

# **ANNAI WOMEN`S COLLEGE**

**(Arts & Science)**

**(Affiliated to Bharathidasan University Tiruchirappalli)**

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## **Department of Commerce**

**Course Material**

**SUBJECT :INVESTMENT MANAGEMENT**

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## INVESTMENT MANAGEMENT

### Meaning of investment:

Investment is an activity that is engaged in by people who have savings, i.e. investments are made from savings, or in other words, people invest their savings. But all savers are not investor's. Investment is an activity which is different from saving. Let us see what is meant by investment.

It may mean many things to many persons. If one person has advanced some money to another, he may consider his loan as an investment. He expects to get back the money along with interest at a future date. Another person may have purchased one kilogram of gold for the purpose of price appreciation and may consider it as an investment.

### Definition:

Thus investment may be defined as "a commitment of funds made in the expectation of some positive rate of return" since the return is expected to realize in future, there is a possibility that the return actually realized is lower than the return expected to be realized. This possibility of variation in the actual return is known as investment risk. Thus every investment involves return and risk.

F. Amling defines investment as "purchase of financial assets that produces a yield that is proportionate to the risk assumed over some future investment period."

Definition given by Donald E. Fischer and Ronald J. Jordan: "an investment is a commitment of funds made in the expectation of some positive rate of returns."

### CONCEPT OF INVESTMENT:

1. Financial investment
2. Economic investment
3. Business investment
4. General investment

#### Financial investment:

Allocation of monetary resources to assets that are expected to yield some gain or positive return over a given period of time is known as financial investment. Purchasing of shares, debentures, post office saving certificate and insurance policies all are investment in the financial assets.

#### Economic investment:

According to the economists, investment means the net additions to the economy's capital stock, which consists of goods and services that are used in the production of other goods and services.

Business investment:

Putting money in a private business, is known as business investment. For instance, a man is investing Rs.200, 000 in his newly started provisional store.

General investment:

Sometimes, some persons invest in the avenues, which do not give any additional income such as interest, dividend, rent etc., or capital growth. Such people are called” the man on the street”.

### **NATURE OF INVESTMENT/OBJECTIVES:**

Investment is made because it serves some objective for an investor. Depending on the life stage and risk appetite of the investor, there are three main objectives of investment: safety, growth and income. Every investor invests with a specific objective in mind, and each investment has its own unique set of benefits and risks. Let us understand these objectives in detail.

#### **SAFTY:**

While no investment option is completely safe, there are products that are preferred by investors who are risk averse. Some individuals invest with an objective of keeping their money safe, irrespective of the rate of return they receive on their capital. Such near-safe products include fixed deposits, savings accounts, government bonds, etc.

#### **Growth:**

While safety is an important objective for many investors, a majority of them invest to receive capital gains, which means that they want the invested amount to grow. There are several options in the market that offer this benefit. These include stocks, mutual funds, gold, property, commodities, etc. It is important to note that capital gains attract taxes, the percentage of which varies according to the number of years of investment.

#### **Risk:**

Risk is inherent in any investment. It may relate to loss of capital, delay in repayment of capital, non-payment of interest etc. Some instruments such as government securities and bank deposits are almost riskless, while others are highly risky.

#### **Income:**

Some individuals invest with the objective of generating a second source of income. Consequently, they invest in products that offer returns regularly like bank fixed deposits, corporate and government bonds, etc.

#### **Other Objectives:**

While the aforementioned objectives are the most common ones among investors today, some

other objectives include:

### **Tax Exemptions:**

Some people invest their money in various financial products solely for reducing their tax liability. Some products offer tax exemptions while many offer tax benefits on long-term profits.

### **Liquidity:**

Many investment options are not liquid. This means they cannot be sold and converted into cash instantly. However, some people prefer investing in options that can be used during emergencies. Such liquid instruments include stock, money market instruments and exchange-traded funds, to name a few.

### **Capital appreciation:**

Capital appreciation is one of the important objectives of investment. Investment involve real assets or financial assets. Real assets are tangible assets such as land, building, and bullions, financial asset refer to piece of paper having an indirect claim to real assets held by some others.

