SUDHRASAN COLLEGE OF ARTS AND SCIENCE, PERUMANADU, PUDUKKOTTAI.

INVERSTMENT MANAGEMENT

CLASS: II M.COM SET-I1I SUBJECT CODE:P16MC41

Max.marks :75

SECTION – A (10 X2 =20)

Answer all the questions

1. **Define diversification.**
   Diversification is an asset allocation plan, which properly allocates assets among different types of investment. Investors accept a certain level of risk, but they also need to have an exit strategy, if their investment does not generate the expected return.

2. **What is mutual funds?**
   A mutual fund collects money from investors and invests the money on their behalf. It charges a small fee for managing the money. Mutual funds are an ideal investment vehicle for regular investors who do not know much about investing. Investors can choose a mutual fund scheme based on their financial goal and start investing to achieve the goal.

3. **What is SEBI?**
   Securities and Exchange Board of India (SEBI) was established in 1988. Primary role at that time was to observe the market but SEBI had no power to control anything. It was a non-statutory body. To give it powers, Union Government of India passed SEBI Act 1992. On 12 April 1992 SEBI became an autonomous body with statutory powers.

4. **Name the mutual funds operated in private sector.**
   Private mutual funds can be as exclusive as limosines. A **mutual fund** is an investment instrument which combines **funds** from many investors to invest in stocks, bonds, money market instruments and other financial assets. **Mutual funds**can be either public or **private**. "

5. **What do you understand by debt schemes of mutual fund?**

   These funds invest in debt instruments like bonds, securities, fixed income assets, the company's debentures etc. They provide a safer investment option for investors looking for small regular returns with low risk.

6. What is UTI?

UTI began operations in July 1964. It provides opportunity for small-savers to invest in areas where their risk is diversified.

The Unit-holders, if necessary, can sell their units to UTI at the prices determined by UTI. One of the attractions is that the investment in UTI has an income-tax rebate and the income from the UTI is exempted; from income-tax subject to certain limits.

7. What is optimal portfolio?

Optimal portfolio is a term used in **portfolio** theory to refer to the one **portfolio** on the Efficient Frontier with the highest return-to-risk combination given the specific investor's tolerance for risk. It's the point where the Efficient Frontier (supply) and the Indifference Curve (demand) meet.

8. What is CAPM?

The **Capital Asset Pricing Model** predicts the relationship between the risk of an **asset** and its expected returns. The **capital asset pricing model** asserts that the investor should be compensated in two ways: Time value of money and the Risk. ... A risk-free rate in the formula of **CAPM**.

9. What is a close-ended scheme?

These funds are listed on the stock exchange. They have a fixed number of outstanding shares and operate for a fixed duration. The fund is open for subscription only during a specified period. These funds also terminate on a specified date. Hence, the investors can redeem their units only on a specified date.

10. What Net present value?

Net Present Value (NPV) is the value of all future cash flows (positive and negative) over the entire life of an investment discounted to the present. NPV analysis is a form of intrinsic valuation and is used extensively across finance and accounting for determining the value of a business, investment security, capital project, new venture, cost reduction program, and anything that involves cash flow.

SECTION – B (5 X 5 =25)

Answer all the questions

11. (a) What are the objectives of UTI?

Objectives ofUnit Trust of India

The basic objective of the establishment of Unit Trust of India was toencourage investment and participation in the income, profits and gains accruingto the corporation from the acquisition, holding, management and dispersal ofsecurities.

The other objectives are as follows :

1. To stimulate and pool the savings of the middle and low income groups.
2. To enable unit holders to share the benefits and prosperity of the rapidlygrowing industrialisation in the country.
3. To sell units among as many investors as possible.
4. To invest the money raised from the sale of units and its own capital incorporate and industrial securities
5. To pay dividend to the unit holders.

(OR)

(b) Despite its limitations, why is the CAPM widely used?

1. Cumbersome calculation of Beta factor:

The CAPM employs beta as a measure of relationship between the risk factor and expected return. But the calculation of beta factor is very tedious as it calls for a greater deal of data. The beta factor is calculated by carefully considering the security's historical returns relevant to the return of the market portfolio. The limitation of the beta factor is that it may or may not represent the future variability of returns. Moreover, the beta factor does not remain constant over a period of time and so it needs to be updated periodically.

2. Unrealistic assumption:

The CAPM is based on certain assumptions which are highly unrealistic in the real world. The assumption are that all inverstors are risk averse, higher the risks more is the return and transaction costs are nil.

3. Approximation of the required rate of return:

The CAPM attempts to measure the risk of a security in terms of its contribution to the riskiness of the portfolio. It considers the required rate of return of a security on the basis of its contribution to total portfolio risk. But the required rate of return which is key to the CAPM is merely a rough approximation.

