Scope: Investment Management represents the investment process, risk and securities, company and portfolio analysis. This paper provides knowledge regarding the securities market, investment options, fundamentals of investment and securities, portfolio construction and portfolio management.

Course Objective:

- To expose the students about the various investment alternatives
- To stress the need of portfolio management and its applications
- To Impart students knowledge on the fundamentals of valuation of securities

Course Outcome:

- Students will understand the characteristics of different financial assets such as money market instruments, bonds, and stocks, and how to buy and sell these assets in financial markets.
- Students will understand the benefit of diversification of holding a portfolio of assets, and the importance played by the market portfolio.
- Students will know how to apply different valuation models to evaluate fixed income securities, stocks, and how to use different derivative securities to manage their investment risks.

Unit I: Investment – Nature – Meaning – Scope of investment – Importance of investment – Factors influencing investment – Investment Media – Features of an investment programme – investment process – alternative forms of investment – Mutual Fund Risk – Systematic Risk – Unsystematic Risk.

Unit II: Securities Market – Capital Market – Mechanics of Security trading in Stock Exchange – Valuation of Securities – Valuation of Bonds – Valuation of Preference and Equity Shares – Derivatives – Assets Pricing Theory – CAPM.

Unit III: Fundamental Analysis – Economic Analysis – Economic Forecasting – Forecasting Techniques – Industry Analysis – Industry Classification – Economy and Industry Analysis – Industry Life Cycle.

Unit IV: Company Analysis – Measuring Earning – Forecasting Earnings – Technical Analysis – Charting Methods – Market Indicators – Trend – Moving Average – Fundamental Vs Technical Analysis

Unit V: Portfolio Analysis – Markowitz Theory – Optimum Portfolio – Portfolio Construction – Performance Evaluation – Portfolio Revision

TEXT BOOKS :

1. Preethi Singh. (2015), Investment Management, Himalaya Publications, Mumbai.

REFERENCES:

- 1. Avadhani Ph.D, (2014), Investment Management, Himalaya Publications, Mumbai.
- 2. Jack Clark Francis, (2001), *Investment Analysis and Management*, Mc Graw Hill International Editions, Singapore.
- 3. Srivatsava, R.M. (2010) Management of Indian Financial Institutions, Himalaya Publishing House, Mumbai.
- 4. Bhalla, V.K. (2010), Investment Management, Sultan Chand & Sons, New Delhi



KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University Established under section 3 of UGC Act 1956) Coimbatore-641021

Department of Management

Name: Dr M Ashok Kumar (Professor & Head)Department: ManagementSubject Code: 15BAU601Semester: VISubject: Investment Management- Lesson Plan

Year: 2015-18 Batch

	UNIT 1					
SI.No	Lecture Hours	Contents	References			
1	1	Investment: Meaning, Definition and Characteristics: Risk, Return, Safety, Liquidity	T: Page No : 1-2 R1: Page No : 50-51			
2	1	Investment Vs Speculation and Gambling	T: Page No : 2-3, W1			
3	1	Nature, Scope and Importance of Investment: Longer Life Expectancy, Taxation, Interest Rates, Inflation, Larger Incomes and Investment outlets	T: Page No : 3-4			
4	1	Process of Investment: Investment Goal, Investment Policy, Security Analysis, Investment, Valuation, Construction of Portfolio and Evaluation	T: Page No : 9-11			
5	1	Features of Investment Programme	R4: 9 to 11			
6	1	TUTORIAL : Process of Investment	T: Page No : 9-11			
7	1	Investment Medias: Direct and Indirect Media	T: Page No : 6-8			
8	1	Factors influencing Investment: Taxation, World Events, Inflation, Government Policy	T: Page No: 4-6			
9	1	Sources of Investment Information: Indicators of Economic Development, Economic information, GNP and Consumer Price Index, Unemployment Rates and Money Supply	R1: Page No : 251-257 W2			
10	1	Alternative forms of investments	R3 :Page No: 195, 233,242			
11	1	Mutual Funds : Introduction	R1:Page No:652to679			
12	1	TUTORIAL : Sources of Investment Information	R1:Page No:251-257			
13	1	Mutual Funds : Types & Basis of issue	R1:Page No:652to679			
14	1	Risk – Systematic & Unsystematic	R4: Page No: 65 to 90			
15	1	Recapitulation and Discussion of Important Questions	-			
	ן 	Fotal Number of hours planned for Unit 1	15			

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UNIT 2					
1	1	Nature of Capital / Security Market & its types	T : Page No : 14-18		
2	1	Security Market: Introduction: Primary, Secondary and New Issue Market – Nature & Types	T: Page No : 48-57		
3	1	Mechanics of security trading in Stock Exchanges: Finding a Broker and kinds of selection, Opening an Account and Order, Exercising Choice of Order.	T: Page No: 57-61		
4	1	Mechanics of security trading in Stock Exchanges: Giving Margin, Money to Broker, Execution of order, Preparing Contract Note, Settlement of Contract –	T: Page No: 61-67		
5	1	Asset Pricing Theory	T: Page No: 110-120		
6	1	TUTORIAL : Mechanics of security trading in Stock Exchanges	T: Page No: 61-67		
7		Valuation of Bonds or Debentures: Yield to Maturity, Coupon Rate, Current Rate	R1: Page No: 452-488		
8	1	Valuation of Preference Shares: Yield on Preference Shares.	T: Page No: 121-122		
9	1	Valuation of Preference Shares: Present Value Approach, One and Multiple Year Holding Period	T: Page No: 123-125		
10	1	Valuation of Equity Shares: Dividend Capitalization, Single and Multiple period valuation models - CAPM	R1: Page No: 420-424		
11		Valuation of Equity Shares: P/E Ratio, Security pricing Model.	R2: Page No: 397-419		
12	1	TUTORIAL : Valuation of Bonds or Debentures	R1: Page No: 452-488		
13	1	Security Valuation in India: Free market pricing, Security Exchange Board of India Guidelines	R1: Page No: 425-428		
14	1	Derivatives: Meaning, Definition, Futures Markets, Over-the- counter markets, Netting, Controversy about the financial crisis	W3		
15	1	Recapitulation and Discussion of Important Questions	-		
	Tot	al Number of hours planned for Unit 2	15		
	T	UNIT 3	- 1		
1	1	Fundamental Analysis: Meaning, Definition, Components Fundamental Analysis Economic Analysis Vs Industrial Portfolio Analysis.	of and T: Page No: 124-125		
2	1	Factors Affecting Fundamental Analysis: Inflation, Interest Rates, Investment Risk and Opportunity.W4			
3	1	Economic Analysis: Population, Research and Technical Development, Capital Formation, National Resources and Raw T: Page No: 278-283 Materials			
4	1	Economic Analysis: Impact, Methods and Analysis	W4		
5	1	Economic Forecasting: Industrial Economic Forecasting, Econo Model Building	mic W4		
6		TUTORIAL : Fundamental Analysis	T: Page No: 124-125		
7	1	Forecasting Technique: Survey, Economic Indicators, Econo Model Building	mic R2: Page No:104-120		
8	1	Forecasting Technique: Opportunistic Model Building	R2: Page No:121-126		

9	1	Industrial Analysis: Concept, Characteristics and Stages	T: Page No: 284-285				
10	10 Classifications of Industry: Small Scale, Medium Scale and Larg		ge W4				
	1	R1:Page No: 303-308					
11	11 1 Factors Influencing Industry Analysis: Product Line, Raw Material and Input, Capacity Installed and Utilization, Demand.						
12	1	TUTORIAL : Industry Life Cycle	T: Page No: 285-287				
13	1	Factors Influencing Industry Analysis: Government Policy, Labor and Management. Examples of Industry Analysis	^{ur} R1: Page No:309-311				
14	1	Industry Life Cycle: Pioneering, Expansion & Stagnation Stages	T: Page No: 285-287				
15	1	Recapitulation and Discussion of Important Questions	-				
	Т	otal Number of hours planned for Unit 3	15				
		UNIT 4					
1	1	Company Analysis: Meaning, Inventory Cost Method, Depreciation, Earning from Regular Inventories, EPS, Financial Position	T: Page No: 284-287 R1: Page No:312-315				
2	1	Company Analysis: Ratio Analysis and BEP	T: Page No: 287-326				
3	1	Measuring Earnings: Operating Results, Earnings from Regular Operations, Depreciation, EPS, Financial Position	R3: Page No:158-191				
4	1	Forecasting Earning: Asset Productivity and Earnings, Debt Finance and Earnings, Earning Models, Break Even Point	R3: Page No:217-236				
5	1	Technical Analysis: Tripod of Technical Analysis, Principles of Technical Analysis R2: Page No:					
6		TUTORIAL : Company Analysis	T: Page No: 287-326				
7	1	Technical Analysis: Dow Theory and Odd-Lot Theory.	T: Page No: 331-356				
8	1	Technical Analysis: Charting Methods: Line Chart, Bar Chart, Construction Chart, Analysis Charts, Wave Theories and Oscillators	R2: Page No:502-504 R2: Page No:333-335				
9	1	Fundamental Vs Technical Analysis: Timbergen Model, William's Model, Graham Dodd, Walter, Earning.	W5				
10	1	Market Indicators: ET/BSE Indicators, Market Macro Indicators.	R1: Page No:715-718				
11	1	Trend Analysis: Primary, Secondary and Minor	R1: Page No: 324-328				
12	1	TUTORIAL : Fundamental Vs Technical Analysis	W5				
13	1	Moving Average: Meaning, Advantages, Criticisms	R1: Page No: 324-328				
14	1	Moving Average: Problems and Charts	R1: Page No: 328-330				
15	1	Recapitulation and Discussion of Important Questions	W5				
	Total Number of hours planned for Unit 415						
	UNIT 5						
1	1	Portfolio Analysis: Traditional Vs Modern Analysis and the Rationale of Diversification of Investment	T: Page No: 353-355 R1: Page No: 562-574				
2	1	Markowitz Theory: Combining Two Securities, Interactive Risk through Covariance, Co-Efficient Correlation	T: Page No: 356-368				
3	1	Sharpe's Model: Single Index Model and Difference between Markowitz and Sharp's Model	T: Page No: 369-375				
4	1	Optimum Portfolio Theory: Cut Off Rate and New Securities, Effective Frontier and Portfolio Selection – Portfolio	T: Page No: 381-391 R1: Page No: 625-631				

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		Construction	
5	1	Portfolio Selection: Meaning, Significance, Traditional Portfolio	
		Building, Life Cycle Approach; Capital Market Theory, Security	T: Page No: 389-395
		Market Line, Internal Diversification and Pattern of Foreign	369 - 397
		Security Investment	
6	1	TUTORIAL : Portfolio Diversification	T: Page No: 376-388
7	1	Portfolio Diversification: Meaning and Optimum Portfolio	T: Page No: 376-388
8	1	Portfolio Diversification: Portfolio Revision	T: Page No: 405 -414
9	1	Performance Evaluation: Sharpe's Performance Measure,	T: Page No: 418-424
		Treyner's Performance Measure, Jenson's Model,	111 uge 110. 110 121
10	1	Rules in Portfolio Revision: Constant Rupee Value Plan,	T. Page No: 405-414
		Constant Ratio Plan, Variable Ratio Plan.	1.14ge 110. 100 111
11	1	Recapitulation and Discussion of Important Questions	-
12	1	TUTORIAL : Performance Evaluation	T: Page No: 418-424
	То	tal Number of hours planned for Unit 5	15
13	1	Discussion of previous year ESE Question papers	
14	1	Discussion of previous year ESE Question papers	
15	1	Discussion of previous year ESE Question papers	
Tota	l Number of h	12+3=15	
		ESE Question papers	

Suggested Readings:

TEXT BOOKS:

T : Preethi Singh.,(2010). Investment Management. Himalaya Publications Mumbai

REFERENCE BOOKS:

R₁: Avadhani, V.A. (2011). Investment Management. Himalaya Publications Mumbai

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W1: http://en.wikibooks.org/Investment

W2 http://www.sebi.gov.in/acts/contractact.pdf

W3: http://en.wikibooks.org/Derivatives&APdf

W4: http://en.wikibooks.org/fundamentalanalysis

W5: http://www.investopedia.com/articles/stocks

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<u>UNIT-I</u>

SYLLABUS

Introduction to Investment - Investment - Nature - Meaning - Scope of investment - Importance of investment - Factors influencing investment - Investment Media - Features of an investment programme - investment process - alternative forms of investment - Mutual Fund Risk - Systematic Risk - Unsystematic Risk.

MEANING OF INVESTMENT

Investment is the allocation of monitory resources to assets that are expected to yield some gain or positive return over a given period of time. These assets range from safe Investments to risky Investment. Investments in this form are also called 'Financial Investment'.

Investment is time, energy, or matter spent in the hope of future benefits actualized within a specified date or time frame. Investment has different meanings in economics and finance.

In economics, investment is the accumulation of newly produced physical entities, such as factories, machinery, houses, and goods inventories.

MEANING OF INVESTMENT MANAGEMENT

Investment management is the professional asset management of various securities (shares, bonds and other securities) and other assets (e.g., real estate) in order to meet specified investment goals for the benefit of the investors.

A generic term that most commonly refers to the buying and selling of investments within a portfolio. Investment management can also include banking and budgeting duties, as well as taxes. But the term most often refers to portfolio management and the trading of securities to achieve a specific investment objective

OBJECTIVES OF INVESTMENT

- Maximizing of current income
- Capital preservation
- Total returns and liquidity
- Tax advantage
- Aggressive capital growth

Preservation of Capital

Wealthy clients and those in the spending and gifting phases are most interested in preservation of capital. This is the most conservative investment strategy, and it is intended solely to avoid risk of loss. Less risk, of course, means less return. Low-yielding bonds and money market funds are the foundation of a capital preservation strategy.

Current Income

Conversely, current income is the strategy focused on getting returns on investment as quickly as possible. High-interest bonds and high-dividend stocks are its mainstays.

Current Growth

The current growth strategy is intended for investors with time to "get in on the ground floor" of the "next big thing". As risky as that sounds, it is not a bad strategy for someone who understands the potential downside.

Investing in any one growth stock is adventurous, but the idea is to collect an array of these emerging stocks - generally shares of small companies in new businesses - in a portfolio. The expectation is that a couple of these investments will turn out to be blockbusters, which will more than offset the ones that crash and burn. A growth stock generally does not offer a dividend, and the

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entire payoff with this strategy is in selling it years from now for many multiples of what you paid for it today.

Total Return

Total return investing factors in both capital appreciation - how fast the share price grows - and dividend yield. It also considers the tax implications for the individual investor: a tax-free return of 5% is as good as a taxable dividend of 7% to someone in the 40% bracket. Total return is sometimes called growth-with-income.

Just as clients do not necessarily fit into convenient investment phases, they tend not to have just one objective. Your goal should be to blend all their objectives proportionately into their individual portfolios..

CHARACTERISTICS OF INVESTMENT

The characteristics of investment can be understood in terms of as

- Return
- Risk
- Safety
- Liquidity

Return

All investments are characterized by the expectation of a return. In fact, investments are made with the primary objective of deriving return. The expectation of a return may be from income (yield) as well as through capital appreciation. Capital appreciation is the difference between the sale price and the purchase price. The expectation of return from an investment depends upon the nature of investment, maturity period, market demand and so on.

Risk

Risk is inherent in any investment. Risk may relate to loss of capital, delay in repayment of capital, nonpayment of return or variability of returns. The risk of an investment is determined by the investments, maturity period, repayment capacity, nature of return commitment and so on. Risk and expected return of an investment are related. Theoretically, the higher the risk, higher is the expected returned. The higher return is a compensation expected by investors for their willingness to bear the higher risk.

Safety

The safety of investment is identified with the certainty of return of capital without loss of time or money. Safety is another feature that an investor desires from investments. Every investor expects to get back the initial capital on maturity without loss and without delay.

Liquidity

An investment that is easily saleable without loss of money or time is said to be liquid. A well developed secondary market for security increases the liquidity of the investment. An investor tends to prefer maximization of expected return, minimization of risk, safety of funds and liquidity of investment.

SCOPE OF INVESTMENT

The business of investment has several facets, the employment of professional fund managers, research (of individual assets and asset classes), dealing, settlement, marketing, internal auditing, and the preparation of reports for clients. The largest financial fund managers are firms that exhibit all the complexity their size demands. Apart from the people who bring in the money (marketers) and the people who direct investment (the fund managers), there are compliance staff (to ensure accord with legislative and regulatory constraints), internal auditors of various kinds (to examine internal systems and controls), financial controllers (to account for the institutions' own money and costs), computer experts, and "back office" employees (to track and record transactions and fund valuations for up to thousands of clients per institution).

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INVESTMENT VS SPECULATION

Investment is distinguished from three ways, they are

- Risk
- Capital Gain
- Time Period

Risk

The term risk refers to the possibility of incurring a loss in a financial transaction.

In a broad sense, investment is considered to involve limited risk and is confined to those avenues where the principal is safe. 'Speculation' is considered as an involvement of funds of high risk.

Capital Gain

Another distinction between investment and speculation emphasizes that if the motive is primarily to achieve profits through price changes, it is speculation. If purchases of securities is preceded by proper investigation and analysis and review to receive a stable return over a period of time, it is termed as investment.

Time

A longer fund allocation is termed as investment. A short – term holding is associated with trading for the "quick turn" and is called as Speculation.

INVESTMENT VS GAMBLING

The investment is an attempt to carefully plan, evaluate allocate funds in various investable outlets which offer safely of principal, moderate and continues return and long – term commitment. Gambling connotes high risk and expectation of high returns. It consists of uncertainty and high stakers of thrill and excitements.

Example

- Risk management tactics differ
- Gambling is time-bound
- In stock investing, you can limit your losses
- Indicators are different
- In stock investing, helpful information is readily available
- In gambling, you are safe until you place a bet
- Stock investing makes you an entrepreneur
- Stock investing has economic benefits
- In stock investing, more is usually better
- Gambling is pure chance or luck

IMPORTANCE OF INVESTMENT

Investments are both important and useful in the context of present day conditions, in that we have some importance,

- Longer life expectancy or planning for retirement
- Increasing rates of taxes
- High interest rates
- High rate of inflation
- Larger incomes
- Availability of a complex number of investment outlets.

PROCESS OF INVESTMENT

- Investment Goal
- Investment policy
- Construction of Portfolio
- Diversification
- Selection

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- Allocation
- Portfolio Evaluation

Investment Goal

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The first step for an investor is to set an investment goal. This goal differs for every individual investor.

Investment Policy

After setting the investment goal, the next step is to create an investment policy. This starts with asset allotment between the key asset categories present in the capital market ranging from equities, fixed income securities, property, currency and the like. An investment management consultant keeps into consideration various parameters during the process of instituting the investment policy for the investor. These parameters include constraints of the environment such as the governmental rules, laws, etc. Moreover, the parameters also include the constraints of the investor such as monetary ability, time constraints, risk profile, etc.

Construction of Portfolio

The next step that an investment management consultant follows is the selection of the portfolio strategy. This is done in compliance with the investment goals and investment policy guiding principles. This step is equally crucial as the aforementioned ones. Hence it is pertinent to seek the guidance of an expert investment management consultant if you are unsure about the entire investment management process because any inconsistency here would make the things and cause the entire process to go kaput and lead you in the direction of losses. Portfolio strategies are primarily categorized into two forms; viz. active and passive. Active strategies provide more prospects regarding the features that are projected to control the asset categories' performance, whereas passive strategies involve fewer prospects.

Selection

The next step in line is the process of selecting the assets. The selection and inclusion of specific assets in the portfolio is extremely important. It is here that the investment management consultant advises the investor about building a well organized portfolio, one that would give the anticipated ROI.

Portfolio Evaluation

The next step is the measurement and evaluation of the performance. This is done in absolute and relative terms, against a preset, practical and attainable yardstick. Additionally, the portfolio performance is assessed in the context of the goal and various performance considerations.

FACTORS AFFECTING INVESTMENT

(1) Element of Uncertainty

According to Keynes, the MEC is more volatile than the rate of interest. This is because the prospective yield of capital assets depends upon the business expectations. These business expectations are very uncertain. "They may change quickly and drastically in response to the general mood of the business community, rumours, news of technical developments, political events, even directors' ulcers may cause a sudden rise or fall of the expected rate of yield."

(2) Existing Stock of Capital Goods

If the existing stock of capital goods is large, it would discourage potential investors from entering into the making of goods. Again, the induced investment will not take place if there is excess or idle capacity in the existing stock of capital assets.

In case the existing stock of machines is working to its full capacity, an increase in the demand for goods manufac-tured by them will raise the demand for capital goods of this type and raise the inducement to invest. But it is the capital stock which influences the MEC. The MEC and the capital stock are inversely related.

(3) Level of Income

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If the level of income rises in the economy through rise in money wage rates and other factor prices, the demand for goods will rise which will, in turn, raise the inducement to invest. Contrariwise, the inducement to investment will fall with the lowering of income levels.

(4) Consumer Demand

The present and future demand for the products greatly influences the level of investment in the economy. If the current demand for consumer goods is increasing rapidly more investment will be made. Even if we take the future demand for the products, it will be consider-ably influenced by their current demand and both will influence the level of investment. Investment will be low if the demand is low, and vice versa.

(5) Liquid Assets

The amount of liquid assets with the investors also influences the inducement to invest. If they possess large liquid assets, the inducement to invest is high. This is especially the case with those firms which keep large reserve funds and undistributed profits. On the contrary, the induce-ment to invest is low for investors having little liquid assets.

(6) Inventions and Innovations

Inventions and innovations tend to raise the inducement to invest. If inventions and technological improvements lead to more efficient methods of production which reduce costs, the MEC of new capital assets will rise. Higher MEC will induce firms to make larger investments in the new capital assets and in related ones.

The absence of new technologies will mean low inducement to invest. An innovation also includes the opening of new areas. This requires the development of means of transport, the construction of houses, etc., leading to new investment oppor-tunities. Thus inducement to invest rises.

(7) New Products

The nature of new products in terms of sales and costs may also influence their MEC and hence investment. If the sale prospects of a new product are high and the expected revenues more than the costs, the MEC will be high which will encourage investment in this and related industries.

FEATURES OF INVESTMENT PROGRAMME

1. Safety of Principal

The investor, to be certain of the safety of principal, should carefully review the economic and industry trends before choosing the types of investment. Errors are avoidable and, therefore, to ensure safety of principal, the investor should consider diversification of assets.

Adequate diversification involves mixing investment commitments by industry, geographically, by management, by financial type and by maturities. A proper combination of these factors would reduce losses. Diversification to a great extent helps in proper investment programmes but it must be reasonably accomplished and should not be carried out to extremes.

2. Liquidity

Even investor requires a minimum liquidity in his investments to meet emergencies. Liquidity will be ensured if the investor buys a proportion of readily saleable securities out of his total portfolio. He may, therefore, keep a small proportion of cash, fixed deposits and units which can be immediately made liquid investments like stocks and property or real estate cannot ensure immediate liquidity.

3. Income Stability

Regularity of income at a consistent rate is necessary in any investment pattern. Not only stability, it is also important to see that income is adequate after taxes. It is possible to find out some good securities which pay practically all their earnings in dividends.

4. Appreciation and Purchasing Power Stability

Investors should balance their portfolios to fight against any purchasing power instability. Investors should judge price level inflation, explore the possibility of gain and loss in the investments available to them, limitations of personal and family considerations.

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The investors should also try and forecast which securities will possibly appreciate. A purchase of property at the right time will lead to appreciation in time. Growth stock will also appreciate over time. These, however, should be done thoughtfully and not in a manner of speculation or gamble.

5. Legality and Freedom from Care

All investments should be approved by law. Law relating to minors, estates, trusts, shares and insurance be studied. Illegal securities will bring out many problems for the investor. One way of being free from care is to invest in securities like Unit Trust of India, Life Insurance Corporation or Savings Certificates.

The management of securities is then left to the care of the Trust who diversifies the investments according to safety, stability and liquidity with the consideration of their investment policy. The identity of legal securities and investments in such securities will also help the investor in avoiding many problems.

6. Tangibility

Intangible securities have many times lost their value due to price level inflation, confiscatory laws or social collapse. Some investors prefer to keep a part of their wealth invested in tangible properties like building, machinery and land. It may, however, be considered that tangible property does not yield an income apart from the direct satisfaction of possession or property.

INVESTMENT MEDIA

Many types of investment media or channels for making investments are available. A sound investment programme can be constructed if the investor familiarises himself with the various alternative investments available.Investment media are of several kinds. Some media are simple and direct, others present complex problems of analysis and investigation.

1. Direct Investment Alternatives

a) Fixed Principal Investments

- Cash
- Savings account
- Savings certificates
- Government Bonds
- Corporate Bonds and debentures
- b) Variable Principal Securities
 - Equity shares
 - Convertible debentures or preference shares

c) Non security Investments

- Real estate
- Mortgages
- Commodities
- Business ventures
- Art, Antiques and other variables

2. Indirect Investment Alternatives

- Pension fund
- Provident fund
- Insurance
- Investment companies
- Unit trust and other trust funds

INVESTMENT ALTERNATIVES Non marketable financial assets

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These are such financial assets which gives moderately high return but cannot be traded in market.

- Bank Deposits
- Post Office Schemes
- Company FDs
- PPF

Equity shares

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These are shares of company and can be traded in secondary market. Investors get benefit by change in price of share and dividend given by companies. Equity shares represent ownership capital. As an equity shareholder, a person has an ownership stake in the company. This essentially means that the person has a residual interest in income and wealth of the company. These can be classified into following broad categories as per stock market:

- Blue chip shares
- Growth shares
- Income shares
- Cyclic shares
- Speculative shares

Bonds

Bonds are the instruments that are considered as a relatively safer investment avenues.

- G sec bonds
- GOI relief funds
- Govt. agency funds
- PSU Bonds
- RBI BOND
- Debenture of private sector company

Money market instrument

By convention, the term "money market" refers to the market for short-term requirement and deployment of funds. Money market instruments are those instruments, which have a maturity period of less than one year.

- T-Bills
- Certificate of Deposit
- Commercial Paper

Mutual Funds

A mutual fund is a trust that pools together the savings of a number of investors who share a common financial goal. The fund manager invests this pool of money in securities, ranging from shares, debentures to money market instruments or in a mixture of equity and debt, depending upon the objective of the scheme. The different types of schemes are

- Balanced Funds
- Index Funds
- Sector Fund
- Equity Oriented Funds

Life insurance

Now-a-days life insurance is also being considered as an investment avenue. Insurance premiums represent the sacrifice and the assured sum the benefit. Under it different schemes are:

- Endowment assurance policy
- Money back policy
- Whole life policy
- Term assurance policy

Real estate

One of the most important assets in portfolio of investors is a residential house. In addition to a residential house, the more affluent investors are likely to be interested in the following types of real estate:

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- Agricultural land
- Semi urban land
- Farm House

Precious objects

Investors can also invest in the objects which have value. These comprises of:

- Gold
- Silver
- Precious stones
- Art objects

Financial Derivatives

These are such instruments which derive their value from some other underlying assets. It may be viewed as a side bet on the asset. The most important financial derivatives from the point of view of investors are:

- Options
- Futures

Government Securities (Bonds)

Bonds issued by Central or State government. These bonds are termed as the safest investment instruments in India. Example of these bonds are "Dated government security" which are issued for a period of 10 years with a fixed coupon payment. These securities carry least amount of credit risk as they are backed by the Government of India.

Equity

Investing in direct equity. One can start investing in Indian equities by participating in primary markets (applying for IPO's) and also by purchasing securities from secondary markets (stock exchanges).Investing in direct equity is termed risky and one needs to diversify the risk by investing in multiple securities from various sectors. Example: investing in real estate stocks, pharma stocks, PSU stocks and Oil stocks all at once.

Mutual Funds

Mutual fund is a financial instrument created with pool of investments from many investors. Mutual funds are professionally managed and they invest in equity, debt, gold, foreign equity, etc. on your behalf. Mutual funds are one of the best way to diversify your portfolio.

Debentures/ Bonds

Corporate's need money and they don't go to banks every time to fulfill their needs, they have two options to raise money – come up with an IPO or issue bond with fixed term to maturity and fixed coupon payments. They function just like the government bonds and the only difference is that they are a bit riskier compared to government bonds.

Returns offered by these bonds are higher compared to government bonds.

Real Estate

In India investing in real estate is considered as the best form of investment but only after gold. Historically real estate has performed well in India.

Gold

The only form of investment which most of our mothers and fathers would believe in. Gold is considered as the best investment in India, that is the only reason why India is the highest consumer of gold in the world.

Most of the people in India buy physical gold. ETF's, Mutual funds, etc. are yet to pick up as an investment avenues in India.

Bank fixed deposits

This considered as one of the traditional ways of Investing. Most of the people in India with a bank account will have at least one fixed deposit. FD's offer a fixed return at the end of specified period.

Corporate Fixed Deposits

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They are just like bank FD's they only difference is that they are issued by corporations. They are a bit riskier compared to bank FD's as most of these corporate deposits are unsecured an hence offer higher interest rate.