### **TYPES OF INVESTMENT:**

- I. Direct investment
- II. Indirect investment

### **Direct investment:**

Direct investment alternatives are those where the individual makes his own choice and investment decision.

1. Fixed principal investment
2. Variable principal securities, and
3. Non-security investments.

### **Fixed principal investment:**

**Fixed principal investments are those whose principal amount and the terminal value are known with certainty.**

- 1. Cash: Cash has a definite and constant value. It dose not earn any return, while in hand. It is the safest investment.**
  
- 2. Savings Accounts: Savings accounts have a fixed return. They differ only in terms of time period.**

**3. Savings certificate: savings certificates are quite recent. Some of the examples of savings certificates are national savings certificates, bank savings certificates, postal savings certificates etc.**

**4. Government bonds: state government and central governments issue government bonds. these bonds are having a fixed maturity value.**

**5. Corporate bonds and debentures: corporate bonds and debentures also have a fixed maturity value and a fixed rate of return over time.**

Variable principal securities:

The variable principal securities are those whose terminal values are not known with certainty. They include the following:

1) Preference shares: preference share is a share that bears a stated dividend and has priority of claim over equity shares in the matter of dividend and assets in the event of liquidation of the company. even though preference shares have a fixed return, the price of preference shares is determined by demand and supply forces.

2) Equity shares: equity share is a security that represents ownership interest in a company. It is issued to those who have contributed capital in setting up an enterprise. They have not fixed return in the maturity period. the amount invested in these shares shall be returned either at the time of winding up or at the time of merger or external reconstruction etc.

3) Non-security investments: Non-security investments are those, which are other than corporate securities, these include the following:

i) Real Estate: it denote the ownership of residential as well as commercial properties. It is less liquid than corporate securities. The terminal value of real estate is uncertain. But generally there ia a price appricioation.

ii) Mortgages: mortgages denote the financing of real estate. It has a periodic fixed income and the principal is recovered at a stated maturity date.

iii) Commodities: in the process of buying and selling commodities, while purchasing the goods we pay the price for them.

iv) Business Venture: Business ventures denote direct ownership investments in new or growing business before firms sell securities on a public basis.

v) Art, Antiques and other valuables: Art, Antiques and other valuables include silver, gold and jewellery. They are also another type of specialised investments, which offer aesthetic qualities also.

## **II. Indirect investment:**

**Indirect investment are those in which the individual has no direct hold on the amount he invests. He contribute his savings to certain organisations such as LIC, UTI etc.**

**An individual also makes indirect investment, for retirement benefits in the form of provident funds and pension, life insurance policy, investment company securities and units of UTI.**

### **TYPES OF INVESTORS:**

**Investors are of three categories. they are as follows:**

- 1. Conservative investors**
- 2. Speculative investors**
- 3. Enterprising investors**

#### **Conservative investors:**

**Conservative investors buy the securities with a view to invest their savings in profitable income earning securities. They generally retain the security for a considerable length of time and care much about the safety of their investment. They are also called genuine investors.**

### **Speculative investors:**

**Speculative investors are popularly known as speculators. The speculators are not genuine investors. They buy securities with a hope to sell them in future at a profit. They are not interested in holding the securities for longer period.**

### **Enterprising investors:**

**they assume risks very boldly as well as willingly. They aim at earning income as well as enjoying capital appreciation.**

### **Investment decision process:**

1. Defining the investment objective
2. Analyzing securities
3. Construct a portfolio
4. Evaluate the performance of portfolio
5. Review the portfolio

### **Defining the investment objective:**

Investment objective may vary from person to person .it should be stated in terms of both risk and return. In other words ,the objective of an investor is to make money accepting the fact of risks that likely to happen .The typical objectives of investor include the current income ,capital appreciation, and safety of principal. More over constrains arising due to liquidity, the time horizon, tax and other special circumstances, if any must also be considered this steps of investment process also identifies the potential financial assets that may be included in the portfolio based on the investment objectives.

### **Analyzing securities:**

The second steps of analyzing securities enable the investor to distinguish between underpriced and overpriced stock. Return can be maximized by investing in stocks which are currently underpriced but have the potential to increase .it might be useful to remember the golden principle of investment; buy low sell high. There are two approaches used for analyzing securities ;technical analysis and fundamental analysis.

