FN 6.4 SECURITY ANALYSIS & PORTFOLIO MANAGEMENT

UNIT 01

BASICS OF INVESTMENTS

INTRODUCTION

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 savings are not investment.

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 realized is lower than the return expected to be realized. This possibility of variation in the actual return from the expected return is known as investment risk. Thus, every investment involves return and risk.

In the **Financial sense**, investment is the commitment of a person's fund to derive future in-come in the form of income, dividend premium, pension benefit or appreciation in the value of their capital example: purchasing of shares, debentures, post office saving certificates, insurance policies are all investments in the financial sense such investment generates financial assets.

In the **Economics sense**, Investment means the net addition to the economy's capital stock which consists of goods and services that are used in the production of other goods and ser- vices. Example: new constructions of plants and machines, inventories etc.

In **finance**, investment is the commitment of funds through collateralized lending or making a deposit into a secured institution.

For example: Deposit money in a bank account to purchase a long-term government bond or invest in the equity shares of a company or acquire a plot of land.

DEFINITION

In finance, the purchase of a financial product or other item of value with an expectation of favourable future returns. In general terms, investment means the use money in the hope of making more money.

In business, purchase by a producer of a physical good, such as durable equipment or inventory, in the hope of improving future business.

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MEANING

In finance, the purchase of a financial product or other item of value with an expectation of favourable future returns. It is the commitment of a person's funds to derive future income or appreciation for the value of the capital.

In general terms, investment means the use of money with the hope of making more money. Investment involves employment of funds with the aim of achieving additional income or growth in values.

Investment may be defined as "a commitment of funds made in the expectation of some positive rate of return".

It can also be defined as "a sacrifice of current money or other resources for future benefits".

Examples:

- Lending money to another [interest]
- Purchasing of gold [value appreciation]
- Purchase of insurance plan [promised future benefits]

The essential quality of an investment is that it involves waiting for a reward.

Future income may be:

- Interest
- Dividend
- Premiums
- Pension benefits
- Purchasing of shares/debentures
- Post office saving certificates.
- Insurance policies

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ECONOMIC MEANING OF INVESTMENT

Investment refers to net addition to the economy's capital stock which consists of goods and services that are used in the production of other goods and services.

Formation of new and productive capital

- New construction
- Plant and machinery
- Inventories

All these investments generate physical assets.

CHARACTERISTICS / NATURE OF INVESTMENT

The characteristics of Investment are outlined below:

1. Return

Return is the profit that an investor makes on an investment. It can come in two different forms: income or capital gain.

2. Risk

Risk means uncertainty. We are not sure whether our investment will give high returns or could also lose money. Risk and return both go hand-in-hand which means that to get higher return on our investments we will be exposed to more risk. Higher the risk higher the returns. Lower the risk low returns.

3. Liquidity

Liquidity is the ability to cash in or sell an investment quickly at or near the current market price means how quickly we can convert our investment into cash. It affects the value of an investment. Listed stocks and government bonds are liquid because we can usually sell them easily.

4. Safety

Safety refers to the protection of investor principal amount and expected rate of return.

5. Marketability

Marketability is buying and selling of Securities in market. Or otherwise, transferability or saleability of an asset. Securities listed in a stock market which are more easily marketable than which are not listed, and public limited companies shares are more easily transferable than those of private limited companies.

6. Capital Growth

Capital growth has become an important characteristic of investment. Growth of investment depends upon the industry growth. Capital Growth refers to appreciation of investment.

7. Stability of Income

Another major characteristic feature of the Investment is the stability of income. Stability of income looks for different path just as security of principal. Every investor considers stability of monetary income. It refers to constant return from an investment.

8. Tax Shelter

Tax benefits are mainly of three kinds:

a) Initial tax benefit: Initial tax benefit: It is the tax relief enjoyed by the investor at the time of making the Investment.

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b) Continuing tax benefit: A continuing tax benefit represents the tax shield associated with the periodic returns from the Investment.

c) Terminal tax benefit: Relief from taxation when an investment is realized or liquidated Ex withdrawal from a public provident fund account is not subject to tax.

WHY INVESTMENTS ARE IMPORTANT?

