CHAPTER 3

CONCEPTUAL FRAMEWORK

CONCEPTUAL FRAMEWORK ON PORTFOLIO MANAGEMENT, TECHNIQUES AND STRATEGIES

3.1 INTRODUCTION

Decision making is a very challenging and complicated task. Any decision needs little spadework to be done and a procedure to be followed. Once a platform is formed for taking decision then a proper approach or policy is needed to reach to a conclusion. Portfolio management is one such area where a procedure or method is to be followed to make an investment decision and after the decision is made, a method is followed to materialize the decision. The procedure followed to make investment decision is known as the techniques of portfolio management which includes specification of investment objectives & constraints, Choice of the asset mix, Formulation of portfolio strategy, Selection of securities, Portfolio Execution, Portfolio Revision and Performance Evaluation. Once the technique is adopted, the investment is made based on plan called as the investment strategy. This investment strategy can either be ACTIVE MANAGEMENT STRATEGY (Aggressive investment strategy) or PASSIVE INVESTMENT STRATEGY (Defensive management strategy)
To be a successful investor two main things are needed - the knowledge and the right trading platform. Investing can be an emotional process unless one understands what to investing in, what is to be accomplished and understand a few basic facts and statistics, because investors often get into the market too late and get out too early. Most investors look favorably upon stocks rising in price and reject those falling. The conventional model of thinking that self made decisions are always rational causes to overlook quality companies with prices that have fallen because of events or perceptions that are transitory in nature. Investor behaviour is characterized by overexcitement and overreaction in both rising and falling markets. The average investor has the tendency to purchase or increase their holdings in investments that perform the best in the short term. At the same time, these same investors tend to sell or reduce their holdings in investments that have performed poorly, again, in the short term. As a result, just prior to a market correction, the average investor will hold a portfolio that is heavily weighted in asset classes that have demonstrated the best short-term performance. Since a large proportion of funds have been added to these investments after most of the growth has occurred, this strategy leads to a dramatic decline in their portfolio when the market corrects.

During a stock market correction, investors tend to panic, believing that they will lose all or most of their money, and so the most common reaction is to sell to "cut their losses". This behaviour drags the market down further than fundamentals suggest – it is a self-fulfilling prophecy.

Every individual has its own ways of analysing Markets. Investors often have a tendency to get hold a share. They don't sell it even if the prices have gone down steeply and hold on to the position despite of the fact that it is not moving in line with the markets when they are moving upwards. In such situations investors should shift this position in some other good stock
that have a potential to go in line with market. This process should not be
treated as loss booking, instead this is just shifting. If the investor makes the
right kind of decision he will make the right kind of profit. Being vigilant in
approach is the keyword to success. The road to success must be paved with
behaviour, attitude, opinions and rational thinking.

3.2 PORTFOLIO MANAGEMENT

Portfolios are combinations of securities, which may or may not
take on the aggregate characteristics of their individual parts. Risk in a
portfolio is defined a standard deviation around the expected return. More
dispersion or variability about a security’s expected return means that the
security was riskier than one with less dispersion. The effort to spread and
minimize risk is called diversification in portfolio.

Formation of efficient portfolio requires analysis of securities. A
security represents a claim on an asset and any future cash flows the asset
may generate. Security analysis involves the process of estimating the future
cash flows, which will accrue to the owners of a particular security and the
risk associated with the prospective cash flows. Security analysis focuses on
risk and returns. Since portfolios are combination of individual securities,
portfolio analysis depends on those the two decision elements, that is, risk and
return.¹

Individuals and organizations having different objectives and
constraints own portfolios. To determine appropriate goals and policies,
certain basic facts about the investor like age, health, responsibilities, income,
attitude toward risk and taxation status must be considered. On the basis of
the facts a suitable goal is established which means preparation of list of

¹ Russell J Fuller & James L Farrell Jr, Modern investment and security analysis, McGraw Hill Internal
Editions, Pg 5
securities to meet the needs of the investors. The goals of the investor could be growth or income or combination of both or it could be as much income as moderately safety of principal will allow etc.

The portfolio objectives will determine the investment strategy. The objectives may be achieved by:

a) Balancing fixed interest securities against equities
b) Balancing high dividend payments companies high earnings growth companies
c) Balancing transaction cost against capital gains from rapid switching
d) Balancing income tax payable against capital gains tax.

The investor should be conservative and act rationally when making investment decisions. One of the essential aspects of investment is to minimize risk. As risk and return are correlated it is better to trade off between risk and return, rather than undue risk for a strong possibility of gains and loss.

