NPTEL

Course Name: Security Analysis and Portfolio Management

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Session 30: Equity Portfolio Management Strategy-II

1. How to explain active equity portfolio management strategies?

Ans: Active Equity Portfolio Management Strategies:

- Goal is to earn a portfolio return that exceeds the return of a passive benchmark portfolio, net of transaction costs, on a risk-adjusted basis

- Practical difficulties of active manager is in twofold: Transactions costs must be offset and to manage risk which can exceed passive benchmark

- Strategies Include:

i. Top-down versus bottom-up approaches
ii. Asset and sector rotation strategies
iii. Sector Rotation: move in/out of sectors as economy improves/declines
iv. Technical Strategies: Contrarian investment strategy, Price momentum strategy, Earnings momentum strategy
v. Factor Models Macro Economic and firm specific Factor Models

2. What are the Top-down versus bottom-up approaches of portfolio management?

Ans:

- For top-down approach looks for big picture factors, such as macroeconomics and the industry outlook to guide the investment selection process. Top Down Approach:

- Identify the global market
- Identify the specific domestic economic and market forecast for the domestic country
- Factor in currency risk
- Proper asset allocation
- Identify the sector
- Select the individual company stock

Bottom up approach of portfolio construction starts from the stock level. Bottom-up approach will start with analysis of financial health or company specific factors such as:

- Cash flows and debt levels
- Earnings growth, asset quality and return on investment

- Management quality, governance
- share price

3. Write short note on Salomon Brother’s Risk Attribute Model.
Ans:

In the Risk Attribute Model (RAM) model of Solomon Brothers, the following six macroeconomic factors are used:

- Economic Growth : Monthly change in Industrial Production
- Business Cycle : The spread between the 20 years corporate bond and 20 year Treasury Bond
- Long-term Interest Rate: 10 years treasury yield
- Short-term Interest rate: I month treasury bill rate
- Inflation Shock : Difference between expected inflation and actual inflation
- Value of the currency: The change in value of the domestic currency
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4. Write short note on style Investing
Ans:

Style Investing: Construct a portfolio to capture one or more of the characteristics of equity securities i.e. Small-capitalization stocks, low-P/E stocks, etc…

Types of Equity Styles

- Value stock
- Growth Stock
- Large Stocks
- Small Stocks

Style Classification System

- Collect data relating to the prices and book values of all the stocks available
- Calculate the price to book ratio of all the stocks
- Rank the stocks in the descending order of the price to book ratio
- Classify the first half of the stocks as growth stocks
- Classify the second half as the value stocks
- Use of other ratios like price to book ratio, earnings growth, P/E ratio, dividend yields and historical return