Investments are important and useful in the context of present-day conditions. Some factors that have been made investment decisions increasingly important are:

a) Longer Life Expectancy or Planning for Retirement

Investment decisions have become significant as most of the people in India retire between the age of 55 and 60 years. Also, the trend shows longer life expectancy. The earnings from employment should, therefore, be calculated in such a manner that a portion should be put away as savings. Savings by themselves do not increase wealth. It must be invested in such a way that the principle and income will be adequate for a greater number of retirement years.

b) Increasingly Rates of Taxation

Taxation is one of crucial factors in any country which introduces an element of compilation in a person's savings. There are various forms of saving outlets in our country in the form of investments which helps in bringing down the tax level by offering deductions in personal income. Benefits in tax accrue out of investment in Unit Trust Certificates, Unit Linked Insurance Plan, Life Insurance, National Savings Certificate etc.

c) Interest Rates

A sound investment plan showcases the level of interest rates. Interest rates vary between one investment to another and between risky and safe investments. They may also differ due to different benefits schemes offered by the investments. These aspects must be considered before actually allocating amount.

A high rate of interest may not be the only factor favouring the outlet for investments. Stability of interest is as important as receiving a high rate of interest.

d) Inflation

Inflation has become a continuous problem since a decade. With the rising of prices, several problems are associated coupled with falling standard of living. Before funds are invested, erosion of the resources will have to be carefully considered in order to make the right choice of investments. The investor will try and search an outlet which will give him a high rate of return in the form of interest to cover any decrease due to inflation. He will also have to judge whether the interest or return will be continuous or there is likelihood or irregularity.

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e) Income

Income is another reason why investment decisions are assumed import with the general increase in employment opportunities in India. Post independence, a number of new organizations and services were formed. Which gone employment opportunities to all equally. Increase in incomes and avenues of investment have led to the ability and willingness of working people to save and invest their funds.

f) Investment Channels

The growth and development of the country leading to greater economic activity has lead to the introduction of vast arrays of investment outlets. Apart from savings banks where interest low, investors have the choice of a variety of instruments. The investors in their choice of is vestment will have to try and achieve a proper balance between high rate of return to reap the benefits. Some of the instruments available are corporate stock, provident fund, life insurance, fixed deposits in the corporate sector and so on.

OBJECTIVES OF INVESTMENT

1. Primary Objectives: (i) Safety, (ii) Income and (iii) Growth of capital.

2. Secondary Objectives: (i) Tax Minimization, (ii) Marketability/Liquidity.

1. Primary Objectives

(i) Safety

Safety for the investment funds through the purchase of government-issued securities in stable economic systems or through the purchase of the highest quality corporate bonds issued by the economy's top companies. Such securities are arguably the best means of preserving principal while receiving a specified rate of return. The safest investments are usually found in the money market and include such securities as Treasury bills (T-bills), certificates of deposit (CD), commercial paper or bankers acceptance slips or in the fixed income (bond) market in the form of municipal and other government bonds and in corporate bonds.

(ii) Income

The safest investments are also the ones that are likely to have the lowest rate of income return, or yield. Investors must inevitably sacrifice a degree of safety if they want to increase their yields. This is the inverse relationship between safety and yield: as yield increases, safety generally goes down and vice versa.

(iii) Growth of capital

Growth of capital is most closely associated with the purchase of common stock, particularly growth securities, which offer low yields but considerable opportunity for increase in value. For this reason, common stock generally ranks among the most speculative of investments as their return depends on what will happen in an unpredictable future. Blue-chip stocks, by

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contrast, can potentially offer the best of all worlds by possessing reasonable safety, income and potential for growth in capital generated by long-term increases in corporate revenues and earnings as the company matures.

2. Secondary Objectives

(i) Tax Minimization

An investor may pursue certain investments in order to adopt tax minimization as part of his or her investment strategy. A highly paid executive, for example, may want to seek investments with favourable tax treatment in order to lessen his or her overall income tax burden. Making contributions to an insurance or other tax-sheltered retirement plan, such as pension plan, can be an effective tax minimization strategy.

(ii) Marketability/Liquidity

Most of the assets which are fixed in nature are not liquid, which means they cannot be immediately sold and easily converted into cash. Achieving a degree of liquidity, however, requires the sacrifice of a certain level of income or potential for capital gains.