12. (a) What are the characteristics of mutual fund?

(i) **Management: T**he professional consultants have the specialized knowledge due to expertise and training in evaluating investments. They hae superiority in managing the portfolios due to experience of investing and continuous learning on the job.

(ii) **Small Saver:** Mutual funds accommodate investors who don't have a lot of money to invet by setting relatively low rupee value for initial purchases, subsequent monthly purchases, or both. They also offer schemes that easily fit into the budget of the investor.

(iii) **Liquidity:** Mutual fund investors can readily redeem their shares at the current NAV plus any fees and charges assessed on redemption at any time. Investment made in units give the advantage of liquidity to the investor.

(iv) **Diversification :** Diversification reduces the risk because all stocks may not move in the same direction, in the same proportion at the same time. Share prices can move up or down. The investor should be aware of these risks while making an investment decision.

(v) **Analysis and Selection of Securities:** Mutual funds select a large share of equities in the case of growth schemes. Although this has a greater risk and potential for capital appreciation is higher in growth schemes. Besides growth schemes mutual funds also have income schemes.

(vi) **Professional Management:** Professional money managers research, select and monitor the performance of the securities the fund purchases. This helps the investor in achieving a higher return than he would gain by investing in individual securities without professional help.

(OR)

(b) What are the difference between closed-ended and open-ended schemes?

1. A closed-end fund has a fixed number of shares offered by an investment company through an initial public offering (IPO). Thereafter, closed-end fund shares are traded on an exchange, just like an individual stock.

   Open-end funds (which most of us think of when we think mutual funds) are offered through a fund company that sells shares directly to investors.

2. Closed-end funds can be traded at any time of the day when the market is open, while open-end funds are traded at times of day dictated by the fund managers.
3. Closed-end funds trade throughout the day like individual stocks and can be bought or sold at whatever price the fund is trading at

The number of shares in an open-end fund is not fixed and is theoretically unlimited. The fund sells as many shares as investors wish to buy. Share price is based on the fund's net asset value and reflects the fund's performance

4. Another difference is that a closed-end fund is more likely than an open-end fund to include alternative investments in its portfolios such a*s futures, derivatives or foreign currency.*

13. (a)Write about the origin and formation of UTI.

Origin :

UTI began operations in July 1964. It provides opportunity for small-savers to invest in areas where their risk is diversified.

The Unit-holders, if necessary, can sell their units to UTI at the prices determined by UTI. One of the attractions is that the investment in UTI has an income-tax rebate and the income from the UTI is exempted; from income-tax subject to certain limits.

Formation:

UTI was established with an initial capital of Rs. 5 crore, contributed by the RBI, LIC, SBI and its subsidiaries and scheduled banks and financial institutions. The initial capital of Rs. 5 crore was divided into 1,000 certificates of Rs. 50,000 each. To supplement its financial resources, the trust can borrow from the Reserve Bank of India, the amount being repayable on demand' or within a period of 18 months.

UTI is managed by a Board of Trustees, consisting of a chairman and four members nominated by Reserve Bank of India, one member nominated by LIC, one member nominated by the State Bank of India, and two members elected by the contributing institutions.

(OR)

(b) State the various schemes offered by the UTI

Specific investment schemes of UTI as a mutual fund that are beneficial to mutual fund holder as given below

1. Income plan

   The mutual fund distributes a substantial part of the surplus to investors iin the form of dividends.

2. Growth plan
   An investor realizes only capital appreciation on the investment and normally does not get any income in the form of income distribution.
3. Reinvestment plan
   Here, the accrued income is reinvested in the purchase of additional units.
4. Systematic investment plan
   The investors is given the option of managing his investment on a periodical basis and thus inculcating a regular saving habit. He may issue a pre-determined number of post dated cheques in favour of the fund.
5. Systematic withdrawal plan
   This is quite opposite to the systematic investment plan. In systematic withdrawal plan, investor is given the option of withdrawing his investment amount at a pre-determined date and amount from the fund.
6. Insurance plan
   Here, the investor is given an insurance cover against life or personal accident.

14. (a) Explain the general Benefits of mutual funds.

1. **Diversification**. Mutual funds spread their holdings across a number of different investment vehicles, which reduces the effect any single security or class of securities will have on the overall portfolio.
2. **Expert Management**. Many investors lack the financial know-how to manage their own portfolio. However, non-index mutual funds are managed by professionals who dedicate their careers to helping investors receive the best risk-return trade-off according to their objectives.
3. **Liquidity**. Mutual funds, unlike some of the individual investments they may hold, can be traded daily. Though not as liquid as stocks, which can be traded intraday, buy and sell orders are filled after market close.
4. **Convenience**. If you were investing on your own, you would ideally spend time researching securities. You'd also have to purchase a huge range of securities to acquire holdings comparable to most mutual funds.
5. **Reinvestment of Income**. Another benefit of mutual funds is that they allow you to reinvest your dividends and interest in additional fund shares.
6. **Range of Investment Options and Objectives**. There are funds for the highly aggressive investor, the risk averse, and the middle-of-the-road investor – for example, emerging markets funds, investment-grade bond funds, and balanced funds, respectively.

