NPTEL

Course Name: Security Analysis and Portfolio Management

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Session # 5: Organization and Function of Equity and Debt Markets

Q.1: Define Securities Market and State the broad classification of the same.

Ans.: A market where financial or financial instruments are traded. It comprises of people, institutions, issuing organizations, processes & systems that enable transactions and regulators overseeing the participants as well as the processes. Securities market can be classified in different ways based on certain features as below:

Tenure of the instruments: Long term (Capital Market) and Short term (Money Market)

Transactions in the market: Primary market: when the instruments are sold/ issued for the first time to a particular investor and Secondary market: where securities change hands from one investor to another investor with the help of buy/sell agreement. Such transactions are facilitated by stock exchanges that have brokers as members.

Q.2: What is a stock index and its purpose?

Ans.: Stock index is essentially a barometer of the movements in the stock or capital market in a particular country. Instead of considering the movement of all the shares traded in the market, a proxy of the market is created with the help of Sensex For example, BSE-Sensex is one of the widely referred stock index pertaining to Indian stock market. It comprises of 30 frequently traded blue-chip stocks representing different sectors. Another popular index is Nifty that comprises of 50 stocks. Stock indices are also constituted for a specific sectors (steel/ automobiles/ IT services/ banking and finance to quote a few). Stock indices are usually based on free float market capitalization of constituent stocks.

Q.3. What is debt market? What are the advantages of debt instruments?

Ans.: Debt Market is the market where fixed income securities of various types and features are issued and traded. Such securities are usually issued by various types of agencies like, Central and State Governments, Municipal Corporations, Government entities, Commercial entities like Financial Institutions, Banks, Public Sector Units, Public Ltd. Companies. The various advantages of debt instruments are:

- Fixed and periodic receipts like interests
- Capital is preserved
- Mostly secured
- Can be risk free if invested in government bonds (gilts)
- Lower volatility in comparison to equity market.

- Variety of instruments like index linked bonds; floating rate notes.

Q.4: What are different types of debt instruments?

Debt instruments can be classified based on certain features as below:

- Based on coupon:
  - Fixed coupon or rate: investor gets a fixed rate of interest over the time period. Frequency of interest payment can be annual, semi-annual, quarterly or monthly.
  - Floating coupon or rate investor gets a rate of interest based on a benchmark. With the rise in the benchmark rate, the coupon is revised upwards and vice-versa.
  - Zero coupon: no interest is paid on the instrument in its life. Rather a lump sum amount is paid at the end of the tenure of the instrument. Zero coupon bonds are also known as deep discount bonds.
- Based on conversion option (usually into equity shares of issuing company)
  - Non-convertible: at the time of maturity, the bond holders get back the amount in cash.
  - Convertible: at the time of maturity, the bond holders get other instruments (usually equity shares) instead of cash. It can be partly or fully convertible debt. In case of partly convertible debt, the debt holders get equity shares as well as cash in a pre-defined ratio.

Q.5: What are the risks associated with debt securities?

Ans.: The major risks associated with debt securities are:

- Default Risk: the risk of not getting back the principal amount
- Interest Rate Risk: the risk of changing interest rate in the market.
- Reinvestment Rate Risk: the risk of reinvestment of interest and principal amount received during the life of the debt instrument.