal axis. The horizontal axis represents the historical time periods for which a technical chart has been constructed TYPES OF CHARTS 1. Line Charts A line chart is the simplest type of stock chart. Each closing</p>	<p>price point is represented by a dot and all dots are connected by lines to get graphical representation. It gives a bird's eye view of the historical price action in a single line 2. Bar Charts Bar chart considers the open, high and low of a security along with its closing price. This type of chart in technical analysis provides us more information like where the stock had opened and closed, the high and low point for that trading period and hence the range for the day. They are also called as OHLC charts or Open-High Low-Close charts. The advantage of using a bar chart over a straight line graph is that it shows the high, low, open and close for each particular day 3. Candle Stick Charts A candlestick is composed of three parts; the upper shadow, lower shadow and body. The body is coloured green or red. Bullish Candle: When the close is higher than the open (usually green or white) Bearish Candle: When the close is lower than the open (usually red or black) Upper Shadow: The vertical line between the high of the day and the close (bullish candle) or open (bearish candle) Lower Shadow: The vertical line between the low of the day and the open (bullish candle) or close (bearish candle) Real Body: The difference between the open and close; coloured portion of the candlestick. 4. Point and figure charts A point-and-figure chart plots price movements for stocks, bonds, commodities or futures without taking into consideration the passage of time. The lack of a time constraint gives point and figure charts the advantage of being able to reveal the nature of share price movements over extended time periods. It is generally used to identify periods of consolidation, as well as set price objectives based on chart formations. EFFICIENT MARKET HYPOTHESIS (EMH) According to the EMH, stocks always trade at their fair value on exchanges, making it impossible for investors to purchase undervalued stocks or sell stocks for inflated prices. Therefore, it should be impossible to outperform the overall market through expert stock selection or market timing, and the only way an investor can obtain higher returns is by purchasing riskier investments. Assumptions of the Theory 1. Information is free and quick to flow. 2. All investors have the same access to information. 3. Transaction costs, taxes and any bottlenecks are not there and not hampering the free forces of market. 4. Investors are rational and behave in a cost effective competitive manner for optimization of returns. 5. Every investor has access to lending and borrowing at the same rate. 6. Market absorbs the information quickly and the market responds to new technology, new trends, changes in tastes, and habits of consumers etc., efficiently and quickly. FORMS OF MARKET EFFICIENCY 1. Strong-form: The strong-form of market efficiency states that the current price of stock reflects all information available. It does not matter if this information is available to the public or to top management. If it exists, it is definitely reflected in the current price. 2. Semi-Strong Form: The semi strong form EMH states that all publicly available information is similarly already incorporated into asset prices. In another word, all publicly available information is fully reflected in a security's current market price. 3. Weak-form: The weak-form of market efficiency states that the current price does not reflect fair value and is only a reflection of past prices. Furthermore, the future price cannot be determined using past or current prices. RANDOM WALK THEORY The random walk theory states that market prices evolve at random and do not follow any regular pattern. Hence price cannot be predicted. The theory says that future stock prices are completely independent of past stock prices. In other words, the path that a stock's price follows is a "random walk" that cannot be determined</p>	<p>from historical price information, especially in the short term. Assumption of Random Walk Theory 1. Market is supreme and no individual investor or group can influence it. 2. Stock prices discount all information quickly. 3. Markets are efficient and that the flow of information is free and unbiased. 4. All investors have free access to the same information and nobody has superior knowledge or expertise. 5. Market quickly adjusts itself to any deviation from equilibrium level due to the operation of free forces of demand and supply. 6. Market prices change only on information relating to the fundamentals, when the equilibrium level itself may shift. 7. These prices move in an independent fashion, without undue pressures or manipulation. 8. Nobody has better knowledge or insider information. 9. Investors behave in a rational manner and demand and supply forces are the result of rational investment decisions. 