

INVESTMENT MANAGEMENT

Theory & Practice

Dr. R.P. Rustagi



Invest



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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

<i>S. No.</i>	<i>Chapters</i>	<i>Pages</i>	<i>Objective Type Questions</i>	<i>Self-Review Assignments</i>	<i>Examples</i>	<i>Graded Illustrations</i>	<i>Problems</i>	<i>Concept Check – Test Your-self</i>	<i>Tables</i>	<i>Figures</i>
Part I: Investment Environment										
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
7.	Valuation of Equity Shares	205–240	14	16	4	23	10	2	2	1
Part IV: Mutual Funds and Financial Derivatives										
8.	Mutual Funds	243–268	15	16	1	7	–	3	–	2
9.	Financial Derivatives	269–306	22	15	4	22	9	3	–	6
Part V: Indian Capital Market										
10.	Indian Capital Market : Structure and Emerging Trends	309–348	20	18	–	–	–	–	1	3
11.	Investors' Protection, Unfair Trade Practices and Insider Trading	349–362	15	13	–	–	–	–	–	–
Appendices										
Appendix I		365–380								
	Investment Decision Making with EXCEL	365								
Appendix II		381–412								
	Solved Question Papers of <i>Fundamentals of Investment</i> [B.Com. (H.), D.U.] for the years 2018, 2019, 2020, 2021 and 2022	381								
Appendix III		413–430								
	Glossary	413								
Appendix IV		431–436								
	Present Value of Future Amount <i>i.e.</i> , $PVF_{(r, n)}$	431								
	Present Value of an Annuity <i>i.e.</i> , $PVAF_{(r, n)}$	434								

Contents

Part I : Investment Environment

1. Understanding Investment	3–18
Investment	4
Investment and Speculation	5
Real Assets and Financial Assets	6
Factors of Sound Investment	7
Liquidity	8
Risk of an Investment	8
Capital Appreciation	9
Tax Aspects of Investments	9
Investment Horizon	9
Relevance of Investment Analysis	9
Investment Decision Process	10
Asset Allocation Decision	10
Security Analysis.....	10
Return	11
Expected Return	11
Realised Returns	11
Required Return.....	11
Risk.....	11
Risk-Return Trade-off	12
Direct and Indirect Investing	14
Direct Investing	14
Indirect Investing.....	14
Manoeuvring with Investments	15
Hedging.....	15
Arbitrage.....	16
Diversification	16
Points to Remember	16
Objective Type Questions	17
Self-Review Assignments	17
2. Financial Markets, Participants and Instruments	19–30
Financial System	20
Functions of Financial System	20
Components of Financial System	22
Financial Markets	22
Types and Classification of Financial Markets	22
Players and Participants in Financial Markets	24
Financial Instruments	26
Ownership Securities	26
Debt Securities	26

Mutual Fund Units	26
Money Market Instruments	26
Financial Engineering and Financial Instruments.....	27
Financial Engineering and Derivatives.....	28
Points to Remember	28
Objective Type Questions.....	28
Self-Review Assignments	29

Part II : Risk-Return Relationship and Portfolio Management

3. Risk and Return	33-60
Concept of Return and Risk	34
Return	34
Expected Value of Return	36
Risk.....	37
Sources of Risk.....	38
Market Risk	38
Interest-Rate Risk	38
Purchasing Power or Inflation Risk	39
Business Risk	39
Financial Risk	39
Types of Risk.....	39
Systematic Risk	40
Unsystematic Risk	40
Measurement of Risk	42
Range as a Measure of Risk	42
Standard Deviation as a Measure of Risk	42
Coefficient of Variation as a Measure of Risk	45
β as a measure of Risk	46
Taxes and Investment Strategy	46
After-tax Rate of Return	46
Taxable Equivalent Yield	46
Inflation and Investment Strategy.....	47
Points to Remember	47
Graded Illustrations	48
Objective Type Questions	57
Self-Review Assignments	58
Problems.....	58
4. Portfolio Selection and Management	61-116
Portfolio Management	62
Security Analysis.....	62
Analysis and Selection of Portfolio.....	63
Revision of Portfolio	63
Evaluation of Portfolio	63
Return and Risk in the Context of Portfolio	63
Return of Two-Security Portfolio	64
Risk of Two-Security Portfolio	65
Correlation Coefficient and Risk of a Portfolio	67
Uncorrelated Returns	68
Zero-Risk Portfolio of Perfectly Negatively Correlated Securities.....	68
Portfolio Selection	70
Portfolio Theory : The Harry Markowitz Model	71
Setting the Risk-Return Opportunity Set	71

