Investments – Concepts and features- Objectives – Constraints - Investment vs Speculation - Investment Process, Investment Planning - Investment Avenues – Securities Market – Participants – Securities – Indices - Factors Influencing Risk.

Investment

Investment In finance, the purchase of a financial product or other item of value with an expectation of favourable future returns. In general terms, investment means the use money in the hope of making more money.

Investment can be defined in different aspects. These are: Generally, investment is the application of money for earning more money. Investment also means savings or savings made through delayed consumption. In Finance, the purchase of a financial product or other item of value with an expectation of favorable future returns. the practice of investment refers to the buying of a financial product or any valued item with an anticipation that positive returns will be received in the future. In Business, the purchase by a producer of a physical good, such as durable equipment or inventory, in the hope of improving future business.

Investment is defined as a sacrifice made now to obtain a return later. It is current consumption that is sacrificed. Two forms of investment can be defined} ◦ Real investment is the purchase of land, machinery, etc. ◦ Financial investment is the purchase of a "paper" contract

Nature and Scope of Investment

- It helps in making investment decisions. Higher the risk, higher the expected return. One can take decision only after analyzing entire process of investment that starts with fund contribution and ends with getting expectations fulfilled. Higher the time period of investment, lesser the uncertainties of investment.

- Cash has an investment opportunity when you decide to invest it you are deprived of this opportunity to earn a return on that cash. When the general price level rises the purchasing power of cash declines- larger the increase in inflation, the greater the depletion in the buying power of cash. Some investors buy government securities or deposit their money in bank accounts that are adequately secured. In contrast, some others prefer to buy, hold and sell equity shares even when they know that they get exposed to risk.

 Risk is the probability that the actual return on an investment will be different from its expected return. Using this definition of risk, you may} classify various investments into risk categories. Government securities would be seen as} risk free investments because the probability of actual return diverging from expected return is zero.

Factors Influencing Investment Decision

There are many factors which directly or indirectly, influence capital investment decisions, beside the availability of funds to invest, profitability of the investment, market for the product, etc. they are as below:

1. Technological Changes: Technological development changes at present is much more faster than that at past. The new technology increases the productivity of labour and capital. The selection of new technology depends on the net benefit over the cost of having the technology. Benefits from and cost of new technology also influences the investment decision.

2.Competitors' Strategy: If the competitors are installing the new equipment to expand output or to improve of their products, the firm under consideration will have no alternative but to follow suit, else it will be loss. It is therefore, often found that the competitor's strategy regarding capital investment plays a very significant role in forcing capital decision of the firm.

3.Demand Forecast: The long term demand forecast is one of the determinants of investment decision. If the firm finds market potentials for the product in the long run, the firm will have to take decision for investment.

4.Outlook Of Management: Investment decision depends on the management outlook. If the management is progressive in its outlook, the innovations will be encouraged.

5.Fiscal Policy: Various tax policies of the government relating the tax concession on prioritized investment, rebate on new investment, methods allowing depreciation deduction allowance etc. Also have influence on the capital investment.

6.Cash Flow: Every firm makes a cash flow budget. Its analysis influences capital investment decision. On the basis of each cash flow budget the firm plans the funds for acquiring the capital assets. The budget also shows the timing of availibility of cash flows for alternative investment proposals.

7.Expected Return From The Investment: Investment decisions are mostly done anticipation of increased return future. So, it is necessary to estimate future net returns from the investment proposals while evaluating the investment proposals.

8.Non-Economic Factors: The factors which cannot be evaluated in money terms is called non-economic terms or factors. Sometime the non-economic factors also influence investment decisions. Working environment in the firm, safety measures in the operation of machines, brotherhood and good relation among employer and employees, etc. influences the firm's output and also the investment decision

INVESTMENT AND SPECULATION

• Investment involves making a sacrifice of in the present with the hope of deriving future benefits.

• Postponed consumption

• The two important features are : – Current Sacrifice. – Future Benefits.

It also involves putting money into an asset which is not necessarily marketable in the short run in order to enjoy the series of returns the investment is expected to yield.

• People who make fortunes in stock market and they are called investors.

• Decision making is a well thought process.• Key determinant of investment process: – Risk – Expected Return.

Speculation

• Speculation is a financial action that does not promise safety of the initial investment along with the return on the principal sum.

• Its is usually short run phenomenon.

• Speculator the person tend to buy the assets with the expectation that a profit cane earned from subsequent price change and sale.

The main difference between speculating and investing is the amount of of risk undertaken in the trade. Typically, high-risk trades that are almost akin to gambling fall under the umbrella of speculation, whereas lower-risk investments based on fundamentals and analysis fall into the category of investing. Investors seek to generate a satisfactory return on their capital by taking on an average or below-average amount of risk. On the other hand, speculators are seeking to make abnormally high returns from bets that can go one way or the other. It should be noted that speculation is not exactly like gambling because speculators do try to make an educated decision on the direction of the trade, but the risk inherent in the trade tends to be significantly above average.

As an example of a speculative trade, consider a volatile junior gold mining company that has an equal chance over the near term of skyrocketing from a new gold mine discovery or going bankrupt. With no news from the company, investors would tend to shy away from such a risky trade, but some speculators may believe that the junior gold mining company is going to strike gold and may buy its stock on a hunch. This would be speculation.

As an example of investing, consider a large stable multinational company. The company may pay a consistent dividend that increases annually, and its business risk is low. An investor may choose to invest in this company over the long-term to make a satisfactory return on his or her capital while taking on relatively low risk. Additionally, the investor may add several similar companies across different industries to his or her portfolio to diversify and further lower their risk.

The Investment Process

As investors, we would all like to beat the market handily, and we would all like to pick "great" investments on instinct. However, while intuition is undoubtedly a part of the process of investing, it is just part of the process. As investors, it is not surprising that we focus so much of our energy and efforts on investment philosophies and strategies, and so little on the investment process. It is far more interesting to read about how Peter Lynch picks stocks and what makes Warren Buffett a valuable investor, than it is to talk about the steps involved in creating a portfolio or in executing trades. Though it does not get sufficient attention, understanding the investment process is critical for every investor for several reasons:

1. The investment process outlines the steps in creating a portfolio, and emphasizes the sequence of actions involved from understanding the investor?s risk preferences to asset

allocation and selection to performance evaluation. By emphasizing the sequence, it provides for an orderly way in which an investor can create his or her own portfolio or a portfolio for someone else.

1. The investment process provides a structure that allows investors to see the source of different investment strategies and philosophies. By so doing, it allows investors to take the hundreds of strategies that they see described in the common press and in investment newsletters and to trace them to their common roots.

1. The investment process emphasizes the different components that are needed for an investment strategy to by successful, and by so doing explain why so many strategies that look good on paper never work for those who use them.

The best way of describing this book is by noting what it does not do. It does not emphasize individual investors or push an investment philosophy. It does not focus heavily on coming up with strategies that beat the market, though there is reference to some of them in the course of the book. Instead, it talks about the process of investing and how this process is the same no matter what investment philosophy one might have.

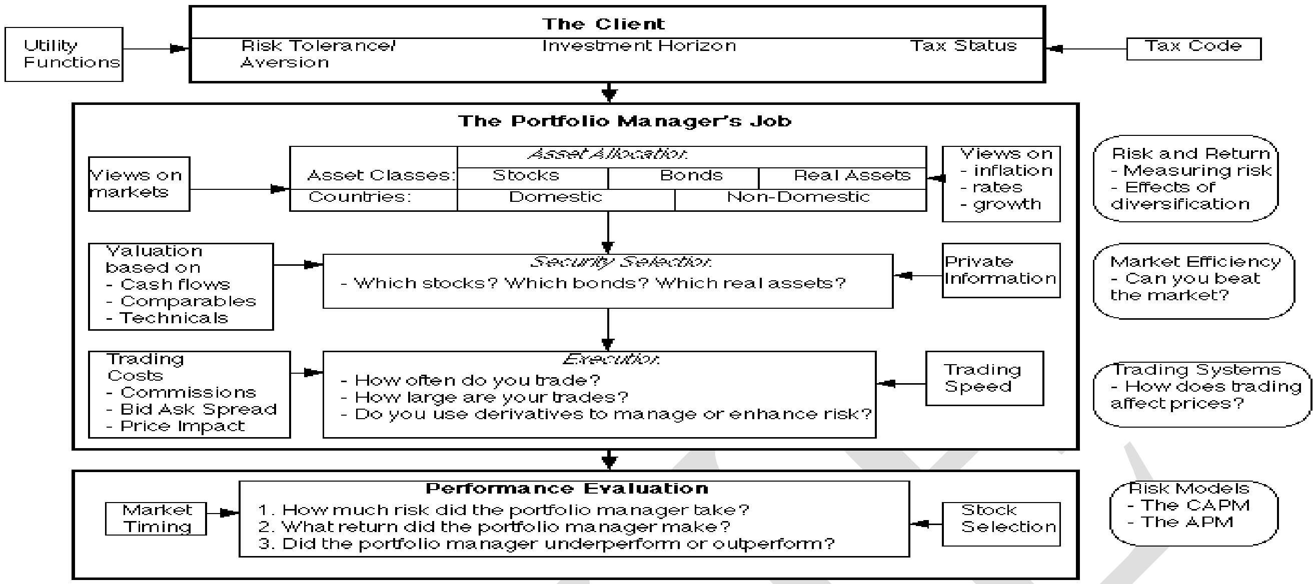
The book is built around the investment process. The process always starts with the investor and understanding his or her needs and preferences. For a portfolio manager, the investor is a client, and the first and often most significant part of the investment process is understanding the client?s needs, the clients tax status and most importantly, his or her risk preferences. For an individual investor constructing his or her own portfolio, this may seem simpler, but understanding one?s own needs and preferences is just as important a first step as it is for the portfolio manager.

The next part of the process is the actual construction of the portfolio, which we divide into three sub-parts. The first of these is the decision on how to allocate the portfolio across different asset classes defined broadly as equities, fixed income securities and real assets (such as real estate, commodities and other assets). This asset allocation decision can also be framed in terms of investments in domestic assets versus foreign assets, and the factors driving this decision. The second component is the asset selection decision, where individual assets are picked within each asset class to make up the portfolio. In practical terms, this is the step where the stocks that make up the equity component, the bonds that make up the fixed income component and the real assets that make up the real asset component are picked. The final component is execution, where the portfolio is actually put together, where investors have to trade off transactions cost against transactions speed. While the importance of execution will vary across investment strategies, there are many investors who have failed at this stage in the process.

The final part of the process, and often the most painful one for professional money managers, is the performance evaluation. Investing is after all focused on one objective and one objective alone, which is to make the most money you can, given the risk constraints you operate under. Investors are not forgiving of failure and unwilling to accept even the best of excuses, and loyalty to money managers is not a commonly found trait. By the same token, performance evaluation is just as important to the individual investor who constructs his or her own portfolio, since the feedback from it should largely determine how that investor approaches investing in the future.

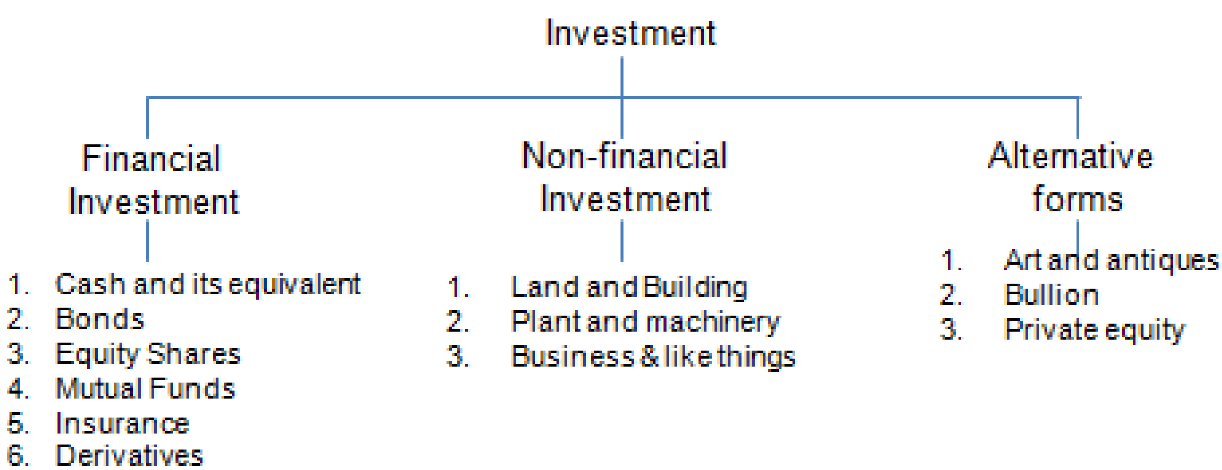
These parts of the process are summarized in Figure 1, and we will return to this figure to emphasize the steps in the process as we move through the book. The book is built around the same structure. It begins with a chapter that provides an overview of investment management as a business. The first major section is on understanding client needs and preferences, where we look at not only how to think about risk in investing but also at how to measure an investor?s willingness to take risk. The second section looks at the asset allocation decision, while the third section examines different approaches to selecting assets. The fourth section takes a brief look at the execution decision, and the fifth section develops different approaches to evaluating performance.

The Investment Process



Alternative forms of Investment

Investment alternative refer to those options/instruments that help investor save and invest. These are issued by various banks, financial institutions, stock brokerages, insurance providers, credit card agencies and government sponsored entities. These instruments are categorized in terms of their volatility, risk, liquidity and return.



The various investment options available to an investor are -

1. Shares

These represent ownership of a company. While shares are initially issued by corporations to finance their business needs, they are subsequently bought and sold by individuals in the share market. They are associated with high risk and high returns. Returns on shares can be in the form of dividend payouts by the company or profits on the sale of shares on the stock market (capital appreciation), Shares, stocks, equities and securities are words that are generally used interchangeably.

There are two types of shares - Equity and preference shares. Preference are those shares which have first preference for payment of dividend and refund of capital in case of winding up. Equity shares are those shares which are not preference shares. Preference shares aren't popular in india. These shares may be cumulative, participating and convertible.

Shares of known and financially sound companies are called Blue chip shares and such companies are blue chip companies because of their market reputation and goodwill that they carry. Investors usually prefer investing in blue chip companies due to the safety and attractive returns.

2. Debentures and Government Bonds

These are issued by companies to finance their business operations and by governments to fund expenses like infrastructure and social programs. A debenture is a document issued by a company as an evidence of debt. Bonds are issued by the government and debentures are issued by the private sector companies. Bonds have a fixed interest rate, making the risk associated with them lower than shares. The face value of bonds is recovered at the time of maturity. Debentures may be convertible or non-convertible. If a debenture is convertible into shares at maturity, it is called convertible. Convertible Debentures may be partly or fully convertible.

However the method of raising long term funds through debentures is not very popular in India.

3. Treasury Bills

These are instruments issued by the government for financing short term needs. They are issued at a discount and redeemed at face value. The profit earned is the difference between face value and the price at which the T-bill was issued. It is highly liquid because of the repayment guaranteed by the Government. There are two types of t-bills i.e. regular and ad-hoc (ad- hoc are issued in favour of RBI only). T-bills have maturity period of 91 days or 182 days or 364 days. State Governments do not issue T-bills.

4. Bank Deposits

These are low risk and low-medium return investments. In India, people trust the banking system more than the stock markets with their money. There are various types of deposits: *Savings* , *Recurring* , *Current and Fixed*. Savings a/c‟s give a return from 3-6% pre-tax. Current a/c‟s are for businessmen and generate no returns. Fixed deposits generate a return from 7-12% pre-tax.

5. Mutual Fund

These are professionally managed financial instruments that involve the diversification of investment into a number of financial products such as shares, bonds and government securities. This helps to reduce an investor‟s risk exposure, while increasing the profit potential. There are open-ended and close- ended funds.

6. Certificate of Deposit

Certificates of deposit (CDs) are issued by banks, thrift institutions and credit unions. They usually have a fixed term and fixed interest rate.

7. Annuities

These are contracts between investors and insurance companies, wherein the latter makes periodic payments in exchange for financial protection in the event of an unfortunate incident.

8. Derivatives

This includes futures, options, swaps, etc. It is a contract or agreement between two entities to buy or sell the underlying asset at a future date, at today's pre-agreed price.

Futures

A futures contract is an agreement between two parties to buy or sell the underlying asset at a future date at today's future price. Futures contracts differ from forward contracts in the sense that they are standardised and exchange traded. They are exchange-traded. They are standardised. The parties have to deposit certain initial margin (small percentage of the trade amount). They are highly regulated and are liquid. As a result, eliminate the counter-party risk.

Options

An option gives the holder of the option the right to do something. The holder does not have to exercise this right. However for this right the holder pays a price, known as the option premium. The writer of the option receives this premium. There are two types of options - *Call* and *Put*.

9. Real Estate

Investment in real estate include properties like buildings, lands, farm houses, flats or houses. Such properties attract the attention of affluent investors. As the demand increases but the supply of land is limited, the prices tend to increase. Therefore, it is an attractive form of investment but is the most illiquid asset. It is a long term investment, requires payment of stamp duty and a lot of legal formalities along with registration. SEBI has recently come out with guidelines for introduction and functioning of Real Estate Investment Trust (REIT) in the Indian real estate market. Once introduced these REITs will benefit retail investors the most. REIT is a trust which issues real estate in the form of units as a result even a small investors can benefit from capital appreciation, these are liquid and exchange traded.

10. Insurance

When talking about insurance, Life insurance is a kind of investment because it provides family protection to the investor as well as return on investment in he form of yearly bonus on the policy. The return is as low as 6% because of the risk coverage and tax incentives. The amount of premium paid on a life insurance policy is exempt u/s 80C of Income-Tax Act. There are different policies such as whole life policy, endowment policy, money back policy, etc.

11. Gold and silver

They are also called as precious metals or objects. Everybody likes gold and hence requires gold or silver. These two precious metals are used for making ornaments and they hold an emotional value in India. In India, investment in gold is more psychological than calculated, many individuals think that gold is an investment which can never give negative returns. They act as a store of wealth. Gold bars are highly liquid and can be easily sold anytime. The pricing depends on the purity of the objects. The risk faced is of theft and fraud. India is the largest consumers of gold in the world followed by china at the second position. India accounts for about 20 percent of global demand. Recently in India, Gold Exchange Traded Funds (ETF"s) were launched which made it easier for individuals to own gold in electronic format. It is less costly, high liquidity and guarantees purity to the investors.

12. Alternative investments

They include investments made in arts, antiques, etc. These investments are not in the form of traditional investments i.e. not availed by the masses. They were availed only by the High Net Worth clients in the past are now availed by retail investors. They are in the form of paintings or their equivalent holding some historic value or just as a hobby. They may fetch good returns if one finds a buyer who is either a huge fan of the artists" work, or is an archaeologist. These works are usually kept in museums or halls.

Features of investment Programme

Some of the Important Features of an Investment Programme are as follows:
In choosing specific investments, investors will need definite ideas regarding features which their portfolios should possess. These features should be consistent with the investors" general objectives and, in addition, should afford them all the incidental conveniences and advantages which are possible under the circumstances. The following are the suggested features as the ingredients from which many successful investors compound their selection policies.

Safety of Principal :

The safety sought in investment is not absolute or complete; it rather implies protection against loss under reasonably likely conditions or variations. It calls for careful review of economic and industry trends before deciding types and/or timing of investments. Thus, it recognizes that errors are unavoidable for which extensive diversification is suggested as an antidote.

Adequate diversification means assortment of investment commitments in different ways. Those who are not familiar with the aggressive-defensive approach nevertheless often carry out the theory of hedging against inflation-deflation. Diversification may be geographical, wherever possible, because regional or local storms, floods, droughts, etc. can cause extensive real estate damage.

Vertical and horizontal diversification can also be opted for the same. Vertical diversification occurs when securities of various companies engaged in different phases of production from raw material to finished goods are held in the portfolio. On the other hand, horizontal diversification is the holding by an investor in various companies all of which carry on activity in the same stage ofproduction.

Another way to diversify securities is to classify them according to bonds and shares and reclassify according to types of bonds and types of shares. Again, they can also be classified according to the issuers, according to the dividend or interest income dates, according to the products which are made by the firms represented by the securities. But over diversification is undesirable.

By limiting investments to a few issues, the investor has an excellent opportunity to maintain knowledge of the circumstances surrounding each issue. Probably the simplest and most effective diversification is accomplished by holding different media at the same time having reasonable concentration in each.

Adequate Liquidity and Collateral Value :

An investment is a liquid asset if it can be converted into cash without delay at full market value in any quantity. For an investment to be liquid it must be (1) reversible or (2) marketable. The difference between reversibility and marketability is that reversibility is the process whereby the transaction is reversed or terminated while marketability involves the sale of the investment in the market for cash.

To meet emergencies, every investor must have a sound portfolio to be sure of the additional funds which may be needed for the business opportunities. Whether money rising is to be done by sale or by borrowing it will be easier if the portfolio contains a planned proportion of high- grade and readily saleable investment.

Stability of Income :

Stability of income must be looked at in different ways just as was security of principal. An investor must consider stability of monetary income and stability of purchasing power of income. However, emphasis upon income stability may not always be consistent with other investment principles. If monetary income stability is stressed, capital growth and diversification will be limited.

Capital Growth:

Capital appreciation has today become an important principle. Recognising the connection between corporation and industry growth and very large capital appreciation, investors and their advisers constantly are seeking "growth stocks". It is exceedingly difficult to make a successful choice. The ideal "growth stock" is the right issue in the right industry, bought at the right time.

Tax Benefits:

To plan an investment programme without regard to one‟s tax status may be costly to the investor. There are really two problems involved here, one concerned with the amount of income paid by the investment and the other with the burden of income taxes upon that income.

When investors‟ incomes are small, they are anxious to have maximum cash returns on their investments, and are prone to take excessive risks. On the other hand, investors who are not pressed for cash income often find that income taxes deplete certain types of investment incomes less than others, thus affecting their choices.

Purchasing Power Stability:

Since an investment nearly always involves the commitment of current funds with the objective of receiving greater amounts of future funds, the purchasing power of the future fund should be considered by the investor.

For maintaining purchasing power stability, investors should carefully study (1) the degree of price level inflation they expect, (2) the possibilities of gain and loss in the investment available to them, and (3) the limitations imposed by personal and family considerations.

Concealability:

To be safe from social disorders, government confiscation, or unacceptable levels of taxation, property must be concealable and leave no record of income received from its use or sale. Gold and precious stones have long been esteemed for these purposes because they combine high value with small bulk and are readily transferable.

Mutual Fund

An open-ended fund operated by an investment company which raises money from shareholders and invests in a group of assets, in accordance with a stated set of objectives.

Mutual funds raise money by selling shares of the fund to the public, much like any other type of company can sell stock in itself to the public. Mutual funds then take the money they receive from the sale of their shares (along with any money made from previous investments) and use it to purchase various investment vehicles, such as stocks, bonds and money market instruments. In return for the money they give to the fund when purchasing shares, shareholders receive an equity position in the fund and, in effect, in each of its underlying securities. For most mutual funds, shareholders are free to sell their shares at any time, although the price of a share in a mutual fund will fluctuate daily, depending upon the performance of the securities held by the fund.

Benefits of mutual funds include diversification and professional money management. Mutual funds offer choice, liquidity, and convenience, but charge fees and often require a minimum investment.

A closed-end fund is often incorrectly referred to as a mutual fund, but is actually an investment trust. There are many types of mutual funds, including aggressive growth fund, asset allocation fund, balanced fund, blend fund, bond fund, capital appreciation fund, clone fund, closed fund, crossover fund, equity fund, fund of funds, global fund, growth fund, growth and income fund, hedge fund, income fund, index fund, international fund, money market fund, municipal bond fund, prime rate fund, regional fund, sector fund, specialty fund, stock fund, and tax-free bond fund.

A mutual fund is a professionally-managed trust that pools the savings of many investors and invests them in securities like stocks, bonds, short-term money market instruments and commodities such as precious metals. Investors in a mutual fund have a common financial goal and their money is invested in different asset classes in accordance with the fund"s investment objective. Investments in mutual funds entail comparatively small amounts, giving retail investors the advantage of having finance professionals control their money even if it is a few thousand rupees.

Mutual funds are pooled investment vehicles actively managed either by professional fund managers or passively tracked by an index or industry. The funds are generally well diversified to offset potential losses. They offer an attractive way for savings to be managed in a passive manner without paying high fees or requiring constant attention from individual investors. Mutual funds present an option for investors who lack the time or knowledge to make traditional and complex investment decisions. By putting your money in a mutual fund, you permit the portfolio manager to make those essential decisions for you.

Mutual Fund Set Up

A mutual fund is set up in the form of a trust that has a Sponsor, Trustees, Asset Management Company (AMC). The trust is established by a sponsor(s) who is like a promoter of a company and the said Trust is registered with Securities and Exchange Board of India (SEBI) as a Mutual Fund. The Trustees of the mutual fund hold its property for the benefit of unit holders. An Asset Management Company (AMC) approved by SEBI manages the fund by making investments in various types of securities.

The trustees are vested with the power of superintendence and direction over the AMC. They monitor the performance and compliance of SEBI regulations by the mutual fund. The trustees are vested with the general power of superintendence and direction over AMC. They manage the performance and compliance of SEBI Regulations by the mutual fund.

Operation of Mutual Fund

A mutual fund company collects money from several investors, and invests it in various options like stocks, bonds, etc. This fund is managed by professionals who understand the market well, and try to accomplish growth by making strategic investments. Investors get units of the mutual fund according to the amount they have invested. The Asset Management Company is responsible for managing the investments for the various schemes operated by the mutual fund. It also undertakes activities such like advisory services, financial consulting, customer services, accounting, marketing and sales functions for the schemes of the mutual fund

Net Asset Value

Net Asset Value (NAV) is the total asset value (net of expenses) per unit of the fund and is calculated by the AMC at the end of every business day. In order to calculate the NAV of a mutual fund, you need to take the current market value of the fund's assets minus the liabilities, if any and divide it by the number of shares outstanding. NAV is calculated as follows:

$$\text{NAV (₹)} = \frac{\text{Market/Fair Value of Securities + Accrued Income + Receivable + other assets + Accrued Expenses – payables – other liabilities}}{\text{No of Units outstanding of the Scheme / Option}}$$

For example, if the market value of securities of a Mutual Fund scheme is ₹500 lakh and the Mutual Fund has issued 10 lakh units of ₹10 each to investors, then the NAV per unit of the fund is ₹50.

Types of Mutual Fund

Based on the maturity period

Open-ended Fund

An open-ended fund is a fund that is available for subscription and can be redeemed on a continuous basis. It is available for subscription throughout the year and investors can buy and sell units at NAV related prices. These funds do not have a fixed maturity date. The key feature of an open-ended fund is liquidity.

Close-ended Fund

A close-ended fund is a fund that has a defined maturity period, e.g. 3-6 years. These funds are open for subscription for a specified period at the time of initial launch. These funds are listed on a recognized stock exchange.

Interval Funds

Interval funds combine the features of open-ended and close-ended funds. These funds may trade on stock exchanges and are open for sale or redemption at predetermined intervals on the prevailing NAV.

Based on investment objectives

Equity/Growth Funds

Equity/Growth funds invest a major part of its corpus in stocks and the investment objective of these funds is long-term capital growth. When you buy shares of an equity mutual fund, you effectively become a part owner of each of the securities in your fund‟s portfolio. Equity funds invest minimum 65% of its corpus in equity and equity related securities. These funds may invest in a wide range of industries or focus on one or more industry sectors. These types of funds are suitable for investors with a long-term outlook and higher risk appetite.

Debt/Income Funds

Debt/ Income funds generally invest in securities such as bonds, corporate debentures, government securities (gilts) and money market instruments. These funds invest minimum 65% of its corpus in fixed income securities. By investing in debt instruments, these funds provide low risk and stable income to investors with preservation of capital. These funds tend to be less volatile than equity funds and produce regular income. These funds are suitable for investors whose main objective is safety of capital with moderate growth.

Balanced Funds

Balanced funds invest in both equities and fixed income instruments in line with the pre-determined investment objective of the scheme. These funds provide both stability of returns and capital appreciation to investors. These funds with equal allocation to equities and fixed income securities are ideal for investors looking for a combination of income and moderate growth. They generally have an investment pattern of investing around 60% in Equity and 40% in Debt instruments.

Money Market/ Liquid Funds

Money market/ Liquid funds invest in safer short-term instruments such as Treasury Bills, Certificates of Deposit and Commercial Paper for a period of less than 91 days. The aim of Money Market /Liquid Funds is to provide easy liquidity, preservation of capital and moderate income. These funds are ideal for corporate and individual investors looking for moderate returns on their surplus funds.

Gilt Funds

Gilt funds invest exclusively in government securities. Although these funds carry no credit risk, they are associated with interest rate risk. These funds are safer as they invest in government securities.

Some of the common types of mutual funds and what they typically invest in:

Type of Fund	**Typical Investment**
Equity or Growth Fund	Equities like stocks
Fixed Income Fund	Fixed income securities like government and corporate bonds
Money Market Fund	Short-term fixed income securities like treasury bills
Balanced Fund	A mix of equities and fixed income securities
Sector-specific Fund	Sectors like IT, Pharma, Auto etc.
Index Fund	Equities or Fixed income securities chosen to replicate a specific Index for example S&P CNX Nifty
Fund of funds	Other mutual funds

Other Schemes

Tax-Saving (Equity linked Savings Schemes) Funds

Tax-saving schemes offer tax rebates to investors under specific provisions of the Income Tax Act, 1961. These are growth-oriented schemes and invest primarily in equities. Like an equity scheme, they largely suit investors having a higher risk appetite and aim to generate capital appreciation over medium to long term.

Index Funds

Index schemes replicate the performance of a particular index such as the BSE Sensex or the S&P CNX Nifty. The portfolio of these schemes consist of only those stocks that represent the index and the weightage assigned to each stock is aligned to the stock‟s weightage in the index. Hence, the returns from these funds are more or less similar to those generated by the Index.

Sector-specific Funds

Sector-specific funds invest in the securities of only those sectors or industries as specified in the Scheme Information Document. The returns in these funds are dependent on the performance of the respective sector/industries for example FMCG, Pharma, IT, etc. The funds enable investors to diversify holdings among many companies within an industry. Sector funds are riskier as their performance is dependent on particular sectors although this also results in higher returns generated by these funds. Benefits of Investing in Mutual Funds

Benefits of investing in mutual funds:

Professional Management

When you invest in a mutual fund, your money is managed by finance professionals. Investors who do not have the time or skill to manage their own portfolio can invest in mutual funds. By investing in mutual funds, you can gain the services of professional fund managers, which would otherwise be costly for an individual investor.

