

**SUDHRASAN COLLEGE OF ARTS AND SCIENCE, PERUMANADU,
PUDUKKOTTAI.**

INVERSTMENT MANAGEMENT

CLASS: II M.COM

SET-II

SUBJECT CODE:P16MC41

Max.marks :75

SECTION – A (10X2 =20)

Answer all the questions

1. What is online Trading?

Online trading is the act of purchasing and selling financial products on the Internet. The trader buys and sells using an **online trading platform**. Online trading may include trading in bonds, stocks (shares), futures, international currencies, and other financial instruments.

2. What is Annuity?

An annuity is a contract aimed at generating steady income during retirement, where in lump sum payment is made by an individual to obtain certain amounts immediately or at some point of future.

3. Write a note on OTCEI.

The over-the-counter exchange of India (OTCEI) is an electronic stock exchange based in India that consists of small- and medium-sized firms aiming to gain access to the [capital markets](#) like electronic exchanges in the U.S. such as the [Nasdaq](#), there is no central place of exchange, and all trading occurs through electronic networks.

4. What is Fundamental analysis?

Fundamental analysis is the examination of the underlying forces that affect the well being of the economy, industry groups, and companies. As with most analysis, the goal is to derive a forecast and profit from future price movements.

5. Write note on return

Return on investment (ROI) measures the [gain](#) or loss generated on an investment relative to the amount of money invested. ROI is usually expressed as a percentage and is typically used for personal financial decisions, to compare a company's profitability or to compare the efficiency of different investments.

6. What is Technical analysis?

Technical Analysis is the forecasting of future financial price movements based on an examination of past price movements. Like weather forecasting, technical analysis does not result in absolute predictions about the future. Instead, technical analysis can help investors anticipate what is “likely” to happen to prices over time.

7. What is portfolio analysis?

Portfolio Analysis is the process of reviewing or assessing the elements of the entire portfolio of securities or products in a business. The review is done for careful analysis of risk and return. Portfolio Analysis conducted at regular intervals helps the investor to make changes in the portfolio allocation and change them according to the changing market and different circumstances.

8. What is company analysis?

Company analysis is a study of those variables which influence the future of the company, both qualitatively and quantitatively. Company analysis involves a scrutiny of the company’s financial and non-financial aspects with a view to indentifying its strength, weak nesses and future business prospects.

9. Write a short note on Efficient Market Theory.

A market where there are a large number of rational profit maximisers, actively competing with each trying to predict the future market and where the current information is almost freely and equully available to all participants.

10. What is risk?

Risk is the opposite of safety. Safety is the certainty with which the investment is expected to fulfil the investor’s expectations, while risk is merely the uncertainty surrounding the investment.

SECTION – B (5 X 5 =25)

Answer all the questions

11. (a) What are the features of OTCEI? (OR)

- 1. Use of Modern technology:** Unlike other stock market, OTCEI does not have any special counters and it is an electronically operated stock exchange.
- 2. Restrictions for other stocks:** Stocks and shares listed in other stock exchanges will not be listed in the OTCEI and similarly, stocks listed in OTCEI will not be listed in other stock exchanges.
- 3. Minimum issued capital requirements:** Minimum issued equity capital should be Rs. 30 Lakhs, out of which minimum public offer should be Rs. 20 Lakhs.

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4. Restrictions for large companies: No company with the issued equity share capital of more than Rs. 25 Crores is permitted for listing.

5. Base Capital requirement for members: Members will be required to maintain a minimum base capital of Rs. 4 Lakhs to trade on the permitted or on listed segment.

6. All India Network: The network of counters links OTCEI members, located in different parts of the country.

7. Satellite facility: The satellite required for OTCEI for its operations is jointly held with Press Trust of India (PTI) and hence, PTI-OTCEI scan displays the prices of OTCEI's scripts.

8. Computerization of transactions: Computers at each counter enable to dealers to enter various transactions or queries or quotes through a central OTCEI computer, using telecommunications links.