SCOPE OF INVESTMENT MANAGEMENT

The business of investment has several facets, the employment of professional fund managers, research of individual assets and asset classes, dealing, settlement, marketing, internal auditing, and the preparation of reports for clients. The largest financial fund managers are firms that exhibit all the complexity their size demands. Apart from the people who bring in the money and the people who direct investment, there are compliance staff i.e., to ensure accord with legislative and regulatory constraints, internal auditors of various kinds i.e., to examine internal systems and controls, financial controllers i.e., to account for the institutions own money and costs, computer experts and "back office" employees i.e., to track and record transactions and fund valuations for up to thousands of clients per institution.

IMPORTANCE OF INVESTMENT

Every branch of knowledge has its own contributions that made a turning point in the historical lanes of human beings. In mechanics it is wheel, in science it is fire. In political science it is vote and in economics it is money. Money is the queen among all these fundamental discoveries Money is anything that is generally acceptable as a means of exchange and that at the same time act a store of value. So, there is no question in the fact that money is important, and money does matter. The importance of investment are as follows:

1. Transaction motive

It refers to the demand for money for the current transaction of the people. People hold cash in order to bridge the interval between receipt of income and the expenditure. This amount will depend

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upon the interval at which income is received. The businessmen and entrepreneurs also will keep a portion of their resource in ready cash to meet the current needs. Keynes calls this as business motive. The amount hold in liquid form will depend upon the business turnover. Transaction demand for money is independent of rate of interest and it will remain constant at a particular level of income.

2. Precautionary motive

It refers to the desire of the public to hold cash balances for meeting unforeseen or unpredictable contingencies such as unemployment, sickness, accidents etc. The amount of money hold under this motive will depend on the nature of individuals' income.

3. Speculative motive

It refers to the desire to hold one's resources in liquid form in order to take advantage in market movements regarding future changes in price and rate of interest. There is an inverse relation between rate of interest and people's tendency to spend money.

On the other hand, by the term investment, we mean an addition to the stock of physical capital. Savings and investment are two crucial economic variables by which we can measure person's physical quality of life and standard of living. The importance of savings may be analyzed on the basis of the reasons by which people are induced to save.

1. To meet unexpected expenditure in life:

According to a modern monetarist Milton Friedman, people's current income has two components namely permanent and transitory component. Transitory component refers to the amount of income generated accidentally and unanticipated. It may be positive or negative. If it is negative people's current income will decrease and they will become unable to meet their needs. At this time savings plays a crucial role in compensating this adverse situation and rescue them from borrowing.

2. Savings act as an inducement for investment:

If a person has considerable savings, he will have a feeling that he is able to meet some unexpected expenditure and to face moderate risk. This feeling induces him to make investments. Savings can provide an excellent source for future business ventures as capital. It also allows for exploring sleeping talents and other interests that may increase one's income.

3. Makes a felling of rationality:

Every normal human beings are rational in behavior. It means that they try to maximize their satisfaction with minimum spending. It induces them to save a part of their income.

4. Children's education:

One of the most important things a person can do is to educate his children. In today's world education is very essential and so expensive. Therefore, savings is very important on the side of education also. Quality based education will provide a great sense of accomplishment and peace of mind foe a person.

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5.Achieve a feeling of self-reliance:

A habit of savings gives people the ability to enjoy independence and power to do things.

6. Security of the family:

Even though in the process of income determination, we take income of an individual over his entire life span, death is an accidental fact. Everyone fears death. So, they are always aware of the stability and security of their family. It forces them to save a portion of their income.

INVESTMENT AVENUES

Investment is putting money into an asset with the expectation of capital appreciation, dividends and/or interest earnings. All forms of investment involve some form of risk, such as investment in equities, property and even fixed interest securities which are subject, among other things, to inflation risk. It is indispensable for project investors to identify and manage the risks related to the investment.

Types of investments include:

- **Traditional investments** refer to bonds, cash, real estate and stocks and shares.
- **Alternative investment** is an investment in asset classes other than stocks, bonds and cash. The term is a relatively loose one and includes tangible assets such as precious metals, art, wine, antiques, coins or stamps and some financial assets such as a Real Estate Fund, commodities, private equity, distressed securities, hedge funds, carbon credits, venture capital, film production and financial derivatives. Investments in real estate and forestry are also often termed alternative despite the ancient use of such real assets to enhance and preserve wealth.

