EQUITY RESEARCH AND PORTFOLIO MANAGEMENT

UNIT I- INVESTMENT PROCESS AND ALTERNATIVES

Investment Process-Investment Alternatives-Risk and Return-Bonds, Preference Shares, Equity Shares, Fixed Income Securities. Securities Market in India: Capital Market, Money Market, Debt Market, Futures and Option Market. SEBI- guidelines on Regulations of Primary Market and Secondary Market and its Operations. Stock Market Indices- NSE and BSE.

UNIT II ESTIMATING THE PORTFOLIO RETURN AND RISK

Portfolio Theory-Estimating the portfolio return and portfolio risk, Efficient Frontier of Portfolios and Capital Asset Pricing Model –Basic Assumptions, Capital Market Line, Security Market Line-Arbitrage Pricing Theory (APT). Options: Types, Strategies. Option Pricing-Black-Scholes Model. Growth of Options and Futures Markets in India.

UNIT III-FUNDAMENTAL AND TECHNICAL ANALYSIS

Economic Analysis, Industry Analysis, Company Analysis- Financial Statements Analysis, Ratio Analysis, Du Pont Analysis. Technical Analysis: Dow Theory, Charts and Signals, Trends, Technical Indicators.

UNIT IV- VALUATION OF BONDS AND STOCKS

Valuation of Equity Shares-Various models; Valuation of Bonds. Efficient Market Hypothesis- Weak Form, Semi-Strong Form, Strong Form.

UNIT V - PORTFOLIO MANAGEMENT

Selection of Asset Mix- Selection of Securities-Portfolio Revision-Formula Plans-Evaluation of Portfolio Performance-Sharp‟s Model, Treynor‟s Index, Jenson‟s Index.

1.1 INTRODUCTION:

- **Investment** is putting money into something with the expectation of profit. The word originates in the Latin "vestis", meaning garment, and refers to the act of putting things (money or other claims to resources) into others' pockets.

- The term "investment" is used differently in economics and in finance. Economists refer to a real investment (such as a machine or a house), while financial economists refer to a financial asset, such as money that is put into a bank or the market, which may then be used to buy a real asset.

- Investment involves making of a sacrifice in the present with the hope of deriving future benefits. Two most important features of an investment are current sacrifice and future benefit. Investment is the sacrifice of certain present values for the uncertain future reward. It involves numerous decision such as type, mix, amount, timing, grade etc, of investment the decision making has to be continues as well as investment may be defined as an activity that commits funds in any financial/physical form in the present with an expectation of receiving additional return in the future.

1.2 FINANCIAL MEANING OF INVESTMENT:

•Financial investment involves of funds in various assets, such as *stock, Bond, Real Estate, Mortgages* etc.

•Investment is the employment of funds with the aim of achieving additional income or growth in value.

•It involves the commitment of resources which have been saved or put away from current consumption in the hope some benefits will accrue in future. Investment involves long term commitment of funds and waiting for a *reward in the future*.

•From the point of view people who invest their finds, they are the supplier of Capital and in their view investment is a commitment of a person s funds to derive future income in the form of interest, dividend, rent, premiums, pension benefits or the appreciation of the value of their principle capital

To the financial investor it is not important whether money is invested for a productive use or for the purchase of secondhand instruments such as existing shares and stocks listed on the stock exchange.

• Most investments are considered to be transfers of financial assets from one person to another.

1.3 Economic meaning of investment:

➢ Economic investment means the net additions to the capital stock of the society which consists of goods and services that are used in the production of other goods and services. Addition to the capital stock means an increase in building, plants, equipment and inventories over the amount of goods and services that existed.

➢ The financial and economic meanings are related to each other because investment is a part of the savings of individuals which flow into the capital market either directly or through institutions, divided in new and secondhand capital financing. Investors as suppliers and investors as users of long-term funds find a meeting place in the market.

1.4 Investors and speculators: Investors:

The investors buy the securities with a view to invest their savings in profitable income earning securities. They generally retain the securities for a considerable length of time. They are assured of a profit in cash. They are also called genuine investors.

Speculators:

The speculators buy securities with a hope to sell them at a profit in future. They do not retain their holdings for a longer period. They buy the securities with the object of selling them and not to retain them. They are interested only in price differentials. They are not genuine investors.

Differences between investors and speculators:

S. No	Investors	Speculators
1	An investors is interested in safety of his investment	A speculators is interested in appreciation of capital and earning profits quickly
2	Seeks income from his investment	Seeks profit from sale and purchase of securities
3	Makes payment and takes delivery of the securities on purchasing. Receives payment and delivers the securities on sales.	He neither delivers nor takes the delivery of the securities on sale or purchase.
4	Retains holding for longer period i.e. commitment is for longer period of time	Tries to sell the securities quickly ie his commitment is for shorter period.
5	Risk is low	Risk is high
6	Stable income	Earnings of profit is uncertain
7	His income depends on the earnings of the enterprise	The profit earned by him depends on the fluctuation/change in the market price of securities.

Speculation:

Speculation refers to the buying and selling of securities in the hope of making a profit from expected change in the price of securities. Those who engage in such activity are known as speculators.

A speculator may buy securities in expectation of rise in price. If his expectation comes true, he sells the securities for a higher price and makes a profit. Similarly a speculator may expect a price to fall and sell securities at the current high price to buy again when prices decline. He will make a profit if prices decline as expected. The benefits of speculation are:

1. It leads to smooth change and prevents wide fluctuations in security prices at different times and places.

2. Speculative activity and the resulting effect in the prices of securities provided a guidance to the public about the market situation.

1.5 Differences between speculation and gambling:

S. No	Speculation	Gambling
1	It is based on knowledge and foresight	It is based on chance of events happening.
2	It is a lawful activity	It is an illegal activity
3	It performs economic functions	It has no benefits to offer to the economy
4	Speculators bears the risk of loss on the basis of logical reasoning	Gamblers bear the risk of loss on the basis of blind and reckless expectation.

1.6 Basic Investment Objectives

Investment triangle three compromising objectives

Any investment decision will be influenced by three objectives security, liquidity and yield. A best investment decision will be one, which has the best possible compromise between these three objectives.

Security

Liquidity

Yield

Security:

Central to any investment objective, we have to basically ensure the safety of the principal. One can afford to lose the returns at any given point of time but s/he can ill afford to lose the very principal itself. By identifying the importance of security, we will be able to identify and select the instrument that meets this criterion. For example, when compared with corporate bonds, we can vouch safe the safety of return of investment in treasury bonds as we have more faith in governments than in corporations. Hence, treasury bonds are highly secured instruments. 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.