Diversification

Mutual funds provide the benefit of diversification across different sectors and companies. Mutual funds widen investments across various industries and asset classes. Thus, by investing in a mutual fund, you can gain from the benefits of diversification and asset allocation, without investing a large amount of money that would be required to build an individual portfolio.

Liquidity

Mutual funds are usually very liquid investments. Unless they have a pre-specified lock-in period, your money is available to you anytime you want subject to exit load, if any. Normally funds take a couple of days for returning your money to you. Since they are well integrated with the banking system, most funds can transfer the money directly to your bank account.

Flexibility

Investors can benefit from the convenience and flexibility offered by mutual funds to invest in a wide range of schemes. The option of systematic (at regular intervals) investment and withdrawal is also offered to investors in most open-ended schemes. Depending on one‟s inclinations and convenience one can invest or withdraw funds.

Low transaction cost

Due to economies of scale, mutual funds pay lower transaction costs. The benefits are passed on to mutual fund investors, which may not be enjoyed by an individual who enters the market directly.

Transparency

Funds provide investors with updated information pertaining to the markets and schemes through factsheets, offer documents, annual reports etc.

Well regulated

Mutual funds in India are regulated and monitored by the Securities and Exchange Board of India (SEBI), which endeavors to protect the interests of investors. All funds are registered with SEBI and complete transparency is enforced. Mutual funds are required to provide investors with standard information about their investments, in addition to other disclosures like specific investments made by the scheme and the quantity of investment in each asset class.

Risk involved in Mutual Fund

Mutual funds invest in different securities like stocks or fixed income securities, depending upon the fund‟s objectives. As a result, different schemes have different risks depending on the underlying portfolio. The value of an investment may decline over a period of time because of economic alterations or other events that affect the overall market. Also, the government may come up with new regulations, which may affect a particular industry or class of industries. All these factors influence the performance of Mutual Funds.

Risk and Reward: The diversification that mutual funds provide can help ease risk by offsetting losses from some securities with gains in other securities. On the other hand, this could limit the upside potential that is provided by holding a single security.

Lack of Control: Investors cannot determine the exact composition of a fund‟s portfolio at any given time, nor can they directly influence which securities the fund manager buys.

5 Good Reasons to Invest

"Save for a rainy day" goes a wise old saying. While saving worked in the past, today, you need to invest. If you believe that saving and investing imply the same thing, think again.

While saving is a part of your income that you put away regularly, it does not necessarily provide returns and it can only meet your short-term needs. Investing on the other hand, provides returns and helps you grow your capital, which in turn, will help you fulfil your financial goals.

Now that you are convinced that investing is a „must", getting started is the next challenge. Everyone needs some motivation to get started. It is more tempting to spend what you have today than put it away for the future. Our needs for today seem far more pressing than tomorrow"s. Here are five reasons that will change the way you think and make you more determined to invest:

Be prepared for emergencies: A sudden medical emergency or unemployment can cause a financial crisis. For instance, do you have the means to provide for your family if you were hit by unforeseen circumstances such as an illness that makes you unable to work, or an accident that immobilizes you? Investing helps you create a financial cushion for your family. Ideally you should have investments to the extent of at least six months" income at all times. Debt-oriented Unit Linked Insurance Plans (ULIPs) will help you accumulate the funds you need for this purpose.

Financial security: Your financial security depends on how much you invest and how efficiently you do so. Investments can help you build a corpus so that you can generate a large cash reserve. A large cash reserve means no anxiety about your financial security and more empowerment. Investing regularly in equity-oriented ULIPs over the long term has the potential to help you build a sizeable corpus to fulfil this purpose.

Fulfilling financial goals: Buying your own home, or a bigger home, buying a new car, your children"s education and their marriage are some goals that are important to you. To fulfil these goals, you need the right type of investment plans. Depending on when the financial goal will come up for fulfilment, you can select investment-oriented insurance plans. For goals that will arise in the near future (say 5-7 years hence) debt-oriented or balanced ULIPs would be suitable. You could also choose investment-oriented traditional plans such as endowment plans which mature at around the time the goal comes up for fulfilment or money back plans which provide funds at fixed intervals of time (these are usually suitable for children‟s education needs). For goals that will arise in the distant future (beyond 7 years), equity-oriented ULIPs would be more suitable since these ULIPs have the potential to provide you higher returns over a longer period of time.

Wealth creation: In order to create wealth you need investment options that add an element of growth to your money. Equity-oriented ULIPs have the potential to help you build your wealth kitty over an investment horizon of 7-10 years and beyond.

Fighting inflation: Inflation eats away at your savings. With each passing year, prices keep rising. Investments help you protect your capital against price rise. A good way to beat inflation is to park your money in investments that offer returns that are higher than the rate of inflation. Equity-oriented and balanced ULIPs come to the rescue here. Historically, equity investments have given returns that are higher than the inflation rate thereby providing investors real returns (real returns = investment returns *minus* inflation rate).

Importance of investment

Be prepared for emergencies: A sudden medical emergency or unemployment can cause a financial crisis. For instance, do you have the means to provide for your family if you were hit by unforeseen circumstances such as an illness that makes you unable to work, or an accident that immobilizes you? Investing helps you create a financial cushion for your family. **Financial security:** Your financial security depends on how much you invest and how efficiently you do so. Investments can help you build a corpus so that you can generate a large cash reserve. A large cash reserve means no anxiety about your financial security and more empowerment.

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Risk and Types of Risk

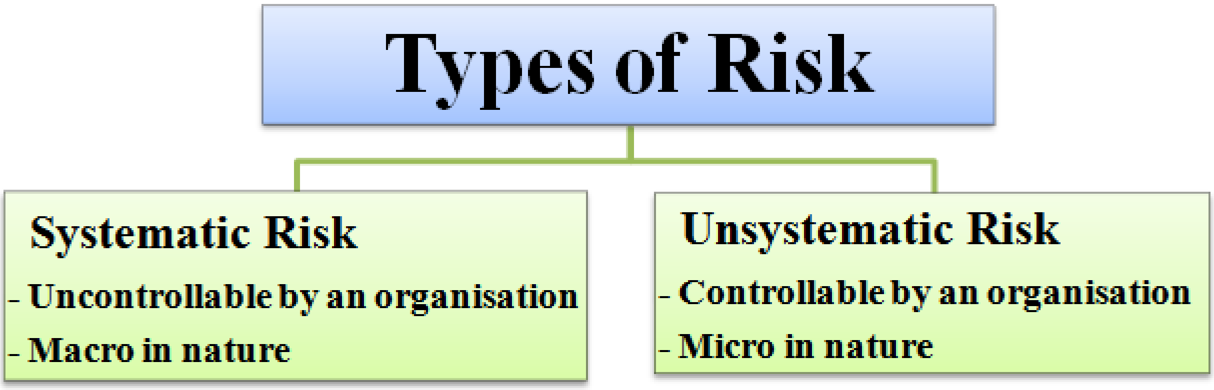
Risk is the possibility you'll lose money if an investment you make provides a disappointing return. All investments carry a certain level of risk, since investment return is not guaranteed.

According to modern investment theory, the greater the risk you take in making an investment, the greater your return has the potential to be if the investment succeeds.

For example, investing in a startup company carries substantial risk, since there is no guarantee that it will be profitable. But if it is, you're in a position to realize a greater gain than if you had invested a similar amount in an already established company.

As a rule of thumb, if you are unwilling to take at least some investment risk, you are likely to limit your investment return.

In finance, different types of risk can be classified under two main groups, viz.,



1. Systematic risk.
2. Unsystematic risk.

The meaning of systematic and unsystematic risk in finance:

1. Systematic risk is uncontrollable by an organization and macro in nature.
2. Unsystematic risk is controllable by an organization and micro in nature.

A. Systematic Risk

Systematic risk is due to the influence of external factors on an organization. Such factors are normally uncontrollable from an organization's point of view.

It is a macro in nature as it affects a large number of organizations operating under a similar stream or same domain. It cannot be planned by the organization.

The types of systematic risk are depicted and listed below.

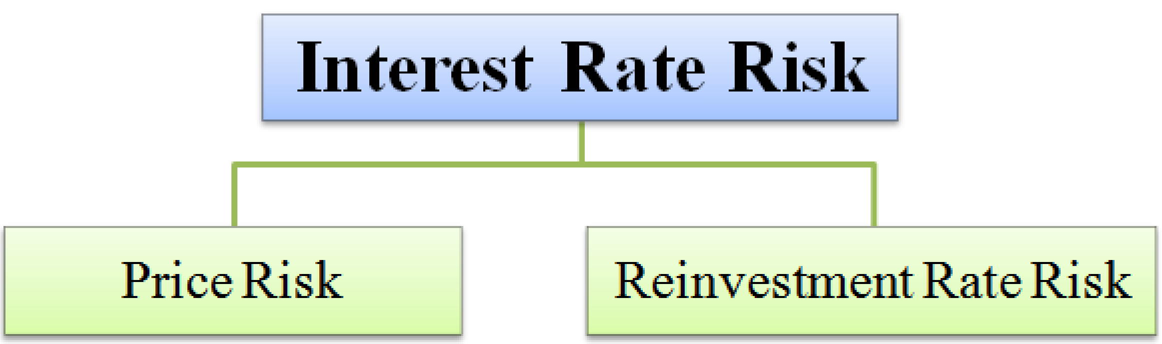
1. Interest rate risk,
2. Market risk and
3. Purchasing power or inflationary risk.

Now let's discuss each risk classified under this group.

1. Interest rate risk

Interest-rate risk arises due to variability in the interest rates from time to time. It particularly affects debt securities as they carry the fixed rate of interest.

The types of interest-rate risk are depicted and listed below.



1. Price risk and
2. Reinvestment rate risk.

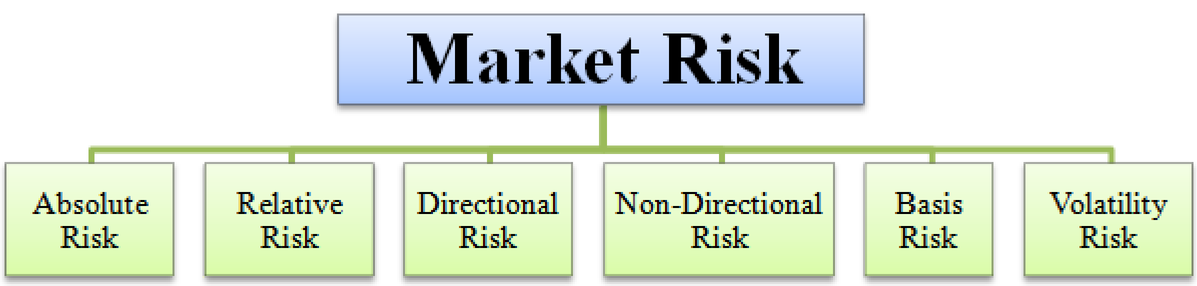
The meaning of price and reinvestment rate risk is as follows:

1. Price risk arises due to the possibility that the price of the shares, commodity, investment, etc. may decline or fall in the future.
2. Reinvestment rate risk results from fact that the interest or dividend earned from an investment can't be reinvested with the same rate of return as it was acquiring earlier.

2. Market risk

Market risk is associated with consistent fluctuations seen in the trading price of any particular shares or securities. That is, it arises due to rise or fall in the trading price of listed shares or securities in the stock market.

The types of market risk are depicted and listed below.



1. Absolute risk,
2. Relative risk,
3. Directional risk,
4. Non-directional risk,
5. Basis risk and
6. Volatility risk.

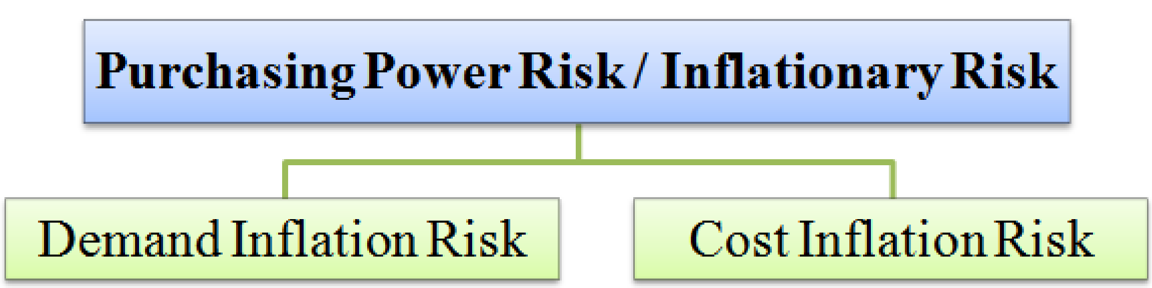
The meaning of different types of market risk is as follows:

1. Absolute risk is without any content. For e.g., if a coin is tossed, there is fifty percentage chance of getting a head and vice-versa.
2. Relative risk is the assessment or evaluation of risk at different levels of business functions. For e.g. a relative-risk from a foreign exchange fluctuation may be higher if the maximum sales accounted by an organization are of export sales.
3. Directional risks are those risks where the loss arises from an exposure to the particular assets of a market. For e.g. an investor holding some shares experience a loss when the market price of those shares falls down.
4. Non-Directional risk arises where the method of trading is not consistently followed by the trader. For e.g. the dealer will buy and sell the share simultaneously to mitigate the risk
5. Basis risk is due to the possibility of loss arising from imperfectly matched risks. For e.g. the risks which are in offsetting positions in two related but non-identical markets.
6. Volatility risk is of a change in the price of securities as a result of changes in the volatility of a risk-factor. For e.g. it applies to the portfolios of derivative instruments, where the volatility of its underlying is a major influence of prices.

3. Purchasing power or inflationary risk

Purchasing power risk is also known as inflation risk. It is so, since it emanates (originates) from the fact that it affects a purchasing power adversely. It is not desirable to invest in securities during an inflationary period.

The types of power or inflationary risk are depicted and listed below.



1. Demand inflation risk and
2. Cost inflation risk.

The meaning of demand and cost inflation risk is as follows:

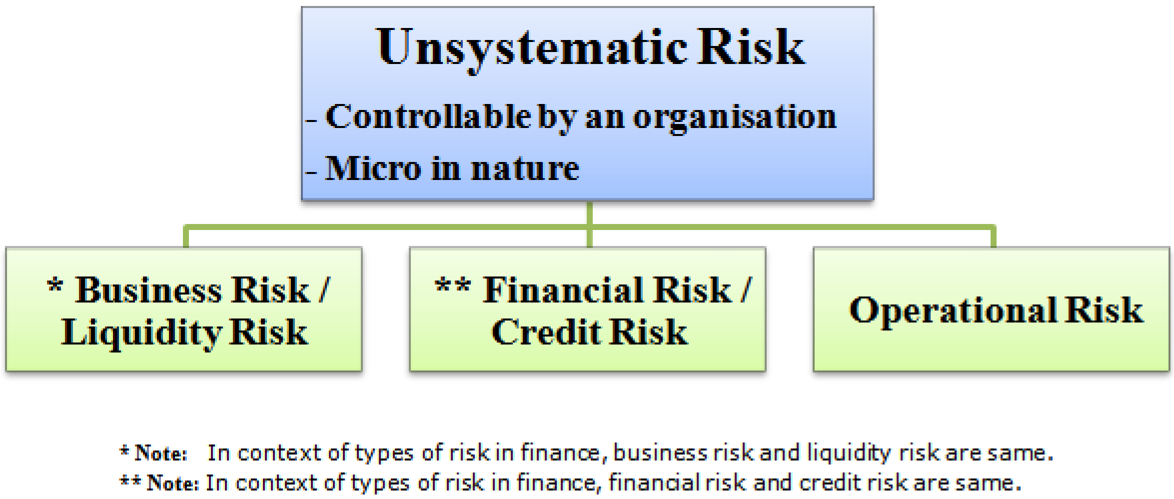
1. Demand inflation risk arises due to increase in price, which result from an excess of demand over supply. It occurs when supply fails to cope with the demand and hence cannot expand anymore. In other words, demand inflation occurs when production factors are under maximum utilization.
2. Cost inflation risk arises due to sustained increase in the prices of goods and services. It is actually caused by higher production cost. A high cost of production inflates the final price of finished goods consumed by people.

B. Unsystematic Risk

Unsystematic risk is due to the influence of internal factors prevailing within an organization. Such factors are normally controllable from an organization's point of view.

It is a micro in nature as it affects only a particular organization. It can be planned, so that necessary actions can be taken by the organization to mitigate (reduce the effect of) the risk.

The types of unsystematic risk are depicted and listed below.



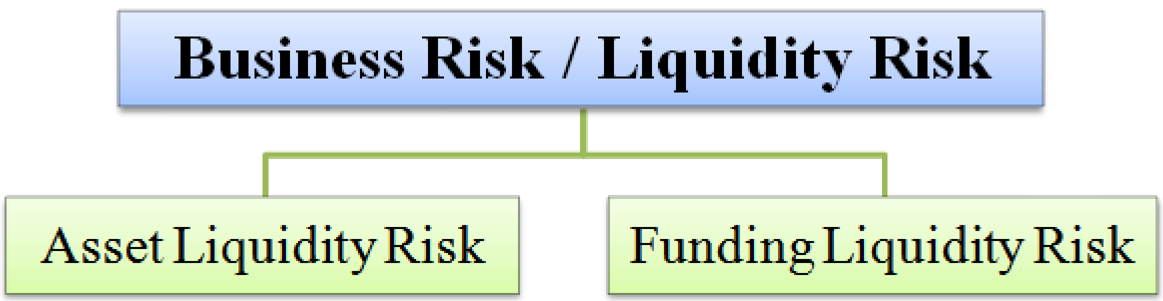
1. Business or liquidity risk,
2. Financial or credit risk and
3. Operational risk.

Now let's discuss each risk classified under this group.

1. Business or liquidity risk

Business risk is also known as liquidity risk. It is so, since it emanates (originates) from the sale and purchase of securities affected by business cycles, technological changes, etc.

The types of business or liquidity risk are depicted and listed below.



1. Asset liquidity risk and
2. Funding liquidity risk.

The meaning of asset and funding liquidity risk is as follows:

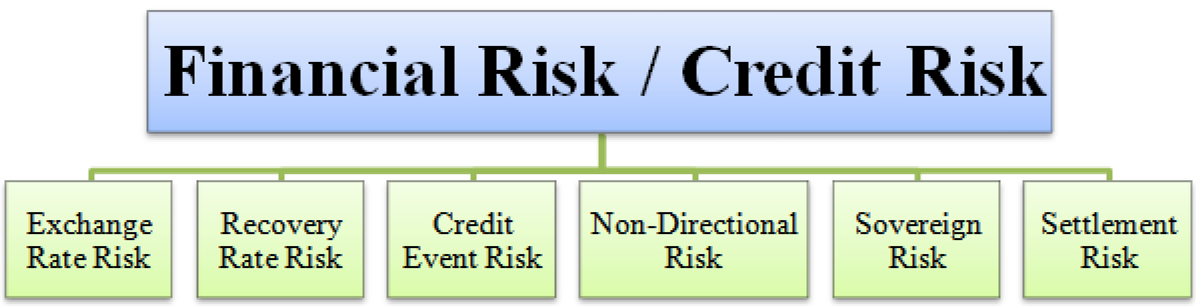
1. Asset liquidity risk is due to losses arising from an inability to sell or pledge assets at, or near, their carrying value when needed. For e.g. assets sold at a lesser value than their book value.
2. Funding liquidity risk exists for not having an access to the sufficient-funds to make a payment on time. For e.g. when commitments made to customers are not fulfilled as discussed in the SLA (service level agreements).

2. Financial or credit risk

Financial risk is also known as credit risk. It arises due to change in the capital structure of the organization. The capital structure mainly comprises of three ways by which funds are sourced for the projects. These are as follows:

1. Owned funds. For e.g. share capital.
2. Borrowed funds. For e.g. loan funds.
3. Retained earnings. For e.g. reserve and surplus.

The types of financial or credit risk are depicted and listed below.



1. Exchange rate risk,
2. Recovery rate risk,
3. Credit event risk,
4. Non-Directional risk,
5. Sovereign risk and
6. Settlement risk.

The meaning of types of financial or credit risk is as follows:

1. Exchange rate risk is also called as exposure rate risk. It is a form of financial risk that arises from a potential change seen in the exchange rate of one country's currency in relation to another country's currency and vice-versa. For e.g. investors or businesses face it either when

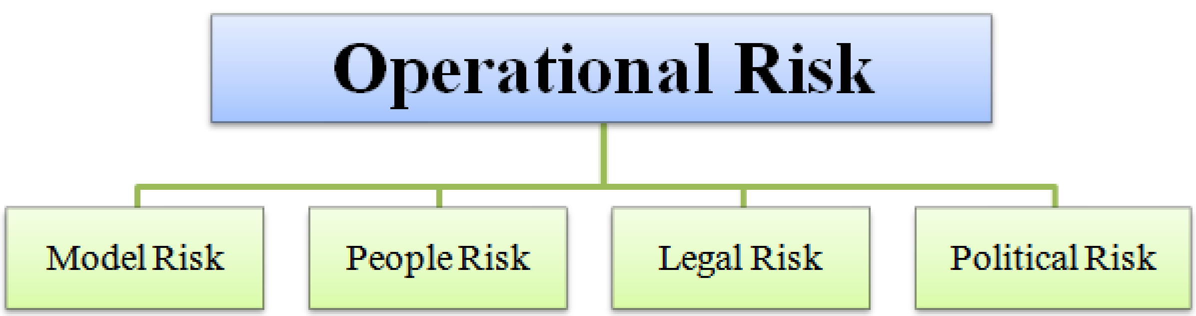
they have assets or operations across national borders, or if they have loans or borrowings in a foreign currency.

2. Recovery rate risk is an often neglected aspect of a credit-risk analysis. The recovery rate is normally needed to be evaluated. For e.g. the expected recovery rate of the funds tendered (given) as a loan to the customers by banks, non-banking financial companies (NBFC), etc.
3. Sovereign risk is associated with the government. Here, a government is unable to meet its loan obligations, reneging (to break a promise) on loans it guarantees, etc.
4. Settlement risk exists when counterparty does not deliver a security or its value in cash as per the agreement of trade or business.

3. Operational risk

Operational risks are the business process risks failing due to human errors. This risk will change from industry to industry. It occurs due to breakdowns in the internal procedures, people, policies and systems.

The types of operational risk are depicted and listed below.



1. Model risk,
2. People risk,
3. Legal risk and
4. Political risk.

The meaning of types of operational risk is as follows:

1. Model risk is involved in using various models to value financial securities. It is due to probability of loss resulting from the weaknesses in the financial-model used in assessing and managing a risk.
2. People risk arises when people do not follow the organization‟s procedures, practices and/or rules. That is, they deviate from their expected behaviour.
3. Legal risk arises when parties are not lawfully competent to enter an agreement among themselves. Furthermore, this relates to the regulatory-risk, where a transaction could conflict with a government policy or particular legislation (law) might be amended in the future with retrospective effect.
4. Political risk occurs due to changes in government policies. Such changes may have an unfavourable impact on an investor. It is especially prevalent in the third-world countries.

Investment Media

The most common terms that are related to different types of investments:

Bond: A debt instrument, a bond is essentially a loan that you are giving to the government or an institution in exchange for a pre-set interest rate paid regularly for a specified term. The bond pays interest (a coupon payment) while it's active and expires on a specific date, at which point the total face value of the bond is paid to the investor. If you buy the bond when it is first issued, the face or par value you receive when the bond matures will be the amount of money you paid for it when you made the purchase. In this case, the return you receive from the bond is the coupon, or interest payment. If you purchase or sell a bond between the time it is issued and the time it matures, you may experience losses or gains on the price of the bond itself.

Stock: A type of investment that gives you partial ownership of a publicly traded company.

Mutual fund: An investment vehicle that allows you to invest your money in a professionally-managed portfolio of assets that, depending on the specific fund, could contain a variety of stocks, bonds, market-related indexes, and other investment opportunities.

Money market account: A type of savings account that offers a competitive rate of interest (real rate) in exchange for larger-than-normal deposits.

Exchange-Traded Fund (ETF): ETFs are funds – sometimes referred to as baskets or portfolios of securities – that trade like stocks on an exchange. When you purchase an ETF, you are purchasing shares of the overall fund rather than actual shares of the individual underlying investments.

PART B

1. Give the financial meaning of investment.
2. Define risk.
3. Write short notes on various types of risks.
4. Who are the participants in Indian securities market?
5. What do you mean by mutual fund?
6. Give the meaning of fund of fund.
7. What is gambling?
8. Differentiate investment and speculation
9. What is interest rate risk?
10. What are the tools available to measure risk?

PART – C

1. Explain the importance of Investment programme?
2. What is the factor that determines Risk? Describe the various methods of measuring risk.
3. Explain the process of Investment programme?
4. Enumerate the Investment Media with suitable examples?
5. Explain the various features of Investment Programme.
6. Define Risk? Explain the Systematic risk and its types.
7. The investment process involves a series of activities starting from thepolicy formulation - Discuss
8. Enumerate the Alternative sources of Investment in India with suitable example?
9. Explain the factor favourable for making Investment?
10. Explain the different types of Risk with suitable example?

PART D

CASE STUDY

1. Illustrate the computation of stock index from the following data.

Market Price at N Period:

S. No	Company Name	Share Price	No. of Outstanding Shares
1	A	25	100
2	B	35	150
3	C	45	120
4	D	85	100
5	E	20	50

Market Price at N + 1 Period:

S. No	Company Name	Share Price	No. of Outstanding Shares
1	A	30	100
2	B	40	150
3	C	45	120
4	D	95	100
5	E	21	50

Assume the base index value is 100.

SUBJECT: :SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT
SEMESTER : II
LASS : I M.COM
SUBJECT CODE: 19CMP205A

UNIT I
Real assets in the economy include all but which one of the following?
___________ assets generate net income to the economy and ___________ assets
Which of the following are financial assets? I. Debt securities II. Equity securities III. Derivative securities
Which one of the following best describes the purpose of derivatives markets?
Information that can be found on the Internet at no cost includes I. P/E ratios. II. recent news about a company. III. financial statements. IV. future earnings and stock prices.
Which one of the following can be considered a pitfall for investors new to on-line trad
Which of the following types of information will NOT be found in major urban newspap
Current price information is found in which of the following? I. Dow Theory Letters II. Yahoo!Finance III. CNBC TV website IV. Hulbert Financial Digest
MSN Money, Yahoo! Finance, and the Money control are all classified as
Stock market averages and indexes are commonly used to measure the
Which one of the following statements is correct?
Because common shareholders are entitled to the profits that remain after all of a corp
Which of the following is unlikely to be found in an internet stock quotation?
Which type of mutual fund consists of both stocks and bonds with a combined objectiv
Which one of the following statements about common stock is correct?
Stock market averages reflect the arithmetic average price behavior of a group of stock
Which of the following sites is especially valuable for information concerning mutual fu
Assume you wanted to find the most current price for Home Depot's stock. Your most l
Which one of the following statements about back-office research reports is FALSE?
The published analysis and recommendations of an individual brokerage firm is called a

Debt securities promise __________. I. a fixed stream of income II. a stream of income that is determined according to a specific formula III. a share in the profits of the issuing entity
Money Market securities are characterized by ________. I. maturity less than one year II. safety of the principal investment III. low rates of return
In an investment policy statement the objectives of an investor are expressed in terms
Which of the following is not a step in the portfolio management process?
____ phase is the stage when investors in their early-to-middle earning years attempt t
The first step in the investment process is the development of a(n)
Which of the following is not a typical portfolio constraint?
Important reasons for constructing a policy statement include:
Which of the following statements is false
____ refer(s) to the ability to convert assets to cash quickly and at a fair market price ar
The primary market tends to be more active when
Individuals can use the Internet to I. analyze individual securities. II. search for stocks that meet specific investment criteria. III. organize their financial information. IV. track the performance of their portfolio.
The current outlay of money to guard against a potentially large future loss is commonl
Individuals can now use the Internet to buy and sell I. stocks. II. bonds. III. mutual funds. IV. stock options.
IPO activity tends to peak when stock prices
____ must be stated in terms of expected returns and risk. An investor's tolerance for r
Which of the following is not a life cycle phase?
An example of a derivative security is __________.
Which of the following is not a money market security?
Which of the following is usually available on a companies website?
Which of the following is not traded in the securities markets?
Debt represents funds loaned in exchange for
Investors seeking to increase their wealth as quickly as possible would invest in
Speculative and growth oriented investments are least appropriate for
Stocks are a(n) _________ investment representing _________ of a business
Tax planning
Which of the following is an example of a tangible asset?
Which of the following is NOT an investment as defined in the text?
The great majority of transactions on the NSE are executed
Beginning investors with small amounts to invest should
In selecting investments consistent with your goals, you should consider

Which of the following represent investment goals? I. saving for major expenditures such as a house or education II. sheltering income from taxes III. increasing current income IV. saving funds for retirement
Short-term securities are bought and sold in the
Research indicates that investors who closely monitor their portfolios and trade c
Investors seeking a diversified, professionally managed portfolio of securities ca
A rights offering is the
Which of the following investments represents partial ownership of a corporatio
Information that can be found on the Internet at no cost includes I. P/E ratios. II. recent news about a company. III. financial statements. IV. future earnings and stock prices.
The Internet provides I. educational sites for financial investing. II. the ability to trade securities on-line. III. current information on stocks and bonds. IV. analysts reports on individual stocks.
Which of the following is(are) issue characteristics of an investment? I. type of investment such as stocks or bonds II. financial condition of the issuer III. coupon or dividend payments IV. time to maturity

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I

option A	option B
Land	Buildings
Financial, financial	Financial, real
I only	I and II only
Transferring risk from one party	Investing for a short time period to earn a smal
I and IV only	II and III only
On-line trading is fast and efficient.	On-line investors tend to trade too frequently.
stories concerning local business le	interest rates offered by local and national banks
II and III only	I, II and III only
subscription services.	comparative data sources.
specific behavior of companies.	general behavior of stock prices.
The S&P 500 Index is based on 500	Because of mergers and bankruptcies, the S&P 50(
residual owners	temporary owners.
earning per share (EPS)	beta
equity-income	balanced
Each share of stock has a specified	Common stock gives stockholders first title to a sh
at a given point in time.	relative to a base value set at an earlier point in tir
www.investopedia.com	www.morningstar.com
Yahoo Finance website	Investor's Business Daily.
They frequently include buy or sell	They include analyses of current and future prospe
prospectus.	comparative data source.