Alternative investments are sometimes used as a tool to reduce overall investment risk through diversification.

Some of the characteristics of alternative investments include:

- Low correlation with traditional financial investments such as stocks and bonds.
- It may be difficult to determine the current market value of the asset.
- Alternative investments may be relatively illiquid.
- Costs of purchase and sale may be relatively high.
- There may be limited historical risk and return data.
- A high degree of investment analysis may be required before buying.

Investments are often made indirectly through intermediaries, such as banks, credit unions, brokers, lenders, and insurance companies. Though their legal and procedural details differ, an intermediary generally makes an investment using money from many individuals, each of whom receives a claim on the intermediary.

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SELECTION OF INVESTMENT

Selection of the investment is the choice of the right security or fund to best use to take particular exposure to the targeted risk or asset. The investment selection process is perhaps the most interesting and intellectual part of investment management. The ability to choose the right investment company is the most rewarding because it is close to people and the real economy The selection process used to be simple bond and stock selection but in recent years the emergence of strategies and formalization in the private equity arena have led to a plethora of funds.

The investment selection criteria are the section of the investment policy statement includes the rules for choosing investments. These rules will vary significantly from investor to investor, based on each investor's investment philosophy.

Criteria's to consider while investing in mutual funds:

1. Maximum bear-market rank.

2.Maximum expense ratio.

3. Minimum or maximum asset size.

4. Minimum manager tenure.

5. Minimum category rating.

6.Minimum tax-efficiency ratio.

7. Minimum total return percentage category rank over various periods.

8. Maximum percentage of assets in top-10 holdings.

9.Maximum percentage of assets in any one sector.

Criteria for stocks:

1.Minimum return on equity.

2. Minimum free cash flow.

3. Maximum leverage.

4. Minimum dividend yield.

5. Maximum price for each stock.

6. Minimum market capitalization.

7. Maximum price/earnings ratio.

8. Minimum revenue growth rate.

9. Minimum forecasted five-year earnings-growth rate.

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INVESTOR

An investor is a person who allocates capital with the expectation of a future financial re- turn. A person who provides a business with capital and one who buys a stock are both investors. An investor who owns a stock is a shareholder.

TYPES OF INVESTORS

Following are the types of investors:

1. Cautious Investors

Cautious Investors are very conservative; this type of investor has a need for financial security and will avoid high-risk ventures as well as listening to professional advice, preferring to conduct their own financial affairs. They don't like to lose even small amounts of money and never rush into investments, always giving financial opportunities a great deal of thought.

2. Emotional Investors

Emotional Investors are easily attracted to fashionable investments or 'hot' tips, these investors act with their heart and not their head. A whim or a gut feeling leads their decisions, and they have great difficulty disengaging from poor investments or cutting losses. They have an un- reasonable belief that things will come right in the end and often put their trust in luck or 'providence' to safeguard their financial assets.

3. Technical Investors

Technical Investors are hard facts numbers lead this type of investor to active trading based on price movements. They are screen-watchers, sometimes obsessional, but their diligence can be rewarded if they spot trends. They may also have a tendency to 'need' and buy the latest technology as they are always looking for some edge.

4. Busy Investors

Busy Investors need to be involved with the markets; it gives them a buzz when they check the latest price movements, which may be several times a day. They have to keep buying and selling on rumours, on overheard gossip, from the mass of newspapers and magazines they collect. Any titbit of information they can glean is imbued with significance and a cause to take financial action.

5. Casual Investors

Casual Investors have a laid-back attitude towards investment; these individuals are often hardworking and involved with work or family. They tend to believe that once an investment is made it will take care of itself, and that a good job or a profession is the way to make real money. They easily forget that they own investment assets and rarely check on their financial or Investment Management affairs. And, though they may leave the running of their investments to professional advisors, they haven't been in contact with them for years.

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6. Informed Investors

Informed Investors use information from a variety of sources and keep an ongoing watch on their investments, the markets, and the economy. They listen carefully to financial opinions and expert assessments, and will only go against market fashion after weighing up all the pros and cons. They are financially confident and have faith in their decisions, knowing that knowledge and experience will always win out to give them long-term profits.