Liquidity:

Because we may have to convert our investment back to cash or funds to meet our unexpected demands and needs, our investment should be highly liquid. They should be en cashable at short notice, without loss and without any difficulty. If they cannot come to our rescue, we may have to borrow or raise funds externally at high cost and at unfavorable terms and conditions. Such liquidity can be possible only in the case of investment, which has always-ready market and willing buyers and sellers. Such instruments of investment are called highly liquid investment.

Yield:

Yield is best described as the net return out of any investment. Hence given the level or kind of security and liquidity of the investment, the appropriate yield should encourage the investor to go for the investment. If the yield is low compared to the expectation of the investor, s/he may prefer to avoid such investment and keep the funds in the bank account or in worst case, in cash form in lockers. Hence yield is the attraction
for any investment and normally deciding the right yield is the key to any investment.

Relationship:

- There is a tradeoff between risk (security) and return (yield) on the one hand and liquidity and return (yield) on the other.
- Normally, higher the risk any investment carries, the greater will be the yield, to compensate the possible loss. That is why, fly by night operators, offer sky high returns to their investors and naturally our gullible investors get carried away by such returns and ultimately lose their investment. Highly secured investment does not carry high coupon, as it is safe and secured.

- When the investment is illiquid, (i.e. one cannot get out of such investment at will and without any loss) the returns will be higher, as no normal investor would prefer such investment.
- These three points security, liquidity and yield in any investment make an excellent triangle in our investment decision-making. Ideally, with given three points of any triangle, one can say the center of the triangle is fixed. In our investment decision too, this center the best meeting point for S, L and Y is important for our consideration.
- However, if any one or two of these three points are disturbed security, liquidity and yield in any investment the center of the triangle would be disturbed and one may have to revisit the investment decision either to continue the investment or exit the investment.
- All these points security, liquidity and yield are highly dynamic in any market and they are always subject to change and hence our investor has to periodically watch his/her investment and make appropriate decisions at the right time.
- Thus, we will return to our original statement - A best investment decision will be one, which has the best possible compromise between these three objectives security, liquidity and yield.

Secondary Objectives:

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 favorable tax treatment in order to lessen his or her overall income tax burden. Making contributions to an IRA or other tax-sheltered retirement plan, such as a 401(k), can be an effective tax minimization strategy.

Marketability / Liquidity:

Many of the investments we have discussed are reasonably illiquid, 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. Common stock is often considered the most liquid of investments, since it can usually be sold within a day or two of the decision to sell. Bonds can also be fairly marketable, but some bonds are highly illiquid, or non-tradable, possessing a fixed term. Similarly, money market instruments may only be redeemable at the precise date at which the fixed term ends. If an investor seeks liquidity, money market assets and non -tradable bonds aren't likely to be held in his or her portfolio.

1.7 CHARACTERISTICS OF GOOD INVESTMENT

a. Objective fulfillment

- An investment should fulfill the objective of the savers. Every individual has a definite objective in making an investment. When the investment objective is contrasted with the uncertainty involved with investments, the fulfillment of the objectives through the chosen investment avenue could become complex.

b. Safety

- The first and foremost concern of any ordinary investor is that his investment should be safe. That is he should get back the principal at the end of the maturity period of the investment. There is no absolute safety in any investment, except probably with investment in government securities or such instruments where the repayment of interest and principal is guaranteed by the government.

c. Return

- The return from any investment is expectedly consistent with the extent of risk assumed by the investor. Risk and return go together. Higher the risk, higher the chances of getting higher return. An investment in a low risk - high safety investment such as investment in government securities will obviously get the investor only low returns.

d. Liquidity

- Given a choice, investors would prefer a liquid investment than a higher return investment.

  Because the investment climate and market conditions may change or investor may be confronted by an urgent unforeseen commitment for which he might need funds, and if he can dispose of his investment without suffering unduly in terms of loss of returns, he would prefer the liquid investment.

e. Hedge against inflation

- The purchasing power of money deteriorates heavily in a country which is not efficient or not well endowed, in relation to another country. Investors, who save for the long term, look for hedge against inflation so that their investments are not unduly erod ed; rather they look for a capital gain which neutralizes the erosion in purchasing power and still gives a return.

f. Concealabilty

- If not from the taxman, investors would like to keep their investments rather confidential from their own kith and kin so that the investments made for their old age/ uncertain future does not become a hunting ground for their own lives. Safeguarding of financial instruments representing the investments may be easier than investment made in real estate. Moreover, the real estate may be prone to encroachment and other such hazards.

h. Tax shield

- Investment decisions are highly influenced by the tax system in the country. Investors look for front-end tax incentives while making an investment and also rear-end tax reliefs while reaping the benefit of their investments. As against tax incentives and reliefs, if investors were to pay taxes on the income earned from investments, they look for higher return in such investments so that their after tax income is comparable to the pre-tax equivalent level with some other income which is free of tax, but is more risky.

Other Characteristics an ideal Investment:

1. RISK:

   Do you want risk involved in your account? Is it okay if you lose the money?

2. GUARANTEES:

   Do you want guarantees offered to protect your money?

3. PENALTIES:

   Are there fees and/or penalties for using or withdrawing your money before a certain date?

4. LIQUIDITY, USE AND CONTROL:

   If you need your money, can you get to it easily and quickly?

5. PROTECTION:

   Is your money protected from creditors and lawsuits? (This varies from state to state)

6. LEVERAGE:

   Does your account allow you to create the most wealth from the least amount of money?

7. TAX-ADVANTAGED: Does your money grow tax-advantaged?

8. TAX-FREE: Is your money tax-free upon distribution?

9. TAX-DEDUCTIBLE PAYMENTS:

   When you put money in, are your payments tax deductible?

10. COLLATERAL:

    Can your money be used as collateral for a loan if necessary?

11. DISABILITY BENEFITS:

    If you become disabled does someone continue to put money in?