Due to the above features, OTCEI has an edge over other stock exchanges in the country.

(OR)

(b) What are the methods of Issues securities in the market?

1] Selecting a Broker or Sub-broker

When a person wishes to trade in the stock market, it cannot do so in his/her individual capacity. The transactions can only occur through a broker or a sub-broker. So according to one's requirement, a broker must be appointed.

2] Opening a Demat Account

Since the reforms, all securities are now in electronic format. There are no issues of physical shares/securities anymore. So an investor must open a dematerialized account, i.e. a demat account to hold and trade in such electronic securities.

3] Placing Orders

And then the investor will actually place an order to buy or sell shares. The order will be placed with his broker, or the individual can transact online if the broker provides such services. One thing of essential importance is that the order /instructions should be very clear. the shares at the price mentioned or an even better price if available. The broker will issue an order confirmation slip to the investor.

4] Execution of the Order

Once the broker receives the order from the investor, he executes it. Within 24 hours of this, the broker must issue a Contract Note. This document contains all the information about the transactions, like the number of shares transacted, the price, date and time of the transaction, brokerage amount etc.

Contract Note is an important document. In case of a legal dispute, it is evidence of the transaction. It also contains the Unique Order Code assigned to it by the stock exchange.

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5] Settlement

Here the actual securities are transferred from the buyer to the seller. And the funds will also be transferred. Here too the broker will deal with the transfer. There are two types of settlements,

- On the Spot settlement:
- Forward Settlement:

12. (a) Explain the procedure adopted for listing.

The following are the steps to be followed in listing of a company's securities in a stock exchange:

1. The promoters should first decide on the stock exchange or exchanges where they want the shares to be listed.
2. They should contact the authorities to the respective stock exchange/ exchanges where they propose to list.
3. They should discuss with the stock exchange authorities the requirements and eligibility for listing.
4. The proposed Memorandum of Association, Articles of Association and Prospectus should be submitted for necessary examination to the stock exchange authorities
5. The company then finalizes the Memorandum, Articles and Prospectus
6. Securities are issued and allotted.
7. The company enters into a listing agreement by paying the prescribed fees and submitting the necessary documents and particulars.
8. Shares are then and are available for trading.

(OR)

(b) Explain about Industry analysis

Industry analysis is a type of investment research that begins by focusing on the status of an industry or an industrial sector.

Classification Of Industry

Industry means a group of productive or profit making enterprises organizations that have a similar technically substitute goods, services or source of income. Besides Standard Industry Classification (SIC), industries can be classified on the basis of products and business cycle i.e. classified according to their reactions to the different phases of the business cycle. These are classified as follows:

1. *Engineering*
2. *Textiles*
3. *Steel mills and alloys*
4. *Plantation*
5. *Paper*
6. *Rubber*
7. *Cement*
8. *Electricity generation*
9. *Chemicals and pharmaceuticals*
10. *Sugar*

Industry life cycle analysis

1. Pioneering stage
2. Rapid growth stage
3. Maturity and stabilization stage
4. Decline stage

Characteristics Of An Industry Analysis

In an industry analysis, the following key characteristics should be considered by the analyst. These are explained as below:

1. Post sales and Earnings performance
2. Nature of Competition
3. Raw Material and Inputs
4. Attitude of Government towards Industry
5. Management
6. Labor Conditions and Other Industrial Problems
7. Nature of Product Line
8. Capacity Installed and Utilized
9. Industry Share Price Relative to Industry Earnings
10. Research and Development
11. Pollution Standards

13. (a) Difference between Technical Analysis and Fundamental analysis.