10. Institutional investors or any major fund managers have to follow the market and market cannot be influenced by them CHAPTER 5 Portfolio Management PORTFOLIO A portfolio is a collection of securities. It is a collection of a wide range of assets that are owned by investors. A portfolio refers to set of financial assets owned by an investor that may include bonds, stocks, currencies, cash and cash equivalents, and commodities. TYPES OF PORTFOLIOS 1. Aggressive Portfolio: An aggressive portfolio includes those stocks that offer high returns and carry high risks. Stocks in this category typically have a high beta, or sensitivity to the overall market. Higher beta stocks consistently experience larger fluctuations relative to the overall market. 2. Defensive Portfolio: Defensive stocks do not usually carry a high risk. They are relatively free from broad market movements. Defensive stocks do well in bad times as well as good times. Even during the bad times of the economy, companies that make products that are essential to everyday life will survive. A defensive portfolio is a better choice for most investors. 3. Conservative Portfolio: The conservative investment strategies, which give priority to safety, are most appropriate for investors who are risk averse and have a shorter time horizon. Conservative portfolio will consists of risk free investments like bank deposits, govt. bonds etc. The main goal of a conservative portfolio strategy is to maintain the real value of the portfolio, or to protect the value of the portfolio against inflation. 4. Income Portfolio: This is another common type of portfolio that focuses on investments making money from dividends or other types of distributions. Generally speaking, an income portfolio is more focused on securing regular income from investments as opposed to focusing on potential capital gains. Generating a positive cash flow, an income portfolio invests in companies that return a major share of their profits to shareholders. 5. Efficient Portfolio: The proper goal of portfolio construction is to generate a portfolio that provides the highest returns at a given level of risk. An efficient portfolio, also known as an "optimal portfolio", is one that provides that best expected return on a given level of risk, or alternatively, the minimum risk for a given expected return. PORTFOLIO MANAGEMENT Investment management, also called portfolio management is a branch of investment analysis that looks into the process of managing investments. The art of selecting the right investment policy for the individuals in terms of minimum risk and maximum return is called portfolio management. It refers to managing an individual's investments in the form of bonds, shares, cash, mutual funds etc so that he earns the maximum profits within the stipulated time frame.. NEED AND IMPORTANCE OF PORTFOLIO MANAGEMENT 1. Stable Current Return: One</p>
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<p>of the main objectives of portfolio management is to ensure a stable return. Once investment safety is guaranteed, the portfolio should bring a steady current income. The current returns should at least match the opportunity cost of the funds of the investor. Current income means income by way of interest of dividends, not capital gains.</p> <p>2. Marketability: A good portfolio consists of investment, which can be marketed without difficulty. If there are too many unlisted or inactive shares in a portfolio, it is very difficult to dispose them and switching from one investment to another. It is desirable to invest in companies listed on major stock exchanges, which are actively traded.</p> <p>3. Tax Planning: Since taxation is an important variable in total planning, a good portfolio should enable its owner to enjoy a favourable tax planning. The portfolio should be developed considering not only income tax, but capital gains tax, and gift tax, as well. A good portfolio always aims at is tax planning, not tax evasion or tax avoidance.</p> <p>4. Capital Growth: A good portfolio should appreciate in value in order to protect the investor from any erosion in purchasing power due to inflation. In other words, a balanced portfolio must consist of certain investments, which tend to appreciate in real value after adjusting for inflation.</p> <p>5. Liquidity: The portfolio should ensure that there are enough funds available at short notice to meet the investor's liquidity requirements. It is desirable to keep some stocks which can easily be converted into cash in case of urgent financial requirements.</p> <p>6. Safety of the investment: Safety of investment is all the more important. The investment should be absolutely safe. Other considerations like income, growth, etc., only come into the picture after the safety of investment is ensured. Investment safety or minimization of risks is one of the important objectives of portfolio management.</p> <p>7. Diversification: Portfolio management is designed to reduce the risk of investment and provide optimum or highest return on investment. The basic objective of building a portfolio is to reduce risk of loss of capital and / or income by investing in various types of securities and over a wide range of industries.</p> <p>PORTFOLIO MANAGEMENT PROCESS</p> <p>1. Setting the objectives: The main objectives of any investment would be the expectation regarding returns and the ability of the investor to assume risk. Investors would aim to achieve a steady income involving growth and higher returns.