12. WEALTH TRANSFERS: Will your money transfer to your heirs tax free

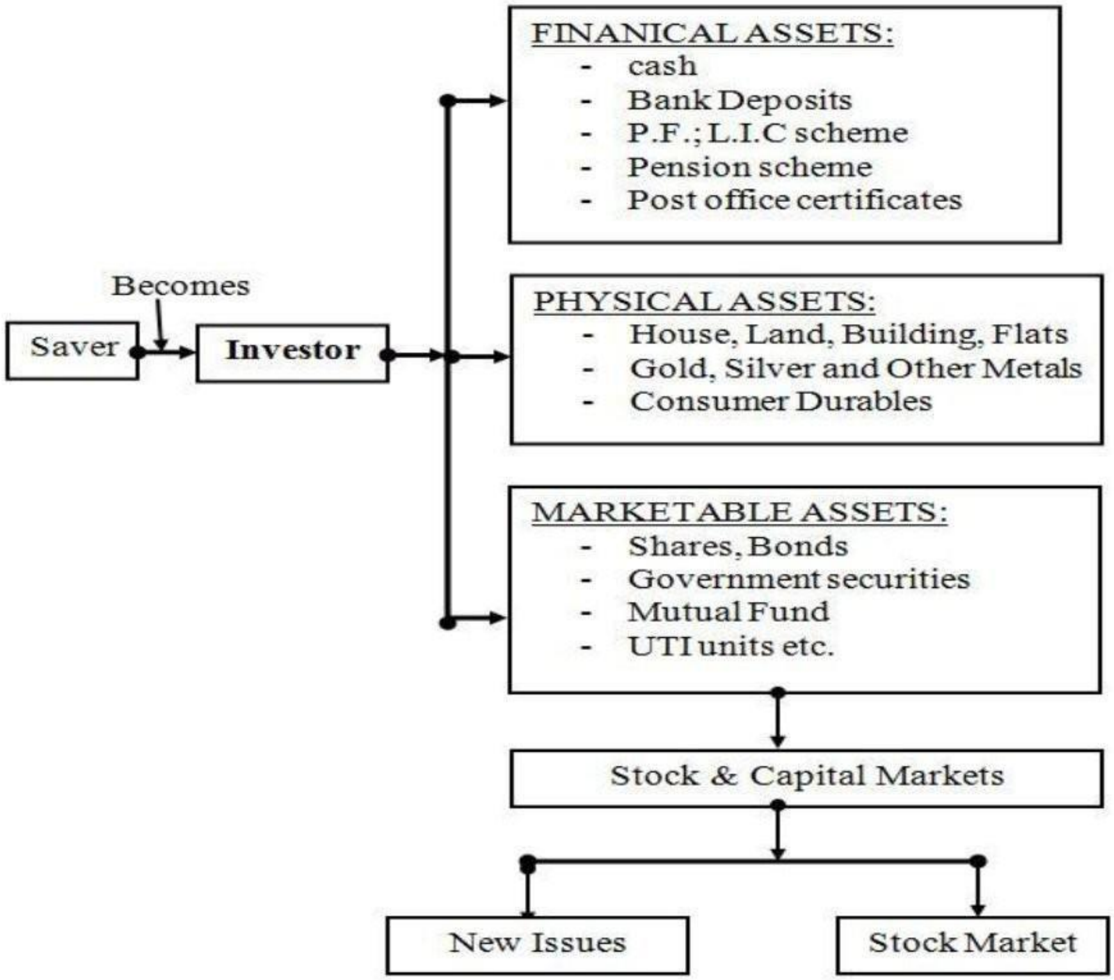
1.8 Different types of investors:

- ***Conservative*** investors often invest in cash. THIS means that they put their money in interest bearing savings accounts, money market accounts, mutual funds, US Treasury bills, and Certificates of Deposit. These are very safe investments that grow over a long period of time. These are also low risk investments.

- ***Moderate*** investors often invest in cash and bonds, and may dabble in the st ock market. Moderate investing may be low or moderate risks. Moderate investors often also invest in real estate, providing that it is low risk real estate.

- ***Aggressive*** investors commonly do most of THEIR investing in the stock market, which is higher risk. They also tend to invest in business ventures as well as higher risk real estate. For instance, if an aggressive investor puts his or her money into an older apartment building, then invests more money renovating the property, they are running a risk. They expect to be able to rent the apartments out for more money than the apartments are currently worth or to sell the entire property for a profit on their initial investments. In some cases, this works out just fine, and in other cases, it doesn't. It's a
risk.

INVESTMENT ALTERNATIVES:



A good portion of financial assets is represented by non-marketable financial assets. A distinguishing feature of these assets is that they represent personal transactions between the investor and the issuer. For example, when you open a savings bank account at a bank you deal with the bank personally. In contrast when you buy equity shares in the stock market you do not know who the seller is and you do not care. These can be classified into the following broad

Categories:

- Post office deposits
- Company deposits
- Provident fund deposits
- Bank deposits

Equity Shares:

Equities are a type of security that represents the ownership in a company. Equities are traded (bought and sold) in stock markets. Alternatively, they can be purchased via the Initial Public Offering (IPO) route, i.e. directly from the company. Investing in equities is a good long-term investment option as the returns on equities over a long time horizon are generally higher than most other investment avenues. However, along with the possibility of greater returns comes greater risk.

Equity shares are classified into the following broad categories by stock market analysts:

- Blue chip shares
- Growth shares
- Income shares
- Cyclical shares # Speculative shares

Bonds:

Bond is a debt instrument issued for a period of more than one year with the purpose of raising capital by borrowing. It is certificates acknowledging the money lend by a bondholder to the company. It states it maturity date, interest rate, and par value.

The Federal government, states, cities, corporations, and many other types of institutions sell bonds. When an investor buys a bond, he/she becomes a creditor of the issuer. However, the buyer does not gain any kind of ownership rights to the issuer, unlike in the case of equities. On the hand, a bond holder has a greater claim on an issuer's income than a shareholder in the case of financial distress (this is true for all creditors).

The yield from a bond is made up of three components: coupon interest, capital gains and interest on interest (if a bond pays no coupon interest, the only yield will be capital gains). A bond might be sold at above or below par (the amount paid out at maturity), but the market price will approach par value as the bond approaches maturity. A riskier bond has to provide a higher payout to compensate for that additional risk. Some bonds are tax-exempt, and these are typically issued by municipal county or state governments, whose interest payments are not subject to federal income tax, and sometimes also state or local income tax.

Bonds may be classified into the following categories:

- Government securities
- Government of India relief bonds
- Government agency securities
- PSU bonds
- Debentures of private sector companies # Preference shares

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 deposits

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.

A mutual fund is made up of money that is pooled together by a large number of investors who give their money to a fund manager to invest in a large portfolio of stocks and / or bonds Mutual fund is a kind of trust that manages the pool of money collected from various investors and it is managed by a team of professional fund managers (usually called an Asset Management Company) for a small fee.