	Fundamental Analysis	Technical Analysis
Definition	Calculates stock value using economic factors, known as fundamentals.	Uses price movement of security to predict future price movements
Data gathered from	Financial statements	Charts
Stock bought	When price falls below intrinsic value	When trader believes they can sell it

		on for a higher price
Time horizon	Long-term approach	Short-term approach
Function	Investing	Trade
Concepts used	Return on Equity (ROE) and Return on Assets (ROA)	Dow Theory, Price Data
Vision	looks backward as well as forward	looks backward

(OR)

(b) Explain the modern approach to portfolio construction

Modern Approach of Portfolio Construction

The modern approach of portfolio construction also known as **Markowitz Approach** emphasizes on selection of [securities](#) on the basis of risk and return analysis. The financial plan of an individual is audited in terms of [risks](#) and returns and efforts are made to maximize expected returns for a given level of risk.

Unlike traditional approach which considers an investors need for income or capital appreciation as basis for selection of stocks, the modern approach takes into account the investors needs in from of market return or [dividend](#) and his tolerance for risks as basis for selection of stocks. Returns are usually measured in terms of market return and dividend and form the basis of selection of stocks.

Ten to Fifteen stocks are selected after thorough [analysis](#) and expected risk and return is computed for each stock. Stocks with good return prospects are selected and funds are appropriately allocated among different stocks according to the portfolio requirements (risk & return) of the investor.

An investor may adopt an active or passive approach to manage his portfolio. Under passive approach, the investor holds the [securities](#) for a previously established holding period while an active approach involves continuous assessment of [risk](#) and return of securities and replacing low performing securities with high performing securities over time.

14. (a) Write about company analysis.

Company analysis attempts to estimate the real worth of the security by condering certain aspects. These aspects are:

1. **Marketing :** The first and foremost variable which influences the future earnings of the company is its overall marketing strategies. (i) sales (ii) Growth in sales (iii) stability of sales
2. **Accounting Policies:** While analyzing a company the investor should carefully consider the accounting policies followed by the company. (i) inventory pricing (ii) Methods of Depreciation (iii) Non - Operating income (iv) Recurring income (v) Tax Carryover
3. **Profitability:** A study of profitability ratios will be helpful in understanding the relationship between sales and earnings. Gross profit margin, netprofit margin, earning power, return on equity, earning per share, and cash earning per share indicate the profitability of the company.
4. **Dividend policy:** The investor should verify whether a company follows a stable dividend policy. Management of a company increases the rate of dividend only when it firmly believes that it will be able to maintain the higher rate of dividend in future also.
5. **Capital structure:** The capital structure affects return on the equity shareholder's investment. Equity shareholders return can be increased by using more debts than equity capital.
6. **Operating efficiency: The investor** attempts to estimate the real worth of the security by studying the operating efficiency of the company. The operating efficiency of the company signifies its efficiency in utilization of its assets to generate profits.
7. **Management:** An efficient management of a company will ensure successful investment. Planning, organizing, directing, co-ordinating and controlling are the important function of the management.
8. **Analysis of Financial Statement:** the financial statements of a company provide the best possible information about the profitability and financial soundness of the company.

(OR)

(b) Explain about random walk theory

Random Walk Theory

The Weak form of the efficient market hypothesis is popularly known as the Random Walk Theory. The random walk theory suggests that changes in stock prices have the same distribution and are independent of each other, therefore, the past movement or trend of a stock

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price or market cannot be used to predict its future movement. In short, this is the idea that stocks take a random and unpredictable path.

Assumption of Random Walk Theory

Before the Random Walk Theory was developed there were several empirical test on the Random walk theory. These test, to some extent, supported the hypothesis that price changes of today are independent of the past prices. These are:

- Empirical tests of the weak form
- Simulation test
- Serial Correlation test
- Run test
- Filter test

The Random Walk theory has certain assumptions in proving its hypothesis:

1. Market is so supreme that no individual investor or group can influence it.
2. The efficient market is based on the flow of free and correct information.
3. Market absorbs all information quickly.
4. All investors are equipped with latest information as they have free access to information flow in the market.
5. The equilibrium value of a stock is determined by the free forces of demand and supply.
6. A price change occurs in the value of stock only.
7. There is no scope for insider information.
8. Investors behave in a rational manner.
9. Markets cannot be influenced by institutional investors or any major fund manager.
10. Perfect market conditions prevail due to the presence of large number of buyer and sellers.