Determining the Efficient Set	72
Selecting the Optimal Portfolio	72
Capital Market Line (CML)	74
Limitations of the HM Model	77
Capital Market Theory : CAPM	77
Systematic or Market Risk	77
Unsystematic Risk	78
Systematic Risk and β Factor	78
Capital Assets Pricing Model	80
Assumptions of CAPM	80
The Model	81
Security Market Line	83
Limitations of CAPM	84
Portfolio Evaluation	85
Measures of Portfolio Performance	85
Return Per Unit of Risk	85
Jensen's Alpha	86
Points to Remember	87
Graded Illustrations	88
Objective Type Questions	113
Self-Review Assignments	113
Problems	114

Part III : Securities Analysis and Valuation

5. Fixed Income Securities : Yield and Valuation	119-168
Fixed Income Securities	120
Bonds and Debentures	120
Features of Debt Instruments	120
Types of Debt Instruments	121
Regulation of Bonds in India	124
Bond Indenture	124
Bond Yield	125
Types of Yield	125
Current Yield or Basic Yield	126
Weighted Yield	126
Annualised Equivalent Return	126
Yield to Maturity (YTM)	127
Approximate YTM	129
YTM of Zero-Coupon Bond	130
Yield to Call	131
Holding Period Return	132
Valuation Principle	133
Required Rate of Return	135
Basic Model of Valuation	135
Bond Pricing and Valuation	136
Valuation of Convertible Debentures	139
Valuation of Compulsorily Convertible Debentures (CCD)	139
Valuation of Optionally Convertible Debentures (OCD)	140
Valuation of Deep Discount Bonds (DDB)	140
Interaction Between Bond Value, Market Interest Rate and Coupon Rate	141
Bond Valuation and Required Rate of Return	141
Bond Valuation and Time to Maturity	143

Malkiel's Properties of Bond Values.....	144
Duration of a Bond	145
Valuation of Preference Shares	146
Assumptions	147
Redeemable Preference Shares	147
Irredeemable Preference Shares	147
Credit Rating	148
Credit Rating in India	149
Credit Rating Information Services of India Ltd. (CRISIL).....	149
Investment Information and Credit Rating Agency of India (ICRA)	149
Credit Analysis and Research Ltd. (CARE)	150
Fitch Ratings India Pvt. Ltd.....	150
Regulatory Framework	150
Process of Credit Rating	150
Importance of Credit Rating.....	151
Investors	151
Issuers	152
Intermediaries	152
Precautions of Credit Rating	152
Points to Remember	152
Graded Illustrations	153
Objective Type Questions.....	164
Self-Review Assignments	164
Problems.....	165
6. Equity Shares: Fundamental and Technical Analysis	169–204
Security Analysis	170
Approaches to Equity Analysis	171
Fundamental Analysis	171
Economic Analysis	173
Industry Analysis	174
Key Factors in Industry Analysis	175
Company Analysis	176
Sources of Information	176
Analysing Company's Earnings	177
Economic Value Added	181
Technical Analysis	181
Fundamental Analysis and Technical Analysis	182
Basic Tenets and Premises of Technical Analysis	183
Charting : The Basic Tool of Technical Analysis	184
Prices and Price Charts	184
Dow Theory.....	185
Elliott Wave Theory	186
Bar Chart.....	187
Line Chart	188
Point-and-Figure Chart	188
Candlestick Chart	189
Analysis of Price-Volume Charts	190
Pattern Analysis.....	190
Support and Resistance Levels	192
Principles of Analysis of Price Patterns.....	194
Indicator Analysis	195
Weaknesses and Shortcomings of Technical Analysis	197

Efficient Market Hypothesis	197
Weak Form of Market Efficiency	199
Semi-Strong Form of Market Efficiency	199
Strong Form of Market Efficiency	199
Points to Remember	200
Objective Type Questions	201
Self-Review Assignments	202
7. Valuation of Equity Shares	205–240
Valuation of Equity Shares	206
Assumptions	207
Valuation of Equity Shares based on Accounting Information	207
Book Value or Balance Sheet Value (BV)	207
Liquidation Value (LV)	208
Valuation of Equity Shares based on Dividends	208
Assumptions	208
Zero Growth in Dividends or Constant Dividends	210
Constant Growth in Dividends	211
Variable Growth in Dividends	213
Valuation of the Shares Currently Not Paying Dividends	215
Valuation Based on Finite Holding Period	216
valuation of Equity Shares under Specific Methods	216
The Gordon's Model	217
Walter's Model	219
Earnings Multiplier Approach or Price-Earnings Ratio (P/E Ratio)	220
Relative Valuation Methods	221
Price to Book Value Ratio	221
Price to Sales Ratio	221
Required Rate of Return, Risk and Equity Valuation	222
Aggressive and Defensive Stock	223
Points to Remember	223
Graded Illustrations	224
Objective Type Questions	238
Self-Review Assignments	238
Problems	239