Post office savings schemes

These saving schemes by post offices are trusted by many Indians. The scheme attracts decent returns. One can start investing with as low as Rs 100 per month. Check out the details here. **National Pension Scheme**

The National Pension System (NPS) is a defined contribution based pension system launched by Government of India. This instrument is used for retirement planning by many. One can find more details here.

Commodity

This is one of the latest passion for investors, trading in MCX to offset the risk of their equity portfolio. Many headers and arbitrageurs use this financial instrument.

Investing in Art

Art as a form of investment is quite common in developed nations and the trend is picking up in India. Many affluent Indians buy art preserve it and diversify their portfolios.

Venture Capital/ Angle Investing

Investing in someones business idea at an early stage of the venture. You get equity for the amount invested and one can exit the investment when the business is acquired by some other company or when the company gets listed. These investments are highly il-liquid and carry huge risk. **TYPES OF RISK**

Systematic Risk

Systematic risk influences a large number of assets. A significant political event, for example, could affect several of the assets in your portfolio. It is virtually impossible to protect yourself against this type of risk.

Unsystematic Risk

Unsystematic risk is sometimes referred to as "specific risk". This kind of risk affects a very small number of assets. An example is news that affects a specific stock such as a sudden strike by employees. Diversification is the only way to protect y from unsystematic risk.

Credit or Default Risk

Credit risk is the risk that a company or individual will be unable to pay the contractual interest or principal on its debt obligations. This type of risk is of particular concern to investors who hold bonds in their portfolios. Government bonds, especially those issued by the federal government, have the least amount of default risk and the lowest returns, while corporate bonds tend to have the highest amount of default risk but also higher interest rates. Bonds with a lower chance of default are considered to be investment grade, while bonds with higher chances are considered to be junk bonds.

Country Risk

Country risk refers to the risk that a country won't be able to honor its financial commitments. When a country defaults on its obligations, this can harm the performance of all other financial instruments in that country as well as other countries it has relations with. Country risk applies to stocks, bonds, mutual funds, options and futures that are issued within a particular country. This type of risk is most often seen in emerging markets or countries that have a severe deficit.

Foreign-Exchange Risk

When investing in foreign countries you must consider the fact that currency exchange rates can change the price of the asset as well. Foreign-exchange risk applies to all financial instruments that are in a currency other than your domestic currency.

Interest Rate Risk

Interest rate risk is the risk that an investment's value will change as a result of a change in interest rates. This risk affects the value of bonds more directly than stocks.

Political Risk

Political risk represents the financial risk that a country's government will suddenly change its policies. This is a major reason why developing countries lack foreign investment.

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Market Risk

This is the most familiar of all risks. Also referred to as volatility, market risk is the the dayto-day fluctuations in a stock's price. Market risk applies mainly to stocks and options. As a whole, stocks tend to perform well during a bull market and poorly during a bear market - volatility is not so much a cause but an effect of certain market forces. Volatility is a measure of risk because it refers to the behaviour, or "temperament", of investment rather than the reason for this behaviour. Because market movement is the reason why people can make money from stocks, volatility is essential for returns, and the more unstable the investment the more chance there is that it will experience a dramatic change in either direction.

Part B (5 x 8 = 40marks)

- 1. Explain Investment? Differentiate between Speculation, Gambling and Investment.
- 2. Discuss in detail various features of an investment programme.
- 3. What is a market? Evaluate various markets operating in Investment Arena.
- 4. Discuss the methods of floating new Issues in stock market.
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- 6. Discuss the constituents involved in analyzing a company.
- 7. Explain "Technical Analysis". List the methods of technical analysis.
- 8. Bring out various charting patterns underlying technical analysis.
- 9. What is Portfolio Selection? Discuss optimal portfolio selection.
- 10. Explain Portfolio Revision? Bring out the constraints in portfolio revision.
- 11. Explain the process of Investment programme?
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- 13. Explain the concept of Asset Pricing Theory with suitable example?
- 14. Explain the Factors Affecting Industry Analysis?
- 15. Enumerate the reasons for a firm to come into the Stagnation Stage?
- 16. Explain the Techniques used in analyzing a Company's Performance?
- 17. Enumerate the difference between Fundamental Analysis and Technical Analysis?
- 18. Explain the process of Portfolio Construction?
- 19. Enumerate the Capital Market Theory in Portfolio Analysis?
- 20. Consider the following Bonds and calculate Present Value of the Bonds.

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Particulars	Face Value	Coupon Rate	YTM	Maturity Period
Bond A	1000	12%	15%	2years
Bond B	1000	10%	15%	3years

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	DEPARTMENT OF MANAGMENET							
	Unit 1- Introduction to Investment, Meaning Multiple Choice Questions- Each Question carries ONE Mark							
SN	Questions	Option 1	Option 2	Option 3	Option 4	Answer		
1	is the employment of funds.	Investment	Speculation	Gambling	Portfolio	Investment		
2	involves long tern commitment	Investment	Speculation	Gambling	Portfolio	Investment		
3	It refers to the possibility of incurring a loss in a financial transaction	Capital gains	Risk	Uncertainty	Return	Risk		
4	It is an involvement of funds of high risk	Investment	Speculation	Risk	Gambling	Speculation		
5	A longer term fund allocation is termed as	Speculation	Investment	Gambling	Portfolio	Investment		
6	A short term holding is associated with trading is called	Speculation	Investment	Gambling	Portfolio	Speculation		
7	consists of uncertainty and high stackers for thrill and excitement	Investment	Gambling	Speculation	Portfolio	Gambling		
8	is based on tips, removers and hunches	Speculation	Investment	Gambling	Portfolio	Gambling		
9	Investor requires in his investments to meet emergencies	Stability	Liquidity	Tangibility	Uncertainty	Liquidity		
10	Building machinery & land are considered as	Tangible properties	Intangible	Liquidity	Uncertainty	Tangible properties		
11	requires a knowledge of the different aspects of securities	Portfolio	Investment	Speculation	Gambling	Portfolio		
12	is the usual form of government securities	Promissory notes	Stock certificates	Deposits	Common stocks	Promissory notes		
13	are the biggest purchasers of stock certificates	LIC	Provident funds	Pension fund	LIC & Provident fund	LIC & Provident fund		
14	Government securities are invested by	Financial institutions	Commercial banks	Financial institutions and Commercial Banks	Mutual fund	Financial institutions and Commercial Banks		
15	provides protection against early death.	Life insurance	Investment	Mutual Fund	Bank Deposits	Life insurance		

16	fixed deposits also qualify as collateral for loans	Commercial banks	Saving banks	RBI	LIC	Commercial banks
17	is usually opened by a business house	Savings account	Current account	Fixed deposit scheme	Mutual fund schemes	Current account
18	has a definite and constant rupee value	Certificates	Saving accounts	Cash	Bonds	Cash
19	Principal amount and terminal value are known with certainty	Fixed principal investments	Variable investments	Indirect alternatives	Direct alternatives	Fixed principal investments
20	the terminal value are not known with certainty	Fixed principal investments	Variable investments	Indirect alternatives	Direct alternatives	Variable investments
21	The price of preference shares is determined by	Demand	Supply	Demand and Supply	Return	Demand and Supply
22	have no fixed return or maturity date	Preference shares	Equity shares	Debentures	Bond	equity shares
23	The terminal value of real estate is	Certain	Uncertain	Risk	Return	Uncertain
24	represent the financing of real estate	Securities	Commodities	Business undertaking	LIC Schemes	Commodities
25	the following are the convertible securities	Preference shares	Equity shares	Debentures	Preference and Debenture	Preference and Debenture
26	are the integral part of an investment decision	Risk	Uncertainty	Risk & Uncertain	Return	Risk & Uncertain
27	risk is alo called as operating risk	Financial risk	Business risk	Management risk	Political risk	Business risk
28	risk is associated with day to day operations of enterprise	Political risk	Financial risk	Business risk	Management risk	Business risk
29	Certificate of Deposit is a certificate issued by to depositors	RBI	Banks	Government	LIC	Banks
30	The borrowing of Money among banks is called	Call money	Put money	Borrow money	Money plus	Call money
31	The interest rate on commercial paper is determined by the	Market	Government	RBI	SEBI	Market
32	The objectives of any investments made by an investor	Maximisation of return	Maximisation of return and	Minimisation of return	Minimisation of risk	Maximisation of return and Maximum

			Maximum of risk			of risk
33	The National savings Certificate issued by the Post office has a maturity	5 years	10 years	4 Years	6 Years	6 Years
34	The NSC is issued by the post office is eligible for Tax savings under section	80 CCC	80 C	88	80 D	80 C
35	A voluntary provident fund scheme called Public Provident Fund is operated by	Post office	Certain authorized Banks	Employee Provident fund organization	Post office and Certain authorized Banks	Post office and Certain authorized Banks
36	Risk can be defined as the variability in	Results	Returns	Rates	Resource	Returns
37	The Gilt Bonds are bonds issued by	Government	Public sector banks	Private companies	Defence organization	Government
38	A portfolio is a of assets	Concentration	Combination	Indicator	Underlying	Combination
39	refers to the ease of converting an asset into money quickly, conveniently and at little cost	Safety	Returns	Risk	Liquidity	Liquidity
40	The interest payment stated as a percentage of the maturity value of a bond is called as	Coupon rate	Interest rate	Maturity rate	Bond rate	Coupon rate
41	Fixed income securities are subject to risk	Interest rate	Performance	Capital	Dividends	Interest rate
42	The borrowing of Money among banks is called	Call money	Bank money	Borrow money	Money plus	Call money
43	The interest rate on commercial paper is determined by the	Market	Investors	RBI	SEBI	Market
44	The objectives of any investments made by an investor	Maximisation of return	Minimisation of return	Tax free	Coupon rate	Maximisation of return
45	The National savings Certificate issued by the Post office has a maturity	5 years	10 years	4 Years	6 Years	6 Years
46	is operated by Post office and Certain authorized Banks	Public Provident Fund	LIC Scheme	Employee Provident fund	Equity capital fund	Public Provident Fund
47	Risk can be defined as the variability in	Results	Returns	Rates	Resource	Returns
48	The Gilt Bonds are bonds issued by	Government	Public sector banks	Private companies	Defence organization	Government

49	A portfolio is a of assets	Concentration	Combination	Indicator	Underlying	Combination
50	refers to the ease of converting an asset into money quickly, conveniently and at little cost	Safety	Returns	Risk	Liquidity	Liquidity
51	The interest rate on commercial paper is determined by the	Market	Government	RBI	Investors	Market
52	it refers to the possibility of incurring a loss in a financial transaction	Capital gains	Risk	Uncertainty	Return	Risk
53	a long-term fund allocation is termed as	Speculation	Investment	Gambling	Insurance	Investment
54	a short term holding is associated with trading is called	Speculation	Investment	Gambling	Insurance	Speculation
55	is based on tips , rumours and hunches	Speculation	Investment	Gambling	Insurance	Gambling
56	investor requires in his investments to meet emergencies	Stability	Liquidity	Tangibility	Flexibility	Liquidity
57	building , machinery & land are considered as	Tangible properties	Intangible properties	Tangible and Intangible properties	Visible properties	Tangible properties
58	deals with new securities issued for the first time to the public	Stock exchange	Secondary market	New issue market	Private issue	New issue market
59	does not have physical form or existence	Stock exchange	Secondary market	New issue market	Private issue	New issue market
60	There are types of Risk.	Two	One	Three	Five	Two

Unit – **I** - **Part B** (5 x 8 = 40marks)

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<u>UNIT-II</u>

SYLLABUS

Securities Market – Capital Market – Mechanics of Security trading in Stock Exchange – Valuation of Securities – Valuation of Bonds – Valuation of Preference and Equity Shares – Derivatives – Assets Pricing Theory – CAPM

MEANING OF CAPITAL MARKET

A capital market is a financial market in which long-term debt or equity-backed securities are bought and sold. Capital markets are defined as markets in which money is provided for periods longer than a year.

Modern capital markets are almost invariably hosted on computer-based electronic trading systems; most can be accessed only by entities within the financial sector or the treasury departments of governments and corporations, but some can be accessed directly by the public. There are many thousands of such systems, most serving only small parts of the overall capital markets. Entities hosting the systems include stock exchanges, investment banks, and government departments.

A capital market can be either a primary market or a secondary market. In primary markets, new stock or bond issues are sold to investors, often via a mechanism known as underwriting. The main entities seeking to raise long-term funds on the primary capital markets are governments (which may be municipal, local or national) and business enterprises (companies). Governments issue only bonds, whereas companies often issue either equity or bonds. The main entities purchasing the bonds or stock include pension funds, hedge funds, sovereign wealth funds, and less commonly wealthy individuals and investment banks trading on their own behalf. In the secondary markets, existing securities are sold and bought among investors or traders, usually on an exchange, over-the-counter, or elsewhere. The existence of secondary markets increases the willingness of investors in primary markets, as they know they are likely to be able to swiftly cash out their investments if the need arises.

A second important division falls between the stock markets (for equity securities, also known as shares, where investors acquire ownership of companies) and the bond markets (where investors become creditors)

DEFINITION

Capital markets are markets for buying and selling equity and debt instruments. Capital markets channel savings and investment between suppliers of capital such as retail investors and institutional investors, and users of capital like businesses, government and individuals. Capital markets are vital to the functioning of an economy, since capital is a critical component for generating economic output. Capital markets include primary markets, where new stock and bond issues are sold to investors, and secondary markets, which trade existing securities.

Difference between Capital Market and Money Market

The money markets are used for the raising of short term finance, sometimes for loans that are expected to be paid back as early as overnight. Whereas the capital markets are used for the raising of long term finance, such as the purchase of shares, or for loans that are not expected to be fully paid back for at least a year.

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Funds borrowed from the money markets are typically used for general operating expenses, to cover brief periods of liquidity. For example, a company may have inbound payments from customers that have not yet cleared, but may wish to immediately pay out cash for its payroll. When a company borrows from the primary capital markets, often the purpose is to invest in additional physical capital goods, which will be used to help increase its income. It can take many months or years before the investment generates sufficient return to pay back its cost, and hence the finance is long term.

Together, money markets and capital markets form the financial markets as the term is narrowly understood. The capital market is concerned with long term finance. In the widest sense, it consists of a series of channels through which the savings of the community are made available for industrial and commercial enterprises and public authorities.

STRUCTURE OF CAPITAL MARKET

The capital market is classified in to two categories. They are the Primary market (New Issues Market) and the Secondary market (Old (Existing) Issues Market). This classification is done on the basis of the nature of the instrument brought in the market. However on the basis of the types of institutions involved in capital market, it can be classified into various categories such as the Government Securities market or Gilt-edged market, Industrial Securities market, Development Financial Institutions (DFIs) and Financial intermediaries. All of these components have specific features to mention. The structure of the Indian capital market has its distinct features. These different segments of the capital market help to develop the institution of capital market in many dimensions. The primary market helps to raise fresh capital in the market. In the secondary market, the buying and selling (trading) of capital market instruments takes place. The following chart will help us in understanding the organizational structure of the Indian Capital market.



- 1. Government Securities Market : This is also known as the Gilt-edged market. This refers to the market for government and semi-government securities backed by the Reserve Bank of India (RBI).
- 2. Industrial Securities Market : This is a market for industrial securities i.e. market for shares and debentures of the existing and new corporate firms. Buying and selling of such instruments take

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place in this market. This market is further classified into two types such as the New Issues Market (Primary) and the Old (Existing) Issues Market (secondary). In primary market fresh capital is raised by companies by issuing new shares, bonds, units of mutual funds and debentures. However in the secondary market already existing i.e old shares and debentures are traded. This trading takes place through the registered stock exchanges. In India we have three prominent stock exchanges. They are the Bombay Stock Exchange (BSE), the National Stock Exchange (NSE) and Over The Counter Exchange of India (OTCEI).

- 3. Development Financial Institutions (DFIs): This is yet another important segment of Indian capital market. This comprises various financial institutions. These can be special purpose institutions like IFCI, ICICI, SFCs, IDBI, IIBI, UTI, etc. These financial institutions provide long term finance for those purposes for which they are set up.
- 4. Financial Intermediaries : The fourth important segment of the Indian capital market is the financial intermediaries. This comprises various merchant banking institutions, mutual funds, leasing finance companies, venture capital companies and other financial institutions.

5.

MECHANICS OF SECURITY TRADING IN STOCK EXCHANGES

An investor must have some knowledge of how the securities markets operate. The marketing of old or new securities of the stock markets can be done only through members of the Stock Exchange. These members are either individuals or partnership firms.

An individual must use the facilities of these members for trading in securities. The member is a registered dealer of an organized stock exchange. Trading among the members of a recognized stock exchange is to be done under the statutory regulations of the stock exchange. The members carrying on business are known as 'brokers' and can trade only on listed securities.

These members execute customer's orders to buy and sell on the exchange and their firms receive negotiated commissions on those transactions. About one-fourth of all members of the exchange are 'specialists', so called because they specialize in 'making a market' for one or more particular kind of stock.

In the process of trading in stock exchanges, there is the basic need for a 'transaction' between an individual and broker. A transaction to buy and sell securities is also called 'trades'. This is to be done through selection of a broker.

Specified and Non-specified Securities:

It is useful to know that three kinds of securities can be traded upon in the Mumbai Stock Exchange — specified, non-specified and odd lot. In the specified category of equity shares, the criteria are that the share should be listed on the stock exchange for at least 3 years and the issued capital should not be less than Rs. 75 crores.

A capital adequacy norm has also been suggested for individual brokers. These reforms have been brought about after recommendations were made by G. S. Patel Committee in 1995. SEBI was set up to regulate the organization and working of the stock exchanges and members operating within it.

SEBI has brought about uniformity in the different stock exchanges. Nine stock exchanges were given permanent recognition. Every stock exchange is to be managed by a committee called a governing board consisting of brokers, directors, government, SEBI and public representatives.

NEW ISSUE MARKET

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.

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The primary market is the part of the capital market that deals with issuing of new securities. Primary markets create long term instruments through which corporate entities raise funds from the capital market.

In a primary market, companies, governments or public sector institutions can raise funds through bond issues and corporations can raise capital through the sale of new stock through an initial public offering (IPO). This is often done through an investment bank or finance syndicate of securities dealers. The process of selling new shares to investors is called underwriting. Dealers earn a commission that is built into the price of the security offering, though it can be found in the prospectus.

Instead of going through underwriters, corporations can make a primary issue of its debt or stock, which involves the issue by a corporation of its own debt or new stock directly to institutional investors or the public or it can seek additional capital from existing shareholders.

Once issued the securities typically trade on a secondary market such as a stock exchange, bond market or derivatives exchange.

FEATURES OF PRIMARY MARKET

The main features of primary markets are:

This is the market for new long term equity capital. The primary market is the market where the securities are sold for the first time. Therefore, it is also called the new issue market (NIM).

- In a primary issue, the securities are issued by the company directly to investors.
- The company receives the money and issues new security certificates to the investors.
- Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business.

The primary market performs the crucial function of facilitating capital formation in the economy.

The new issue market does not include certain other sources of new long term external finance, such as loans from financial institutions. Borrowers in the new issue market may be raising capital for converting private capital into public capital; this is known as "going public."

Its share can be issue in face value, premium value & par value.

ROLE AND 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.

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.

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(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

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(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.

SECONDARY MARKET

The secondary market is where investors buy and sell securities they already own. It is what most people typically think of as the "stock market," though stocks are also sold on the primary market when they are first issued. The national exchanges, such as the New York Stock Exchange (NYSE) and theNASDAQ, are secondary markets.

Primary vs. Secondary Markets

It is important to understand the distinction between the secondary market and the primary market. When a company issues stock or bonds for the first time and sells those securities directly to investors, that transaction occurs on the primary market. Some of the most common and well-publicized primary market transactions are IPOs, or initial public offerings. During an IPO, a primary markettransaction occurs between the purchasing investor and the investment bank underwriting the IPO. Any proceeds from the sale of shares of stock on the primary market go to the company that issued the stock, after accounting for the bank's administrative fees.

If these initial investors later decide to sell their stake in the company, they can do so on the secondary market. Any transactions on the secondary market occur between investors, and the proceeds of each sale go to the selling investor, not to the company that issued the stock or to the underwriting bank.

The secondary market, also called the aftermarket, is the financial market in which previously issued financial instruments such as stock, bonds, options, and futures are bought and sold.^[1] Another frequent usage of "secondary market" is to refer to loans which are sold by a mortgage bank to investorssuch as Fannie Mae and Freddie Mac.

The term "secondary market" is also used to refer to the market for any used goods or assets, or an alternative use for an existing product or asset where the customer base is the second market (for example, corn has been traditionally used primarily for food production and feedstock, but a "second" or "third" market has developed for use in ethanol production).

With primary issuances of securities or financial instruments, or the primary market, investors purchase these securities directly from issuers such ascorporations issuing shares in an IPO or private placement, or directly from the federal government in the case of treasuries. After the initial issuance, investors can purchase from other investors in the secondary market. FUNCTIONS

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In the secondary market, securities are sold by and transferred from one investor or speculator to another. It is therefore important that the secondary market be highly liquid (originally, the only way to create this liquidity was for investors and speculators to meet at a fixed place regularly; this is how stock exchanges originated, see History of the Stock Exchange). As a general rule, the greater the number of investors that participate in a given marketplace, and the greater the centralization of that marketplace, the more liquid the market.

Fundamentally, secondary markets mesh the investor's preference for liquidity (i.e., the investor's desire not to tie up his or her money for a long period of time, in case the investor needs it to deal with unforeseen circumstances) with the capital user's preference to be able to use the capital for an extended period of time.

Accurate share price allocates scarce capital more efficiently when new projects are financed through a new primary market offering, but accuracy may also matter in the secondary market because: 1) price accuracy can reduce the agency costs of management, and make hostile takeover a less risky proposition and thus move capital into the hands of better managers, and 2) accurate share price aids the efficient allocation of debt finance whether debt offerings or institutional borrowing

The financial market is a world where new securities are issued to the public regularly. It is a world full of varied financial products and services, tailored to the need of every individual from all income brackets. These financial products are bought and sold on the capital market, which is divided into primary market and secondary market.

This post will be a detailed explanation of primary market and secondary market, and will draw the distinction of primary market vs. secondary market.



What Is Primary Market?

The primary market is also known as new issues market. Here, the transaction is conducted between the issuer and the buyer. In short, the primary market creates new securities and offers them to the public.

For instance, Initial Public Offering (IPO) is an offering of the primary market where a private company decides to sell stocks to the public for the first time. An important point to remember here is that in the primary market, securities are directly purchased from the issuer.

Capital or equity can be raised in primary market by any of the following four ways:

1. Public Issue

As the name suggests, public issue means selling securities to public at large, such as IPO. It is the most vital method to sell financial securities.

2. Rights Issue

Whenever a company needs to raise supplementary equity capital, the shares have to be offered to present shareholders on a pro-rata basis, which is known as the Rights Issue.

3. Private Placement

This is about selling securities to restricted number of classy investors like frequent investors, venture capital funds, mutual funds and banks comes under Private Placement.

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4. Preferential Allotment

When a listed company issues equity shares to a selected number of investors at a price that may or may not be pertaining to the market price is known as Preferential Allotment.

The primary market is also known as the New Issue Market (NIM) as it is the market for issuing longterm equity capital. Since the companies issue securities directly to the investors, it is responsible to issue the security certificates too. The creation of new securities facilitates growth within the economy. What Is Secondary Market?

What Is Secondary Market?

In secondary market, the securities issued in the primary market are bought and sold. Here, you can buy a share directly from a seller and the stock exchange or broker acts as an intermediary between two parties. The secondary market is actually formed by another layer of investors who deal with primary market

investor to buy and sell financial securities such as bonds, futures and stocks. These dealings happen in the proverbial stock exchange.

National Stock Exchange (NSE) and New York Stock Exchange (NYSE) are some popular stock exchanges. Majorly, the trade happens between investors without any involvement with the company that issued the securities in the primary market.

The secondary market is further divided into two kinds of market.

1. Auction Market

The auction market is a place where buyers and sellers convene at a place and announce the rate at which they are willing to sell or buy securities. They offer either the 'bid' or 'ask' prices, publicly. Since all buyers and sellers are convening at the same place, there is no need for investors to seek out profitable options. Everything is announced publicly and interested investors can make their choice easily.

2. Dealer Market

In a dealer market, none of the parties convene at a common location. Instead, buying and selling of securities happen through electronic networks which are usually fax machines, telephones or custom order-matching machines.

Interested sellers deliver their offer through these mediums, which are then relayed over to the buyers through the medium of dealers. The dealers possess an inventory of securities and earn their profit through the selling. A lot of dealers operate within this market and therefore, a competition exists between them to deliver the best offer to their investors. This makes them deliver the best price to the investors. An example of a dealer market is the NASDAQ.

The secondary markets are important for price discovery. The market operations are carried out on stock exchanges.

A variation to the dealer market is the OTC market. OTC stands for 'Over the Counter' market. The concept came into existence during the early 1920's period through Wall Street trading, which implied the prevalence of an unorganized system of dealers who conducted trades via networks. Stock shops existed to buy and sell shares over-the-counter. In other words, these were unlisted stocks which were sold privately.

Over time, the notion of OTC underwent a change. These days the over-the-counter denotes those stocks which are not traded over NYSE, NASDAQ or American Stock Exchange (AMEX). The over-the-counter implies those stocks which are traded on the pink sheetsor on over-the-counter bulletin boards (OTCBB). Pink sheets are a name given to the daily list of stocks published with ask and bid prices by the National Quotation Bureau. The OTCBB service is offered by the National Association of Securities Dealers (NASD) which accurately displays the last sale prices, real time quotations and other volume information of over-the-counter securities.

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Course Name: Investment Management Unit I-Securities Market

Part B (5 x 8 = 40marks)

- 1. What is Risk? How risk are classified from Investment point of view?
- 2. How can you become an successful investor in the present scenario.
- 3. Explain how intermediaries shall entering into agreement for floating the instruments.
- 4. What is an Stock Exchange? Discuss the functions of Stock Exchanges operating in India.
- 5. What do you mean by forecasting? Discuss various indicators involved in forecasting.
- 6. Explain Industry analysis? List various factors involved in industry analysis.
- 7. Draft basic principles of technical analysis.
- 8. Discuss various mathematical indicators of technical analysis.
- 9. Explain the meaning of Portfolio Evaluation? Discuss the need for portfolio evaluation?
- 10. Discuss the assumptions underlying Markowitz Theory.
- 11. Explain the importance of Investment programme?
- 12. What is meant by Primary Market? Explain the Functions of primary market?
- 13. Explain the different types of Debentures with suitable example?
- 14. Explain the Mechanics of Security Trading in Stock Exchange?
- 15. Explain the factors affecting Fundamental Analysis?
- 16. Enumerate the forecasting techniques used in Economic Analysis?
- 17. Explain the concept of Company Analysis with suitable illustration?
- 18. Elucidate the difference between Fundamental Analysis and Technical Analysis?
- 19. Explain the Markowitz Theory in detail?
- 20. Enumerate the Sharpe's Model with suitable example?

