Introduction to the Landscape of Investments

Module-I

NEW TO THE STOCK MARKET?

NO WORRIES

VIEW THIS SLIDE SHOW

NOW!

Terms you should know, if you want to be involved with the stock market

Investments

Preferred stock

Shareholder

Common stock

Stock value

Primary Market

WHAT DOES IT MEAN ...

TO INVEST:

**to put (money) to use,
by purchase or expenditure,
in something offering potential profitable
returns, interest, income,
or appreciation in value.**

So Now tell me what is an Investment?

An Investment is the COMMITMENT of MONEY or other RESOURCES in the expectation of obtaining FUTURE BENEFITS.

How do they Invest ?

By saving money (instead of spending it), individuals trade off present consumption for a larger future consumption.

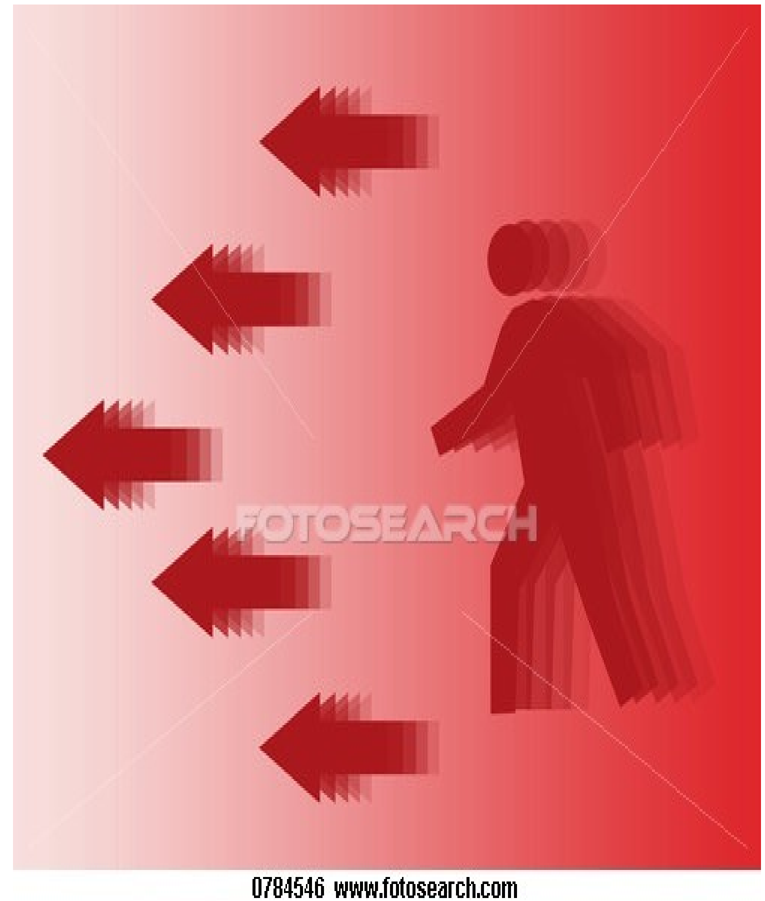
Lets define Investment in other words & way…….

- **A current commitment of Rupees for a period of time in order to derive future payments that will compensate for:**
  - the time the funds are committed
  - the expected rate of inflation
  - uncertainty of future flow of funds.

- For example, an individual might purchase shares of stock anticipating that the future proceeds from the shares will justify both the time that her money is tied up as well as the risk of the investment.

Objectives of Investment

- **Main Objectives**
- 1.Increasing the rate of return
- 2.Reducing the Risk
- **Other Objectives**
- 1.Liquidity
- 2.Hedge against inflation
- 3.Safety



Investment

- **Investment** is the employment of funds on assets to earn income or capital appreciation. The individual who makes an investment is known as the **investor.**
- In **economic terms**, investment is defined as the net addition made to the capital stock of the country.
- In **financial terms**, investment is defined as allocating money to assets with a view to gain profit over a period of time.
- Investments in economic and financial terms are **inter-related** where an individual's savings flow into the capital market as financial investment, which are further used as economic investment.

What is Securities?

- According to the Securities Contract regulation Act 1956
- “Securities include Shares, Scrips, Stocks, Bonds, Debentures or other marketable securities of any incorporated company or other corporate body or government.

Securities

- They are instruments which represent a claim over an asset or any future cash flows.
- Securities are classified on the basis of return and source of issue.

  Fixed income securities

  - **Return**

  Variable income securities

  - **Issuers**
    - Government
    - Quasi-Government
    - Public Sector Enterprises
    - Corporates

Essential nature of investment

1. Reduced small Current Consumption
2. Planned later large consumption

Real Assets & Financial Assets

Real Assets

Assets used to produce goods and services

Financial Assets

Claims on real assets

Real Assets & Financial Assets

Real Assets	*Financial Assets*
Land and building, Furniture, Machinery	Shares, Debentures, Bonds, Derivatives, Fixed Deposits, Bills, Loans
Tangible Assets Moveable and Immoveable	These are called *paper securities* as they deal with claims generated on the issuer.
Theses assets are used for production of goods and services.	These assets are financial claims represented by securities.