The investments by the Mutual Funds are made in equities, bonds, debentures, call money etc., depending on the terms of each scheme floated by the Fund. The current value of such investments is now a day is calculated almost on daily basis and the same is reflected in the Net Asset Value (NAV) declared by the funds from time to time. This NAV keeps on changing with the changes in the equity and bond market. Therefore, the investments in Mutual Funds is not risk free, but a good managed Fund can give you regular and higher returns than when you can get from fixed deposits of a bank etc.

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. **Life insurance** is a contract between the policy holder and the insurer, where the insurer promises to pay a designated beneficiary a sum of money (the "benefits") upon the death of the insured person.

Depending on the contract, other events such as terminal illness or critical illness may also trigger payment. In return, the policy holder agrees to pay a stipulated amount (the "premium") at regular intervals or in lump sums. 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

Precious Objects:

Precious objects are items that are generally small in size but highly valuable in monetary terms. Some important precious objects are:

- Gold and silver
- Precious stones
- Art objects

Financial Derivative:

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

Non-financial Instruments

Real estate

With the ever-increasing cost of land, real estate has come up as a profitable investment proposition.

Gold

The 'yellow metal' is a preferred investment option, particularly when markets are volatile. Today, beyond physical gold, a number of products which derive their value from the price of gold are available for investment. These include gold futures and gold exchange traded funds.

Preference shares:

Preference shares commonly known as preferred stocks, are those shares that enable shareholders to receive dividends announced by the company before receiving to the equity shareholders.

If the company has decided to pay out its dividends to investors, preference shareholders are the first to receive payouts from the company, preference shares are released to raise capital for the company, which is known as preference share capital. If the company is going through a loss and winding up, the last payments will be made to preference shareholders before paying to equity shareholders.

Preference shares that can be easily converted into equity shares are known as convertible preference shares. Some preference shares also receive arrears of dividends, which are called cumulative preference shares.

In India, preference shares should be redeemed within 20 years of issuance, and these types of preference shares are called redeemable preference shares. As per the Companies Act 2013, companies do not have any right to issue irredeemable preference shares in India.

Types of Preference Shares:

There are nine different types of preference shares given below:

- Convertible Preference Shares
- Non-Convertible Preference Shares
- Redeemable Preference Shares
- Non-Redeemable Preference Shares
- Participating Preference Shares
- Non-Participating Preference Shares
- Cumulative Preference Shares
- Non-Cumulative Preference Shares
- Adjustable Preference Shares

1. Convertible Preference Shares

Convertible preference shares are those shares that can be easily converted into equity shares.

2. Non-Convertible Preference Shares

Non-Convertible preference shares are those shares that cannot be converted into equity shares.

3. Redeemable Preference Shares

Redeemable preference shares are those shares that can be repurchased or redeemed by the issuing company at a fixed rate and date. These types of shares help the company by providing a cushion during times of inflation.

4. Non-Redeemable Preference Shares

Non-redeemable preference shares are those shares that cannot be redeemed or repurchased by the issuing company at a fixed date. Non-redeemable preference shares help companies by acting as a lifesaver during times of inflation.

5. Participating Preference Shares

Participating preference shares help shareholders demand a part in the company's surplus profit at the time of the company's liquidation after the dividends have been paid to other shareholders.

However, these shareholders receive fixed dividends and get part of the surplus profit of the company along with equity shareholders.

6. Non-Participating Preference Shares

These shares do not benefit the shareholders the additional option of earning dividends from the surplus profits earned by the company, but they receive fixed dividends offered by the company.

7. Cumulative Preference Shares

Cumulative preference shares are those type of shares that gives shareholders the right to enjoy cumulative dividend payout by the company even if they are not making any profit.

These dividends will be counted as arrears in years when the company is not earning profit and will be paid on a cumulative basis the next year when the business generates profits.

8. Non - Cumulative Preference Shares

Non - Cumulative Preference Shares do not collect dividends in the form of arrears. In the case of these types of shares, the dividend payout takes place from the profits made by the company in the current year.

So if a company does not make any profit in a single year, then the shareholders will not receive any dividends for that year. Also, they cannot claim dividends in any future profit or year.

9. Adjustable Preference Shares

In the case of adjustable preference shares, the dividend rate is not fixed and is influenced by current market rates.

Features of preference shares:

Several features of preference shares have made normal investors superior earners even during low phases of economic growth. The most attractive features of preference shares are given below:

1. **They Can Be Converted Into Common Stock**

Preference shares can be easily converted into common stock. If a shareholder wants to change its holding position, they are converted into a predetermined number of preference stocks.

Some preference shares inform investors that they can be converted beyond a specific date, while others may require permission and approval from the company's board of directors to be converted.

2. **Dividend Payouts**

Preference shares allow shareholders to receive dividend payouts when other stockholders may receive dividends later or may not be receiving dividends.

3. **Dividend Preference**

When it comes to dividends, preference shareholders have the major advantage of receiving dividends first compared to equity and other shareholders.

4. **Voting Rights**

Preference shareholders are entitled to the right to vote in case of extraordinary events. However, this happens in only some cases. Generally, purchasing a company's stock does not give one voting rights in the company's management.