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DEPARTMENT OF MANAGMENET						
Unit I1- Securities Market - Multiple Choice Questions- Each Question carries ONE Mark						
SN	Questions	Option 1	Option 2	Option 3	Option 4	Answer
1	The work begins before an issue is actually floated in the market	Distribution	Underwriting	Origination	Subscription	Origination
2	It is a kind of guarantee undertaken by an institution or firm	Distribution	Underwriting	Origination	Subscription	Underwriting
3	Merchant banking division was first started in India	1969	1979	1981	1980	1969
4	The players in the new issue market are	merchant bankers	registrars	underwriters, merchant bankers & registrars	Organisations	underwriters, merchant bankers & registrars
5	collect information on subscriptions	registrars	underwriters & brokers	collecting bankers	advertising agencies	collecting bankers
6	When the public fails to subscribe the shares to make a promise to purchase the shares	brokers	bankers	underwriters	agencies	underwriters
7	method no intermediary is involved	offer for sale	public issue	private placement	Underwriting	public issue
8	is a popular method for floating issues	prospectus	private placement	offer for sale	Underwriting	prospectus
9	is a method of floating shares through an issuing house	private placement	public issue]	rights issue	offer for sale	offer for sale
10	involves selling of ordinary shares to the existing shareholders of the company	public issue]	rights issue	offer for sale	none	rights issue
11	shares allotted to existing shareholders without any	rights issue	public issue	bonus shares	none	bonus shares

	considerations					
12	the issue price is not determined in advance	book building	bonus shares	public issue	rights issue	book building
13	is a two way market in which there are investors and buyers	primary market	new issue market	secondary market	stock exchange	secondary market
14	is a place of trading in securities	stock exchange	primary market	secondary market	Underwriting	stock exchange
15	is a facility of postponing a transaction till the next settlement day	badla financing	arbitrageur	security dealers	taraniwalla	badla financing
16	the balda trade was banned in	march 1994	march 1995	feb 1995	feb 1996	march 1994
17	is an option to sell	put	call	future	spread	put
18	is an potion to purchase	put	call	future	spread	call
19	consist of both put and call option	spread	straddle	futures	forward	spread
20	The delivery price is the spot price	forward market	futures market	options market	spread	futures market
21	shares are also called as ordinary shares	preference shares	equity shares	debentures	Share certificates	equity shares
22	The speculator sells the security and then buys it at a higher price through another broker	Wash sales	Cornering	Buying a call	Writing options	Wash sales
23	involves the simultaneous purchase and sale of different options of the same security	Spread	Call	Option	Market	Spread
24	it is the purchase of two options with the same expiry date with different prices	Horizontal spread	Vertical spread	Call	Put	Vertical spread
25	the sharing price is the same but the expiry date differs	Writing options	Vertical spread	Horizontal spread	Future	Horizontal spread

26	it is written against an owned stock position	Covered	Uncovered	Spread	One	Covered
27	it is written without owing the security	Covered	Uncovered	Spread	One	Uncovered
28	is also called as naked position	Covered	Uncovered	Spread	One	Covered
29	the transfer signs the form but does not fill in the name of the transferee	Wash sales	Writing options	Blank transfers	Spread	Blank transfers
30	it involves temporary purchase and sales of securities without registration	Blank transfers	Writing options	Blank transfers	Future option	Writing options
31	is a technique of making a profit on stock exchange trading	Blank transfer	Writing options'	Arbitrage	Future option	Arbitrage
32	price is taken between in the two markets in the same country it is called	Domestic arbitrage	Foreign arbitrage	Foreign and Domestic arbitrage	Future arbitrage	Domestic arbitrage
33	arbitrage may also between one country ti another	Domestic arbitrage	Foreign arbitrage	Foreign and Domestic arbitrage	Future arbitrage	Foreign arbitrage
34	the speculators in the market are generally represented by	Bull	Bear	Stag	Bull, Bear & Stag	Bull, Bear & Stag
35	is a person is also called a tegiwala	Bear	Stag	Lameduck	Bull	Bull
36	He expects a fall in prices always	Bull	Bear	Stag	Lameduck	Bear
37	is also called as mandiwalla	Bear	Bull	Lameduck	Bull, Bear & Stag	Bear
38	is a cautious Speculator	Bull	Stag	Lameduck	Bull, Bear & Stag	Stag
39	is a device through which a person protects himself against loss	LIC	Investment	Speculation	Hedging	Hedging
40	forward contracts are settled over a period of	7 days	5 days	6 days	9 days	6 days

41	in forward contracts the memorandum slips are compared by the buying and selling brokers	First day	Second day	Fifth day	Sixth day	First day
42	The actual delivery of shares to clearing house	First day	third day	Fifth day	Sixth day	third day
43	day is also called as pay day or account day	Second day	Third day	Fourth day	Fifth day	Third day
44	day is also called as settlement day	First day	Second Day	Fifth day	Sixth day	Sixth day
45	is also called as buyer	Bull	Bear	Stag	Bull, Bear & Stag	Bull
46	shares in the share market can be bought as	Cum dividend	Ex dividend	Cum and Ex dividend	Interest	Cum and Ex dividend
47	The Stock exchanges in India are regulated by the securities contract act	Feb 20 1955	Feb 20 1957	Feb 20 1958	Feb 20 1960	Feb 20 1957
48	A doctorate of stock exchange was setup in	1956	1957	1958	1969	1969
49	Capital issues control act was passed in	1940	1945	1947	1957	1947
50	The reforms in new issue market are related to	Allotment of shares	Bookbuilding	Issue	Allotment of shares and Book building	Allotment of shares and Book building
51	The most popular method for floating shares in new issue market is	Prospectus	Offer for sale	Placement	Rights issue	Prospectus
52	are inexpensive mode of flotation of shares	Prospectus	Offer for sale	Placement	Rights issue	Rights issue
53	The SEBI was to cover all the activities of the	Stock exchange	Financial institutions	NIM	Secondary market	NIM
54	is an independent dealers in securities	Brokers	Representatives	Security dealers	Market dealers	Brokers
55	buys and sells shares for other brokers on the floor of the exchange	Jobber	Floor broker	Odd lot dealer	Security dealers	Floor broker

56	is also called as jobber	Floor broker	Tarniwalla	Odd lot dealer	Jobber	Tarniwalla
57	The financier in the stock exchange is called	Budiwalla	Tarniwalla	Floor broker	Odd lot dealer	Budiwalla
58	are complimentary in nature	New issue market	Stock exchange	Provident fund	Public issue	Stock exchange
59	The Capital Asset Pricing Model was developed by	William Sharpe	Jan Mossin and William Sharpe	Jan Mossin	John William	Jan Mossin and William Sharpe
60	The Capital Asset Pricing Model is really an extension of the portfolio Theory of	Dow Jones	Treynor	Warren Buffet	Markowitz	Markowitz
Unit – II - Part B (5 x 8 = 40marks)

- 1. What is Risk? How risk are classified from Investment point of view?
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<u>UNIT-III</u>

SYLLABUS

Fundamental Analysis – Economic Analysis – Economic Forecasting – Forecasting Techniques – Industry Analysis – Industry Classification – Economy and Industry Analysis – Industry Life Cycle.

FUNDAMENTAL ANALYSIS

Fundamental analysis is the foundation of solid investing. It helps you determine the underlying health of a company by examining the business' core numbers: its income statements, its earnings releases, its balance sheet, and other indicators of economic health.

Fundamental analysis is a method of evaluating a security in an attempt to measure its intrinsic value, by examining related economic, financial and other qualitative and quantitative factors. Fundamental analysts study anything that can affect the security's value, including macroeconomic factors such as the overall economy and industry conditions, and microeconomic factors such as financial conditions and company management. The end goal of fundamental analysis is to produce a quantitative value that an investor can compare with a security's current price, thus indicating whether the security is undervalued or overvalued.

The Basics of Fundamental Analysis

Fundamental analysis uses real, public data in the evaluation a security's value. Although most analysts use fundamental analysis to value stocks, this method of valuation can be used for just about any type of security. For example, an investor can perform fundamental analysis on a bond's value by looking at economic factors such as interest rates and the overall state of the economy. He can also look at information about the bond issuer, such as potential changes in credit ratings.

For stocks and equity instruments, this method uses revenues, earnings, future growth, return on equity, profit margins and other data to determine a company's underlying value and potential for future growth. In terms of stocks, fundamental analysis focuses on the financial statements of the company being evaluated. One of the most famous and successful fundamental analysts is the so-called "Oracle of Omaha", Warren Buffett, who is well known for successfully employing fundamental analysis to pick securities. His abilities have turned him into a billionaire.

Class: III BBACourse Name: Investment ManagementCourse Code: 15BAU601Unit I-Fundamental AnalysisBatch: 2015-18ECONOMIC ANALYSIS

A systematic approach to determining the optimum use of scarce resources, involving comparison of two or more alternatives in achieving a specific objective under the given assumptions and constraints.

Economic analysis takes into account the opportunity costs of resources employed and attempts to measure in monetary terms the private and social costs and benefits of a project to the community or economy.

DIFFERENCE BETWEEN FUNDAMENTAL ANALYSIS AND ECONOMIC ANALYSIS

These terms refer to two different stock-picking methodologies used for researching and forecasting the future growth trends of stocks. Like any investment strategy or philosophy, both have their advocates and adversaries. Here are the defining principles of each of these methods of stock analysis:

Fundamental analysis is a method of evaluating securities by attempting to measure the intrinsic value of a stock. Fundamental analysts study everything from the overall economy and industry conditions to the financial condition and management of companies.

Technical analysis is the evaluation of securities by means of studying 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 stock charts to identify patterns and trends that may suggest what a stock will do in the future.

In the world of stock analysis, fundamental and technical analysis are on completely opposite sides of the spectrum. Earnings, expenses, assets and liabilities are all important characteristics to fundamental analysts, whereas technical analysts could not care less about these numbers. Which strategy works best is always debated, and many volumes of textbooks have been written on both of these methods. So, do some reading and decide for yourself which strategy works best with your investment philosophy.

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WHAT IS FUNDAMENTAL ANALYSIS?

Fundamental analysis is the cornerstone of investing. In fact, some would say that you aren't really investing if you aren't performing fundamental analysis. Because the subject is so broad, however, it's tough to know where to start. There are an endless number of investment strategies that are very different from each other, yet almost all use the fundamentals. he goal of this tutorial is to provide a foundation for understanding fundamental analysis. It's geared primarily at new investors who don't know a balance sheet from an income statement. While you may not be a "stock-picker extraordinaire" by the end of this tutorial, you will have a much more solid grasp of the language and concepts behind security analysis and be able to use this to further your knowledge in other areas without feeling totally lost. The biggest part of fundamental analysis involves delving into the financial statements.

Also known as quantitative analysis, this involves looking at revenue, expenses, assets, liabilities and all the other financial aspects of a company. Fundamental analysts look at this information to gain insight on a company's future performance. A good part of this tutorial will be spent learning about the balance sheet, income statement, cash flow statement and how they all fit together. Fundamental analysis is the process of looking at a business at the basic or fundamental financial level. This type of analysis examines key ratios of a business to determine its financial health and gives you an idea of the value its stock. Many investors use fundamental analysis alone or in combination with other tools to evaluate stocks for investment purposes. The goal is to determine the current worth and, more importantly, how the market values the stock. This article focuses on the key tools of fundamental analysis and what they tell you. Even if you don't plan to do in-depth fundamental analysis yourself, it will help you follow stocks more closely if you understand the key ratios and term.

Fundamental analysis typically refers to a method of analyzing and evaluating equities, though it may also apply to any kind of security. A whole slew of data including, but not limited to, financial statements, economics, health, management, interest rates, production, earnings, competitive advantages, competitors and many other qualitative and quantitative factors are considered.

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These are the primary factors to consider when conducting fundamental analysis:

- 1. What is the company's revenue?
- 2. Is it growing?
- 3. Are they even making a profit?
- 4. Are they in or paying off debt?
- 5. What are their turnover rates?
- 6. Does management take care of employees?

Fundamental Analysis Tools : These are the most popular tools of fundamental analysis. They focus on earnings, growth, and value in the market. Basically they are

- 1. Earnings per Share EPS
- 2. Price to Earnings Ratio P/E
- 3. Projected Earning Growth PEG
- 4. Price to Sales P/S
- 5. Price to Book P/B
- 6. Dividend Payout Ratio
- 7. Dividend Yield
- 8. Book Value
- 9. Return on Equity

ECONOMIC ANALYSIS

Economic analysis helps assess sustainability of investment projects that will improve the welfare of the beneficiaries and a country as a whole. Economic analysis is the procedure for assessing the opportunity of a project by considering the benefits compared to the costs, both elements being considered economically. The economic analysis uses the same indicators as financial analysis, but unlike it has in considering other additional aspects such as: Market influences; Other external factors influences; The social and environmental costs, etc. A systematic approach to determining the optimum use of scarce resources, involving comparison of two or more alternatives in achieving a specific objective under the given assumptions and constraints. Economic analysis takes into account the opportunity costs of resources employed

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and attempts to measure in monetary terms the private and social costs and benefits of a project to the community or economy.

Definition

The study of forces that determine the distribution of scarce resources. Economic analysis provides insight into how markets operate, and offers methods for attempting to predict future market behavior in response to events, trends, and cycles. Economic analysis is also used by governments to determine tax rates and evaluate the financial health of the nation or state.

A few different methods are used to carry out economic analysis.

Cost/Benefit

Cost/benefit is an economic analysis technique used to determine whether a project is feasible. This is accomplished by weighing the cost of implementation against the benefits of the project's creation. For example, prior to installing a new voice-over-Internet protocol (VoIP) telephone system into its facility, a small business may perform a cost/benefit analysis. Currently, the organization's traditional telephone system requires the employment of a receptionist at \$30,000 a year. Without accounting for wage increases and inflation, the company will have spent a total of \$300,000 on the services of the receptionist over a 10-year period. The implementation of the VoIP system may cost \$50,000. Once installed, however, the automated system will not require the use of a receptionist. Over a 10-year period, this amounts to a savings of \$250,000. After performing the cost/benefit analysis, the small-business owner can make an educated business decision.

Cost/Effectiveness

Cost/effectiveness analysis is a technique used in weighing the effectiveness of a project against its price. Unlike cost/benefit, however, a low cost does not equate to high effectiveness, and vice versa. Using the same scenario as an example, the owner of a small business has determined that implementing a VoIP system is the cheapest solution for his business. After much research, however, she also determines that a high percentage of calls that come into a VoIP system are not completed. This is due to callers' frustration with the automated system. In addition, a survey of current customers indicates that the customer service provided by live interaction with a receptionist has led to many of the business' sales. Although a live receptionist is the more expensive alternative, it is found to be the most effective.

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Cost/Minimization

Cost/minimization analysis is the technique of seeking out the least expensive method of carrying out a project. This method of economic analysis is used primarily when costs savings are at a premium and must outweigh all other considerations. In this example, the small-business owner has determined that the implementation of a VoIP system is the least expensive alternative for his business. Implementing a cost/minimization analysis, he will seek out the least expensive VoIP provider.

Forecasting is in PDF format separately refer = http://mech.at.ua/Forecasting.pdf Categories of Forecasting Techniques / Methods shall include

- 1. Qualitative vs. quantitative methods. ...
- 2. Average approach. ...
- 3. Naïve approach. ...
- 4. Drift method. ...
- 5. Seasonal naïve approach. ...
- 6. Time series methods. ...
- 7. Causal / econometric forecasting methods. ...
- 8. Judgmental methods.
- 9. Time series
- 10. Moving average
- 11. Weighted moving average
- 12. Kalman filtering
- 13. Exponential smoothing
- 14. Autoregressive moving average (ARMA)
- 15. Autoregressive integrated moving average (ARIMA)
- 16. Extrapolation
- 17. Linear prediction
- 18. Trend estimation
- 19. Growth curve (statistics)

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20.	Judgmental metho	ds include:			
21.	Composite forecas	ts			
22.	Cooke's method				
23.	Delphi method				
24.	Forecast by analog	у			
25.	Scenario building				
26.	Statistical surveys				
27.	Technology foreca	sting			
28.	Artificial intelliger	nce methods]			
29.	Artificial neural ne	etworks			
30.	Group method of a	lata handling			
31.	Support vector ma	chines			
32.	Data mining				
33.	Machine Learning				
34.	Pattern Recognition	n			
35.	Other methods - S	imulation	~		
36.	Prediction market				
37.	Probabilistic forec	asting and Ensemble forecasting etc.,,.			

INDUSTRY ANALYSIS

A market assessment tool designed to provide a business with an idea of the complexity of a particular industry. Industry analysis involves reviewing the economic, political and market factors that influence the way the industry develops. Major factors can include the power wielded by suppliers and buyers, the condition of competitors, and the likelihood of new market entrants. Industry analysis—also known as Porter's Five Forces Analysis—is a very useful tool for business strategists. It is based on the observation that profit margins vary between industries, which can be explained by the structure of an industry.

The Five Forces primary purpose is to determine the attractiveness of an industry. However, the analysis also provides a starting point for formulating strategy and understanding the competitive landscape in which a company operates.

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Porter's Five Forces Analysis

The framework for the Five Forces Analysis consists of these competitive forces:

• Industry rivalry (degree of competition among existing firms)—intense competition leads to reduced profit potential for companies in the same industry

• Threat of substitutes (products or services)—availability of substitute products will limit your ability to raise prices

• Bargaining power of buyers—powerful buyers have a significant impact on prices

• Bargaining power of suppliers—powerful suppliers can demand premium prices and limit your profit

• Barriers to entry (threat of new entrants)—act as a deterrent against new competitors Industry analysis and competition

Competition within an industry is grounded in its underlying economic structure. It goes beyond the behaviour of current competitors.

The state of competition in an industry depends upon five basic competitive forces. The collective strength of these forces determines profit potential in the industry. Profit potential is measured in terms of long-term return on invested capital. Different industries have different profit potential—just as the collective strength of the five forces differs between industries.

Industry analysis as a tool to develop competitive strategy

Industry analysis enables a company to develop a competitive strategy that best defends against the competitive forces or influences them in its favour. The key to developing a competitive strategy is to understand the sources of the competitive forces. By developing an understanding of these competitive forces, the company can:

- Highlight the company's critical strengths and weaknesses
- Animate its position in the industry
- Clarify areas where strategic changes will result in the greatest payoffs

• Emphasize areas where industry trends indicate the greatest significance as either opportunities or threats

Industry analysis and structure

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The five competitive forces reveal that competition extends beyond current competitors. Customers, suppliers, substitutes and potential entrants—collectively referred to as an extended rivalry—are competitors to companies within an industry.

The five competitive forces jointly determine the strength of industry competition and profitability. The strongest force (or forces) rules and should be the focal point of any industry analysis and resulting competitive strategy.

Short-term factors that affect competition and profitability should be distinguished from the competitive forces that form the underlying structure of an industry. Although these short-term factors may have some tactical significance, analysis should focus on the industry's underlying characteristics.

What Is Industry Analysis?

Industry analysis is a market strategy tool used by businesses to determine if they want to enter a product or service market. Company management must carefully analyze several aspects of the industry to determine if they can make a profit selling goods and services in the market. Analyzing economic factors, supply and demand, competitors, future conditions and government regulations will help management decide whether to enter an industry or invest money elsewhere.

Industry analysis can be delineated as a market assessment tool which is designed to provide a business with ideas of complexity in a specific industry. Putting it simple, the industry analysis is a report that guides companies on their business strategy. The concept of industry analysis includes reviewing the economic, political, and market factors influencing the manner in which the industry develops. Most important factors can involve the power exerted by the buyers and suppliers, the possibility of fresh market entrants, and the condition of competitors.

Benefits of industrial analysis

The key advantage of accomplishing an industry analysis is that the company managers obtain a better understanding about the position of their business in the respective sector. This allows the businesses to spot themselves vigilantly in the specific industry where they can serve a niche market or proffer a particular product/service that provides them a benefit over competitors. The analysis is also helpful to the companies respond in a better way to changes in the industry.

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Importance of industry analysis

The industry analysis is an important element of a business plan. It is important for the business owners to understand the industries in which they operate to guarantee unrelenting success. The financial health of a company is generally an indication of the company's health. Therefore, by carrying out an industry analysis, the business owners can form a strategy which is more likely to assist the business in growth and success. Moreover, industry analysis is helpful for the planners in positioning their business in the niche market for the products and services offered by them. Another reason indicating the importance of industry analysis lies in the fact that it aids the companies in recognizing the potential opportunities for the business to develop, in addition to threats that could be an obstacle in the growth of the company. Being capable of congregating requirement of a consumer, which is else wise undeserved, may be an opportunity. Conversely, high capital costs or strict government rules on exports and imports can be considered as examples of probable threats in different industries.

INDUSTRY CLASSIFICATION : Essence of industry

Cottage industry - Heavy industry - Light industry - Manufacturing Industry sectors

Primary sector of industry (the raw materials industry) - Secondary sector of industry (manufacturing and construction) - Tertiary sector of industry (the "service industry") - Quaternary sector of industry (intellectual services industry)

Major industries

Aerospace industry - Agriculture - Fishing industry - Timber industry - Tobacco industry -Chemical industry - Pharmaceutical industry - Computer industry - Software industry -Construction industry - Defense industry - Arms industry - Education industry - Energy industry - Electrical power industry - Petroleum industry - Entertainment industry - Financial services industry - Insurance industry - Food industry - Fruit production - Health care industry -Hospitality industry - Information industry - Manufacturing - Automotive industry -Electronics industry - Pulp and paper industry - Steel industry - Shipbuilding industry - Mass media -Broadcasting - Film industry - Internet - Music industry - News media - Publishing - Mining – Telecommunications -industry - Transport industry - Water industry - Direct Selling industry

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INDUSTRY LIFE CYCLE

Industries experience a similar cycle of life. The distinct stages of an industry life cycle are: introduction, growth, maturity, and decline. Sales typically begin slowly at the introduction phase, and then take off rapidly during the growth phase. After leveling out at maturity, sales then begin a gradual decline. Life cycle models are not just a phenomenon of the life sciences. Industries experience a similar cycle of life. Just as a person is born, grows, matures, and eventually experiences decline and ultimately death, so too do industries and product lines. The stages are the same for all industries, yet every industry will experience these stages differently, they will last longer for some and pass quickly for others. Even within the same industry, various firms may be at different life cycle stages. A firms strategic plan is likely to be greatly influenced by the stage in the life cycle at which the firm finds itself. Some companies or even industries find new uses for declining products, thus extending their life cycle. The growth of an industry's sales over time is used to chart the life cycle. The distinct stages of an industry life cycle are: introduction, growth, maturity, and decline. Sales typically begin slowly at the introduction phase, then take off rapidly during the growth phase. After leveling out at maturity, sales then begin a gradual decline. In contrast, profits generally continue to increase throughout the life cycle, as companies in an industry take advantage of expertise and economies of scale and scope to reduce unit costs over time.

What is the life cycle of a company?

The business life cycle usually includes its birth or incorporation stage, its initial growth stage, its expansion stage as it moves into new markets, its mature operation stage, and its eventual decline as consumer interest in its products wane and key employees depart.

What is the growth of industry?

The growth industry is the sector of the economy experiencing a higher-than-average growth rate. Growth industries are often associated with new or pioneer industries that did not exist in the past and their growth is related to consumer demand for the new products or services offered by the firms within the industry.

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What is the life cycle of a product?

A new product progresses through a sequence of stages from introduction to growth, maturity, and decline. This sequence is known as the product life cycle and is associated with changes in the marketing situation, thus impacting the marketing strategy and the marketing mix.

What is industry lifecycle ?

The normal stages that a industry goes through during the course of its lifecycle in the market. An industry lifecycle is broken into five separate phases: Early stages phase, innovation phase, cost/shakeout phase, maturity phase and decline phase. During the initial phase, the product may be altered to make a place for it in the industry. The innovation phase looks to expand the product even further to come up with a concrete design. The next phase involves companies within the industry establishing a concrete design thus eliminating some of the smaller companies that do not follow this patter.

Part B (5 x 8 = 40marks)

- 1. Why Investment is important? Discuss the factors influencing investment decisions.
- 2. Narrate various factors in favourable for making investment.
- 3. Write in detail about the organisation, membership and management of stock exchange.
- 4. Write down procedure in trading an security in Indian stock exchange.
- 5. Bring out the influence of economy during fundamental analysis.
- 6. Discuss the factors influencing industry analysis.
- 7. Differentiate between Technical analysis and Fundamental analysis.
- 8. Write down the tools applicable for company analysis from financial statement point of view.
- 9. Discuss Markowitz theory with illustration.
- 10. Discuss the factors influencing investment in India.
- 11. Discuss the investment opportunities in the Indian sector.
- 12. Explain the various features of Investment Programme.
- 13. Define Risk? Explain the possibilities to reduce it while planning an organization.
- 14. Enumerate the different types of Equity Shares.
- 15. Explain the factors affecting Economic Analysis with example.
- 16. Elucidate the concept Industry Analysis with suitable example.

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17. Enumerate the constituents	s of Company Analysis.				
18. Explain the Merits and Der	merits of Moving Average.				
19. Elucidate Treyner's Perfor	mance Measurement in Portfolio Analy	sis.			
20. Enumerate the Techniques	used in Portfolio Evaluation.				
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DEPARTMENT OF MANAGMENET								
	Unit III- Fundamental Analysis - Multiple Choice Questions- Each Question carries ONE Mark							
SN	Questions	Option 1	Option 2	Option 3	Option 4	Answer		
1	The is a description of how rational investors should build efficient portfolio and select the optimal portfolio	САРМ	APT	Option pricing theory	Portfolio theory	Portfolio theory		
2	Risk is measured as a variability in	Principle	Return	Safety	Return and Safety	Return		
3	The derives the relationship between the expected return and risk of individual securities and portfolios	САРМ	APT	Option pricing theory	Portfolio theory	САРМ		
4	Investors attempt to reduce the variability of returns through of investments	Concentration	Sectorisation	Indexation	Diversification	Diversification		
5	With a given set of securities , any number of portfolio may be created by	Random Techniques	Altering the proportion of funds invested in each security	Investing equal amounts of funds in each security	Modern techniques	Investing equal amounts of funds in each security		
6	This un diversifiable variable is known as	Market risk	Interest rate risk	Portfolio risk	Diverse risk	Market risk		
7	The higher the risk of a security, the would be the return expected from it	Lower	Higher	Higher and lower	Medium	Higher		
8	Portfolio theory Talks about of stocks	Concentration	Segmentation	Diversification	Modernisation	Diversification		
9	If we construct a portfolio including all the securities in the stock market, that would be the most diversified portfolio. Even such a portfolio would be subject to considerable variability in returns . This variability is un diversifiable and is known as	Systematic risk	Interest rate risk	Portfolio risk	Diverse risk	Systematic risk		
10	The Capital Asset Pricing model is really an extension of the portfolio theory of	Dow Jones	Treynor	Warren Buffet	Markowitz	Markowitz		
11	The CAPM gives the nature of the relationship between the expected return and	Actual return	Systematic risk	Unsystematic risk	Market risk	Systematic risk		

	the of the securities					
12	At the core of Arbitrage pricing theory is the recognition that several factors affect security returns	External	Non Systematic	Systematic	Internal	Systematic
13	Talks about Diversification of stocks	Portfolio theory	Teynor, Theory	Market Theory	Modernisation Theory	Portfolio theory
14	is a contract between a buyer and seller , wherein they agree to exchange something at a specified price at the end of a designated period of time	Exchange contract	Futures contract	Period contract	Option contract	Futures contract
15	The basic framework for fundamental analysis is	Economic analysis	Industry analysis	Company analysis	Fundamental Analysis	Fundamental Analysis
16	is the total value of the final output of goods and services produced in the economy	Final output	Economic value	GNP	SDP	GNP
17	is the field of study that applies mathematical and statistical techniques to economic theory	Econ ometrics	Econo statistics	Analytics	Econo maths	Econometrics
18	The is the rate at which one's domestic currency can be converted into the currency of another Country	Exchange rate	Currency rate	Currency exchange	Exchange currency rate	Exchange rate
19	are those that are most likely to benefit from a period of economic prosperity and most likely to suffer from a period of economic recession	Growth industry	Value industry	Cyclical industry	Sick Industry	Cyclical industry
20	Working Capital = Current Liabilities	Current asset	Fixed asset	Investments	Debt	Current asset
21	A fund investing in the shares underlying an index is called	Shares fund	Index fund	Underlying fund	Stock fund	Index fund
22	is defined as the closing price of the share, divided by the reported earnings of the most recent 12 months	PE ratio	EPS	Index	Earnings multiple	PE ratio
23	Current ratio is	Current Assets / current liabilities	Current Liabilities /	Debt / Current liabilities	Earnings after interest / Sales	Current Assets / current liabilities

			Current assets			
24	Debt Equity ration is	Current Assets / current liabilities	Long term debt / Shareholder's equity	Debt / Current liabilities	Earnings after interest / Sales	Long term debt / Shareholder's equity
25	Net profit ratio is	Current Assets / current liabilities	Long term debt / Shareholder's equity	Earnings after tax / Sales	Earnings after interest / Sales	Earnings after tax / Sales
26	EPS is	Net profit / No of equity shares	Long term debt / Shareholder's equity	Earnings after tax / Sales	Sales / Current Liabilities	Net profit / No of equity shares
27	PE ratio is	Net profit / No of equity shares	Market price per share / EPS	Earnings after tax / Sales	Earnings after interest / Sales	Market price per share / EPS
28	Return on Investment is	Net profit / No of equity shares	Market price per share / EPS	Earnings after tax / Total assets	Sales / Current Liabilities	Earnings after tax / Total assets
29	Current assets turnover is	Sales / Current Assets	Market price per share / EPS	Earnings after tax / Sales	Sales / Current Liabilities	Sales / Current Assets
30	Liquidity ratios are	Current ratio	Quick ratio	Current and Quick ratio	Proprietary ratio	Current and Quick ratio
31	Leverage ratios are	Debt – Equity ratio	Proprietary ratio	Debt – Equity and Proprietary ratio	Net profit ratio	Debt – Equity and Proprietary ratio
32	Capital Structure ratios are	Debt – Equity ratio	Proprietary ratio	Debt – Equity and Proprietary ratio	Operating profit ratio	Debt – Equity and Proprietary ratio
33	Profitability ratios are	Gross profit ratio	Operating profit ratio	Net profit ratio	Profitability ratio	Profitability ratio
34	is not a leverage ratio	Debt equity ratio	Proprietary ratio	Interest coverage ratio	Currents ratio	Currents ratio
35	is not a liquid ratio	Current ratio	Quick ratio	Debt equity ratio	Net profit ratio	Debt equity ratio

36	gives you an idea of the profitability of a company related to the investments made by the company	Return on assets	Return on Equity	EPS	Return on assets ans equity	Both A and B
37	Dividend yield of a share is	Dividend per share / market price of a share	Quick ratio	Debt equity ratio	Solvancy ratio	Dividend per share / market price of a share
38	The standard denomination for preference shares and non convertible debentures are	Rs 1	Rs 10	Rs 1000	Rs 100	Rs 100
39	Support occurs when price is	Falling but bounces back	Increases but reverses	Falling continuously	Increasing continuously	Falling but bounces back
40	In a chart, when all low points are connected by a horizontal line, it forms the	Support line	Resistance line	Pattern	Trend	Support line
41	In a chart, when all high points are connected by a horizontal line, it forms the	Support line	Resistance line	Pattern	Trend	Resistance line
42	According to Dow theory, the formation of lower tops and lower bottoms indicate	Bullish trend	Bearish trend	Flat market	Cyclical market	Bearish trend
43	bid in the auction of 91 / 364 Days Treasury bills	Banks	State Government	Primary Dealers	Central Government	Primary Dealers
44	plays a vital role in the returns generated through a bond	Economic scenario	Industry scenario	Interest rate	Maturity value	Interest rate
45	When a trend reverses and begins to fall, a technical analyst would recommend of a share	Purchase	Sale	Hold	Both purchase and sales	Sale
46	Support occurs when price is	Falling but bounces back	Increases but reverses	Falling continuously	Increasing continuously	Falling but bounces back
47	According to Dow theory, the formation of higher bottoms and higher tops indicate a	Bearish trend	Bullish trend	Flat market	Cyclical market	Bullish trend
48	According to Dow theory, each peak will be followed by a bottom formed because of	Primary movements	Secondary reaction	Minor movements	Primary and Secondary movements	Minor movements

49	A white candlestick is used to represent a situation where	The highest price happens first	The lowest price happens first	The closing price of the day is higher than the opening price	The opening price is higher than the closing price	The closing price of the day is higher than the opening price
50	Short selling refers to	Selling a share which a person does not own	Selling a friend's share	Selling a share which a person owns	Selling a newly listed share	Selling a share which a person does not own
51	It emphasis the protection of prices and dividends	Security analysis	Portfolio analysis	Fundamental analysis	Securities	Security analysis
52	Portfolios are combinations of	Assets	Liabilities	Assets and Liabilities	Securities	Assets
53	The maturity period of government bonds in india are	10-20 years	15-20 years	20- 30 years	above 30 years	10-20 years
54	At the time of maturity period the bond holders receive	Face value	Nominal premium	Face value and Normal premium	External value	Face value and Normal premium
55	are also called as systematic risk	External risk	Internal risk	Uncertainty	Financial risk	External risk
56	are uncontrollable	Internal risk	External risk	Uncertainty	Financial risk	External risk
57	Internal risk also called as	Systematic risk	Unsystematic risk	Systematic and Unsystematic risk	Purchasing power risk	Unsystematic risk
58	risk are unique to a firm or industry	Systematic risk	Unsystematic risk	Systematic risk and Unsystematic risk	Purchasing power risk	Unsystematic risk
59	can be reduced but not eliminated	Market risk	Financial risk	Business risk	Purchasing power risk	Market risk
60	is also known as inflation risk	Market risk	Financial risk	Purchasing power risk	Business risk	Purchasing power risk

Unit – III - Part B ($5 \times 8 = 40$ marks)

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<u>UNIT-IV</u>

SYLLABUS

Company Analysis – Measuring Earning – Forecasting Earnings – Technical Analysis – Charting Methods – Market Indicators – Trend – Moving Average – Fundamental Vs Technical Analysis

Introduction to company analysis

Company analysis is a process carried out by investors to evaluate securities, collecting info 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, important6 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

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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.