3.3 PORTFOLIO INVESTMENT PROCESS:

The basic principles of portfolio investment process are:

➢ It is the portfolio that matters

Individual securities are important only to the extent that they affect the aggregate portfolio. For example: A security risk should not be based on the uncertainty of a simple security’s return but instead on its contribution to the uncertainty of the total portfolio’s return.
Larger expected portfolio returns come only with larger portfolio risk

The most important decisions is the amount of risk which is acceptable, which is determined by the asset allocation within the security portfolio. This requires that the investors have some ideas of risks and expected returns available on many different classes of assets.

The risk associated with a security type depends on when the investment will be liquidated

A person who plans to sell his securities in one year will find equity returns to be more risky than a person who plans to sell in 10 years. Alternatively the person who plans to sell in 10 years will find one-year maturity bonds more risky than the person who plans to sell in one year. Selecting securities with a payoff close to when the portfolio is to be liquidated reduces risk.

Diversification works

One of the most important aspects of investment planning is diversification. Diversification means different. If you want to diversify your investments then it is important to ensure you are buying investments which are not correlated with each other. The investor should buy investments that are not concentrated into one company, industry, country or even class. Spreading your investments into different asset classes, industries, countries and even currencies will help guard against a major loss. The various ways to diversify the portfolio are:

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2 V K Bhalla, Investment management: Security analysis and portfolio management, S Chand & co. ltd, 8th edition, Pg 641 & 642
- **Asset classes** – stocks, bonds and cash are all generally not correlated with each other so owning some of each will help diversify your investment portfolio.

- **Industry** – If you own stocks either directly or in mutual funds then make sure there is adequate representation from different industries.

- **Country** – Most investors tend to own too much equity in their home country which reduces their diversification

A well diversified portfolio can reduce risk and volatility. To understand portfolio construction you must first understand the term risk. Risk is not only the chance of a capital loss but also the volatility of returns. For instance an investment over a 5 year period may produce a profit of 50% but a closer look at the figures may show that the investment made a loss over 3 of the 5 years. Diversification can reduce the volatility of a portfolio. Also by investing in different asset classes potential losses can be minimized

Diversification across various securities will reduce a portfolio risk. If such broad diversification results in an expected portfolio return or risk level, which is a lower (or higher) than desired, then borrowing or lending can be used to achieve the desired level.

- Each portfolio should be tailored to the particular need of its owner

People have varying tax rated, knowledge, transaction costs etc. Individuals who are in high tax brackets should stress portfolio strategies which increase after-tax returns. Portfolio strategy should be molded to the unique needs and characteristics of the portfolio’s owner.
Competition for abnormal returns is extensive

A large number of people are continuously using a large variety of techniques in an attempt to obtain abnormal returns — returns larger than the security’s risk. Securities, which are believed to be under valued, are bought until price rises to a proper level and securities, which are overvalued, are sold until the prices falls to a proper level. If the actions of these speculators are truly effective, security prices will adjust instantaneously to new information.

3.4 PORTFOLIO OBJECTIVES

There are four main portfolio objectives. They are stability of principal, income, growth, and capital appreciation.

- Stability of principal

Sometimes the beneficiary of a portfolio cannot stand any chance of loss to the original principal. The main reason for this might be because of the client’s attitude towards risk. The main emphasis here is on preserving the original value of the fund. This is the most conservative portfolio objective and in the long run it will generate modest returns. When stability of principal is the objective, the appropriate investment portfolio includes any of the money market instruments and bank certificates.

- Income

The income objective differs from stability of principal. There is no specific proscription against periodic declines in principal value. When income is the chosen objective, appropriate investments include corporate bonds, government bonds, government securities and preferred stock.

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3 Robert A strong, Portfolio management handbook, Jaico Pub House, Ed194, Pg 85-88
• **Growth of income**

A growth of income objective sacrifices some current return for some purchasing power protection. The growth of income objective differs from income objective in the sense that an income objective seeks to generate as much current income as possible within the risk parameters established. Initially this amount will be higher than that generated by a portfolio seeking growth of income whereas a growth of income objective requires the fund manager to seek some capital appreciation in the original principal. This means that some funds have to be invested in equity securities. The common stock purchased will generate some income from dividends whereas the bulk income will come from fixed income securities such as long-term bonds.

• **Capital appreciation**

Sometimes it is not necessary that a portfolio must generate income at all. For example: a retired couple might receive pension that is sufficient of finance their life style. If these people have an investment portfolio then they will be more interested in having it to grow in value rather than in getting additional income from it. Another reason could be tax consideration whereby interest or dividends received are immediately taxable whereas capital gains are not taxed until they are actually realized.