I only	I or II only
I only	I and II only
risk and return	risk
Sell all assets and reinvestment pro	Develop a policy statement
Accumulation	Spending
Objective statement.	Policy statement
Liquidity needs	Risk tolerance
Helps investors decide on realistic i	Help support liquid needs
Unrealized capital gains are taxable	Realized capital gains are taxable.
Liquidity needs	Time horizons
the economy is slowing and stock p	the economy is expanding and stock prices are risi
I and IV only	II and III only
Asset management	Insurance
I and IV only	II and III only
have fallen sharply	are volatile and unstable
Investment objectives	Investment requirements
Discovery phase	Accumulation phase
a common share of General Mot	a call option on Intel stock
Treasury bill	Six month maturity certificate of deposit
brokerage reports	annual reports
stocks	bonds
dividend income and the repaym	dividend income and an ownership interest in t
corporate bonds and preferred st	large company stocks with high dividends
young investors	middle-aged investors
direct; ownership	direct; debt
guides investment activities to m	ignores the source of income and concentrates
Bonds	Mutual Fund
a certificate of deposit issued by	a new automobile
automatically through electronic	on the trading floor by brokers known as speci
avoid stock investments complet	invest all of their money in one high quality st
rates of return and taxes only	the pre-tax rate of return only

I and IV only	III and IV only
capital market	primary market
outperform those who hold inves	underperform those who hold investments for
preferred stock	convertible securities
initial offering of securities to th	offering of new securities to current sharehold
Bonds	Mutual Fund
I and IV only	II and III only
II and III only	III and IV only
I and II only	III only

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ndidates admitted from 2018 onwards)
ARTMENT OF COMMERCE

option C	option D	Answer
Consumer durables	Common stock	Common stock
Real, financial	Real, real	Real, financial
II and III only	I, II and III	I, II and III
Investing for retirement	Earning interest incom	Transferring risk from one p
I, II and III only	I, II, III and IV	I, II and III only
On-line trading is available to the average invest	On-line investors pay low	On-line investors tend to trade
price quotations for stocks of local interest	real time price quotes fo	real time price quotes for wide
II, III and IV only	I, II, III and IV	II and III only
financial portals.	institutional news sites.	financial portals.
specific behavior of alternative investments.	specific behavior of the e	general behavior of stock price
S&P 500 Index is carefully constructed to reflect	The S&P 500 is based on	The S&P 500 Index is based on
debt owners.	owners of last resort.	residual owners
previous day's closing price	broker's commission per	broker's commission per 100 sh
value	bond	balanced
Common stock typically provides higher levels of	Each share of common st	Each share of common stock of
relative to other indexes.	relative to a base price o	at a given point in time.
www.moody's.com	www.bondsonline.com	www.morningstar.com
Readers Digest	The Wall Street Journal.	Yahoo Finance website
They look at specific companies as well as indust	They are only available to	They are only available to high-
back-office research report.	broker's subscription rep	back-office research report.

I and III only	II or III only	I or II only
I and III only	I, II and III	I, II and III
return	time horizon	risk and return
Construct the portfolio	Monitor investor's needs	Sell all assets and reinvestment
Gifting	Consolidation	Accumulation
Financial statement.	Statement of cash needs	Policy statement
Time horizon	Tax concerns	Risk tolerance
Develop an instrument to judge risk	Help the investor on time	Helps investors decide on realis
Tax-exempt investments are attractive to individ	Tax exempt investors pre	Unrealized capital gains are tax
Liquidation values	Liquidation essentials	Liquidity needs
interest rates are rising.	early in the calendar yea	the economy is expanding and
I, III and IV only	I, II, III and IV	I, II, III and IV
Portfolio management	Minimizing risk	Insurance
I, III and IV only	I, II, III and IV	I, II, III and IV
have risen sharply	Stock prices have relative	have risen sharply
Investment constraints	Investment rewards	Investment objectives
Consolidation phase	Spending phase	Discovery phase
a Ford bond	Treasury bond	a call option on Intel stock
Common stock	Banker's acceptance	Common stock
back-office reports	red herrings	annual reports
derivatives	real estate	real estate
interest income and a partial ownership inter	interest income and the	interest income and the repay
smaller companies pursuing rapid growth.	government bonds and	smaller companies pursuing
retired investors	high income investors	retired investors
indirect; ownership	indirect; debt	direct; ownership
is primarily done by individuals with income	is limited to reviewing	guides investment activities
real estate	stocks	real estate
Government Saving Bond	a mutual fund held in a	a new automobile
by dealers known as market makers	by auction in trading a	automatically through electro
buy mutual funds or exchange traded funds (	buy a portfolio of very	buy mutual funds or exchang
annual dividends and taxes only	risks, returns, and taxe	risks, returns, and taxes

I, III and IV only	I,,II, III and IV	I,,II, III and IV
money market	stock market	money market
earn rates of return similar to those who hold	be more highly educate	underperform those who hol
insurance policies	mutual funds	mutual funds
sale of newly issued shares of stock to the ge	sale of securities direct	offering of new securities to
Commercial Paper	Common stock	Common stock
I, II and III only	I, II, III and IV	I, II and III only
I, II and III only	I, II, III and IV	I, II, III and IV
I, III and IV only	I, II, III and IV	I, III and IV only

arty to another

too frequently.
ly held stocks and exchange traded funds

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500 large companies that trade on NSE

hares

f a given class entitles the holder to an equal ownership position and an equal vote in the corporation

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stic investment goals
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current shareholders on a pro-rata basis.

Over view of capital market - Structure in Indian capital market- Major players - Role of stock exchanges - Trading and settlement procedures at NSE and BSE. Securities Contract Regulation Act - Securities and Exchange Board of India - Indian debt market- Stock Market Indices.

CAPITAL MARKET :-

Capital market deals with medium term and long term funds. It refers to all facilities and the institutional arrangements for borrowing and lending term funds (medium term and long term). The demand for long term funds comes from private business corporations, public corporations and the government. The supply of funds comes largely from individual and institutional investors, banks and special industrial financial institutions and Government.

STRUCTURE I CONSTITUENTS I CLASSIFICATION OF CAPITAL MARKET:-

Capital market is classified in two ways

1) CAPITAL MARKET

Gilt – Edged Market	Industrial Securities Market	Development Financial Institutions (DFIs)	Financial intermediaries

a) Gilt - Edged Market :-

Gilt - Edged market refers to the market for government and semi-government securities, which carry fixed rates of interest. RBI plays an important role in this market.

b) Industrial Securities Market :-

It deals with equities and debentures in which shares and debentures of existing companies are traded and shares and debentures of new companies are bought and sold.

c) Development Financial Institutions :-

Development financial institutions were set up to meet the medium and long-term requirements of industry, trade and agriculture. These are IFCI, ICICI, IDBI, SIDBI, IRBI, UTI, LIC, GIC etc. All These institutions have been called Public Sector Financial Institutions.

d) Financial Intermediaries :-

Financial Intermediaries include merchant banks, Mutual Fund, Leasing companies etc. they help in mobilizing savings and supplying funds to capital market.

2) The Second way in which capital market is classified is as follows :-

CAPITAL MARKET IN INDIA

a) Primary market b)Secondary market

a) Primary Market :-

Primary market is the new issue market of shares, preference shares and debentures of non-government public limited companies and issue of public sector bonds.

b) Secondary Market

This refers to old or already issued securities. It is composed of industrial security market or stock exchange market and gilt-edged market.

ROLE AND IMPORTANCE OF CAPITAL MARKET IN INDIA :-

Capital market has a crucial significance to capital formation. For a speedy economic development adequate capital formation is necessary. The significance of capital market in economic development is explained below :-

1. Mobilisation Of Savings And Acceleration Of Capital Formation :-

In developing countries like India the importance of capital market is self evident. In this market, various types of securities helps to mobilise savings from various sectors of population. The twin features of reasonable return and liquidity in stock exchange are definite incentives to the people to invest in securities. This accelerates the capital formation in the country.

2. Raising Long - Term Capital :-

The existence of a stock exchange enables companies to raise permanent capital. The investors cannot commit their funds for a permanent period but companies require funds permanently. The stock exchange resolves this dash of interests by offering an opportunity to investors to buy or sell their securities, while permanent capital with the company remains unaffected.

3. Promotion Of Industrial Growth:-

The stock exchange is a central market through which resources are transferred to the industrial sector of the economy. The existence of such an institution encourages people to invest in productive channels. Thus it stimulates industrial growth and economic development of the country by mobilising funds for investment in the corporate securities.

4. Ready And Continuous Market :-

The stock exchange provides a central convenient place where buyers and sellers can easily purchase and sell securities. Easy marketability makes investment in securities more liquid as compared to other assets.

5. Technical Assistance :-

An important shortage faced by entrepreneurs in developing countries is technical assistance. By offering advisory services relating to preparation of feasibility reports, identifying growth potential and training entrepreneurs in project management, the financial intermediaries in capital market play an important role.

6. Reliable Guide To Performance :-

The capital market serves as a reliable guide to the performance and financial position of corporates, and thereby promotes efficiency

.

7. Proper Channelization of Funds :-

The prevailing market price of a security and relative yield are the guiding factors for the people to channelise their funds in a particular company. This ensures effective utilisation of funds in the public interest.

8. Provision Of Variety Of Services :-

The financial institutions functioning in the capital market provide a variety of services such as grant of long term and medium term loans to entrepreneurs, provision of underwriting facilities, assistance in promotion of companies, participation in equity capital, giving expert advice etc.

9. Development Of Backward Areas :-

Capital Markets provide funds for projects in backward areas. This facilitates economic development of backward areas. Long term funds are also provided for development projects in backward and rural areas.

10. Foreign Capital :-

Capital markets makes possible to generate foreign capital. Indian firms are able to generate capital funds from overseas markets by way of bonds and other securities. Government has liberalised Foreign Direct Investment (FDI) in the country. This not only brings in foreign capital but also foreign technology which is important for economic development of the country.

11. Easy Liquidity :-

With the help of secondary market investors can sell off their holdings and convert them into liquid cash. Commercial banks also allow investors to withdraw their deposits, as and when they are in need of funds.

12. Revival Of Sick Units :-

The Commercial and Financial Institutions provide timely financial assistance to viable sick units to overcome their industrial sickness. To help the weak units to overcome their financial industrial sickness banks and FIs may write off a part of their loan.

FACTORS CONTRIBUTING TO THE GROWTH AND DEVELOPMENT OF CAPITAL MARKET :-

1) Growth Of Development Banks And Financial Institutions :-

For providing long term funds to industry, the government set up Industrial Finance Corporation in India (IFCI) in 1948. This was followed by a number of other development banks and institutions like the Industrial Credit and Investment Corporation of India (ICICI) in 1955, Industrial Development Bank of India (IDBI) in 1964, Industrial Reconstruction Corporation of India (IRCI) in 1971, Foreign Investment Promotion Board in 1991, Over the Counter Exchange of India (OTCEI) in 1992 etc. In 1969, 14 major commercial banks were nationalised. Another 6 banks were nationalised in 1980. These financial institutions and banks have contributed in widening and strengthening of capital market in India.

2) Setting Up **Of SEBI :-**

The Securities Exchange Board of India (SEBI) was set up in 1988 and was given statutory recognition in 1992.

3) Credit Rating Agencies :-

Credit rating agencies provide guidance to investors / creditors for determining the credit risk. The Credit Rating Information Services of India Limited (CRISIL) was set up in 1988 and Investment Information and Credit Rating Agency of India Ltd. (ICRA) was set up in 1991. These agencies are likely to help the development of capital market in future.

4) Growth Of Mutual Funds :-

The mutual funds collects funds from public and other investors and channelise them into corporate investment in the primary and secondary markets. The first mutual fund to be set up in India was Unit Trust of India in 1964. In 2007-08 resources mobilised by mutual funds were Rs. 1,53,802 crores.

5) Increasing Awareness :-

During the last few years there have been increasing awareness of investment opportunities among the public. Business newspapers and financial journals (The Economic Times, The Financial Express, Business India, Money etc.) have made the people aware of new long-term investment opportunities in the security market.

6) Growing Public Confidence

A large number of big corporations have shown impressive growth. This has helped in building up the confidence of the public. The small investors who were not interested to buy securities from the market are now showing preference in favour of shares and debentures. As a result, public issues of most of the good companies are now over-subscribed many times.

7) Legislative Measures :-

The government passed the companies Act in 1956. The Act gave powers to government to control and direct the development of the corporate enterprises in the country. The capital Issues (control) Act was passed in 1947 to regulate investment in different enterprises, prevent diversion of funds to non-essential activities and to protect the interest of investors. The Act was replaced in 1992.

8) Growth Of Underwriting Business :-

The growing underwriting business has contributed significantly to the development of capital market.

9) Development Of Venture Capital Funds :-

Venture capital represents financial investment in highly risky projects with a hope of earning high returns After 1991, economic liberalisation has made possible to provide medium and long term funds to those firms, which find it difficult to raise funds from primary markets and by way of loans from FIs and banks.

10) Growth Of Multinationals (MNCs) :-

The MNCs require medium and long term funds for setting up new projects or for expansion and modernisation. For this purpose, MNCs raise funds through loans from banks and FIs. Due to the presence of MNCs, the capital market get a boost.

11) Growth Of Entrepreneurs :-

Since 1980s, there has been a remarkable growth in the number of entrepreneurs. This created more demand for short term and long term funds. FIs, banks and stock markets enable the entrepreneurs to raise the required funds. This has led to the growth of capital market in India.

12) Growth Of Merchant Banking :-

The credit for initiating merchant banking services in India goes to Grindlays Bank in 1967,followed by Citibank in 1970. Apart from capital issue management, merchant banking divisions provide a number of other services including provision of consultancy services relating to promotion of projects, corporate restructuring etc.

REFORMS I DEVELOPMENTS IN CAPITAL MARKET SINCE 1991:-

The government has taken several measures to develop capital market in post-reform period, with which the capital market reached new heights. Some of the important measures are

1) Securities And Exchange Board Of India (SEBI) :-

SEBI became operational since 1992. It was set with necessary powers to regulate the activities connected with marketing of securities and investments in the stock exchanges, merchant banking, portfolio management, stock brokers and others in India. The objective of SEBI is to protect the interest of investors in primary and secondary stock markets in the country.

2) National Stock Exchange (NSE) :-

The setting up to NSE is a landmark in Indian capital markets. At present, NSE is the largest stock market in the country. Trading on NSE can be done throughout the country through the network of satellite terminals. NSE has introduced inter-regional clearing facilities.

3) Dematerialisation Of Shares :-

Demat of shares has been introduced in all the shares traded on the secondary stock markets as well as those issued to the public in the primary markets. Even bonds
and debentures are allowed in demat form. The advantage of demat trade is that it involves
Paperless trading.

4) Screen Based Trading :-

The Indian stock exchanges were modernised in 90s, with Computerised Screen Based Trading System (SBTS), It cuts down time, cost, risk of error and fraud and there by leads to improved operational efficiency. The trading system also provides complete online market information through various inquiry facilities.

5) Investor Protection :-

The Central Government notified the establishment of Investor Education and Protection Fund (IEPF) with effect from 1st Oct. 2001: The IEPF shall be credited with amounts in unpaid dividend accounts of companies, application moneys received by companies for allotment of any securities and due for refund, matured deposits and debentures with companies and interest accrued there on, if they have remained unclaimed and unpaid for a period of seven years from the due date of payment. The IEPF will be utilised for promotion of awareness amongst investors and protection of their interests.

6) Rolling Settlement :-

Rolling settlement is an important measure to enhance the efficiency and integrity of the securities market. Under rolling settlement all trades executed on a trading day (T) are settled after certain days (N). This is called T + N rolling settlement. Since April 1, 2002 trades are settled' under T + 3 rolling settlement. In April 2003, the trading cycle has been reduced to T + 2 days. The shortening of trading cycle has reduced undue speculation on stock markets. ?

7) The Clearing Corporation Of India Limited (CCIL) :-

The CCIL was registered in 2001, under the Companies Act, 1956 with the State Bank of India as the Chief Promoter. The CCIL clears all transactions in government securities and repos and also Rupee / US $ forex spot and forward deals All trades in government securities below Rs. 20 crores would be mandatorily settled through CCIL, white those above Rs. 20 crores would have the option for settlement through the RBI or CCIL.

8) The National Securities Clearing Corporation Limited (NSCL) :-

The NSCL was set up in 1996. It has started guaranteeing all trades in NSE since July 1996. The NSCL is responsible for post-trade activities of NSE. It has put in place a comprehensive risk management system, which is constantly monitored and upgraded to pre-expect market failures.

9) Trading In Central Government Securities :-

In order to encourage wider participation of all classes of investors, Including retail investors, across the country, trading in government securities has been introduced from January 2003. Trading in government securities can be carried out through a nation wide, anonymous, order-driver, screen-based trading system of stock exchanges in the same way in which trading takes place in equities.

10) Credit Rating Agencies :-

Various credit rating agencies such as Credit Rating Information services of India Ltd. (CRISIL – 1988), Investment Information and credit Rating Agency of India Ltd. (ICRA – 1991), etc. were set up to meet the emerging needs of capital market. They also help merchant bankers, brokers, regulatory authorities, etc. in discharging their functions related to debt issues.

11) Accessing Global Funds Market :-

Indian companies are allowed to access global finance market and benefit from the lower cost of funds. They have been permitted to raise resources through issue of American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Further Indian financial system is opened up for investments of foreign funds through Non-Resident Indians (NRIs), Foreign Institutional investors (FIls), and Overseas Corporate Bodies (OCBs).

12) Mutual Funds :-

Mutual Funds are an important avenue through which households participate in the securities market. As an investment intermediary, mutual funds offer a variety of services / advantages to small investors. SEBI has the authority to lay down guidelines and supervise and regulate the working of mutual funds.

13) Internet Trading :-

Trading on stock exchanges is allowed through internet, investors can place orders with registered stock brokers through internet. This enables the stock brokers to execute the orders at a greater pace.

14) Buy Back Of Shares :-

Since 1999, companies are allowed to buy back of shares. Through buy back, promoters reduce the floating equity stock in market. Buy back of shares help companies to overcome the problem of hostile takeover by rival firms and others.

15) Derivatives Trading :-

Derivatives trading in equities started in June 2000. At present, there are four equity derivative products in India Stock Futures, Stock Options, Index Futures, Index Options.

Derivative trading is permitted on two stock exchanges in India i.e. NSE and BSE. At present in India, derivatives market turnover is more than cash market.

16) PAN Made Mandatory :-

In order to strengthen the "Know your client" norms and to have sound audit trail of transactions in securities market, PAN has been made mandatory with effect from January 1, 2007.

New Issue Market

New issues are offered in the primary market and sold to the public for the first time as initial public offerings, or IPOs. New issues are usually handled for a corporation by an underwriting syndicate comprised of investment banks and selling groups. An underwriter will advise the issuing corporation on the best price at which to offer shares of the new security to the public. Factors considered in arriving at a price include prevailing market conditions, indications of interest from the underwriter's book of business, prices of similar companies and the company's general financial health.

The industrial securities market in India consists of new issue market and stock exchange. The new issue market deals with the new securities which were not previously available to the investing public, i.e., the securities that are offered to the investing public for the first time. The market, therefore, makes available a new block of securities for public subscription. In other words, new issue market deals with raising of fresh capital by companies either for cash or for consideration other than cash.

The new issue market encompasses all institutions dealing in fresh claim. These claims may be in the form of equity shares, preference shares, debentures, right issues, deposits etc. All financial institutions which contribute, underwrite and directly subscribe to the securities are part of new issue market.

Functions of New Issue Market

The main function of the New Issue Market is to facilitate the „transfer of resources" from savers to users. Conceptually, however, the New Issue Market should not be conceived as a platform only for the purpose of raising finance for new capital expenditure.

In fact, the facilities of the market are also utilised for selling existing concerns to the public as going concerns through conversions of existing proprietary enterprises or private companies into public companies.

It, therefore, becomes imperative at this stage to classify new issues. One classification suggested by R.F. Henderson (c.f. The New Issue Market & Finance for Industry, 1951), categorises new issues into those by:

(a) New companies also called „initial issues‟ and

(b) Old companies also called „further issues‟.

These bear no relation to the age of the company, but are based on the fact whether the company already has stock exchange listing. This classification is thus concerned only with the flow of „new money‟. Another classification (c.f. Merrett, Howe & New bould "Equity Issues and the London Capital Market" 1967) distinguishes between flow of funds into the market and flow of "new money" hence we have „new money issues‟ or issues of capital involving newly created share and „no new money issues‟ i.e. sale of securities already in existence and sold by their holders.

This is more an "exclusive" classification in that two types of issues are excluded from the category of new issues.

(a) Bonus/capitalisation issues which represent only book keeping entries.

(b) Exchange issues: by which shares in one company are/exchanged for securities of another.

Now, the main function of the New Issue Market, i.e. channelling of investible funds, can be divided, from the operational stand-point, into a triple-service function:

(a) Origination

(b) Underwriting

(c) Distribution

The institutional setup dealing with these can be said to constitute the New Issue Market organisation. Let us elucidate a little on all of these.

(a) Origination :

Origination refers to the work of investigation and analysis and processing of new proposals. This in turn may be:

(i) A preliminary investigation undertaken by the sponsors (specialised agencies) of the issue. This involves a/careful study of the technical, economic, financial and/legal aspects of the issuing companies to ensure that/it warrants the backing of the issue house.

(ii) Services of an advisory nature which go to improve the quality of capital issues. These services include/advice on such aspects of capital issues as: determination of the class of security to be/issued and price of the issue in terms of market conditions; the timing and magnitude of issues; method of flotation; and technique of selling and so on.

The importance of the specialised services provided by the New Issue Market organisation in this respect can hardly be over-emphasized. On the thoroughness of investigation and soundness of judgement of the sponsoring institution depends, to a large extent, the allocative efficiency of the market. The origination, however, thoroughly done, will not by itself guarantee success of an issue. A second specialised service i.e. “Underwriting” is often required.

(b) Underwriting:

The idea of underwriting originated on account of uncertainties prevailing in the capital market as a result of which the success of the issue becomes unpredictable. If the issue remains undersubscribed, the directors cannot proceed to allot the shares, and have to return money to the applicants if the subscription is below a minimum amount fixed under the Companies Act. Consequently, the issue and hence the project will fail.

Underwriting entails an agreement whereby a person/organisation agrees to take a specified number of shares or debentures or a specified amount of stock offered to the public in the event of the public not subscribing to it, in consideration of a commission the underwriting commission.

If the issue is fully subscribed by the public, there is no liability attaching to the underwriters; else they have to come forth to meet the shortfall to the extent of the under- subscription. The underwriters in India may broadly be classified into the following two types:

(i) Institutional Underwriters;

(ii) Non-Institutional Underwriting.

Institutional Underwriting in our country has been development oriented. It stands as a major support to those projects which often fail to catch the eye of investing public. These projects rank high from the points of view of national importance e.g. steel, fertilizer, and generally receive higher priority by such underwriters.

Thus institutional underwriting may be broadly recognised, in the context of development credit, as playing a decisive role in directing the economic resources of the country towards desired activities.

This does not mean that they are barred entrance in the issue market from so called glamorous issues to which public can be expected to readily subscribe. They may be underwriting in such cases, but what is expected of them is their support to projects in the priority sector.

One of the principal advantages they offer is that resource-wise they are undoubted. They are in a position to fulfill their underwriting commitments even in the worst foreseeable situations.

The public financial institutions namely IDBI, IFCI, ICICI, LIC and UTI, underwrite a portion of the issued capital. Usually, the underwriting is done in addition to granting term finance by way of loans on debentures. These institutions are usually approached when one or more of the following situations prevail:

(i) The issue is so large that broker-underwriting may not be able to cover the entire issue.

(ii) The gestation period is long enough to act as distinctive

(iii) The project is weak, inasmuch as it is being located in a backward area.

(iv) The project is in the priority sector which may not be able to provide an attractive return on investment.

(v) The project is promoted by technicians.

(vi) The project is new to the market.

The quantum of underwriting assistance varies from institution to institution according to the commitments of each of them for a particular industry.

However, institutional underwriting suffers from the following two drawbacks:

1. The institutional handling involves procedural delays which sometimes dampen the initiative of the corporate managers or promoters.

2. The other disadvantage is that the institutions prefer to wait and watch the results to fulfill their obligations only where they are called upon to meet the deficit caused by under subscription.

(c) Distribution :

The sale of securities to the ultimate investors is referred to as distribution; it is another specialised job, which can be performed by brokers and dealers in securities who maintain regular and direct contact with the ultimate investors. The ability of the New Issue Market to cope with the growing requirements of the expanding corporate sector would depend on this triple-service function.

Stock Exchanges in India

S.No.	Name of the Stock Exchange	Headquarters	About the Stock Exchange / Vision	Year of Formation	No. of listings
1	Bombay Stock Exchange (BSE)	Mumbai, India	Emerges as the premier Indian stock exchange by establishing global benchmarks.	1875	5112
2	National Stock Exchange of India (NSE)	Mumbai, India	It is mutually-owned by a set of leading financial institutions, banks, insurance companies and other financial intermediaries in India but its ownership and management operate as separate entities.	1992	1640
3	Calcutta Stock	Kolkata, India	It is the second largest bourse in	1908	3500

	Exchange (CSE)		India.		
4	Madras Stock Exchange	Chennai, India	The MSE is the fourth stock exchange to be established in the country and the first in South India.	1937	1785
5	Inter-connected Stock Exchange Ltd.	Mumbai, India	It is a national-level stock exchange, providing trading, clearing, settlement, risk management and surveillance support to its trading members.	1998	4500 members and listing securities
6	United Stock Exchange of India	Mumbai, India	It is the fourth pan India exchange to be launched for trading financial instruments in India over the last 140 years.	2010	--

7	OTC Exchange Of India	Mumbai, India	It is the first exchange for small companies.	1990	115
8	MCX Stock Exchange	Mumbai, India	is an India-wide electronic platform for trading in currency futures under the regulatory control of Securities and Exchange Board of India (SEBI) and Reserve Bank of India (RBI).	2008	--
9	Multi Commodity Exchange of India Ltd (MCX)	Mumbai, India	It is an independent commodity exchange based in India.	2003	--
10	Bangalore Stock Exchange (BSE)	Bangalore, India	The stock exchange is managed by a Council of Management, consisting of	1963	595

			members appointed by the Securities and Exchange Board of India.		

S.No.	Name of the Stock Exchange	Headquarters	About the Stock Exchange / Vision	Year of Formation	No. of listings
1	Ahmedabad Stock Exchange	Ahmedabad, India	It is recognized by Securities Contract (Regulations) Act, 1956 as permanent stock exchange.	1894	--
2	Bhubaneshwar Stock Exchange	Bhubaneshwar, India	It is one among the 21 odd regional stock exchanges in India.	1989	--
3	Vadodara Stock Exchange	Gujarat, India	It is the third largest stock exchange in the state of Gujarat after Ahmedabad	1986	459

			and Rajkot.		
4	Cochin Stock Exchange	Kerala, India	It is a capital stock market in Kochi, Kerala in India. I	1978	350
5	Hyderabad Stock Exchange	Hyderabad, India	It was a stock exchange established in 1941 located in Hyderabad, India. The exchange was disbanded in 2007.	1941	--
6	Delhi Stock Exchange (DSE)	New Delhi, India	It is India's fifth exchange. The exchange is one of the premier Stock Exchange in India.	1947	3000
7	Madhya Pradesh Stock Exchange (MPSE)	Madhya Pradesh, India	It was granted permanent recognition under the provisions of the Securities Contract (Regulation)	1928	343

			Act, 1956 ("SCRA"), by the Government of India in 1988.		
8	Jaipur Stock Exchange (JSE)	Jaipur, Rajasthan	JSE is the third largest exchange in India in terms of membership.	1989	740
9	UP Stock Exchange Limited	UP, India	It plays an important role in the development of the capital market of North India.	1982	

Mechanism of Trading

The trading mechanism in the stock exchange is based on a transaction between a buyer, seller, and a trading specialist who actually executes transactions in a stock exchange. In general, the trading mechanism is similar to a simple auction, with investors biddng on a particular stock or security. If the bid is accepted by the owner of the security, the trading specialist executes the sale.

Most major stock exchanges trade a collection of stocks, bonds, and other domestic and foreign investments.

Purpose

- The trading mechanism exists because of the constant need to channel money from investors into business entities. Investors range from wealthy individuals and investment funds to small-scale investors saving for retirement. Entities that raise money in the stock market include corporations, governments, and government agencies. The combination of investors and borrowers creates the market for securities. The trading mechanism refines the market by matching buyers and sellers with the prices they are willing to pay or take.

Bid Price

- A potential buyer of a particular security proposes a price for the security. This is commonly called a bid price. This bid reflects how much the buyer is willing to pay to buy the security.

Ask Price

- The ask price is amount the owner wants for the stock or other security. Generally, the ask price and the bid price are different. The difference between bid and ask price is usually called a spread. For the trading specialist, the spread is an opportunity to make money from the trade.

Trade

- The trade specialist working in the stock exchange itself is the most important part of the trading mechanism, because he matches buyers with sellers. In addition to making the trade happen, a trade specialist must have a ready supply of the security being bought and sold, to avoid corruption and distortion in stock market transactions. Trade specialists can also calculate the supply and demand levels of certain securities of stocks.

Supply and Demand

- Supply and demand theories help illustrate the market forces that influence the trading mechanism in the stock exchange. These forces affect the trading specialist inventories as well as the bid and ask prices. Generally, a certain stock or other security might increase in price if it is highly sought by investors. High demand can cause sellers to increase their ask prices because the security is worth more. In turn, buyers may be willing to increase bid prices because of the improved value of the security. As more buyers seek out an investment with upward momentum, traders must react with increased inventories to meet the demand for the security.

Legal Control of stock Exchanges

The Indian stock market is regulated as per the guidelines laid down by the Securities and Exchange Board of India (SEBI). We bring you the details.

A regulating body called the Securities and Exchange Board of India (SEBI) was established in 1992 with a view of protecting the interest of investors. This body lays down regulations in order to ensure orderly growth and smooth functioning of the Indian capital market.

A regulating body called the Securities and Exchange Board of India (SEBI) was established in 1992 with a view of protecting the interest of investors.