15. (a) Briefly explain about Sharpe's portfolio theory (OR)

Sharpe's portfolio model:

Prof. William Sharpe developed a simplified model involving reduced amount of data. He published his model in the article "A simplified model for portfolio analysis" in January 1963. His work is a single index model, and is a substantial simplification of Markowitz model. Sharpe, in his model, proposed a general theory of pricing of stocks and shares.

The covariance data in the Sharpe's index model reduces from $\left(\frac{N^2 - N}{2}\right)$

Assumptions:

- a. Expectations of all investors with regard to return, variances and correlation among securities are identical
- b. All investors have the same one-period horizon and their expectations are geared accordingly.

- c. Transaction costs do not exist
- d. There are no corporate taxes
- e. Borrowing and lending rates remain constant

Risk-return and the Sharp model

Sharpe, in his model, abandons the covariances of each security with each other security. On the other hand, he substitutes information on the relationship of each security to the market. Each security is calculated by the following formula

$$R_i = \alpha_i + \beta_i I + e_i$$

Where, R_i = expected return on security

α_i = intercept of a straight line or alpha coefficient

β_i = slope of straight line or beta coefficient

I = expected return on index

e_i = error term with a mean of zero and standard deviation which is a constant.

(OR)

(b) What are the difference between traditional theory and modern theory.

1. Traditional portfolio analysis has been of a very subjective nature but it has provided success to some persons who have made their investments by making analysis of individual securities through evaluation of return and risk conditions in each security.

The modern portfolio theory believes in the maximization of return through a combination of securities. The modern portfolio theory discusses the relationship between different securities and then draws inter-relationships of risks between them.

2. Traditional theory was based on the fact that risk could be measured on each individual security through the process of finding out the standard deviation and that security should be chosen where the deviation was the lowest. Greater variability and higher deviations showed more risk than those securities which had lower variation.

The modern theory is of the view that by diversification risk can be reduced. Diversification can be made by the investor either by having a large number of shares of companies in different regions, in different industries, or those producing different types of product lines.

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3. Traditional theory believes that the market is inefficient and the fundamental analyst can take advantage of the situation. By analysing internal financial statements of the company, he can make superior profits through higher returns.

Modern portfolio theory, as brought out by Markowitz and Sharpe, is the combination of the securities to get the most efficient portfolio. Combination of securities can be made in many ways. Markowitz developed the theory of diversification through scientific reasoning and method.

SECTION –C (3 X 10 =30)

Answer any Three questions

16. How does Markowitz theory helps in planning an investors portfolio.

Harry Markowitz model, shortly known as HM Model, was developed by Harry Markowitz in 1952. Harry Markowitz introduced new concepts of risk measurement which are quite useful while selecting portfolios. Generally the average investors wish to maximize their return with least risks. With this objective in mind, Markowitz related his model to the analysis of risk and return and their interrelationship.

The objectives of the investors vary in terms of their risk tolerance, asset preference, investment requirements financial means etc. only a careful combination of right securities can make an efficient portfolio. Markowitz laid emphasis on the fact that the quality of a portfolio will be completely. Risk is greater when there is greater variability in return. So, the investor selects assets with lower variability of returns.

Assumptions of Markowitz theory

1. Investors are generally rational.
2. The market is efficient and all investors have a complete knowledge about the market.
3. The investment decisions taken by the investors are based on the expected rate of return on an investment. Variance or standard deviation of these returns is the important parameter for ascertaining the worthiness of the investment.
4. Security returns are correlated in such a way that an investor could get maximum returns at a given level of risk.

5. Before selecting any portfolio, the factors to be considered are (i) returns (ii) standard deviation, (iii) co-efficient of correlation.
6. The markets are so efficient that they can absorb the information quickly and perfectly
7. Investors are risk-averse and they attempt to minimize risk and maximize return.
8. The investor can reduce his risk if he adds more investments to his portfolio.