All these four objectives are the common portfolio objectives.

### 3.5 SELECTION OF PORTFOLIO:

The selection of portfolio depends on the various objectives of the investors. The selections of portfolio under different objective are:
• **Objectives and asset mix**

The proportion of investment in debt and equity differ according to the individual’s preferences. If the main objective is getting adequate amount of current income then money is invested in short term debt and fixed income securities. The growth of income becomes the secondary objective and stability of principal amount may become the third. To ensure adequate amount of fixed income the investor may prefer sixty percentage of investment in debts and forty percentages in equities.

• **Growth of income and asset mix**

The investor’s portfolio may consist of 60 to 100% equities and 0 to 40% debt instrument as the investor requires certain percentage of growth in the income received from his investment.\(^4\)

• **Capital appreciation and asset mix**

Capital appreciation means that the value of the original investment increases over the years. In the capital market, the value of shares is much higher than their original issue prices. The stock market provides best opportunity for capital appreciation. If the investor’s objective is capital appreciation then 90 to 100% of his portfolio may consist of equities.

• **Safety of principal and asset mix**

All the investors require their money invested in different assets to be safe. The risk adverse investors are very particular about the stability of principal. The degree of risk that an investor is willing to take differs from person to person. The investors for whom the safety of principal amount is

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primary objective, their portfolio will consist more of debt instrument and that more of short-term debts.

Risk and return analysis: Investment in portfolio is based on certain assumptions like the individual prefers larger to smaller returns from securities. To achieve this goal, the investor has to take more risk. The ability to achieve higher returns depends upon his ability to judge risk and his ability to take specific risks. The investor analysis the varying degrees of risk and constructs his portfolio. A policy statement is prepared which allows the investor to determine what factors are personally important for investor’s objectives (risk and return) and constraints. Having a policy statement allows the investor to communicate his needs to the advisor who can do a better job of constructing an investment strategy to satisfy the investor’s objectives. A policy statement does not indicate which specific securities to purchase, when they should be sold, rather it should provide guidelines as to the asset classes to include and relative proportions of the investor’s fund to invest in each class. While constructing an investment strategy the following points are considered:

a. What asset classes would be considered for investment?

b. What weight should be assigned to each eligible asset class?

c. What is the allowable allocation ranges based on policy weights?

d. What specific securities should be purchased for portfolio?

The asset allocation decision is based on all such factors. An asset allocation decision is the process of deciding how to distribute an investor’s wealth among different classes for investment purpose. An asset class is comprised of securities that have similar characteristics, attributes, and risk
return relationships. The asset allocation decision is not a isolated choice. It depends on the investor’s policy statement which includes the investor’s goal or objectives, constraints and investment guidelines.

3.6 INVESTMENT CONSTRAINTS

The selection of portfolio or investment in securities is subject to various constraints which include liquidity needs, an investment time horizon, tax factors, legal and regulatory constraints and unique needs and preferences.\(^5\)

- **Liquidity needs**

  An asset is liquid if it can be quickly converted into cash at a price close to fair market value. Investors may have liquidity needs that the investment plan must consider. For example: wealthy individuals with sizable tax obligations need adequate liquidity to pay their taxes without upsetting their investment plan.

- **Time horizon**

  There is a close relationship between an investor’s time horizon, liquidity needs and ability to handle risk. Investors with long investment horizon generally require less liquidity and can tolerate greater portfolio risk. Less liquidity because the funds are not usually needed for many years, greater risk tolerance because any shortfalls or losses can be overcome by returns earned in subsequent years. Investors with short time horizon generally favour more liquid and less risky investment because losses are harder to overcome during short time frame.

\(^5\) Frak K Kelly & Keith C Brown, Investment analysis & portfolio management, Sheroff Pub & Distributors Pvt Ltd, Mumbai, 7th edition, Pg 46
- **Tax concerns**

  Incomes like interest, dividend, rent are taxed when they are received whereas capital gains are taxed only when the assets are sold. The incidence of tax also influences the portfolio selection.

- **Legal and regulatory factors**

  Regulations constraints the investment choice available to a person in a fiduciary role. The fiduciary must make investment decisions in accordance with the owner’s wishes. All investors must respect some laws, such as insider trading prohibitions. Insider trading involves the purchase and sale of securities on the basis of important information that is not publicly known. The people possessing such private informations are generally the managers who have fiduciary duty to their shareholders. Security transactions made based on insider information for personal gains violate the fiduciary duty.

- **Unique needs and preferences**

  Some investors may want to exclude certain investment from their portfolio solely on the basis of personal preferences.

