DEPARTMENT OF BUSINESS ADMINISTRATION

GOVERNMENT ARTS COLLEGE(AUTONOMOUS), COIMBATORE 18.

INVESTMENT MANAGEMENT

UNIT I

Concept of investment- Principles- Importance-Need- Alternate forms of investment- Government Securities – Post Office Schemes – LIC schemes- Bank deposits- Mutual Fund Schemes- Provident Fund- Company Deposits- Real Estate – Gold and Silver.

UNIT II

Investment in Shares and Debuntures- Comparison with other forms of investment- Primary Market: Role of NIM- Mechanics of floating new issue. Secondary market- Functions- Mechanics of Security Trading.

UNIT III

Risk- Kinds- Measures of Risk- Returns. Valuation of securities- Valuation of Bonds-Valuation of preference and Equity Shares.

UNIT IV

Security Analysis – Fundamental Analysis: Economic, Industry and Company Analysis- Technical Analysis- DOW Theory – Types of Charts- Important Chart Patterns.

UNIT V

Portfolio – meaning- Objectives – Principles – Diversification-Portfolio Construction- Portfolio Revision – Optimum Portfolio.

(Theory only)

Text Book: Preethi Singh - Investment Management

Reference Books

1. Bhalla V. K - Investment Management, S. Chand Limited, 2006
2. A. Avadhani - Investment Management, Himalaya Publishing House, 1993.
3. Prasanna Chandra - Investment Analysis & Portfolio Management, 2nd Edition, Tata Mc.Graw Hill Publications.

UNIT I

Subject Name	Subject Code	Semester	Prepared by
INVESTMENT MANAGEMENT	**18BBA41C**	**IV**	**Dr.S.Akilandeswari, Assistant Professor**

Nature and scope of Investment

Investment involves making of a sacrifice in the present with the hope of deriving future benefits. Two most important features of an investment are current sacrifice and future benefit. Investment is the sacrifice of certain present values for the uncertain future reward. It involves numerous decision such as type, mix, amount, timing, grade, etc. of investment the decision-making has to be continuous as well as investment may be defined as an activity that commits funds in any financial/physical form in the present with an expectation of receiving additional return in the future. The expectation brings with it a probability that the quantum of return may vary from a minimum to a maximum. This possibility of variation in the actual return is known as investment risk. Thus every investment involves a return and risk. Investment is the process of, “sacrificing something now for the prospect of gaining something later”. So, the definition implies that we have four dimensions to an investment- time, today be sacrifice and prospective gain. The word investment has many interpretations as it means different things to different persons. For a person who has lent money to another, it may be an investment for a return. Similarly, if a person purchases share of a company, bullion or real estate’s for the purpose of price appreciation, it is also an investment for him and an insurance plan or a pension plan is an investment to its purchaser. It is clear that investment is a commitment of funds for earning an additional income. In other words, investment is considered the sacrifice of certain value of money in anticipation of a reward.

Meaning of Investment

The term “investing” could be associated with the different activities, but the common target in these activities is to “employ” the money (funds) during the time period seeking to enhance the investor’s wealth.

Funds to be invested come from assets already owned, borrowed money and savings. By foregoing consumption today and investing their savings, investors expect to enhance their future consumption possibilities by increasing their wealth. Corporate finance typically covers such issues as capital structure, short-term and long-term financing, project analysis and current asset management. Capital structure addresses the question of what type of long-term financing is the best for the company under current and forecasted market conditions. Project analysis is concerned with the determining whether a project should be undertaken. Current assets and current liabilities management addresses how to manage the day-by-day cash flows of the firm. Corporate finance is also concerned with how to allocate the profit of the firm among shareholders (through the dividend payments), the government (through tax payments) and the firm itself (through retained earnings). But one of the most important questions for the company is financing. Modern firms raise money by issuing stocks and bonds. These securities are traded in the financial markets and the investors have possibility to buy or to sell securities issued by the companies. Thus, the

investors and companies, searching for financing, realize their interest in the same place in financial markets. Corporate finance area of studies and practice involves the interaction between firms and financial markets and Investment area of studies and practice involves the interaction between investors and financial markets. Investment field also differ from the corporate finance in using the relevant methods for research and decision making. Investment problems in many cases allow for a quantitative analysis and modeling approach and the qualitative methods together with quantitative methods are more often used analysing corporate finance problems. The other very important difference is, that investment analysis for decision making can be based on the large data sets available from the financial markets, such as stock returns Thus, the mathematical statistics methods can be used.