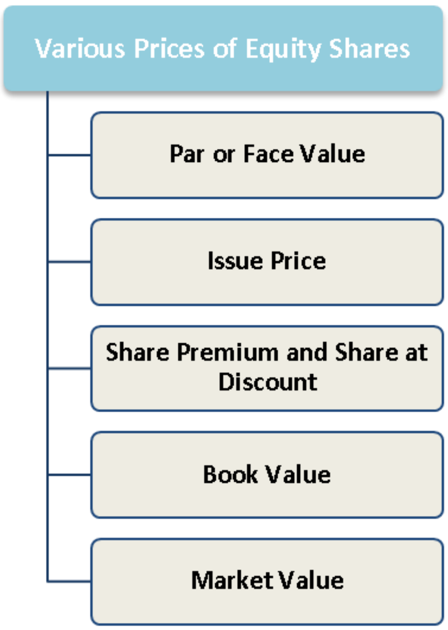
5. **Preference In Assets**

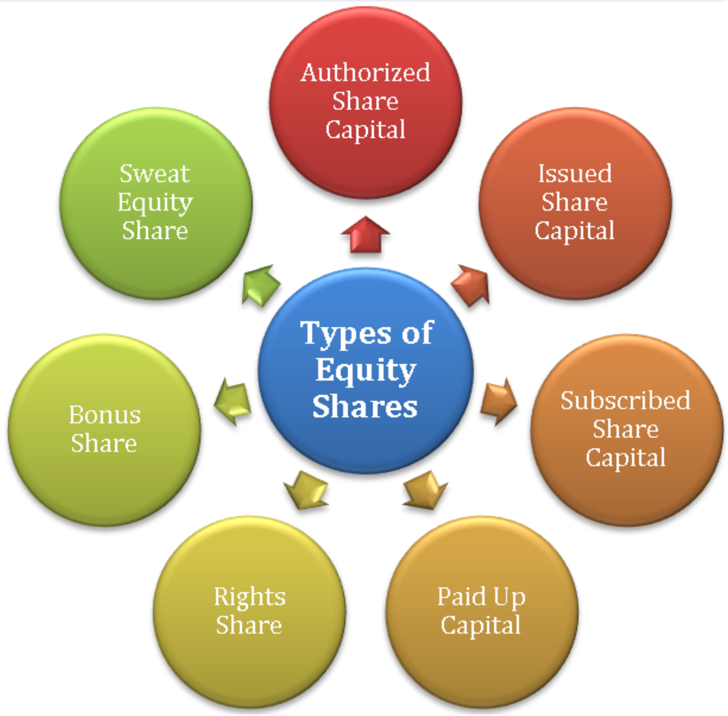
While discussing a company's assets in the case of liquidation, preference shareholders have priority over non-preferential shareholders.

Equity Shares:

Equity Shares :

They are categorized under long-term sources of finance because legally they are irredeemable in nature. For an investor, these shares are a certificate of ownership in the company by virtue of which investors are entitled to share the net profits and have a residual claim over the assets of the company in the event of liquidation.





To understand equity share capital, individuals need to familiarize themselves with the meaning of equity shares.

Equity shares or ordinary shares that represent ownership stake in a company. Shares sold by a company function as a source of investment for the company as well, also, individuals who hold equity shares are said to hold fractional ownership of a company.

It also extends these following benefits to shareholders –

- **Fair liquidity:** Share prices are directly proportional to fluctuations in the market or to the company's revenue generation. They may even be affected on both.
- **Profitability:** Investors not just benefit from the capital appreciation feature of equity shares but also earn regular dividends on their investments.

- **Control on management:** Shareholders with a significant per cent of shareholding can influence a company's management significantly.

Types of Equity Share Capital

Several types of equity shares help companies generate **equity share capital.**

The following highlights **types of equity share capital** –

- **Authorised share capital:** The maximum amount of capital that can be issued by a particular company is known as authorised share capital. Companies can increase their permissible limit to authorise shares after they have availed permission from respective authority and have paid the required fees.
- **Issued share capital:** Shares which a company offers to its investors are known as issued share capital.
- **Subscribed share capital:** It comprises of the part of issued share capital, which the investors agree upon and accept.
- **Right shares:** The shares that are issued to individuals after they have invested in equity shares are known as right shares**.** They are issued to safeguard existing investor's ownership.
- **Sweat equity shares:** As an appreciation for a job well-done, companies reward their employees or directors with shares. Such shares are known as sweat equity shares.
- **Paid-up capital:** It forms the part of subscribed capital which the company invests in their business.
- **Bonus shares:** These shares are issued to the investors in the form of a dividend.

SECURITIES MARKETS IN INDIA:

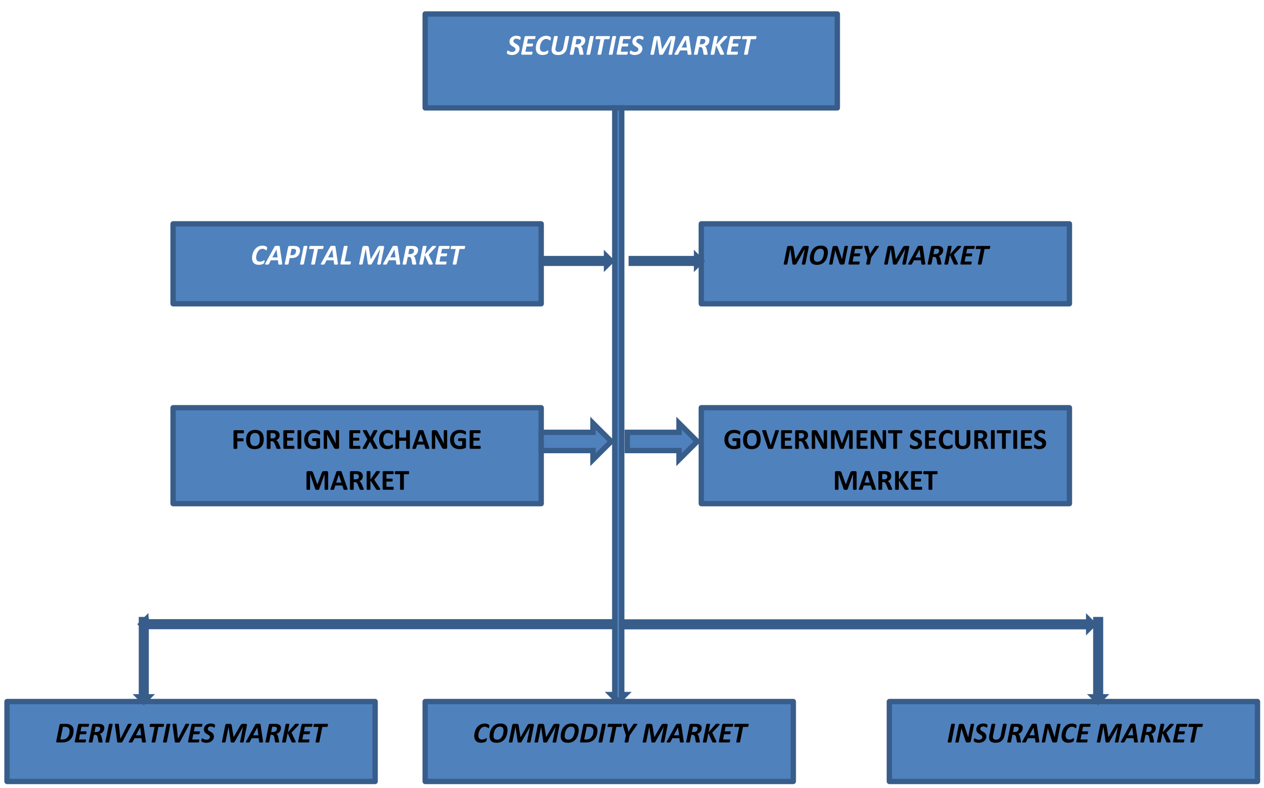
FINANCIAL MARKETS

In economics, a **financial market** is a mechanism that allows people to buy and sell (trade) financial securities (such as stocks and bonds), commodities (such as precious metals or agricultural goods), and other fungible items of value at low transaction costs and at prices that reflect the efficient-market hypothesis. Financial markets can be domestic or they can be international.