### 3.7 DETERMINANTS OF RATE OF RETURNS

The rate of return on securities determines the individual’s interest in investing in certain portfolio.

Investment means postponed consumption. In order to encourage an individual to invest (rather postpone consumption) a potential investment must offer a positive rate of return. This will result in the investor having greater future wealth and greater future consumption than the current...
consumption. For example, if a person invests Rs 100 @ 3%, his returns after one year would be Rs.103 at normal rate of return.

If suppose inflation is expected at 3% over the next year, then the investor will add the rate of inflation to the real rate of return which they require. Then the normal rate of return would be increased by 6%, that is, 3% real rate + 3% rate of inflation.6

Therefore nominal rate = stated market rate

Real rate = nominal rate – inflation rate

If risk is considered, then the additional rate of risk will be added to the normal rate of return. Thus three major factors that determine the return, which investors require in order to forgo current consumption, are:

a) time preference for consumption as measured by risk free real rate of return.

b) The expected rate of inflation

c) The risk associated with the investment

Therefore, required rate of return = Risk free real rate + expected inflation + risk premium.

The risk free real rate and inflation will affect the rate of return required on all the potential investments. The third factor, that is, the risk associated with an investment is unique to each investment opportunity.

3.8 TYPES OF INVESTMENT STRATEGIES

➢ Growth Investment Strategy

Growth investing strategy includes the search of stocks that have a potential for growth. The latter means that at a certain point in time the price of the stock will rise. As a result, growth investors target young companies that have the potential of exceeding its peers in the industry or sector. An example of such companies is the technology oriented ones that began their development during the 1990s. Now, most of these companies are prosperous leaders in the field. The investors that bet on the mere idea, which in their beginning was all that such companies were able to offer, now enjoy their profits. However, it is important to be able to spot those companies that are to succeed. You should also keep in mind that growth investing implies risk in its nature since some of the young companies may fail in their innovative activities.

➢ Income Investment Strategy

Income investors are characterized as the most conservative ones. The major goal of these investors is the acquisition of income. As a result they aim at companies that pay on regular basis dividends, which are of a stable and high nature. Additionally, these companies are large and well-established. People that are most often found in this category are those that are nearing their retirement. Even though this investing philosophy does involve a degree of risk, it is still qualified as one of the most conservative.

➢ Value Investment Strategy

The target stocks of value investment strategy are those that are undervalued by the market. This means that the price of the stock is lower than the real value of the company that has issued it. Such stocks have been
overlooked by the market in its chase after what is considered hot at the moment. In order to determine whether the stock is of a value type, most investors refer to its price to earnings ratio. If it is low, then the market is unwilling to pay more for the stock.

However, a value investor makes sure that there are no other reasons for the low price of the stock, such as an inner problem within the company. If there isn't such, then purchase the stock and hold it until the market recognizes its real value and corrects the price.

3.9 FORMULATION OF PORTFOLIO STRATEGY

- ACTIVE MANAGEMENT STRATEGY (Aggressive investment strategy)

Active management is holding securities based on the forecast about the future. It is a strategy followed by most investment professionals and aggressive investors who strive to earn superior returns, after adjustment for risk. The strategy involves investing in high return high risk investments with the sole purpose of maximizing return from investments. It involves allocating major portion of portfolio capital to invest in equities, equity based funds and highly volatile markets. Investors following aggressive investment strategy often look for comparatively short-term profiting and wish to invest more in growth stocks, and small caps and mid cap stocks. Advantages of aggressive investing include quick profit, high return over investment and no need of large portfolio capital. It can work really well for experienced investors and investors who are very strict in their money management. Disadvantages include high risk, high volatility in total portfolio value and no
surety of profit. It less supports novice investors and investor looking for monthly earnings or living costs.  

**The four principal factors or approaches for active management strategy are:**

- **Market timing**

  This involves departing from the normal asset mix to reflect one’s assessment of the prospects of various assets in the near future. Suppose the asset mix comprising of stock and bond is 50:50 and the investor expects the stocks to outperform bond on risk adjusted basis, in near future, then he may increase the stock component of his portfolio to 60% or 70%. On the other hand, if bonds are expected to outdate stock, on risk adjusted basis, in near future, then bond component of portfolio may increase to 60% to 70%. Market timing is based on an explicit or implicit forecast of general market movements. For this various tools like business cycle analysis, moving average analysis etc are employed.

- **Sector rotation**

  The concept of sector rotation can be applied to stocks as well as bonds. It involves shifting the weights for various industrial sectors based on their assessed outlook.