Some of the most important functions of SEBI to regulate the Indian stock market are listed below:

- **Specifying rules and regulations:**SEBI has the authority to specify rules and regulations to control the stock exchange. For instance, the opening (9.15 am) and closing (3.30 pm) time of the market has been determined by SEBI, and it has the right to change the timing if deemed necessary.
- **Providing licenses to dealers and brokers:**No dealer or broker can start distributing securities to investors without getting a prior approval and license from SEBI. It also has the right to withhold or cancel the license of brokers and dealers not adhering to the specified guidelines.
- **Auditing the performance of various stock exchanges:**The regulating body is also responsible for auditing the performances of various stock exchanges and bringing transparency in their functioning.
- **Controlling mergers, acquisitions and take-overs of the companies:**Some companies try to manipulate stocks and buy a majority stake in other companies with an intention of a take-over. SEBI controls and prohibits such movements if it is not in the interest of the company.
- **Prohibiting unfair trade practices in the market:**While SEBI has laid down specific guidelines that promote fair trade practices, many companies occasionally undertake

activities that are not healthy for the market. SEBI has the power to prohibit such activities and take action against the parties involved in such a trade.

Apart from these important functions, SEBI has many other responsibilities, which it exercises appropriately in order to regulate the Indian stock market.

SEBI Laws

An improved corporate governance is the key objective of the regulatory framework in the securities market. Accordingly, Securities and Exchange Board of India (SEBI) has made several efforts with a view to evaluate the adequacy of existing corporate governance practices in the country and further improve these practices. It is implementing and maintaining the standards of corporate governance through the use of its legal and regulatory framework, namely:-

1. Securities Contracts (Regulation) Act, 1956

This Act was enacted to prevent undesirable transactions and to check speculation in the securities by regulating the business of dealing therein. Any stock exchange, which is desirous of being recognised, may make an application in the prescribed manner to the Central Government. Every application shall contain such particulars as may be prescribed, and shall be accompanied by a copy of the bye-laws of the stock exchange for the regulation and control of contracts as well as a copy of the rules relating in general to the constitution of the stock exchange, and in particular to:- (i) the governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted; (ii) the powers and duties of the office bearers of the stock exchange; (iii) the admission into the stock exchange of various classes of members, the qualifications for membership, and the exclusion, suspension, expulsion and re-admission of members there from or there into; (iv) the procedure for the registration of partnerships as members of the stock exchange, in cases where the rules provide for such membership; and the nomination and appointment of authorised representatives and clerks.

Every recognised stock exchange shall furnish the Central Government with a copy of the annual report, and such annual report shall contain such particulars as may be prescribed. It may make rules or amend any rules made by it to provide for all or any of the following matters, namely:- (i) the restriction of voting rights to members only in respect of any matter placed before the stock exchange at any meeting; (ii) the regulation of voting rights in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid-up equity capital of the stock exchange; (iii) the restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange; etc.

If, in the opinion of the Central Government, an emergency has arisen and for the purpose of meeting the emergency, the Central Government considers it expedient so to do, it may, by notification in the Official Gazette, for reasons to be set out therein, direct a recognised stock exchange to suspend such of its business for such period not exceeding seven days and subject to such conditions as may be specified in the notification, and, if, in the opinion of the Central Government, the interest of the trade or the public interest requires that the period should be extended, it may, by like notification extend the said period from time to time.

Securities Contracts (Regulation) Amendment Act, 2007 has been enacted in order to further amend the Securities Contracts (Regulation) Act, 1956, with a view to include securitisation instruments under the definition of 'securities' and provide for disclosure based regulation for issue of the securitised instruments and the procedure thereof. This has been done keeping in view that there is considerable potential in the securities market for the certificates or instruments under securitisation transactions. Further, replication of the securities markets framework for these instruments would facilitate trading on stock exchanges and, in turn, help development of the market in terms of depth and liquidity.

2. <u>Securities and Exchange Board of India Act, 1992</u>

This Act was enacted to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto. For this purpose, the SEBI (the Board), by regulation, specify:- (i) the matters relating to issue of capital, transfer of securities and other matters incidental thereto; and (b) the manner in which such matters shall be disclosed by the companies.

No stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act.

No depository, participant, custodian of securities, foreign institutional investor, credit rating agency, or any other intermediary associated with the securities market as the Board may by notification in this behalf specify, shall buy or sell or deal in securities except under and in accordance with the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act.

Further, no person shall sponsor or cause to be sponsored or carry on or caused to be carried on any venture capital funds or collective investment scheme including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations.

Every application for registration shall be in such manner and on payment of such fees as may be determined by regulations. The Board may, by order, suspend or cancel a certificate of registration in a prescribed manner, as may be determined by regulations under this Act. However, no order shall be made unless the person concerned has been given a reasonable opportunity of being heard.

3. <u>Depositories Act, 1996</u>

This Act was enacted to provide for regulation of depositories in securities and for matters connected therewith or incidental thereto. It provides for the introduction of scrip less trading system and settlement, which is considered necessary for the effective functioning of the securities markets. As per the Act, the term 'depository' means "a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992".

No depository shall act as a depository unless it obtains a certificate of commencement of business from the Board (the SEBI). The Board shall grant a certificate only if it is satisfied that the depository has adequate systems and safeguards to prevent manipulation of records and transactions. However, a certificate shall not be refused unless the depository concerned has been given a reasonable opportunity of being heard.

A depository shall enter into an agreement with one or more participants as its agent, in such form as may be specified by the bye-laws. Any person, through a participant, may enter into an agreement, in such form as may be specified by the bye-laws, with any depository for availing its services. Any such person shall surrender the certificate of security, for which he seeks to avail the services of a depository, to the issuer in such manner as may be specified by the regulations. The issuer, on receipt of certificate of security, shall cancel the certificate of security and substitute in its records the name of the depository as a registered owner in respect of that security and inform the depository accordingly. A depository shall, on receipt of information, enter the name of the person referred in its records, as the beneficial owner.

On receipt of intimation from a participant, every depository shall register the transfer of security in the name of the transferee. If a beneficial owner or a transferee of any security seeks to have custody of such security, the depository shall inform the issuer accordingly.

Every person subscribing to securities offered by an issuer shall have the option either to receive the security certificates or hold securities with a depository. Where a person opts to hold a security with a depository, the issuer shall intimate such depository the details of allotment of the security, and on receipt of such information the depository shall enter in its records the name of the allottee as the beneficial owner of that security.

A depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner. However, it shall not have any voting rights or any other rights in respect of securities held by it. The beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.

The Board, on being satisfied that it is necessary in the public interest or in the interest of investors so to do, may, by order in writing,:- (i) call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require; or (ii) authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall submit a report of such enquiry or inspection to it within such period as may be specified in the order.

SEBI

The **Securities and Exchange Board of India** (frequently abbreviated **SEBI**) is the regulator for the securities market in India. It was established in the year 1988 and given statutory powers on 12 April 1992 through the SEBI Act, 1992.

It was established by The Government of India in the year 1988 and given statutory powers in 1992 with SEBI Act 1992 being passed by the Indian Parliament. SEBI has its Headquarters at the business district of Bandra Kurla Complex in Mumbai, and has Northern, Eastern, Southern and Western Regional Offices in New Delhi, Kolkata, Chennai and Ahmedabad respectively.

Controller of Capital Issues was the regulatory authority before SEBI came into existence; it derived authority from the Capital Issues (Control) Act, 1947.

Initially SEBI was a non statutory body without any statutory power. However in the year of 1995, the SEBI was given additional statutory power by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992. In April, 1988 the SEBI was constituted as the regulator of capital markets in India under a resolution of the Government of India.

The SEBI is managed by its members, which consists of following: a) The chairman who is nominated by Union Government of India. b) Two members, i.e. Officers from Union Finance Ministry. c) One member from The Reserve Bank of India. d) The remaining 5 members are nominated by Union Government of India, out of them at least 3 shall be whole-time members.

The office of SEBI is situated at SEBI Bhavan, Bandra Kurla Complex, Bandra East, Mumbai-400051, with its regional offices at Kolkata, Delhi,Chennai & Ahmadabad. It has recently opened local offices at Jaipur and Bangalore and is planning to open offices at Guwahati, Bhubaneshwar, Patna, Kochi and Chandigarh in Financial Year 2013 - 2014.

Functions and responsibilities

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as "...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto".

SEBI has to be responsive to the needs of three groups, which constitute the market:

- the issuers of securities
- the investors
- the market intermediaries.

SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. Though this makes it very powerful, there is an appeal process to create accountability. There is a Securities Appellate Tribunal which is a three-member tribunal and is presently headed by Mr. Justice J P Devadhar, a former judge of the Bombay High Court. A second appeal lies directly to the Supreme Court. SEBI has taken a very proactive role in streamlining disclosure requirements to international standards.

Powers

For the discharge of its functions efficiently, SEBI has been vested with the following powers:

1. to approve by−laws of stock exchanges.sebi
2. to require the stock exchange to amend their by−laws.
3. inspect the books of accounts and call for periodical returns from recognized stock exchanges.
4. inspect the books of accounts of a financial intermediaries.

5. compel certain companies to list their shares in one or more stock exchanges.
6. registration brokers.

There are two types of brokers.

1.circuit broker 2.merchant broker

SEBI Committees

1. Technical Advisory Committee
2. Committee for review of structure of market infrastructure institutions
3. Members of the Advisory Committee for the SEBI Investor Protection and Education Fund
4. Takeover Regulations Advisory Committee
5. Primary Market Advisory Committee (PMAC)
6. Secondary Market Advisory Committee (SMAC)
7. Mutual Fund Advisory Committee
8. Corporate Bonds & Securitization Advisory Committee

SEBI Role

Securities Exchange Board of India (SEBI) was set up in 1988 to regulate the functions of securities market. SEBI promotes orderly and healthy development in the stock market but initially SEBI was not able to exercise complete control over the stock market transactions.

It was left as a watch dog to observe the activities but was found ineffective in regulating and controlling them. As a result in May 1992, SEBI was granted legal status. SEBI is a body corporate having a separate legal existence and perpetual succession.

Reasons for Establishment of SEBI:

With the growth in the dealings of stock markets, lot of malpractices also started in stock markets such as price rigging, „unofficial premium on new issue, and delay in delivery of shares, violation of rules and regulations of stock exchange and listing requirements. Due to these malpractices the customers started losing confidence and faith in the stock exchange. So government of India decided to set up an agency or regulatory body known as Securities Exchange Board of India (SEBI).

Purpose and Role of SEBI:

SEBI was set up with the main purpose of keeping a check on malpractices and protect the interest of investors. It was set up to meet the needs of three groups.

1. Issuers:

For issuers it provides a market place in which they can raise finance fairly and easily.

2. Investors:

For investors it provides protection and supply of accurate and correct information.

3. Intermediaries:

For intermediaries it provides a competitive professional market.

Objectives of SEBI:

The overall objectives of SEBI are to protect the interest of investors and to promote the development of stock exchange and to regulate the activities of stock market. The objectives ofSEBI are:

1. To regulate the activities of stock exchange.

2. To protect the rights of investors and ensuring safety to their investment.

3. To prevent fraudulent and malpractices by having balance between self regulation of businessand its statutory regulations.

4. To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc.

Functions of SEBI:

The SEBI performs functions to meet its objectives. To meet three objectives SEBI has three important functions. These are:

i. Protective functions

ii. Developmental functions

iii. Regulatory functions.

1. Protective Functions:

These functions are performed by SEBI to protect the interest of investor and provide safety of investment.

As protective functions SEBI performs following functions:

(i) It Checks Price Rigging:

Price rigging refers to manipulating the prices of securities with the main objective of inflating or depressing the market price of securities. SEBI prohibits such practice because this can defraud and cheat the investors.

(ii) It Prohibits Insider trading:

Insider is any person connected with the company such as directors, promoters etc. These insiders have sensitive information which affects the prices of the securities. This information is not available to people at large but the insiders get this privileged information by working inside the company and if they use this information to make profit, then it is known as insider trading, e.g., the directors of a company may know that company will issue Bonus shares to its shareholders at the end of year and they purchase shares from market to make profit with bonus issue. This is known as insider trading. SEBI keeps a strict check when insiders are buying securities of the company and takes strict action on insider trading.

(iii) SEBI prohibits fraudulent and Unfair Trade Practices:

SEBI does not allow the companies to make misleading statements which are likely to induce the sale or purchase of securities by any other person.

(iv) SEBI undertakes steps to educate investors so that they are able to evaluate the securities of various companies and select the most profitable securities.

(v) SEBI promotes fair practices and code of conduct in security market by taking following steps:

(a) SEBI has issued guidelines to protect the interest of debenture-holders wherein companies cannot change terms in midterm.

(b) SEBI is empowered to investigate cases of insider trading and has provisions for stiff fine and imprisonment.

(c) SEBI has stopped the practice of making preferential allotment of shares unrelated to market prices.

2. Developmental Functions:

These functions are performed by the SEBI to promote and develop activities in stock exchange and increase the business in stock exchange. Under developmental categories following functions are performed by SEBI:

(i) SEBI promotes training of intermediaries of the securities market.

(ii) SEBI tries to promote activities of stock exchange by adopting flexible and adoptable approach in following way:

(a) SEBI has permitted internet trading through registered stock brokers.

(b) SEBI has made underwriting optional to reduce the cost of issue.

(c) Even initial public offer of primary market is permitted through stock exchange.

3. Regulatory Functions:

These functions are performed by SEBI to regulate the business in stock exchange. To regulate the activities of stock exchange following functions are performed:

(i) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc.

(ii) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

(iii) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner.

(iv) SEBI registers and regulates the working of mutual funds etc.

(v) SEBI regulates takeover of the companies.

(vi) SEBI conducts inquiries and audit of stock exchanges.

SEBI Guidance or Guidelines

The Securities & Exchange Board of India (Sebi) has issued final guidelines for infrastructure investment trusts (Invits) and real estate investment trusts (REITs), instruments expected to help these sectors raise resources to meet a funds crunch. They could generate investment of as much as $20 billion, according to some experts.

Final guidelines were issued after a meeting of the capital market regulator's board in New Delhi on Sunday that also eased registration requirements for stock brokers and clearing members. Finance minister Arun Jaitley also addressed the board on Sunday.

Jaitley had, in his budget speech announced pass-through status for the purpose of taxation to these two instruments to make them attractive to investors. Trusts are like mutual funds that raise resources from many investors to be directly invested in realty or infrastructure projects.

The pass-through status means that the return from investments through these instruments will be taxed only in the hands of investors and the trusts will not have to pay tax on income. Once the relevant changes in other regulations are made, overseas investors will be able to bring funds into India through these vehicles, reducing the need for bank funds for these sectors.

Sebi has said Reits and Invits should have a starting asset value of at least Rs 500 crore and the initial offer has to be Rs 250 crore or more. Importantly, REITs will be allowed to invest only in commercial property. They have to be listed on a recognised stock exchange and would have to meet stringent disclosure norms.

Trading lot will be Rs 1 lakh with minimum subscription size ofRs 2 lakh. For Invits, this will be Rs 5 lakh andRs 10 lakh, respectively. REITs will invest in commercial real estate through special purpose vehicles (SPVs) in which they must hold a controlling stake of more than 50 per cent.

The SPV in turn must hold at least 80 per cent of its assets directly in properties and won't be allowed to invest in other SPVs. "This is a welcome move, especially coming within a month of the budget," said Neeraj Bansal, partner and head of real estate and construction, KPMG. "Expediting Reit and Invit norm notification will facilitate infusion of $15-20 billion in the sector, and an alternative to bank finances."

Invits will allow infrastructure developers to monetise specific assets, helping them use proceeds for completing projects of theirs stalled for want of funds. "We expect this to be a positive move for capital markets. It could free up some liquidity for real estate and infrastructure players," said Bhairav Dalal, associate director, PwC.

Sebi has also simplified registration for stock brokers and clearing members, who can now seek a unified registration for doing business on all stock exchanges and depositories in the country.

NSE

The **National Stock Exchange of India Ltd.** (**NSE**) (Hindi:राष्ट्रीय शेयर बाजार *Rashtriya Śhare Bāzaār*) is an Indian stock exchange located at Mumbai, Maharashtra, India.

National Stock

Exchange (NSE) was established in 1992 as a demutualised electronic exchange. NSE provides a modern, fully automated screen-based trading system, with over two lakh trading terminals, through which investors in every nook and corner of India can trade.

NSE has a market capitalization of more than US$1.4 trillion making it one of the world‟s top twenty stock exchanges by market capitalization.[1] Though a number of other exchanges exist, NSE and the Bombay Stock Exchange are the two most significant stock exchanges in India, and between them are responsible for the vast majority of share transactions. NSE's flagship index, the **CNX Nifty**, is used extensively by investors in India and around the world to take exposure to the Indian equities market.

NSE was started by a clutch of leading Indian financial institutions at the behest of the Government of India to bring transparency to the Indian market, and has a diversified shareholding comprising domestic and global investors. The domestic investors includes Life Insurance Corporation of India, GIC, State Bank of India and Infrastructure Development Finance Company (IDFC) Ltd, while the foreign investors include MS Strategic (Mauritius) Limited, Citigroup Strategic Holdings Mauritius Limited, Tiger Global Five Holdings and Norwest Venture Partners X FII-Mauritius. It offers trading, clearing and settlement services in equity, debt and equity derivatives. It is India's largest exchange, globally in cash market trades, in currency trading and index options. As on June 2013, NSE has 1673 VSAT terminals and 2720 leaselines, spread over more than 2000 cities across India.

The exchange was incorporated in 1992 as a tax-paying company and was recognized as a stock exchange in 1993 under the Securities Contracts (Regulation) Act, 1956, when Mr. P. V. Narasimha Rao was the Prime Minister of India and Dr. Manmohan Singh was the Finance Minister. NSE commenced operations in the Wholesale Debt Market (WDM) segment in June 1994. The Capital market (Equities) segment of the NSE commenced operations in November 1994, while operations in the Derivatives segment commenced in June 2000.

OTCEI

Securities markets in developed countries are multi-tiered with an element of in-built competition amongst various layers. This prevents monopolisation of securities exchange and makes the markets more efficient. In India, however, the situation has been altogether different because of the virtual monopoly enjoyed by stock exchanges till recently.

The multi-tier securities exchange model was adopted in our country in October 1990 with the establishment of the Over the Counter Exchange of India (OTCEI). The object of the OTCEI "is to provide an alternate market for the securities of smaller companies, public-sector companies, closely-held companies desirous of listing, etc.

It has been promoted jointly by UTI, ICICI, IDBI, SBI Capital Markets Ltd., IFCI, GIC and Canbank Financial Services Ltd. The Government has conferred it the status of a „recognised stock exchange‟ under Sec. 4 of the Securities Contracts Regulation Act. Consequently, companies listed with OTCEI will practically be at par with companies listed on any stock exchange in the country.

The OTCEI is „floor-less exchange‟ where all the activities are computerised be it trading, billing, payments, etc. OTC designated dealers operate through their computer terminals which are hooked to a central computer. All quotes and transactions are recorded and processed here.

The dealers are spread over the country and have access to the central computer. Besides, PTI OTC scan is available to each dealer which displays the best bids and offers of the market makers in respect of each scrip. A transaction can be effected by entering the bid or offer in a dealer‟s computer counter. The exact transaction price alongwith other details is also displayed in the counter computer.

The trading documents of OTCEI include: (a) Counter Receipt (CR) which is handed over to the buyer when a deal is made. It is a tradeable document and hence must be preserved carefully. It is akin to a share certificate so far as its contents are concerned; (b) Sale Confirmation Slip (SCS) which is passed on to the seller when a deal is made. The seller also must preserve it carefully since he gets the payment against this slip later on.

Trading at OTCEI will be permitted only in respect of the securities of the listed companies. Listing may be obtained by (i) Companies with issued equity capital between Rs. 30 lacs to 25 crores; (ii)

Closely held companies interested in listing; (iii) Venture capital companies; (iv) Companies which are not listed on any other recognised stock exchange provided:

(a) they offer to the public at least 40% of the issued equity or Rs. 20 lacs, whichever is higher, where the issued equity ranges between Rs. 30 lacs to less than Rs. 300 lacs (i.e. 3 crores),

(b) they offer to the public at least 60% of the issued equity v. .ore issued equity is between 3 crores to 25 crores of rupees,

(c) they offer at least 25% of the issued equity to the public in case of a venture capital company,

(d) where the issued equity ranges between 3 crores to 25 crores of rupees, the norms for listing on a recognised stock exchange must be satisfied,

(e) the company is not carrying on the business of investment, leasing, finance, hire-purchase or amusement parks.

OTCEI promoters have been designated as „sponsor members‟ and they alone are entitled to sponsor a company for listing here. Before recommending a company for enlistment, such members have to carry out the appraisal of the project to ensure its technological and financial viability.

They also ensure that all government rules and regulations have been complied with. They are required to clarify the investment worthiness of the company and its project.

Finally, they would value the shares of the company, comply with SEBI guidelines for the issue of securities and manage the public issue. OTCEI requires such sponsor members to act as „market makers‟ in that scrip for at least 3 years and also to appoint an additional market maker for that scrip for a period of at least one year.

SEBI relaxed norms for listing on the OTCEI during March 1995. The minimum post- issue capital to be offered to the public to enable listing was lowered from 40 per cent to 25 per cent. SEBI also permitted finance and leasing companies to get listed on the OTCEI.

In April 1995, OTCEI modified its guidelines to allow listing of finance companies-albeit with more stringency. The minimum issued capital was increased from Rs. 30 lakh to Rs. 1 crore for finance companies.

Further, a three-year track record of profitability was made compulsory before listing takes place. The new guidelines also state that the OTCEI- sponsor of these companies should hold at least 10 per cent of the public offer as market making inventory as against 5 per cent for other companies. However, till December 1996, no companies engaged in finance or leasing services was listed on the OTCEI.

To facilitate offers for sale of bought-out deals, OTCEI changed its guidelines in January 1996. The revised guideline did away with the requirement of making an offer for sale of the entire bought-out deal to the public, except the market making inventory. The offered can now offer a minimum of 25 per cent of the bought-out deal to the public.

At the same time, the ratio of involvement of OTCEI members to non-OTCEI members has been brought down from 60:40 to 10:90. These guidelines came into effect from 22 January 1996 and were made applicable to all the bought-out deals registered with SEBI and the offer documents for offers for sale which were awaiting SEBI clearance.

Later in August 1996, SEBI exempted offers for sale of bought-out deals registered with OTCEI on or before 16 April 1996 from the new guidelines governing entry norms for public issues.

Briefly, the new guidelines issued by SEBI stated that any company wanting to make a public issue should have a track record of dividend payment for at least three in the immediately preceding five years before the making public issue.

If companies do not satisfy this requirement, then they must at least get their project appraised by a financial institution or a nationalised bank which would participate in the public issue to an extent of at least 10 per cent of the total project outlay. The relaxation would benefit the 50-odd bought out deals registered with the OTCEI.

With a view to review the working of the OTCEI and to make recommendations for its further improvement, SEBI appointed an eight-member committee under the chairmanship of Dr. S.A. Dave on 17 April 1996. On the recommendations of the Committee, SEBI has made the eligibility criteria for companies desirous of making a public issue very stringent.

The companies unable to make a public issue as a consequence of these guidelines be allowed to seek listing on the OTCEI, albeit with some checks. Currently, only those companies which have a track record of dividend payment of three years out of the immediately preceding five years can make a public issue.

If the company does not have such a teach record, then the project for which the company is entering the capital market needs to be appraised by a financial institution or a nationalised bank. Further, there should be a minimum participation of 10 per cent of the project outlay by the appraiser, in the form of equity or long-term debt.

The committee has recommended that companies which do not satisfy these criteria should be allowed to get listed on the OTCEI provided they appoint a sponsor and two market makers to the issue. The committee has also recommended that companies which do not meet the minimum shareholding norm of having at least 5 shareholders for every Rs. 1 lakh of issued capital can get listed on the OTCEI but should appoint sponsors and market makers.

Companies which get delisted from regional stock exchanges should be allowed to list on the OTCEI since shareholders of delisted companies do not have a platform to off load their holdings. These companies should, however, be traded under a separate category on the OTCEI.

Further, all the companies discussed above should be allowed listing on the OTCEI with a minimum lock-in period of three years. After three years, these companies may either choose to remain on the OTCEI or seek listing on other stock exchanges.

The committee has recommended that the ceiling of Rs.25 crore on the equity capital of a company seeking listing on the OTCEI be removed. It has also suggested that the current rolling settlement system of three days (known as T ± 3) should be increased to five days.

The committee has also stressed upon the need ofincreased involvement of the promoters of OTCEI. The main promoters of the exchange are Unit Trust of India, Industrial Development Bank of India, Industrial Credit & Investment Corporation of India, Industrial Finance Corporation of India, Life Insurance Corporation and General Insurance Corporation.

The report points out that the some of these entities have promoted the National Stock Exchange which has grown at a much faster pace than the OTCEI. One recommendation for increased promoter participation is that the promoters should have an OTCEI-dedicated fund of a corpus of around Rs.100 crore which would invest in fundamentally sound companies of the OTCEI.

OTCEI is intended to provide easy marketability and better liquidity of securities to an investor. Besides, it also offers facilities for transfer of shares listed here. The investor can submit the transfer documents at any of the OTCEI counters in the country. There is total transparency and fairness so far as the deals are concerned. It takes lesser time to finalise a deal too. The companies listed with OTCEI are also benefitted to a large extent.

Raising of funds becomes cheaper since they are priced fairly and the investor base is large. The company can obtain enlistment even with 40% public issue (which is 60% in case of listing on a recognised stock exchange).

The company has also the option of allotting all the shares to a sponsor. In this case, the company has only to negotiate the issue price with the sponsor who finally markets the issue.

Despite being in existence for a number of years, the exchange does not have a major presence amongst stock exchanges of the country.

Stock Market Operations

Stock markets play a vital economic role, helping large companies raise finance and giving access to an alternative stream of capital alongside loan finance and company revenue. The markets are heavily traded worldwide, with billions in transactions processed every single day across the major global exchanges. But how exactly do stock markets operate on a technical level, and what is it about the markets specifically that attracts the brightest and best from all walks of life to make their fortune?

Investors confused by stock market whenever they lose money while investing in it. Its better to understanding what is stock exchange and how it works will help you to make better investment decisions. Luckily market is not very much confusing like it seems to be. Stock market is actually a place where investors can buy and sell shares of a particular company. Main aim of all investors is to get the maximum return on their investment the purpose is to buy the stock before the price goes up and then to sell it before it goes back down.

Stock markets play a vital economic role, helping large companies raise finance and giving access to an alternative stream of capital alongside loan finance and company revenue. The markets are heavily traded worldwide, with billions in transactions processed every single day across the major global exchanges. But how exactly do stock markets operate on a technical level, and what is it about the markets specifically that attracts the brightest and best from all walks of life to make their fortune?

Stock markets provide the opportunity for traders to make (and lose) fortunes speculating on the price of shares and other securities. Savvy traders can interpret market behaviour and try to anticipate movements in price to ride both positive and negative trends across particular companies and industries, allowing the free-flowing trade of shares in both directions without the need for physical interaction or negotiation of contract terms.

Shares are largely standardised instruments which enable the free transaction from one trader to the next without the need for registration or any further administrative burden. They are the lifeblood of many growing plc's, and provide strong indicators of economic outlook and prosperity.
The markets operate by creating a platform for buyers and sellers of securities to meet and exchange their share assets, which in and of themselves generate an often tax-free ongoing yield in the form of dividend payouts.

Markets trade in real-time throughout the business day, and constantly match orders on both sides of the table to make fluid trading possible. Traders can either buy shares in companies they forecast to perform well, or often sell shares they don't yet own in the anticipation of buying them back at a lower price point (known as short selling, or 'going short').

With the help of a broker, who executes the trades automatically on demand, the trader is able to engage in active speculation throughout the trading day, and indeed across a wider timeframe of months and even years depending on the exact nature of each trade. Brokers will often also offer financing for certain trades, allowing traders to 'leverage' the gains (and losses) beyond the limits of their own resources.

For those trades that are unmet by market demand, i.e. those for which there is no corresponding buyer or seller, a designated 'market maker' steps in to fill the order, ensuring that shares can be traded freely even where the markets take a largely bearish approach to a particular stock or index.

The major global stock markets operate smoothly throughout the day to allow live trading without the need for exchanging physical share certificates or meeting face to face. In this sense, the markets provide an ideal opportunity for determined individuals and trading organizations alike to invest, with the potential for significant gains for the savvy trader.

Security Market Indicators

An index that uses the performance of a sampling of securities to represent the performance of a market segment or overall market. The security market indicator series assumes that the performance of a statistically valid set of securities will reflect the performance of a larger set of securities. Its purpose is to give investors a general idea of the way a larger segment of the market performs in aggregate.

Security market indicator series are often used in benchmarking. For example, an analyst may compare a security considered high growth to a sampling of similarly labeled securities to determine if the security performs better or worse than its peers.

SMIS may also be used in the creation of index funds, which are designed to follow the performance of a much larger market. Because the SMIS is an approximation for the performance of a larger segment, an index that follows the S&P 500, for example, will not have the same return as the overall S&P 500 index.

While SMIS can be used to determine the performance of a larger market segment, it can also be used to compare the performance of a money manager to the overall market performance. Because money managers charge fees, it is helpful for investors to determine whether those fees are warranted by performance. Ideally the money manager will outperform the market once fees are taken into account.

Recent Trends

Screen Based Trading: Prior to setting up of NSE, the trading on stock exchanges in India was based on an open outcry system. The system was inefficient and time consuming because of its inability to provide immediate matching or recording of trades. In order to provide efficiency, liquidity and transparency, NSE introduced a nation-wide on-line fully automated screen based trading system (SBTS) on the CM segment on November 3, 1994.

PART B

1. Define new issue market.
2. Write down the objectives of securities contract and regulation act, 1956.
3. Stretch the structure of Indian capital market.
4. Write down the objectives of SEBI.
5. What is OTCEI?
6. What is equity?
7. Give the meaning of sweat equity?
8. What do you mean by demutualization?
9. What is stock exchange?
10. Differentiate the stock exchange and recognized stock exchange.

PART – C

1. Discuss the methods of floating shares in new issue market?
2. Explain the Mechanics of Security Trading in Stock Exchange?
3. Elaborate the different types of stock exchange functioning in India.
4. Discuss the features and advantages of NSE.
5. What is the role of SEBI in regulating the new issue market / primary market?
6. Write short note on i. BSE, ii. NSE, iii. OTCEI.
7. Discuss the various methods of floating new shares.