Fundamental analysis

Fundamental analysis seeks to determine the intrinsic value of a company's stock. But since qualitative factors, by definition, represent aspects of a company's business that are difficult or impossible to quantify, incorporating that kind of information into a pricing evaluation can be quite difficult. On the flip side, as we've demonstrated, you can't ignore the less tangible characteristics of a company.

In this section we are going to highlight some of the company-specific qualitative factors that you should be aware of.

Business Model

Even before an investor looks at a company's financial statements or does any research, one of the most important questions that should be asked is: What exactly does the company do? This is referred to as a company's business model - it's how a company makes money. You can get a good overview of a company's business model by checking out its website or reading the first part of its 10-K filing.

Sometimes business models are easy to understand. Take McDonalds, for instance, which sells hamburgers, fries, soft drinks, salads and whatever other new special they are promoting at the time. It's a simple model, easy enough for anybody to understand.

Other times, you'd be surprised how complicated it can get. Boston Chicken Inc. is a prime example of this. Back in the early '90s its stock was the darling of Wall Street. At one point the company's CEO bragged that they were the "first new fast-food restaurant to reach \$1 billion in sales since 1969". The problem is, they didn't make money by selling chicken. Rather, they made their money from royalty fees and high-interest loans to franchisees. Boston Chicken was really nothing more than a big franchisor. On top of this, management was aggressive with how it recognized its revenue. As soon as it was revealed that all the franchisees were losing money, the house of cards collapsed and the company went bankrupt.

At the very least, you should understand the business model of any company you invest in. The "Oracle of Omaha", Warren Buffett, rarely invests in tech stocks because most of the time he doesn't understand them. This is not to say the technology sector is bad, but it's not Buffett's area of expertise; he doesn't feel comfortable investing in this area. Similarly, unless you understand a company's business model, you don't know what the drivers are for future growth, and you leave yourself vulnerable to being blindsided like shareholders of Boston Chicken were.

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Competitive Advantage

Another business consideration for investors is competitive advantage. A company's long-term success is driven largely by its ability to maintain a competitive advantage - and keep it. Powerful competitive advantages, such as Coca Cola's brand name and Microsoft's domination of the personal computer operating system, create a moat around a business allowing it to keep competitors at bay and enjoy growth and profits. When a company can achieve competitive advantage, its shareholders can be well rewarded for decades.

Management

Just as an army needs a general to lead it to victory, a company relies upon management to steer it towards financial success. Some believe that management is the most important aspect for investing in a company. It makes sense - even the best business model is doomed if the leaders of the company fail to properly execute the plan.

Average investor evaluating the management of a company

This is one of the areas in which individuals are truly at a disadvantage compared to professional investors. You can't set up a meeting with management if you want to invest a few thousand dollars. On the other hand, if you are a fund manager interested in investing millions of dollars, there is a good chance you can schedule a face-to-face meeting with the upper brass of the firm.

Every public company has a corporate information section on its website. Usually there will be a quick biography on each executive with their employment history, educational background and any applicable achievements. Don't expect to find anything useful here. Let's be honest: We're looking for dirt, and no company is going to put negative information on its corporate website.

Instead, here are a few ways for you to get a feel for management:

1. Conference Calls

The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) host quarterly conference calls. (Sometimes you'll get other executives as well.) The first portion of the call is management basically reading off the financial results. What is really interesting is the question-and-answer portion of the call. This is when the line is open for analysts to call in and ask management direct questions. Answers here can be revealing about the company, but more importantly, listen for candor.

2. Management Discussion and Analysis (MD&A)

The Management Discussion and Analysis is found at the beginning of the annual report (discussed in more detail later in this tutorial). In theory, the MD&A is supposed to be frank commentary

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on the management's outlook. Sometimes the content is worthwhile, other times it's boilerplate. One tip is to compare what management said in past years with what they are saying now. Is it the same material rehashed? Have strategies actually been implemented? If possible, sit down and read the last five years of MD&As; it can be illuminating.

3. Ownership and Insider Sales

Just about any large company will compensate executives with a combination of cash, restricted stock and options. While there are problems with stock options, it is a positive sign that members of management are also shareholders. The ideal situation is when the founder of the company is still in charge. Examples include Bill Gates (in the '80s and '90s), Michael Dell and Warren Buffett. When you know that a majority of management's wealth is in the stock, you can have confidence that they will do the right thing. As well, it's worth checking out if management has been selling its stock. This has to be filed with the Securities and Exchange Commission (SEC), so it's publicly available information. Talk is cheap - think twice if you see management unloading all of its shares while saying something else in the media.

4. Past Performance

Another good way to get a feel for management capability is to check and see how executives have done at other companies in the past. You can normally find biographies of top executives on company web sites. Identify the companies they worked at in the past and do a search on those companies and their performance.

Corporate Governance

Corporate governance describes the policies in place within an organization denoting the relationships and responsibilities between management, directors and stakeholders. These policies are defined and determined in the company charter and its bylaws, along with corporate laws and regulations. The purpose of corporate governance policies is to ensure that proper checks and balances are in place, making it more difficult for anyone to conduct unethical and illegal activities.

Good corporate governance is a situation in which a company complies with all of its governance policies and applicable government regulations (such as the Sarbanes-Oxley Act of 2002) in order to look out for the interests of the company's investors and other stakeholders.

Although, there are companies and organizations (such as Standard & Poor's) that attempt to quantitatively assess companies on how well their corporate governance policies serve stakeholders, most of these reports are quite expensive for the average investor to purchase.

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Fortunately, corporate governance policies typically cover a few general areas: structure of the board of directors, stakeholder rights and financial and information transparency. With a little research and the right questions in mind, investors can get a good idea about a company's corporate governance.

Financial and Information Transparency

This aspect of governance relates to the quality and timeliness of a company's financial disclosures and operational happenings. Sufficient transparency implies that a company's financial releases are written in a manner that stakeholders can follow what management is doing and therefore have a clear understanding of the company's current financial situation.

Stakeholder Rights

This aspect of corporate governance examines the extent that a company's policies are benefiting stakeholder interests, notably shareholder interests. Ultimately, as owners of the company, shareholders should have some access to the board of directors if they have concerns or want something addressed. Therefore companies with good governance give shareholders a certain amount of ownership voting rights to call meetings to discuss pressing issues with the board.

Another relevant area for good governance, in terms of ownership rights, is whether or not a company possesses large amounts of takeover defenses (such as the Macaroni Defense or the Poison Pill) or other measures that make it difficult for changes in management, directors and ownership to occur.

Structure of the Board of Directors

The board of directors is composed of representatives from the company and representatives from outside of the company. The combination of inside and outside directors attempts to provide an independent assessment of management's performance, making sure that the interests of shareholders are represented.

The key word when looking at the board of directors is independence. The board of directors is responsible for protecting shareholder interests and ensuring that the upper management of the company is doing the same. The board possesses the right to hire and fire members of the board on behalf of the shareholders. A board filled with insiders will often not serve as objective critics of management and will defend their actions as good and beneficial, regardless of the circumstances.

Information on the board of directors of a publicly traded company (such as biographies of individual board members and compensation-related info) can be found in the DEF 14A proxy statement.

We've now gone over the business model, management and corporate governance. These three areas are all important to consider when analyzing any company. We will now move on to looking at qualitative factors in the environment in which the company operates.

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MEASURING EARNINGS

Accountants use the income statement to provide information about a firm's operating activities over a specific time period. The income statement is designed to measure the earnings from assets in place. This section examines the principles underlying earnings and return measurement in accounting, and the way they are put into practice.

Accounting Principles Underlying Measurement of Earnings

Two primary principles underlie the measurement of accounting earnings and profitability. The first is the principle of accrual accounting. In accrual accounting, the revenue from selling a good or service is recognized in the period in which the good is sold or the service is performed (in whole or substantially). A corresponding effort is made on the expense side to match expenses to revenues. This is in contrast to a cash-based system of accounting, where revenues are recognized when payment is received and expenses are recorded when paid.

The second principle is the categorization of expenses into operating, financing, and capital expenses. Operating expenses are expenses that, at least in theory, provide benefits only for the current period; the cost of labor and materials expended to create products that are sold in the current period is a good example. Financing expenses are expenses arising from the non-equity financing used to raise capital for the business; the most common example is interest expenses. Capital expenses are expenses that are expected to generate benefits over multiple periods; for instance, the cost of buying land and buildings is treated as a capital expense.

Operating expenses are subtracted from revenues in the current period to arrive at a measure of operating earnings of the firm. Financing expenses are subtracted from operating earnings to estimate earnings to equity investors or net income. Capital expenses are written off over their useful lives (in terms of generating benefits) as depreciation or amortization.

Measuring Accounting Earnings

Since income can be generated from a number of different sources, generally accepted accounting principles (GAAP) require that income statements be classified into four sections income from continuing operations, income from discontinued operations, extraordinary gains or losses, and adjustments for changes in accounting principles.

Generally accepted accounting principles require the recognition of revenues when the service for which the firm is getting paid has been performed in full or substantially, and the firm has received in

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return either cash or a receivable that is both observable and measurable. Expenses linked directly to the production of revenues (like labor and materials) are recognized in the same period in which revenues are recognized. Any expenses that are not directly linked to the production of revenues are recognized in the period in which the firm consumes the services. Accounting has resolved one inconsistency that bedeviled it for years, with a change in the way it treats employee options. Unlike the old rules, these option grants were not treated as expenses when granted but only when exercised, the new rules require that employee options be valued and expensed, when granted (with allowances for amortization over periods). Since employee options are part of compensation, which is an operating expense, the new rules make more sense.

While accrual accounting is straightforward in firms that produce goods and sell them, there are special cases where accrual accounting can be complicated by the nature of the product or service being offered. For instance, firms that enter into long-term contracts with their customers are allowed to recognize revenue on the basis of the percentage of the contract that is completed. As the revenue is recognized on a percentage-of-completion basis, a corresponding proportion of the expense is also recognized. When there is considerable uncertainty about the capacity of the buyer of a good or service to pay for it, the firm providing the good or service may recognize the income only when it collects portions of the selling price under the installment method.

Reverting back to the discussion of the difference between capital and operating expenses, operating expenses should reflect only those expenses that create revenues in the current period. In practice, however, a number of expenses are classified as operating expenses that do not seem to meet this test. The first is depreciation and amortization. While the notion that capital expenditures should be written off over multiple periods is reasonable, the accounting depreciation that is computed on the original historical cost often bears little resemblance to the actual economic depreciation. The second expense is research and development expenses, which accounting standards classify as operating expenses, but which clearly provide benefits over multiple periods. The rationale used for this classification is that the benefits cannot be counted on or easily quantified.

Much of financial analysis is built around the expected future earnings of a firm, and many of these forecasts start with the current earnings. It is therefore important to know how much of these earnings comes from the ongoing operations of the firm and how much can be attributed to unusual or extraordinary events that are unlikely to recur on a regular basis. From that standpoint, it is useful that firms categorize expenses into operating and nonrecurring expenses, since it is the earnings prior to extraordinary items that should be used in forecasting. Nonrecurring items include:

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- Unusual or infrequent items, such as gains or losses from the divestiture of an asset or division, and write-offs or restructuring costs. Companies sometimes include such items as part of operating expenses. As an example, Boeing in 1997 took a write-off of \$1,400 million to adjust the value of assets it acquired in its acquisition of McDonnell Douglas, and it showed this as part of operating expenses.
- Extraordinary items, which are defined as events that are unusual in nature, infrequent in occurrence, and material in impact. Examples include the accounting gain associated with refinancing high-coupon debt with lower-coupon debt, and gains or losses from marketable securities that are held by the firm.
- Losses associated with discontinued operations, which measure both the loss from the phaseout period and any estimated loss on sale of the operations. To qualify, however, the operations have to be separable from the firm.
- Gains or losses associated with accounting changes, which measure earnings changes created by both accounting changes made voluntarily by the firm (such as a change in inventory valuation) and accounting changes mandated by new accounting standards.
- •

FORECASTING EARNINGS

Consensus Earnings

Consensus earnings estimates are far from perfect, but they are watched by many investors and play an important role in measuring the appropriate valuation for a stock. Investors measure stock performance on the basis of a company's earnings power. To make a proper assessment, investors seek a sound estimate of this year's and next year's earnings per share (EPS), as well as a strong sense of how much the company will earn even farther down the road.

As part of their services to clients, large brokerage firms such as Citigroup and Merrill Lynch employ legions of stock analysts to publish forecast reports on companies' earnings over the coming years.

A consensus forecast number is normally an average or median of all the forecasts from individual analysts tracking a particular stock. So, when you hear that a company is expected to earn \$1.50 per-share this year, that number could be the average of 30 different forecasts. On the other hand, if it's a smaller company, the estimate could be the average of just one or two stock analyst forecasts.

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A few companies, such as Thomson First Call, Reuters and Zacks Investment Research, compile estimates and compute the average or consensus. Consensus numbers can also be found at a number of financial websites, including Yahoo! Finance and MSN MoneyCentral. Some of these sites also show how estimates get revised upwards or downwards.

Consensus estimates of quarterly earnings are published for the current quarter, the next quarter and so on for about eight quarters. In some cases, forecasts are available beyond the first few quarters. Forecasts are also compiled for the current and next 12 month periods.

A consensus forecast for the current year is reported once actual results for the previous year are released. As actual numbers are made available, analysts typically revise their projections within the quarter or year they are forecasting.

Even the most sophisticated investors - such as mutual fund and pension fund managers - rely heavily on consensus estimates. Most of them do not have the resources to track thousands of publicly-listed companies in detail - or even to keep tabs on a fraction of them, for that matter.

On 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.

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.

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.

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Basis of Analysts' Forecasts

Earnings forecasts are based on analysts' expectations of company growth and profitability. To predict earnings, most analysts build financial models that estimate prospective revenues and costs.

Many analysts will incorporate top-down factors such as economic growth rates, currencies and other macroeconomic factors that influence corporate growth. They use market research reports to get a sense of underlying growth trends. To understand the dynamics of the individual companies they cover, really good analysts will speak to customers, suppliers and competitors. The companies themselves offer earnings guidance that analysts build into the models.

To predict revenues, analysts estimate sales volume growth and estimate the prices that companies can charge for the products. On the cost side, analysts look at expected changes in the costs of running the business. Costs include wages, materials used in production, marketing and sales costs, interest on loans, etc.

According to Damodaran, the general consensus is that analyst forecasts are better than extrapolating from historical growth over the very short-term (up to 1 year) but not over longer time frames. He suggests several factors/questions that can help determine the weight assigned to analyst forecasts:

- How much recent firm-specific information is there? Have there been significant changes in management or business conditions in the recent past, for example, a restructuring?
- Generally speaking, the more there are, the better informative the consensus (although there is also a risk of "herding")
- What much disagreement is there? Because of this herding phenomenon, the extent of disagreement between analysts, for example measured by the standard deviation in growth predictions, is also a useful measure of the reliability of the consensus forecasts.
- Quality of analysts following the stock.

TECHNICAL ANALYSIS

In finance, technical analysis is a security analysis methodology for forecasting the direction of prices through the study of past market data, primarily price and volume. Behavioral economics and quantitative analysis use many of the same tools of technical analysis which, being an aspect of active management, stands in contradiction to much of modern portfolio theory. The efficacy of both technical

and fundamental analysis is disputed by the efficient-market hypothesis which states that stock market prices are essentially unpredictable.

Characteristics

Technical analysis employs models and trading rules based on price and volume transformations, such as the relative strength index, moving averages, regressions, inter-market and intra-market price correlations, business cycles, stock market cycles or, classically, through recognition of chart patterns.

Technical analysis stands in contrast to the fundamental analysis approach to security and stock analysis. Technical analysis analyzes price, volume and other market information, whereas fundamental analysis looks at the facts of the company, market, currency or commodity. Most large brokerage, trading group, or financial institutions will typically have both a technical analysis and fundamental analysis team.

Technical analysis is widely used among traders and financial professionals and is very often used by active day traders, market makers and pit traders. In the 1960s and 1970s it was widely dismissed by academics. In a recent review, Irwin and Park reported that 56 of 95 modern studies found that it produces positive results but noted that many of the positive results were rendered dubious by issues such as data snooping, so that the evidence in support of technical analysis was inconclusive; it is still considered by many academics to be pseudoscience. Academics such as Eugene Fama say the evidence for technical analysis is sparse and is inconsistent with the weak form of the efficient-market hypothesis. Users hold that even if technical analysis cannot predict the future, it helps to identify trading opportunities.

In the foreign exchange markets, its use may be more widespread than fundamental analysis. This does not mean technical analysis is more applicable to foreign markets, but that technical analysis is more recognized as to its efficacy there than elsewhere. While some isolated studies have indicated that technical trading rules might lead to consistent returns in the period prior to 1987, most academic work has focused on the nature of the anomalous position of the foreign exchange market. It is speculated that this anomaly is due to central bank intervention, which obviously technical analysis is not designed to predict. Recent research suggests that combining various trading signals into a Combined Signal Approach may be able to increase profitability and reduce dependence on any single rule.

Principles

Stock chart showing levels of support (4,5,6, 7, and 8) and resistance (1, 2, and 3); levels of resistance tend to become levels of support and vice versa.

A fundamental principle of technical analysis is that a market's price reflects all relevant information, so their analysis looks at the history of a security's trading pattern rather than external drivers such as economic, fundamental and news events. Therefore, price action tends to repeat itself due to investors collectively tending toward patterned behavior – hence technical analysis focuses on identifiable trends and conditions.

Market action discounts everything

Based on the premise that all relevant information is already reflected by prices, technical analysts believe it is important to understand what investors think of that information, known and perceived.

Prices move in trends

Technical analysts believe that prices trend directionally, i.e., up, down, or sideways (flat) or some combination. The basic definition of a price trend was originally put forward by Dow Theory.

An example of a security that had an apparent trend is AOL from November 2001 through August 2002. A technical analyst or trend follower recognizing this trend would look for opportunities to sell this security. AOL consistently moves downward in price. Each time the stock rose, sellers would enter the market and sell the stock; hence the "zig-zag" movement in the price. The series of "lower highs" and "lower lows" is a tell tale sign of a stock in a down trend. In other words, each time the stock moved lower, it fell below its previous relative low price. Each time the stock moved higher, it could not reach the level of its previous relative high price.

Note that the sequence of lower lows and lower highs did not begin until August. Then AOL makes a low price that does not pierce the relative low set earlier in the month. Later in the same month, the stock makes a relative high equal to the most recent relative high. In this a technician sees strong indications that the down trend is at least pausing and possibly ending, and would likely stop actively selling the stock at that point.

History tends to repeat itself

Technical analysts believe that investors collectively repeat the behavior of the investors that preceded them. To a technician, the emotions in the market may be irrational, but they exist. Because

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investor behavior repeats itself so often, technicians believe that recognizable (and predictable) price patterns will develop on a chart. Recognition of these patterns can allow the technician to select trades that have a higher probability of success.

Technical analysis is not limited to charting, but it always considers price trends. For example, many technicians monitor surveys of investor sentiment. These surveys gauge the attitude of market participants, specifically whether they are bearish or bullish. Technicians use these surveys to help determine whether a trend will continue or if a reversal could develop; they are most likely to anticipate a change when the surveys report extreme investor sentiment Surveys that show overwhelming bullishness, for example, are evidence that an uptrend may reverse; the premise being that if most investors are bullish they have already bought the market (anticipating higher prices). And because most investors are bullish and invested, one assumes that few buyers remain. This leaves more potential sellers than buyers, despite the bullish sentiment. This suggests that prices will trend down, and is an example of contrarian trading.

Recently, Kim Man Lui, Lun Hu, and Keith C.C. Chan have suggested that there is statistical evidence of association relationships between some of the index composite stocks whereas there is no evidence for such a relationship between some index composite others. They show that the price behavior of these Hang Seng index composite stocks is easier to understand than that of the index.

Industry

The industry is globally represented by the International Federation of Technical Analysts (IFTA), which is a Federation of regional and national organizations. In the United States, the industry is represented by both the Market Technicians Association (MTA) and the American Association of Professional Technical Analysts (AAPTA). The United States is also represented by the Technical Security Analysts Association of San Francisco (TSAASF). In the United Kingdom, the industry is represented by the Society of Technical Analysts (STA). In Canada the industry is represented by the Canadian Society of Technical Analysts. In Australia, the industry is represented by the Australian Technical Analysts Association (ATAA), (which is affiliated to IFTA) and the Australian Professional Technical Analysts (APTA) Inc.

Professional technical analysis societies have worked on creating a body of knowledge that describes the field of Technical Analysis. A body of knowledge is central to the field as a way of defining how and why technical analysis may work. It can then be used by academia, as well as regulatory bodies, in developing proper research and standards for the field. The Market Technicians Association (MTA) has published a body of knowledge, which is the structure for the MTA's Chartered Market Technician (CMT) exam.

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Systematic trading

Neural networks

Since the early 1990s when the first practically usable types emerged, artificial neural networks (ANNs) have rapidly grown in popularity. They are artificial intelligence adaptive software systems that have been inspired by how biological neural networks work. They are used because they can learn to detect complex patterns in data. In mathematical terms, they are universal function approximators, meaning that given the right data and configured correctly, they can capture and model any input-output relationships. This not only removes the need for human interpretation of charts or the series of rules for generating entry/exit signals, but also provides a bridge to fundamental analysis, as the variables used in fundamental analysis can be used as input.

As ANNs are essentially non-linear statistical models, their accuracy and prediction capabilities can be both mathematically and empirically tested. In various studies, authors have claimed that neural networks used for generating trading signals given various technical and fundamental inputs have significantly outperformed buy-hold strategies as well as traditional linear technical analysis methods when combined with rule-based expert systems.

While the advanced mathematical nature of such adaptive systems has kept neural networks for financial analysis mostly within academic research circles, in recent years more user friendly neural network software has made the technology more accessible to traders. However, large-scale application is problematic because of the problem of matching the correct neural topology to the market being studied.

Back testing

Systematic trading is most often employed after testing an investment strategy on historic data. This is known as back testing. Back testing is most often performed for technical indicators, but can be applied to most investment strategies (e.g. fundamental analysis). While traditional back testing was done by hand, this was usually only performed on human-selected stocks, and was thus prone to prior knowledge in stock selection. With the advent of computers, back testing can be performed on entire exchanges over decades of historic data in very short amounts of time.

The use of computers does have its drawbacks, being limited to algorithms that a computer can perform. Several trading strategies rely on human interpretation, and are unsuitable for computer processing. Only technical indicators which are entirely algorithmic can be programmed for computerized automated back testing.

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Combination with other market forecast methods

John Murphy states that the principal sources of information available to technicians are price, volume and open interest. Other data, such as indicators and sentiment analysis, are considered secondary.

However, many technical analysts reach outside pure technical analysis, combining other market forecast methods with their technical work. One advocate for this approach is John Bollinger, who coined the term rational analysis in the middle 1980s for the intersection of technical analysis and fundamental analysis. Another such approach, fusion analysis, overlays fundamental analysis with technical, in an attempt to improve portfolio manager performance.

Technical analysis is also often combined with quantitative analysis and economics. For example, neural networks may be used to help identify inter-market relationships. A few market forecasters combine financial astrology with technical analysis. Chris Carolan's article "Autumn Panics and Calendar Phenomenon", which won the Market Technicians Association Dow Award for best technical analysis paper in 1998, demonstrates how technical analysis and lunar cycles can be combined. Calendar phenomena, such as the January effect in the stock market, are generally believed to be caused by tax and accounting related transactions, and are not related to the subject of financial astrology.

Investor and newsletter polls, and magazine cover sentiment indicators, are also used by technical analysts.

Empirical evidence

Whether technical analysis actually works is a matter of controversy. Methods vary greatly, and different technical analysts can sometimes make contradictory predictions from the same data. Many investors claim that they experience positive returns, but academic appraisals often find that it has little predictive power. Of 95 modern studies, 56 concluded that technical analysis had positive results, although data-snooping bias and other problems make the analysis difficult. Nonlinear prediction using neural networks occasionally produces statistically significant prediction results. A Federal Reserve working paper regarding support and resistance levels in short-term foreign exchange rates "offers strong evidence that the levels help to predict intraday trend interruptions," although the "predictive power" of those levels was "found to vary across the exchange rates and firms examined".

Technical trading strategies were found to be effective in the Chinese marketplace by a recent study that states, "Finally, we find significant positive returns on buy trades generated by the contrarian

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version of the moving-average crossover rule, the channel breakout rule, and the Bollinger band trading rule, after accounting for transaction costs of 0.50 percent."

An influential 1992 study by Brock et al. which appeared to find support for technical trading rules was tested for data snooping and other problems in 1999; the sample covered by Brock et al. was robust to data snooping.

Subsequently, a comprehensive study of the question by Amsterdam economist Gerwin Griffioen concludes that: "for the U.S., Japanese and most Western European stock market indices the recursive out-of-sample forecasting procedure does not show to be profitable, after implementing little transaction costs. Moreover, for sufficiently high transaction costs it is found, by estimating CAPMs, that technical trading shows no statistically significant risk-corrected out-of-sample forecasting power for almost all of the stock market indices." Transaction costs are particularly applicable to "momentum strategies"; a comprehensive 1996 review of the data and studies concluded that even small transaction costs would lead to an inability to capture any excess from such strategies.

In a paper published in the Journal of Finance, Dr. Andrew W. Lo, director MIT Laboratory for Financial Engineering, working with Harry Mamaysky and Jiang Wang found that "

Technical analysis, also known as "charting," has been a part of financial practice for many decades, but this discipline has not received the same level of academic scrutiny and acceptance as more traditional approaches such as fundamental analysis. One of the main obstacles is the highly subjective nature of technical analysis – the presence of geometric shapes in historical price charts is often in the eyes of the beholder. In this paper, we propose a systematic and automatic approach to technical pattern recognition using nonparametric kernel regression, and apply this method to a large number of U.S. stocks from 1962 to 1996 to evaluate the effectiveness of technical analysis. By comparing the unconditional empirical distribution of daily stock returns to the conditional distribution – conditioned on specific technical indicators such as head-and-shoulders or double-bottoms – we find that over the 31-year sample period, several technical indicators do provide incremental information and may have some practical value.