- **Security selection**

  This involves a search for under priced securities. Stocks, which seem to promise superior returns, will be overweighed compared to stocks, which are unattractive. They will be under weighted. As concerns bonds,

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7 Prasanna Chandra, Investment analysis & portfolio management, Tata McGraw hill pub Co.ltd, Pg 493-497
security selection calls for choosing bonds which offer the highest yield to maturity at a given level of risk.

- **PASSIVE MANAGEMENT STRATEGY** (Defensive management strategy)

  Passive management is a process of holding a well-diversified portfolio for a longer term with the buy and hold approach. Passive management refers to the investor’s attempt to construct a portfolio that resembles the overall market returns. This strategy is just opposite of aggressive investment; it’s purpose is to preserve the capital and ensure some return from investments. It involves investing in low profit low risk investments like bonds, money market funds, treasury notes, and equities with minimum price volatility and good dividends. Defensive investors look for long-term profits and/or monthly earnings. Advantages of defensive investment strategy include reduced risk, predictable income, better investment planning and diversification of portfolio. This strategy mainly suits beginners. Disadvantages include low return from investments and requirement of high capital investments. This strategy rests on the assumption that capital market is fairly efficient with respect to the available information. It involves adhering to the following:

1. Create a well-diversified portfolio at a pre-determined level of risk.

2. Hold the portfolio relatively unchanged over time, unless it becomes inadequately diversified or inconsistent with the investor’s risk return preferences.
BALANCED INVESTMENT STRATEGY:

In balanced investment strategy, the investor tries to keep a balance between his aggressive and defensive behaviors. It involves balancing of both return and risk by diversifying investments in both high return high risk and low return low risk investments. Balanced investors often follow a portfolio capital allocation rule telling how much to invest in equities and bonds and how much to invest in treasury notes, precious metals and funds. Usually one portion of portfolio is actively managed and other portion is left to grow automatically. The great advantage of balanced investment strategy is the diversification of portfolio and hedging against high total portfolio value volatility. It is good for investors looking for medium-term (3 to 5 years) profits. Other advantages include flexibility in portfolio management, better results with better capital investments, (almost) predictable income and manageable portfolio risk. Balanced investment strategy support both beginners and experienced investors and can be an option for monthly earnings for living.

3.10 PORTFOLIO REVISION

Irrespective of how well a portfolio is constructed, it soon tends to become inefficient. Therefore, it needs to be monitored and revised periodically. Portfolio revision involves portfolio rebalancing and portfolio upgrading.

Portfolio rebalancing

This involves revising and reviewing the portfolio composition. There are three basic policies with respect to portfolio rebalancing. They are:

a. Buy and hold policy: Under this policy, the initial portfolio is left undisturbed. Irrespective of what happens to relative
b. The constant mix policy: This policy calls for maintaining the proportion of stock and bond in line with their target value. Eg: If stock-bond mix is 50:50, the policy calls for rebalancing the portfolio when relative values of its component changes, so that the target proportions are maintained.

c. Portfolio insurance policy: This calls for increasing the exposure to stock when portfolio appreciates in value and decreasing the exposure to stocks when the portfolio depreciated in value. The idea is to ensure that portfolio value does not fail below a floor level.

Portfolio upgrading

This involves shifting from stock to bond or vice versa. It calls for reassessing the risk-return characteristics of various securities, selling over-priced securities, and buying under-priced securities. Portfolio revision calls for developing an appropriate response of trading and the subtle cost of inaction. An investor may hesitate to revise his portfolio as he does not want to incur cost of trading like commission costs, taxes etc. but there are costs of untrading which may be significant. Like the portfolio may drift into an asset mix which is no longer suitable to his needs, he may be holding over-priced investments, offering inferior returns and he may forgo opportunities of making promising investment. The investor should learn how to weigh the opportunity cost of non-trading against explicit cost of trading.
3.11 FIXED INCOME SECURITIES AND PORTFOLIO MANAGEMENT

Fixed income securities are financial claims issued by government, government agencies, state government, corporations, municipalities, banks and other financial intermediaries. The cash flows promised to the buyers of fixed income securities is a contractual obligation of the respective issuers. Fixed income securities (or debt securities) are issued, traded and invested in markets called fixed income markets. The sellers of securities would like to receive fair value for their securities and would like to be able to issue securities that best fit their needs. Some would like to issue simple no callable securities with a fixed maturity date and others would like to issue securities that are callable. The buyers of fixed income securities are large institutions such as pension funds, insurance companies, commercial banks, mutual funds and individual investors.

