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Scheme of Presentation
UNIT-V

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Investment Management

Introduction: Investment management refers to the professional management of various securities (like stocks and bonds) and assets to meet specified investment goals for the benefit of clients, which can include individuals, institutions, or funds. The process involves a range of activities, including:

Portfolio Management: Creating and managing a diversified portfolio to balance risk and return according to the investor's objectives.

Research and Analysis: Conducting thorough analysis of financial markets, economic trends, and individual securities to inform investment decisions.

Asset Allocation: Determining the optimal distribution of an investment portfolio among different asset classes (equities, fixed income, cash, real estate, etc.) based on risk tolerance, time horizon, and investment goals.

Risk Management: Identifying, assessing, and mitigating risks associated with investment decisions to protect capital and achieve returns.

Performance Monitoring: Continuously tracking and analyzing the performance of investments to ensure they align with the investor’s goals, making adjustments as necessary.

Client Communication: Keeping clients informed about portfolio performance, market developments, and any changes in investment strategy.

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Investment Companies:

Investment companies are firms that pool funds from multiple investors to purchase securities and manage portfolios on their behalf. They offer a range of investment products and services, making it easier for individuals and institutions to access diverse asset classes. Here are the main types of investment companies:

1. Mutual Funds

- **Description**: These are investment vehicles that pool money from many investors to buy a diversified portfolio of stocks, bonds, or other securities.
- **Key Features**:
  - Professionally managed by fund managers.
  - Investors buy shares in the fund, with prices typically calculated daily based on net asset value (NAV).
  - Suitable for both long-term and short-term investors.

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2. Exchange-Traded Funds (ETFs)

- **Description**: Similar to mutual funds but traded on stock exchanges like individual stocks.
- **Key Features**:
  - Typically have lower fees than mutual funds.
  - Can be bought and sold throughout the trading day at market prices.
  - Often designed to track a specific index or sector.

3. Hedge Funds

- **Description**: Private investment funds that use a range of strategies to achieve high returns, often involving higher risk.
- **Key Features**:
  - Typically available only to accredited investors due to their complexity and risk.
  - Employ strategies like leverage, short selling, and derivatives.
  - Less regulated than mutual funds and ETFs.

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4. Private Equity Firms

- **Description**: Firms that invest directly in private companies or buy out public companies, taking them private.
- **Key Features**:
  - Focus on long-term capital appreciation through active management.
  - Often involve a significant investment lock-up period.
  - Typically target established businesses with potential for growth or restructuring.

5. Closed-End Funds

- **Description**: Investment funds that issue a fixed number of shares and are traded on stock exchanges.
- **Key Features**:
  - Share prices can vary significantly from the NAV due to market demand.
  - Often invest in a specific sector or asset class.
  - Typically pay dividends from the income generated by their investments.

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Benefits of Investment Companies

- **Diversification**: They provide investors access to a diversified portfolio, reducing individual risk.
- **Professional Management**: Investors benefit from the expertise of professional fund managers.
- **Liquidity**: Many investment companies, particularly mutual funds and ETFs, offer liquidity, allowing investors to buy or sell shares easily.
- **Variety of Options**: Investors can choose from a range of strategies and asset classes to match their financial goals.

Investment companies play a crucial role in the financial markets, offering investors a structured and managed approach to investing.

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Active Vs. Passive Portfolio Management:

Active and passive portfolio management are two distinct approaches to investing, each with its own strategies, goals, and philosophies. Here's a breakdown of the key differences:

Active Portfolio Management

Definition: Active management involves a hands-on approach where portfolio managers make specific investment decisions to outperform a benchmark index.

Key Features:

- **Research-Driven**: Managers conduct in-depth analysis of securities, market trends, and economic indicators to identify undervalued or overvalued assets.
- **Frequent Trading**: Active managers often buy and sell securities frequently to capitalize on market fluctuations.
- **Goal**: Aim to outperform a benchmark (like the S&P 500) by selecting stocks or other assets expected to deliver higher returns.
- **Higher Costs**: Due to frequent trading and active management, costs (management fees, trading commissions) tend to be higher than passive strategies

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Pros:

- Potential for higher returns, especially in volatile markets.
- Flexibility to adjust the portfolio in response to market changes.
- Ability to take advantage of inefficiencies in the market.

Cons:

- Greater risk of underperforming the benchmark.
- Higher fees can erode returns.
- Requires more time and expertise

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Passive Portfolio Management

Definition: Passive management involves investing in a portfolio that mirrors a market index, aiming to match its performance rather than outperform it.

Key Features:

- **Index Tracking**: Investors purchase a fund that tracks a specific index, such as the S&P 500, without attempting to outperform it.
- **Buy-and-Hold Strategy**: Investments are typically held for the long term, with minimal trading.
- **Goal**: Achieve returns that closely align with the index being tracked.
- **Lower Costs**: Lower management fees and trading costs due to less frequent trading and minimal active management.

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Pros:

- Generally lower costs compared to active management.
- Simplicity and transparency in investment strategy.
- Historically, many active managers fail to consistently outperform their benchmarks over time.