Investment Definitions

1. “An investment is a commitment of funds made in the expectation of some positive rate of returns. If the investment is properly undertaken, the returns will commensurate with the risk the investor assumes”.

2. “The purchase by an individual or institutional investor of a financial or real asset that produces a return in proportion to the risk assumed over some future investment period”.

3. “Investment means conversion of cash or money into monetary asset or a claim on future money for a return. Purchase of assets like shares and securities can be either for investment or speculation or both. Investments are long term in nature”. In the financial sense, investment is the commitment of a person’s funds to derive future income in the form of interest, dividend, premiums, pension’s benefits or appreciation in the value of their capital. Purchasing of shares, debentures, post offices savings certificates and insurance policies are all investments in the financial sense. Such investments generate financial assets. Investing in various types of assets is an interesting activity that attracts people from all walks of life irrespective of their occupation, economic status, education and family background. When a person has more money than he requires for current consumption, he would be coined as a potential investor. The investor who is having extra cash could invest it in securities or in any other assets like or gold or real estate or could simply deposit it in his bank account. The companies that have extra income may like to invest their money in the extension of the existing firm or undertake new venture. All of these activities in a broader sense mean investment. Investment has many meaning and facets. However, investment can be interpreted broadly from three angles –

1. Economic: Investment includes the commitment of the fund for net addition to the capital stock of the economy. The net additions to the capital stock means an increase in building equipment or inventories over the amount of equivalent goods that existed, say, one year ago at the same time.

2. Layman: uses of the term investment as any commitment of funds for a future benefit not necessarily in terms of return. For example a commitment of money to buy a new car is certainly an investment from an individual point of view. In the Economic sense, investment means the net addition to the economy’s capital stock which consists of goods and services that are used in the production of other goods and services. Investment, in this sense, includes the information of new

productive capital in the form of new construction, plant and machinery; inventories etc., such investment generate real assets.

3. Financial: investment is the commitment of funds for a future return, thus investment may be understood as an activity that commits funds in any financial or physical form in the presence of an expectation of receiving additional return in future. In the present context of portfolio management, the investment is considered to be financial investment, which imply employment of funds with the objective of realising additional income or growth in value of investment at a future date.

Investment is concerned with the management of an investors' wealth which is the sum of current income and the present value of all future incomes. Financial investments are commitments of funds to derive income in form of interest, dividend premium, pension benefits or appreciation in the value of initial investment. Hence the purchase of shares, debentures post office savings certificates and insurance policies all are financial investments. Such investment generates financial assets. These activities are undertaken by anyone who desires a return, and is willing to accept the risk from the financial instruments

A genuine investor is interested in a good rate of return, earned on a rather consistent basis for a relatively long period of time. The speculator, on the other hand, seeks opportunities promising very large returns, earned rather quickly. In this process, he assumes a risk that is disproportionate to the anticipated return. Thus, from the discussion we cannot infer that there exists a demarcation between stocks and speculative stocks. The same stock can be purchased as a speculation or as investment, depending on the motive of the purchaser. For example, the decision of the professor to invest in the stock of Reliance Industries is considered as a genuine investment because he seems to be interested in a regular dividend income and prospects of long-term capital appreciation. However, if another person buys the same stock with the anticipation that the share price is likely to rise, his decision will be characterised as speculation.

But at the same time, both Corporate Finance and Investments are built upon a common set of financial principles such as the present value, the future value, the cost of capital. And very often investment and financing analysis for decision making use the same tools, but the interpretation of the results from this analysis for the investor and for the financier would be different.