(OR)

(b) Explain the RBI guidelines for Mutual Funds

Coverage of the Guidelines

1. Broadly, banks can acquire shares, debentures and units of mutual funds etc., for three different purposes :

(a) for making direct investment in shares / debentures etc. at bank's own risk;

(b) for making loans and advances to individuals and sharebroking entities for the purpose of making investment in capital markets on their own account. Here, the investment risk is that of the individual or stock-broking entities. Loans / advances by banks are normally fixed in value and carry the stipulated interest rate, and the risk to banks could arise on account of inadequacy of margins or the inability of borrowers to meet their repayment / interest obligations to banks because of volatility in share prices or other related reasons, and

(c) shares/ debentures may be assigned to banks by individuals and corporates as collateral and additional security for certain approved purposes which do not involve stock broking or investment in capital market.

These guidelines cover investments in shares, convertible bonds and debentures and units of equity-oriented mutual funds and advances against equity shares, bonds and debentures, units of mutual funds, etc. for purposes (a) and (b) above. In respect of (c) above, banks are free to accept additional shares, debentures, units of mutual funds etc. as collateral for approved purposes as per the normal banking practice and appraisal procedures.

15. (a) Explain the regulation of mutual funds.

1. The mutual fund company must be registered company
2. Before commencing mutual find, prior permission of SEBI must be obtained.
3. Capital structure must be according to the regulations stipulated by SEBI.
4. Every mutual fund company must give their Net Asset Value periodically preferably weekly in the leading newspapers of the country.
5. Proper information about the mutual funds must be made through pamphlets, through websites and other methods so that the public is clear about their investment.
6. While investing funds, a mutual find company cannot invest more thean 10%of his investable funds in single company.
7. Not more than 10% of the issued shaes of the company can be purchased by mutual find companies
8. Issuing of dividends, bonus shares, right shares etc. requires prior permission of SEBI.

OR

(b)Explain the causes of risk.

- Wrong decision or wrong timing
- Term of Investment – Long term investments are more risky than short-term investments as future is uncertain
- Level of Investment – Higher the quantum of investment the higher is the risk
- Nature of Industry – Risk is higher in speculative and cyclical industries while less in defensive and growth industries
- Political and Legal factor – Risk may arise due to changes in government policy and legislative regulations in a country

SECTION –C (3 X 10 =30)

Answer any Three questions

16. Describe the various types of mutual fund operation in India

Based on Structure

Open-Ended mutual funds

Open-ended fund is the most common type of mutual fund available. Mutual fund houses trade units of mutual funds at NAV (Net Asset Value). Open-ended funds provide exit anytime for the investor and make pay out on the basis of the NAV, which is published by the fund houses daily.

Close-Ended Mutual Funds

On closing of New Fund Offer (NFO), investors cannot trade their units. The price of the closed-ended mutual funds is based on the demand and supply just like stocks.

Interval Funds

The funds which have a features-mix of open-ended and closed-ended are called interval funds..

Based on Asset Class

Equity Funds

Equity funds are mutual funds which invest majorly in equity stocks of the company. Equity funds are considered to be risky but they tend to give higher returns in the long term.

Debt Funds

Debt funds are mutual funds which usually invest in the government securities, corporate bonds etc. Debt funds are more stable and less volatile to the market conditions.

Money Market Funds

A money market refers to the mutual funds that are highly liquid and where the money is invested in short-term investments like deposits certificates, treasury bills etc. You can have your money invested in money market funds for a duration like a day.

Balanced or Hybrid Funds

Balance or hybrid funds are a mix of equity and debt funds. They tend in to invest an equal amount in equity and debt funds to keep the risk level balanced in the investment.

Based on Investment Objective

Growth Funds

The money is invested in growth funds with the prime objective of getting a capital appreciation. Although growth funds are risky, they tend to offer high returns in the long run.

Income Funds

Money gets invested in fixed income instruments like government bonds and debentures under income funds. The objective of the income fund is stable income on investment with modern growth of capital.

Liquid Funds

Liquid funds are considered to be low risk with average returns and are ideal for people looking for short-term investment.

Tax-Saving Funds or ELSS

The majority of the investment gets invested in equity stocks. There is a lock-in period of 3 years on the ELSS investment.

Capital Protection Funds

The primary objective of these funds is to protect the money invested and thus the funds get split in between equity and fixed income investments.

Fixed Maturity Funds

In fixed maturity funds, the investment is made in closed-ended debt funds having a fixed date of maturity.