Speculation

- Speculation means taking business risks with the anticipation of acquiring short term gain.
- It also involves the practice of buying and selling activities in order to profit from the price fluctuations.
- An individual who undertakes the activity of speculation is known as speculator.

Difference between Investor and Speculator

Base	Investor	Speculator
Time horizon	Has a relatively longer planning horizon. His holding period is usually of one or more than one year.	Has a very short planning horizon. His holding period may be few days to months.
Risk return	His risk is less.	His risk is high.
Decision	Attaches greater significance to fundamental factors and carefully evaluates the performance of the company.	Attaches greater significance to market behaviour and inside information.
Funds	Uses his own funds.	Uses borrowed funds along with his personal funds.

Investment and Gambling

INVESTMENT

- Careful planning, Safety of returns, Continuous returns and Long term commitment.

GAMBLING

- High risk, high returns, uncertainty and unplanned. Ex., Horse racing, game of cards, lottery.

The Investment Process

The process of investment includes five stages:

1. **Investment Policy**: The policy is formulated on the basis of investible funds, objectives and knowledge about investment sources.
2. **Security Analyses**: Economic, industry and company analyses are carried out for the purchase of securities.
3. **Valuation**: Intrinsic value of the share is measured through book value of the share and P/E ratio.
4. **Portfolio Construction**: Portfolio is diversified to maximise return and minimise risk.
5. **Portfolio Evaluation**: The performance of the portfolio is appraised and revised.

Investment policy

- The government or the investor before proceeding into investment formulates the policy for the systematic functioning.
- The essential ingredients of the policy are the investible funds, objectives and the knowledge about the investment alternatives and m
- **Investible funds** The entire investment procedure revolves around the availability of investible funds. The fund may be generated through savings or from borrowings.
- **Objectives** The objectives are framed on the premises of the required rate of return, need for regularity of income, risk perception and the need for liquidity.
- **Knowledge** The knowledge about the investment alternatives and markets plays a key role in the policy formulation. The investment alternatives range from security to real estate. The risk and return associated with investment alternatives differ from each other.

Security analysis

- After formulating the investment policy, the securities to be bought have to be scrutinized through the market, industry and company analysis.
- **Market analysis**
- **Industry analysis**
- **Company analysis**

Valuation

- The valuation helps the investor to determine the return and risk expected from an investment in the common stock.
- The intrinsic value of the share is measured through the book value of the share and price earnings ratio. Simple discounting models also can be adopted to value the shares.
- The stock market analysis have developed many advanced models to value the shares. The real worth of the share is compared with the market price and then the investment decision are made.
- Future value Future value of the securities could be estimated by using a statistical technique like trend analysis. The analysis of the historical behaviour of the price enable the investor to predict the future value.

Construction of portfolio

- A portfolio is a combination of securities. The portfolio is constructed in such a manner to meet the investor's goals and objectives. The investor tries to attain maximum return with minimum risk. Towards this end he diversifies his portfolio and allocates funds among the securities.
- **Diversification**
- **Debt and equity diversification**
- **Industry diversification**
- **Company diversification**
- **Selection**

Evaluation

- The portfolio has to be managed efficiently. The efficient management calls for evaluation of the portfolio. This process consists of portfolio appraisal and revision.
- **Appraisal.** The return and risk performance of the security vary from time to time. The variability in returns of the securities is measured and compared. The developments in the economy, industry and relevant companies from which the stocks are bought have to be appraised. The appraisal warns the loss and steps can be taken to avoid such losses.
- **Revision.** Revision depends on the results of the appraisal. The low yielding securities with high risk are replaced with high yielding securities with low risk factor. To keep the return at a particular level necessitates the investor to revise the components of the portfolio periodically

Investment Alternatives

Investment Avenues

- Non-marketable Financial Assets
- Bonds
- Mutual Fund Schemes
- Real Estate
- Equity Shares
- Money Market Instruments
- Life Insurance Policies
- Precious Objects
- Financial Derivatives

Non-Marketable Financial Assets

- A good portion of financial assets is represented by non-marketable financial assets. They can be classified into the following broad categories:
- Bank deposits
- Post office deposits
- Company deposits
- Provident fund deposits

Equity shares

- **Common stock or ordinary shares are most commonly known as equity shares.**
- Equity Shares represent ownership capital. As an equity shareholder, you have an ownership stake in the company.
- Stock is a set of shares put together in a bundle.
- A share is a portion of the share capital of a company divided into small units of equal value.
- The advantages of equity shares are:
  - Capital appreciation
  - Limited liability
  - Hedge against inflation

Sweat Equity

- It is a new equity instrument introduced in the Companies (Amendment) Ordinance, 1998.
- It forms a part of the equity share capital as its provisions, limitations and restrictions are same as that of equity shares.