Cons:

- Limited potential for outperforming the market.
- Less flexibility to react to market changes.
- Potential for market downturns to impact the entire portfolio similarly to the index.

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Cost of Management:

The cost of management in investment portfolios can significantly impact overall returns. Understanding these costs is essential for making informed investment decisions. Here's an overview of the main components involved in the cost of management:

1. Management Fees

- **Description**: Fees charged by investment managers for their services in managing a fund or portfolio.
- **Structure**: Typically expressed as a percentage of assets under management (AUM) and can range from 0.1% for passive funds to 2% or more for actively managed funds.
- **Impact**: Higher fees can erode returns over time, especially in actively managed funds that may not consistently outperform benchmarks.

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2. Performance Fees

- **Description**: Fees based on the fund's performance, usually applicable to hedge funds and some mutual funds.
- **Structure**: Often includes a base management fee plus a performance fee (e.g., 20% of profits exceeding a benchmark).
- **Impact**: Can align the interests of managers with those of investors, but also lead to higher overall costs in strong market periods.

3. Transaction Costs

- **Description**: Costs incurred from buying and selling securities within the portfolio.
- **Components**:
  - **Brokerage Fees**: Charges from brokers for executing trades.
  - **Bid-Ask Spread**: The difference between the buying and selling price of a security.
  - **Market Impact Costs**: Costs that arise from the effect of a trade on the market price.
- **Impact**: Frequent trading in actively managed portfolios can lead to significant transaction costs.

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Administrative Fees

Description: Costs related to the operational aspects of managing a fund, such as record-keeping, accounting, and compliance.

Impact: These fees are usually lower than management fees but can still affect the overall cost structure of a fund.

5. Custodial Fees

Description: Fees paid to a custodian for holding and safeguarding the fund's assets.

Impact: These fees can vary based on the type of assets and the custodian's services.

6. Expense Ratios

Description: A measure of the total costs associated with managing a fund, expressed as a percentage of the fund's average net assets.

Components: Includes management fees, administrative fees, and other operational costs.

Impact: A higher expense ratio indicates higher costs, which can diminish returns for investors.

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Entry/Exit loads Fees:

Entry and exit loads are fees associated with mutual funds and other investment vehicles that can impact the overall return on investment. Here's a breakdown of what these fees are and how they work:

Definition: Entry loads are fees charged at the time of investing in a mutual fund. They are deducted from the investment amount.

Key Features:

- **Regulation**: As of August 2009, the Securities and Exchange Board of India (SEBI) banned entry loads for mutual funds. This means that investors do not pay any entry fee when they invest in mutual fund schemes.
- **Impact**: This change was made to enhance transparency and reduce costs for investors, encouraging more people to invest without worrying about upfront fees.

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Exit Loads in India

Definition: Exit loads are fees charged when an investor redeems their mutual fund units. These are deducted from the redemption proceeds.

Key Features:

- **Varied Structure**: Exit loads vary from one mutual fund scheme to another. Commonly, they are a percentage of the redemption amount and may depend on how long the investor has held the units.
- **Typical Rates**:
    - For instance, a fund might charge a 1% exit load if the units are redeemed within one year, but there may be no exit load after one year.
    - Some funds may have different structures, such as declining exit loads (e.g., 2% if redeemed within six months, 1% if redeemed within one year).
- **Purpose**: Exit loads are intended to discourage short-term trading and help stabilize the fund's net asset value (NAV).

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Net Asset Value (NAV):

Net Asset Value (NAV) is a crucial concept in the world of mutual funds and other investment vehicles.

It represents the per-share value of a fund and is calculated by dividing the total assets of the fund by the total number of outstanding shares.

Definition

NAV: The Net Asset Value is the value of a mutual fund's assets minus its liabilities, divided by the number of outstanding shares. It reflects the market value of each share of the fund.

Unit-V: Investment Management

Importance of NAV

Pricing of Mutual Fund Shares: NAV is used to determine the price at which investors buy or sell mutual fund shares. Investors typically buy shares at the NAV at the end of the trading day.

Performance Measurement: Changes in NAV over time reflect the performance of the fund. An increasing NAV indicates growth, while a decreasing NAV suggests a decline in value.

Investment Decisions: Investors use NAV to evaluate the relative value of different funds and to make informed decisions about where to invest.

Redemption and Purchase: When investors redeem shares, they receive the NAV at the time of redemption, and when they purchase shares, they do so at the NAV.

Unit-V: Investment Management

Classification of Funds:

Mutual funds can be classified into various categories based on different criteria, including their investment objectives, asset classes, and strategies. Here's a detailed overview of the main classifications of funds:

1. Based on Asset Class

- **Equity Funds**: Invest primarily in stocks. These funds aim for long-term capital growth and can be further categorized into:
  - **Large-Cap Funds**: Invest in large, well-established companies.
  - **Mid-Cap Funds**: Focus on medium-sized companies.
  - **Small-Cap Funds**: Target smaller companies with growth potential.
  - **Sectoral/Thematic Funds**: Invest in specific sectors (like technology or healthcare) or themes.