</p> <p>2. Selection of Asset Mix: The second activity in portfolio management is to decide the proportion of the various asset categories to include in the investor's portfolio. The various asset categories include bonds and debentures, stocks, cash investments, precious metals like gold and silver, investment in real estate etc.</p> <p>3. Formulation of Portfolio Strategy: After fixing the asset mix, the next step for the investor is to formulate a portfolio strategy. Portfolio strategy includes both active portfolio strategy and passive portfolio strateg.</p> <p>4. Security analysis: In this step, an investor actively involves himself in selecting securities. Security analysis requires the sources of information on the basis of which analysis is made. The selection of securities involves technical and fundamental analysis.</p> <p>5. Portfolio Execution: After the formulation of investment objectives, choosing asset mix, formulating portfolio strategy and selection of securities, the portfolio has to be executed by buying or selling specified securities in given amounts.</p> <p>6. Portfolio Revision: Portfolio revision is one of the most important steps in portfolio management. A portfolio manager has to constantly monitor and review portfolio according to the market condition.</p> <p>7. Performance Evaluation: Evaluating the performance of portfolio is another important</p>	<p>step in portfolio management. Portfolio manager has to assess the performance of portfolio over a selected period of time. It is essentially the process of comparing the return earned on a portfolio with the return earned on one or more other portfolio or on a benchmark portfolio.</p> <p>PORTFOLIO DIVERSIFICATION</p> <p>Diversification is a risk reduction concept that involves the allocation of investments among various financial instruments, industries and other investment categories. Diversification can be achieved by investing in different stocks, different asset classes such as shares, bonds, real estate, etc. A well-diversified portfolio consists of different types of securities from diverse industries, with varying degrees of risk.</p> <p>BENEFITS OF DIVERSIFICATION</p> <p>1. Less impact of market volatility: A diversified portfolio minimizes the overall risk associated with the portfolio. Since investment is made across different asset classes and sectors, the overall impact of market volatility comes down.</p> <p>2. Less time for monitoring the portfolio: A diversified portfolio is more stable because not all investments will perform badly at the same time.</p> <p>3. Benefit from different instruments: Diversification of the portfolio will balance the risk and return associated with different funds. Even if one fund does not perform well, the loss may be compensated by the profits made from other funds.</p> <p>4. Achievement of long-term investment plans: It is important for the investor to invest in high-performing sectors. If the market volatility has a positive impact on stocks, the investor will be able to generate higher returns on them.</p> <p>5. Benefit of compounding: Selecting a mutual fund as an investment option allows investors to avail of the benefit of compounding interest. This means that every investment made will generate interest on the principal amount as well as on the accumulated interest over the previous invested years.</p> <p>6. Safety of capital: Diversification allows investors to achieve their investment plans while maintaining the investment risk at a minimum. It is also a method of playing safe in the volatile market.</p> <p>7. Practical approach: Diversification is a practical approach that every investor should take advantage of. It allows investors to shuffle their investments and take advantage of the market movement. It lets investors spread their investment across different asset classes and increase annual returns.</p> <p>8. Peace of mind: The great advantage of diversification is peace of mind. When the total investment is divided amongst a number of asset classes, an investor will not be stressful about the performance of the portfolio.</p> <p>Disadvantages of Diversification</p> <p>1. Investing in unnecessary assets: Sometimes in the name of portfolio diversification, investors may invest in too many assets that they don't even require.</p> <p>2. Tax Complications: Tax complications are another major disadvantage of diversification. The tax structure differs across asset classes, and buying and selling them can lead to major complications.</p> <p>3. Risk of Investing in an Unfamiliar Asset: Sometimes, in the name of diversification, we may be investing in an asset that is not familiar to us. Sometimes such investments may not be legal in the country.</p> <p>4. Complexity of Investments: When too much diversification is made, it can complicate investments.</p> <p>MARKOWITZ MODEL or MODERN PORTFOLIO THEORY(MPT)</p> <p>The modern portfolio theory argues that any given investment's risk and return characteristics should not be viewed alone but should be evaluated by how it affects the overall portfolio's risk and return. That is, an investor can construct a portfolio of multiple assets that will result in greater returns without a higher level of risk.</p> <p>Assumptions</p> <p>1. Investors are rational. They seek to maximize returns</p>	<p>while minimizing risk.</p> <p>2. Investors are only willing to accept higher amounts of risk if they are compensated by higher expected returns.