In finance, financial markets facilitate:

- The raising of capital (in the capital markets)
- The transfer of risk (in the derivatives markets)
- International trade (in the currency markets)

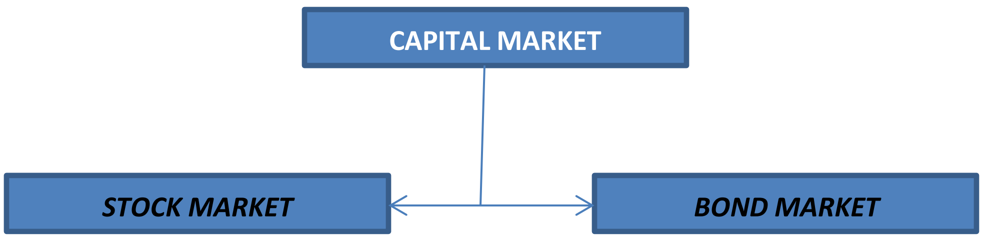
- And are used to match those who *want* capital to those who *have* it.



I. Capital Market:

The capital market deals in long term funds (shares and debentures). Companies raise their capital through the issue of shares and debentures.

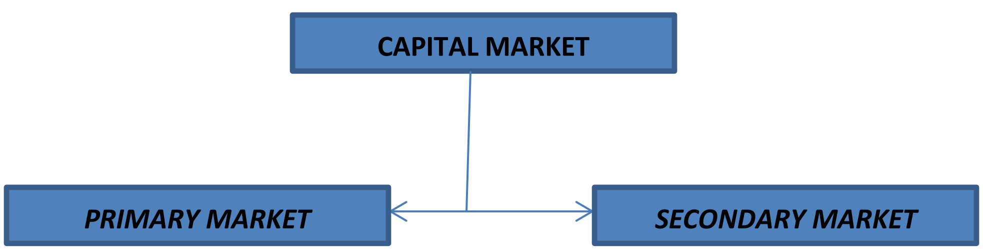
Capital markets which consist of:



Stock markets: which provide financing through the issuance of shares or common stock, and enable the subsequent trading thereof.

Bond markets: which provide financing through the issuance of **bonds,** and enable the Subsequent trading thereof.

Another classification of capital market is as follows:



II. Money Market:

Money market is a market for short-term loan or financial assets. It as a market for the lending and borrowing of short term funds. As the name implies, it does not actually deals with near substitutes for money or near money like trade bills, promissory notes and government papers drawn for a short period not exceeding one year.

Money market is the centre for dealing mainly in short — term money assets. It meets the short-term requirements of borrowers and provides liquidity or cash to lenders. It is the place where short-term surplus funds at the disposal of financial institutions and individuals are borrowed by individuals, institutions and also the Government.

Features of Money Market:

- It is market purely for short-term funds or financial assets called near money.
- It deals with financial assets having a maturity period up to one year only.
- It deals with only those assets which can be converted into cash readily without loss and with minimum transaction cost.
- Generally transactions take place through phone i.e., oral communication. Relevant documents and written communications can be exchanged subsequently. There is no formal place like stock exchange as in the case of a capital market.
- Transactions have to be conducted without the help of brokers.
- The components of a money market are the Central Bank, Commercial Banks, Non-banking financial companies, discount houses and acceptance house. Commercial banks generally play a dominant in this market.

Objectives of Money Market:

The following are the important objectives of a money market:

- To provide a parking place to employ short-term surplus funds.
- To provide room for overcoming short-term deficits.
- To enable the Central Bank to influence and regulate liquidity in the economy through its intervention in this market.
- To provide a reasonable access to users of Short-term funds to meet their requirements quickly, adequately and at reasonable costs.

Debt Market:

The debt markets today are a major source of financing than the banking system. It is any market situation where debt instruments are traded. It establishes a planned environment where the debts are traded amongst the interested parties.

The debt markets are known by other names based on the types of instruments are traded. For example when municipal or corporate bond are traded, debt market is called bond market whereas if notes or securities or mortgages are traded market is called credit market. The debt market is three times larger than stock/equity market. The debt markets are categorized into two other markets called money market and capital market.

Debt Instruments

A debt instrument is an electronic obligation or any paper that permits an issuing party to raise funds by assuring it to pay back a lender in accordance with the terms and conditions of a contract. The predetermined conditions which are mentioned in the contract are the periodicity and rate of interest and the date of the repayments of the principal amount.

Objectives and Features of Debt Instruments:

The main objectives of debt instruments are:

1. Safety of the principal amount.

2. Guaranteed returns for the investors. Currently 8-9% interest per annum are quoted for medium to long-term deposits whereas it is 6-7% returns for short-term deposits.

3. Some of these instruments also qualify for tax rebates under Section 80C.

There are three main features of debt instruments;

1. **Maturity**: Maturity refers to the date on which the bond matures. It is the date on which the borrower agrees to repay the principal amount. Term-to-maturity refers to the number of years remaining for the bond to mature. It changes every day from the date of the issue to the maturity of the bond. It is also called the tenure or term of the bond.
2. **Coupon:** Coupon Rate refers to the periodic payment of interest made by the issuer of the bond to the lender of the bond. Coupons are declared either by stating the number (example: 8%) or with a benchmark rate (example: MIBOR+0.5%). It is usually represented as a percentage of the face value or the par value of the bond.
3. **Principal:** It is the amount which is borrowed. It is the face or the par value of the bond. The product of the coupon rate and principal is the coupon.

Future and Option Market:

Futures markets provide a central market place where buyers and sellers from all over the world can interact to determine prices. The second purpose is to transfer price risk. Futures give buyers and sellers of commodities the opportunity to establish prices for future delivery.

Buying and selling options are done on the options market, which trades contracts based on securities. Buying an option that allows you to buy shares at a later time is called a "call option," whereas buying an option that allows you to sell shares at a later time is called a "put option."