Sweat Equity is for:

- The directors or employees involved in the process of designing strategic alliances.
- The directors or employees who have helped the company to achieve a significant market share.

Non-voting Shares

- The shares that carry no voting rights are known as non-voting shares.
- They provide additional dividends in the place of voting rights.
- They can be listed and traded on the stock exchanges.

Bonus Shares

- Distribution of shares, in addition to the cash dividends, to the existing shareholders are known as **bonus shares.**
- These are issued without any payment for cash.
- These are issued by cashing on the reserves of the company.
- A company builds up its reserves by retaining part of its profit over the years.

Preference Stock

- Preference stock provides fixed rate of return.
- Preference stockholders do not have any voting rights.
- Like the equity, it is a perpetual liability of the corporate.
- Preference stockholders do not have any share in case the company has surplus profits.

Debenture

- It is a debt instrument issued by a company, which carries a fixed rate of interest.
- It is generally issued by private sector companies in order to acquire loan.
- The various features of a debenture are:
  - Interest
  - Redemption
  - Indenture
- A company can issue various types of debentures, which are:
  - Secured bonds or unsecured debenture
  - Fully convertible debenture
  - Partly convertible debenture
  - Non-convertible debenture

Bond

- A bond is a debt security issued by the government, quasi-government, public sector enterprises and financial institutions.
- Various features of a bond are:
  - The interest rate is generally fixed
  - It is traded in the securities market
  - At the time of issue of bonds, maturity date is specified
- Some of the types of bonds that a company can issue are:
  - Secured bonds and unsecured bonds
  - Perpetual bonds and redeemable bonds
  - Fixed interest rate bonds and floating interest rate bonds
  - Zero coupon bonds

Warrants

- A warrant is a detachable instrument, which gives the right to purchase or sell equity shares at a specified price and period.
- It is traded in the securities market where the investor can sell it separately.
- Two types of warrants are:
  - **Detachable warrants:** When the warrants are issued along with host securities and detachable, then they are known as detachable warrants.
  - **Puttable warrants:** Represent a certain amount of equity shares that can be sold back to the issuer at a specified price, before a stated date.
- Some of the advantages of warrants are:
  - They have limited risk.
  - They offer potential for unlimited profits.
  - They can be traded in the securities market.

Money Market Instruments

- Debt instruments which have a maturity of less than one year at the time of issue are called money market instruments. The important money market instruments are:
- Treasury bills
- Commercial paper
- Certificates of deposit

Treasury Bills Market

- A Treasury bill is promissory note or a finance bill arising without any genuine transaction in goods.
- It is a claim against the government and does not require any ‘grading’, ‘endorsement’ or ‘acceptance’.
- It is highly liquid because it is guaranteed for repayment by the government.
- In India, treasury bills are of two types – ‘ordinary’ and ‘ad-hoc’.
- The ordinary treasury bills are issued to the public and the RBI to enable the government to meet its requirement for short-term finance.
- Ad hoc treasury bills, popularly known as ‘ad hocs’ are created in favor of the Reserve Bank of India.
- Both types of treasury bills have a maturity of 91 days.

Mutual funds

- Instead of directly buying equity shares and/or fixed income instruments, you can participate in various schemes floated by mutual funds which, in turn, invest in equity shares and fixed income securities. There are three broad types of mutual fund schemes:
- Equity schemes
- Debt schemes
- Balanced schemes

Life Insurance

- In a broad sense, life insurance may be viewed as an investment. Insurance premiums represent the sacrifice and the assured sum, the benefit. The important types of insurance policies in India are:
- Endowment assurance policy
- Money back policy
- Whole life policy
- Term assurance policy

Real Estate

- For the bulk of the investors the most important asset in their portfolio is a residential house. In addition to a residential house, the more affluent investors are likely to be interested in the following types of real estate:
- Agricultural land
- Semi-urban land
- Commercial property
- A resort home
- A second house

Precious Objects

- Precious Objects are items that are generally small in size but highly valuable in monetary terms. The important precious objects are:
- Gold and silver
- Precious stones
- Art objects

Financial derivatives

- A financial derivative is an instrument whose value is derived from the value of an underlying asset. It may be viewed as a side bet on the asset. The most important financial derivatives from the point of view of investors are:
- Options
- Futures

