STUDY NOTE

SEM - VI

Paper : DSE - 3T

FUNDAMENTAL OF INVESTMENT

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INVESTMENT DECISION PROCESS

A typical investment decision goes through a five step procedure which is known as investment process, these are:-

1. Defining the investment objective
2. Analysing Securities
3. Construct a portfolio
4. Evaluate the performance of portfolio
5. Review the portfolio.

TYPES OF INVESTMENTS

REAL ESTATE:- The word real estate means land and buildings. It offers a high return to investors. It can not be encashed quickly. It involve high transaction cost.

COMMODITIES

Commodities have emerged as an alternative investment option now adays and investors make use of this option to hedge against spairaing inflation. Commodities may be broadly divided into three - i) Metals
ii) petroleum products
iii) agricultural commodities

Financial Assets

The financial assets can be defined as an investment assets whose value is derived from a contractual claim of what they represent. Theare are also known as financial instruments or securities. There are - 1) Bank deposits (2) Bonds (3) Stock (4) Loan (5) Small Savings (6) Mutual fund

THE INDIAN SECURITY MARKET

The securities market include equities, index futures, index option
- Stock futures
- Stock options.
- longterm bonds
- Medium-term bonds
- short-term bonds
- money market securities
- equity funds
- debt funds
- structured Products etc.

TYPES OF SECURITY MARKET

Security is a financial instrument That can be traded between parties in the open market. The types are:-

i) Debt securities
ii) equity "
iii) Derivative "
iv) Hybrid Securities

What are the main problems of Security market in India?

The Indian market suffer from the following deficiencies:-

a) Lack of diversity in The financial Instruments
b) Lack of Control over The fair disclosure of financial information
c) poor growth in the Secondary market.

WHO REGULATES SECURITY MARKET

Securities and Exchange Board of India (SEBI) is the regulatory authority established under the SEBI Act 1992 and is the principal regulator for Stock Exchanges in India

TYPES OF SECURITY MARKETS ?

It can be spilt into two levels:

i) Primary Markets → where new securities are issued

ii) Secondary Markets → where existing securities can be bought and sale

MARKET PARTICIPANTS IN SECURITIES MARKET IN INDIA

i) Stock Exchanges
ii) Depository participant
iii) Trading members / Stock Brokers
iv) Authorized person
v) Clearing Corporation
vi) Clearing Banks
vii) Commercial banks
viii) Public financial institutions
ix) NBFCs
x) Sub-Brokers
xi) Foreign Banks operating in India

(A) What do you mean by Security market indices?

A Security market ~~index~~ index is a means to measure the growth of value of a set of securities.

Some of the notable indices in India are as follows:-

i) Benchmark indices
like - NSE Nifty
BSE Sensex

ii) Broad-based indices:-
like a) Nifty 50
b) BSE 100

iii) Sectoral Indices like
a) Nifty FMCG
b) CNX IT

iv) Indices based on market capitalisation like
a) BSE Smallcap
b) BSE Mid cap

SOURCES

1) Publication of RBI
2) DFHI
3) Indian banks association
4) Securities trading Corporation
5) Banks
6) NSE
7) Foreign Exchange dealers Association.

(5)

UNIT-2

FIXED INCOME SECURITIES

Bond features

A bond is generally a form of debt which the investors pay to the issuer for a defined time. Its features are-

i) generally a form of debt
ii) have a fixed maturity date
iii) All bonds repay the principal amount after the maturity

TYPES OF BOND

Following are the types of bonds:

1> Fixed Rate Bonds
2> Floating Rate Bonds
3> Zero interest Rate Bonds
4> Inflation Linked Bonds
5> Perpetual Bonds
6> Subordinated Bonds
7> Bearer Bonds
8> War Bonds
9> Serial Bonds
10> climate Bonds

ESTIMATING BOND YIELDS

The simplest way to calculate a bond yield is to divide its coupon payment by the face value of the bond. This is called the ~~coupon~~ coupon rate

(6) The formula to calculate yield to Maturity (YTM) of a discount bond is as follows:

$$YTM = \sqrt[n]{\frac{\text{Face value}}{\text{Current price}}} - 1$$

n = number of years to maturity

BOND VALUATION

Bond valuation is a technique for determining the theoritical fair value of a particular bond.

