NPTEL

Course Name: Security Analysis and Portfolio Management

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Session 1: Introduction to Investment Management

1. Explain the meaning of investment? What are the qualities and constraint of successful investment?

Ans:

It is the current commitment / holding of money or other resources in the expectation of reaping further benefits and that will compensate the investor for: The time the investors hold the fund, Expected rate of inflation, Uncertainty of the future.

- Qualities for Successful Investment: Contrary thinking, Patience, Composure, Flexibility, Decisiveness.
- Major Investment Constraints are: Time, Age, Risk Tolerance, Tax Liability, Income fluctuations, Economic Conditions.

2. What are the Investment Decision Processes?

Ans.

Investment Decision Processes:

- Knowledge About Fundamentals of Investment: Expected Return and Realized Return
- Risk Return Tradeoff

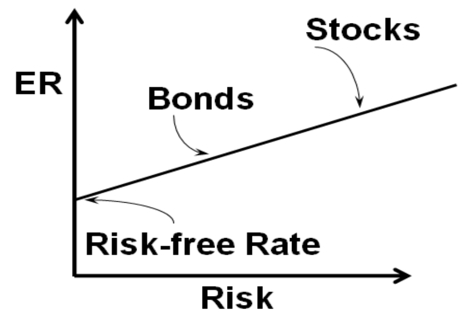
The Investment Decision Process: Two-step process

- Security analysis and valuation: Necessary to understand security characteristics
- Portfolio management
  - Selected securities viewed as a single unit
  - Efficient financial markets
  - Measurement of portfolio performance

3. What do you mean by Trade-off between Expected Return and Risk?

Ans.

In competitive financial markets, the largest risks have the largest payoffs. In financial markets, investors are constantly on the lookout for either the same risk for a larger return, or the same return for lower risk. Investors manage risk at a cost - lower expected returns (ER).



4. Discuss portfolio management process and factors affecting portfolio performance?

Ans.

Portfolio Management Process:

- Objectives and Constraint
- Choice of the asset mix
- Formulation of Strategy
- Selection of Securities
- Portfolio Execution
- Portfolio Revision
- Performance Evaluation

Factors Affecting the Portfolio Management Process:

- Uncertainty in ex post returns
- Quick adjustments
- Investment opportunities
- Types of Investors

5. What are the different approaches towards investment decision in relation to better trade of between risk and return?

Ans.

Approaches to Investment Decision Making:

- Fundamental: Analysis of Macroeconomic, company specific and industry specific factors for decision making.
- Psychological: Each investor is having own preference point of risk-return trade-off. Risk aversion in general may be true but given the individual investor's behavioral judgment the choice of portfolio will be different.
- Academic: Valuation technique suggested by finance theories.
- Specialized: Technical analysis.

Qualities for Successful Investment:

- Contrary thinking: Investment choice without any heard behaviour. Investor try to time the market in opposite to the common trend across the market.
- Patience: Difference between investing and trading. In long run investment horizon risk must be rewarded with higher premium.
- Composure: Capable to distinguish between noise and information

- Flexibility: Proper balance of low risk and high risk investment avenues
- Decisiveness: Sound judgment based on the economic and fundamental factors.

Common Errors in Investment Management decision process;

- Inadequate idea about return and risk
- Biased formulation of investment policy
- Naive extrapolation of the past
- Simultaneous switching
- Love for cheap stocks
- Over diversification or Under diversification
- Wrong attitude towards losses and profits
- Tendency to speculate