

INVESTMENT MANAGEMENT

Theory & Practice

Dr. R.P. Rustagi



Sultan Chand & Sons

Investment Management

THEORY AND PRACTICE

Dedicated to the
ALMIGHTY
who bestowed on me
the inspiration and strength
to take up this work
and to share my experience
with the readers

Investment Management

THEORY AND PRACTICE

*For B.Com. (H.), IV-Semester (UGCF 2022)
University of Delhi and other Courses in Finance*

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Twelfth Edition



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Preface

To the Twelfth Edition

The motivation for the Twelveth Edition of ‘Investment Management’ has been provided by the enthusiastic response of the readers and reviewers to the earlier editions which, together with reprints, were sold out within a few months of the Publication. The book has been presented as an introductory level text on the theory and practice of investment. It has been accepted by the students of finance preparing for a paper on investment management, particularly the B.Com. (H.) VIth Semester (CBCS) University of Delhi. The present Edition also confirms with the syllabus of B.Com. (H.), IVth Semester, UGCF-2022 based on National Education Policy (NEP) 2020.

The highlight of the Twelfth Edition is the presentation of ‘Concept Checks’ in the form of ‘Test-Yourself’ at various places in different chapters. This will give an opportunity to the students to apply the concepts which they have read so far. Additional working notes and explanations have been provided at various places through out the book. Comments and suggestions received from students as well as teachers have been duly incorporated. In an attempt to keep intact the basic structure of the book, the chapter plan has not been changed. Nevertheless, sufficient material has been added in Chapter 6, ‘Fundamental and Technical Analysis’ with a view to provide more insight into technical analysis. Several numerical illustrations have been added in different Chapters at appropriate places.

In view of the requirements of syllabus, investment decision making through EXCEL has been introduced in the Appendix-I. I am indebted to Sh. H.N. Tiwari, Asstt. Professor, Shri Ram College of Commerce for immensely helping in preparation of Appendix I “Investment Decision Making with Excel”.

I am thankful to the students and faculty for the well acceptance of the book. Comments and suggestions about this new edition would be gratefully acknowledged. In am also thankful to the publishers for their cooperation in bringing this Twelfth Edition in time.

Dr. R.P. RUSTAGI

To the First Edition

Investment Management and Environment is becoming more and more complex over the years. Types of instruments and financial products, types and number of financial intermediaries and the overall investment process, all have seen a revolution. Financial engineering, Investors' Protection and Transparency have been the buzz words. On-line trading systems in the financial markets, holding and transfer of securities in the electronic mode, significant presence of mutual funds, more active role assumed by the regulatory authorities are some of the features of present day investment environment. More and more linkages and interdependence of different financial systems are giving way to global financial markets and systems.

The subject matter of the present text, **Investment Management** is to explain the investment decision making and investment process. It focuses on the investment analysis. In an effort to link the theory and practice, the entire investment process has been discussed in the context of Indian Financial System. Frequent references to the regulatory mechanism of Securities and Exchange Board of India (SEBI) and the practices prevailing in the Indian Capital Market, have been the focal point of the discussion. It presents the concepts, theories, techniques and practices of investment management in simple, lucid and easy to understand language.

Gradually, several specialized areas have branched out from the financial management, including Investment Management, Portfolio Management, Management of Derivatives, *etc.* The present text deals with the investment in general and limited coverage of the portfolio management and derivatives. The unifying philosophy of the book has been to present the investment decision process in terms of the risk-return perspective of the investor.

Investment management, as an academic discipline, is constantly changing and stimulating. There is always a quest to discuss the subject matter with reference to the practices prevailing. The book has emerged out of the experience of teaching financial management and investment management and other related subjects to a wide variety of students including that of professional courses. The motivation for the book has been provided by the interaction and responses in the classroom.

The book has been designed as a first book on Investment management. The subject matter has been presented in 11 Chapters grouped in 5 Parts each dealing with a particular area.

The book is meant for the students preparing for a course in investment management and other related subjects at the under-graduate/post-graduate level, or for management courses such as MBA, PGDBM, CFA, *etc.*

Finally, I will like to acknowledge the contributions made to the literature by authors and researchers, and my teachers who have helped me a lot in understanding various issues and concepts in finance and related areas. I am thankful to my students who have provided the initiative and stimulus for writing this work. I also feel obliged to all my colleagues and teachers at different management institutes for their suggestions. Messers Sultan Chand and Sons, the Publishers, deserve a deep sense of gratitude to bring out the book well in time and in an elegant style.

Discussion in the present text is purely academic and neither attempt nor tantamount to expertise/professional service to the readers on the subject. Sufficient care has been taken to ensure the correctness of formulae, equations and calculations. Still, there might be some unintended errors. Further comments and suggestions for improving the quality of the book are welcome and will be gratefully acknowledged.

Dr. R.P. RUSTAGI

Syllabus

B.Com. (H.), UGCF-2022

based on NEP-2020

Investment Management

Unit 1: Introduction to Investment

Concept of Investment, Investment Decision Process; Avenues for investment – Features and Classes; Difference between Investment, Speculation, and Gambling; Primary Market – IPO, Secondary Markets – Trading of Securities; Security Market Indices; Return and Risk: Concept, Calculation, Trade-off between Risk and Return; Impact of Taxes and Inflation on Investments.

Unit 2: Bond Analysis and Valuation

Bond Fundamentals; Estimating Bond Yields; Bond Valuation and Malkiel Theorems; Bond Risks and Credit Rating; Present Scenario of Indian Debt Market.

Unit 3: Equity Analysis and Valuation

Fundamental Analysis; Technical Analysis and Efficient Market Hypothesis; Valuation of Equity Shares using Dividend Discount Model and P/E Ratio Model.