7. Passive Investors

Passive Investors are characterized as individuals who have become wealthy passively - by inheriting, by a professional career or by risking the money of others rather than their own money. To these investors security is more important than risk. In addition, certain classes of occupation are more likely to contain passive investors. For example, non-surgical doctors, corporate executives, lawyers, and accountants who work in companies. Reasons for this are that these individuals are less likely to have high financial resources at an early stage in their careers, having had to delay earning good salaries in order to study or having to repay student loans. Once earning a decent wage, they are then more careful with their money, having a greater need for security. Anyone, therefore, with reduced financial recourses is likely to be more risk conscious and hence, a passive investor.

8. Active Investors

According to Barnwell, Active Investors are those who have achieved significant wealth, of earned well, during their own lifetime. They are more likely to take risks in investing because they have previous experience of taking risks in their previous wealth creation. These individuals have a high-risk tolerance and less of a need for security. They also need to feel in control of their own abilities. Once they feel they are losing control of an investment situation, their risk tolerance reduces. By being actively involved and in control, these investors feel they are reducing risk. However, such involvement may actually be detrimental as it is likely to be a source of imitation to their investment advisor who cannot get on with the business of running their clients affairs due to constant questioning and harassment.

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DIFFERENCES BETWEEN INVESTMENT AND SPECULATION

Speculation means taking up the business risk with the hope of getting short term gain. Speculation essentially involves buying and selling activities with the expectation of getting profit from the price fluctuations.

The following points will differentiate between investment and speculation:

Basis of comparison	Investment	Speculation
Planning	Investments are carefully thought-out decisions which involve calculated risk	Whereas speculation on the other hand is based on rumours, hearsay, tips etc.
Time Horizon	An investor has a relatively longer time horizon.	An Speculator has a relatively short time horizon.
Risk	An investor is generally risk averse.	Whereas a speculator is generally risk prone.
Consistency of returns	An investors expected return is consistent with underlying risk of the investment. The returns are moderate.	Whereas risk assumed by speculator and his anticipated return is disproportionate. The returns are high.
Leverage	An investor generally uses his own funds eschews borrowing	Whereas a speculator normally goes for borrowed funds.
Volume of trades	The volume of a trade of an investor is generally smaller.	The volume of a trade of a speculator is generally larger.
Basis for decision	Careful evaluation of the prospects of the firm is the bais for decision making.	Hearsay, technical charts, market psychology are the basis for decision making.

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INVESTMENT PROCESS

The investment process involves a series of activities leading to the purchase of securities or other investment alternatives. The investment process can be divided into five stages or steps as mentioned below:

1. Framing of 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 markets.

(i) Investible Funds

The entire investment procedure revolves around the availability of investment funds. The funds may be generated through savings or from borrowings. If the funds are borrowed, the investor has to be extra careful in the selection of investment alternatives. The return should be higher than the interest he pays. Mutual funds invest their owners' money in securities,

(ii) 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. The risk takers objective is to earn high rate of return in the form of capital appreciation, whereas the primary objective of the risk averse is the safety of the principal.

(iii) 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 assets. The risk and return associated with investment alternatives differ from each other. Investment in equity is high yielding but has more risk than the fixed income securities. The tax-sheltered schemes offer tax benefits to the investors.

2. Investment Analysis

The investor should be aware of the stock market structure and the functions of the brokers. The mode of operation varies among BSE, NSE and OTCOEL Brokerage charges are also different. The knowledge about the stock exchanges enables him to trade the stock intelligently. After formulating the investment policy, the securities to be bought have to be scrutinized through the market, industry, and company analysis.

(i) Market Analysis

The stock market mirrors the general economic scenario. The growth in gross domestic product and inflation are reflected in the stock prices. The recession in the economy results in a bear market. The stock prices may be fluctuating in the short run but in the long run they move trends i.e., either upwards or downwards. The investor can fix his entry and exit points through technical analysis.

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(ii) Industry Analysis

The industries that contribute to the output of the major segments of the economy vary in their growth rates and their overall contribution to economy activity. Some industries grow faster than the GDP and are expected to continue in their growth. For example, the information technology industry has experienced higher growth rate than the GDP in 1998. The economic significance and the growth potential of the industry have to be analysed.

(iii) Company Analysis

The purpose of company analysis is to help the investors to make better decisions. The company's earnings, profitability, operating efficiency, capital structure and management have to he screened. These factors have direct bearing on the stock prices and the return of the investors. Appreciation of the stock value is a function of the performance of the company. Company with high product market share is able to create wealth to the investors in the form of capital appreciation.