Objectives of Investments

The main investment objectives are increasing the rate of return and reducing the risk. Other objectives like safety, liquidity and hedge against inflation can be considered as subsidiary objectives.

Return: Investors always expects a good rate of return from their investments. Rate of return could be defined as the income the investor receives during the holding period stated as a percentage of the purchasing price at the beginning of the holding period. Investors wish to earn a return on their money. Cash has an opportunity cost. By holding cash, you forego the opportunity to earn a return on that cash. Furthermore, in an inflationary environment, the purchasing power of cash diminishes, with high rates of inflation bringing a relatively rapid decline in purchasing power. In

investments, it is critical to distinguish between an expected return (the anticipated return for some future period) and a realised return (the actual return over some past period). Investors invest for the future for the returns they expect to earn but when the investing period is over, they are left with their realised returns. What investors actually earn from their holdings may turn out to be more or less than what they expected to earn when they initiated the investment. This point is the essence of the investments process; Investors must always consider the risk involved in investing.

Return = End Period Value- Beginning Period Value + Dividend/Beginning Period Value ×100

Return = Sale Price Value – Purchasing Price Value + Dividend Yield/Purchasing Price Value × 100

Return = Capital Gains or Price changes or Capital appreciation + Dividend Yield.

Risk: Risk is inherent in any investment. Risk may relate to loss of capital, delay in repayment of capital, non-payment of return or variability of returns. 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. Risk of holding securities is related with probability of actual return becoming less than the expected return. The word risk is synonymous with the phrase variability of return. Investment' risk is just as important as measuring its expected rate of return because minimising risk and maximising the rate of return are interested objectives in the investment management. An investment whose rate ofreturn varies widely from period to period is risky than whose return that does not change much.

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. The selected investment avenue should be under the legal regulatory framework. If it is not under the legal framework, it is difficult to represent the grievances, if any approval of the law itself adds a flavour of safety. Even though approved by law, the safety of the principal differs from one mode of investment to another.

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 increase the liquidity of the investment. An investor tends to prefer maximisation of expected return, minimisation of risk, safety of funds and liquidity of investment. Marketability of the investment provides liquidity to the investment. The liquidity depends upon the marketing and trading facility.

Hedge against inflation: Since there is inflation in almost all the economy, the rate of return should ensure a cover against the inflation. The return rate should be higher than the rate of inflation; otherwise the investor will have loss in real terms. Growth stocks would appreciate in their values over time and provide a protection against inflation. The return thus earned should assure the safety of the principal amount, regular flow of income and be hedge against inflation.

Tax Planning: In practice, many investors are tax paying individuals. As the income tax rates vary from 10% to 30% with a surcharge, the tax liability of those with higher income brackets is somewhat heavy. The interest earned by the investor from his investment is a taxable income, and in certain cases, tax is to be deducted at source of interest income (TDS). An investor generally prefers liquidity for his investment along with safety of his funds and a good return with minimum stock.

Importance of Investment

1.**Longer life expectancy**

Investment provides safety of funds for the future. Thus investors are protected against uncertain situation arising in business in future.

2.Income

Investment provides revenue to firm in future. They are assured of income which provides better financial flow for smooth transactions in business.

3.Taxation

Investing can also help in saving taxes as there are accounts such as the RRSP, TFSA, 401k, Roth IRA and others where the taxes on your investments is lower or non-existent. As governments reduce their responsibility towards funding their citizens' retirement years, they have created these types of accounts so that citizens can contribute and fund their own retirement.

4.Interest rates

Investors are able to generate income due to interest rates offered by bankers for their investments.

5.Inflation

Investing is also important to beat inflation. While the reported inflation is quite low nowadays, the actual inflation is quite high as education and healthcare expenses are increasing much faster than reported inflation.

Even this 2% return may not sustain for long as other foreign central banks have cut close to 0% or even lower. This means that you could face a day when your bank deposits earn 0% return or even negative returns sometime in the future when inflation is taken into account.

Principles of Investment

1.Embrace an Investing Strategy

It is necessary for the investor to follow a good investing strategy. An investor should maintain a consistent approach. In other words, a value investor should not be participated in momentum investing.