### **Construct a portfolio:**

The actual construction of portfolio can be divided into three sub parts.

a) How to allocate the portfolio across different asset classes such as equities, fixed income securities and real assets

b) The assets selection decision, this is the step where the stocks make up the equity component, the bonds that make up the fixed income component.

c) The final component is execution, where the portfolio is actually put together, where investors have to trade off transaction cost against transaction speed.

Evaluate the performance of portfolio:

The performance evaluation of the portfolio is to be done in terms of risk and return. Evaluation measures are to be developed. CAGR (Compounded Annual Growth Rate) may be one criteria. Hindustan Unilever gave a CAGR of 21 percent in returns to the shareholders for the last 13 years.

Review the portfolio:

It involves the periodic repetition of the above steps. The investment objective of an investor may change overtime and the current portfolio may no longer be optimal for him. so the investor may form a new portfolio by selling certain securities and purchasing others that are not held in the current portfolio.

Speculation

Speculation is the practice of engaging in risky financial transactions in an attempt to profit from short or medium term fluctuations in the market value of a tradable good such as a financial instrument, rather than attempting to profit from the underlying financial attributes embodied in the instrument such as capital gains, interest, or dividends. Many speculators pay little attention to the fundamental value of a security and instead focus purely on price movements. Speculation can in principle involve any tradable good or financial instrument. Speculators are particularly common in the markets for stocks, bonds, commodity futures, currencies, fine art, collectibles, real estate, and derivatives.

Difference between Investment and Speculation

1. **Investment** is all about value creation (e.g. manufacturing products and providing services) while **speculation** is concerned about price movement. In the latter, you profit purely from price differences. The price movement is mostly influenced by the psychology of the market.
2. **Investment** is has lower risk but need more capital to generate more value while **speculation** is challenging, has higher risk but requires less capital. This explains why most people are speculating because its entry requirement (capital) is lower.
3. **Investment** is about getting what market offers you while **speculation** is about trying to get more by doing more in believing that you can beat the market.
4. **Investment** is about doing least since you let the companies or industries work for you by owning a piece of their businesses while **speculation** is about doing the most (unconsciously) and it is more involving because you keep chasing the price movement. You need to keep buying and selling to generate profit.
5. **Investment** is over long term while **speculation** is of shorter term. For the former, the success rate is highest by maximizing the holding period of a position while for the latter; the success rate



will peak if the position is kept open for the shortest time possible. This also explains why people like to speculate because it provides “shortcuts” to wealth.

6. **Investment** is about simplicity while **speculation** is about complexity (timing market, predicting market direction, stock picking...). That’s why most people fail when speculating. It gives a false sense of simplicity.
7. **Investment** = growing system (like a living organic creature) while **speculation** = zero- sum game (one person’s gain is another person’s loss). The former will grow over time while the latter remains constant or shrinking over time.



### types of speculators:

There are four types of speculators who are active on the stock exchanges in India. They are known as Bull, Bear, Stag, and Lame Duck. These names have been derived from the animal world to bring out the nature and working of speculators.

#### **Bull**

A Bull or Tejiwala is an operator who expects a rise in prices of securities in the future. In anticipation of price rise he makes purchases of shares at present and other securities with the intention to sell at higher prices in future. He is called bull because just like a bull tends to throw his victim up in the air, the bull speculator stimulates the price to rise. He is an optimistic speculator

#### **Bear**

A bear or Mandiwala speculator expects prices to fall in future and sells securities at present with a view to purchase them at lower prices in future. A bear does not have securities at present but sells them at higher prices in anticipation that he will supply them by purchasing at lower prices in future. A bear usually presses its victim down to ground. Similarly the bear speculator tends to force down the prices of securities. A bear is a pessimistic speculator..

#### **Stag**

A stag is a cautious speculator in the stock exchange. He applies for shares in new companies and expects to sell them at a premium, if he gets an allotment. He selects those companies whose shares are in more demand and are likely to carry a premium. He sells the shares before being called to pay the allotment money. He is also called a premium hunter.