Futures and options are the major types of stock derivatives trading in a share market. These are contracts signed by two parties for trading a stock asset at a predetermined price on a later date. Such contracts try to hedge market risks involved in stock market trading by locking in the price beforehand.

Future and options in the share market are contracts which derive their price from an underlying asset (known as underlying), such as shares, stock market indices, commodities, ETFs, and more. Futures and options basics provide individuals to reduce future risk with their investment through pre-determined prices.

However, since a direction of price movements cannot be predicted, it can cause substantial profits or losses if a market prediction is inaccurate. Typically, individuals well versed with the operations of a stock market primarily participate in such trades.

Features:

- ✓ Options and futures are similar trading products that provide investors with the chance to make money and hedge current investments.

- ✓ An option gives the buyer the right, but not the obligation, to buy (or sell) an asset at a specific price at any time during the life of the contract.
- ✓ A futures contract gives the buyer the obligation to purchase a specific asset, and the seller to sell and deliver that asset at a specific future date unless the holder's position is closed prior to expiration.

SEBI – Securities and Exchange Board of India

SEBI is a statutory regulatory body established on the 12th of April, 1992. It monitors and regulates the Indian capital and securities market while ensuring to protect the interests of the investors, formulating regulations and guidelines. The head office of SEBI is at Bandra Kurla Complex, Mumbai.

- ❖ The chairman of SEBI is nominated by the Union Government of India.
- ❖ Two officers from the Union Finance Ministry will be a part of this structure.
- ❖ One member will be appointed from the Reserve Bank of India.
- ❖ Five other members will be nominated by the Union Government of India.

Functions of SEBI

- ❖ SEBI is primarily set up to protect the interests of investors in the securities market.
- ❖ It promotes the development of the securities market and regulates the business.
- ❖ SEBI provides a platform for stockbrokers, sub-brokers, portfolio managers, investment advisers, share transfer agents, bankers, merchant bankers, trustees of trust deeds, registrars, underwriters, and other associated people to register and regulate work.
- ❖ It regulates the operations of depositories, participants, custodians of securities, foreign portfolio investors, and credit rating agencies.

- It prohibits insider trading, i.e. fraudulent and unfair trade practices related to the securities market.
- It ensures that investors are educated on the intermediaries of securities markets.
- It monitors substantial acquisitions of shares and take-over of companies.
- SEBI takes care of research and development to ensure the securities market is efficient at all times.

Regulations by SEBI

- A sponsor of a mutual fund, an associate or a group company, which includes the asset management company of a fund, through the schemes of the mutual fund in any form cannot hold: (a)10% or more of the shareholding and voting rights in the asset management company or any other mutual fund. (b) An asset management company cannot have representation on a board of any other mutual fund.
- A shareholder cannot hold 10% or more of the shareholding directly or indirectly in the asset management company of a mutual fund.
- No single stock can have more than 35% weight in the index for a sectoral or thematic index; the cap is 25% for other indices.
- The cumulative weight of the top three constituents of the index cannot exceed 65%.
- An individual constituent of the index should have a trading frequency of a minimum of 80%.
- AMCs must evaluate and ensure compliance to the norms at the end of every calendar quarter. The constituents of the indices must be made public by publishing them on their website.
- New funds must submit their compliance status to SEBI before being launched.

- All liquid schemes must hold a minimum of 20% in liquid assets such as government securities (G-Secs), repo on G-Secs, cash, and treasury bills.
- A debt mutual fund can invest up to only 20% of its assets in one sector; previously the cap was 25%. The additional exposure to housing finance companies (HFCs) is updated to 15% from 10% and a 5% exposure on securitised debt based on retail housing loan and affordable housing loan portfolios.
- As per SEBI's recommendation, amortisation is not the only method for evaluating debt and money market instruments. The mark-to-market methodology is also used.
- An exit penalty will be levied on investors of liquid schemes who exit the scheme within a period of seven days.
- Mutual funds schemes must invest only in the listed non-convertible debentures (NCD). Any fresh investment in commercial papers (CPs) and equity shares are allowed in listed securities as per the guidelines issued by the regulator.
- Liquid and overnight schemes are no longer allowed to invest in short-term deposits, debt, and money market instruments that have structured obligations or credit enhancements.
- When investing in debt securities having credit enhancements, a minimum of four times security cover is mandatory for investing in mutual funds schemes. A prudential limit of 10% is prescribed on total investment by such schemes in debt and money market instruments.

Role of SEBI

1. **Protecting the interest of investors**
   - SEBI ensures that the investors do not get befooled by misleading and false advertisements. In return, SEBI issued guidelines so as to protect investors and also ensured that the advertisement is fair and concise.
   - Regulation of price rigging: Price rigging refers to manipulation of prices by way of fluctuating the prices with the object of inflating and depressing the market price of securities.
   - SEBI make efforts to educate investors so that they are able to make choices between the offerings of different companies and choose the most profitable securities.
   - SEBI has issued guidelines to investigate cases of fraud and insider trading. Adding to this the provisions for fine and Imprisonment.
2. To ensure Development activities in Stock Exchange
   - E-Trading: Concept of E-trading have been introduced few years back by SEBI to eliminate the discomfort. It simplifies the process of buying and selling of securities.
   - The initial public offering of Primary Market (which is a part of Capital market) permits through stock exchange.
   - SEBI promotes training of intermediaries of securities market with the object of smooth functioning.

3. Regulate the business of stock exchange and activities of stock exchange
    - SEBI introduced proper Code Of Conduct applicable to everyone who is a part of the process of buying and selling of securities, stock exchange, etc. Following are the areas of concern:
    - Rules and Regulations to regulate intermediaries such as Broker, underwriters, etc.
    - Registers and Regulates the working of merchant Bankers, sub-brokers, stock-brokers, share transfer agent, trustees, etc.
    - Registers the working of mutual Funds.
    - SEBI regulates turnover of the companies.
    - It also conducts inquiry and audits.

Stock Market Index:

Stock Market Indices give an insight into the overall trends of the capital markets and sentiment of the investors towards a particular stock or set of stocks in an industry**.**

Stock Indices:

A stock market index is a statistical measure which shows changes taking place in the stock market. To create an index, a few similar kinds of stocks are chosen from amongst the securities already listed on the exchange and grouped together.

The criteria of stock selection could be the type of industry, market capitalization or the size of the company. The value of the stock market index is computed using values of the underlying stocks. Any change taking place in the underlying stock prices impact the overall value of the index. If the prices of most of the underlying securities rise, then the index will rise and vice-versa.