2. Invest with a Margin of Safety

An investor should buy an asset for less than its real value to have a margin of safety. The best plan to lower risk is to buy investments at a price that is lower than the real or intrinsic value.

A low price means greater upside appreciation if conditions are favorable. At the same time, a low price provides a margin of safety if circumstances are not ideal. Always plan on less than ideal conditions, something usually goes wrong.

3. Asset Allocation

Asset allocation is how portfolio is divided among different asset categories, will be the biggest determinant of investment returns. Many investors fail because they put little thought or effort into their asset allocation strategy.

Placing money into overvalued asset categories will experience poor long- term returns.

4. Diversification is Vital

Investment diversification in small numbers provides enormous benefits. However, the marginal benefits of adding additional investments decreases as the numbers get larger until the costs become greater than the benefits.

Both under diversification and over diversification are common mistakes made in portfolio management.

5. Invest for the Long Term

Short term investing is one of the biggest downfalls of current investing strategies. The truly great investors realize an investment at a favorable price may take time for the market to recognize its true value.

Long term investing is one of the most important investing principles because short term trading usually leads to poor long -term performance. This is common because many investors let fear and greed cause them to make bad decisions. The long term will take care of itself if you make wise investment decisions.

6. Keep Expenses Low

Most investors don’t realize how much difference high expenses make to their portfolio. In other words, over a 30year period, an increase in expenses of 1% can cost the portfolio more than the original principal.

7. Use Compounding to your Advantage

Compounding or exponential growth (they mean the same thing) is a powerful financial concept. Understand how it works for you and why dividend growth compounding multiplies the value of compounding.

It’s equally important to understand the devastation of reverse compounding. The more of your portfolio you lose the harder it is to make it back because you lose your principal. A 10% loss only requires an 11% gain to get back to break-even. However, a 50% loss requires a 100% gain to get back to break-even.

8. Employ Risk Management Strategies

Because it is so important to not lose your principal you must employ risk management strategies. Portfolio volatility is an investment return killer. If risk is not controlled the investor will suffer greatly in bear markets. Avoiding large portfolio drawdowns should be one of the preeminent investing principles.

9. Anticipate Market Volatility and Make it Your Friend

Despise portfolio volatility but embrace market volatility. Therefore, an investor should be prepared to take advantage of investment opportunities. At the same time, it is necessary to be cognizant of overvalued assets and be willing to move to cash when conditions are unfavorable.

10. Control Your Own Destiny

Technology and the internet have brought down transaction costs and provide the means to get information and guidance at a very low cost. There has never been a better time period for the self-directed investor who is willing to put a little effort into investing.

Alternate forms of Investment

Government Securities

The securities issued by the central, state and quasi-governments are known as Government securities. In these securities the income and capital are guaranteed by the government. The rates of interest on these securities are relatively lower because of their high liquidity and safety. Government Securities in India have a large market. Promissory notes and stock certificates are the important forms of Government securities.

Post Office Schemes

Post office schemes are like commercial bank schemes. Apart from savings bank account, post office offers various schemes which prove to be attractive for the investors who attach utmost importance to safety aspect. The schemes include:

1. Post office monthly income scheme
2. Kisan Vikas Patra
3. National Saving Certificate
4. Public Provident Fund
5. Post Office Recurring Deposit
6. Post Office Time Deposits
7. Deposit Schemes for retired Govt. employees
8. Post office Savings Accounts
9. Savings schemes for Senior Citizens

LIC schemes

Life insurance is a contract for payment of a sum of money to the person who is insured with the insurance company on the happening of event insured against. It is a contract between the insurance company and the insured for a number of years covering either the life-time period or a fixed number of years. Though the primary aim of taking a life insurance policy is coverage of risk the policy undertakes all the characteristics of a investment. The annual bonus which is accruing to the policyholders gets accumulated into a substantial amount over a period of time.