TYPES OF BOND RISK

1) Interest rate risk and bond
2) Reinvestment Risk
3) Inflation Risk
4) credit/default risk
5) Rating Downgrades of Bond risk
6) Liquidity Risk

DEFAULT RISK

The risk that the bond's issuer will be unable to pay the contractual interest or principal on the bond in a timely manner or at all. Credit rating services such as Moody's, standard & poor's and Fitch give credit ratings to bond issues, which helps to give investors an idea of how likely it is that a payment default

(7) will occur. For example, most federal governments have very high credit ratings (AAA); they can raise taxes or print money to pay debts, making default unlikely.

BOND RATING

A grade given to bonds that indicates their credit quality. Private independent rating services such as Standard & Poor's, Moody's and Fitch provide these evaluations of a bond issuer's financial strength, or its the ability to pay a bond's principal and interest in a timely fashion.

CREDIT RATING is a highly concentrated industry with the two largest rating agencies —

1) Moody's Investor Service
2) Standard & Poor's — having 80% market share globally

and the "Big Three" credit rating agencies —

1) Moody's
2) S&P
3) Fitch Ratings — controlling approximately 95% of the rating business.

The CREDIT RATING is a financial indicator to potential investors of debt securities ~~and~~ such as bonds. These are assigned by credit rating agencies.

UNIT - 3

APPROACHES to Equity Analysis

Equity analysis is a lot like travel all of us want to chose the best performing stock but we may have varied approaches to do that. It we broadly classify these approaches; they are

1) Fundamental Analysis
2) Technical Analysis

FUNDAMENTAL ANALYSIS

Fundamental analysis aims to understand and forecast the intrinsic value of stock based on a through analysis of various macro, company-specific as well as qualitative and quantitative factors. There are two approaches

i) Top-Down Approaches
ii) Bottom-up Approaches

COMPONENTS OF FUNDAMENTAL ANALYSIS

components are:-

a) Earning per share
b) P/E Ratio
c) P/B Ratio
d) Debt Equity Ratio
e) ROE Ratio

(9) What are the steps of fundamental Analysis?

Steps are :—

1) Economic and market Analysis
2) Analysis of financial Statements
3) Forecasting relevent payoffs
4) Formulating a Security value
5) Making a recommendation

OBJECTIVES OF FUNDAMENTAL ANALYSIS

(1) To make projection on its business performance (2) To evaluate the management of the property and make internal financial dicisions.
(3) To calculate credit risk of the assets
(4) To find out the intrinsic value of the property

TOP-down APPROACH

This is also known as the Economy-industry-Company or the EIC approach wherein the analyst starts analysing the economy at large and delving down further into the relevent Sector and then the Company in particular

Bottom-up APPROACH

It is just the opposite of top-down approach. where in the company is analyzed first and then it is validated in the back drop of the forecast economy.

TECHNICAL ANALYSIS

What is meant by technical analysis?

Technical analysis is a trading discipline employed to evaluate investments and identify trading opportunities by analysing statistical trends gathered from trading activity, such as price movement and volume.

TOOLS USED FOR TECHNICAL Analysis

1) Price
2) Time
3) volume
4) width

Is Technical Analysis a Substitute for Fundamental Analysis

There is no definitive answer whether technical analysis can be used as a whole substitution for fundamental analysis. More there is a little doubt that combining the strengths of both strategies can help investors better understands the markets and gauge the direction in which their investments might be headed.

Difference between Fundamental Analysis and Technical Analysis

FUNDAMENTAL ANALYSIS	TECHNICAL ANALYSIS
(1) It is a method of examining security	(1) It is a method of evaluting.
(2) It is Longterm analysis	(2) It is short-term analysis
(3) It aims at ascertaining the true intrinsic value of the stock	(3) It aims to identify the right time to enter or exit the market
(4) It is based on the information available	(4) It is based on the market trends and the stock
(5) Here both past and present data are considered	(5) Here only past data is considered
(6) It depend on financial statement	(6) It on charts with price movement
(7)	

EFFICIENT MARKET HYPOTHSIS (EMH)

DEFINITION :- A financial market is efficient when market prices reflect all available information about value.