8 Trace the growth and development of the stock market in India.

9. Explain the relationship between New Issue Market and Stock Exchange?
10. Name some of well known national stock indices. How is the BSE Sensitivity Index constructed?

PART D

CASE STUDY

1. Consider two situations: a young man X in early twenties and another young man Y in the late thirties X and Y earns same amount of money. Mr. Y has a family, a house, a car and all the encumbrances related with the marital status. Both of them like to invest in securities.

   a) What would be their investment constraints?

   b) What would be their investment objectives?

SUBJECT: :SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT
SEMESTER : II
LASS : I M.COM
SUBJECT CODE: 19CMP205A

UNIT II

The basic trade-off in the investment process is
The ____ the variance of returns, everything else remaining constant, the ____ the dispersion of expectations
The nominal risk free rate of interest is a function of
The real risk-free rate is affected by a two factors
Christopher invests Rs.400 today at a 4% rate of return which is compounded annually. What is the future va
Roy is going to receive a payment of Rs.5,000 one year from today. He earns an average of 6% on his investm
If the present value of an investment's benefits equals the present value of the investment's costs, then the inv
Which one following will lower required rates of return?
business has strong sales and profits, but its stock price falls anyway because stock prices in general are decl
Which of the following factors will increase the risk level of an investment?
I. a firm's decision to use a high percentage of debt financing
II. an economic situation in which consumer prices are rising at a rapid rate
III. the ability to trade the investment in a broad market rather than in a thin market
IV. unstable currency values
Each of the following investments produces the same rate of return. Which one has the greatest amount of ris
Since each share of common stock represents ownership in a company, shares of common stock are often ref
When a corporation declares a stock split, it usually does so because
Under normal economic conditions, the major source of risk faced by investors who purchase investment gra
When interest rates are falling, most of the return on bonds will come from
The single most important factor that influences the behavior of market interest rates is
Which of the following are needed to determine the appropriate value of a bond?
I. required rate of return
II. time to maturity
III. frequency of interest payments
IV. coupon rate

The actual return on a bond is dependent upon which of the following?
I. the coupon rate
II. the reinvested interest rate
III. any changes in par value
IV. any changes in market price

In the one-period valuation model, a stock's value will be higher
In the one-period valuation model, a stock's value falls if the ________ rises.
In the generalized dividend valuation model, a stock's value depends only on

Which of the following is not an element of the Gordon growth model of stock valuation?
According to the Gordon growth model, what is an investor's valuation of a stock whose current dividend is r

Which of the following are associated with bear markets?
I. investor pessimism
II. rising profits
III. economic slowdown
IV. rising security prices

Which of the following can be encountered when investing in foreign markets?
I. foreign taxation of dividends
II. different accounting standards for financial disclosure
III. restrictions on types of investments
IV. illiquid markets

Which of the following are characteristics of short selling?
I. borrowing shares of stock from a brokerage firm or other investors
II. selling shares of stock you do not own
III. betting the stock price will increase
IV. limiting losses per share to the price at which the stock was sold

Which of the following is true regarding a firm's securities?

Which of the following is not a characteristic of a money market instrument?

Which of the following is not a component of the money market?

In the event of the firm's bankruptcy

Which of the following are characteristics of preferred stock?
I) It pays its holder a fixed amount of income each year at the discretion of its managers.
II) It gives its holder voting power in the firm.
III) Its dividends are usually cumulative.
IV) Failure to pay dividends may result in bankruptcy proceedings.

Stocks related to computers and the Internet are classified as

ADRs
I. are shares of U.S. companies traded on foreign exchanges.
II. are shares of foreign companies traded on U.S. exchanges.
III. pay dividends in U.S. dollars if they pay dividends.
IV. are subject to exchange rate risk.

In a severe recession, the major source of risk faced by investors who purchase corporate bonds is

An investment produced annual rates of return of 5%, 12%, 8% and 11% respectively over the past four year

Which of the following should be considered when deciding among alternative investment?
I. time value of money
II. risks associated with each investment
III. risk free rate of return
IV. personal risk tolerance level

If a significant change is noted in the yield of a T-bill, the change is most likely attributable to
In the phrase "nominal risk free rate," nominal means
The rate of exchange between future consumption and current consumption is
The value of a stock is a function of
Which one of the following statements concerning interest rates is correct?
When calculating the present value of either a future single sum or a future annuity, the applicable interest ra
The present value of Rs.10,000 discounted at 5% per year and received at the end of 5 years is
Which type of risk is based on the financial integrity of a bond issuer?

As gasoline prices fell in 2015, sales of hybrid and electric vehicles dropped sharply. This is an example of
Which of the following choices is in the correct order from less risk to more risk?
Elias is a risk-averse investor. David is a less risk-averse investor than Elias. Therefore
The stock of Plomb Co. falls sharply on news that its CEO has drowned in a boating accident while on vacati
Over the long term, which one of the following has historically had the lowest risk and lowest average annua
The primary risk associated with a short-term investment is
A petroleum refinery in the Gulf region is forced to shut down for several months because of hurricane dama
In some markets it may take many months to sell a residential property. This is an example of
Historically, what is the correct ranking of the following securities from lowest rate of return to the highest?
Inflation tends to have a particularly negative impact on the price of
Asset allocation should focus on
Liquidity risk is defined as the risk of
The most predictable component of stock returns is
A holding period return is calculated by adding the current income to the capital gains and dividing this sum
Rational investor's are motivated to purchase an asset because of its
A capital loss is computed by

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option A

between the anticipated rate of return for a given investment instrument and its degree of risk.

Larger, greater, lower

The real risk free rate and the rate of inflation

Time preference for income consumption and the set of investment opportunities available in the economy

342

4,717

return equal to the discount rate.

higher rates of inflation

business risk.

I and II only

investment A with a standard deviation of 4%

illiquid investments

the firm's retained earnings are excessive.

purchasing power risk.

inflation gains.

inflation.

II and III only

I, II and III only

the higher its expected future price is

dividend

its future dividend payments

The required return on investments in equity
5.24

I and III only
II and III only
I and II only
Common dividends are paid before preferred dividends
Liquidity
Repurchase agreements
the most shareholders can lose is their original investment in the firm's stock.
I, III, and IV

blue-chip stocks

I and II only
purchasing power risk.

3.20%
I and II only

A downturn in the economy
Historical
The nominal risk-free rate
future returns
A decrease in the money supply will cause interest rates to decline
yield to maturity
Rs.10,000/1.25.
liquidity risk

liquidity risk.
corporate bonds, certificates of deposit, mutual funds that invest in stock, common stock
for the same risk, David requires a higher rate of return than Elias.
liquidity risk
common stock
purchasing power risk.
market risk
business risk
Short-term government bills, long-term government bonds, stocks.
real estate
the investor's financial and family situation.
having to trade a security in a broad market
capital gains
average investment value
expected returns
subtracting the original cost of an investment from the proceeds received from the sale of that investment mi

option B

between understanding the nature of a particular investment and having the opportunity to purchase it.

Larger, smaller, higher

The T-bill rate plus the inflation rate

Time preference for income consumption and the relative ease or tightness in capital markets.

416

4,821

negative rate of return.

higher risk premiums

financial risk.

I, II and IV only

investment B with a standard deviation of 12%

equity securities

there are too many shares of stock outstanding

interest rate risk.

interest income.

business profits.

III and IV only

II, III and IV only

the lower its dividend is.

current price

its future dividend payments and the required return on equity

The expected constant growth rate of dividends
10

II and III only

II and IV only

III and IV only

Preferred stockholders have voting rights.

Long maturity

Real estate investment trusts

the most shareholders can lose is their original investment in the firm's stock and the claims of preferred shar

I, II, and III

income stocks.

II and III only

interest rate risk.

2.70%

III and IV only

A static economy

Market.

The pure rate of interest

historic dividend growth rate

A government budget surplus will cause interest rates to decline

compound interest rate

Rs.10,000(1.05)5

call risk

event risk
certificates of deposit, corporate bonds, common stock, mutual funds that invest in stock
for the same return, Elias tolerates higher risk than David.
event risk.
long-term government bonds
default risk
speculation
credit risk
Long-term government bonds, short-term government bills, stocks
bonds
selection of individual securities within an asset class
not being able to sell an investment conveniently and at a reasonable price
capital losses
beginning investment value
past returns.
subtracting the original cost of an investment from the proceeds received from the sale of that investment plu

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DEPARTMENT OF COMMERCE

option C
between high returns available on single instruments and the diversification of instruments into a portfolio
Larger, greater, higher
The real risk free rate and the investment's variance.
The expected rate of inflation and the set of investment opportunities available in the economy.
464
5,000
0% rate of return.
lower rates of inflation
market risk.
II and IV only
investment C with a standard deviation of 8%
fixed-income securities
investors sometimes require nontaxable returns
liquidity risk
capital gains.
the supply of new bonds.
II, III and IV only
I, III and IV only
Lower is the expected future value
required return on equity
its future price and the required return on investments on equity

The stock's most recent dividend paid

100

I, II and III only

I, II and IV only

I, II and IV only

Preferred dividends are usually cumulative

Liquidity premium

Money market mutual funds

common shareholders are the first in line to receive their claims on the firm's assets.

I and III

cyclical stocks.

II. III and IV only

liquidity risk

3.60%

I, II and IV only

A change in the expected rate of inflation

Computed

The consumption/investment paradigm

most recent earnings per share

Economic expansions will cause interest rates to decline

internal rate of return

Rs.10,000/(1.05)5.

default risk

business risk
certificates of deposit, mutual funds that invest in stock, common stock, corporate bonds
for the same risk, Elias requires a lower rate of return than David
accidental risk
real-estate
interest rate risk
event risk.
market risk
Stocks, short-term government bills,long-term government bonds
gold
maximization of current income
having inflation erode the purchasing power of your investment
inflation adjusted return
total income received
emotional benefits
subtracting the proceeds received from the sale of an investment from the original cost of the investment

option D

between the desired level of investment and possessing the resources necessary to carry it out
Smaller, greater, lower
The prime rate and the rate of inflation
The relative ease or tightness in capital markets and the expected rate of inflation.

468
5,300
return greater than the discount rate.
lower dividend yields
liquidity risk.
I, III and IV only
investment D with a standard deviation of 19%

unit-cost securities
it wants to make its stock more affordable to average investors.
default risk
risk premiums.
the stock market.

I, II, III and IV

I, II and IV only

the higher the required return on investments in equity is.
expected future price
its future dividend payments and its future price

The stock's expected future price
110

II, III and IV only
I, II, III and IV
I, II, III only
Common dividends usually can be paid if preferred dividends have been skipped
Long maturity and liquidity premium
Commercial paper
bondholders have claim to what is left from the liquidation of the firm's assets after paying the shareholders.
I, II, and IV

tech stocks.

I, II, III and IV

default risk

3.80%
I, II, III and IV

A change in the real rate of interest
Average
The coefficient of investment exchange
past returns
Rising interest rates in foreign countries will cause interest rates to decline
discount rate
Rs.10,000 (1.05)1/5
interest rate risk

purchasing power risk
certificates of deposit, corporate bonds, mutual funds that invest in stock, common stock
for the same return, David tolerates higher risk than Elias
flotation risk
corporate bonds
economic risk
business risk
liquidity risk
Historical returns do not exhibit a consistent pattern
crude oil
maximization of short-term profits
having declining price levels affect the reinvestment rate of your current income stream
dividend income
selling price of the investment
duration
subtracting the original cost of an investment from the proceeds received from the sale of that investment

Answer

between the anticipated rate of return for a given investment instrument and its degree of risk.
Larger, greater, higher
The real risk free rate and the rate of inflation
Time preference for income consumption and the set of investment opportunities available in the economy

468
4,717
return equal to the discount rate.
lower rates of inflation
market risk.
I, II and IV only
investment D with a standard deviation of 19%

equity securities
it wants to make its stock more affordable to average investors.
interest rate risk.
capital gains.
inflation.

I, II, III and IV

I, II and IV only

the higher its expected future price is
required return on equity
its future dividend payments and the required return on equity

The stock's expected future price
110

I and III only
I, II, III and IV
I and II only
Preferred dividends are usually cumulative
Long maturity and liquidity premium
Real estate investment trusts
the most shareholders can lose is their original investment in the firm's stock and the claims of preferred shar
I and III

tech stocks.

II. III and IV only
default risk

3.20%
I, II and IV only

A change in the expected rate of inflation
Market.
The pure rate of interest
future returns
A government budget surplus will cause interest rates to decline
discount rate
Rs.10,000/(1.05)5.
default risk

business risk
certificates of deposit, corporate bonds, mutual funds that invest in stock, common stock
for the same return, David tolerates higher risk than Elias
event risk.
long-term government bonds
purchasing power risk.
event risk.
liquidity risk
Short-term government bills, long-term government bonds, stocks.
bonds
the investor's financial and family situation.
not being able to sell an investment conveniently and at a reasonable price
dividend income
beginning investment value
expected returns
subtracting the original cost of an investment from the proceeds received from the sale of that investment

eholders are honored before those of the common shareholders.

Fundamental Analysis: Economic analysis – Economic Forecasting - Industrial Analysis - Industry life cycle – Analytical tools – SWOT – Porter's Five Force Model – Company Analysis.

Fundamental Analysis

"The crux of Fundamental Analysis lies in its attempt to determine the economic value of a security (a generic term for stocks and shares)"

Fundamental Analysis covers the area of research that studies economics, industry and company information for the purpose of making an informed judgement on a stock's value and its growth potential. The crux of Fundamental Analysis lies in its attempt to determine the economic value of a security (a generic term for stocks and shares).

The Focus of Fundamental Analysis

Economic Analysis covers the study of the country's economic indicators such as new orders, money supply, stock price indices, stocks of unfinished goods, new business formations, consumer price index and unit labour costs. Important economic considerations would include interest rates and inflation and its impact on the stock market, the level of government debt, the level of corporate debts, monetary and fiscal policy.

Industry Analysis covers the structure and state of competition in the industry, nature and prospects of demand for products and services of the industry, cost conditions and profitability, technology and research requirements, the immediate and long term outlook for sales and profit.

Types of Fundamental Analysis

Although it is generally accepted that the aim Fundamental Analysis is to determine the economic value of a security, it is the practice of Fundamental Analysis that gives rise to two sub types namely Macro-Fundamental Analysis and Micro-Fundamental Analysis.

Macro-Fundamental Analysis: The Top Down Approach

Macro-Fundamental Analysis focuses on broad economic factors that affect the stock market as a whole or industry groups of securities. This approach is known as the Top Down approach of Macro-Fundamental Analysis. The practice of Macro-Fundamental Analysis starts at the overall performance of the economy, its impact on industry groups. It is noteworthy that Macro-Fundamental Analysis has a more formal and structured approach and as such this approach is much favoured by research departments of investment management companies and brokerage houses.

Micro- Fundamental Analysis: The Bottom Up Approach

Micro-Fundamental Analysis starts by considering the current price of a stock and compares it to measures of value. Hence the current price of a stock is compared to its dividend, its earnings, and to its assets resulting in valuation ratios such as its dividend yield, price to earnings ratio and its price to asset ratio. The resultant valuations enable comparisons to be made amongst stocks in the same industry groups and undervalued and overvalued stocks are identified by comparisons to the industrial norm. after this phase of analysis, the Micro-Fundamental Analysis attempts to predict industry and economic developments that may positively or negatively impact the stocks current price.

It is pertinent to note that investment icons such as Benjamin Graham, his prodigies Warren Buffet, Charles Munger and William Ruane tend toward Micro-Fundamental Analysis.

Economic Analysis

Economic analysis is a process whereby the strengths and weaknesses of an economy are analyzed. Economic analysis is important in order to understand the exact condition of an economy.

Macroeconomics and Economic Analysis

Macroeconomic issues are important aspects of the economic analysis process. However, economic analysis can also be done at a microeconomic level.

Macroeconomic analysis gives insight into the fundamentals of an economy - and the strengths and weaknesses of economies.

Macroeconomic analysis takes into account growth achieved by par economy, or rather a sector of that economy. It tries to reveal reasons behind a particular economic phenomenon like growth or reversal of the economy.

Inflation and Economic Analysis

Many countries in the world are plagued by rising inflation. Economic analysis tells us why inflation has taken place. It also suggests ways in which the rate of inflation could be reduced, so that economic development could continue.

Economic Analysis and Government Policies

Government policies and plans that affect the economy have always been an important part of economic analysis. Since policies and plans adopted by a particular government are responsible for shaping an economy, they are always closely scrutinized by various processes of economic analysis.

Economic Ratings and Economic Analysis

Economic ratings are another important aspect of economic analysis, as it provides an accurate picture of how an economy is faring compared to others.

Economic Analysis and Comparison of Economic Policies

It is a good way to analyze an economy by comparing its policies with those of other economies. This is all more applicable in the case of economies that are of similar types, for example developing economies.

Economic Forecasting

Economic forecasting, the prediction of any of the elements of economic activity. Such forecasts may be made in great detail or may be very general. In any case, they describe the expected future behaviour of all or part of the economy and help form the basis of planning.

Formal economic forecasting is usually based on a specific theory as to how the economy works. Some theories are complicated, and their application requires an elaborate tracing of cause and effect. Others are relatively simple, ascribing most developments in the economy to one or two basic factors. Many economists, for example, believe that changes in the supply of money determine the rate of growth of general business activity. Others assign a central role to investment in new facilities—housing, industrial plants, highways, and so forth. In the United States, where consumers account for such a large share of economic activity, some economists believe that consumer decisions to invest or save provide the principal clues to the future course of the entire economy. Obviously the theory that a forecaster applies is of critical importance to the forecasting process; it dictates his line of investigation, the statistics he will regard as most important, and many of the techniques he will apply.

Although economic theory may determine the general outline of a forecast, judgment also often plays an important role. A forecaster may decide that the circumstances of the moment are unique and that a forecast produced by the usual statistical methods should be modified to take account of special current circumstances. This is particularly necessary when some event outside the usual run of economic activity inevitably has an economic effect. For example, forecasts of 1987 economic activity in the United States were more accurate when the analyst correctly foresaw that the exchange value of the dollar would fall sharply during the year, that consumer spending would slacken, and that interest rates would rise only moderately. None of these conclusions followed from purely economic analysis; they all required judgment as to future decisions. Similarly, an economist may decide to adjust an economic forecast that was made by traditional methods to take account of other unique conditions; he may, for example, decide that consumers will alter their spending patterns because of special circumstances such as rising prices of imports or fear of threatened shortages.

Although judgment may be based on experience and understanding, it may also be no more than unconscious bias. Forecasts based on judgment cannot be subjected to the kind of rigorous checks applied to forecasts developed by the use of more objective techniques. Consequently, the most accurate and useful forecasts are likely to be those founded on essentially economic considerations and standard statistical techniques. Though they can then be modified by the application of judgment, the resulting changes should be stated explicitly enough so that anyone wishing to use a forecast will know where, and how, it has been affected by the forecaster's own judgment, or bias.

Economic forecasting is probably as old as organized economic activity, but modern forecasting got its impetus from the Great Depression of the 1930s. The effort to understand and correct the worldwide economic disaster led to the development of a vastly greater supply of statistics and also of the techniques needed to analyze them. After World War II, many governments committed themselves to maintaining a high level of employment. Most governments of the industrialized Western countries were prepared to intervene more often and more directly in economic affairs than previously. Business organizations manifested more concern with anticipating the future. Many trade associations now provide forecasts of future trends for their members, and a number of highly successful consulting firms have been formed to provide additional forecasting help for governments and businesses.

Forecasting Techniques

Forecasting the GNP and its elements

Perhaps the forecasts most familiar to the public are those of gross national product and its elements. Gross national product, or GNP, is the total value of the goods and services produced in a nation. It is, therefore, a convenient and comprehensive measure for assessing changes in general economic welfare. A forecast of the GNP also provides a useful framework for more detailed forecasts of specific industries. Almost all developed nations maintain sets of national income accounts and make forecasts as well.

Forecasting for an industry or firm

General economic conditions set the tone for all parts of the economy. Good forecasting for an industry or firm begins, therefore, with a good analysis of the overall economy. Within this framework, the analyst must then take account of the particular factors that are most important to his own industry. In some cases, the sales of an industry may correlate fairly directly with one or more of the elements of the national income and product accounts—lumber sales with home construction, for example, or sales of nondurable consumer goods with consumer income and total consumer spending.

Forecasting for industries that produce basic materials usually requires a series of projections for specific markets. A steel forecast might be based on the outlook for such major steel markets as automobiles, construction, and metal containers. The basic forecast would then be adjusted for expected shifts in exports and imports of steel and for changes in inventories of steel or steel-using products.

Long-term forecasting

In recent years, increasing effort has been devoted to long-range forecasting for periods extending five, 10, or more years past the normal ―short-term‖ forecast period of one or two years. Business has come to recognize the usefulness of such forecasts in developing plans for future expansion and financing.

Long-range forecasts usually are based on the assumption that activity toward the end of the period will reflect normal ―full‖ employment. Given this assumption, the overall rate of growth depends on two principal factors: the number of people in the labour force and the rate at which productivity (output per worker) increases. The number of people of working age is known, barring some natural disaster (and excluding immigration), far into the future; they have already been born. Forecasters usually assume that productivity will continue to grow at the typical rates of recent decades. Expected technological developments, however, may alter the projected rate of change. The combination of changes in the labour force and productivity produces an estimate of the total growth rate for the economy.

Industry analysis

An industry analysis is a business function completed by business owners and other individuals to assess the current business environment. This analysis helps businesses understand various economic pieces of the marketplace and how these various pieces may be used to gain a competitive advantage. Although business owners may conduct an industry analysis according to their specific needs, a few basic standards exist for conducting this important business function.

Features

Industry analysis features include a review of the economic and political underpinnings of the business environment. Economic reviews often include an examination of the industry's business cycle. The business cycle helps individuals understand if the industry is growing, reaching a plateau or in decline. A political review helps individuals understand the amount of government regulation and taxation present in the business industry. Industries with heavy government involvement may have fewer profits for companies operating in these environments.

Facts

Business owners often conduct industry analysis before starting their business. This analysis is included in the entrepreneur's business plan that outlines specific elements of the economic marketplace. Elements may include the number of competitors, availability of substitute goods, target markets and demographic groups or various other pieces of essential business information. This information is commonly used to secure external financing from banks or lenders for starting a new business venture.

Industry Classification

On the basis of the number of labour employed. On this basis the industries are classified into three classes :

- Large scale industries: Large scale industries include cotton and jute textile industries. Number of labourers working in this industry is large.
- Medium scale industries: Medium scale industries include electric fan, sewing machine, cycle, radio, television industries etc.
- Small scale industries: Small scale industries include soap, basket, match-box, bidi industries etc.

On the basis of the nature of the product manufactured. On this basis industries are classified into three classes :

- Primary industry is one which is concerned with collecting or making available materials produced by nature. For example— food gathering, hunting, fisheries, forestry, agriculture and mining.

- Secondary industry is one which is connected with the transformation of material provided by primary industry. For example—Iron and steel industry, textile industry, cement industry, chemical, drug industry etc.
- Tertiary industries are those which render help and services to all other industries. For example—Management, Banking, Transportation, etc.

On the basis of raw material and finished products. On this basis the industries fall into three categories :

- Heavy industries
- Medium industries
- Light industries.

On the basis of ownership. On the basis of ownership, industries are divided into four categories :

- Public sector industries
- Private sector industries
- Joint sector industries
- Co-operative sector industries.

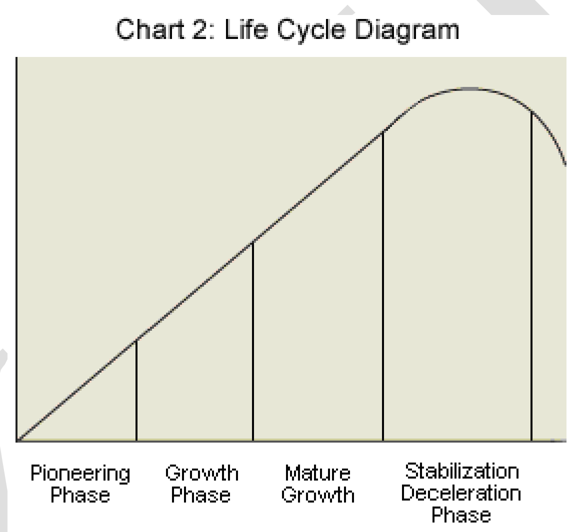
On the basis of origin of their raw material. This basis divides the industries into two main classes :

- Agro-based industries. Agro-based industries are those industries which are based on agricultural products. These industries occupy an important place in our economy, both in respect of their output and the employment opportunities. Textiles, sugar, vegetable oil, tobacco, rubber, paper and dairying are the important ones in this category.
- Mineral-based industries. The industries, which are based on mineral products are known as mineral-based industries. Unlike the traditional industries, most of the modem industries in India are mineral-based. The iron and steel and chemical industries are the important ones in this category.

Industry Life Cycle

The industry life cycle is made up of the following stages:

1. Pioneering Phase
2. Growth Phase
3. Mature Growth Phase
4. Stabilization/Maturity Phase
5. Deceleration/Decline Phase



1) Pioneering Phase

This phase is characterized by low demand for the industry's product and large upstart costs. Industries in this phase are typically start-up firms, with large upfront costs and few sales.

2) Growth Phase

After the pioneering phase, an industry can transfer into the growth phase. The growth phase is characterized by little competition and accelerated sales. Industries in this phase have typically survived the pioneering phase and are beginning to recognize sales growth.

3) Mature Growth Phase

After the growth phase, an industry will reach the mature growth phase. The mature growth phase is characterized above average growth, but no longer accelerating growth. Industries in this phase now face increasing competition and, as a result, profit margins begin to erode.

4) Stabilization/Maturity Phase

After the growth phases, an industry will enter in the stabilization/maturity phase. The stabilization/maturity phase is characterized by growth that is now average. Industries in this phase have significant competition and the return on equity is now more normalized. This is typically the longest phase an industry will go through.

5) Deceleration/Decline Phase

The deceleration follows the growth and maturity phases. The deceleration/decline phase is characterized by declining growth as demand shifts to other substitute (new) products.

PART B

1. What is fundamental analysis?

2. Write short notes on economic analysis.

3. Why do we need company analysis?

4. List out the factors affecting industry analysis.

5. What is SWOT?

6. How porters five force model help in industry analysis?

7. Define ratio.

8. What is EPS?

9. Give the meaning of industry.

10. Sketch the industry life cycle.

PART – C

1. Explain the factors affecting Fundamental Analysis?

2 Enumerate the forecasting techniques used in Economic Analysis?

3. Explain the Factors Affecting Industry Analysis?

4 Describe the various steps involved in fundamental analysis briefly?

5. Explain the factors affecting Economic Analysis withexample.

6. Elucidate the concept Industry Analysis with suitableexample.

7. Explain the factors affecting Industrial Analysis in detail?

8. What is company analysis? Explain how financial ratios can be used to determine the strengths and weaknesses of a company.

9. Elucidate the difference between Fundamental Analysis and Technical Analysis?

10. Enumerate the Characteristics and types of Industries with suitable examples?

PART D

CASE STUDY

1. The Philips lighting sales force saved 2,500 hours per month by integrating digital voice technology and cloud storage into its CRM system data entry workflow. Philips Lighting is dedicated to introducing innovative end-user-driven and energy-efficient solutions and applications for lighting, based on a thorough understanding of customer needs. Its sales team in the US is a highly mobile force of between 100 to 150 account representatives who serve at both a regional and national level and make an average of three to four customer calls each day. As required by their sales leaders, for each call a sales rep makes, they must either create or update information in Philips Lighting's customer relations management (CRM) system.

a. Examine the above problem using SWOT analysis.

SUBJECT: :SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT
SEMESTER : II
LASS : I M.COM
SUBJECT CODE: 19CMP205A

UNIT III
The three steps in determining a stock's intrinsic value are I. estimating the stock's future cash flows. II. estimating the risk associated with future cash flows. III. careful analysis of patterns in the stock's recent price history. IV. estimating an appropriate discount rate to apply to future cash flows
Which of the following businesses will be negatively impacted by a strong dollar?
Which of the following tend to signal that stock prices are likely to rise in the future? I. Employment increases after several months of recession. II. Interest rates are low compared to the recent past. III. Major market indexes have just reached record highs. IV. Housing starts increase after several months of decline.
Which of the following are characteristics of an expansionary fiscal policy? I. Increased government spending on infrastructure projects. II. Reduction in defense and education budgets. III. Reduction in employment taxes. IV. Reduction in government borrowing.
Which one of the following statements is correct?
Investors who conduct industry analyses typically favor companies with strong market positions over companies with less secure market positions because firms with strong market positions tend to I. be price leaders. II. benefit more from economies of scale. III. have better R&D programs. IV. have lower production costs.
The consumer electronics industry would be most significantly affected by
Which of the following factors are considered when analyzing an industry? I. the nature and conditions of governmental regulations II. the involvement and relations, if any, with labor unions III. the development of new technologies relevant to the industry IV. the extent of competition within the industry
Which stage of an industry's growth cycle is most influenced by economic events?