Pension funds

Money invested in pension funds are for a long period of time keeping in mind the long-term objective of getting a regular pension to the investor when he retires.

Based on Specialty

Sector Funds

Sector funds are the funds that stick to one sector of the industry when investing. The returns of the investment also depend on the performance of the particular sector.

Index Funds

The index fund is a type of investment which is made to match the working of a market index like BSE. These funds provide broader exposure to the market, less operating cost and low portfolio turnover.

Fund of Funds

Funds of funds are the types of mutual funds that invest in other mutual funds. The returns solely depend upon the performance of the target fund. These types of funds are also referred to as multi-manager funds.

17. **Explain the SEBI guidelines for mutual funds**

    SEBI regulated the mutual funds to protect the interest of the investors. In 1996 new guidelines were issued to regulate the mutual fund investments in India. Some of the important provisions are:

    - All mutual fund must be compulsorily registered with SEBI.
    - The sponsors of mutual funds should have contributed a minimum of 40% of the net worth of the Asset Management Company and should have a record of good reputation in financial services for at least 5 years
    - All new mutual funds schemes hae to be approved by the trustees of the mutual fund.
    - Mutual funds have to follow investment norms provided by SEBI to protect the investor from high-risk exposure.
    - A report has to be published by the mutual fund for each new scheme that it launches.
    - A mutual fund has to publish sale price and repurchase price of a unit in open-ended schemes at least once a week.
    - The repurchase price of a unit should not be less than 93% of NAV and sale price should not be more than 107% NAV. In closed ended scheme the repurchase price should not be less than 95% of the NAV
    - SEBI permits mutual funds to participate in its Security Lending scheme.
    - SEBI permits mutual funds to invest in Indian and Foreign ADR'S AND GDRS with in its guidelines.

- SEBI has provided that 90% of the mutual fund profits should be distributed every year and the earnings have to be shown as current income, short-term capital gains and long-term capital gain.
- To protect the investors SEBI can impose monetary penalties on mutual funds for violating regulations and guidelines.

18. What are the basic assumptions of CAPM? What are the advantages of adopting portfolio management?

Assumptions of the CAPM

Since the preconditions of the CAPM will be of great importance in the following course of this paper, one has to be aware of their rigidity in order to assess the limitations of the models and to discuss new developments in asset pricing theory. The key assumptions of the CAPM were first stated by Michael C. Jensen in 1972 and are as follows

1. All investors think in terms of a single period.
2. Investors act rational and choose their portfolio solely based on the expected return and its standard deviation over that period, which means that returns have to be normally distributed
3. All investors can borrow or lend an unlimited amount of money at a given (and for all equal) risk-free rate of interest.
4. All investors have homogeneous expectations, meaning that they identically estimate expected returns, standard deviations and correlations of returns among all assets.
5. Homogeneous expectations require that all investors have constant and free access to all required information regarding the investment decision. Furthermore, this information has to be analyzed and evaluated equally by all.
6. All assets are perfectly divisible and are perfectly marketable at the going price.
7. There are no transaction costs, taxes and restrictions on short sales of any asset.
8. The market is not constricted by any institution
9. Investors assume that their own acting will not affect prices (= price takers).
10. The quantities of all assets are given and fixed.
11. Investors are risk averse

Efficient Frontier:

The above assumptions, although some of them are unrealistic provide a basis for an efficient frontier line common to all. Different expectations lead to different frontier lines. If borrowing and lending is introduced the efficient frontier line can be thought of as a straight line. Lending is like investing in a riskless security say of Rf in the Fig.1.

Rf = Risk free investment. If he places part of his funds in Risk free assets (Rf) and part of his funds in risky securities (B) along the efficient frontier, he would generate portfolios along the straight line segment R_fB.

19. Explain the Features of Markowitz model.

The broad features of Markowitz model can be discussed under the following heads:

1. **Investment portfolio criteria**

   There is a relationship between expected return and level of risk in a portfolio. This forms the criteria for selecting the optimal portfolio. The merits of each portfolio is evaluated with the measures, namely, (a) expected return from the portfolio and (b) level of risk. The risk involved in individual securities is measured by standard deviation or variance.

2. **Efficient Portfolio**

   Efficient portfolio is one which gives the highest return at a particular level of risk or minimum risk for given levels of return. In other words, a portfolio is considered efficient, if there is no other portfolio which gives a higher return at the same risk or a lower risk for the same expected return. After carefully examining the expected return and risk and co-variance, the manager choose securities and constructs a portfolio.

3. **Portfolio selection**

   Out of the various possible portfolios, the investors has to choose and build a specific portfolio, so, the final task for the portfolio manager is to selext the optimum portfolio for the organization. An optimum portfolio is one which has a maximum utility for the investor.