EMPIRICAL TEST OF EMH

A. Supportive Evidence

i) weak form of EMH is supported by the data

ii) Semi-strong form of EMH is generally supported by the data

iii) Strong-form of EMH has mixed evidence

B. Ambiguous Evidence

a) Stock market crash of 1987

b) Smooth dividends but volatile price

C. IMPLICATIONS OF EMH

1. Trust market price
2. Read into price
3. There are no Financial illusions.
4. value comes from economic rents such as —

i) Superior information

ii) Superior technology

iii) access to cheap resource etc

DIVIDEND DISCOUNT MODELS

The simplest model for valuating equity is the dividend discount model - the value of stock is the present value of expected dividends on it

The General Model

As per this model

$$\text{value per share of stock} = \sum_{t=1}^{t=\infty} \frac{E(DPS_t)}{(1+K_e)^t}$$

where,

DPS_t = Expected dividends per share

K_e = Cost of equity

PRICE EARNINGS MULTIPLE APPROACH

A multiple of earnings is a valuation method whereby the value of company is expressed through the use of a multiple applied to the company's earnings.

How it is used

Step-I. Select Comparable Company's
2. Select LTM P/E Multiple
3. Select Forward P/E Multiple
4. Conclude on a fair value

How is the P/E Ratio calculated :-

P/E multiple is the ratio of the current stock price of a company divided by its EPS or earnings per share.

The formula depends on whether we are using the trailing P/E or the forward P/E ratio-

$$\text{Trailing P/E} = \frac{\text{current Stock Price}}{\text{EPS for the trailing 12 months}}$$

$$\text{Forward P/E} = \frac{\text{current Stock Price}}{\text{Estimated EPS for the next 12 months}}$$

UNIT - 5

INVESTOR PROTECTION

What do you mean?

Investment protection is ~~broad~~ a broad economic term referring to any form of guarantee or insurance that investments made will not be lost, which may be through fraud or otherwise.

What are basic needs for investors protection

(i) Keeping a check on frauds and unfair trading methods related to the securities market.

(ii) observing and regulating major transactions and

iii) take over the companies

iv) Carry out investor awareness and education programme

v) Train the intermediaries of the business.

Who protects investors?

The mission of the Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets; and facilitate capital formation

ROLE OF SEBI

To protect investor SEBI performs various functions to:-

1) Regulatory functions

2) Development functions

3) Protective functions

PROTECTIVE FUNCTIONS (SEBI)

i) SEBI checks price Rigging
ii) SEBI prohibits Insider Trading
iii) SEBI prohibits fraudulent and unfair trade practices
iv) Educate the investors
v) Promotion of fair practices and code of conduct in Security market.

GRIEVANCES AND THEIR REMOVAL

Redressal of investor grievances is one of the key components of SEBI's efforts to protect the interest of investors in securities.

USUAL GRIEVANCES

A. Against Companies
i) Delay in registering transfer
ii) Delay in payment of dividend.
iii) Non-repayment
iv) Non-receipt of duplicate share certificate
v) Non-receipt of right issue share
vi) Transmission of shares
vii) Non-receipt of notice of meeting

B. Against Brokers

a) Delay in payment for Securities Sold.

b) Delay in delivery of purchase Security to the client.

c) Non-Issue of Contract note

d) Charging brokerage from clients

e) Non-passing of Corporate benefits

C. Against Depository Participants

- Every depository participant must forward all the dematerialization or materialization request of his clients to the concern company with in 7 days of the receipt of the request but delays are quite common.

Main depositories

a) NSDL (National Securities Depositories Ltd. 1996)

b) CDSL (central depositories Services Ltd. 1999)

METHODS OF REDRESSAL OF INVESTORS GRIEVANCE

From the following agencies

1) Grievance cells in Stock Exchange

2) SEBI

3) Company law Board

4) Courts
5) Press

INSIDER TRADING

Insider trading refers to transactions in a Company's securities, such as stock or options, by corporate insiders or their associates.

Example

1) A CEO of corporation buys 1000 shares of stock in the corporation

2) A Board member of a Corporation buys 5000 shares of stock in the corporation

Two main theories of INSIDER

1) The classical Theory
2) Misappropriation Theory

Who Investigates insider trading?

1) Securities and Exchange Commission (SEC)
2) Self-Regulatory organisation (SRO)

How can we insider trading?

1. Restrict risky trading
2. Appoint an in-house watchdog.
3. Ensure that your employees are educated on insider trading.
4. Act quickly to investigate insider trading
5. Leverage technology to prevent insider trading.

INVESTOR AWARENESS AND ACTIVISM

Awareness is a term used in investor relations, by public companies and similar bodies, to describe how well their investors, and the investment market in general, know their business.

How do you organize

1) To pull the audience, distribute in newspapers and create buzz on social media
2) Reach out to associations, rotary clubs and corporates

ACTIVISM It is found to be dependent on period on investment.

Activist investor push for changes to that would increase the company shares price or benefit the activist investor.