The rapid expansion phase of an industry is characterized by
Well managed companies rarely reach the decline stage because
Which of the following are considered in the ratio analysis of a firm? I. profitability II. market share III. liquidity IV. leverage
Which of the following accounting practices are potentially misleading or even fraudulent? I. writing off goodwill as an extraordinary loss II. using accrual rather than cash basis reporting III. off-balance sheet liabilities IV. recognizing revenues prematurely
Cash flow from operations includes all of the following adjustments to net income EXCEPT
Which of the following would be typical of a Statement of Cash Flows for a healthy firm in a sustainable bus
Which of the following would be found on a company's income statement? I. cost of goods sold II. interest expense III. cash flow from operations IV. earnings before taxes
Which of the following would be found on a company's balance sheet? I. Accounts receivable II. Interest expense III. Property plant and equipment IV. Total stockholders' equity
Which of the following are measures of liquidity? I. net working capital II. accounts receivable turnover III. current ratio IV. times interest earned
Financial ratios I. allow comparisons across firms without concern over firm size. II. can compare a firm's operating and financial status to industry norms. III. provide insights into a companies future. IV. look at the liquidity, activity, leverage, profitability and market measures of a firm.
To determine whether a company is using leverage effectively, an analyst should consider
The measure that indicates how efficiently assets are being used to support sales is called the
A lending institution would prefer that a firm have a _________ debt-equity ratio and a _________ times intere
Worcester Corporation has a P/E ratio of 15. Natick Corporation is in the same industry as Worcester, but has a P/E ratio of 20. Possible interpretations of this discrepancy include
If a company's ROA is high, then an investor can assume that the company

Which of the following may be signs of future problems for a company? I. Inventories growing faster than sales. II. Rapidly increasing debt to equity ratio. III. Cash flow from operations is higher than net income. IV. Current liabilities increasing faster than current assets.
The principal objective of technical analysis is
One of the most popular tools of technical analysis is
Which one of the following relative strength values would most indicate that a stock is oversold?
Which one of the following combinations best signals a strong market? I. a greater number of advancing stocks than declining stocks II. a greater number of declining stocks than advancing stocks III. a greater volume in rising stocks than in declining stocks IV. a greater volume in declining stocks than in advancing stocks
Technical analysts consider the stock market to be strong when volume ________ in a rising market and ___
Which of the following is used to identify long-term trends?
Which of the following signals that a market top or bottom is near?
According to chartists, a breakout below a support level
A comparison of a firm's current financial ratios to those of prior years allows one to
Chartists advocate that
The new highs-new lows measure typically looks at a period of
A total asset turnover of 3 means that every
The inventory turnover rate for a firm is 14.5 as compared to the relevant industry rate of 13.2. In this case, t
Substituting EBITDA for EBIT when computing the times interest earned ratio will make the company appea
Which stage of an industry's growth cycle is interesting only for potentially high dividend payouts?
Which of the following businesses will be positively impacted by a weak dollar?
Rising corporate profits are likely to have the greatest effect on which of the following industrial sectors?
The government has an expansionary economic policy when it
A sell signal is indicated by a security's price
The major forces behind earnings per share are
The RBI through monetary policy can help expand the economy by
The normal sequence in performing top down analysis is
The single most important factor that influences the behavior of market interest rates is
Which of the following factors are considered when analyzing an industry? I. the nature and conditions of governmental regulations II. the involvement and relations, if any, with labor unions III. the development of new technologies relevant to the industry IV. the extent of competition within the industry
Top-down security analysis
Which stage of an industry's growth cycle offers the greatest opportunity for an investor who is seeking capit
Charting is the technique of
Which one of the following is likely to have a negative effect on stock prices?
Technical analysis primarily monitors shifts in the ________ in the market.
Which measure of the business cycle represents the market value of all goods and services produced in a cou
Investment analysts who believe that a thorough investigation of a company's financial condition, product development, management and other intrinsic factors can discover stocks that are priced above or below

Which of the following practices are typical of technical analysis? I. charting II. computing moving averages III. computing financial ratios IV. plotting advance-decline lines
Technical analysis is used for which of the following purposes? I. deciding when to enter the market II. deciding whether to sell a stock III. deciding which stocks to buy IV. deciding whether basic economic conditions are favorable for investing
Rising interest rates tend to
Fundamental analysis involves the in-depth study of the

option A
II, III and IV only
retailing
I and II only
I and III only
Stock prices are independent of the economic cycle
II and IV only
developments in technology
I, II and IV only
initial development

extreme sensitivity to interest rates and other economic fa
the world's population is growing
I and II only
I and II only
purchases of new equipment
Cash flow from operations is negative, cash flows from in
I an IV only
I an IV only
I and III only
II and IV only
the current ratio and net working capital
total asset turnover
higher; higher
Worcester Corporation is overpriced.
is in danger of defaulting on its loans

I and III only
determining the best time to get into or out of the market
charting
80
I and III
increases; increases
odd-lot trading
mutual fund cash ratio
is a sell signal
accurately predict the future performance of a firm.
patterns appear that are very clear and distinctive
10 trading days
Re.1 in sales is supported by Rs.3 of assets
selling its inventory slower than the industry.
more leveraged
initial development
retailing
business equipment
increases taxes
rising above the moving average
return on assets and total asset value
lowering income taxes on individuals
competition, consumer demand, threat of substitute produ
inflation
I, II and IV only
starts with the fundamental analysis of a firm
initial development
plotting the performance of a security over time
falling interest rates
level of risk
industrial production index
fundamental analysis

I and III only
I and II only
contract the level of economic activity.
role of non-diversifiable risk in an investor's portfolio

option B
I, II and IV only
imports
II and III only
II and III only
Stock prices change simultaneously with the economy
I, II and IV only
interest rates and inflation.
II, III and IV only
stability or decline

high returns and relatively low risks
they continuously develop new products to meet the needs of changing markets
I, III and IV only
I, II and IV only
depreciation.
Cash flow from operations , investment activities and financing activities must all be
I, II and III only
I, II and III only
I, II and III only
I and II only
inventory, accounts receivable and total asset turnover ratios.
current ratio
higher; lower
Natick Corporation has higher earnings per share
pays a high dividend

II and IV only
maintaining the lowest level of risk possible
financial statement analysis
120
I and IV
increases; decreases
breadth of market and market volume
the relative strength index
is a signal that the market is stagnant
see how a firm's performance compares to that of a competitor
history repeats itself
one month.
Rs.3 in assets produces Re.1 in net earnings
underperforming the industry.
less leveraged
stability or decline
imports
defense
increases government spending
falling below the moving average
gross revenue and the stock price
reducing tariffs such that foreign exports can increase
market conditions, risk, company fundamentals
business profits
II, III and IV only
includes economic, industry, and company analysis
mature growth
sorting through databases of securities to select one based on certain parameters
a decrease in the money supply (M2)
supply and demand forces
money supply
behavioral analysis

I, II and IV only
II and III only
increase the level of business investment
financial condition and operating results of a given firm.

KARPAGAM ACADEMY OF H
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Coimbatore - 64
(For the candidates admitted f
DEPARTMENT OF C

option C
I, III and IV only
exports
I, II and IV only
I, II and IV only
Stock prices are often start to rise before the end of a recession
I, II and III only
labor relations
I, II and III only
mature growth

willingness of investors to buy almost any stock associated with the industry
consumers remain loyal to established brands
II and IV only
III and IV only
increase or decrease in current liabilities
Cash flow from operations is positive, cash flows from investment activities and
I, II and IV only
I, II and IV only
I, II and IV only
I, II and IV only
the debt to equity and times interest earned ratios
book value
lower; higher
Investors expect Natick to grow faster than Worcester
is profitable

I, II and IV only
avoiding all unpleasant surprises in the market
investor profiling
20
II and III
decreases; increases
10 moving average
odd-lot volume
is a buy signal but only for value investors
see trends that are developing
formations are less important than the direction of the latest price movement
100 days
Re.1 in total assets is replaced on average every 3 years
averaging fewer days of sales in inventory than the industry.
more profitable
mature growth
exports
food and agriculture
limits exports of goods and services
equaling the moving average
growth and the number of shares outstanding
supporting a moderate growth of the money supply
economy, industry, company
the supply of new bonds
I, II and III only
concentrates on the competency of the senior management of a firm
stability or decline
monitoring a stock based on the underlying economic conditions
low inflation
volume of trading
gross domestic product
the efficient market hypothesis

I, II and III only
I, II and III only
indicate governmental expansion of the economy
pattern of security prices as revealed in chart formations

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· Section 3 of UGC Act 1956)
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from 2018 onwards)
OMMERCE

option D	
I, II, III and IV	
automotive	
I, II, III and IV	
I, II, III and IV	
Changes in stock prices generally lag changes in the economy	
I, II, III and IV	
government regulations	
I, II, III and IV	
rapid expansion	

many decades of sustained above average growth	
The customers preferences changes	
I, II, and III Only	
I, III and IV only	
increase or decrease in current inventory	
If the Statement shows a net increase in cash, the source is unimportant.	
I, II, III and IV	
I, III and IV only	
I, III and IV only	
I, II, III and IV	
ROA and the net profit margin	
net profit margin	
lower; lower	
Natick's stock price is higher than Worcester's	
has more equity than debt in its capital structure	

I, II and III only	
increasing trading to improve overall profits	
investor behavior analysis	
-20	
II and IV	
decreases; decreases	
100 day moving average	
on balance volume	
is a buy signal.	
determine if the firm is performing better than the overall industry	
a breakout below a support line is a buy signal	
52 weeks	
Re.1 in assets produces Rs.3 in sales.	
generating fewer sales per dollar of inventory.	
less efficient	
rapid expansion	
personal services	
consumer durables	
promotes rising interest rates.	
running parallel to the moving average	
net income and the number of shares outstanding	
increasing government spending on the national infrastructure	
profitability, efficiency, liquidity	
the stock market.	
I, II, III and IV	
centers on the past performance of a firm	
rapid expansion	
determining the amount of money that must be saved based on a given financial goal	
a decrease in the unemployment rate	
rate of return	
productivity average	
technical analysis	

I, II, III and IV	
I, II, III and IV	
signal the trough of a recessionary market	
role of diversifiable risk in an investor's portfolio	

Answer
I, III and IV only
exports
I, II and IV only
I and III only
Stock prices are often start to rise before the end of a recession
I, II, III and IV
developments in technology
I, II, III and IV
mature growth

willingness of investors to buy almost any stock associated with the industry
they continuously develop new products to meet the needs of changing markets
I, III and IV only
I, III and IV only
purchases of new equipment
Cash flow from operations is positive, cash flows from investment activities and financing ac
I, II and IV only
I, III and IV only
I and III only
I, II, III and IV
the debt to equity and times interest earned ratios
total asset turnover
lower; higher
Investors expect Natick to grow faster than Worcester
is profitable

I, II and IV only
determining the best time to get into or out of the market
charting
20
I and III
increases; decreases
100 day moving average
the relative strength index
is a sell signal
see trends that are developing
history repeats itself
52 weeks
Re.1 in assets produces Rs.3 in sales.
averaging fewer days of sales in inventory than the industry.
less leveraged
stability or decline
exports
business equipment
increases government spending
falling below the moving average
net income and the number of shares outstanding
supporting a moderate growth of the money supply
economy, industry, company
inflation
I, II, III and IV
includes economic, industry, and company analysis
rapid expansion
plotting the performance of a security over time
a decrease in the money supply (M2)
supply and demand forces
gross domestic product
fundamental analysis

I, II and IV only
I, II and III only
contract the level of economic activity.
financial condition and operating results of a given firm.

:tivities are negative.

Forecasting individual stock performance: Technical analysis – Charting methods – Market indicators, Trends –Trend reversals- Moving average – Oscillators - CAPM –APT theory Valuation of securities- Risk and return – Types - Factors affecting option price.

Company Analysis

Company analysis is a process carried out by investors to evaluate securities, collecting information related to the company's profile, products and services as well as profitability. It is also referred as „fundamental analysis.‟ A company analysis incorporates basic info about the company, like the mission statement and apparition and the goals and values. During the process of company analysis, an investor also considers the company's history, focusing on events which have contributed in shaping the company.

Also, a company analysis looks into the goods and services proffered by the company. If the company is involved in manufacturing activities, the analysis studies the products produced by the company and also analyzes the demand and quality of these products. Conversely, if it is a service business, the investor studies the services put forward.

How to do a company analysis

It is essential for a company analysis to be comprehensive to obtain strategic insight. Being a thorough evaluation of an organization, the company analysis provides insight to rationalize processes and make revenue potentials better.

The process of conducting a company analysis involves the following steps:

- The primary step is to determine the type of analysis which would work best for your company.
- Research well about the methods for analysis. In order to perform a company analysis, it is important to understand the expected outcome for doing so. The analysis should provide answer about what is done right and wrong on the basis of a

thorough evaluation. It is, therefore, important to make the right choice for the analysis methods.

- The next step involves implementing the selected method for conducting the financial analysis. It is important for the analysis to include internal and external factors affecting the business.
- As a next step, all the major findings should be supported by use of statistics.
- The final step involves reviewing the results. The weaknesses are then attempted to be corrected. The company analysis is used in concluding issues and determining the possible solutions. The company analysis is conducted to provide a picture of the company at a specific time, thus providing the best way of enhancing a company, internally as well as externally.

Measuring Earnings

The portion of a company's profit allocated to each outstanding share of common stock. Earnings per share serves as an indicator of a company's profitability.

Calculated as:

$$= \frac{\text{Net Income - Dividends on Preferred Stock}}{\text{Average Outstanding Shares}}$$

When calculating, it is more accurate to use a weighted average number of shares outstanding over the reporting term, because the number of shares outstanding can change over time. However, data sources sometimes simplify the calculation by using the number of shares outstanding at the end of the period.

Diluted EPS expands on basic EPS by including the shares of convertibles or warrants outstanding in the outstanding shares number.

BREAKING DOWN 'Earnings Per Share - EPS'

Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

For example, assume that a company has a net income of Rupees 25 million. If the company pays out Rupees 1 million in preferred dividends and has 10 million shares for half of the year and 15 million shares for the other half, the EPS would be Rupees 1.92 (24/12.5). First, the Rupees1 million is deducted from the net income to get $24 million, then a weighted average is taken to find the number of shares outstanding (0.5 x 10M+ 0.5 x 15M = 12.5M).

An important aspect of EPS that's often ignored is the capital that is required to generate the earnings (net income) in the calculation. Two companies could generate the same EPS number, but one could do so with less equity (investment) - that company would be more efficient at using its capital to generate income and, all other things being equal, would be a "better" company. Investors also need to be aware of earnings manipulation that will affect the quality of the earnings number. It is important not to rely on any one financial measure, but to use it in conjunction with statement analysis and other measures.

Forecasting Earnings

Many investors rely on earnings performance to make their investment decisions. Stocks are assessed according to their ability to increase earnings as well as to meet or beat analysts' consensus estimates. (For more on this, see *Why would my stock's value decline despite good news being released?*)

The basic measurement of earnings is earnings per share. This metric is calculated as the company's net earnings - or net income found on its income statement - less dividends on preferred stock, divided by the number of outstanding shares. For example, if a company (with no preferred stock) produces a net income of $12 million in the third quarter and has eight million shares outstanding, its EPS would be $1.50 ($12 million /8 million). (To read more, see *Types Of EPS*, *How To Evaluate The Quality Of EPS* and *Getting The Real Earnings*.)

So, why does the investment community focus on earnings, rather than other metrics such as sales or cash flow? Any finance professor will tell you that the only proper way to value a stock is to predict the long-term free cash flows of a company, discount those free cash flows to the present day and then divide by the number of shares. But this is much easier said than done, so investors often shortcut the process by using accounting earnings as a "good enough" substitute for free cash flow. Accounting earnings certainly are a much better proxy for free cash flow than sales. Besides, accounting earnings are fairly well defined and public companies' earnings statements must go through rigorous accounting audits before they are released. As a result, the investment community views earnings as a fairly reliable - not to mention convenient - measure.

Technical Analysis

The methods used to analyze securities and make investment decisions fall into two very broad categories: fundamental analysis and technical analysis. Fundamental analysis involves analyzing the characteristics of a company in order to estimate its value. Technical analysis takes a completely different approach; it doesn't care one bit about the "value" of a company or a commodity. Technicians (sometimes called chartists) are only interested in the price movements in the market.

Despite all the fancy and exotic tools it employs, technical analysis really just studies supply and demand in a market in an attempt to determine what direction, or trend, will continue in the future. In other words, technical analysis attempts to understand the emotions in the market by studying the market itself, as opposed to its components.

If you understand the benefits and limitations of technical analysis, it can give you a new set of tools or skills that will enable you to be a better trader or investor.

In this tutorial, we'll introduce you to the subject of technical analysis. It's a broad topic, so we'll just cover the basics, providing you with the foundation you'll need to understand more advanced concepts down the road.

The Basic Assumptions

Technical analysis is a method of evaluating securities by analyzing the statistics generated by market activity, such as past prices and volume. Technical analysts do not attempt to measure a security's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future activity.

Just as there are many investment styles on the fundamental side, there are also many different types of technical traders. Some rely on chart patterns, others use technical indicators and oscillators, and most use some combination of the two. In any case, technical analysts' exclusive use of historical price and volume data is what separates them from their fundamental counterparts. Unlike fundamental analysts, technical analysts don't care whether a stock is undervalued - the only thing that matters is a security's past trading data and what information this data can provide about where the security might move in the future.

The field of technical analysis is based on three assumptions:

1. The market discounts everything.
2. Price moves in trends.
3. History tends to repeat itself.

1. The Market Discounts Everything

A major criticism of technical analysis is that it only considers price movement, ignoring the fundamental factors of the company. However, technical analysis assumes that, at any given time, a stock's price reflects everything that has or could affect the company - including fundamental factors. Technical analysts believe that the company's fundamentals, along with broader economic factors and market psychology, are all priced into the stock, removing the need to actually consider these factors separately. This only leaves the analysis of price movement, which technical theory views as a product of the supply and demand for a particular stock in the market.

2. Price Moves in Trends

In technical analysis, price movements are believed to follow trends. This means that after a trend has been established, the future price movement is more likely to be in the same direction as the trend than to be against it. Most technical trading strategies are based on this assumption.

3. History Tends To Repeat Itself

Another important idea in technical analysis is that history tends to repeat itself, mainly in terms of price movement. The repetitive nature of price movements is attributed to market psychology; in other words, market participants tend to provide a consistent reaction to similar market stimuli over time. Technical analysis uses chart patterns to analyze market movements and understand trends. Although many of these charts have been used for more than 100 years, they are still believed to be relevant because they illustrate patterns in price movements that often repeat themselves.

Technical analysis can be used on any security with historical trading data. This includes stocks, **futures** and **commodities**, fixed-income securities, **forex**, etc. In this tutorial, we'll usually analyze stocks in our examples, but keep in mind that these concepts can be applied to any type of security. In fact, technical analysis is more frequently associated with commodities and forex, where the participants are predominantly **traders**. Now that you understand the philosophy behind technical analysis, we'll get into explaining how it really works. One of the best ways to understand what technical analysis is (and is not) is to compare it to fundamental analysis. We'll do this in the next section.

Types of Trend

There are three types of trend:

- Uptrends
- Downtrends

Sideways/Horizontal Trends As the names imply, when each successive peak and trough is higher, it's referred to as an upward trend. If the peaks and troughs are getting lower, it's a downtrend. When there is little movement up or down in the peaks and troughs, it's a sideways or horizontal trend. If you want to get really technical, you might even say that a sideways trend is actually not a trend on its own, but a lack of a well-defined trend in either direction. In any case, the market can really only trend in these three ways: up, down or nowhere.

The Importance of Trend

It is important to be able to understand and identify trends so that you can trade with rather than against them. Two important sayings in technical analysis are "the trend is your friend" and "don't buck the trend," illustrating how important trend analysis is for technical traders.

The Purpose of Technical Analysis

The purpose of technical analysis is to carry out price forecasts. By processing historical market data of any instrument, you can try to anticipate how it should be traded. There are several premises in favor of the reliability of technical analysis that are based on the experience and prolonged observation. These premises are the following:

1. A market trend in motion is more likely to persist than to reverse.

This is obvious by simply looking at any price chart. Of course the aim of any trader is to be aware of the overall market direction, to lock into the prevailing trend and trade it for profit.

2. Markets are discounting mechanisms.

In other words, technical analysts assume that market fundamentals are already represented in the price so what you perceive in the charts is a reflection on any fundamental variable impacting the market. Nowadays, with instant communications this is truer than ever.

Either the unidirectional price move during a trend or the rapid reaction to any new fundamental data throws evidence that markets show up human behavior. From the above premises we can derive that human psychology is always at work in the markets and that technical analysis aims to visualize and quantify it.

3. What has happened in the past will happen again.

This third premise is based on the assumption that human behavior as well as human psychology never change, and that price will reflect it through the repeated emergence of certain price action patterns and trends.

Price action, as a result of human decision making, can be thus considered as being purposeful. Although some people believe that price movement is completely random and unpredictable, technical analysts are always prone to identify and quantify those behavior patterns by examining past markets. While markets are unpredictable in essence, market participants are typically considered to adhere to certain habits, which are rarely broken. As a trader, your goal is to make use of this information in order to gain a slight advantage over the eventual unpredictability of the market.

Drawbacks of technical analysis

Despite the fact it represents a true edge for the trader, technical analysis presents some disadvantages. Those who oppose technical analysis point out several problems related to the application of its methods.

1. The failure to know the underlying fundamentals.

A common argument is that technical analysis is aimed at predicting a certain outcome for a chart pattern, ignoring the reasons of the movements which are due to fundamental factors. This is an obvious limitation of technical analysis and any trader feeling uncomfortable with this handicap should find support in the next chapter dedicated to fundamental analysis.

2. The lack of scientific objectivity.

Although some theories offer a certain objectivity to the analysis, other studies may not necessarily lead to an objective interpretation. That is why technical analysis is sometimes referred to as being more an art than a science. It is also where individual and mass biases come into play.

In Chapter A4, we wrotte about the self-fulfilling prophecy referring to the fact that the more people approaching markets with technical analytical methods, the more likely the expected move in price occurs. This is a common argument that points out the lack of a proven thesis. The fact that traders operate with different time horizons, different expectations and risk profiles makes it difficult to find a common approach to the self-fulfilling prophecy.

3. The uniqueness of the pattern occurrences.

Another legitimate argument in favor of the unreliability of technical analysis is based on the true observation that past price action upon which technical methods are based does not often repeat exactly the same way. This can lead to incongruities in the analysis and to inconsistency in the methods.

At this point, however, you should ask yourself whether these arguments can be dealt with in order to make money in the markets. Of course they can, and we are going to show you how!

It's true that traders will never be 100% correct when using any strategy based on technicals. However, more often than not technical studies do create a positive expectancy.

Technical Analysis

The methods used to analyze securities and make investment decisions fall into two very broad categories: fundamental analysis and technical analysis. Fundamental analysis involves analyzing the characteristics of a company in order to estimate its value. Technical analysis takes a completely different approach; it doesn't care one bit about the "value" of a company or a commodity. Technicians (sometimes called chartists) are only interested in the price movements in the market.

Despite all the fancy and exotic tools it employs, technical analysis really just studies supply and demand in a market in an attempt to determine what direction, or trend, will continue in the future. In other words, technical analysis attempts to understand the emotions in the market by studying the market itself, as opposed to its components.

If you understand the benefits and limitations of technical analysis, it can give you a new set of tools or skills that will enable you to be a better trader or investor.

In this tutorial, we'll introduce you to the subject of technical analysis. It's a broad topic, so we'll just cover the basics, providing you with the foundation you'll need to understand more advanced concepts down the road.

The Basic Assumptions

Technical analysis is a method of evaluating securities by analyzing the statistics generated by market activity, such as past prices and volume. Technical analysts do not attempt to measure a security's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future activity.

1. Just as there are many investment styles on the fundamental side, there are also many different types of technical traders. Some rely on chart patterns, others use technical indicators and oscillators, and most use some combination of the two. In any case, technical analysts' exclusive use of historical price and volume data is what separates them from their fundamental counterparts. Unlike fundamental analysts, technical analysts don't care whether a stock is undervalued - the only thing that matters is a security's past trading data and what information this data can provide about where the security might move in the future.

The Importance of Trend

It is important to be able to understand and identify trends so that you can trade with rather than against them. Two important sayings in technical analysis are "the trend is your friend" and "don't buck the trend," illustrating how important trend analysis is for technical traders.

The Purpose of Technical Analysis

The purpose of technical analysis is to carry out price forecasts. By processing historical market data of any instrument, you can try to anticipate how it should be traded. There are several premises in favor of the reliability of technical analysis that are based on the experience and prolonged observation. These premises are the following:

1. A market trend in motion is more likely to persist than to reverse.

This is obvious by simply looking at any price chart. Of course the aim of any trader is to be aware of the overall market direction, to lock into the prevailing trend and trade it for profit.

2. Markets are discounting mechanisms.

In other words, technical analysts assume that market fundamentals are already represented in the price so what you perceive in the charts is a reflection on any fundamental variable impacting the market. Nowadays, with instant communications this is truer than ever.

Either the unidirectional price move during a trend or the rapid reaction to any new fundamental data throws evidence that markets show up human behavior. From the above premises we can derive that human psychology is always at work in the markets and that technical analysis aims to visualize and quantify it.

3. What has happened in the past will happen again. This third premise is based on the assumption that human behavior as well as human psychology never change, and that price will reflect it through the repeated emergence of certain price action patterns and trends.

Price action, as a result of human decision making, can be thus considered as being purposeful. Although some people believe that price movement is completely random and unpredictable, technical analysts are always prone to identify and quantify those behavior patterns by examining past markets. While markets are unpredictable in essence, market participants are typically considered to adhere to certain habits, which are rarely broken. As a trader, your goal is to make use of this information in order to gain a slight advantage over the eventual unpredictability of the market.

Drawbacks of technical analysis

Despite the fact it represents a true edge for the trader, technical analysis presents some disadvantages. Those who oppose technical analysis point out several problems related to the application of its methods.

1. The failure to know the underlying fundamentals.

A common argument is that technical analysis is aimed at predicting a certain outcome for a chart pattern, ignoring the reasons of the movements which are due to fundamental factors. This is an obvious limitation of technical analysis and any trader feeling uncomfortable with this handicap should find support in the next chapter dedicated to fundamental analysis.

2. The lack of scientific objectivity.

Although some theories offer a certain objectivity to the analysis, other studies may not necessarily lead to an objective interpretation. That is why technical analysis is sometimes referred to as being more an art than a science. It is also where individual and mass biases come into play.

In Chapter A4, we wrotte about the self-fulfilling prophecy referring to the fact that the more people approaching markets with technical analytical methods, the more likely the expected move in price occurs. This is a common argument that points out the lack of a proven thesis. The fact that traders operate with different time horizons, different expectations and risk profiles makes it difficult to find a common approach to the self-fulfilling prophecy.

3. The uniqueness of the pattern occurrences.

Another legitimate argument in favor of the unreliability of technical analysis is based on the true observation that past price action upon which technical methods are based does not often repeat exactly the same way. This can lead to incongruities in the analysis and to inconsistency in the methods.

At this point, however, you should ask yourself whether these arguments can be dealt with in order to make money in the markets. Of course they can, and we are going to show you how!

It's true that traders will never be 100% correct when using any strategy based on technicals. However, more often than not technical studies do create a positive expectancy.

Market Indicators

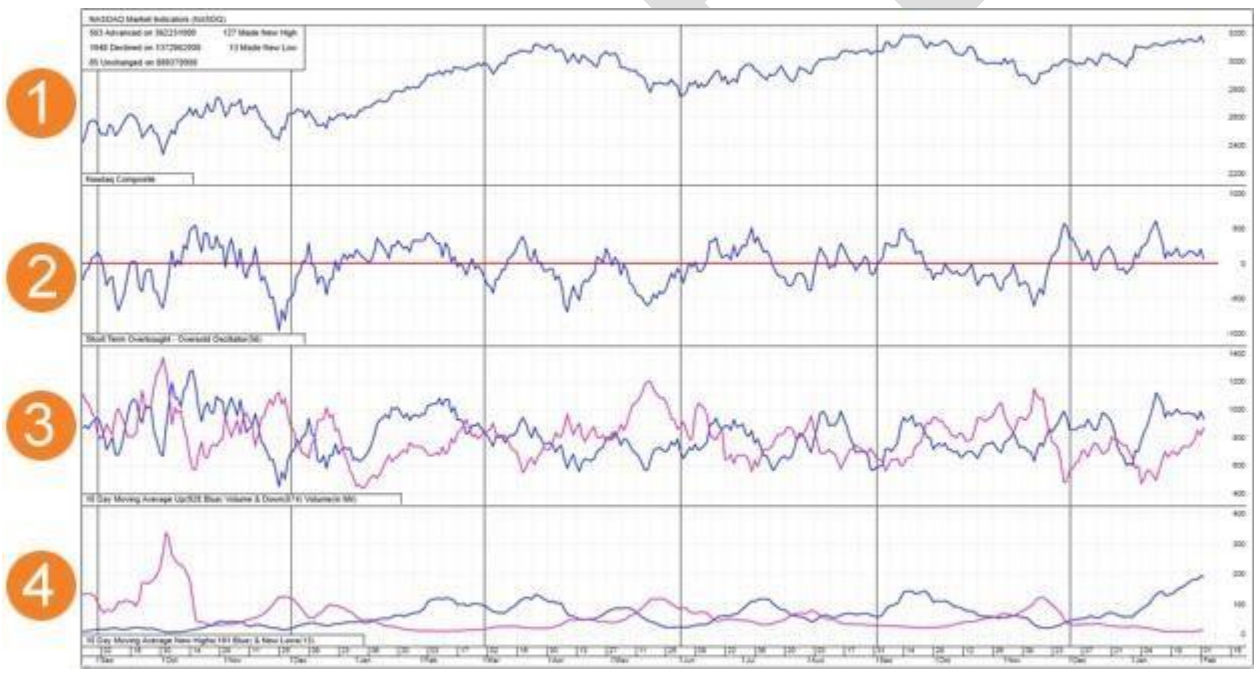
Market Indicators are datasets that contain meta data about the health of various markets or groups of related stocks. Examples include “Advancers,” “Decliners,” and the “McClellan Summation Index”. A list of our important market indicators can be found below:

Primary Indicators

Most investors rely on a few favorite stock market indicators, and new ones seem to pop up all the time, but the two most reliable ones for determining the strength of the market are price and volume. Most other stock market indicators are derived from price and volume data. So it stands to reason that if you follow the price and volume action on the major market indices each day, you will always be in sync with the current trend.

Using price and volume to analyze stock market trends, while incorporating historical stock market data, should be all you need to discern the current market‟s strength and direction. That said, secondary indicators can also help clarify the picture.

Secondary Indicators



1. Advance/Decline Line

Plots the number of advancing shares versus the number of declining shares. At times, a small number of larger weighted stocks may experience significant moves, up or down, that skew the price action on the index. This line, and its accompanying data, reveals whether a majority of stocks followed the direction of the major indexes on that day.

2. Short Term Overbought — Oversold Oscillator

A 10-day moving average of the number of stocks moving up in price less the number of stocks moving down in price (for a specific exchange). Stocks with prices that did not change from the previous close are not included in this calculation. Some investors may use this indicator to take a contrarian position when the market has moved too in far in one direction over a short period of time.

3.10 Day Moving Average Up & Down Volume

Two 10-day moving average lines are presented to illustrate the volume of all stocks on an exchange (AMEX, NASDAQ, NYSE) that are moving up or down in price. Blue line: A 10-day moving average of the total volume of all stocks on an exchange moving up in price. Pink line: A 10-day moving average of the total volume of all stocks on an exchange moving down in price. When the two lines cross, this may indicate a trend change in favor of whichever line is moving up.