3. Valuation

The valuation helps the investors to determine the return and risk expected from an investment in the common stock.

(i) Intrinsic Value

The intrinsic value of the share is measured through the book value of the share and the price earnings ratio. Simple discounting models also can be adopted to value the shares. The stock markets analysts have developed many advances models to value the shares. The real worth of the share is compared with the market price and then the investment decisions are made.

(ii) Future Value

The future value of the securities could be estimated by using a simple statistical technique like trend analysis. The analysis of the historical behavior of the price enables the investor to predict the future value.

4. Portfolio Construction

A portfolio is a combination of securities. The portfolio is constructed in such a manner to meet the investor goals and objectives. The investor should decide how best to reach the goals with the securities available.

The investor tries to attain maximum return with minimum risk. Towards this end he diversifies his portfolio and allocates funds among the securities.

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(i) Diversification

The main objective of diversification is the reduction of risk in the loss of capital and income. A diversified portfolio is comparatively less risky than holding a single portfolio. There are several ways to diversify the portfolio.

(ii) Debt and Equity Diversification

Debt instruments provide assured return with limited capital appreciation. Common stocks provide income and capital gain but with the favour of uncertainty. Both debt instruments and equity are combined to complement each other.

(iii) Industry Diversification

Industries growth and their reaction to government policies differ from other. Banking industry share may provide regular return but with limited capital appreciation. The information technology stock yields high return and capital appreciation but their growth potential after year 2002 is not predictable. Thus, industry diversification is needed, and it reduces risk.

(iv) Company Diversification

Securities from different companies are purchased to reduce risk. Technical analysis suggests the investors to buy securities based on the price movement. Fundamental analysts suggest the selection of financially sound and investor friendly companies.

(v) Selection

Based on the diversification level, industries and company analyze the securities have to be selected. Funds are allocated for the selected securities.

5. Portfolio Evaluation

The portfolio has to be managed efficiently. The efficient management calls for evaluation of the portfolio. The process consists of portfolio appraisal and revision.

(i) 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 economy, industry, and relevant companies from which the stocks are bought have to appraise. The appraisal warns the loss and steps can be taken to avoid such losses.

(ii) 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.

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INVESTMENT GOALS

Investment objectives are related to what the investors wants to achieve with the portfolio of investments. Objectives define the purpose of setting the portfolio. Generally, the objectives are concerned with return and risk considerations. These two objectives are interdependent as the risk objective defines how high the client can place the return objective.

1. Minimizing the risk:

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. Government securities would constitute the low-risk category as they are practically risk free. Debentures and preference shares of companies may be classified as medium risk assets. Equity shares of companies would form the high-risk category of financial assets.

2. Protection of Capital:

The selected investment avenue should be under the legal and regulatory framework. If it is not under the legal framework, it will be difficult to represent grievances. Approval of the law itself adds a feature of safety to the financial asset.

3. Maximisation of return/growth:

While minimizing the risk of investment is an important objective of any 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. The rate of return can be expressed as: Return Capital Appreciation + Yield (Dividend, Interest)

4. Regular Income:

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

5. Liquidity:

Liquidity depends upon marketability of securities. If a portion of the investment could be converted into cash without much loss of time, it helps the investor to meet emergencies. Stocks are liquid only if they are providing adequate returns through dividends and capital appreciation.

6. Hedging against inflation:

The rate of return the investor get should ensure a cover against inflation to protect against a rise in prices and fall in the purchasing value of money. The rate of return should be higher than the rate of inflation otherwise the investor will experience loss in real terms.

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7. Tax exemption:

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.

INVESTMENT CONSTRAINTS

There are some factors that influence the choice of investments, these are known as investment constraints. The constraints may be external, or out of the investors control or there might be some internal constraint which are within the control of investor.

1. Liquidity:

Liquidity in the investment sense is the ability to quickly convert investments into cash at a price close to their market value. Having the investment that can be converted into cash can affect investors choice of investment. Not everyone likes the idea of having their money tied up for long term, or the idea of facing penalties for terminating their investment early. Although, illiquid investments traditionally earn more returns many don't prefer it.