In that same paper Dr. Lo wrote that "several academic studies suggest that ... technical analysis may well be an effective means for extracting useful information from market prices." Some techniques such as Drummond Geometry attempt to overcome the past data bias by projecting support and resistance levels from differing time frames into the near-term future and combining that with reversion to the mean techniques.

Efficient market hypothesis

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The efficient-market hypothesis (EMH) contradicts the basic tenets of technical analysis by stating that past prices cannot be used to profitably predict future prices. Thus it holds that technical analysis cannot be effective. Economist Eugene Fama published the seminal paper on the EMH in the Journal of Finance in 1970, and said "In short, the evidence in support of the efficient markets model is extensive, and (somewhat uniquely in economics) contradictory evidence is sparse."

Technicians EMH ignores the way markets work, in that many investors base their expectations on past earnings or track record, for example. Because future stock prices can be strongly influenced by investor expectations, technicians claim it only follows that past prices influence future prices. They also point to research in the field of behavioral finance, specifically that people are not the rational participants EMH makes them out to be. Technicians have long said that irrational human behavior influences stock prices, and that this behavior leads to predictable outcomes. Author David Aronson says that the theory of behavioral finance blends with the practice of technical analysis:

- By considering the impact of emotions, cognitive errors, irrational preferences, and the dynamics of group behavior, behavioral finance offers succinct explanations of excess market volatility as well as the excess returns earned by stale information strategies.... cognitive errors may also explain the existence of market inefficiencies that spawn the systematic price movements that allow objective TA [technical analysis] methods to work.
- EMH advocates reply that while individual market participants do not always act rationally (or have complete information), their aggregate decisions balance each other, resulting in a rational outcome (optimists who buy stock and bid the price higher are countered by pessimists who sell their stock, which keeps the price in equilibrium). Likewise, complete information is reflected in the price because all market participants bring their own individual, but incomplete, knowledge together in the market.

Random walk hypothesis

The random walk hypothesis may be derived from the weak-form efficient markets hypothesis, which is based on the assumption that market participants take full account of any information contained in past price movements (but not necessarily other public information). In his book A Random Walk Down Wall Street, Princeton economist Burton Malkiel said that technical forecasting tools such as pattern analysis must ultimately be self-defeating: "The problem is that once such a regularity is known to market participants, people will act in such a way that prevents it from happening in the future."[63]

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Malkiel has stated that while momentum may explain some stock price movements, there is not enough momentum to make excess profits. Malkiel has compared technical analysis to "astrology".

In the late 1980s, professors Andrew Lo and Craig McKinlay published a paper which cast doubt on the random walk hypothesis. In a 1999 response to Malkiel, Lo and McKinlay collected empirical papers that questioned the hypothesis' applicability[65] that suggested a non-random and possibly predictive component to stock price movement, though they were careful to point out that rejecting random walk does not necessarily invalidate EMH, which is an entirely separate concept from RWH. In a 2000 paper, Andrew Lo back-analyzed data from U.S. from 1962 to 1996 and found that "several technical indicators do provide incremental information and may have some practical value". Burton Malkiel dismissed the irregularities mentioned by Lo and McKinlay as being too small to profit from.

The random walk index (RWI) is a technical indicator that attempts to determine if a stock's price movement is random in nature or a result of a statistically significant trend. The random walk index attempts to determine when the market is in a strong uptrend or downtrend by measuring price ranges over N and how it differs from what would be expected by a random walk (randomly going up or down). The greater the range suggests a stronger trend.

Scientific Technical Analysis

Caginalp and Balenovich in 1994 used their asset-flow differential equations model to show that the major patterns of technical analysis could be generated with some basic assumptions. Some of the patterns such as a triangle continuation or reversal pattern can be generated with the assumption of two distinct groups of investors with different assessments of valuation. The major assumptions of the models are that the finiteness of assets and the use of trend as well as valuation in decision making. Many of the patterns follow as mathematically logical consequences of these assumptions.

One of the problems with conventional technical analysis has been the difficulty of specifying the patterns in a manner that permits objective testing.

Japanese candlestick patterns involve patterns of a few days that are within an uptrend or downtrend. Caginalp and Laurent were the first to perform a successful large scale test of patterns. A mathematically precise set of criteria were tested by first using a definition of a short term trend by smoothing the data and allowing for one deviation in the smoothed trend. They then considered eight major three day candlestick reversal patterns in a non-parametric manner and defined the patterns as a set

of inequalities. The results were positive with an overwhelming statistical confidence for each of the patterns using the data set of all S&P 500 stocks daily for the five year period 1992-1996.

Among the most basic ideas of conventional technical analysis is that a trend, once established, tends to continue. However, testing for this trend has often led researchers to conclude that stocks are a random walk. One study, performed by Poterba and Summers, found a small trend effect that was too small to be of trading value. As Fisher Black noted, "noise" in trading price data makes it difficult to test hypotheses.

One method for avoiding this noise was discovered in 1995 by Caginalp and Constantine who used a ratio of two essentially identical closed-end funds to eliminate any changes in valuation. A closed-end fund (unlike an open-end fund) trades independently of its net asset value and its shares cannot be redeemed, but only traded among investors as any other stock on the exchanges. In this study, the authors found that the best estimate of tomorrow's price is not yesterday's price (as the efficient market hypothesis would indicate), nor is it the pure momentum price (namely, the same relative price change from yesterday to today continues from today to tomorrow). But rather it is almost exactly halfway between the two.

A survey of modern studies by Park and Irwin showed that most found a positive result from technical analysis.

In 2011, Caginalp and DeSantisZ have used large data sets of closed-end funds, where comparison with valuation is possible, in order to determine quantitatively whether key aspects of technical analysis such as trend and resistance have scientific validity. Using data sets of over 100,000 points they demonstrate that trend has an effect that is at least half as important as valuation.

The effects of volume and volatility, which are smaller, are also evident and statistically significant. An important aspect of their work involves the nonlinear effect of trend. Positive trends that occur within approximately 3.7 standard deviations have a positive effect. For stronger uptrends, there is a negative effect on returns, suggesting that profit taking occurs as the magnitude of the uptrend increases. For downtrends the situation is similar except that the "buying on dips" does not take place until the downtrend is a 4.6 standard deviation event. These methods can be used to examine investor behavior and compare the underlying strategies among different asset classes.

In 2013, Kim Man Lui and T Chong pointed out that the past findings on technical analysis mostly reported the profitability of specific trading rules for a given set of historical data. These past studies had not taken the human trader into consideration as no real-world trader would mechanincially

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adopt signals from any technical analysis method. Therefore, to unveil the truth of technical analysis, we should get back to understand the performance between experienced and novice traders. If the market really walks randomly, there will be no difference between these two kinds of traders. However, it is found by experiment that traders who are more knowledgeable on technical analysis significantly outperform those who are less knowledgeable.

Ticker tape reading

Until the mid-1960s, "tape reading" was a popular form of technical analysis. It consisted of reading market information such as price, volume, order size, and so on from a paper strip which ran through a machine called a stock ticker. Market data was sent to brokerage houses and to the homes and offices of the most active speculators. This system fell into disuse with the advent of electronic information panels in the late 60's, and later computers, which allow for the easy preparation of charts.

Quotation board

Another form of technical analysis used so far was via interpretation of stock market data contained in quotation boards, that in the times before electronic screens, were huge chalkboards located into the stock exchanges, with data of the main financial assets listed on exchanges for analysis of their movements. It was manually updated with chalk, with the updates regarding some of these data being transmitted to environments outside of exchanges (such as brokerage houses, bucket shops, etc.) via the aforementioned tape, telegraph, telephone and later telex.

This analysis tool was used both, on the spot, mainly by market professionals for day trading and scalping, as well as by general public through the printed versions in newspapers showing the data of the negotiations of the previous day, for swing and position trades.

Despite to continue appearing in print in newspapers, as well as computerized versions in some websites, analysis via quotation board is another form of technical analysis that has fallen into disuse by the majority.

MARKET INDICATOTRS

A series of technical indicators used by traders to predict the direction of the major financial indexes. Most market indicators are created by analyzing the number of companies that have reached new highs relative to the number that created new lows, also known as market breadth.

Charting terms and indicators

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Concepts

- Average true range averaged daily trading range, adjusted for price gaps
- Breakout the concept whereby prices forcefully penetrate an area of prior support or resistance, usually, but not always, accompanied by an increase in volume.
- Chart pattern distinctive pattern created by the movement of security prices on a chart
- Cycles time targets for potential change in price action (price only moves up, down, or sideways)
- Dead cat bounce the phenomenon whereby a spectacular decline in the price of a stock is immediately followed by a moderate and temporary rise before resuming its downward movement
- Elliott wave principle and the golden ratio to calculate successive price movements and retracements
- Fibonacci ratios used as a guide to determine support and resistance
- Momentum the rate of price change
- Point and figure analysis A priced-based analytical approach employing numerical filters which may incorporate time references, though ignores time entirely in its construction
- Resistance a price level that may prompt a net increase of selling activity
- Support a price level that may prompt a net increase of buying activity
- Trending the phenomenon by which price movement tends to persist in one direction for an extended period of time

Types of charts

- Candlestick chart Of Japanese origin and similar to OHLC, candlesticks widen and fill the interval between the open and close prices to emphasize the open/close relationship. In the West, often black or red candle bodies represent a close lower than the open, while white, green or blue candles represent a close higher than the open price.
- Line chart Connects the closing price values with line segments.
- Open-high-low-close chart OHLC charts, also known as bar charts, plot the span between the high and low prices of a trading period as a vertical line segment at the trading time, and the open and close prices with horizontal tick marks on the range line, usually a tick to the left for the open price and a tick to the right for the closing price.

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• Point and figure chart – a chart type employing numerical filters with only passing references to time, and which ignores time entirely in its construction.

Overlays

Overlays are generally superimposed over the main price chart.

- Bollinger bands a range of price volatility
- Channel a pair of parallel trend lines
- Ichimoku kinko hyo a moving average-based system that factors in time and the average point between a candle's high and low
- Moving average the last n-bars of price divided by "n"—where "n" is the number of bars specified by the length of the average. A moving average can be thought of as a kind of dynamic trend-line.
- Parabolic SAR Wilder's trailing stop based on prices tending to stay within a parabolic curve during a strong trend
- Pivot point derived by calculating the numerical average of a particular currency's or stock's high, low and closing prices
- Resistance a price level that may act as a ceiling above price
- Support a price level that may act as a floor below price
- Trend line a sloping line described by at least two peaks or two troughs

Breadth Indicators

These indicators are based on statistics derived from the broad market

- Advance–decline line a popular indicator of market breadth
- McClellan Oscillator a popular closed-form indicator of breadth
- McClellan Summation Index a popular open-form indicator of breadth

Price-based indicators

These indicators are generally shown below or above the main price chart.

- %C denotes current markets environment as range expansion or a range contraction, it also forecast when extremes in trend or choppiness are being reached, so the trader can expect change.
- Average directional index a widely used indicator of trend strength
- Commodity Channel Index identifies cyclical trends
- MACD moving average convergence/divergence
- Momentum the rate of price change

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- Relative strength index (RSI) oscillator showing price strength
- Relative Vigor Index (RVI) oscillator measures the conviction of a recent price action and the likelihood that it will continue
- Stochastic oscillator close position within recent trading range
- Trix an oscillator showing the slope of a triple-smoothed exponential moving average

Volume-based indicators

- Accumulation/distribution index based on the close within the day's range
- Money Flow the amount of stock traded on days the price went up
- On-balance volume the momentum of buying and selling stocks

Trend Analysis

Trend Analysis is the practice of collecting information and attempting to spot a pattern, or trend, in the information. In some fields of study, the term "trend analysis" has more formally defined meanings.

Although trend analysis is often used to predict future events, it could be used to estimate uncertain events in the past, such as how many ancient kings probably ruled between two dates, based on data such as the average years which other known kings reigned.

Project management

In project management trend analysis is a mathematical technique that uses historical results to predict future outcome. This is achieved by tracking variances in cost and schedule performance. In this context, it is a project management quality control tool.

Statistics

In statistics, trend analysis often refers to techniques for extracting an underlying pattern of behaviour in a time series which would otherwise be partly or nearly completely hidden by noise. A simple description of these techniques is trend estimation, which can be undertaken within a formal regression analysis.

Trend analysis for business improvement

Trend analysis for business improvement Choosing trends and results to analyse. Developing a trend analysis system Analysing trends to improve business. Trend analysis is the process of comparing business data over time to identify any consistent results or trends. You can then develop a strategy to respond to these trends in line with your business goals.

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Trend analysis helps you understand how your business has performed and predict where current business operations and practices will take you. Done well, it will give you ideas about how you might change things to move your business in the right direction. Trend analysis to help improve your business by:

- Identifying areas where your business is performing well so you can duplicate success
- Identifying areas where your business is underperforming
- Providing evidence to inform your decision making.

This guide explains how you can use historical data to analyse trends and improve your business.

Moving Average

The moving average forecast is based on the assumption of a constant model. In practice the moving average will provide a good estimate of the mean of the time series if the mean is constant or slowly changing. In the case of a constant mean, the largest value of m will give the best estimates of the underlying mean. A longer observation period will average out the effects of variability.

The purpose of providing a smaller m is to allow the forecast to respond to a change in the underlying process. To illustrate, we propose a data set that incorporates changes in the underlying mean of the time series.

The example curves do not match these equations because the example model is not continuously increasing, rather it starts as a constant, changes to a trend and then becomes constant again. Also the example curves are affected by the noise.

The moving average forecast of periods into the future is represented by shifting the curves to the right. The lag and bias increase proportionally. The equations below indicate the lag and bias of a forecast periods into the future when compared to the model parameters. Again, these formulas are for a time series with a constant linear trend.

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Part B (5 x 8 = 40marks)

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	KARPAGAM ACADEMY OF HIGHER EDUCATION, COIMBATORE						
DEPARTMENT OF MANAGMENET							
Unit IV- Company Analysis - Multiple Choice Questions- Each Question carries ONE Mark							
SN	Questions	Option 1	Option 2	Option 3	Option 4	Answer	
1	are senior securities of a firm	Bond	Preference shares	Equity shares	Gilt-edged shares	Bond	
2	A technical analyst looks at the to see if he can establish any pattern	Performance of industry	Performance of the company	Past share price data	Goodwill of the company	Past share price data	
3	Charles H Dow was the editor of	Wall street journal	Stock analysis	Fortune	The economist	Wall street journal	
4	According to Dow Theory, the stock market has	Primary movements	Secondary reactions	Minor movements	Primary, Secondary and Minor movements	Primary, Secondary and Minor movements	
5	According to Dow theory , the primary movement is the that carries the market up or down	Restraining force	Long range cycle	Restraining force and Long range cycle	Short range cycle	Restraining force and Long range cycle	
6	The secondary reactions are also called as	Predictions	Movements	Momentum	Correction	Correction	
7	The market is moving upwards continuously, the upward movement will be interrupted by downward movement of short duration is referred as	Bull run	Bear phase	Correction	Movements	Correction	
8	According to Dow Theory, the third movement is the	Long term movement	Day to day fluctuations	Correction	Short term movement	Day to day fluctuations	
9	A bull market is market where the prices are having a	Downward movement	Upward movement	Cyclical movement	Flat movement	Upward movement	
10	A Bear market is market where the prices are having a	Downward movement	Upward movement	Cyclical movement	Flat movement	Downward movement	
11	In the Japanese candlestick charts	The highest price and the lowest price are joined by a vertical bar	The highest price and the lowest price are joined by a horizontal bar	The opening price and the closing price are joined by a horizontal bar	The opening price and the closing price are joined by a vertical bar	The highest price and the lowest price are joined by a vertical bar	
12	A white candlestick is used to	The highest price	The lowest price	The closing price of	The opening price is	The closing price of	

	represent a situation where	happens first	happens first	the day is higher than	higher than the closing	the day is higher than
13	A white candle stick represents a	Bullish trend	Bearish trend	Flat market	Cyclical trend	Bullish trend
14	A black candle stick represents a	Bullish trend	Bearish trend	Flat market	Cyclical trend	Bearish trend
15	A Doji candlestick is the one where	Opening price is lower than the closing price	Opening price is higher than the closing price	Opening price is same as the closing price	No change in price	Opening price is same as the closing price
16	Resistance happens when the share price moves	Upward	Downward	Flat	Equal	Upward
17	are the mathematical indicators calculated with the help of the closing price data	Waves	Oscillators	Moving averages	Exponential moving averages	Oscillators
18	Oscillators are mathematical indicators calculated with the help of	Opening price data	Closing price data	Lowest price of the day	Highest price of the data	Closing price data
19	The difference between the advances and declines is called as of the market	Length	Breadth	Width	Depth	Breadth
20	Short selling refers to	Selling a share which a person does not own	Selling a friend's share	Selling a share which a person owns	Selling a newly listed share	Selling a share which a person does not own
21	According to Dow theory, the formation of higher bottoms and higher tops indicate a	Bearish trend	Bullish trend	Flat market	Cyclical market	Bullish trend
22	According to Dow theory, each peak will be followed by a bottom formed because of	Primary movements	Secondary reaction	Minor movements	Primary, Secondary and Minor movements	Minor movements
23	According to Dow theory, the formation of lower tops and lower bottoms indicate	Bullish trend	Bearish trend	Flat market	Cyclical market	Bearish trend
24	The Dow theory makes certain assumptions. The first assumption is	The primary trend cannot be manipulated	The primary trend can be manipulated	Secondary reactions are manipulated	Corrections are not manipulated	The primary trend cannot be manipulated
25	The Dow theory makes certain assumptions. The second hypothesis is	Corrections are manipulated	Secondary reactions are manipulated	The averages discount everything	Primary trend can be manipulated	The averages discount everything
26	The Dow theory makes certain assumptions. The third	The theory is infallible	The theory is not infallible	Corrections are manipulated	Secondary reactions are manipulated	The theory is not infallible

	hypothesis is					
27	Charting is representation of share prices.	Graphical	Systematic	Tabular	Systematic or tabular	Graphical
28	In a bar chart , a bar is formed by joining	Highest price and lowest price of a day by a vertical line	Opening price and closing price of a day by a vertical line	Highest price and lowest price of a day by a horizontal line	Opening price and closing price of a day by a horizontal line	Highest price and lowest price of a day by a vertical line
29	When a trend reverses and begins to rise, a technical analyst would recommend of a share	Purchase	Sale	Hold	Hedge	Purchase
30	When a trend reverses and begins to fall, a technical analyst would recommend of a share	Purchase	Sale	Hold	Hedge	Sale
31	Support occurs when price is	Falling but bounces back	Increases but reverses	Falling continuously	Increasing continuously	Falling but bounces back
32	In a chart, when all low points are connected by a horizontal line, it forms the	Support line	Resistance line	Pattern	Trend	Support line
33	In a chart, when all high points are connected by a horizontal line, it forms the	Support line	Resistance line	Pattern	Trend	Resistance line
34	NCFM is a certification programme of	BSE	SEBI	RBI	NSE	NSE
35	Distributors of Mutual fund Have to Obtain a	ARN number	RBI registration	License	SEBI registration	ARN number
36	Economic indicators are identified as	Coincidental	Leading	Lagging	Coincidental, Leading & Lagging	Coincidental, Leading & Lagging
37	indicators help us to assess the future course of action	Coincidental	Leading	Lagging	Coincidental, Leading & Lagging	Leading
38	indicators releting to economic position of the country	Coincidental	Leading	Lagging	Coincidental, Leading & Lagging	Coincidental
39	It gives an idea of the kind of labour force in a country	Capital formation	Forecasting	Population	Share vaiue	Population
40	combines the different indicators into one total measure	surveys	indicators	diffusion indexes	Brokers	diffusion indexes

41	is a mathematical & statiscal application to forecast the future trend of the company	Indicators	Economic model building	Opportunistic model building	Analitical model	Opportunistic model building
42	It is alsO called as sectoral analysis of the gdp model building	Indicators	Serveys	Opportunistic model building	Economic model building	Opportunistic model building
43	is also called as census or composite index	Diffusion index	Economic model building	Opportunistic model building	Analitical model	Diffusion index
44	Sharpe ration is also called as	Return to Variability ratio	Return Reward ration	Return risk ratio	Reward risk ratio	Return to Variability ratio
45	Determining the expected return and risk of different portfolios is called as	Returns analysis	Risk analysis	Portfolio analysis	Portfolio, Risk and Return analysis	Portfolio analysis
46	Treynor ratio is also called as	Reward to variability ration	Return to risk ratio	Return to Volatility ratio	Risk reward ratio	Risk reward ratio
47	measures the differential between the actual return earned on a portfolio and the return expected	Sharpe ratio	Treynor ratio	Jenson measure	Dow Jones index	Jenson measure
48	The analytical frame work that allows a detailed breakdown of a fund's performance into the source of performance is called	Dow Decomposition	Fama Decomposition of total returns	Sharpe decomposition of total returns	Treynor decomposition of total returns	Fama Decomposition of total returns
49	Risk adjusted returns are calculated using	Sharpe ratio	Treynor ratio	Sharpe ratio and Treynor ratio	Profitability ratio	Sharpe ratio and Treynor ratio
50	The PE ratio of a share is	Market price per share / EPS	Market price of share / profit	Market price per share / Dividends	Market price of all share / Dividends	Market price per share / EPS
51	is the total market value of the fund's portfolio minus any liabilities, divided by the total number of units outstanding	Asset value	Fund value	NAV	Net fund value	NAV
52	Growth funds are typically a portfolio of	Bonds	Equities	Money market instruments	Preference shares	Money market instruments
53	Income funds are typically a portfolio of	Bonds	Gold	Real estate	Equity	Bonds
54	Balanced funds are typically a	Equities	Bonds	Equities and Bonds	Commodities	Equities and Bonds

	portfolio of					
55	An index fund is typically a portfolio of	Shares of an index	Bonds of an index	A or B	Gold	Shares of an index
56	Liquid fund is typically a portfolio of	Equities	Bonds	Money market Instruments	Gold	Money market Instruments
57	Determining the expected returns and risk of different portfolio is called	Return analysis	Risk analysis	Risk return analysis	Portfolio analysis	Portfolio analysis
58	The Dow theory makes certain assumptions. The first assumption is	The primary trend cannot be manipulated	The primary trend can be manipulated	Secondary reactions are manipulated	Corrections are not manipulated	The primary trend cannot be manipulated
59	The Dow theory makes certain assumptions. The second hypothesis is	Corrections are manipulated	Secondary reactions are manipulated	The averages discount everything	Primary trend can be manipulated	The averages discount everything
60	The Dow theory makes certain assumptions. The third hypothesis is	The theory is infallible	The theory is not infallible	Corrections are manipulated	Secondary reactions are manipulated	The theory is not infallible

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Batch: 2015-18

<u>UNIT-V</u>

SYLLABUS

Portfolio Analysis – Markowitz Theory – Optimum Portfolio – Portfolio Construction – Performance Evaluation – Portfolio Revision

Meaning

Portfolio is a combination of securities such as stocks, bonds and money market instruments. The process of blending together the broad asset classes so as to obtain optimum return with minimum risk is called portfolio construction. Individual securities have risk return characteristics of their own. Portfolios may or may not take on the aggregate characteristics of their individual parts.

Diversification of investment helps to spread risk over many assets. A diversification of securities gives the assurance of obtaining the anticipated return on the portfolio. In a diversified portfolio, some securities may not perform as expected, but others may exceed the expectation and making the actual return of the portfolio reasonably close to the anticipated one. Keeping a portfolio of single security may lead to a greater likelihood of the actual return somewhat different from that of the expected return. Hence, it is a common practice to diversify securities in the portfolio.

Benefits of portfolios

Expected return from individual securities carrying some degree of risk. Risk was defined as the standard deviation around the expected return. In effect we equated a security's risk with the variability of its return. More dispersion or variability about a security's expected return meant the security was riskier than one with less dispersion. The simple fact that securities carrying differing degrees of expected risk lead most investors to the notion of holding more than one security at a time is an attempt to spread risks by not putting all their eggs into one basket. Diversification of one's holdings is intended to reduce risk in an economy in which every asset's returns are subject to some degree of uncertainty. Even the value of cash suffers from the inroads of inflation. Most investors hope that if they hold several assets, even if one goes bad, the others will provide some protection from an extreme loss.

Approaches in portfolio construction

Commonly, there are two approaches in the construction of the portfolio of securities viz.

- Traditional approach and
- Markowitz efficient frontier approach.

In the traditional approach, investor's needs in terms of income and capital appreciation are evaluated and appropriate securities are selected to meet the needs of the investor. The common practice in the traditional approach is to evaluate the entire financial plan of the individual. In the modern approach, portfolios are constructed to maximise the expected return for a given level of risk. It views portfolio construction in terms of the expected return and the risk associated with obtaining the expected return.

Traditional approach

The traditional approach basically deals with two major decisions.

They are:

(a) Determining the objectives of the portfolio.

(b) Selection of securities to be included in the portfolio.

Normally, this is carried out in four to six steps. Before formulating the objectives, the constraints of the investor should be analysed. Within the given framework of constraints, objectives are formulated. Then based on the objectives, securities are selected. After that, the risk and return of the securities should be studied. The investor has to assess the major risk categories that he or she is trying to minimise. Compromise on risk and non-risk factors has to be carried out. Finally relative portfolio weights are assigned to securities like bonds, stocks and debentures and then diversification is carried out.

Analysis of constraints

The constraints normally discussed are: income needs, liquidity, time horizon, safety, tax considerations and the temperament. Income needs- The income needs depend on the need for income in constant rupees and current rupees. The need for income in current rupees arises from

the investor's need to meet all or part of the living expenses. At the same time inflation may erode the purchasing power, the investor may like to offset the effect of the inflation and so, needs income in constant rupees.

- Need for current income: The investor should establish the income which the portfolio should generate. The current income need depends upon the entire current financial plan of the investor. The expenditure required to maintain a certain level of standard of living and all the other income generating sources should be determined. Once this information is arrived at, it is possible to decide how much income must be provided for the portfolio of securities.
- Need for constant income: Inflation reduces the purchasing power of the money. Hence, the investor estimates the impact of inflation on his estimated stream of income and tries to build a portfolio which could offset the effect of inflation. Funds should be invested in such securities where income from them might increase at a rate that would offset the effect of inflation. The inflation or purchasing power risk must be recognised but this does not pose a serious constraint on portfolio if growth stocks are selected.
- Liquidity: Liquidity need of the investment is highly individualistic of the investor. If the investor prefers to have high liquidity, then funds should be invested in high quality short term debt maturity issues such as money market funds, commercial papers and shares that are widely traded. Keeping the funds in shares that are poorly traded or stocks in closely held business and real estate lack liquidity. The investor should plan his cash drain and the need for net cash inflows during the investment period.
- Safety of the principal: Another serious constraint to be considered by the investor is the safety of the principal value at the time of liquidation, investing in bonds and debentures is safer than investing in the stocks. Even among the stocks, the money should be invested in regularly traded companies of longstanding. Investing money in the unregistered finance companies may not provide adequate safety.
- **Time horizon:** Time horizon is the investment-planning period of the individuals. This varies from individual to individual. Individual's risk and return preferences are often described in terms of his 'life cycle'. The states of the life cycle determine the nature of

investment. The first stage is the early career situation. At the career starting point assets are lesser than their liabilities. More goods are purchased on credit. His house might have been built with the help of housing loan scheme. His major asset may be the house he owns. His priority towards investments may be in the form of savings for liquidity purposes. He takes life insurance for protecting him from unforeseen events like death and accidents and then he thinks of the investments. The investor is young at this stage and has long horizon of life expectancy with possibilities of growth in income, he can invest in high-risk and growth oriented investments.

The other stage of the time horizon is the mid-career individual. At this stage, his assets are larger than his liabilities. Potential pension benefits are available to him. By this time he establishes his investment program. The time horizon before him is not as long as the earlier stage and he wants to protect his capital investment. He may wish to reduce the overall risk exposure of the portfolio but, he may continue to invest in high risk and high return securities.

The final stage is the late career or the retirement stage. Here, the time horizon of the investment is very much limited. He needs stable income and once he retires, the size of income he needs from investment also increases. In this stage, most of his loans are repaid by him and his assets far exceed the liabilities. His pension and life insurance programmes are completed by him. He shifts his investment to low return and low risk category investments, because safety of the principal is given priority. Mostly he likes to have lower risk with high interest or dividend paying component to be included in his portfolio. Thus, the time horizon puts restrictions on the investment decisions.

Tax consideration: Investors in the income tax paying group consider the tax concessions they could get from their investments. For all practical purpose, they would like to reduce the taxes. For income tax purpose, interests and dividends are taxed under the head "income from other sources". The capital appreciation is taxed under the head "capital gains" only when the investor sells the securities and realizes the gain. The tax is then at a concessioanl rate depending on the period for which the asset has been held before being sold. From the tax point of view, the form in which the income is received i.e. interest, dividend, short term capital gains and long term capital gains are important. If the investor cannot avoid taxes, he can delay the taxes. Investing in

government bonds and NSC can avoid taxation. This constraint makes the investor to include the items which will reduce the tax.

Temperament: The temperament of the investor himself poses a constraint on framing his investment objectives. Some investors are risk lovers or takers who would like to take up higher risk even for low return. While some investors are risk averse, who may not be willing to undertake higher level of risk even for higher level of return. The risk neutral investors match the return and the risk.