The schemes include:

1. Whole life assurance plan
2. Endowment assurance plan
3. Jeevan Anurag Plan
4. Jeevan Nidhi Plan
5. Jeevan Pramukh
6. Jeevan Mitra
7. Jeevan Saral
8. Jeevan Aadhar
9. Money Back Policy
10. Bima Plus

Bank deposits

Among investment, deposits with banks are more popular. Banks have introduced different types of deposit accounts with various facilities and privileges. Traditionally, deposits with banks are classified into three categories namely,

(a) Savings bank account
(b) Current account
(c) Recurring deposits
(d) Fixed deposit schemes

Mutual Fund Schemes

Mutual funds have become popular all over the world. Mutual funds carry benefits in the form of safety of principal, capital appreciation, and interest or dividend. Under mutual fund scheme, an investor even with a little money can be a participant in investing in big companies, which are otherwise inaccessible to him because of small investment. Mutual funds collect the savings of small investors, invest them in Government and other corporate securities and earn income in the form of interest and dividend. Mutual funds are able to perform better than an individual investor. The investor should be aware of the risks of these growth schemes while making an investment decision. When mutual funds have income schemes, then investment is made in securities of a guaranteed return. Under income schemes, mutual funds select a large share of fixed income securities like debentures and bonds.

Provident Fund

Provident fund scheme is a retirement benefit scheme. Under this scheme a stipulated sum is deducted from the salary of the employee as his contribution towards the fund while in service as contribution. The employer contributes an equal amount to the fund. The employees and employers contributions are invested in gilt-edged securities. Interest earned is also credited to the provident fund account of employees. Thus credit balance in a provident fund account of an employee consists of employees contribution, interest on employee's contribution, employer's contribution and interest on employer's contribution. The accumulated sum is paid to the employee at the time of retirement or resignation. In case of death of an employee, accumulated balance is paid to legal heirs. The Government provides tax incentives under Sec 88.

Types of Provident fund schemes.

1. Statutory Provident Fund
2. Recognised Provident Fund
3. Unrecognised Provident Fund
4. Public Provident Fund

Company Deposits

Public limited companies in the private sector offer fixed deposit investment schemes. Such deposit schemes may be cumulative or non-cumulative and they are offered through newspaper advertisements. These schemes are governed by the provisions of the Companies Rules of 1975. The announcement of fixed deposit schemes gives particulars such as name of the company, date of incorporation, type of business carried on by the company, names, addresses and occupation of the directors, particulars of profits and dividends, latest audited balance sheet, particulars of contingent liabilities, amount to be raised in the fixed deposit scheme, amount of deposit already held by the company, declaration of the company that the fixed deposit is within the purview of the Deposit Rules of 1975, etc.

Real Estate

Real estate includes land and house property. Real estate offer a rate of return which is superior to avenues such as company deposits on a long term basis.

Reasons:

1. Real estate ensures high capital appreciation as compared against gold and silver particularly in the urban area.
2. Loans are available on liberal terms for purchase of land site and construction of houses.In India, apex banks like Housing and Urban Development bank encourage mortgage loans in the form of housing loans. The rates of interest are not only cheaper but also the payment of interest and principal sum qualify in the form of tax concessions to the assesses.
3. Ownership of a house gives an investor a secured feeling and enhances their status in the society.

Gold and Silver

In India, real assets are extremely popular. In fact they were almost the only choice in rural and semi-urban areas for a longer period.

Generally, investors like to invest in jewellery instead of pure gold. Gold is the primary form of saving to housewives.

Advantages of investing in Gold

1. In India, gold is primarily considered a security and a fixed asset. So, gold is not purchased in order to make profit.
2. Gold acts as a hedge against inflation.
3. Gold acts as a reservoir for future use and contingencies. It enables the investor to meet any emergent needs as it is quickly convertible into money and without substantial monetary loss.
4. Gold will always be popular choice for investment to the investor because of rise in prices due to inflation in the economy.
5. Investing in gold is flexible, as it may be invested in any of the following forms- gold coins, gold bars, gold jewellery etc.
6. Gold is used for speculation which gives quick profits.

The Contents in this E-Material is taken from the text and reference book as given in the syllabus.