2. Taxation:

Investments are subject to tax. Often, tax regimes will treat capital gains and income differently. Capital gains may be subject to a lower tax rate payable only when they are realized rather than when they are received. Long term investments are subject to time value of money benefit to deferring tax.

3. Legal and regulatory factors:

There are even legal issues that need to be considered while deciding about different investment options. Individual investors are generally not affected by regulations, but professional and institutional investors need to be aware of regulations. For example, a government agency may limit investments in certain asset classes in retirement portfolios.

4. Investor unique needs and preferences:

There may be a number of unusual considerations that affects the investor's risk-return profile. Many investors avoid certain investments based on personal, moral and ethical choices. For example, investors may specify that no investments in their portfolio be affiliated with the manufacture or distribution of alcohol, pornography, tobacco or environmental harmful products.

5. Time horizon:

Investment objectives and associated time horizons may be short-term, long term, or a combination of these two. Investors with long investment horizons generally require less liquidity and can tolerate greater portfolio risk and losses are harder to overcome during a short time frame for investors with short investment horizons.

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FACTORS TO BE CONSIDERED IN INVESTMENT DECISIONS

Various factors to be considered in Investment Decisions are:

1. Liquidity

Liquidity refers to how easily assets can be converted into cash. Assets like stocks and to bonds are very liquid since they can be converted to cash within days. However, large assets such as property, plant, and equipment are not as easily converted to cash. For example, your checking account is liquid, but if you owned land and needed to sell it, it may take weeks or months to liquidate it, making it less liquid.

2. 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.

3. Risk

Risk is an important component of every investment; thus, it is necessary to analyse it as both, the objective component of the investment, and as the subjective factor of the investment decision making.

4. Maturity

Debt maturity influences investment incentives in a more nuanced way than suggested by existing analysis. By definition, investment incentives are weak (and debt overhang is severe) when very little of the return from investment accrues to equity. For a single immediate investment, we show in a Black-Scholes-Merton model that shorter maturity debt is less sensitive to increased firm value from a new investment. This provides an intuition why shorter-term debt may impose fewer overhangs, because the difference between the total return from investment and the part accruing to equity is the change in the value of debt. When investment opportunities are present in the future, this intuition is incomplete. Less risk shared with existing shorter-term debt makes equity values and debt overhang more volatile, which affects future investment incentives.

5. Safety

Safety investments are therefore either defined as costs attributed to the prevention of serious accidents or as costs for the prevention of less serious accidents. This is reflected in the fact that the subtotals of the two kinds of costs, when added, amount to the total safety investment cost.

6. Tax

Minimizing taxes or avoiding them altogether, plays an important role in many investment decisions. Whether looking at this year's tax burden or thinking far ahead into the future, tax planning is a component of determining an investment mix. While tax avoidance should not drive all of your investment decisions, you need to consider tax consequences.

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7. Inflation

Inflation is also a concern to investors since changes in inflation and interest rates affect various asset types in different ways. This is an especially important issue for people living on a fixed income, such as retirees.

The impact of inflation on your portfolio depends on the type of securities you hold. If you invest only in stocks, worrying about inflation shouldn't keep you up at night since historically stocks have been quite good hedges against inflation. Over the long run, a company's revenue and earnings should increase at approximately the same pace as inflation, so the prices of stocks should rise along with the general prices of consumer and producer goods. The exception to this is stagflation; the combination of a bad economy with an increase in costs is bad for stocks. Not all companies fare the same with inflation - for example a company with a lot of cash will see the value of that cash decrease with increases in inflation.

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REVIEW QUESTIONS

Conceptual Type

1. Define of Investment.
2. What is Investment?
3. Give the meaning of Speculative motive.
4. Give the meaning of Transaction motive
5. Give the meaning of Alternative investments.
6. What do you mean by Traditional investments?
7. What is Growth of capital?
8. Why Investments are important?
9. Who is a Investor?
10. What is Market Analysis?
11. Define valuation.
12. Give the meaning of company analysis?
13. What do you mean by investment information?

Analytical Type

1. What are the characteristics of Investment?
2. What are the Objectives of Investment?

3. Explain the Scope of Investment Management.
4. Explain the various types of investors.
5. Differences between Investment, Trading and Speculation.
6. Explain the investment process involves a series of activities leading.
7. Explain the various objectives of investment.
8. Discuss the various factors to be considered in Investment Decisions.

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