The most distinguishing features differentiating fixed income securities from equities are the priority of lien position and the size and certainty of cash flows. Fixed income securities have specified, contractually guaranteed interest payment during the period to maturity that are typically larger, in percentage terms, than the individually paid on stock. They also have a defined maturity date as opposed to stock, which have a perpetual existence. The fixed income securities have relatively large assured cash flows permitting the accommodation of particular objective.

- Classification of debt securities
  1. Treasury securities: This comprises of US treasury securities, UK gilts and German government bonds.
  2. Agency securities: These are the debt securities issued by government agencies.
3. Corporate securities: Corporations issue these securities.

4. Mortgage backed securities: Pools of mortgage back these securities.

5. Asset backed securities: Portfolio of assets back these securities.

6. Municipal issues: These are securities issued by State government and municipalities.

7. Emerging market securities: These are securities issued by less developed and developing countries.\(^8\)

### A SYSTEMATIC REPRESENTATION OF DEBT-MARKET

<table>
<thead>
<tr>
<th>Issuer of debt securities</th>
<th>Financial intermediaries</th>
<th>Institutional and retail investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government and municipalities</td>
<td>Primary dealers</td>
<td>Government</td>
</tr>
<tr>
<td>Corporations</td>
<td>Other dealers</td>
<td>Pension fund</td>
</tr>
<tr>
<td>Commercial banks</td>
<td>Investment banks</td>
<td>Insurance companies</td>
</tr>
<tr>
<td>States and municipalities</td>
<td>Credit rating agencies</td>
<td>Mutual funds</td>
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<td>Foreign institutions</td>
<td>Creditliquidity enhancers</td>
<td>Commercial banks</td>
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<td></td>
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<td>Foreign insurance</td>
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<td></td>
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<td>Households</td>
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</tbody>
</table>

Objectives:

- To sell securities at fair market price
- To have orderly and liquid secondary market

Objectives:

- To provide primary market making services, such as bidding, auction, underwriting.
- To provide orderly

Objectives:

- To buy securities of different risk return profiles at a fair price.
- To obtain

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\(^8\) Suresh Sundaresan, Fixed income markets and their derivatives, Thomson south western, II edition. Pg 3,4
in their securities
- To design and issue debt securities that best suits their needs

market making in secondary market
- To provide risk management and asset liability management services.

diversification at a low cost
- To get information on credit-rating
- To have access to risk management services.

<table>
<thead>
<tr>
<th>Types of risk faced by the holder of fixed income securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <strong>Interest rate risk</strong>: The risk is that the price of the security will decline if the interest rate rises.</td>
</tr>
<tr>
<td>2. <strong>Reinvestment risk</strong>: All coupon bonds are subject to reinvestment risk. Interest on interest is an important source of total return for some fixed income securities. It is risk that the coupon payments or repayment of principal will be reinvested at a lower rate than when the instrument was acquired.</td>
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<tr>
<td>3. <strong>Inflation or purchasing power risk</strong>: It is risk that the return realized will not be sufficient to offset the loss in purchasing power due to inflation.</td>
</tr>
<tr>
<td>4. <strong>Default risk (business risk or credit risk)</strong>: It the risk that the issuer will default in the contractual payment of principal and interest.</td>
</tr>
<tr>
<td>5. <strong>Call risk</strong>: It is the risk where in the issuer has the right to call in the issue prior to maturity. The risk that the investor faces is that the issue will be called when interest rates have increased so much since the issue was originally sold that it is economically beneficial for the issuer to call the issue and refund it at the prevailing lower rate. In such case the holder will be forced to reinvest the proceeds received from the issuer at a lower rate.</td>
</tr>
</tbody>
</table>
6. **Marketability risk:** It involves the liquidity of security and the case with which the issue can be sold at or near prevailing market prices.\(^9\)

### 3.12 COMMON ERRORS IN INVESTMENT MANAGEMENT:

Investors are prone to following errors on investment management:

- **Ill defined approach**

  Lots of confusions are created because the investors do not spell out clearly their risk disposition and investment policy. This impairs the quality of investment decisions. The fear of losing capital when prices are low and declining, and the greed for more capital gains when prices are rising, are responsible for poor performance compared to all other factors.

- **Unrealistic goals**

  Many investors have unrealistic and exaggerated expectations from investments. This could be because they have been misled by

  - Tall and unjustified claims made in the publicity campaigns of new issues
  - Exceptional performance of some portfolio they have seen
  - Promises made by agents and operators

- **Decision making**

  Investment decision making is characterized by lots of curiousness. Investors tend to base their decisions on partial evidence, unrealistic hearsay

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or casual tips given by brokers, friends, etc. They also follow others to overcome the lack of confidence in their own judgment.