Part IV : Mutual Funds and Financial Derivatives

8. Mutual Funds	243–268
Mutual Fund	244
Features and Characteristics of Mutual Fund	244
Mechanism of Mutual Fund Operations	245
Benefits of Mutual Funds	245
Mutual Fund Schemes	246
Open-ended and Close-ended Mutual Fund Schemes	247
Income Fund and Growth Fund	248
Domestic Funds and Off-shore Funds	248
Tax-Saving Schemes	248
Money Market Mutual Funds (MMMFs)	249
Specialised Sector Funds	249
Index Schemes	249
Equity Funds Schemes	249
Debt Funds Schemes	249
Balanced Funds	249

Gilt Funds	250
Schemes Based on Market Capitalisation	250
Fund of Funds	250
Load and No-load Funds	250
Exchange Traded Funds	251
Gold ETF	252
Systematic Investment Plan (SIP)	252
Systematic Withdrawal Plan (SWP)	253
Net Assets Value (NAV) and Corpus of a Mutual Fund	254
Costs and Loads in Mutual Fund Investments	255
Operating Expenses	255
Loads	255
Return from a Mutual Fund	256
Structure of a Mutual Fund	257
Mutual Funds in Indian Capital Market	257
Regulation of Mutual Funds in India	258
Conversion of Close-ended Scheme to Open-ended Scheme	261
Mutual Fund Investment and Investors' Protection in India	261
Points to Remember	262
Graded Illustrations	262
Objective Type Questions	266
Self-Review Assignments	266
9. Financial Derivatives	269–306
Derivatives	270
Characteristics of Derivatives	271
Types of Derivatives	271
Commodity Derivatives and Financial Derivatives	271
Basic Derivatives and Complex Derivatives	272
Exchange Traded and OTC Derivatives	272
Participants in Derivatives Market	273
Types of Financial Derivatives	273
Forwards	273
Futures	274
Differences between Forwards and Futures	275
Pricing of Futures	276
Options	278
Difference between Futures and Options	279
Types of Options	279
Working of an Option	280
Terminology of Options	281
Option Premium	281
Expiration Date	281
Strike Price	281
Options Positions	282
Profit and Payoff from Basic Option Positions	282
Buying a Call Option	282
Selling a Call Option	283
Buying a Put Option	284
Selling a Put Option	285
Break-even Positions of Option Parties	285
Pricing and Valuation of Option	286
Value of an Option	287
Intrinsic Value of an Option	287

Time Value of Option	288
Valuation Models	289
Derivatives Market in India	289
Points to Remember	291
Graded Illustrations	292
Objective Type Questions	303
Self-Review Assignments	304
Problems	304

Part V : Indian Capital Market

10. Indian Capital Market : Structure and Emerging Trends	309-348
Indian Capital Market : An Overview	310
Primary Market or New Issue Market	311
Secondary Market	312
Securities and Exchange Board of India	313
Capital Market Reforms by the SEBI	315
Primary Market Reforms	315
Secondary Market Reforms	315
Types of Issue of Securities in Indian Capital Market	316
Public Issue through Prospectus	316
Offer for Sale	317
Issue through Private Placement of Securities	317
Offer through Book-building Process	317
Public Offer through Stock Exchange On-line System	317
Structure and Trading System in Secondary Market	318
The Stock Exchange, Mumbai	318
National Stock Exchange	319
Market Segments of NSE	319
Over The Counter Exchange of India	320
Inter-connected Stock Exchange (ICSE) Ltd.	320
Listing of Securities at the Stock Exchanges	320
Trading Procedure at the Stock Exchanges	321
Salient Features of Trading System at NSE	321
Trading System and Investors	321
Participants in Indian Capital Market	322
Indices in the Indian Capital Markets	322
S&P Sensex : The Barometer of Indian Capital Market	323
Other Indices	323
Emerging Trends in Indian Capital Market	324
Depositories and Scripless Trading	325
Constituents of Depository System	325
The Working and Operations of Depository System	326
Benefits of Depository System to Investors	327
Benefits to the Issuing Companies	327
Costs to the Companies	328
Depository System in India	328
Other Aspects of Depository System	329
Book Building	329
Types of Book Building in India	329
Evaluation of Book Building Process	330
Buy-back of Shares	331
Companies Act, 2013 and Buy-back of Shares	331
SEBI Regulations and Buy-back of Shares	332