Features of Markowitz Model

1. Investment portfolio criteria
2. Efficient portfolio
3. Portfolio selection

17. Critically examine Dow theory point out its assumptions.

Dow Theory

Charles H. Dow was the editor of Wall Street Journal in 1900. He formulated a hypothesis that the stock market does not perform on a random basis and that three cyclical trends guide the general market direction. Which are (i) Primary trend (ii) Secondary trend (iii) Minor trend

(i) Primary Trend

The primary trend is the main movement which is a long-term of 4-year duration. The trend may be either increasing or decreasing. When the market shows an increasing trend, it is known as bull market. The bull market shows three clear cut peaks with each peak being higher than the previous ones. These peaks (a) revival, (b) improvement in corporate profit and (c) speculation.

During the revival period, only a few investors buy scrips who perceive a favourable future. The second phase improvement in corporate profit encourages the investors to buy more and thus mass buying starts leading to a rise in the price of securities. In the third phase, price advance due to inflation and speculation.

The bear market also has three phases. In the first phase, prices begin to fall due to abandonment of hopes this results in the sale of shares. The second phase companies report lower profits and consequently lower dividends. Exert Selling pressure. The final phase, prices fall still further on account of distress sale of securities.

ii. Secondary Trend (Corrections)

The secondary movements are those which last only for a short while. They are also known as corrections. According to Dow Theory, a bull market takes place when successive high are reached after secondary corrections and when secondary upswings advance beyond previous secondary downswings.

In the bull market, secondary trend results in the fall of about 33.66% of the earlier rise. But in the bear market, the secondary trend causes a price upward trend and corrects the main trend. It is stated that the correction would be 33% to 66% of the earlier fall.

iii. Minor Trends

Minor trends are also called territory moves, random wriggles, narrow movements and fluctuations. Minor trends are daily fluctuations and they try to correct the secondary movements.

18. Discuss the functions and powers of SEBI

Powers of SEBI:

- To regulate and approve by-laws of stock exchanges
- Inspect the books of accounts of recognized stock exchanges and call for periodical returns
- Inspect the books of financial Intermediaries.
- Compel certain companies to get listed on one or more stock exchanges
- To handle the registration of brokers

We can classify the functions of SEBI into three categories:-

1. Protective functions
2. Developmental functions
3. Regulatory functions

1. Protective Functions:

As protective functions SEBI performs following functions:

- (i) SEBI checks Price Rigging:
- (ii) SEBI prohibits Insider trading:

(iii) SEBI prohibits fraudulent and Unfair Trade Practices:

(iv) SEBI sometimes educate the investors so that become able to evaluate the securities and always invest in profitable securities.

(v) SEBI issues guidelines to protect the interest of debenture holders.

(vi) SEBI is empowered to investigate cases of insider trading and has provision for stiff fine and imprisonment.

(vii) SEBI has stopped the practice of allotment of preferential shares unrelated to market prices.

(vii) SEBI has stopped the practice of making a preferential allotment of shares unrelated to market prices.

2. Developmental Functions:

Under developmental categories following functions are performed by SEBI:

(i) SEBI promotes training of intermediaries of the securities market.

(ii) SEBI tries to promote activities of stock exchange by adopting a flexible and adaptable approach in following way:

(a) SEBI has permitted **internet trading** through **registered stock brokers**.

(b) SEBI has made underwriting optional to reduce the cost of issue.

(c) An Even initial public offer of primary market is permitted through the stock exchange.

3. Regulatory Functions:

These functions are performed by SEBI to regulate the business in stock exchange. To regulate the activities of stock exchange following functions are performed:

(i) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc.

(ii) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

(iii) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner.

(iv) SEBI registers and regulates the working of mutual funds etc.

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(v) SEBI regulates takeover of the companies.

(vi) SEBI conducts inquiries and audit of stock exchanges.