- **Simultaneous switching**

  Investors, while switching over from one stock to another, often buy and sell more or less simultaneously. They think that the right time for selling stock is also the right time for buying another stock, Where as this may not be so very often.

- **Misplaced love for cheap stock**

  Investors often have a weakness for stocks, which look cheap. They buy a stock that is on its way down because somehow a falling share looks a good bargain. They like to buy a stock that is quoting low as they feel comforted when they buy 1000 shares of a company that is quoting at Rs.10 rather than 100 shares of a company that is quoting at Rs.100.

- **Over-diversification and under-diversification**

  Many individuals have portfolios consisting of different stocks, which could range from 20-50. They fail to realize that over-diversification is the greatest enemy of portfolio performance. So is under-diversification, as many individuals do not realize the principles of diversification and its benefits in terms of risk reduction.¹⁰

- **Buying shares of familiar companies**

  Investors are often tempted to buy shares of companies with which they are familiar. They must realize that in stock market there is hardly any

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correlation between the fame of a company’s products and the return on its equity stocks.

- **Wrong attitude towards profits or losses**

  An investor has an aversion to admit his mistakes and cut losses short. If the prices fall, contrary to his expectations at the time of purchase, he somehow hopes that it will rebound and he can break-even. Such a belief persists even when the prospects look dismal and there is greater possibility of a further decline. And if the price recovers due to favorable conditions, there is a tendency to dispose off the shares when its price more or less equals the original purchase price, even though there may be a fair chance of further increase.

### 3.13 QUALITIES OF SUCCESSFUL INVESTING

An investor must have the following qualities to be successful in investment:

- **Contrary thinking**

  Investors generally follow the crowd. This is due to the reason that they want to be part of the group and they do not have confidence in their own judgment. This compels them to substitute other’s opinion for their own. An investor should cultivate contrary thinking which can be done by avoiding stocks which have a high price earning ratio. A high relative price earning ration implies that the stock is very popular with investors. An investor must realize that in investment, many people have the temptation to play the wrong game. An investor must buy from pessimist and sell to an optimist.11

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Patience

In the game of investment, patience and diligence is required. Young investors are generally the most impatient ones than the old investors. They look for instantaneous result and often check prices on daily basis.

Composure

The ability to maintain composure is a virtue required to be a successful investor. An investor should understand his own impulse and instincts towards greed and fear. He must surmount these emotions that can wrap his judgment and must capitalize on the greed and fear of other investors.

Flexibility and openness

Changes in technology, consumer tastes and preferences shift, investment habits and company prospects and also the investor’s expectations. The investors do not accept all these changes. They develop a defensive interpretation of new developments and this cripples the capacity to make good judgment about the future, an open mind, free from biases and prejudices, is crucial for success in investing. A conscious and deliberate effort should be made to re-examine the old portfolio, assimilate new information and cultivate mental flexibility.

Decisiveness

Investment decisions generally call for reaching conclusions on the basis of inadequate information. To succeed, and investor should be decisive. Decisiveness refers to the ability to quickly weigh and balance a variety of factors, form a basic judgment and act promptly.
3.14 SPECTRUM OF INVESTMENT

An investor has a wide range of investment avenues:

**Investment avenues**

1. Equity shares 2. Fixed income securities

3. Mutual funds 4. Deposits

5. Tax-sheltered schemes 6. Life insurances

7. Real estates 8. Precious objects

9. Financial derivatives

1. Equity share: These represent ownership capital. Equity share are classified into:

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

2. Fixed income securities: These securities provide a fixed stream of returns. They are

   - Preference shares
   - Corporate debentures
   - Government securities
3. Mutual funds: Instead of buying equity shares or fixed income securities directly, an investor can participate in various schemes floated by mutual funds which in turn invests in equity shares and fixed income securities. The various types of mutual fund schemes are:

- Growth schemes
- Income schemes
- Balanced schemes

Mutual funds offer convenience because they typically:

a) Have a low minimum investment amount
b) Can be bought or sold on any business day
c) Allow free exchanges of funds within the fund family
d) Offer funds with various objectives for almost any investment need, such as growth, income, growth and income, aggressive or aggressive income and provide automatic reinvestment of dividends and capital gains

4. Deposits: Deposits earn a fixed return but are not transferable. Like

- Bank deposits

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12 Prasanna Chandra, The investment game, Tata McGraw hill pub, 6th edition, pg 4,5
- Company deposits
- Postal deposits

5. Tax sheltered schemes: These schemes provide tax benefits like Employees Provident Fund Scheme, Public Provident Fund Scheme, NSC VIII Series.