Determination of objectives

Portfolios have the common objective of financing present and future expenditures from a large pool of assets. The return that the investor requires and the degree of risk he is willing to take depend upon the constraints. The objectives of portfolio range from income to capital appreciation. The common objectives are stated below:

- Current income
- Growth in income
- Capital appreciation
- Preservation of capital

The investor in general would like to achieve all the four objectives, nobody would like to lose his investment. But, it is not possible to achieve all the four objectives simultaneously. If the investor aims at capital appreciation, he should include risky securities where there is an equal likelihood of losing the capital. Thus, there is a conflict among the objectives.

Selection of portfolio

The selection of portfolio depends on the various objectives of the investor. The selection of portfolio under different objectives are dealt subsequently.

Objectives and asset mix

If the main objective is getting adequate amount of current income, sixty per cent of the investment is made on debts and 40 per cent on equities. The proportions of investments on debt and equity differ according to the individual's preferences.

Money is invested in short term debt and fixed income securities. Here the growth of income becomes the secondary objective and stability of principal amount may become the third.

Even within the debt portfolio, the funds invested in short term bonds depends on the need for stability of principal amount in comparison with the stability of income. If the appreciation of capital is given third priority, instead of short term debt the investor opts for long term debt. The period may not be a constraint. Growth of income and asset mix- Here the investor requires a certain percentage of growth in the income received from his investment. The investor's portfolio may consist of 60 to 100 per cent equities and 0 to 40 per cent debt instrument. The debt portion of the portfolio may consist of concession regarding tax exemption. Appreciation of principal amount is given third priority.

Software, hardware and non-conventional energy producing company shares provide good possibility of growth in dividend. Capital appreciation and asset mix- Capital appreciation means that the value of the original investment increases over the years. Investment in real estates like land and house may provide a faster rate of capital appreciation but they lack liquidity. In the capital market, the values of the shares are much higher than their original issue prices.

Safety of principal and asset mix

Usually, the risk averse investors are very particular about the stability of principal. According to the life cycle theory, people in the third stage of life also give more importance to the safety of the principal. All the investors have this objective in their mind. No one like to lose his money invested in different assets. But, the degree may differ. The investor's portfolio may consist more of debt instruments and within the debt portfoliomore would be on short term debts. **Risk and return analysis:** The traditi onal approach to portfolio building has some basic assumptions. First, the individual prefers larger to smaller returns from securities. To achieve this goal, the investor has to take more risk. The ability to achieve higher returns is dependent upon his ability to judge risk and his ability to take specific risks. The risks are namely interest rate risk, purchasing power risk, financial risk and market risk. The investor analyses the varying degrees of risk and constructs his portfolio. At first, he establishes the minimum income that he must have to avoid hardships under most adverse economic condition and then he decides risk of loss of income that can be tolerated. The investor makes a series of compromises on risk and non-risk factors like taxation and marketability after he has assessed the major risk categories,

which he is trying to minimise. The methods of calculating risk and return of a portfolio is classified in following pages of this chapter.

Diversification: Once the asset mix is determined and the risk and return are analysed, the final step is the diversification of portfolio. Financial risk can be minimised by commitments to topquality bonds, but these securities offer poor resistance to inflation. Stocks provide better inflation protection than bonds but are more vulnerable to financial risks. Good quality convertibles may balance the financial risk and purchasing power risk. According to the investor's need for income and risk tolerance level portfolio is diversified. In the bond portfolio, the investor has to strike a balance between the short term and long term bonds. Short term fixed income securities offer more risk to income and long term fixed income securities offer more risk to principal.

As investor, we have to select the industries appropriate to our investment objectives. Each industry corresponds to specific goals of the investors. The sales of some industries like two wheelers and steel tend to move in tandem with the business cycle, the housing industry sales move counter cyclically. If regular income is the criterion then industries, which resist the trade cycle should be selected. Likewise, the investor has to select one or two companies from each industry.

The selection of the company depends upon its growth, yield, expected earnings, past earnings, expected price earning ratio, dividend and the amount spent on research and development. Selecting the best company is widely followed by all the investors but this depends upon the investors' knowledge and perceptions regarding the company. The final step in this process is to determine the number of shares of each stock to be purchased. This involves determining the number of different stocks that is required to give adequate diversification. Depending upon the size of the portfolio, equal amount is allocated to each stock. The investor has to purchase round lots to avoid transaction costs.

Modern Approach

We have seen that the traditional approach is a comprehensive financial plan for the individual. It takes into account the individual needs such as housing, life insurance and pension plans. But these types of financial planning approaches are not done in the Markowitz approach.

Markowitz gives more attention to the process of selecting the portfolio. His planning can be applied more in the selection of common stocks portfolio than the bond portfolio. The stocks are not selected on the basis of need for income or appreciation. But the selection is based on the risk and return analysis. Return includes the market return and dividend. The investor needs return and it may be either in the form of market return or dividend. They are assumed to be indifferent towards the form of return. Among the list of stocks quoted at the Bombay Stock Exchange or at any other regional stock exchange, the investor selects roughly some group of shares say of 10 or 15 stocks.

For these stocks' expected return and risk would be calculated. The investor is assumed to have the objective of maximising the expected return and minimising the risk. Further, it is assumed that investors would take up risk in a situation when adequately rewarded for it. This implies that individuals would prefer the portfolio of highest expected return for a given level of risk.

In the modern approach, the final step is asset allocation process that is to choose the portfolio that meets the requirement of the investor. The risk taker i.e. who are willing to accept a higher probability of risk for getting the expected return would choose high risk portfolio. Investor with lower tolerance for risk would choose low level risk portfolio. The risk neutral investor would choose the medium level risk portfolio.

Portfolio risk/return

As mentioned earlier, an investment decision involves selection of a combination or group of securities for investment. This group of securities is referred to as a portfolio. The portfolio can be a combination of securities irrespective of their nature, maturity, profitability, or risk characteristics. Investors, rather than looking at individual securities, focus more on the performance of all securities together. While portfolio returns are the weighted returns of all securities constituting the portfolio, the portfolio risk is not the simple eighted average risk of all securities in the portfolio. Portfolio risk considers the standard deviation together with the covariance between securities. Co-variance measures the movement of assets together.

The portfolio risk and return using historical data is computed using Portfolio risk is thus the summation of the individual security variance and the co-movement with other securities in

the portfolio. The above formula can be split into a spreadsheet showing all the co-movement measures of the securities. The total variance is the summation of all cells in the following table.

The diagonal summation represents the first part. This is the variance of each security individually. The weights of the securities in the portfolio are represented by the variables

The second part of the variance computation equation is the summation of all other cells except the diagonal cells. These are the co-variance of one security with another security in the portfolio. The total covariance is computed by considering the weight of each security in the portfolio. When the weight of each security is different Co-variance can also be measured in terms of the correlation coefficient. The correlation coefficient is a measure of the relationship between two assets.

The correlation coefficient ranges between the value +1 and -1. A correlation coefficient of +1 indicates that two securities returns move perfectly in tandem with each other. A negative correlation coefficient of -1 implies that when one securities' returns increase, the other securities' return reduces by the same quantum.

Markowitz Portfolio Selection

Markowitz Portfolio Selection Method identifies an investor's unique risk-return preferences, namely utilities. The Markowitz portfolio model has the following assumptions:

Investors are risk averse Investors are utility maximisers than return maximisers All investors have the same time period as the investment horizon An investor who is a risk seeker would prefer high returns for a certain level of risk and he is willing to accept portfolios with lower incremental returns for additional risk levels.

A risk averse investor would require a high incremental rate of return as compensation for every small amount of increase in risk. A moderate risk taker would have utilities in between these two extremes. 16.6. Sharpe's Single Index Portfolio Selection Method Sharpe W.E. (1964) justified that portfolio risk is to be identified with respect to their return co-movement with the market and not necessarily with respect to within the security co-movement in a portfolio. He therefore concluded that the desirability of a security for its inclusion is directly related to its excess return to beta ratio.

Managing the portfolio

After establishing the asset allocation, the investor has to decide how to manage the portfolio over time. He can adopt passive approach or active approach towards the management of the portfolio. In the passive approach the investor would maintain the percentage allocation for asset classes and keep the security holdings within its place over the established holding period. In the active approach the investor continuously assess the risk and return of the securities within the asset classes and changes them accordingly. He would be studying the risks (1) market related

(2) group related and

(3) security specific and changes the components of the portfolio to suit his objectives.

Concept

The fundamental concept behind MPT is that the assets in an investment portfolio should not be selected individually, each on its own merits. Rather, it is important to consider how each asset changes in price relative to how every other asset in the portfolio changes in price.

Investing is a tradeoff between risk and expected return. In general, assets with higher expected returns are riskier. For a given amount of risk, MPT describes how to select a portfolio with the highest possible expected return. Or, for a given expected return, MPT explains how to select a portfolio with the lowest possible.

Therefore, MPT is a form of diversification. Under certain assumptions and for specific quantitative definitions of risk and return, MPT explains how to find the best possible diversification strategy.

Assumptions

The framework of MPT makes many assumptions about investors and markets. Some are explicit in the equations, such as the use of Normal distributions to model returns. Others are implicit, such as the neglect of taxes and transaction fees. None of these assumptions are entirely true, and each of them compromises MPT to some degree.

Investors are interested in the optimization problem described above (maximizing the mean for a given variance). In reality, investors have utility functions that may be sensitive to higher moments of the distribution of the returns. For the investors to use the mean-variance

optimization, one must suppose that the combination of utility and returns make the optimization of utility problem similar to the mean-variance optimization problem. A quadratic utility without any assumption about returns is sufficient. Another assumption is to use exponential utility and normal distribution, as discussed below.

Asset returns are (jointly) normally distributed random variables. In fact, it is frequently observed that returns in equity and other markets are not normally distributed. Large swings occur in the market far more frequently than the normal distribution assumption would predict. While the model can also be justified by assuming any return distribution that is jointly elliptical, all the joint elliptical distributions are symmetrical whereas asset returns empirically are not.

Bouchaud and Chicheportiche (2012) empirically reject the elliptical hypothesis, writing "intuitively, the failure of elliptical models can be traced to the inadequacy of the assumption of a single volatility mode for all stocks. "

Correlations between assets are fixed and constant forever. Correlations depend on systemic relationships between the underlying assets, and change when these relationships change. Examples include one country declaring war on another, or a general market crash. During times of financial crisis all assets tend to become positively correlated, because they all move (down) together. In other words, MPT breaks down precisely when investors are most in need of protection from risk.

All investors aim to maximize economic utility. This is a key assumption of the efficient market hypothesis, upon which MPT relies.

All investors are rational and risk-averse. This is another assumption of the efficient market hypothesis. In reality, as proven by behavioral economics, market participants are not always rational or consistently rational. The assumption does not account for emotional decisions, stale market information, "herd behavior", or investors who may seek risk for the sake of risk. Casino gamblers clearly pay for risk, and it is possible that some stock traders will pay for risk as well.

All investors have access to the same information at the same time. In fact, real markets contain information asymmetry, insider trading, and those who are simply better informed than

others. Moreover, estimating the mean and the covariance matrix of the returns are difficult statistical tasks.

Investors have an accurate conception of possible returns, i.e., the probability beliefs of investors match the true distribution of returns. A different possibility is that investors' expectations are biased, causing market prices to be informationally inefficient. This possibility is studied in the field of behavioral finance, which uses psychological assumptions to provide alternatives to the CAPM such as the overconfidence-based asset pricing model of Kent Daniel, David Hirshleifer, and Avanidhar Subrahmanyam (2001).

There are no taxes or transaction costs. Real financial products are subject both to taxes and transaction costs (such as broker fees), and taking these into account will alter the composition of the optimum portfolio. These assumptions can be relaxed with more complicated versions of the model.

All investors are price takers, i.e., their actions do not influence prices. In reality, sufficiently large sales or purchases of individual assets can shift market prices for that asset and others (via cross elasticity of demand.) An investor may not even be able to assemble the theoretically optimal portfolio if the market moves too much while they are buying the required securities.

Any investor can lend and borrow an unlimited amount at the risk free rate of interest. In reality, every investor has a credit limit.

All securities can be divided into parcels of any size. In reality, fractional shares usually cannot be bought or sold, and some assets have minimum orders sizes.

Risk/Volatility of an asset is known in advance/is constant. In fact, markets often misprice risk (e.g. the US mortgage bubble or the European debt crisis) and volatility changes rapidly.

More complex versions of MPT can take into account a more sophisticated model of the world (such as one with non-normal distributions and taxes) but all mathematical models of finance still rely on many unrealistic premises.

Assumptions to Markowitz Portfolio Theory

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- Investors consider each investment alternative as being represented by a probability distribution of expected returns over some holding period.
- Investors maximize one-period expected utility and their utility curves demonstrate diminishing marginal utility of wealth.
- Investors estimate risk on basis of variability of expected returns.
- Investors base decisions solely on expected return and risk.
- Investors prefer higher returns to lower risk and lower risk for the same level of return.
- Markowitz Portfolio Theory
- Harry Markowitz developed the portfolio model. This model includes not only expected return, but also includes the level of risk for a particular return. Markowitz assumed the following about an individual's investment behavior:
- Given the same level of expected return, an investor will choose the investment with the lowest amount of risk.
- Investors measure risk in terms of an investment's variance or standard deviation.
- For each investment, the investor can quantify the investment's expected return and the probability of those returns over a specified time horizon.
- Investors seek to maximize their utility.
- Investors make decision based on an investment's risk and return, therefore, an investor's utility curve is based on risk and return.

The Efficient Frontier

Markowitz' work on an individual's investment behavior is important not only when looking at individual investment, but also in the context of a portfolio. The risk of a portfolio takes into account each investment's risk and return as well as the investment's correlation with the other investments in the portfolio.

A portfolio is considered efficient if it gives the investor a higher expected return with the same or lower level of risk as compared to another investment. The efficient frontieris simply a plot of those efficient portfolios, as illustrated below.



Risk-standard deviation

While an efficient frontier illustrates each of the efficient portfolios relative to risk and return levels, each of the efficient portfolios may not be appropriate for every investor. Recall that when creating an investment policy, return and risk were the key objectives. An investor's risk profile is illustrated with indifference curves. The optimal portfolio, then, is the point on the efficient frontier that is tangential to the investor's highest indifference curve. See our article: A Guide to Portfolio Construction, for some essential steps when taking a systematic approach to constructing a portfolio.

Sharpe index model

Casual observation of stock prices over a period of time reveals that most of stock prices move with the market index. When the Sensex increases the price increases and vice versa. Stock prices are related to the market index and this relationship could be used to estimate return on stock. Towards this purpose following equation can be used.

 $Ri = \alpha i + \beta i Rm + ej$

Where,

Ri= expected return of security I

 αi = alpha coefficient

 $\beta i = beta \ coefficient$

Rm = the rate of return of market index

ej = error term

According to the equation, the return of stock can be divided into two components, the return due to the market and the return independent of the market. β i indicates the sensitivity of

stock return to the changes In market return. For example βi of 1.5 means the stock return is expected to increase by 1.5% if market increases by 1% and vice versa. The estimate of βi and αi can be obtained using regression analysis.

The single index model is based on the assumption that stocks vary together because of common movement in the stock market and there are no effects beyond the market (i.e. any fundamental factor effects) that accounts the stock co-movement. The expected return, standard deviation, and co-variance of single index model represents the joint movement of securities. The mean return isRi= $\alpha i + \beta iRm + ej$

The variance of security's return is $\sigma^2 = \beta i^2 \sigma^2 m + \sigma e i^2$. The covariance of returns between securities i and j is $\sigma i j = \beta i \beta j \sigma^2 m$

The variance of security has two components namely, systematic risk or market risk and unsystematic risk or unique risk. The variance explained by index is called systematic risk and the unexplained variance is called unsystematic risk.Systematic risk= $\beta i^2 \sigma^2 m$ Unsystematic risk= total variance – systematic risk $ei^2 = \sigma^2 i$ – systematic riskThus total risk= $\beta i^2 \sigma^2 + ei^2$

From this the portfolio variance can be derived $\sigma^2 p = [(\Sigma x i\beta i)^2 \sigma^2 m] + [\Sigma x i^2 e i^2] \sigma^2 p =$ variance of portfolio $\sigma^2 m$ = expected variance of indexei²= variation in security return not related to the market indexxi = the portion of stock i in the portfolio

Assumptions Made

The Sharpe's Single Index Model is based on the following assumptions:

All investors have homogeneous expectations.

1. A uniform holding period is used in estimating risk and return for each security.

2. The price movements of a security in relation to another do not depend primarily upon the nature of those two securities alone. They could reflect a greater influence that might have cropped up as a result of general business and economic conditions.

3. The relation between securities occurs only through their individual influences along with some indices of business and economic activities. The indices, to which the returns of each security are correlated, are likely to be some securities' market proxy.

4) It has an expected value zero (0) and a finite variance. It is not correlated with the return on market portfolio (Rm) as well as with the error term (ei) for any other securities.

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 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.



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.

Creating an Optimized Portfolio

Prepared by, Dr. M. Ashok Kumar. Professor & HOD, Dept of Management, KAHE Page 16/30

Prior to the era of Markowitz, investors knew that there is a relationship between risk and return but they don't know how to quantify it. To reduce risk they just diversify their portfolio by including many securities into their portfolio. However in Markowitz's model both risk and the expected return are quantifiable.

Risk can be measured by using the standard deviation which in turn is the square root of the variance. The larger the standard deviation then the larger will be the risk.

Return in Markowitz's model can be defined by the following equation.

R = (P1 - P0 + D) / P0

Where,

R = Return on the security

P1 = Current Price

P0 = Previous Price (months before Current Price)

D = Dividend

Or put it in simpler terms,

Return = (capital gain or losses) + dividend

Divided by Previous Price

It is very difficult to predict the future price of a security due to its random variable in nature. Ceteris paribus when a firm increases its Dividend then its Share Price will be increased due to higher demand. However the performance of a company is affected by the following risks during a company's operation.

1. Internal Risk: This part of the risk is diversifiable which include business risk such as labour strike, poor response to new products, power outage, losing talented staff and etc. Another is the interest rate risk which is due to its high debt load and it will affect the bottom line of a firm. If a firm cannot manage its internal risk well then its operating income will be unstable and hence will affects its share price.

2. **External Risk:** This is also refers as Market Risk which is out of control by the firm. A good example is the increase in the interest rate by the banks which cannot be diversifiable by the firm. An increase in the interest means increase costs and hence will affect its bottom line. Another Market risk is the Global Systemic Financial Crisis. During a financial crisis like what

is happening in the Western economies now will surely affects the demand of manufactured goods and raw materials from the rest of the world. Hence the performance of manufacturers from exporting countries will surely be affected and hence their bottom lines and also share prices.

Security Selection for Portfolio

Since now we are now able to quantify both risk and return then we can proceed to select securities based on Markowitz's assumption to build our Portfolio. Based on Markowitz's model a rational investor will do the following.

- 1. If two securities have the same expected return then the investor will choose the one with the lower standard deviation (risk)
- 1. If two securities have the same standard deviation (risk) then the investor will choose the one with the higher return.

In the following we shall build a model to illustrate the above point

Table 1 – Same Risk but different Expected Return

Security	Expected Return	Standard Deviation
1	0.11	0.12
2	0.12	0.12
3	0.13	0.12
4	0.14	0.12
5	0.15	0.12

As can be seen from the above the standard deviations for the 5 securities are the same but expected returns are different. Needless to say as a rational investor he will choose security 5 because with the same risk it offers the highest expected return (0.15)

Table 2 – Same Expected Return but different Risk

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Security	Expected Return	Standard Deviation
1	0.12	0.11
2	0.12	0.12
3	0.12	0.13
4	0.12	0.14
5	0.12	0.15

As can be seen from the above the Expected Returns for the 5 securities are the same but the level of Risk is different. Needless to say as a rational investor he will choose security 1 because with the same Expected Return it offers the lowest Risk (0.1)

Table 3 – Different Expected Return and Risk

Security	Expected Return	Standard Deviation
1	0.13	0.11
2	0.14	0.12
3	0.15	0.13
4	0.15	0.14
5	0.17	0.15

From the above the Expected Returns for the 5 securities are different from the level of Risk. In this case the higher the risk the higher will be the Expected Return. Which security the investor will choose? It will depend on the risk appetite of the investor. If his risk appetite is high then probably he will prefer security 5 because it offers the highest expected return. If he is risk adverse then he will prefer security 1.

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.

KARPAGAM ACADEMY OF HIGHER EDUCATION, COIMBATORE Class: III BBA Course Name: Investment Management

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- 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.
- Both of these considerations are important, although academic studies have consistently shown that in the medium to long term, asset allocation usually has a much larger impact on the variability of a portfolio's return.

To help in choosing a suitable asset allocation we have created a Risk Profiler that helps identify your attitude to risk and therefore better identify a combination of investments to build a portfolio.

With such a vast number of investment funds to choose from, spanning the full range of asset classes and world markets it is easy to become confused when choosing which investments to make. It is even more difficult to choose the right combination of investment to potentially meet your investment goals.

Create your risk profile – Measure your perceived level of risk for an investment

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.

Many investors have built collections of funds over their investing lifetime. As markets have developed and investing styles come in and out of fashion, it is likely that the total portfolio may be too heavily invested in a particular asset class, region, sector or even a particular share which

is present in every fund but to varying degrees. In other words, your combined portfolio may no longer meet your needs or aspirations.

Step 1: Determining the Appropriate Asset Allocation

Ascertaining your individual financial situation and investment goals is the first task in constructing a portfolio. Important items to consider are age, how much time you have to grow your investments, as well as amount of capital to invest and future capital needs. A single college graduate just beginning his or her career and a 55-year-old married person expecting to help pay for a child's college education and plans to retire soon will have very different investment strategies.

A second factor to take into account is your personality and risk tolerance. Are you the kind of person who is willing to risk some money for the possibility of greater returns? Everyone would like to reap high returns year after year, but if you are unable to sleep at night when your investments take a short-term drop, chances are the high returns from those kinds of assets are not worth the stress.

As you can see, clarifying your current situation and your future needs for capital, as well as your risk tolerance, will determine how your investments should be allocated among different asset classes. The possibility of greater returns comes at the expense of greater risk of losses. Investors don't want to eliminate risk so much as optimize it for your unique condition and style. For example, the young person who won't have to depend on his or her investments for income can afford to take greater risks in the quest for high returns. On the other hand, the person nearing retirement needs to focus on protecting his or her assets and drawing income from these assets in a tax-efficient manner.

Conservative Vs Aggressive Investors

Generally, the more risk you can bear, the more aggressive your portfolio will be, devoting a larger portion to equities and less to bonds and other fixed-income securities. Conversely, the less risk that's appropriate, the more conservative your portfolio will be. Here are two examples: one suitable for a conservative investor and another for the moderately aggressive investor.
Conservative portfolio

The main goal of a conservative portfolio is to protect its value. The allocation shown above would yield current income from the bonds, and would also provide some long-term capital growth potential from the investment in high-quality equities.

Moderately aggressive portfolio

A moderately aggressive portfolio satisfies an average risk tolerance, attracting those willing to accept more risk in their portfolios in order to achieve a balance of capital growth and income.

Step 2: Achieving the Portfolio Designed in Step 1

Once determined the right asset allocation, you simply need to divide your capital between the appropriate asset classes. On a basic level, this is not difficult: equities are equities, and bonds are bonds.

But you can further break down the different asset classes into subclasses, which also have different risks and potential returns. For example, an investor might divide the equity portion between different sectors and market caps, and between domestic and foreign stock. The bond portion might be allocated between those that are short term and long term, government versus corporate debt and so forth.

There are several ways you can go about choosing the assets and securities to fulfill your asset allocation strategy.

Stock Picking - Choose stocks that satisfy the level of risk you want to carry in the equity portion of your portfolio - sector, market cap and stock type are factors to consider. Analyze the companies using stock screeners to shortlist potential picks, than carry out more in-depth analyses on each potential purchase to determine its opportunities and risks going forward. This is the most work-intensive means of adding securities to your portfolio, and requires you to regularly monitor price changes in your holdings and stay current on company and industry news.

Bond Picking - When choosing bonds, there are several factors to consider including the coupon, maturity, the bond type and rating, as well as the general interest rate environment.

Mutual Funds - Mutual funds are available for a wide range of asset classes and allow you to hold stocks and bonds that are professionally researched and picked by fund managers. Of course, fund managers charge a fee for their services, which will detract from your returns. Index funds present another choice; they tend to have lower fees because they mirror an established index and are thus passively managed.

Exchange-Traded Funds (ETFs) - If you prefer not to invest with mutual funds, ETFs can be a viable alternative. You can basically think of ETFs as mutual funds that trade like stocks. ETFs are similar to mutual funds in that they represent a large basket of stocks - usually grouped by sector, capitalization, country and the like - except that they are not actively managed, but instead track a chosen index or other basket of stocks. Because they are passively managed, ETFs offer cost savings over mutual funds while providing diversification. ETFs also cover a wide range of asset classes and can be a useful tool for rounding out your portfolio.

Step 3: Reassessing Portfolio Weightings

Once established portfolio, you need to analyze and rebalance it periodically because market movements may cause your initial weightings to change. To assess your portfolio's actual asset allocation, quantitatively categorize the investments and determine their values' proportion to the whole.

The other factors that are likely to change over time are your current financial situation, future needs and risk tolerance. If these things change, you may need to adjust your portfolio accordingly. If your risk tolerance has dropped, you may need to reduce the amount of equities held. Or perhaps you're now ready to take on greater risk and your asset allocation requires that a small proportion of your assets be held in riskier small-cap stocks.

Essentially, to rebalance, you need to determine which of your positions are overweighted and underweighted. For example, say you are holding 30% of your current assets in small-cap equities, while your asset allocation suggests you should only have 15% of your assets in that class. Rebalancing involves determining how much of this position you need to reduce and allocate to other classes.

Step 4: Rebalancing Strategically

Once determined which securities you need to reduce and by how much, decide which underweighted securities you will buy with the proceeds from selling the overweighted securities. To choose your securities, use the approaches discussed in Step 2.

When selling assets to rebalance your portfolio, take a moment to consider the tax implications of readjusting your portfolio. Perhaps your investment in growth stocks has appreciated strongly over the past year, but if you were to sell all of your equity positions to rebalance your portfolio, you may incur significant capital gains taxes. In this case, it might be more beneficial to simply not contribute any new funds to that asset class in the future while continuing to contribute to other asset classes. This will reduce your growth stocks' weighting in your portfolio over time without incurring capital gains taxes.

At the same time, always consider the outlook of your securities. If you suspect that those same overweighted growth stocks are ominously ready to fall, you may want to sell in spite of the tax implications. Analyst opinions and research reports can be useful tools to help gauge the outlook for your holdings. And tax-loss selling is a strategy you can apply to reduce tax implications.

Remember the Importance of Diversification.

Throughout the entire portfolio construction process, it is vital that you remember to maintain your diversification above all else. It is not enough simply to own securities from each asset class; you must also diversify within each class. Ensure that your holdings within a given asset class are spread across an array of subclasses and industry sectors.



OPTIMAL PORTFOLIO

Introduction

One of the factors to consider when selecting the optimal portfolio for a particular investor is degree of risk aversion. This level of aversion to risk can be characterized by defining the investor's indifference curve. This curve consists of the family of risk/return pairs defining the trade-off between the expected return and the risk. It establishes the increment in return that a particular investor will require in order to make an increment in risk worthwhile. Typical risk aversion coefficients range between 2.0 and 4.0, with the higher number representing lesser tolerance to risk. The equation used to represent risk aversion in Financial ToolboxTM software is $U = E(r) - 0.005*A*sig^2$

where:

U is the utility value.

E(r) is the expected return.

A is the index of investor's aversion.

sig is the standard deviation.

What is a Portfolio ?

A combination of various investment products like bonds, shares, securities, mutual funds and so on is called a portfolio.

In the current scenario, individuals hire well trained and experienced portfolio managers who as per the client's risk taking capability combine various investment products and create a customized portfolio for guaranteed returns in the long run.

It is essential for every individual to save some part of his/her income and put into something which would benefit him in the future. A combination of various financial products where an individual invests his money is called a portfolio.

What is 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.

Portfolio Revision Strategies

There are two types of Portfolio Revision Strategies.

• Active Revision Strategy

Active Revision Strategy involves frequent changes in an existing portfolio over a certain period of time for maximum returns and minimum risks. Active Revision Strategy helps a portfolio manager to sell and purchase securities on a regular basis for portfolio revision.

• Passive Revision Strategy

Passive Revision Strategy involves rare changes in portfolio only under certain predetermined rules. These predefined rules are known as formula plans. According to passive revision strategy a portfolio manager can bring changes in the portfolio as per the formula plans only.

What are Formula Plans:

Formula Plans are certain predefined rules and regulations deciding when and how much assets an individual can purchase or sell for portfolio revision. Securities can be purchased and sold only when there are changes or fluctuations in the financial market.

Formula plans help an investor to make the best possible use of fluctuations in the financial market. One can purchase shares when the prices are less and sell off when market prices are higher. With the help of Formula plans an investor can divide his funds into aggressive and defensive portfolio and easily transfer funds from one portfolio to other.