#### **Lame Duck**

When a bear finds it difficult to fulfill his commitment, he is said to be struggling like a lame duck. A bear speculator contracts to sell securities at a later date. On the appointed time he is not able to get the securities as the holders are not willing to part with them. In such situations he feels concerned. Moreover, the buyer is not willing to carry over the transactions.

#### **Gambling:**

Gambling refers to wagering money in an event that has an uncertain outcome in hopes of winning more money, whereas speculation involves taking a calculated risk in an uncertain outcome. Speculation involves some sort of positive expected return on investment even though the end result may very well be a loss.

## **Concept of risk and return:**

Any rational investor, before investing his or her investable wealth in the stock, analysis the risk associated with the particular stock. The actual return he receives from a stock may vary from his expected return and is expressed in the variability of return. Risk The dictionary meaning of risk is the possibility of loss or injury; risk the possibility of not getting the expected return. The difference between expected return and actual.

### **Risk:**

**A person making an investment expects to get some return from the investment in the future. But future is uncertain.**

The dictionary meaning of risk is the possibility of loss or injury, risk the possibility of not getting the expected return. The difference between expected return and actual return is called the risk in investment. Investment situation may be high risk, medium and low risk investment.

**Risk is influenced by external and internal factors. External risks are beyond the control of the company and broadly affect the investment. these external risks are also called as systematic risk. Risk on account of internal environment of a firm or those affecting a particular industry are referred to as unsystematic risk.**

**Total Risk= systematic risk + unsystematic risk**

### **Causes of Risks:**

- 1. Default in taking correct investment decision.**
- 2. Failure to decide the correct timing of investment.**
- 3. Selection of the highly risky investment instruments.**
- 4. Unsatisfactory creditworthiness of the issuer.**
- 5. Selection of the investment having large maturity period. This is because, the large the period, the more risky is the investment normally.**
- 6. Putting huge amount in any security. The higher the amount invested in any security the larger is the risk.**
- 7. If the investment is secured by collateral there will not be much risk.**
- 8. Selection of the risky industry or business in which the company is operating.**

### **Types of Risks:**

#### Systematic risk:

The systematic risk is caused by factors external to the particular company and uncontrollable by the company. The systematic risk affects the market as a whole.

#### Sources of risk

- **Interest rate risk:**

Interest rate risk is the variation in the single period rates of return caused by the fluctuations in the market interest rate. Most commonly the interest rate risk affects the debt securities like bond, debentures.

- **Market risk:**

Jack Clark Francis has defined market risk as that portion of total variability of return caused by the alternating forces of bull and bear market. This is a type of systematic risk that affects share .market price of shares move up and down consistently for some period of time.

- **Purchasing power risk**

Another type of systematic risk is the purchasing power risk .it refers to the variation in investor return caused by inflation.

**Unsystematic risk:**

In case of unsystematic risk the factors are specific, unique and related to the particular industry or company.

- **Business risk:** Every company operates with in a particular operating environment, operating environment comprises both internal environment within the firm and external environment outside the firm. Business risk is thus a function of the operating conditions faced by a company and is the variability in operating income caused by the operating conditions of the company.

- **Financial risk**

It refers to the variability of the income to the equity capital due to the debt capital. Financial risk in a company is associated with the capital structure of the company. The debt in the capital structure creates fixed payments in the form of interest this creates more variability in the earning per share available to equity share holders

This variability of return is called financial risk and it is a type of unsystematic risk.

**RETURN ANALYSIS:**

The major objective of an investment is to earn and maximize the return. Return on investment may be because of income, capital appreciation or a positive hedge against inflation .income is either interest on bonds or debenture, dividend on equity, etc

**Rate of return:** The rate of return on an investment for a period is calculated as follows:

Rate of return =  $\frac{\text{annual income} + (\text{ending price} - \text{beginning price})}{\text{Beginning price}}$

Beginning price

**Capital return:**

The term **capital return** refers to the part of the **return** from an asset that is delivered purely through change in the price of that asset. As such, **capital return** excludes any income that has been delivered by that asset (when income is included in the **return** calculation, it is known as the total **return**).

**Factors determining the return on investment:**

AMC

AMC

AMC