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- **Debt Funds**: Invest in fixed-income securities like bonds, government securities, and corporate debt. These funds aim for regular income and capital preservation. Sub-categories include:
  - **Liquid Funds**: Invest in short-term debt instruments.
  - **Short-Term Bond Funds**: Focus on bonds with shorter maturities.
  - **Long-Term Bond Funds**: Invest in long-term debt instruments.
  - **Credit Risk Funds**: Focus on bonds with lower credit ratings.

- **Hybrid Funds**: Combine equity and debt investments to balance risk and return. They can be further divided into:
  - **Balanced Funds**: Maintain a fixed ratio of equity to debt.
  - **Dynamic Asset Allocation Funds**: Adjust the allocation between equity and debt based on market conditions.
  - **Arbitrage Funds**: Invest in equity and simultaneously take positions in derivatives to exploit price differences.

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Based on Investment Objective

- **Growth Funds**: Focus on long-term capital appreciation by investing in high-growth companies.
- **Income Funds**: Aim to provide regular income through dividends or interest from investments in income-generating securities.
- **Tax-Saving Funds (ELSS)**: Equity-linked savings schemes that provide tax benefits under Section 80C of the Income Tax Act in India, with a lock-in period of three years.
- **Capital Preservation Funds**: Focus on preserving capital while providing modest returns, typically through low-risk investments.

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. Based on Fund Management Style

- **Active Funds**: Managed by professional fund managers who actively select securities to outperform a benchmark index.
- **Passive Funds**: Aim to replicate the performance of a specific index, such as an index fund or an exchange-traded fund (ETF).

Based on Structure

- **Open-End Funds**: Allow investors to buy or sell shares at any time based on the current NAV. There is no limit on the number of shares issued.
- **Closed-End Funds**: Issue a fixed number of shares that are traded on stock exchanges. Prices can fluctuate based on market demand and supply, often diverging from NAV.
- **Unit Investment Trusts (UITs)**: Offer a fixed portfolio of securities for a set period, with units sold to investors at a price reflecting the value of the underlying assets.

Based on Geography

- **Domestic Funds**: Invest in securities from a specific country or region.
- **International Funds**: Invest in securities from foreign countries.
- **Global Funds**: Invest in securities from both domestic and international markets.

Unit-V: Investment Management

Other Investment Companies:

In addition to mutual funds, there are several other types of investment companies that cater to different investment needs and strategies. Here's an overview of some key types:

Exchange-Traded Funds (ETFs)

- **Description**: Investment funds that are traded on stock exchanges, similar to individual stocks.
- **Key Features**:
  - Typically track an index or a specific sector.
  - Can be bought and sold throughout the trading day.
  - Generally have lower fees compared to mutual funds.

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Hedge Funds

- **Description**: Private investment funds that use a variety of strategies to achieve high returns, often involving complex financial instruments.
- **Key Features**:
  - Usually open to accredited investors.
  - Can engage in short selling, leverage, and derivatives trading.
  - Typically charge a management fee plus a performance fee (often structured as "2 and 20"—2% management fee and 20% of profits).

3. Private Equity Firms

- **Description**: Firms that invest directly in private companies or buy out public companies to take them private.
- **Key Features**:
  - Focus on long-term capital appreciation through restructuring and management improvements.
  - Investments usually have a long lock-in period.
  - Target a wide range of industries and sectors.

Unit-V: Investment Management

Closed-End Funds

- **Description**: Investment funds that issue a fixed number of shares, which are traded on exchanges.
- **Key Features**:
  - Share prices can differ from the NAV due to market demand.
  - Typically invest in a specific sector or asset class.
  - Often pay dividends from the income generated by their investments.

Unit Investment Trusts (UITs)

- **Description**: Investment vehicles that offer a fixed portfolio of securities for a specific period.
- **Key Features**:
  - Investors buy units in the trust, which holds the securities until maturity.
  - Usually have lower fees than actively managed funds.
  - Provide a set investment strategy with limited active management.

Unit-V: Investment Management

Real Estate Investment Trusts (REITs)

- **Description**: Companies that own, operate, or finance income-producing real estate.
- **Key Features**:
  - Must distribute at least 90% of their taxable income as dividends to shareholders.
  - Provide exposure to real estate markets without requiring direct property ownership.
  - Can be publicly traded or privately held.

Unit-V: Investment Management

. Commodity Investment Funds

- **Description**: Funds that invest in physical commodities (like gold, oil, or agricultural products) or futures contracts.
- **Key Features**:
  - Provide diversification and hedge against inflation.
  - Can be structured as ETFs or mutual funds.

Fund of Funds (FoF)

- **Description**: Investment funds that invest in other mutual funds or hedge funds rather than directly in securities.
- **Key Features**:
  - Aim for diversification by pooling investments in various funds.
  - Typically charge additional management fees due to the layers of investment.