4. 10 Day Moving Average New Highs & New Lows

Two 10-day moving average lines are presented to illustrate stocks reaching new highs and new lows, corresponding to their specific exchange (AMEX, NASDAQ, and NYSE). Blue line: a 10-day moving average of the number of stocks making new price highs. Pink line: a 10-day moving average of the number of stocks reaching new price lows (based on prices at market close). When the two lines cross, this may indicate a trend change in favor of whichever line is moving up.

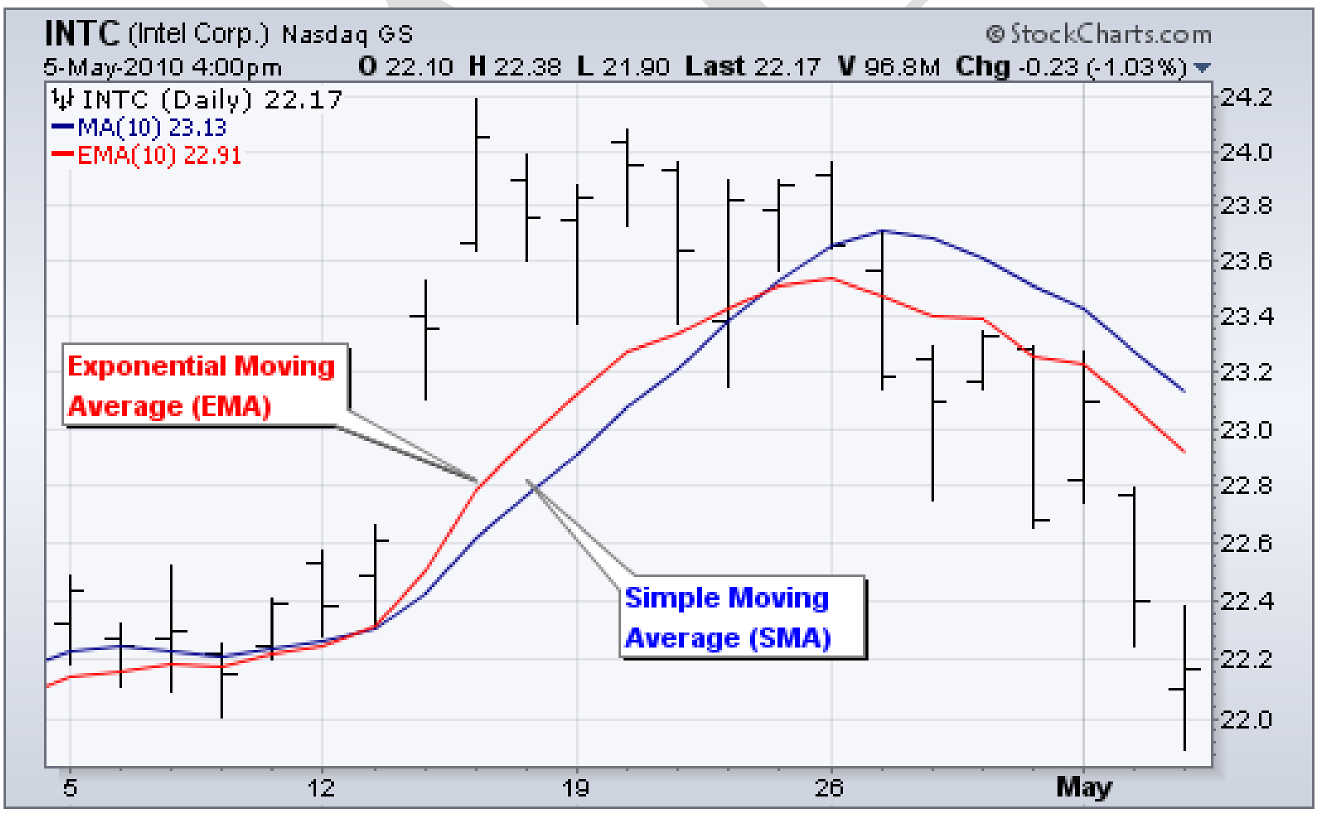
Trend

Bar chart signals often conflict and it is difficult to separate the trend from the surrounding 'noise'. Trend indicators attempt to provide an objective measure of the direction of the trend. Price data is smoothed and the trend is represented by a single line, as in the case of a moving average. Because of the smoothing process the indicators tend to lag price changes and are often called *trend following indicators.*

Moving Average

Moving averages smooth the price data to form a trend following indicator. They do not predict price direction, but rather define the current direction with a lag. Moving averages lag because they are based on past prices. Despite this lag, moving averages help smooth price action and filter out the noise. They also form the building blocks for many other technical indicators and overlays, such as Bollinger Bands, MACD and the McClellan Oscillator. The two most popular types of moving averages are the **Simple Moving Average (SMA)** and the **Exponential Moving Average (EMA)**. These moving averages can be used to identify the direction of the trend or define potential support and resistance levels.

Here's a chart with both an SMA and an EMA on it:



Fundamental Vs Technical Analysis

Investors use techniques of **fundamental analysis** or **technical analysis** (or often both) to make stock trading decisions. Fundamental analysis attempts to calculate the intrinsic value of a stock using data such as revenue, expenses, growth prospects and the competitive landscape, while technical analysis uses past market activity and stock price trends to predict activity in the future.

Comparison chart

	Fundamental Analysis	**Technical Analysis**
Definition	Calculates stock value using economic factors, known as fundamentals.	Uses price movement of security to predict future price movements
Data gathered from	Financial statements	Charts
Stock bought	When price falls below intrinsic value	When trader believes they can sell it on for a higher price
Time horizon	Long-term approach	Short-term approach
Function	Investing	Trade
Concepts used	Return on Equity (ROE) and Return on Assets (ROA)	Dow Theory, Price Data
Vision	looks backward as well as forward	looks backward

PART B

1. What is technical analysis?
2. What are the tools used in technical analysis?
3. What do you mean by trend?
4. Give the meaning of trend reversal.
5. Write short notes on oscillators.
6. How charts are helping to predict market movement?
7. What is APT?
8. What are the assumptions of CAPM?
9. Define the term return.
10. Differentiate fundamental analysis and technical analysis.

PART – C

1. Explain the concept of Company Analysis with suitable illustration?
2. Elucidate the difference between Fundamental Analysis and Technical Analysis?
3. Explain the Techniques used in analyzing a Company"s Performance?
4. Enumerate the difference between Fundamental Analysis and Technical Analysis?
5. Enumerate the constituents of Company Analysis.
6. Explain the concept of industry life cycle. Describe the different stages in the industry life cycle.
7. Explain the Dow Theory with suitable example?
8. Describe the chart patterns that help to identify trend reversal.
9. Enumerate Dow Theory and Odd Lot Theory used in Technical Analysis?
10. Explain the way in ratio analysis an Indicator of a company"s growth with example?

PART – D

CASE STUDY

1. From the following data calculate RSI and predict the market movement.

Share price of State Bank of India	
Date	**Adj Close**
1/1/2018	307.1
1/2/2018	303.25
1/3/2018	302.85
1/4/2018	308.5
1/5/2018	306.35
1/8/2018	305.8
1/9/2018	304.3
1/10/2018	301.1
1/11/2018	302.2
1/12/2018	302.25
1/15/2018	302.6
1/16/2018	296.15
1/17/2018	307.1
1/18/2018	303.25
1/19/2018	309.25
1/22/2018	306.5
1/23/2018	318.1
1/24/2018	329.9
1/25/2018	313.15
1/29/2018	312.1
1/30/2018	313.55
1/31/2018	313.25

SUBJECT: :SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT
SEMESTER : II
LASS : I M.COM
SUBJECT CODE: 19CMP205A

UNIT IV
The central issue of efficient markets concerns
All “known” information means:
According to Markowitz, rational investors will seek efficient portfolios because these portfolios are
In the context of the Capital Asset Pricing Model (CAPM) the relevant risk is
Which of the following statements regarding risk-averse investors is **true**?
I. the president of a company suddenly resigns
The random walk hypothesis is most related to the:
In developing the APT, Ross assumed that uncertainty in asset returns was a result of
An efficient market reflects
In a multi-factor APT model, the coefficients on the macro factors are often called ______.
The market risk, beta, of a security is equal to
Which of the following is NOT a test of semi-strong form efficiency?
Indifference curves reflect -------------- while the efficient set of portfolios represent ---------------.
According to the Capital Asset Pricing Model (CAPM), the expected rate of return on any security is equal to
Two assets have a coefficient of correlation of -.4.
Weak form market efficiency
The highest level of market efficiency is
____________ a relationship between expected return and risk.
In a multi-factor APT model, the coefficients on the macro factors are often called ______.
Which pricing model provides no guidance concerning the determination of the risk premium on factor portf
The APT was developed in 1976 by _____________.
assets, whereas the ______________ implies that this relationship holds for all but perhaps a small number of securities.
The APT differs from the CAPM because the APT _________
The feature of the APT that offers the greatest potential advantage over the CAPM is the _______________.
In terms of the risk/return relationship in the APT
Advantage(s) of the APT is(are)
The statement "A portfolio is less than the sum of its parts." means
If there is no relationship between the rates of return of two assets over time, these assets are

Combining uncorrelated assets will
The risk of a portfolio consisting of two uncorrelated assets will be
Which of the following represent unsystematic risks? I. the president of a company suddenly resigns II. the economy goes into a recessionary period III. a company's product is recalled for defects IV. the RBI unexpectedly changes interest rates
Estimates of a stock's beta may vary depending on I. when the estimate was made. II. the risk-free rate of interest used. III. how many months of returns were used to estimate the beta. IV. the index used to represent market returns.
Which one of the following types of risk cannot be effectively eliminated through portfolio diversification?
Which one of the following conditions can be effectively eliminated through portfolio diversification?
Systematic risks
A measure of systematic risk is
Beta can be defined as the slope of the line that explains the relationship between
In designing a portfolio, relevant risk is
Which of the following best describes the relationship between a stock's beta and the standard deviation of th
A stock's beta value is a measure of
The beta of the market is
Beta is the slope of the best fit line for the points with coordinates representing the ________ and the ______
Which of the following statements concerning beta are correct? I. Stock with high standard deviations of returns will always high betas. II. The higher the beta, the higher the expected return. III. A beta can be positive, negative, or equal to zero. IV. A beta of .35 indicates a lower rate of risk than a beta of -0.50.
The Capital Asset Pricing Model (CAPM) is a mathematical model that depicts the
Which of the following factors comprise the CAPM? I. dividend yield II. risk-free rate of return III. the expected rate of return on the market IV. risk premium for the firm
A type of mutual fund with particular appeal to investors who accept the efficient market hypothesis is
In an efficient market, prices appear to move randomly because
The efficient market hypothesis rests on which of the following assumptions? I. Information is widely available to all investors almost simultaneously. II. Investors react quickly to new information. III. Investors correctly interpret all available information. IV. Events which affect the market occur randomly.
The weak form of the efficient market theory contends that
According to the semi-strong form of the efficient market hypothesis, which of the following might lead to ex
The strong form of the efficient market hypothesis contends that

Followers of the random walk hypothesis believe that
Which one of the following statements concerning the random walk hypothesis is correct?
In the real world, most of the assets available to investors
An efficient market does not require that
Tests of the semistrong EMH include
All of the following conditions must occur for a market to be considered efficient except
The random walk hypothesis
What is the result of the widespread usage of the Internet with regards to efficient markets?
An efficient market is defined as one in which

option A
Regulations
past information only
expected return
unique risk
They only care about the rate of return
II and IV only
weak-form EMH
common macroeconomic factor
only historical information
systemic risk
the covariance between the security's return and the market return divided by the variance of the market's returns
Insider transactions
portfolio possibilities; investor preferences
$R_f + \beta$ [E(R_M)].
Combining these assets will increase risk
implies that the expected return on any security is zer
weak form efficiency
APT stipulates
systemic risk
The CAPM
Lintner
APT, CAPM
places more emphasis on market risk
identification of anticipated changes in production, inflation, and term structure as key factors in explaining the risk-return relationship
only factor risk commands a risk premium in market equilibrium and only systematic risk is related to expected returns
that the model provides specific guidance concerning
it is less expensive to buy a group of assets than to bu
positively correlated

increase the overall risk level of a portfolio
equal to zero
I, II and IV only
I, II and IV only
inflation risk
a general price increase nationwide
can be eliminated by investing in a variety of econom
standard deviation
the return on a security and the return on the market.
total risk
The higher the standard deviation, the higher the beta
interest rate risk
-1
rate of return; level of risk for an individual security
II and III only
positive relationship between risk and return
I and III only
index fund.
investors do not process new information correctly.
I and II only
past price performance is useless in predicting future
studying charts of a stock's past price behavior
a select few institutional investors can earn abnormal

security analysis is the best tool to utilize when invest
Stock price movements are predictable but only over
tend to be somewhat positively correlated
stock prices incorporate all information
regression analysis
Information is costless and widely available to marke
implies that security analysis is unable to predict futu
It makes information cheaper and more accessible thus making markets more efficient
all participants have the same opportunity to make the make the same returns

option B
Information
past and current information
risk
market risk
They accept investments that are fair games
I, II and IV only
semi strong-form EMH
firm-specific factors
only the information related to events that have already occurred
factor sensitivities
the covariance between the security and market returns divided by the standard deviation of the market's returns
Stock splits
investor preferences; portfolio possibilities
$R_f + \beta\ [E(R_M) - R_f]$.
Combining these assets will have no effect on risk
incorporates semi-strong form efficiency
semi-strong form efficiency
CAPM stipulates
firm-specific risk
The multifactor APT
Modigliani and Miller
APT, OPM
minimizes the importance of diversification
superior measurement of the risk-free rate of return over historical time p
only factor risk commands a risk premium in market equilibrium
that the model does not require a specific benchmark market portfolio
portfolio returns will always be lower than the returns on individual stock
negatively correlated

decrease the overall risk level of a portfolio
greater than the risk of the least risky asset but less than the risk level of t
II and IV only
II and IV only
labor problems
an interest rate reduction by the RBI
are forces that affect all investment categories
correlation coefficient
the returns on a security and various points in time.
unsystematic risk.
The higher the standard deviation, the lower the beta.
total risk.
0
rate of inflation; rate of return for an individual security
I and IV only
standard deviation between a risk premium and an investment's expected
II and IV only
asset allocation fund
only new information affects stock price
I, II and III only
past performance can help determine the general direction of future price
thoroughly analyzing the state of the economy, the industry and the comp
abnormal profits are randomly distributed.

the price movements of stocks are unpredictable, and therefore security a
Random price movements support the weak form efficient market hypoth
tend to be somewhat negatively correlated
all known information be reflected in prices
correlation tests that compare the security returns to the overall market re
Information is generated in a specific fashion such that announcements ar
suggests that random patterns appear but only over long periods of time
It increases the volatility of security prices thus making markets less efficient
all participants have the same legal rights and transactions costs

KARP
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option C
Participants
past, current, and inferred information
expected return and risk
standard deviation of returns
They only accept risky investments that offer risk premiums over the risk-free r
I and III only
semi weak-form EMH
neither common macroeconomic factors nor firm-specific factors
all publicly known information related to past events and announced future even
factor betas
the variance of the security's returns divided by the covariance between the security and market returns.
Accounting changes
portfolio return; investor risk
β [E(R_M) - R_f].
Combining these assets may either raise or lower risk
involves price and volume information
random walk efficiency
Both CAPM and APT stipulate
idiosyncratic risk
Both the CAPM and the multifactor APT
Ross
CAPM, APT
recognizes multiple unsystematic risk factors
variability of coefficients of sensitivity to the APT factors for a given asset over
only systematic risk is related to expected returns.
that risk need not be considered
a diversified group of assets will be less volatile than the individual assets withi
perfectly negatively correlated

not change the overall risk level of a portfolio
greater than zero but less than the risk of the more risky asset
I and III only
I, III and IV only
materials shortages
change in the political party that controls Congress
result from random firm-specific events
beta.
the return on stocks and the returns on bonds
event risk
The relationship depends on the correlation between the stock's returns and the
systematic risk.
1
risk level of a stock; market rate of return
II, III and IV only
exact price that an investor should be willing to pay for any given investment.
III and IV only
growth opportunities fund
insider trading has an unpredictable effect on stock prices
II, III and IV only
any publicly available information is useless in predicting future price movemen
possessing private information not available to other investors
no one can consistently earn a profit.

that traders can earn higher than normal returns by exploiting market anomalies
Stock prices in general follow repetitive patterns but the actions of individual in
tend to be uncorrelated
price adjustments occur very quickly
tests of the speed of adjustment of stock prices to company announcements
There are a large number of rational, profit-maximizing investors who actively p
has been disproved based on recent computer simulations
It increases competition among brokers thus making markets more efficient.
securities’ prices quickly and fully reflect all available information

HIGHER EDUCATION
er Section 3 of UGC Act 1956)
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d from 2018 onwards)
DEPARTMENT OF COMMERCE

option D
structure
past, current, inferred and relative information
transactions costs
variance of returns
They are willing to accept lower returns and high risk.
I, II and III only
strong-form EMH
both common macroeconomic factors and firm-specific factors
all information including predictions about future information
both factor sensitivities and factor betas
the variance of the security's returns divided by the variance of the market's returns.
Dividend announcements
investor preferences; portfolio return
$E(R_M) + R_f$
Combining these assets will reduce risk
is compatible with technical analysis
strong form efficiency
Neither CAPM nor APT stipulate
factor betas
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Sharpe
CAPM, OPM
recognizes multiple systematic risk factors
use of several factors instead of a single market index to explain the risk-return relationship
only nonsystematic risk is related to expected returns.
that the model provides specific guidance concerning the determination of the risk premiums on the factor po
for reasons that are not well understood, the value of a portfolio is less than the sum of the values of its comp
uncorrelated

cause the other assets in the portfolio to become positively related
equal to the average of the risk level of the two assets
I, II and III only
I, II and III only
product recalls
increased government regulation of auto emissions
are unique to certain types of investment
variance
the risk free rate of return versus the market rate of return
nondiversifiable risk.
Standard deviation and beta are different ways of measuring the same thing
diversifiable risk
undefined
market rate of return; security's rate of return
I, II, III and IV
difference between a risk-free return and the expected rate of inflation
II, III and IV only
emerging markets fund
the number of investors who can forecast prices correctly is too small to have any effect
I, II, III and IV
price movements are not random but follow a general trend over a period of time
carefully timing trades to buy when the price is low and sell when the price is high
no one can consistently earn abnormal profits

support levels and resistance lines, when combined with basic chart formations, yield both buy and sell signa
Random price movements indicate that investors can earn abnormal profits on a routine basis.
tend to be either perfectly positively or perfectly negatively correlated
each adjustment be perfect
queuing line theory tests
Investors react quickly and fully to the new information, causing stock prices to adjust accordingly
accounts for market anomalies such as calendar effects
It is subject to new regulation thus marking markets less efficient
securities’ prices are completely in line with the intrinsic value.

rtfolios and that the r
onents.

ls	

Answer
Information
past, current, and inferred information
expected return and risk
market risk
They only accept risky investments that offer risk premiums over the risk-free rate
II and IV only
weak-form EMH
both common macroeconomic factors and firm-specific factors
all information including predictions about future information
both factor sensitivities and factor betas
the covariance between the security's return and the market return divided by the variance of the market's returns
Insider transactions
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a diversified group of assets will be less volatile than the individual assets within the group
uncorrelated

decrease the overall risk level of a portfolio
equal to zero
I and III only
I, III and IV only
inflation risk
increased government regulation of auto emissions
are forces that affect all investment categories
beta.
the return on a security and the return on the market.
nondiversifiable risk.
The relationship depends on the correlation between the stock's returns and the market's returns.
systematic risk.
1
market rate of return; security's rate of return
II, III and IV only
positive relationship between risk and return
II, III and IV only
index fund.
only new information affects stock price
I, II, III and IV
past price performance is useless in predicting future price movements.
possessing private information not available to other investors
no one can consistently earn abnormal profits

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tend to be somewhat positively correlated
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Information is generated in a specific fashion such that announcements are basically dependent of each other
implies that security analysis is unable to predict future market behavior
It makes information cheaper and more accessible thus making markets more efficient
securities' prices quickly and fully reflect all available information

ed returns

e market behavior

Portfolio theory – Portfolio construction – Markowitz diversification model – Performance evaluation – Portfolio revision- Portfolio evaluation: Sharpe Index, Treynor Index, Jensen's Model.

Portfolio Analysis

In financial terms,portfolio analysis" is a study of the performance of specific portfolios under different circumstances. It includes the efforts made to achieve the best trade-off between risk tolerance and returns. The analysis of a portfolio can be conducted either by a professional or an individual investor who may utilize specialized software.

What is Portfolio Analysis?

Portfolio analysis involves quantifying the operational and financial impact of the portfolio. It is vital to evaluate the performances of investments and timing the returns effectively.

The analysis of a portfolio extends to all classes of investments such as bonds, equities, indexes, commodities, funds, options and securities. Portfolio analysis gains importance because each asset class has peculiar risk factors and returns associated with it. Hence, the composition of a portfolio affects the rate of return of the overall investment.

What is involved in Portfolio Analysis?

Portfolio analysis is broadly carried out for each asset at two levels:

Risk aversion: This method analyzes the portfolio composition while considering the risk appetite of an investor. Some investors may prefer to play safe and accept low profits rather than invest in risky assets that can generate high returns.

Analyzing returns: While performing portfolio analysis, prospective returns are calculated through the average and compound return methods. An average return is simply the arithmetic average of returns from individual assets. However, compound return is the arithmetic mean that considers the cumulative effect on overall returns.

The next step in portfolio analysis involves determining dispersion of returns. It is the measure of volatility or standard deviation of returns for a particular asset. Simply put, dispersion refers is the difference between the real interest rate and the calculated average return.

Portfolio Analysis Tools

Several specialized portfolio analysis software‟s are available in the market to ease the task for an investor. These application tools can analyze and predict future trends for almost every investment asset. They provide essential data for decision making on the allocation of assets, calculation of risks and attainment of investment objectives.

Scope of Portfolio Analysis

- Monitoring the performance of portfolio by incorporating the latest market conditions.
- Identification of the investor‟s objective, constraints and preferences.
- Making an evaluation of portfolio income (comparison with targets and achievement).
- Making revision in the portfolio.
- Implementation of the strategies in tune with investment objectives.

Markowitz Theory

Harry Markowitz wrote an article titled *Portfolio Selection* that was published in 1952 and is the basis of *Modern Portfolio Theory*. In that paper, he laid out his mathematical arguments in favour of portfolio diversification. Markowitz shared the Nobel Prize in Economics in 1990 with two other scholars "for their pioneering work in the theory of financial economics."

The Modern Portfolio Theory Perspective

Modern Portfolio Theory (MPT) approaches investing by examining the entire market and the whole economy. The theory is an alternative to the older method of analyzing each investment‟s individual merits. When investors look at each investment‟s individual merits, they‟re analyzing one investment without worrying about the way different investments will perform relative to each other. On the other hand, MPT places a large emphasis on the correlation between investments. *Correlation* is the amount we can expect various investments – and various asset classes – to change in value compared with each other. Here is a simple example of correlation:

A company that sells wool products like sweaters and blankets is more profitable when the price of wool is lower. A company that is a wool wholesaler is generally less profitable when the price of wool is lower, unless they are able to sell a lot more wool. Though the companies work together, their profits have a low correlation. In other words, the profitability of one company does not follow the same lines as the profitability of the other company. And sometimes they are even inversely related.

Risk

One important thing to understand about Markowitz‟s calculations is that he treats *volatility* and *risk* as the same thing. In layman‟s terms, Markowitz uses *risk* as a measurement of the likelihood that an investment will go up and down in value – and how often and by how much. The theory assumes that investors prefer to minimize risk. The theory assumes that given the choice of two portfolios with equal returns, investors will choose the one with the least risk. If investors take on additional risk, they will expect to be compensated with additional return.

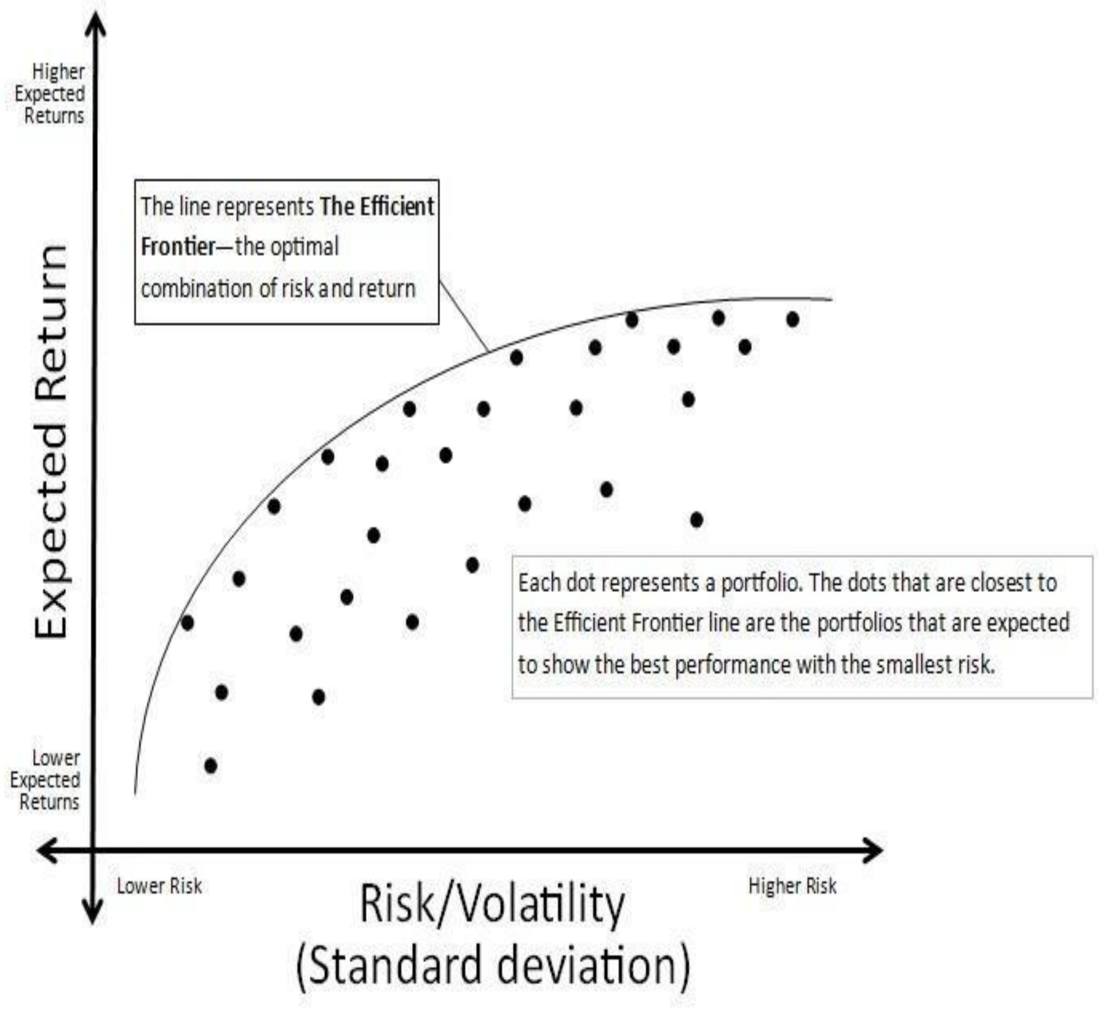
According to MPT, risk comes in two major categories:

- **systematic risk** – the possibility that the entire market and economy will show losses negatively affecting nearly every investment; also called *market risk*
- **unsystematic risk** – the possibility that an investment or a category of investments will decline in value without having a major impact upon the entire market

Diversification generally does not protect against systematic risk because a drop in the entire market and economy typically affects all investments. However, diversification is designed to decrease unsystematic risk. Since unsystematic risk is the possibility that one single thing will decline in value, having a portfolio invested in a variety of stocks, a variety of asset classes and a variety of sectors will lower the risk of losing much money when one investment type declines in value.

The Efficient Frontier

In order to compare investment options, Markowitz developed a system to describe each investment or each asset class with math, using unsystematic risk statistics. Then he further applied that to the portfolios that contain the investment options. He looked at the expected rate-of-return and the expected volatility for each investment. He named his risk-reward equation *The Efficient Frontier*. The graph below is an example of what the Efficient Frontier equation looks like when plotted. The purpose of The Efficient Frontier is to maximize returns while minimizing volatility.



Portfolios along The Efficient Frontier should have higher returns than is typical, on average, for the level of risk the portfolio assumes.

Notice that The Efficient Frontier line starts with lower expected risks and returns, and it moves upward to higher expected risks and returns. So people with different Investor Profiles (determined by investment time horizon, tolerance for risk and personal preferences) can find an appropriate portfolio anywhere along The Efficient Frontier line.

The Efficient Frontier flattens as it goes higher because there is a limit to the returns investors can expect

Portfolios: Types

Stock investors constantly hear the wisdom of diversification. The concept is to simply not put all of your eggs in one basket, which in turn helps mitigate risk, and generally leads to better performance or return on investment. Diversifying your hard-earned dollars does make sense, but there are different ways of diversifying, and there are different portfolio types. We look at the following portfolio types and suggest how to get started building them: *aggressive*, *defensive*, *income*, *speculative* and *hybrid*. It is important to understand that building a portfolio will require research and some effort. Having said that, let's have a peek across our five portfolios to gain a better understanding of each and get you started.

The Aggressive Portfolio

An aggressive portfolio or basket of stocks includes those stocks with high risk/high reward proposition. Stocks in the category typically have a high beta, or sensitivity to the overall market. Higher beta stocks experience larger fluctuations relative to the overall market on a consistent basis. If your individual stock has a beta of 2.0, it will typically move twice as much in either direction to the overall market - hence, the high-risk, high-reward description.

Most aggressive stocks (and therefore companies) are in the early stages of growth, and have a unique value proposition. Building an aggressive portfolio requires an investor who is willing to seek out such companies, because most of these names, with a few exceptions, are not going to be common household companies. Look online for companies with earnings growth that is rapidly accelerating, and have not been discovered by Wall Street. The most common sectors to scrutinize would be technology, but many other firms in various sectors that are pursuing an aggressive growth strategy can be considered. As you might have gathered, risk management becomes very important when building and maintaining an aggressive portfolio. Keeping losses to a minimum and taking profit are keys to success in this type of portfolio.