Importance of stock market index:

Aids in Stock-Picking

In a share market, you would thousands of companies listed on the exchange. Broadly, picking the appropriate stock for investment may seem like a nightmare. Without a benchmark, you may not be able to differentiate between the stocks. Simultaneously sorting the stocks becomes a challenge. In this situation, a stock market acts like an instant differentiator. It classifies the companies and their shares based on key characteristics like the size of company, sector, industry type and so on.

Acts as a Representative

Investing in equities involves risk and you need to take an informed decision. Studying about stocks individually may seem very impractical. Indices help to fill the knowledge gaps that exist among the investors. They represent the trend of the whole market or a certain sector of the market. In India, the NSE Nifty the BSE Sensex act as the benchmark indices. They are believed to indicate the performance of the entire stock market. In the same manner, an index which is made up of pharma stocks is assumed to portray the average price of stocks of companies operating in the pharmaceutical industry.

The Parameter for Peer Comparison

Before including a stock in your portfolio, you have to assess whether it’s worth the money. By comparing with the underlying index, you can easily judge the performance of a stock. If the stock gives higher returns than the index, it’s said to have outperformed the index. If it gives lower returns than the index, it’s said to have underperformed the index.

Reflects Investor Sentiment

Participating in equity markets, amongst other things, knowing investor sentiment becomes an important aspect. It is because the sentiment affects the demand for a stock which in turn impacts the overall price. In order to invest in the right stock, you should know the reason behind the rise/fall in its prices. At this juncture, indices help to gauge the mood of investors. You may even recognize investor sentiment for a particular sector and across market capitalizations.

Helps in Passive Investment

Passive investment refers to investing in a portfolio of securities which replicates the stocks of an index. Investors who want to cut down on the cost of research and stock selection prefer to invest in index portfolio. Consequently, the returns of the portfolio will resemble that of the index. If an investor’s portfolio resembles the Sensex, then his portfolio is going to deliver returns of around 8% when the Sensex earns 8% returns.

NATIONAL STOCK EXCHANGE

The National Stock Exchange of India Limited is the country’s leading financial exchange, with headquarters in Mumbai. It was incorporated in 1992 and, since then, has evolved into an advanced, automated, electronic system offering trading facilities to investor across the country. In 2015, this exchange system ranked in the fourth place in the world according to the metric of its trading volume.

This stock exchange began its operations in 1994 at the behest of the Indian government to bring a level of transparency to the country's capital market. Set up by an assembly of leading financial institutions and at the recommendations formulated by Pherwani Committee, this stock exchange comprised of diverse shareholding assets from both global and domestic investors.

It was also the first stock exchange in the country to introduce electronic trading facilities, thus facilitating the integration of investors throughout the country into a single base.

As of 2018, NSE had a total market capitalisation exceeding the US $2.25 Trillion, putting it in 11th place in the list of the largest stock exchanges in the world.

HOW DOES NSE STOCK EXCHANGE WORK?

Trading through this stock exchange in India is carried out through an electronic limit order book where order matching takes place through a trading computer. This entire process does not have the interference of specialists or market makers and is driven entirely by orders; meaning that when investors place a market order, it is automatically matched with a limit order. Thus, in this market, sellers and buyers have the advantage of remaining anonymous.

Additionally, an order-driven market also offers more transparency to investors by displaying every buy and sell order in the trading system. These orders in NSE are placed via brokers who often provide the facility of online trading to customers. Few institutional investors can also avail this facility of "direct market access" where they can place their orders directly into the trading system.

NSE market trading on equities segment is carried on throughout the week, except on Saturdays, Sundays and other holidays declared by the stock exchange. The market timing is as follows –

Pre-opening session –

Order entry opens at 9.00 hours

Order entry closes at 9.08 hours

Regular session –

Market opens at 9.15 hours

Market closes at 15.30 hours

Benefits of Listing with National Stock Exchange of India –

NSE OFFERS SEVERAL BENEFITS OF LISTING WITH IT. SOME OF THEM ARE AS FOLLOWS

Comprehensive visibility

This trading system is efficient in providing various trade and post-trade information. Investors can easily look up the top buy and sell orders on the trading system, along with the total number of securities available for a transaction. It helps investors to gauge the market's depth easily.

Makes for a premier marketplace

The volume of trading activity in this stock exchange helps to lower the impact cost on it, which decreases the expenses of trading for investors. Additionally, the exchange's automated trading system helps to maintain transparency and consistency with an investor.

Biggest exchange in the country

In terms of trading volume, the NSE National Stock Exchange is the country's largest exchange with its market capitalisation exceeding $2.25 Trillion.

Fast transactions

The pace at which orders are processed in this Exchange helps investors to avail the best prices. For instance, on May 19th 2009, the stock exchange recorded 11,260,392 trades, which was its highest number in a day.

Trade statistics

Listed companies can avail the provision of receiving trade statistics each month, to help track the performance of companies listed on the exchange.

Thus, with the above benefits, NSE National Stock Exchange makes for a favorable facility to conduct market transactions.

Investment Segments

NSE offers investment and trading in the segments mentioned below –

Equity

This comprises of a volatile class of assets which helps investors to maximise the returns from investments. Equity investment consists of several types of assets, namely, Mutual Funds, equities, indices, Exchange Traded Funds, Security Lending and Borrowing Scheme, Initial Public Offerings, etc.

Equity Derivatives

Derivatives traded under this stock exchange includes Global indices like Dow Jones, CNX 500, etc., commodity derivatives, currency derivatives, interest rate futures, etc. The NSE market started derivative trading in 2002 with the launch of index futures. In 2011, it also launched derivative contracts on the world’s most-followed index – Dow Jones Industrial Average and S%P 500.

Thus, this exchange has made remarkable headway in the trade market as far as equity derivatives are concerned.

Debt

This type of investment pool consists of various Mutual Funds, Exchange Traded Funds, etc. where the core asset holdings comprise of different long and short term bonds, corporate bonds, securitised products, etc.

NSE Stock Exchange launched the country’s first debt platform on 13th May 2013 to provide investors with a transparent and liquid trading platform for all debt-associated products.

Major Indices in this Exchange System

A stock market’s index is created by choosing a collection of stocks that represent the whole market, or a specific segment of it. Following are some of the most important broad market indices, consisting of the liquid stocks that are listed on this stock exchange –

- Nifty 50 index
- Nifty 100 index
- Nifty Next 50 index

- Nifty Midcap 50 index
- Nifty Smallcap 250 index
- India Vix index