Stock Lending Scheme	333
Rolling Settlement	334
Green Shoe Option	335
Stabilisation Process (SP)	336
Merchant Banker	337
Lead Manager	338
Code of Conduct for the Merchant Bankers	339
Portfolio Manager	340
Merchant Banker and Portfolio Manager	341
Portfolio Manager and the Client	341
General Responsibilities of a Portfolio Manager	341
Code of Conduct for Portfolio Manager	342
Terms Commonly used in Capital Market	343
Points to Remember	346
Objective Type Questions	346
Self-Review Assignments	347
11. Investors' Protection, Unfair Trade Practices and Insider Trading	349–362
Investors' Protection	350
Investor Protection Fund/Consumer Protection Fund (IPF/CPF)	352
Investors' Grievances	352
Securities Ombudsman	353
Investors' Education	354
Rights of an Investor	355
Responsibilities of an Investor	355
Unfair Trade Practices	356
Insider trading	357
Insider	357
Price Sensitive Information	358
Dealing in Securities	358
Unpublished Information	358
Prohibition on Insider Trading	358
Investigation into Insider Trading	358
Disclosure of Interest	359
Model Code of Conduct for Listed Companies	359
Insider Trading and Corporate Disclosure Policy	360
Arbitration Facility at NSE	360
Points to Remember	360
Objective Type Questions	361
Self-Review Assignments	361

Appendices

Appendix I	365–380
Investment Decision Making with EXCEL	365
Appendix II	381–412
Solved Question Papers of 'Fundamentals of Investment' [B.Com. (H.), D.U.] for the years 2018, 2019, 2020, 2021 and 2022	381
Appendix III	413–430
Glossary	413
Appendix IV	431–436
Present Value of Future Amount <i>i.e.</i> , $PVF_{(r, n)}$	431
Present Value of Future Annuity <i>i.e.</i> , $PVAF_{(r, n)}$	434

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
		K	Strike Price (in Derivatives)
CVF	Cumulative Value Factor	MCX	Multi Commodity Exchange
CV	Coefficient of Variation	MP	Market Price
D	Debt	n, N	Number of Years
D^*	Modified Duration of a Bond	NAV	Net Assets Value
Div.	Dividend on Equity Shares	NEAT	National Stock Exchange Automated Trading
D_0	Dividend for Current Year		
D_1	Dividend Receivable after One Year	NP	Net Profit (also PAT)
		NPV	Net Present Value
DDB	Deep Discount Bonds	NSE	National Stock Exchange
DDM	Dividend Discount Model	NW	Net Worth
DP Ratio	Dividend Payout Ratio	OC	Operating Cycle
DPS	Dividend Per Share	OI	Open Interest (in Derivatives)
e	Base of Natural Logarithms	P_0	Current Market Price of Share
E	Equity or Value of Equity	P_1	Market Price after 1 year
EBIT	Earnings Before Interest & Taxes (also NOP)	P_n	Market Price after n years
		PD	Preference Dividend
EPS	Earnings Per Share	PE Ratio	Price Earnings Ratio
ETF	Exchange Traded Fund	PV	Present Value
F	Futures Value	PVAF	Present Value Annuity Factor
FV	Future Value	PVF	Present Value Factor
g	Growth Rate	ρ	Correlation Coefficient

xviii

\bar{r}	Expected Rate of Return	SIP	Systematic Investment Plan
R_M	Rate of Return on Market Portfolio	STP	Systematic Transfer Plan
R_S	Required Rate of Return of a Security	SWP	Systematic Withdrawal Plan
RV	Redemption Value	t	Tax Rate
σ	Standard Deviation	TR	Total Return
σ^2	Variance	W, w	Weight
σ_p	Standard Deviation of Portfolio	WACC	Weighted Average Cost of Capital, k_0
SENSEX	Sensitivity Index of BSE	YTC	Yield to Call
		YTM	Yield To Maturity
		ZIFCD	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.
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Dr. R.P. Rustagi retired as Associate Professor from Shri Ram College of Commerce, University of Delhi. He is M.Com. and M.Phil. from Delhi School of Economics, University of Delhi and a Fellow Member of the Institute of Company Secretaries of India, New Delhi. He obtained Doctorate from Jiwaji University, Gwalior. He taught Accounting and Finance at Shri Ram College of Commerce for more than 40 Years. He is also associated with Post-graduate teaching in University of Delhi. He is visiting faculty in Executive Development Programmes in Finance arranged by the ICAI, ICSI and other Management Institutes. He is an established author in Accounting and Financial Management.



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