</p> <p>3. Investors 4. Investors can borrow or lend an unlimited amount of capital at a risk free rate of interest, timely receive all pertinent information related to their investment decision.</p> <p>5. Markets are perfectly efficient and absorb information quickly and perfectly.</p> <p>6. Markets do not include transaction costs or taxes.</p> <p>7. It is possible to select securities whose individual performance is independent of other portfolio investments.</p> <p>CAPITAL ASSET PRICING MODEL-CAPM</p> <p>The Capital Asset Pricing Model (CAPM) is a model that describes the relationship between the expected return and risk of investing in a security. It shows that the expected return on a security is equal to the risk-free return plus a risk premium, which is based on the beta of that security.</p> <p>Assumptions of the Model</p> <p>1. Investors are wealth maximisers who select investments based on expected return and standard deviation.</p> <p>2. There is risk free rate at which an investors may either lend (invest) or borrow money.</p> <p>3. Investors are risk-averse.</p> <p>4. All investors have the same expectations related to the market.</p> <p>5. All financial assets are fully divisible and can be sold at any time at the market price.</p> <p>6. There are no transaction costs.</p> <p>7. There are no taxes.</p> <p>8. No investor's activities can influence market prices.</p> <p>9. Information is freely and instantly available to all investors.</p> <p>ADVANTAGES OF CAPM</p> <p>1) Eliminates unsystematic risk: CAPM assumes that investor holds a diversified portfolio, similar to a market portfolio. Diversified portfolio eliminates unsystematic (specific) risk.</p> <p>2) Systematic risk: CAPM takes into account systematic risk, which is left out of other 3) Easy to use: CAPM is simple to calculate and to derive a range of possible outcomes. Those outcomes provide confidence around the required rate of returns.</p> <p>DISADVANTAGES OF CAPM</p> <p>1) Too many assumptions: The CAPM model is based on too many assumptions, which many criticize as being unrealistic.</p> <p>2) Ability to borrow at risk free rate: There are four major assumptions of CAPM. One of the assumptions is that investor can borrow & lend the funds at the risk-free rate. This assumption is unrealistic for the real world.</p> <p>3) Determination of project proxy beta: The problem may arise in using the CAPM to calculate a project-specific discount rate. Generally, equity beta & portfolio/investment beta are different. Therefore, the company needs to find a proxy beta for the project.</p> <p>CAPITAL MARKET LINE</p> <p>Capital Market Line-CML is a graph derived from the Capital Asset Pricing Model that shows the rates of return for efficient portfolios in relation to the level of risk (the market portfolio's beta). The Line is a graphical representation of all the portfolios that optimally combine risk and return.</p> <p>Risk-Adjustment Performance Metric (RAPM)</p> <p>A RAPM is a performance measure that assesses reward with some adjustment for risks. What we mean by reward depends on the application. It might be revenues, profits, returns, etc. Similarly, risk might be measured as volatility, beta, value-at-risk etc. Various RAPMs are employed for portfolio performance. These include the Sharpe's ratio, Treynor's ratio, and Jensen's Alpha.</p> <p>1. SHARPE RATIO (Reward to Variability Ratio)</p> <p>It is the ratio of a portfolio's total return minus the risk-free rate divided by the standard deviation of the portfolio, which is a measure of its risk. The Sharpe ratio is simply the risk premium per unit of risk, which is quantified by the standard deviation of the portfolio.</p> <p>2. TREYNOR RATIO (Reward to Volatility Ratio)</p> <p>this performance measure evaluates portfolio on the basis of Treynor's Index. This Index is a ratio of return generated by the fund over and above risk free rate of return during a given</p>	<p>period and systematic risk associated with it (beta).</p> <p>3. Jenson Model (Differential Return Measure)</p> <p>This measure involves evaluation of the returns that the portfolio has generated vs. the returns actually expected out of the fund given the level of its systematic risk.</p> <p>PORTFOLIO REVISION</p> <p>The art of changing the mix of securities in a portfolio is called as portfolio revision. It involves the process of addition of more assets in an existing portfolio or changing the ratio of funds invested. The sale and purchase of assets in an existing portfolio over a certain period of time to maximize returns and minimize risk is called as Portfolio revision.</p> <p>Portfolio Revision Strategies</p> <p>1. Active Revision Strategy: Active Revision Strategy involves frequent changes in an existing portfolio over a certain period of time for maximum returns and minimum risks. It helps a portfolio manager to sell and purchase securities on a regular basis for portfolio revision.</p> <p>2. Passive Revision Strategy: Passive Revision Strategy involves rare changes in portfolio only under certain predetermined rules. These predefined rules are known as formula plans. According to passive revision strategy a portfolio manager can bring changes in the portfolio as per the formula plans only</p>
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