Investment Information

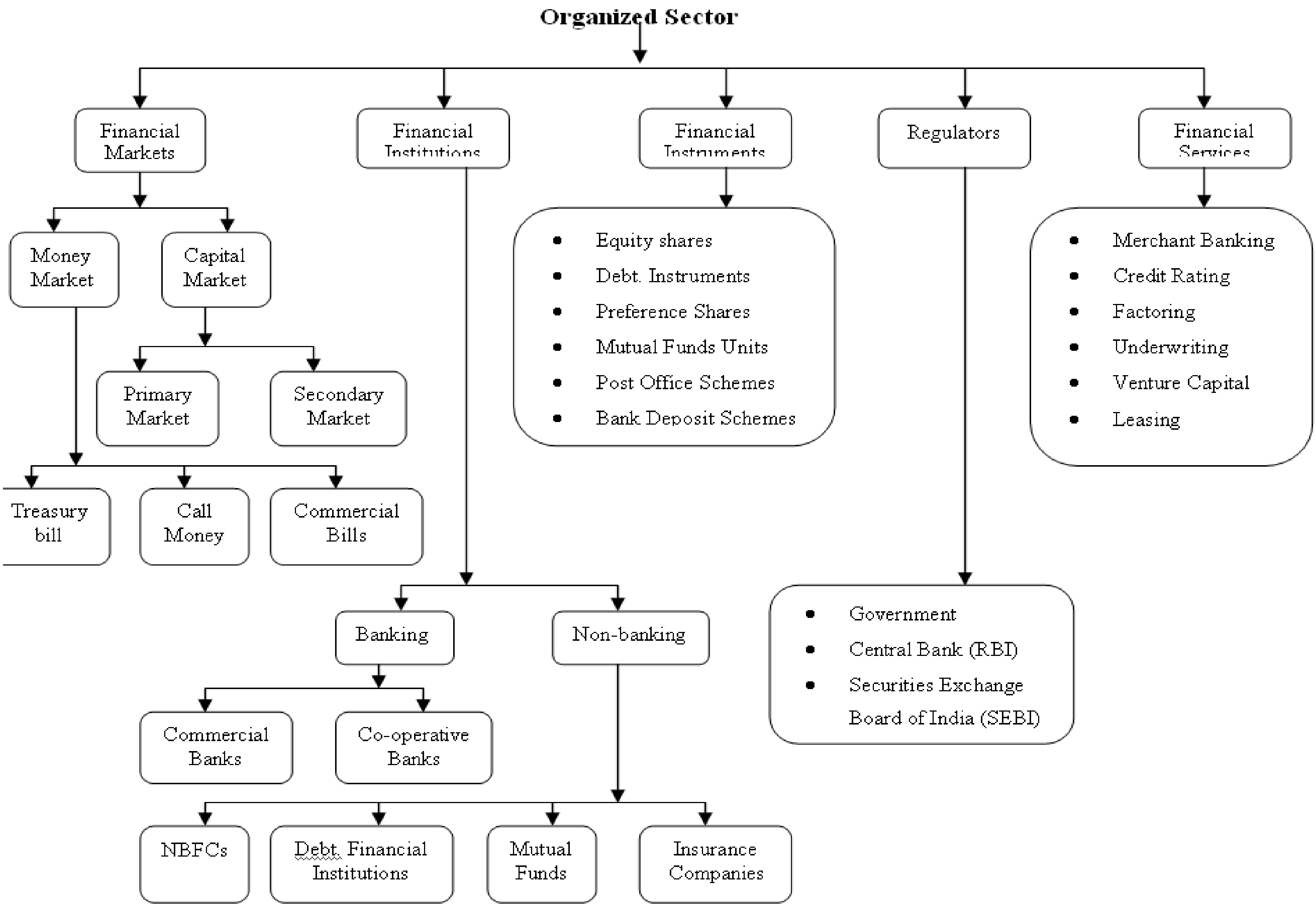
- An investor must have adequate knowledge about the investment alternatives and markets before making any kind of investment.
- The various sources from which an investor can gather the investment information are:
  - Newspapers, Investment dailies
  - Magazines and Journals
  - Industry Reports
  - RBI Bulletin
  - Websites of the SEBI, RBI and other private agencies
  - Stock market information

Investment Attributes

- **RETURN**
- **RISK**
- **LIQUIDITY**
- **TAX SHELTER**
- **CONVENIENCE**

Evaluation Of Various Investment Avenues

Structure of Indian Financial System



CLASSIFICATI ON OF FINANCIAL MARKETS

- NATURE OF CLAIM
  - DEBT MARKET
  - EQUITY MARKET
- MATURITY OF CLAIM
  - MONEY MARKET
  - CAPITAL MARKET
- SEASONING OF CLAIM
  - PRIMARY MARKET
  - SECONDARY MARKET
- TIMING OF DELIVERY
  - CASH OR SPOT MARKET
  - FORWARD OR FUTURES MARKET
- ORGANISATIONAL STRUCTURE
  - EXCHANGE-TRADED MARKET
  - OVER-THE-COUNTER MARKET