Aggressive Portfolio

Aggressive Portfolio consists of funds that appreciate quickly and guarantee maximum returns to the investor.

Defensive Portfolio

Defensive portfolio consists of securities that do not fluctuate much and remain constant over a period of time. Formula plans facilitate an investor to transfer funds from aggressive to defensive portfolio and vice a versa.

Samples to include in a portfolio

- Activities that demonstrate the completion of a topic of study, such as a report
- Projects (or photographs of the projects) on topics of study
- Graphs of reading or math drill rates
- Audio cassettes of oral reading
- Video cassettes of oral presentations
- Worksheets or workbook pages
- Teacher-made tests
- Written compositions and/or journals
- Reading lists

- Parent/teacher observations and anecdotal records
- Choosing an Evaluator

The evaluation is to be done by a certified teacher and the certification number is to be submitted along with the narrative. The evaluator will ultimately determine what specifically he/she will want to look at in order to make an evaluation of the progression of skills. Therefore, it would be prudent to make contact with your evaluator early in the school term and work together in preparation of the portfolio.

Submitting the Narrative

The West Virginia Code specifies that a narrative is to be provided to the county superintendent indicating that a portfolio of samples of the child's work has been reviewed and that the child's academic progress is in accordance with the child's abilities. The narrative should incorporate an accounting of the child's academic progress in relation to his ability level. While one portion of the portfolio may be evaluated at a particular ability level, other subject areas may require evaluation at other levels. West Virginia law does not require evaluation of social experiences. Your evaluator should focus solely on academic progress.

The narrative is to include a statement about the child's progress in the areas of reading, language, mathematics, science and social studies and is to note any areas which, in the professional opinion of the reviewer, show need for improvement or remediation.

Under any of the four assessment options identified in the state law, if a child does not make acceptable progress for the year, the next step is that the home schooling family "shall initiate a remedial program to foster acceptable progress." So the use of the term "remediation" in the evaluator's directive to note any of the subjects needing "improvement or remediation" raises the question of whether the evaluator, by so doing, is identifying the child as having made unacceptable progress for the year. In order to avoid confusion with county superintendents on this issue, we recommend the following approach.

If the evaluator believes that the student has successfully met the standard of "academic progress in accordance with the child's abilities" for all five subject areas, a clear statement to that effect should be included in the portfolio narrative. This should clearly establish that the evaluator considers the child to have made acceptable progress for the year according to the

standard in the law. If the evaluator then goes on to discuss areas needing improvement, we recommend not using the terms "remedial" or "remediation", so as not to confuse the issue of the evaluator's overall assessment of acceptable progress. Conversely, if the evaluator determined that, in his or her professional opinion, the child did not meet the standard of achievement in accordance with ability, a clear statement to that effect would be included, along with identification of the subject areas needing remediation.

Whether you choose achievement testing or portfolio evaluation, the main concern should be how much worthwhile information each will give you in regard to your child's academic progress. Results from your choice should help you evaluate how to move your child along a continuum of skills toward a higher degree of proficiency. Choosing a method simply to meet the requirements of the law in the easiest way possible would be cheating ourselves and our children of some valuable feedback. While parents do know their children better than a portfolio evaluator or a testing instrument, it is natural to be biased and subjective in our evaluations. We invest far too much time, effort and resources into our children's education to overlook an opportunity for evaluating not only our children's progress, but also our teaching methods.

Our intent is to broaden your knowledge of the assessment methods available to us by West Virginia law. The law is very vague in many areas, and it is not CHEWV's intent to regulate these areas or to give you specifics that you must adhere to. Please consider them as recommendations as you seek an appropriate assessment tool.

Portfolio Limitations

Managing portfolios is more involved and complex than testing. They require much effort, thought, and detailed work in their preparation. Portfolio assessments entail human judgments. The progress of your child's academic skills is at the discretion of your evaluator. Weaknesses and learning gaps are more difficult to ascertain because of the nature of the portfolio.

Portfolio Benefits

Portfolios provide an opportunity to give a broad picture of your child's learning and academic progress. Portfolio evaluation enables those who have difficulty with testing to give evidence of academic learning. Portfolio assembly affords you the opportunity to examine results

KARPAGAM ACADEMY OF HIGHER EDUCATION, COIMBATOREClass: III BBACourse Name: Investment Management

Course Code: 15BAU601Unit V-Portfolio AnalysisBatch: 2015-18

of your instruction, both in detail and in retrospect. Portfolio development assures a built-in audience (the evaluator) for your child, and can be very motivating for him.

Part B (5 x 8 = 40marks)

- 1. What is Investment Activity? Discuss various objectives of an investors in investing money.
- 2. List the available modes of investment in detail with two example each.
- 3. Write down the assumptions underlying CAPM model.
- 4. Explain: (a). Coupon Rate (b). Current Yield (c). Yield to Maturity and (d). Yield to Call.
- 5. Explain "Fundamental Analysis". Bring out the steps involved in fundamental analysis.
- 6. Write down the ways and means of economic forecasting techniques.
- 7. Explain Dow Theory with reference to technical analysis.
- 8. Discuss Efficient Market Theory.
- 9. Discuss Performance of Portfolio Management.
- 10. What do you mean by Portfolio Construction?
- 11. Explain the factors favourable for making Investment?
- 12. Explain the different types of Risk with suitable example?
- 13. Elucidate valuation models of Security in India with suitable example?
- 14. Explain the Rights and Duties of Equity Share Holders in a company?
- 15. Elucidate the difference between Economic Analysis and Industrial Analysis?
- 16. Enumerate the Characteristics and types of Industries with suitable examples?
- 17. Enumerate Dow Theory and Odd Lot Theory used in Technical Analysis?
- 18. Explain the way in ratio analysis an Indicator of a company's growth with example?
- 19. Explain the Techniques used in Portfolio Revision?
- 20. Explain any Two Performance Measurement Techniques in Portfolio Analysis?

	KARPAGAM ACADEMY OF HIGHER EDUCATION, COIMBATORE					
	DEPARTMENT OF MANAGMENET					
	Unit V- Portfo	lio Analysis - Multiple Cho	ice Questions- Eac	h Question carries	s ONE Mark	
SN	Questions	Option 1	Option 2	Option 3	Option 4	Answer
1	Charting is representation of share prices.	Graphical	Systematic	Tabular	Systematic or tabular	Graphical
2	2 In a bar chart, a bar is formed by joining Highest price and I price of a day by vertical line		Opening price and closing price of a day by a vertical line	Highest price and lowest price of a day by a horizontal line	Opening price and closing price of a day by a horizontal line	Highest price and lowest price of a day by a vertical line
3	When a trend reverses and begins to fall, a technical analyst would recommend of a share	Purchase	Sale	Hold	Either A or C	Sale
4	Support occurs when price is	Falling but bounces back	Increases but reverses	Falling continuously	Increasing continuously	Falling but bounces back
5	According to Dow theory, the formation of higher bottoms and higher tops indicate a	Bearish trend	Bullish trend	Flat market	Cyclical market	Bullish trend
6	According to Dow theory, each peak will be followed by a bottom formed because ofPrimary movements		Secondary reaction	Minor movements	None of the above	Minor movements
7	7 A white candlestick is used to represent a situation where The highest price happens first		The lowest price happens first	The closing price of the day is higher than the opening price	The opening price is higher than the closing price	The closing price of the day is higher than the opening price
8	The first and the foremost requirement on the part of the company to list in a stock exchange is	To send Memorandum and articles of association for approval	To send the draft red herring prospectus for approval	To have independent director	To send only Memorandum association for approval	To send Memorandum and articles of association for approval
9	The standard denomination for preference shares and non convertible debentures are	Rs 1	Rs 10	Rs 1000	Rs 100	Rs 100

10	Trading in shares using money borrowed from the broker or Banker is called	Margin Trading	Credit Trading	Loan facility	Premium facility	Margin Trading
11	The minimum amount of money that must be provided by the investor at the time of purchase is	Advance	Maintenance margin	Price	Initial margin	Initial margin
12	Temporary mismatches between receipts and expenditure of the Central Government is met through a mechanism called	Auction	Credit	Ways and means allowance	Advance	Ways and means allowance
13	The borrowing of Money among banks is called	Call money	Bank money	Borrow money	Money plus	Call money
14	The interest rate on commercial paper is determined by the	Market	Investors	RBI	SEBI	Market
15	The objectives of any investments made by an investor	Maximisation of return	Maximum of risk	Hedge against inflation	Maximisation of return and Hedge against inflation	Maximisation of return and Hedge against inflation
16	The borrowing of Money among banks is called	Call money	Put money	Bank money	Money plus	Call money
17	The interest rate on commercial paper is determined by the	Market	Government	RBI	Investors	Market
18	The premium paid for Medi claim is eligible for Tax exemption under Section	88	80ccc	80c	80d	80d
19	The premium paid for Medi claim is eligible for Tax exemption up to a limit of	Rs. 1000 /-	Rs 5000 /-	Rs. 7500 /-	Rs 10000 /-	Rs 10000 /-
20	The interest component of Home loan repayment is eligible for tax exemption up to a limit of	Rs 1000 /-	Rs. 1.5 Lacs	Rs. 2 Lacs	Rs. 5 Lacs	Rs. 1.5 Lacs
21	The premium paid for Medi claim is eligible for Tax exemption up to a limit of	Rs. 10000 /-	Rs 5000 /-	Rs. 7500 /-	Rs 1,00,000 /-	Rs. 10000 /-

22	Certificate of Deposit is a certificate issued by to depositors	RBI	Banks	Government	SEBI	Banks
23	The borrowing of Money among banks is called	Call money	Put money	Borrow money	Money plus	Call money
24	The interest rate on commercial paper is determined by the	Market	Government	RBI	SEBI	Market
25	The objectives of any investments made by an investor	Maximisation of return	Minimisation of risk	Hedge against deflation	Maximisation of return and Minimisation of risk	Maximisation of return and Minimisation of risk
26	The National savings Certificate issued by the Post office has a maturity	5 years	10 years	4 Years	6 Years	6 Years
27	The NSC is issued by the post office is eligible for Tax savings under section	80 CCC	80 C	88	80 D	80 C
28	A voluntary provident fund scheme called Public Provident Fund is operated by	Post office	Certain authorized Banks	Employee Provident fund organization	Post office and Certain authorized Banks	Post office and Certain authorized Banks
29	Who is the Chairman of SEBI ?	N. Damodaran	P. Chidambaram	Y V Reddy	Upendra Kumar Sinha	Upendra Kumar Sinha
30	Y V Reddy is the Governor of	Tamil Nadu	Kerala	RBI	SEBI	RBI
31	NCFM is conducted by	BSE	SEBI	RBI	NSE	NSE
32	is a Futures instrument , wherein the underlying is a currency	Stock futures	Index futures	Currency futures	market futures	Currency futures
33	is a Futures instrument, wherein the underlying is a currency	Stock futures	Market futures	Currency futures	Index market futures	Currency futures
34	date of maturity is also called as	Date of maturity	Date of retirement	The specified time	Date of contract	Date of maturity
35	is also called as coupon rate	Call	Repayment	Principal amount	Interest rate	Principal amount
36	they are protective clauses in the bond incentives	Repayment	Principal	Interest rate	Call	Interest rate

37	7 are issued by an organization with different maturity date Debenture bonds		Mortgage bonds	Serial bonds	Collateral bonds	Serial bonds
38	it protects the owner from loss of principal	Registered bonds	Debenture bonds	Serial bonds	Secured bonds	Registered bonds
39	are issued by those companies who have an excellent credit rating but do not have security	Registered bonds	Debenture bonds	Serial bonds	Secured bonds	Debenture bonds
40	these bonds are retired serially	Serial bonds	Sinking funds	Registered bonds	Equipment trust bonds	Equipment trust bonds
41	the terminal value are not known with certainty	fixed principal investments	variable investments	In direct alternatives	Equipment trust bonds	variable investments
42	the price of preference shares is determined by	demand	supply	demand and supply	Equipment trust bonds	demand and supply
43	have no fixed return or maturity date	preference shares	equity shares	debentures	Equipment trust bonds	equity shares
44	the terminal value of real estate is	certain	uncertain	risk	return	uncertain
45	represent the financing of real estate	securities	commodities	business undertaking	Currencies	commodities
46	the following are the convertible securities	preference shares	debentures	equity shares	preference shares and debentures	preference shares and debentures
47	are the integral part of an investment decision	risk	uncertainty	Risk and uncertainty	return	Risk and uncertainty
48	risk is also called as operating	financial risk	business risk	management risk	political risk	business risk
49	requires knowledge of the different aspects of securities	Portfolio	Investment	Speculation	Gambling	Portfolio
50	is the usual form of government securities	Promissory notes	stock certificates	Share certificate	Gambling	Promissory notes
51	government securities in India are invested by	Financial institutions	Commercial banks	Financial institutions and Commercial banks	Only RBI	Financial institutions and Commercial banks
52	it provides protection against risk of	Life insurance	investment	Speculation	Gambling	Life insurance

	early death					
53	is usually opened by business house	savings account	current account	fixed deposit scheme	mutual fund schemes	current account
54	statutory provident fund was set up in	1920	1922	1925	1935	1925
55	generally like the commercial bank schemes	LIC schemes	Government securities	Post office schemes	Shares	Post office schemes
56	fixed deposit can be made for a period between	1 to 3 years	1 to 4 years	1 to 5 years	Above 10 years	1 to 5 years
57	is a two way market in which there are investors and buyers	primary market	new issue market	secondary market	stock exchange	secondary market
58	is a place of trading in securities	stock exchange	primary market	secondary market	new issue market	stock exchange
59	is a facility of postponing a transaction till the next settlement day	badla financing	arbitrageur	security dealers	taraniwalla	badla financing
60	is a road towards a high growth economy.	Venture capital	Merchant banking	Leasing	Common share capital	Venture capital

Unit – **V** - **Part B** (5 x 8 = 40marks)

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KARPAGAM ACADEMY OF HIGHER EDUCATION, COIMBATORE

Class: III BBA Course Code: 15BAU601 **Course Name: Investment Management** Assignment I

Batch: 2015-18

1 15BAU001 ABDUL KABIER A. F What is Investment? Discuss various salient features of investment. 2 15BAU005 ANAND . V List the advantages and disadvantages of investment. 3 15BAU006 ANIR.R.J V.M Discuss the factors influencing investment. 5 15BAU006 ANIR.R.J V.M Discuss the factors influencing investment. 6 15BAU006 AROKIARAJ. J What is an investment programme? Bring out the salient features of investment programme? Bring out the salient features of investment programme? Bring out the salient features of investment Process? 7 15BAU010 DINESIKUMAR. S What is warious? of an Imaginary Investor. 9 15BAU012 GOKUL S Draft the objectives of an Imaginary Investor. 10 15BAU016 KARTHICK.G List the modes of investment in detail. 11 15BAU017 KARTHICK A. R Discuss various objectives of Investment. 12 15BAU018 KEERTHANA. L Differentiate between Investments. 13 15BAU021 MUTHU KUMAR. R Operating in India. 14 15BAU022 MUTHU KUMAR. R Define Murual Fund? List various types of investments. 15 15BAU023 NANTHINI K Illistatreany	SN	Reg.No	Name of the Student	Topics for Assignment
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KARPAGAM ACADEMY OF HIGHER EDUCATION, COIMBATORE

Class: III BBA Course Code: 15BAU601 Course Name: Investment Management Assignment II Ba

Batch: 2015-18

Reg.No	Name of the Student	Topics for Assignment
5BAU001	ABDUL KABIER A. F	Explain Portfolio Revision with current evidence.
5BAU003	AJETHKUMAR. M	What are the factors to be considered while evaluating the performance of securities?
5BAU005	ANAND . V	Discuss what do you mean by Optimizing portfolio Management.
5BAU006	ANIL RAJ V.M	Narrate various tools applied for technical analysis
5BAU007	AROKIARAJ. J	Discuss and Illustrate with an example of Dow Theory
5BAU009	BENIN . G	Discuss the role of Charts and Trend Lines of Technical analysis
5BAU010	DINESHKUMAR . S	Explain the Elliot Wave Theory in detail
5BAU012	GOKUL . S	Discuss Random Walk Theory
5BAU013	GOPINATH . A	Explain various test which are applicable in Random Walk Theory
5BAU016	KARTHICK . G	What is Credit Rating? Discuss the agencies involved in Credit Rating along with the ratings followed presently
5BAU017	KARTHIKEYAN . R	Evaluate the assumptions underlying CAPM
5BAU018	KEERTHANA . L	Discuss CAPM Model with illustration
5BAU019	LOGESH . G	Evaluate Markowitz Model of Portfolio Management
5BAU022	MUHAMMED SHAFIK K.Y	What do you mean by fundamental analysis. Discuss various terms involved in fundamental analysis
5BAU023	MUTHU KUMAR . R	Discuss the components of fundamental analysis
5BAU025	NANDHAKISHORE K.J	List various forecasting techniques in fundamental analysis
5BAU026	NANTHINI . K	Discuss various phases of company analysis
5BAU027	NARMATHA . M	Bring out the difference between Fundamental and Technical analysis
5BAU028	NAVEEN . G	Discuss the types of charts and lines used in technical analysis
5BAU029	NESHA . R	Explain Random walk theory
5BAU030	NIDHIN SATHYAN	Discuss the concept underlying Industry Analysis
5BAU031	NIVETHA . R	Explain SML and CML under CAPM
5BAU032	PANDIYARAJ. R	Explain the Meaning, Need and Constraints in portfolio revision
5BAU033	PAVITHRA . R	What is Portfolio Evaluation? Explain the need for portfolio evaluation
5BAU035	RABIS GOKUL . S	Explain Industry Life Cycle with illustration
5BAU036	RAGUL PRASATH .S	Explain Derivatives? Discuss the types of derivatives practiced in India
5BAU037	RAJA PRABHU . V	Evaluate Sharps performance measures of managing portfolios with illustration
5BAU038	SAI VENKATESH . R	Evaluate Treyners' performance measures of managing portfolios with illustration
5BAU039	SALMAN FARIZ . J	Evaluate Jensens' Model of performance measures of managing portfolios with illustration
5BAU040	SASIKUMAR. M	List various stock exchanges operating in India before scrip less trading with the name of headquarters, name of promoters, capital, its directors etc
5BAU041	SELVAKUMAR . S	Discuss the history, growth and development of NSE
5BAU045	SRINIVASAN . R	Discuss the history, growth and development of BSE
5BAU046	SUDHEER . T	Discuss the history, growth and development of OTCEI
5BAU047	SURYA PRAKASH . S	Select 5 blue chip companies and list the opening and closing price of shares for the month of January 2017, June 2017 and November 2017
5BAU048	SURYA. R	List any five mutual funds operating in India and discuss the history, growth, performance, NAV for six months ending 31 st November 2017
5BAU049	VARATHARAJ . K	Discuss the use of learning "Investment Management" as a separate course. As Investor analyze the drawbacks which has to be improved in this course.

Register No.: [15BAU601] KARPAGAM ACADEMY OF HIGHER EDUCATION (Deemed to be University Established Under Section 3 of UGC Act, 1956) COIMBATORE - 641021 (For the candidates admitted from 2015 onwards) First Internal Examination, January - 2017 III BBA – VI Semester INVESTMENT MANAGEMENT Time: 2 Hours Maximum: 50 Marks Date & Session: 17.01.2018 - FN PART - A (20 X 1 = 20 Marks) ANSWER ALL THE QUESTIONS is the employment of funds. 1. a. Investment b. Speculation c. Gambling d. Portfolio 2. involves long term commitment. c. Gambling d. Portfolio a. Investment b. Speculation 3. refers to the possibility of incurring a loss in a financial transaction. b. Risk c. Uncertainty a. Capital gains d. Return 4. an involvement of funds of high risk. a. Investment b. Speculation c. Risk d. Gambling 5. A longer term fund allocation is termed as a. Speculation b. Investment c. Gambling d. Portfolio 6. A short term holding is associated with trading is called a. Speculation b. Investment c. Gambling d. Portfolio 7. consists of uncertainty and high stackers for thrill and excitement. a. Investment b. Gambling c. Speculation d. Portfolio is based on tips, rumours and hunches. 8. a. Speculation b. Investment c. Gambling d. Portfolio 9. Investor requires in his investments to meet emergencies a. Stability b. Liquidity c. Tangibility d. Uncertainty 10. Building machinery & land are considered as a. Tangible properties b. Intangible c. Liquidity d. Uncertainty 11. requires a knowledge of the different aspects of securities a. Portfolio b. Investment c. Speculation d. Gambling 12. is the usual form of government securities

a. Promissory notes b. Stock certificates c. Deposits d. Common stocks

13 are the biggest purchasers of stock certificates					
a. LIC b. Provident funds c. Pension fund d. LIC & Provident fund					
14. Government securities are invested by a during book like a structure of the securities are invested by					
a. Financial institutions					
c. Financial institutions and Commercial Banks d. Mutual fund					
15 provides protection against early death.					
a. Life insurance b. Investment c. Mutual Fund d. Bank Deposits					
16 also qualify as collateral for loans					
a. Fixed Deposits b. Saving banks c. RBI d. LIC					
17. The work begins before an issue is actually floated in the market					
a. Distribution b. Underwriting c. Origination d. Subscription					
18 is a kind of guarantee undertaken by an institution or firm.					
a. Distribution b. Underwriting c. Origination d. Subscription					
19. The players in the new issue market are					
a. merchant bankers b. registrars					
c. underwriters, merchant bankers & registrars d. Organizations					
20 collects information on subscriptions					
a. registrars b. underwriters & brokers					
c. collecting bankers d. advertising agencies					
separat terminoriding is associated with trading is called					
PART – B ($3 \times 10 = 30$ Marks) ANSWER ALL THE QUESTIONS 21a What is an Investment? Explain its nature scope and importance of Investment (or)					

21b. Discuss in detail necessary features of Investment.22a. Evaluate the investment process to be followed by an investor. (or)

22b. What is Mutual Fund? List its relative features of mutual fund.

23a. Discuss various types of money market functioning in India with its features. (or)23b. Express the mechanics of security trading in stock exchanges.

KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University Established Under Section 3 of UGC Act, 1956)

COIMBATORE-641021

(For the candidates admitted from 2015 onwards)

First Internal Examination, January - 2017

III BBA – VI Semester

INVESTMENT MANAGEMENT

Answer Key

SI.No	Answer
1	A-Investment
2	A-investment
3	B-Risk
4	B-Speculation
5	B-Investment
6	A-Speculation
7	B-Gambling
8	C-Gambling
9	B-Liquidity
10	A-Tangible Properties

PART – A (20 X 1 = 20 Marks)

SI.No	Answer
11	A – Portfolio
12	A-Promissory Notes
13	D-LIC & PF
14	C-Financial Institutions & Commercial Banks
15	A-Life Insurance
16	A-Fixed Deposits
17	C-Origination
18	B-Underwriting
19	C-Underwriters, Merchant Bankers & Registrars
20	C-Collecting Bankers

2017-20

Batch

PART – B (3 x 10 = 30 Marks)

ANSWER ALL THE QUESTIONS

21a.What is an Investment? Explain its nature, scope and importance of investment.

<u>Answer</u>: Investment is the employment of funds with the aim of achieving additional income or growth in value. It is also the sacrifice of certain present value for the uncertain reward.

Nature and scope of investment can be determined from the meaning of financial investments and how it is different from economic investment. It is also determined from the time period and the risk and its differences with speculation, gambling and arbitrage. The nature of scope of investment management is to understand the exact meaning of investment to find out different avenues of investment to maximize return and minimize risk to make a programme for investment through evaluating securities, constructing a portfolio and reviewing a portfolio to find out a time period for investments to take place to evaluate through various techniques to get the best return for the investor

Scope shall include such investments shall have several facets, the employment of professional fund managers, research (of individual assets and asset classes), dealing, settlement, marketing, internal auditing, and the preparation of reports for clients. The largest financial fund managers are firms that exhibit all the complexity their size demands. Apart from the people who bring in the money (marketers) and the people who direct investment (the fund managers), there are compliance staff (to ensure accord with legislative and regulatory constraints), internal auditors of various kinds (to examine internal systems and controls), financial controllers (to account for the institutions' own money and costs), computer experts, and "back office" employees (to track and record transactions and fund valuations for up to thousands of clients per institution).

Importance includes longer life expectancy, Increasing Rates of Taxation, Legal Safeguards, Sable currency, Existence of Financial Institution to encourage savings, Forms of Business Organization, Interest Rates, Inflation, various investment channels for future investment.

21b. Discuss in detail necessary features of investment.

<u>Answer:</u> Essential features of an Investment Programme are Safety of principal, Liquidity and Collateral value, Stable income, Capital growth, Tax implications, Stability of Purchasing Power and Legality.

22a. Evaluate the investment process to be followed by an investor.

<u>Answer</u>: Following are the various process of an investor. Advice and Planning, Portfolio Modeling and Design, Manager Search and Selection, Implementation, Reviewing, Due Diligence and Reporting

The portfolio management process is the process an investor takes to aid him in meeting his investment goals. The procedure is as follows:

Create a Policy Statement -A policy statement is the statement that contains the investor's goals and constraints as it relates to his investments. Develop an Investment Strategy - This entails creating a strategy that combines the investor's goals and objectives with current financial market and economic conditions. Implement the Plan Created -This entails putting the investment strategy to work, investing in a portfolio that meets the client's goals and constraint requirements. Monitor and Update the Plan -Both markets and investors' needs change as time changes. As such, it is important to monitor for these changes as they occur and to update the plan to adjust for the changes that have occurred.

In short it shall have the attributes such as Investment Policy, Analysis, Valuation of Securities, Portfolio Construction,

22b. What is Mutual Fund? List its relative features of mutual fund.

Answer; Mutual fund is an investment security that enables investors to pool their money together into one professionally managed investment. Mutual funds can invest in stocks, bonds, cash or a combination of those assets. The underlying security types, called *holdings*, combine to form one mutual fund, also called a *portfolio*. In simpler terms, mutual funds are like baskets. Each basket holds certain types of stocks, bonds or a blend of stocks and bonds to combine for one mutual fund portfolio. To summarize, the advantages of mutual funds can be described in four words — simplicity, versatility, diversity, and accessibility. As an investor, you can buy mutual fund 'units', which basically represent your share of holdings in a particular scheme. These units can be purchased or redeemed as needed at the fund's current net asset value (NAV). These NAVs keep fluctuating, according to the fund's holdings. So, each investor participates proportionally in the gain loss of the fund. or All the mutual funds are registered with SEBI. They function within the provisions of strict regulation created to protect the interests of the investor.

Features of Mutual Funds and Risk

When you purchase shares in a mutual fund, your dollars are invested in a large number of companies all at once, and your investment risk is spread out over many stocks of many companies, not just one. With mutual funds, your potential for risk is less. The ups and downs in the value of your investment are potentially less with a mutual fund than with an individual stock because you are more diversified.

Mutual funds make it easy for you to invest in stocks and bonds. The two main advantages of investing your money in mutual funds are 1) you receive professional money management and 2) you are able to truly diversify your holdings with a small sum of money. Each mutual fund has one or more fund managers who are skilled in the principles of money management. They have access to a huge database of research—so basically, you're leaving the driving to them. Each fund also has a particular objective. That objective is defined in the fund's prospectus, which describes a mutual fund and offers its shares for sale. The prospectus provides information such as investment objectives, charges, expenses, and operating policies. A prospectus must be provided to an investor at the time of sale. The investor should read it carefully before sending money or investing.

23a. Discuss various types of money market functioning in India with its features.

According to RBI, the money market is the centre for dealing mainly of short character. In monetary assets, it meets the short term requirements of borrowers and provides liquidity or cash to the lenders. It is a place where short term surplus investible funds at the disposal of financial and other institutions and individual are bid by borrowers, again comprising institutions and individuals and also by the government. There are two kinds of markets where borrowing and lending of money takes place between fund scarce and fund surplus individuals and groups. The markets catering the need of short term funds are called Money Markets while the markets that cater to the need of long term funds are called Capital Markets. Thus, money markets is that segment of financial markets where borrowing and lending of the short-term funds takes place. The maturity of the money market instruments is one day to one year. In our country, Money Markets are regulated by both RBI and SEBI. Characteristics of India's Money Market:

The Indian money market is peculiar. It has several important features: Dichotomised, Scattered, Unorganised Sector Virtually Free from the RBI's Control, Before 1969, Commercial Banks Lacked Discipline, Absence of a Bill Market before 1971, Problems Associated with Seasonal Fluctuations in Money Supply, and RBI and Unorganised Component of the Money Market:

23b. Express the mechanics of security trading in Stock Exchanges.

An individual must use the facilities of these members for trading in securities. The member is a registered dealer of an organized stock exchange. Trading among the members of a recognized stock exchange is to be done under the statutory regulations of the stock exchange. The members carrying on business are known as 'brokers' and can trade only on listed securities. These members execute customer's orders to buy and sell on the exchange and their firms receive negotiated commissions on those transactions. About one-fourth of all members of the exchange are 'specialists', so called because they specialize in 'making a market' for one or more particular kind of stock. In the process of trading in stock exchanges, there is the basic need for a 'transaction' between an individual and broker. A transaction to buy and sell securities is also called 'trades'. This is to be done through selection of a broker.