19. What are the steps in Traditional approach.

(1) Analysis of constraints: It involves analysis of constraints of the investor within which the objectives will be formulated. The constraints may be decided on the basis of:

- **Income needs** – Investors need for current income (to meet living expenses) and constant income (to offset the effect of inflation)
- **Liquidity needs** – Investors preference for liquid assets
- **Safety of Principal** – Safety of principal value at the time of liquidation
- **Time Horizon** – Life cycle stage and investment planning period of the investor
- **Tax Consideration** – Tax benefits of investing in a particular asset
- **Temperament** – [Risk](#) bearing capacity of the investor

(2) Determination of objectives: It involves formulation of objectives within the given framework of constraints. Constraints reflect the [risk](#) bearing capacity and income requirements of the investor. Some common objectives of investors are:

- Current Income
- Growth in Income
- Capital Appreciation
- Preservation of Capital

All objectives cannot be achieved simultaneously, hence if an investor's objective is capital appreciation, he must be ready to invest in [securities](#) that have high [risk](#) in order to get high returns.

(3) Selection of Portfolio: The optimum asset mix for an investor depends upon his investment objectives.

Investment Objectives	Asset Mix
Current Income	60% in debt and 40% in equity
Growth in Income	60% in equity and 40% in debt
Capital Appreciation	90% in equity and 10% in debt

Safety of Principal

90% in debt instruments with focus on short term debt instruments and 10% on equity

(4) Risk & Return Analysis: It involves analysis of risk and returns involved in following a particular course of action. Major [risk](#) categories that an investor can tolerate are determined and efforts are made to minimize these risks to get expected returns.

(5) Diversification: It involves assigning relative portfolio weights to different [securities](#) on the basis of which the portfolio is diversified. Diversification is done on the basis of investor's need of income and his risk bearing capacity. Industries that correspond to specific goals of the investor are selected, out of which few companies from each industry are chosen on the basis of its growth, profits, dividend, R&D, expected earnings, goodwill etc.

20. Explain different methods of diversification

Diversification relates to the principle of "Putting all eggs in different baskets". As such, methods of diversification are based on three principles namely,

(1) Random selection:

Random selection means selecting securities of any companies in random manner. Random selection is believed to avoid statistical error of choosing wrong companies in which money is to be invested. Randomness of selection as a statistical technique has more probability of reducing risks.

(2) Optimum selection:

Optimum selection involves selection of optimum number of companies whose securities are to be bought. If the number of companies considered for investment portfolio is small, risk cannot be reduced adequately. If the number of companies is too large, risk will be more due to diseconomies and difficulty of supervision, analysis and monitoring.

(3) Adequate diversification:

Under adequate diversification as many industries and companies or securities as possible are selected to get the best result. This method is based on the assumption that if there are adequate number of companies and industries in a portfolio, it will reduce the risk to zero.

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INVERSTMENT MANAGEMENT

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SET-1

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Max.marks :75

SECTION – A (7 X2 =14)

Answer all the questions

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2. What is Annuity?
3. Write a note on OTCEI.
4. What is fundamental analysis?
5. Write note on return
6. What is Technical analysis?
7. What is portfolio analysis?
8. What is company analysis?
9. Write a short note on Efficient Market Theory.
10. What is risk?

SECTION – B (5 X 5 =25)

Answer all the questions

11. (a) What are the features of OTCEI? (OR)
(b) What are the methods of Issues securities in the market?
12. (a) Explain the procedure adopted for listing.(OR)
(b) Explain about Industry analysis
13. (a) Difference between Technical Analysis and Fundamental analysis.(OR)
(b) Explain the modern approach to portfolio construction
14. (a) Write about company analysis. (OR)
(b) Explain about random walk theory
15. (a) Briefly explain about Sharpe's portfolio theory (OR)
(b) What are the difference between traditional theory and modern theory.

SECTION –C (3 X 10 =30)

Answer any Three questions

16. How does Markowitz theory helps in planning an investors portfolio.
17. Critically examine Dow theory point out its assumptions.

18. **Discuss the functions and powers of SEBI**
19. **What are the steps in Traditional approach.**
20. **Explain the different methods of diversification.**