Unit 4: Portfolio Management

Portfolio Management – Concept and Need, Measurement of Portfolio Return and Risk; Diversification – Markowitz Theory; Capital Asset Pricing Model.

Unit 5: Mutual Fund and Derivatives

Mutual Fund – Concept and Types; Performance Evaluation; Overview of Financial Derivatives – Forwards, Futures and Options.

Brief Contents

S. No.	Chapters	Pages	Objective Type Questions	Self-Review Assignments	Examples	Graded Illustrations	Problems	Concept Check – Test Your-self	Tables	Figures
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	1. Understanding Investment	3–18	12	20	–	–	–	2	3	2
	2. Financial Markets, Participants and Instruments	19–30	13	13	–	–	–	–	–	1
	Part II: Risk-Return Relationship and Portfolio Management									
	3. Risk and Return	33–60	14	11	4	13	10	1	1	1
	4. Portfolio Selection and Management	61–116	17	19	6	37	9	4	–	6
	Part III: Securities Analysis and Valuation									
	5. Fixed Income Securities : Yield and Valuation	119–168	19	22	8	20	11	4	–	4
	6. Equity Shares – Fundamental and Technical Analysis	169–204	23	22	2	–	–	2	–	13
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	Part IV: Mutual Funds and Financial Derivatives									
	8. Mutual Funds	243–268	15	16	1	7	–	3	–	2
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	Part V: Indian Capital Market									
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Abbreviations and Notations

b	Retention Ratio (1 – DP ratio)	GP	Gross Profit
B_0	Bond Value at present	HM Model	Harry Markowitz Model
β	Beta factor (CAPM)	HPR	Holding Period Return
BSE	Mumbai Stock Exchange	I or Int.	Interest
BV	Book Value (Also Balance Sheet Value)	I_{RF}	Risk-Free Rate of Interest
C_0	Cost at Present (Initial Cost)	IRR	Internal Rate of Interest
CA	Current Assets	k	Rate of Discount/Required Rate of Return
CAPM	Capital Assets Pricing Model	k_d	Cost of Debt
CF	Cash Flows	k_e	Cost of Equity Capital
CML	Capital Market Line	k_o	Overall Cost of Capital (also WACC)
COV.	Co-Variance		
CRISIL	Credit Rating Information Services India Ltd.	k_p	Cost of Preference Share Capital
CVAF	Cumulative Value Annuity Factor	k_r	Cost of Retained Earnings
CVF	Cumulative Value Factor	K	Strike Price (in Derivatives)
CV	Coefficient of Variation	MCX	Multi Commodity Exchange
D	Debt	MP	Market Price
D^*	Modified Duration of a Bond	n, N	Number of Years
Div.	Dividend on Equity Shares	NAV	Net Assets Value
D_0	Dividend for Current Year	NEAT	National Stock Exchange Automated Trading
D_1	Dividend Receivable after One Year	NP	Net Profit (also PAT)
DDB	Deep Discount Bonds	NPV	Net Present Value
DDM	Dividend Discount Model	NSE	National Stock Exchange
DP Ratio	Dividend Payout Ratio	NW	Net Worth
DPS	Dividend Per Share	OC	Operating Cycle
e	Base of Natural Logarithms	OI	Open Interest (in Derivatives)
E	Equity or Value of Equity	P_0	Current Market Price of Share
EBIT	Earnings Before Interest & Taxes (also NOP)	P_1	Market Price after 1 year
EPS	Earnings Per Share	P_n	Market Price after n years
ETF	Exchange Traded Fund	PD	Preference Dividend
F	Futures Value	PE Ratio	Price Earnings Ratio
FV	Future Value	PV	Present Value
g	Growth Rate	PVAF	Present Value Annuity Factor
		PVF	Present Value Factor
		ρ	Correlation Coefficient

\bar{r}	Expected Rate of Return	SIP
R_M	Rate of Return on Market Portfolio	STP
R_S	Required Rate of Return of a Security	SWP
RV	Redemption Value	t
σ	Standard Deviation	TR
σ^2	Variance	W, w
σ_p	Standard Deviation of Portfolio	WACC
SENSEX	Sensitivity Index of BSE	YTC
		YTM
		ZIFCD

Systematic Investment Plan
Systematic Transfer Plan
Systematic Withdrawal Plan
Tax Rate
Total Return
Weight
Weighted Average Cost of Capital, k_0
Yield to Call
Yield To Maturity
Zero Interest Fully Convertible Debenture

About the Book

'Investment Management' has been written to meet the need of the students taking B.Com. (H.) and other Undergraduate Courses in Finance in the light of NEP 2020. The scope of investment decision-making has substantially widened with new concepts appearing on the horizon. Appropriately, the syllabi of different courses have been modified and updated. Consistent with the objective, this book presents analytical framework of the related subject matter in the light of SEBI Rules, Regulations and Guidelines. Numerical examples and illustrations have been used extensively to explain the applications of different concepts.

Salient Features

- Comprehensive and systematic coverage and analytical presentation of the subject matter.
- Reader-friendly and frequent references to Indian environment to enhance the understanding of the subject.
- Detailed exposition of Stock Exchange operations and latest developments and emerging trends in Indian capital market given in a capsulated form.
- Frequent references to SEBI Guidelines, Rules and Regulations.
- 'Chapter Theme' and 'Chapter Plan' given in the beginning of each chapter to present the bird's eye view of the contents of the chapter.
- More than 90 examples, nearly 250 solved illustrations, more than 280 assignments and around 120 problems given at the appropriate places.
- Important points, concepts and definitions given in the Side Boxes.
- Extensive use of charts, graphs and diagrams.
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