The Defensive Portfolio

Defensive stocks do not usually carry a high beta, and usually are fairly isolated from broad market movements. Cyclical stocks, on the other hand, are those that are most sensitive to the underlying economic "business cycle." For example, during recessionary times, companies that make the "basics" tend to do better than those that are focused on fads or luxuries. Despite how bad the economy is, companies that make products essential to everyday life will survive. Think of the essentials in your everyday life, and then find the companies that make these consumer staple products.

The opportunity of buying cyclical stocks is that they offer an extra level of protection against detrimental events. Just listen to the business stations and you will hear portfolios managers talking about "drugs," "defense" and "tobacco." These really are just baskets of stocks that these managers are recommending based upon where the business cycle is and where they think it is going. However, the products and services of these companies are in constant demand. A defensive portfolio is prudent for most investors. A lot of these companies offer a dividend as well which helps minimize downside capital losses.

The Income Portfolio

An income portfolio focuses on making money through dividends or other types of distributions to stakeholders. These companies are somewhat like the safe defensive stocks but should offer higher yields. An income portfolio should generate positive cash flow. Real estate investment trusts (REITs) and master limited partnerships (MLP) are excellent sources of income producing investments. These companies return a great majority of their profits back to shareholders in exchange for favorable tax status. REITs are an easy way to invest in real estate without the hassles of owning real property. Keep in mind, however, that these stocks are also subject to the economic climate. REITs are groups of stocks that take a beating during an economic downturn, as building and buying activity dries up.

An income portfolio is a nice complement to most people's paycheck or other retirement income. Investors should be on the lookout for stocks that have fallen out of favor and have still maintained a high dividend policy. These are the companies that can not only supplement income but also provide capital gains. Utilities and other slow growth industries are an ideal place to start your search.

The Speculative Portfolio

A speculative portfolio is the closest to a pure gamble. A speculative portfolio presents more risk than any others discussed here. Finance gurus suggest that a maximum of 10% of one's investable assets be used to fund a speculative portfolio. Speculative "plays" could be initial public offerings (IPOs) or stocks that are rumored to be takeover targets. Technology or health care firms that are in the process of researching a breakthrough product, or a junior oil company which is about to release its initial production results, would also fall into this category.

Another classic speculative play is to make an investment decision based upon a rumor that the company is subject to a takeover. One could argue that the widespread popularity of leveraged ETFs in today's markets represent speculation. Again, these types of investments are alluring: picking the right one could lead to huge profits in a short amount of time. Speculation may be the one portfolio that, if done correctly, requires the most homework. Speculative stocks are typically trades, and not your classic "buy and hold" investment.

The Hybrid Portfolio

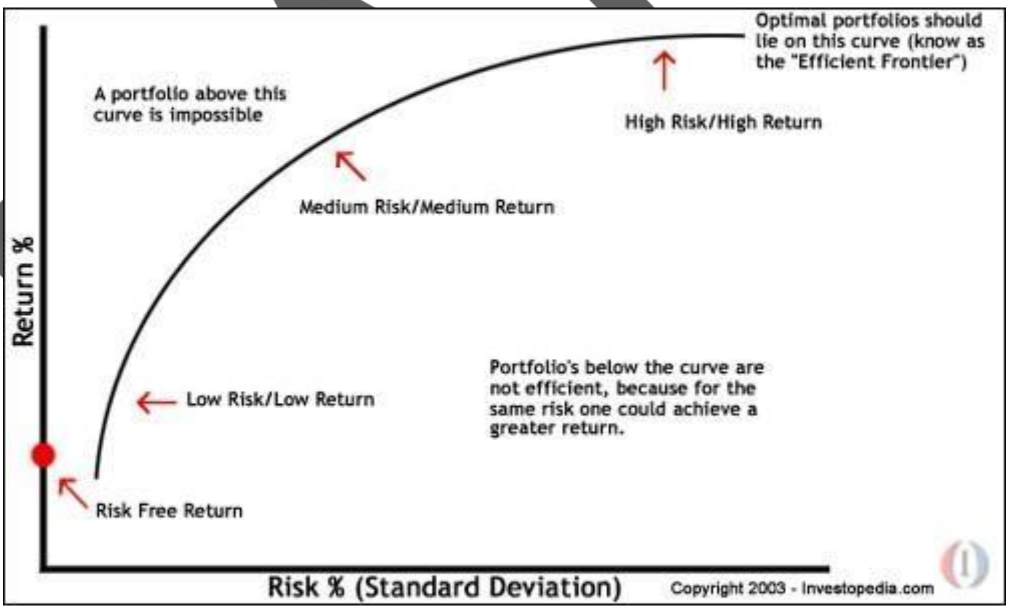
Building a hybrid type of portfolio means venturing into other investments, such as bonds, commodities, real estate and even art. Basically, there is a lot of flexibility in the hybrid portfolio approach. Traditionally, this type of portfolio would contain blue chip stocks and some high grade government or corporate bonds. REITs and MLPs may also be an investable theme for the balanced portfolio. A common fixed income investment strategy approach advocates buying bonds with various maturity dates, and is essentially a diversification approach within the bond asset class itself. Basically, a hybrid portfolio would include a mix of stocks and bonds in a relatively fixed allocation proportions. This type of approach offers diversification benefits across multiple asset classes as equities and fixed income securities tend to have a negative correlation with one another.

Optimum Portfolio

The optimal portfolio concept falls under the modern portfolio theory. The theory assumes (among other things) that investors fanatically try to minimize risk while striving for the highest return possible. The theory states that investors will act rationally, always making decisions aimed at maximizing their return for their acceptable level of risk.

The optimal portfolio was used in 1952 by Harry Markowitz, and it shows us that it is possible for different portfolios to have varying levels of risk and return. Each investor must decide how much risk they can handle and thens allocate (or diversify) their portfolio.

The chart below illustrates how the optimal portfolio works. The optimal-risk portfolio is usually determined to be somewhere in the middle of the curve because as you go higher up the curve, you take on proportionately more risk for a lower incremental return. On the other end, low risk/low return portfolios are pointless because you can achieve a similar return by investing in risk-free assets, like government securities.



You can choose how much volatility you are willing to bear in your portfolio by picking any other point that falls on the efficient frontier. This will give you the maximum return for the amount of risk you wish to accept. Optimizing your portfolio is not something you can calculate in your head. There are computer programs that are dedicated to determining optimal portfolios by estimating hundreds (and sometimes thousands) of different expected returns for each given amount of risk.

Portfolio Construction

Portfolio Construction is all about investing in a range of funds that work together to create an investment solution for investors. Building a portfolio involves understanding the way various types of investments work, and combining them to address your personal investment objectives and factors such as attitude to risk the investment and the expected life of the investment.

When building an investment portfolio there are two very important considerations.

- The first is asset allocation, which is concerned with how an investment is spread across different asset types and regions.
- The second is fund selection, which is concerned with the choice of fund managers and funds to represent each of the chosen asset classes and sectors.

The 4 steps to creating a portfolio

- **Create your risk profile –** Measure your perceived level of risk for an investment (scale of 1 to 10)
- **Asset Allocation –** Determining the right combination of assets – the most important part of the portfolio construction process.
- **Fine tune your portfolio –** Choose to invest in and/or review your existing portfolio to fit in with the asset allocation most suitable to you, potentially reducing your risk and increasing your returns.
- **Review your portfolio regularly –** Once you have constructed your portfolio, it is important to continue to review your asset allocation on a regular basis. Investors failing to do this, may find they become overweight in a particular asset class, potentially increasing the overall risk of their portfolio.

Performance Evaluation

Many investors mistakenly base the success of their portfolios on returns alone. Few consider the risk that they took to achieve those returns. Since the 1960s, investors have known how to quantify and measure risk with the variability of returns, but no single measure actually looked at *both* risk and return together. Today, we have three sets of performance measurement tools to assist us with our portfolio evaluations. The Treynor, Sharpe and Jensen ratios combine risk and return performance into a single value, but each is slightly different. Which one is best for you? Why should you care? Let's find out.

Treynor-Measure

Jack L. Treynor was the first to provide investors with a composite measure of portfolio performance that also included risk. Treynor's objective was to find a performance measure that could apply to all investors, regardless of their personal risk preferences. He suggested that there were really two components of risk: the risk produced by fluctuations in the market and the risk arising from the fluctuations of individual securities.

Treynor introduced the concept of the security market line, which defines the relationship between portfolio returns and market rates of returns, whereby the slope of the line measures the relative volatility between the portfolio and the market (as represented by beta). The beta coefficient is simply the volatility measure of a stock portfolio to the market itself. The greater the line's slope, the better the risk-return tradeoff.

The Treynor measure, also known as the reward to volatility ratio, can be easily defined as:

(Portfolio Return – Risk-Free Rate) / Beta

The numerator identifies the risk premium and the denominator corresponds with the risk of the portfolio. The resulting value represents the portfolio's return per unit risk.

To better understand how this works, suppose that the 10-year annual return for the S&P 500 (market portfolio) is 10%, while the average annual return on Treasury bills (a good proxy for the risk-free rate) is 5%. Then assume you are evaluating three distinct portfolio managers with the following 10-year results:

Managers	Average Annual Return	Beta
Manager A	10%	0.90
Manager B	14%	1.03
Manager C	15%	1.20

Now, you can compute the Treynor value for each:

T(market) = (.10-.05)/1 = .05

T(manager A) = (.10-.05)/0.90 = .056

T(manager B) = (.14-.05)/1.03 = .087

T(manager C) = (.15-.05)/1.20 = .083

The higher the Treynor measure, the better the portfolio. If you had been evaluating the portfolio manager (or portfolio) on performance alone, you may have inadvertently identified manager C as having yielded the best results. However, when considering the risks that each manager took to attain their respective returns, Manager B demonstrated the better outcome. In this case, all three managers performed better than the aggregate market.

Because this measure only uses systematic risk, it assumes that the investor already has an adequately diversified portfolio and, therefore, unsystematic risk (also known as diversifiable risk) is not considered. As a result, this performance measure should really only be used by investors who hold diversified portfolios.

Sharpe-Ratio

The Sharpe ratio is almost identical to the Treynor measure, except that the risk measure is the standard deviation of the portfolio instead of considering only the systematic risk, as represented by beta. Conceived by Bill Sharpe, this measure closely follows his work on the capital asset pricing model (CAPM) and by extension uses total risk to compare portfolios to the capital market line.

The Sharpe ratio can be easily defined as:

(Portfolio Return – Risk-Free Rate) / Standard Deviation

Using the Treynor example from above, and assuming that the S&P 500 had a standard deviation of 18% over a 10-year period, let's determine the Sharpe ratios for the following portfolio managers:

Manager	Annual Return	Portfolio Standard Deviation
Manager X	14%	0.11
Manager Y	17%	0.20
Manager Z	19%	0.27

S(market) = (.10-.05)/.18 = .278

S(manager X) = (.14-.05)/.11 = .818

S(manager Y) = (.17-.05)/.20 = .600

S(manager Z) = (.19-.05)/.27 = .519

Once again, we find that the best portfolio is not necessarily the one with the highest return. Instead, it's the one with the most superior risk-adjusted return, or in this case the fund headed by manager X.

Unlike the Treynor measure, the Sharpe ratio evaluates the portfolio manager on the basis of both rate of return and diversification (as it considers total portfolio risk as measured by standard deviation in its denominator). Therefore, the Sharpe ratio is more appropriate for well diversified portfolios, because it more accurately takes into account the risks of the portfolio.

Jensen-Measure

Like the previous performance measures discussed, the Jensen measure is also based on CAPM. Named after its creator, Michael C. Jensen, the Jensen measure calculates the excess return that a portfolio generates over its expected return. This measure of return is also known as alpha.

The Jensen ratio measures how much of the portfolio's rate of return is attributable to the manager's ability to deliver above-average returns, adjusted for market risk. The higher the ratio, the better the risk-adjusted returns. A portfolio with a consistently positive excess return will have a positive alpha, while a portfolio with a consistently negative excess return will have a negative alpha

The formula is broken down as follows:

Jensen\'s Alpha = Portfolio Return – Benchmark Portfolio Return

Where: Benchmark Return (CAPM) = Risk-Free Rate of Return + Beta (Return of Market – Risk-Free Rate of Return)

So, if we once again assume a risk-free rate of 5% and a market return of 10%, what is the alpha for the following funds?

Manager	Average Annual Return	Beta
Manager D	11%	0.90
Manager E	15%	1.10
Manager F	15%	1.20

First, we calculate the portfolio's expected return:

ER(D)= .05 + 0.90 (.10-.05) = .0950 or 9.5% return

ER(E)= .05 + 1.10 (.10-.05) = .1050 or 10.50% return

ER(F)= .05 + 1.20 (.10-.05) = .1100 or 11% return

Then, we calculate the portfolio's alpha by subtracting the expected return of the portfolio from the actual return:

Alpha D = 11%- 9.5% = 1.5%

Alpha E = 15%- 10.5% = 4.5%

Alpha F = 15%- 11% = 4.0%

Which manager did best? Manager E did best because, although manager F had the same annual return, it was expected that manager E would yield a lower return because the portfolio's beta was significantly lower than that of portfolio F.

Of course, both rate of return and risk for securities (or portfolios) will vary by time period. The Jensen measure requires the use of a different risk-free rate of return for each time interval considered. So, let's say you wanted to evaluate the performance of a fund manager for a five-year period using annual intervals; you would have to also examine the fund's annual returns minus the risk-free return for each year and relate it to the annual return on the market portfolio, minus the same risk-free rate. Conversely, the Treynor and Sharpe ratios examine average returns for the *total period* under consideration for all variables in the formula (the portfolio, market and risk-free asset). Like the Treynor measure, however, Jensen's alpha calculates risk premiums in terms of beta (systematic, undiversifiable risk) and therefore assumes the portfolio is already adequately diversified. As a result, this ratio is best applied with diversified portfolios, like mutual funds.

Portfolio Revision

The art of changing the mix of securities in a portfolio is called as portfolio revision.

The process of addition of more assets in an existing portfolio or changing the ratio of funds invested is called as portfolio revision.

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.

Need for Portfolio Revision

- An individual at certain point of time might feel the need to invest more. The need for portfolio revision arises when an individual has some additional money to invest.
- Change in investment goal also gives rise to revision in portfolio. Depending on the cash flow, an individual can modify his financial goal, eventually giving rise to changes in the portfolio i.e. portfolio revision.
- Financial market is subject to risks and uncertainty. An individual might sell off some of his assets owing to fluctuations in the financial market.

PART B

1. What is portfolio analysis?
2. Write short notes on portfolio management.
3. What is portfolio revision?
4. How do portfolio evaluation done?
5. Why do we go for portfolio revision?
6. What is security market line?
7. Write short notes on capital market line.
8. What is EMH?
9. List out various techniques in portfolio construction.
10. List out the constraints in portfolio revision

PART – C

1. Explain the Markowitz Theory in detail?

2. What is portfolio revision? List out the constraints in portfolio revision

3. Explain the process of Portfolio Construction?

4. Enumerate the Efficient Market Hypothesis.

5. Elucidate Treyner‟s Performance Measurement in Portfolio Analysis.

6. Enumerate the Techniques used in Portfolio Evaluation.

7. Explain the difference between Traditional and Modern Portfolio Analysis?

8. Explain the concept and process of portfolio analysis.

9. Explain the Techniques used in Portfolio Revision?

10. Write short note on:

    i. Capital Market Line

    ii. Security Market Line

PART D

PART D

CASE STUDY

1. Illustrate the computation of stock index from the following data.

Market Price at N Period:

S. No	Company Name	Share Price	No. of Outstanding Shares
1	A	25	100
2	B	35	150
3	C	45	120
4	D	85	100
5	E	20	50

Market Price at N + 1 Period:

S. No	Company Name	Share Price	No. of Outstanding Shares
1	A	30	100
2	B	40	150
3	C	45	120
4	D	95	100
5	E	21	50

Assume the base index value is 100.

SUBJECT: :SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT
SEMESTER : II
LASS : I M.COM
SUBJECT CODE: 19CMP205A

UNIT V
Once the portfolio is constructed, it must be continuously
The policy statement may include a ____ against which a portfolio's or portfolio manager's performance can be meas

Which of the following guidelines are appropriate for inclusion in a portfolio management policy?
I. Diversify among different types of securities and across industry and geographic lines.
II. Determine the risk level and financial situation of the individual investor.
III. Utilize beta to help align the portfolio to the risk level of the investor.
IV. Minimize the standard deviation of each security in the portfolio.

Which of the following will always lower a portfolio's beta?
I. Diversify among different types of securities and across industry and geographic lines.
II. Add investments with low betas to the portfolio.
III. Hold more cash or Treasury Bills in the portfolio.
IV. Reduce the percentage of the portfolio invested in high beta securities.

A portfolio with a beta of 1.26
Large, professionally managed portfolios tend to
The efficient frontier
Which of the following measures or concepts are deliberately used by modern portfolio theory?
I. beta
II. inter industry diversification
III. efficient frontier
IV. correlation

Traditional portfolio managers prefer well-known companies because
I. stocks of well-known firms tend to be less risky than stocks of lesser-known firms.
II. individuals are more apt to purchase a mutual fund if it contains stocks of well-known firms.
III. window dressing encourages the purchase of well-known stocks.
IV. institutional investors tend to exhibit "herd-like" behavior.

Which of the following are advantages of international funds?
I. greater diversification
II. potentially higher returns
III. income is taxed at a lower rate
IV. ease of investing compared to buying individual foreign securities

One characteristic of most index funds is that such funds typically
Returns on exchange traded funds may come from
I. capital gains.
II. dividends.
III. increases in the fund's premium.
IV. decreases in the fund's discount.

Sharpe's measure of portfolio performance compares the risk premium on a portfolio to
Which of the following is a "higher the better" measure?
Advantages of index funds include which of the following?
I. Low management fees.
II. They outperform most actively managed funds.
III. They have a balanced mix of stocks and bonds.
IV. Securities in the portfolio are selected by professional analysts.

Which of the following characteristics apply to closed-end mutual funds?
I. unlimited number of outstanding shares
II. transactions are between shareholders
III. Market prices may be higher or lower than NAV.
IV. Fund will repurchase shares at any time.

The Sharpe's measure for Jane Smith's investment portfolio is 0.40, while the Sharpe's measure for the marke
Which one of the following statements is correct if a portfolio has a Jensen measure of return of zero?
1. Which of the following statements about Jensen's measure are correct?
I. Through its use of the capital asset pricing model, Jensen's measure automatically adjusts for market return.
II. In general, the higher the Jensen's measure, the better a portfolio has performed.
III. Jensen's measure is referred to as alpha.
IV. A positive Jensen's measure indicates an investment has underperformed the market on a risk-adjusted
__________ portfolio management calls for holding diversified portfolios without spending effort or resources attem
The fixed-weightings approach to asset allocation
Aggressive stock management focuses on the pursuit of
Madison believes that the leisure industry (resorts, travel, restaurants, etc.) is about to experience extraordina
An investment advisor has decided to purchase gold, real estate, stocks, and bonds in equal amounts. This decision re
The theory behind the variable ratio plan is to
The process of selling certain issues in a portfolio and purchasing new ones to replace them is known as
For an investor with a time horizon of 5 years and moderate risk tolerance, an appropriate asset allocation str
If we are to assess performance carefully, we must do so on a(n) ___ basis
The reward-to-variability ratio measures:
Benchmark portfolio risk is defined as
Investor overconfidence leads to
Four "decision traps " identified by behavioral finance are
The tendency of investors to blame others for their failures and take personal credit for their successes is refe

Which of the following accurately reflect appropriate investment guidelines?
I. Always invest in last years best performing mutual fund.
II. Trade frequently to increase your investment returns.
III. Sell losing stocks unless you are willing to buy them at the current price.
IV. Take corrective action when so indicated.

Which one of the following statements concerning mutual funds is correct?
Which of the following are advantages offered by mutual funds?
I. professional portfolio management
II. dividend reinvestment
III. consistent returns in excess of the overall market rate of return
IV. modest capital outlay for investors

Mutual fund investors delegate all of the following decisions to the fund's managers EXCEPT
Which type of fund is always passively managed?
A fund that is designed to match the performance of a measure such as the Sensex or the Nifty is called a(n)
Socially responsible funds are distinguished from other mutual funds because they
Funds that invest in a portfolio of companies from the same or closely related industries are known as
One type of mutual fund spreads investors' money across equity markets, bond markets, and money markets.
The ability to automatically buy additional fund shares using the dividend income generated by the fund is ca
An investor who wants to use mutual funds as a preservation of value should invest in
Investors use mutual funds for which of the following reasons?
I. to accumulate wealth
II. to minimize risk
III. as a speculative vehicle
IV. to preserve the value

A mutual fund is generally more tax efficient when it has a ________ turnover rate and a ________ dividend
Investors are generally well advised to avoid mutual funds with
A mutual fund's net asset value is determined by
Investors who who accept the random walk theory should use
The formula plan which requires the greatest management attention and is also the most aggressive is called
Dollar cost averaging is likely to work best with a mutual fund
The general theory of dollar cost averaging is
Which one of the following statements is correct concerning dollar cost averaging plans?
Allison's portfolio has an expected return of 14% and a standard deviation of 20%. Brianna's portfolio has a
Which of the following are reasons to consider selling an investment that is currently in a portfolio?
I. The investment has met the original objective.
II. Better investment opportunities currently exist.
III. The outlook for the investment has improved.
IV. The investment has not met expectations and no change is expected.

Investors who wish to minimize the effect of taxes on their investment returns should try to avoid
One drawback of investing in mutual funds is the

Which of the following characteristics apply to exchange-traded funds (ETFs)? I. unlimited number of outstanding shares II. typically track the performance of some index III. market prices reflect demand for the fund rather than NAV. IV. shares are purchased from and redeemed by the investment company managing the fund.
Which of the following statements is(are) correct concerning exchange-traded funds (ETFs)? I. You can buy and sell ETFs any time during trading hours. II. ETFs are actively managed. III. ETFs have high portfolio turnover rates. IV. ETFs rarely distribute any capital gains.
Back-end loads

option A
Rebalanced
Milestone

I, II and IV only

I, II and IV only
is 126% more risky than the overall market.
lie on or near the efficient frontier
is represented by the rightmost boundary of

II and III only

I only

I and III only

produce a large dollar amount of realized ca

I and II only
a broad-based market index such as the S&I
only Sharpe's measure

I and IV only

I and IV only
exhibits superior performance because its ri
The portfolio has a total return of zero perce

I and IV only
Active
is based on an allocation of an equal percent
dividend income
an asset allocation fund
Asset allocation
passively buy and hold a wide variety of sec
portfolio revision
100% cash
quarterly
return above the risk-free rate.
the return difference between the portfolio and
too little trading
overconfidence, representativeness, loss ave
loss aversion

I and II only
The selection of individual securities remair

I and II only
which companies and industries to invest in
a closed-end fund
index fund
invest only in over-the-counter stocks
aggressive growth funds
socially responsible fund
automatic investment plan
high-yield corporate bond funds and growth

I and II only
low; low
highly rated fund managers
demand for the fund based on the fund's per
a dollar/rupee cost averaging plan
a dollar/rupee cost averaging plan
whose NAV fluctuates widely, but trends up
to time the market to take advantage of low
Dollar cost averaging is an active trading str
Allison has the better portfolio

I, II and IV only
dividend paying stocks
annual management fee

I and II only
I, II and IV only
are charged when an investor buys their mutual

option B
Recycled
Benchmark

II, III and IV only

II, III and IV only
has less risk than the lowest risk security held within that portfolio
exhibit very little overlap in their stock holdings
represents the best attainable tradeoff between risk and return

I and IV only

I and II only

I, III and IV only

have a very low-cost structure with respect to management fees and trans

III and IV only
the portfolio's standard deviation of return
only Treynor's measure

I and II only

II and III only
exhibits poor performance because its risk premium per unit of risk is bel
The portfolio earned exactly its expected return on a risk-adjusted basis

I, II and III only
Momentum
requires periodic rebalancing of the portfolio to maintain the desired wei
short-term capital gains
a fixed income fund
Investment analysis
time the cyclical movements of the stock market and thereby "buy low an
market timing
30% cash, 50% bonds, and 20% stocks
annual
excess return per unit of total risk
the variance of the return of the benchmark portfolio
an overestimation of risk
lack of confidence, representativeness, overreaction, narrow framing
representativeness

III and IV only
Mutual funds were first created in the 2000

I and IV only
when to buy and sell individual stocks
a growth fund
targeted fund
do not charge any sales commission or management fees
sector funds
fiscally responsible fund
automatic reinvestment plan
growth funds and equity-income funds

II, III and IV only

low; high
low fees and high tax efficiency
the fund manager's reputation.
a constant dollar plan
constant dollar
whose NAV remains relatively constant, like a money market fund
to buy more stock when prices are low and less when prices are high.
Dollar cost averaging is a short-term trading strategy
Brianna has the better portfolio

I, III and IV only
short-term capital gains
lack of liquidity of fund shares.

II and III only
I and IV only
are charged if an investor sells his or her shares within the first few years

K
(Deem

option C
Reinvested
Landmark

I, II and III only

I, II and III only
is 26% more risky than a risk-free asset.
hold many of the same large, well-known companies
includes all feasible sets of portfolios based on risk and retur

I, III and IV only

II and III only

I, II and IV only

charge high front-end loads

I, II and III only
the portfolio's beta
only Jensen's measure

I, III, and IV only

I, II and III only
is inadequately diversified, and more securities should be adc
The portfolio outperformed the market on a risk-adjusted bas

II and III only
Passive
is based on periodic adjustments to category weights in respo
long-term capital gains
a sector fund
Portfolio analysis
avoid selling any security for a capital gain, and thus indefini
red herring baiting
20% cash, 40% bonds, and 40% stocks
risk-adjusted
total risk per unit of excess return
the variance of the return difference between the portfolio and th
overly optimistic predictions
overconfidence, representativeness, loss aversion, comprehen
narrow framing

I, III and IV only
The mutual fund industry is the largest financial intermediary

II, III and IV only
how many securities to hold in the portfolio
a value fund
sector fund
invest only in companies that meet specified moral, ethical, o
emerging market funds
growth-and-income fund
systematic withdrawal plan
equity-income funds and long-term bond funds

I, II and IV only
high; low
consistently poor historical performance
the value of the securities held by the fund
a constant ratio plan
a constant ratio plan
whose NAV fluctuates widely, but trends downward
to equal the performance of market averages at the lowest dol
The goal of dollar cost averaging is current dividend income
the portfolio's are equally desirable

I, II and III only
long-term capital gains
amount required for the initial investment

I, II and III only
II and III only
were designed to help no-load funds cover their marketing expens

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option D
Monitored.
Market pair

I, II, III and IV

I, II, III and IV
is considerably more risky than the overall market
be constructed to result in array of portfolio betas allowing investors to choose a position on the efficient fro
provides the highest level of risk for the lowest level of return

I, II, III and IV

I, II , III and IV

II, III and IV only

are designed to "beat the market."

I, II, III and IV
the prevailing risk-free rate of return
All three are "higher the better" measures

I, II, III and IV

II, III and IV only
is overly diversified, and some securities should be sold to bring the portfolio in line with the market
The market provides a better return on a risk-adjusted basis

I, III and IV only
Market timing
uses stock-index futures and bond futures in a market timing strategy
Neither dividend nor capital gain
an aggressive growth fund
Security selection
keep the unit cost of the portfolio at a constant level
dollar cost averaging
10% cash, 30% bonds, and 60% stocks
independent
return above the risk-free rate relative to the risk-free rate
the variance of the return of the actively-managed portfolio
narrow framing
overconfidence, unfamiliarity bias, loss aversion. narrow framing
self-attribution bias

I, II, III and IV
Mutual funds are generally highly concentrated portfolios

I, II and IV only
how to allocate investments among different classes of assets such as stocks, bonds, cash and real estate
an index fund
block fund
will sell their shares only to investors who sign a statement saying they do not smoke tobacco or use alcohol
asset allocation funds
asset allocation fund
conversion plan
money funds and short-term bond funds

I, II, III and IV
high; high
good performance in both up and down markets
from expenses alone
a variable ratio plan
a variable ratio plan
whose NAV fluctuates within a narrow range and is relatively trendless.
to sell as markets decline and buy as they begin to rise
The goal of dollar cost averaging is long-term capital appreciation
the answer depends on Allison and Brianna's risk tolerance

I, II, III and IV
municipal bonds.
lack of information on the performance of the fund

I, II and IV only
I, III and IV only
encourage short-term trading

ntier.	

Answer
Monitored.
Benchmark

I, II and III only

II, III and IV only
is considerably more risky than the overall market
hold many of the same large, well-known companies
represents the best attainable tradeoff between risk and return

I, III and IV only

I, II , III and IV

I, II and IV only

have a very low-cost structure with respect to management fees and transaction fees

I and II only
the portfolio's standard deviation of return
All three are "higher the better" measures

I and II only

II and III only
exhibits superior performance because its risk premium per unit of risk is above that of the m
The portfolio earned exactly its expected return on a risk-adjusted basis

I, II and III only
Passive
requires periodic rebalancing of the portfolio to maintain the desired weights
short-term capital gains
a sector fund
Asset allocation
time the cyclical movements of the stock market and thereby "buy low and sell high."
portfolio revision
30% cash, 50% bonds, and 20% stocks
risk-adjusted
excess return per unit of total risk
the variance of the return difference between the portfolio and the benchmark
overly optimistic predictions
overconfidence, representativeness, loss aversion, narrow framing
self-attribution bias

III and IV only
The mutual fund industry is the largest financial intermediary supporting retail investors to ir

I, II and IV only
how to allocate investments among different classes of assets such as stocks, bonds, cash and
an index fund
index fund
invest only in companies that meet specified moral, ethical, or environmental standards
sector funds
asset allocation fund
automatic reinvestment plan
money funds and short-term bond funds

I, II, III and IV
low; low
consistently poor historical performance
the value of the securities held by the fund
a dollar/rupee cost averaging plan
a variable ratio plan
whose NAV fluctuates widely, but trends upward.
to buy more stock when prices are low and less when prices are high.
The goal of dollar cost averaging is long-term capital appreciation
Brianna has the better portfolio

I, II and IV only
short-term capital gains
annual management fee

I and II only
I and IV only
are charged if an investor sells his or her shares within the first few years

arket

ıvest

. real estate