Trading Mechanics of Securities in Secondary Market

1. Selection of a broker: The buying and selling of securities can only be done through SEBI registered brokers who are members of the Stock Exchange. The broker can be an individual, partnership firms or corporate bodies. So the first step is to select a broker who will buy/sell securities on behalf of the investor or speculator. Trading Mechanics of Securities in Secondary Market.

2. Opening Demat Account with Depository: Demat (Dematerialized) account refer to an account which an Indian citizen must open with the depository participant (banks or stock brokers) to trade in listed securities in electronic form. Second step in trading procedure is to open a Demat account.

3. Placing the Order: After opening the Demat Account, the investor can place the order. The order can be placed to the broker either (DP) personally or through phone, email, etc.

4. Executing the Order: As per the Instructions of the investor, the broker executes the order i.e. he buys or sells the securities. Broker prepares a contract note for the order executed. The contract note contains the name and the price of securities, name of parties and brokerage (commission) charged by him. Contract note is signed by the broker.

5. Settlement: This means actual transfer of securities. This is the last stage in the trading of securities done by the broker on behalf of their clients. There can be two types of settlement. The pay-in and pay-out days for funds and securities are prescribed as per the Settlement Cycle. A typical Settlement Cycle of Normal Settlement is given below:

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KARPAGAM ACADEMY OF HIGHER EDUCATION (Deemed to be University) Established Under Section 3 of UGC Act, 1956) COIMBATORE - 641021 (For the candidates admitted from 2015 onwards) Second Internal Examination, February - 2018 **III BBA - VI Semester** INVESTMENT MANAGEMENT

Time: 2 Hours Date & Session: 26.02.2018 - FN Maximum: 50 Marks

PART - A (20 X 1 = 20 Marks) ANSWER ALL THE QUESTIONS is a description of how rational investors should build efficient portfolio and select the 1 The optimal portfolio (a). CAPM (b). APT

(c). Option pricing theory

(d). Portfolio theory

2 Risk is measured as a variability in (a). Principle

(c). Safety

(b). Return (d). Return and Safety

3 The derives the relationship between the expected return and risk of individual securities and portfolios (a). CAPM (b). APT

(c). Option pricing theory

(d). Portfolio theory

Investors attempt to reduce the variability of returns through 4 of investments (a). Concentration (b). Sectorisation (c). Indexation (d). Diversification

5 With a given set of securities, any	number of portfolio may be created by
(a). Random Techniques	(b). Altering the proportion of funds invested in
each security	(c). Investing equal amounts of funds in each
security	(d). Modern techniques

6 The higher the risk of a security, the would be the return expected from it. (a). Lower (b). Higher (c). Higher and lower (d). Medium

7 Portfolio theory Talks about of stocks

(a). Concentration

(c). Diversification

(b). Segmentation (d). Modernization

(d). Diverse risk

8 If we construct a portfolio including all the securities in the stock market, that would be the most diversified portfolio. Even such a portfolio would be subject to considerable variability in returns . This variability is un diversifiable and is known as (b). Interest rate risk

(a). Systematic risk

(c). Portfolio risk

The Capital Asset Pricing model is really an extension of the portfolio theory of (a). Dow Jones (b). Treynor

(c). Warren Buffet

9

(d). Markowitz

10 The CAPM give. e nature of the relationship be	etween the expected return and the of the
securities	(b) Systematic rick
(c) Unsystematic risk	(d) Market risk
(c). Onsystematic fisk	(d). Market lisk
11 are senior securities of a firm	
(a). Bond	(b). Preference shares
(c). Equity shares	(d). Gilt-edged shares
12 A technical analyst looks at the to see if h	he can establish any pattern performance of indus
(a). Performance of the company	(b). Past share price data
(c). Goodwill of the company	(d). Past share price data
12 Chata II Demonstration of	
13 Charles H Dow was the editor of	(b) Steel englying
(a). Wall street journal	(d) The deeperint
(c). Fortune	(d). The economist
14 According to Dow Theory the stock market has	
(a) Primary movements	(b) Secondary reactions
(c) Minor movements	(d) Primary Secondary and Minor movements
(c). Minor movements	(d). I find y, been duly and find in the ferrend
15 According to Dow theory, the primary movement	t is the that carries the market up or dow
(a). Restraining force	(b) Restraining force and Long range cycle
(c). Short range cycle	(d). Long range cycle
16 The secondary reactions are also called as	
(a). Predictions	(b). Movements
(c). Momentum	(d). Correction
17 According to Dow Theory, the third movement is	s the
(a). Long term movement	(b). Day to day fluctuations
(c). Correction	(d). Short term movement
18 A hull market is market where the prices are have	ing a
(a) Downward movement	(b) Unward movement
(c) Cyclical movement	(d) Elat movement
(c). Cyclical movement	(u). I hat movement
19 A Bear market is market where the prices are have	ving a
(a). Downward movement	(b). Upward movement
(c). Cyclical movement	(d). Flat movement
20 A black candle stick represents	
(a). Bullish trend	(b). Bearish trend
(c). Flat market	(d). Cyclical trend
PART - B (3 X 10 = 30 Marks) AM	NSWER ALL THE QUESTIONS
21a. What is fundamental analysis? List various advar	ntages of fundamental analysis (or)

21b. Explain economic forecasting. Discuss various types of forecasting techniques.

23a. Explain "Technical Analysis". Bring out difference with fundamental analysis.

23b. Explain the ways and means of displaying the results of technical analysis.

22b. Discuss Industry analysis. List the importance of industry analysis.

(or)

(or)

22a. Evaluate the stages of Industry Life Cycle.

KARPAGAM ACADEMY OF HIGHER EDUCATION (Deemed to be University) (Established under section 3 of UGC Act, 1956) (For the candidates admitted from 2015 onwards) Second Internal Examination, March - 2018 Third Year BBA – Sixth Semester Investment Management Part-A (20×1=20 Marks) Answer All the Questions

				· · ·	,			1			
QN	Code	Key	QN	Code	Key	QN	Code	Key	QN	Code	Key
1	d	Portfolio Theory	6	b	Higher	11	a	Bond	16	d	Correction
2	b	Return	7	с	Diversification	12	b	Past Share price data	17	b	Day to day fluctuation
3	а	САРМ	8	a	Systematic Risk	13	a	Wall Street Journal	18	b	Upward movement
4	d	Diversif ication	9	d	Markowitz	14	d	Primary, Secondary & Minor Movements	19	a	Downward movement
5	с	Investing	10	b	Systematic Risk	15	b	Restraining force & Long	20	b	Bearish Trends

Part A - (20 x 1 = 20 marks) Answer ALL the questions

Part B – $(3 \times 10 = 30 \text{ marks})$ Answer ALL the questions

21a. What is fundamental analysis? List various advantages of fundamental analysis.

Fundamental analysis is a method of evaluating a security in an attempt to measure its intrinsic value, by examining related economic, financial and other qualitative and quantitative factors. Fundamental analysis maintains that markets may incorrectly price a security in the short run but that the "correct" price will eventually be reached. Profits can be made by purchasing the wrongly priced security and then waiting for the market to recognize its "mistake" and re-price the security. Advantages shall include : Fundamental data is figured into technical data, but often far. Fundamental Analysis is able to help the human mind. Fundamental study of developmental and exploration. Fundamental Analysis Benefits studied in practice

21b. Explain economic forecasting? Discuss various types of forecasting techniques.

Forecasting is the process of making predictions of the future based on past and present data and most commonly by analysis of trends. A commonplace example might be estimation of some variable of interest at some specified future date. Prediction is a similar, but more general term. Both might refer to formal statistical methods employing time series, crosssectional or longitudinal data, or alternatively to less formal judgmental methods. Usage can differ between areas of application: for example, in hydrology the terms "forecast" and "forecasting" are sometimes reserved for estimates of values at certain specific future times, while the term "prediction" is used for more general estimates, such as the number of times floods will occur over a long period. Surveys, Indicators, Diffusion Indexes, Economic Model Building and Opportunistic Model Building.

22a. Evaluate the stages of Industry Life cycle.

Five Stage Model includes Pioneering development, Rapidly accelerating industry growth, Mature industry growth, Stabilization and market maturity, Deceleration of growth and decline Porter's Competitive Forces, Rivalry among existing competitors, Threat of new entrants, Threat of substitute products, Bargaining power of buyersλBargaining power of suppliers. IT may also be classified as Industry life cycle stages Start-up stage in which growth is extremely fast, consolidation stage in which growth is not as fast as start-up stage but is faster than the general economy, maturity stage in which growth is not faster than the general economy and the relative decline stage in which the growth rate is less than that of general economy.

22b. Discuss Industry analysis? List the importance of industry analysis.

Comprehensive industry analysis requires a small business owner to take an objective view of the underlying forces, attractiveness, and success factors that determine the structure of the industry. Understanding the company's operating environment in this way can help the small business owner to formulate an effective strategy, position the company for success, and make the most efficient use of the limited resources of the small business. "Once the forces affecting competition in an industry and their underlying causes have been diagnosed, the firm is in a position to identify its strengths and weaknesses relative to the industry," Porter wrote. "An effective competitive strategy takes offensive or defensive action in order to create a *defendable* position against the firm to use its unique capabilities as defense, influencing the balance of outside forces in the firm's favor, or anticipating shifts in the underlying industry factors and adapting before competitors do in order to gain a competitive advantage.

23a. Explain Technical analysis. Bring out the difference with fundamental analysis.

Fundamental analysis : Fundamental analysis can be used to evaluate a number of trading instruments, such as shares, indices, currencies and commodities. Some traders will want to weigh up economic factors such as a country's GDP, unemployment levels, company profitability and the health of a sector before taking a decision to buy or sell. This is all fundamental data. Technical analysis : People who just look at price charts are called technical analysts. They argue that everything you need to know about a particular asset, be it a share, forex pair or commodity, is already being reflected in the price. Technical analysts plan their trades and investments based on price trends, chart patterns such as head and shoulders, and more mathematical chart indicators such as moving averages.

Triggers	Fundamental Analysis	Technical Analysis
	Calculating the intrinsic value	Past price movements
Definition	of a stock using economic and	used to predict the future
	individual factors	prices
Purpose	Investing	Trading

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Time horizon	Long Term	Short Term		
Data Sourcing	Financial Statements	Charts		
Target	Intrinsic Value	Future price to trade		

23b. Explain the ways and means of displaying the results of technical analysis.

The following are the ways and means of displaying the result of an technical analysis.

- 1. Technical Analysis: Introduction
- 2. Technical Analysis: The Basic Assumptions
- 3. Technical Analysis: The Use Of Trend
- 4. Technical Analysis: Support And Resistance
- 5. Technical Analysis: The Importance Of Volume
- 6. Technical Analysis: What Is A Chart?
- 7. Technical Analysis: Chart Types
- 8. Technical Analysis: Chart Patterns
- 9. Technical Analysis: Moving Averages
- 10. Technical Analysis: Indicators And Oscillators
- 11. Technical Analysis: Conclusion

KARPAGAM ACADEMY OF HIGHER EDUCATION (Deemed to be University) (Established under section 3 of UGC Act, 1956) (For the candidates admitted from 2015 onwards) Model Examination, March - 2018 Third Year BBA – Sixth Semester Investment Management Part-A (20×1=20 Marks) Answer All the Questions

Q N	Co de	Key	Q N	Co de	Key	Q N	Co de	Key	Q N	Co de	Key
1	D	Liqui dity	6	С	6 days	11	В	Bearish trend	16	В	Debentu re bonds
2	А	Coup on rate	7	В	third day	12	С	Primary Dealers	17	D	Equipm ent trust bonds
3	В	Intere st rate	8	В	Third day	13	C	diffusion indexes	18	В	variable investm ents
4	А	Marke t	9	А	Falling but bounces back	14	C	Opportunis tic model building	19	С	demand and supply
5	D	Hedgi ng	10	В	Resistance line	15	C	Opportunis tic model building	20	В	equity shares

Part A – (20 x 1 = 20 marks) Answer ALL the questions

Part B – $(5 \times 8 = 40 \text{ marks})$ Answer ALL the questions 21a. Bring out various features of a good Investment Programme.

Safety of principal, Liquidity and Collateral value, Stable income, Capital growth, Tax implications and Stability of Purchasing Power and Legality.

TEATURES OF GOOD INVESTEMENT TROOMANNE								
Particulars	Risk	Return / Current Yield	Capital Appreciatio n	Liquidity/M arketability	Tax Benefits			
Equity Share	High	Low	High	High	High			
Debentures	Low	High	Very Low	Very Low	Nil			
Bank Deposits	Low	Low	Nil	High	Nil			
PPF	Nil	Nil	Low	Low	Moderate			
LIC	Nil	Nil	Low	Low	Moderate			
Real Estate	Low	Low	High in Long Term	Moderate	Changes according			

FEATURES OF GOOD INVESTEMENT PROGRAMME

					to rules
Gold & Silver	Nil	Nil	High in Long Term	Moderate	Nil

21b. Discuss alternate forms of investment for an investor.

Peer-to-Peer Lending, Precious Metals, An Investment With a Guaranteed Return: Pay Down Debt, The Ultimate Tangible Investment: Real Estate - Buying property direct - Real estate limited Partnerships. - Real estate investment trusts, Treasury Securities - Bills, Notes, Bonds and Treasury Inflation-Protected Securities, Collectibles -- an Alternative to Penny Stocks, Wine-Bet You Never Thought About This One, Becoming a Silent Partner in a Small, Business and Hedge Funds.

22a. Bring out the mechanics of trading securities in Indian Stock Exchanges.

It is one which is spread across country and connected to National Stock Exchange through VSAT. These two factors combined together helped in reducing the trading and settlement cycle in Indian securities market which got reduced from as long as22 days to 2 days currently. Presently in India, stock exchanges follow T+2 days settlement cycle. Under this system, trading happens on every business day, excluding Saturday, Sunday and exchange notified holidays. The trading schedule is between 10:00 a.m. in the morning to 3:30 p.m. in the evening. During this period, shares of the companies listed on a particular stock exchange can be bought and sold. The SEBI has made it mandatory that only brokers and sub-brokers registered with it can buy and sell shares in the stock exchange. A person desirous of buying or selling shares on the stock market needs to get himself registered with one of these brokers / sub-brokers. There is a provision for signing of broker/sub-broker client agreement form. Brokers/sub brokers ask their clients to deposit money with them known as margin based on which brokers provide exposure to the clients in the stock market.

Trading Mechanism

Trading at both the exchanges takes place through an open electronic limit order book, in which order matching is done by the trading computer. There are no market makers or specialists and the entire process is order-driven, which means that market orders placed by investors are automatically matched with the best limit orders. As a result, buyers and sellers remain anonymous. The advantage of an order driven market is that it brings more transparency, by displaying all buy and sell orders in the trading system. However, in the absence of market makers, there is no guarantee that orders will be executed. All orders in the trading system need to be placed through brokers, many of which provide online trading facility to retail customers. Institutional investors can also take advantage of the direct market access (DMA) option, in which they use trading terminals provided by brokers for placing orders directly into the stock market trading system. (For more, read Brokers And Online Trading: Accounts And Orders.)

Settlement Cycle and Trading Hours

Equity spot markets follow a T+2 rolling settlement. This means that any trade taking place on Monday, gets settled by Wednesday. All trading on stock exchanges takes place between 9:55 am and 3:30 pm, Indian Standard Time (+ 5.5 hours GMT), Monday through Friday. Delivery of shares must be made in dematerialized form, and each exchange has its own clearing house, which assumes all settlement risk, by serving as a central counterparty. **Market Indexes**

The two prominent Indian market indexes are Sensex and Nifty. Sensex is the oldest market index for equities; it includes shares of 30 firms listed on the BSE, which represent about 45% of the index's free-float market capitalization. It was created in 1986 and provides time series data from April 1979, onward. Another index is the S&P CNX Nifty; it includes 50 shares listed on the NSE, which represent about 62% of its free-float market capitalization. It was created in 1996 and provides time series data from July 1990, onward.

Market Regulation

The overall responsibility of development, regulation and supervision of the stock market rests with the Securities & Exchange Board of India (SEBI), which was formed in 1992 as an independent authority. Since then, SEBI has consistently tried to lay down market rules in line with the best market practices. It enjoys vast powers of imposing penalties on market participants, in case of a breach.

22b. Evaluate CAPM.

The capital asset pricing model (CAPM) is a model that describes the relationship between systematic risk and expected return for assets, particularly stocks. CAPM is widely used throughout finance for the pricing of risky securities, generating expected returns for assets given the risk of those assets and calculating costs of capital. BREAKING DOWN 'Capital Asset Pricing Model - CAPM' The formula for calculating the expected return of an asset given its risk is as follows:

$$\overline{r_a} = r_f + \beta_a (r_m - r_f)$$

Where:

r_f = Risk free rate

 β_a = Beta of the security

rm = Expected market return

The general idea behind CAPM is that investors need to be compensated in two ways: time value of money and risk. The time value of money is represented by the risk-free (rf) rate in the formula and compensates the investors for placing money in any investment over a period of time. The risk-free rate is customarily the yield on government bonds like U.S. Treasuries. The other half of the CAPM formula represents risk and calculates the amount of compensation the investor needs for taking on additional risk. This is calculated by taking a risk measure (beta) that compares the returns of the asset to the market over a period of time and to the market premium (Rm-rf): the return of the market in excess of the risk-free rate. Beta reflects how risky an asset is compared to overall market risk and is a function of the volatility of the asset and the market as well as the correlation between the two. For stocks, the market is usually represented as the S&P 500 but can be represented by more robust indexes as well. The CAPM model says that the expected return of a security or a portfolio equals the rate on a risk-free security plus a risk premium. If this expected return does not meet or beat the required return, then the investment should not be undertaken. The security market line plots the results of the CAPM for all different risks (betas).

23a. What do you mean by fundamental analysis. Differentiate with technical analysis.

23a. Fundamental analysis is a method of evaluating securities by attempting to measure the intrinsic value of a stock. Fundamental analysts study everything from the overall

economy and industry conditions to the financial condition and management of companies. Earnings, expenses, assets and liabilities are all important characteristics to fundamental analysts. Technical analysis differs from fundamental analysis in that the stock's price and volume are the only inputs. The core assumption is that all known fundamentals are factored into price; thus, there is no need to pay close attention to them. Technical analysts do not attempt to measure a security's intrinsic value, but instead use stock charts to identify patterns and trends that suggest what a stock will do in the future.

Factors	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		

23b. Illustrate with an example for Industry Life cycle.

The industry lifecycle traces the evolution of a given industry based on the business characteristics commonly displayed in each phase. Industries are born when new products are developed, with significant uncertainty regarding market size, product specifications and main competitors. Consolidation and failure whittle down an established industry as it grows, and the remaining competitors minimize expenses as growth slows and demand eventually wanes. The industry life cycle is made up of the following stages: Pioneering Phase, Growth Phase, Mature Growth Phase, Stabilization/Maturity Phase and Deceleration/Decline Phase. About 95 percent of all newly introduced products fail each year, according to a March 2010 article by Forbes.com. And even the few that succeed have certain life spans called product life cycles. There are four phases to each product's life cycle, not including the innovation and development stage. Companies use various marketing strategies in each stage to prolong the life cycles of their products. Most strategies are implemented to counter key moves and strategies of competitive companies. Introduction Phase : The introduction phase is when the public first sees or hears about a product. The product appears in stores for the first time, and people start seeing print and television ads. During this phase, a company may choose one of two pricing strategies. They may set prices high to recoup initial expenses that went into producing the product. For example, a cell phone manufacturer with new technology may introduce cell phones 10 percent to 20 percent above the prices of most premium cell phones. They may price their phones higher because of the hype and anticipation of the new technology. The company also knows enough people will pay the extra 10 to 20 percent for it to earn substantial profits. Contrarily, the same cell phone company may introduce a cell phone with basic features at reduced prices in hopes of gaining lots of new customers.

24a. Explain Company Analysis. List various stages of company analysis.

Company analysis is a process carried out by investors to evaluate securities, collecting info related to the company's profile, products and services as well as profitability. It is also referred as 'fundamental analysis.' Also, a company analysis looks into the goods and services proffered by the company. industry economic characteristics, Identify company strategies, Assess the quality of the firm's financial statements, Analyze current profitability and risk, Prepare forecasted financial statements and Value the firm.

24b. List the available yardstick to measure companies earnings.

Earnings Per Share as a Measure of Financial Performance, Earnings management, Data and EPS growth analysis model, Price to earnings (P/E) ratio, Price to earnings ratio to growth ratio (PEG), Price to book value ratio (P/B), Dividend payout ratio (DPR) and Dividend yield

25a. Discuss Markowitz Theory in detail.

Harry M. Markowitz is credited with introducing new concepts of risk measurement and their application to the selection of portfolios. He started with the idea of risk aversion of average investors and their desire to maximise the expected return with the least risk. Markowitz model is thus a theoretical framework for analysis of risk and return and their interrelationships. He used the statistical analysis for measurement of risk and mathematical programming for selection of assets in a portfolio in an efficient manner. His framework led to the concept of efficient portfolios. An efficient portfolio is expected to yield the highest return for a given level of risk or lowest risk for a given level of return. Markowitz generated a number of portfolios within a given amount of money or wealth and given preferences of investors for risk and return. Individuals vary widely in their risk tolerance and asset preferences. Their means, expenditures and investment requirements vary from individual to individual. Given the preferences, the portfolio selection is not a simple choice of any one security or securities, but a right combination of securities.

Markowitz Model:

Markowitz approach determines for the investor the efficient set of portfolio through three important variables, i.e., return, standard deviation and coefficient of correlation. Markowitz model is called the "Full Covariance Model".

Through this method the investor can, with the use of computer, find out the efficient set of portfolio by finding out the trade-off between risk and return, between the limits of zero and infinity. According to this theory, the effects of one security purchase over the effects of the other security purchase are taken into consideration and then the results are evaluated.

The assumptions are:

Assumption under Markowitz Theory:

(1) The market is efficient and all investors have in their knowledge all the facts about the stock market and so an investor can continuously make superior returns either by predicting past behaviour of stocks through technical analysis or by fundamental analysis of internal company management or by finding out the intrinsic value of shares. Thus, all investors are in equal category.

(3) All investors would like to earn the maximum rate of return that they can achieve from their investments.

(4) The investors base their decisions on the expected rate of return of an investment. The expected rate of return can be found out by finding out the purchase price of a security dividend by the income per year and by adding annual capital gains.

It is also necessary to know the standard deviation of the rate of return expected by an investor and the rate of return which is being offered on the investment. The rate of return and standard deviation are important parameters for finding out whether the investment is worthwhile for a person.

(5) Markowitz brought out the theory that it was a useful insight to find out how the security returns are correlated to each other. By combining the assets in such a way that they give the lowest risk maximum returns could be brought out by the investor.

(6) From the above, it is clear that every investor assumes that while making an investment he will combine his investments in such a way that he gets a maximum return and is surrounded by minimum risk.

(7) The investor assumes that greater or larger the return that he achieves on his investments, the higher the risk factor surrounds him. On the contrary, when risks are low the return can also be expected to be low.

(8) The investor can reduce his risk if he adds investment to his portfolio.

(9) An investor should be able to get higher return for each level of risk "by determining the efficient set of securities".

25b. Explain (a) Portfolio Construction

1. • Portfolio is a combination of securities such as stocks, bonds, and money market instruments.• The process of blending together the broad classes so as to obtain return with minimum risk is called PORTFOLIO CONSTRUCTION.• Diversification of investments helps to spread risk over many assets and thus reduces unsystematic risk.

2. • TRADITIONAL APPROACH: investors need's in terms of income and capital appreciation are evaluated and appropriate securities are selected to meet the needs of investor.• MARKOWITZ EFFICIENT FRONTIER APPROACH: portfolios are constructed to maximise the expected return for a given level of risk as it views portfolio construction in terms of expected return and the risk associated.

3. • It deals with two major decisions :-(a) Determining the objectives of the portfolio.(b) selection of securities to be included in the portfolio.

4. 2) 3) Selection of1) Analysis of Determination portfolio constrains of objective 5) 4) Assessment diversification of risk and return

5. • Income needsa) Need for current income.b) Need for constant income.• Liquidity• Safety of the principal• Time horizon• Tax consideration• temperament

6. • Current income• Growth in income• Capital appreciation• Preservation of capital

7. • Objectives and asset mix• Growth in income and asset mix• Capital appreciation and asset mix• Safety of principal and asset mix

8. • Tradition approach has some basic assumption like the investor prefers larger to smaller return from securities which requires taking risk.• The risk are namely interest rate risk, purchasing power risk ,financial risk and market risk.• The ability to achieve higher return is dependent upon his/her ability to judge risk and his ability to take specific risk.

better inflation protection. Selection of company in industry• Depending on the preference and needs of investor appropriate combination is selected. Determining the size of participation

10. • Harry Markowitz put forward this model in 1952.• It assists in the selection of the most efficient by analysing various possible portfolios of the given securities. By choosing securities that do not move exactly together, the HM model shows investors how to reduce their risk.

11. • Assumptionsi. Risk of a portfolio is based on the variability of returns from the said portfolio.i. An investor is risk averse.ii. An investor either maximizes his portfolio return for a given level of risk or maximizes his return for the minimum risk.

12. • To choose the best portfolio from a number of possible portfolios, each with different return and risk, two separate decisions are to be made:1. Determination of a set of efficient portfolios.2. Selection of the best portfolio out of the efficient set.

13. • A portfolio that gives maximum return for a given risk, or minimum risk for given return is an efficient portfolio. Thus, portfolios are selected as follows:(a) From the portfolios that have the same return, the investor willprefer the portfolio with lower risk, and(b) From the portfolios that have the same risk level, an investorwill prefer the portfolio with higher rate of return.

14. • The shaded area PVWP includes all the possible securities an investor can invest in. The efficient portfolios are the ones that lie on the boundary of PQVW.• The boundary PQVW is called the Efficient Frontier.

15. • Figure in right shows the risk-return indifference curve for the investors.• Each curve to the left represents higher utility or satisfaction.

16. • The investors optimal portfolio is found at the point of tangency of the efficient frontier with the indifference curve.• R is the point where the efficient frontier is tangent to indifference curve C3, and is also an efficient portfolio.

17. • All portfolios so far have been evaluated in terms of risky securities only, and it is possible to include risk-free securities in a portfolio as well.• A portfolio with risk-free securities will enable an investor to achieve a higher level of satisfaction. This has been explained further.

18. • R1 is the risk-free return. • R1PX is drawn so that it is tangent to the efficient frontier and known as the Capital Market Line (CML). • The P portfolio is known as the Market Portfolio and is also the most diversified portfolio.

19. RP = IRF + (RM - IRF) σ P/ σ M• Where,RP = Expected Return of PortfolioRM = Return on the Market PortfolioIRF = Risk-Free rate of interest σ M = Standard Deviation of the market portfolio σ P = Standard Deviation of portfolio(RM - IRF)/ σ M is the slope of CML. (RM - IRF) is a measure of the riskpremium, or the reward for holding risky portfolio instead of risk-free portfolio. σ M is the risk of the market portfolio. Therefore, the slope measures the rewardper unit of market risk.

20. • The portion from IRF to P, is investment in risk-free assets and is called Lending Portfolio. In this portion, the investor will lend a portion at risk-free rate.• The portion beyond P is called Borrowing Portfolio, where the investor borrows some funds at risk- free rate to buy more of portfolio P.

21. • It requires lots of data to be included. An investor must obtain variances of return, covariance of returns and estimates of return for all the securities in a portfolio.• There are numerous calculations involved that are complicated because from a given set of securities, a very large number of portfolio combinations can be made.• The expected return and variance will also have to computed for each securities.

(b)Portfolio Revision

What is 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.

Portfolio Revision Strategies

There are two types of Portfolio Revision Strategies.

- 1. Active Revision Strategy
 - Active Revision Strategy involves frequent changes in an existing portfolio over a certain period of time for maximum returns and minimum risks.
 - Active Revision Strategy helps a portfolio manager to sell and purchase securities on a regular basis for portfolio revision.
- Passive Revision Strategy
 Passive Revision Strategy involves rare changes in portfolio only under certain
 predetermined rules. These predefined rules are known as formula plans.
 According to passive revision strategy a portfolio manager can bring changes in the
 portfolio as per the formula plans only.

What are Formula Plans?

Formula Plans are certain predefined rules and regulations deciding when and how much assets an individual can purchase or sell for portfolio revision. Securities can be purchased and sold only when there are changes or fluctuations in the financial market. Why Formula Plans ?

- Formula plans help an investor to make the best possible use of fluctuations in the financial market. One can purchase shares when the prices are less and sell off when market prices are higher.
- With the help of Formula plans an investor can divide his funds into aggressive and defensive portfolio and easily transfer funds from one portfolio to other.

Aggressive Portfolio

Aggressive Portfolio consists of funds that appreciate quickly and guarantee maximum returns to the investor.

Defensive Portfolio

Defensive portfolio consists of securities that do not fluctuate much and remain constant over a period of time.

Formula plans facilitate an investor to transfer funds from aggressive to defensive portfolio and vice a versa.