6. Life insurance: Under life insurance premium paid is the sacrifice and sum assured is the benefit. Some of the policies under life insurance are Endowment policy, Money back policy, Whole life policy and Premium back term assurance policy.

7. Real estates: The most important asset in a portfolio is the residential house. Apart from that an investor may be interested in agricultural land, semi-urban land, time-share in holiday resort.

8. Precious stones: Precious objects are small in size but highly valuable in monetary terms like gold and silver, stones and art objects.

9. Financial derivatives: An instrument whose value is derived from the values of underlying assets like futures and options.

### 3.15 INVESTMENT ATTRIBUTES

The various investment attributes are;

1. Rate of returns: Rate of return is defined as

\[
\text{Annual income + (end price – beginning price)} / \text{Beginning price}
\]
2. Risk: Risk refers to the variability of its rate of return. That is how individual outcome deviates from the expected values.

3. Marketability: An investment is highly marketable if it can be transacted quickly. The transaction cost is low, the price change between two successive transactions is negligible. The liquidity of a market may be judged in terms of

   - Depth: Existence of buy as well as sell orders around the current prices
   - Breadth: Presence of substantial orders in substantial volume
   - Resilience: That is new orders emerge in response of price changes.

4. Tax shelter: Some investments provide tax benefits. Some tax benefits are:

   - Initial tax benefits: Tax relief enjoyed at the time of making investment
   - Continuing tax benefits: Tax shield associated with the periodic return from the investment
   - Terminal tax benefits: Relief from taxation when investment is liquidated

5. Convenience: Convenience refers to the ease with which the investment can be made and looked after. The questions that are generally asked to judge convenience is can the investment be made readily and can the investment be easily looked after? The degree of convenience associated with investment varies widely
depending upon which investment avenue has been selected. For example: Deposits in savings bank can be made readily and does not require any maintenance effort whereas purchase of property involves lots of procedural and legal hassles and involves great deal of maintenance effort subsequently.  

Schematic presentation of stages in portfolio management

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13 Prasanna Chandra, The investment game, Tata M cGraw hill pub, 6th edition, pg 7,8
3.16 DIVERSIFICATION

Diversification can be categorized into two types:

Simple diversification and superfluous diversification

Simple diversification

It means that a portfolio made up of 200 securities is ten times more diversified than a portfolio made up of 20 different securities. Simple diversification reduces the unsystematic risk substantially.

Superfluous diversification

If 10 to 15 different assets have been selected for a portfolio, the maximum benefit from simple diversification will most likely be attained. Further spreading of portfolio’s asset is superfluous diversification and should be avoided. Superfluous diversification will result into-

1) Purchase of lackluster performers: These are the securities that do not yield adequate return for the risk they bear.

2) Difficulty with portfolio management: It is difficult to stay informed about all the securities in the portfolio if the assets are too many.

3) High transaction cost: Frequent purchase of assets in small quantities results in large brokerage commission.

3.17 ELEMENTS OF RISK

Risk in an investment is the variation in its return. The elements of risk can be classified into two categories.¹⁴

¹⁴ Kevin S, Security analysis and portfolio management, Estern economy edition 2006 pg 55 56
SYSTEMATIC RISK

Factors, which are external to a company and affect a large number of securities simultaneously, are risk produced by external factors.

UNSYSTEMATIC RISK

Factors, which are internal to companies and affect only those particular companies, are controllable to a great extent. Risk produced by internal factors is unsystematic risk.

Therefore, Total Risk = Systematic risk + unsystematic risk

Systematic risk:

<table>
<thead>
<tr>
<th>Interest rate risk</th>
<th>Market risk</th>
<th>Purchase power risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>This effects the debt securities like bonds and debentures. The variation in bond price caused due to variation in interest rate is interest rate risk</td>
<td>Variations in returns caused by the volatility of stock market is market risk</td>
<td>Variations caused in the purchasing power of investor due to inflation is purchase power risk</td>
</tr>
</tbody>
</table>

Unsystematic risk:

<table>
<thead>
<tr>
<th>Business risk</th>
<th>Financial risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk caused when the revenue of the company declines which results in more than proportionate decline in the operating profit is business risk. This is due to the reason that the company cannot decrease its fixed cost.</td>
<td>Financial risk is the variability in EPS due to the presence of debt in the capital structure of a company.</td>
</tr>
</tbody>
</table>

3.18 TYPES OF INVESTORS (based on risk tolerance)
Investors can be classified on the basis of their risk bearing capacity. The risk bearing capacity of an investor is a function of personal, economic, environmental and situational factors such as income, family size expenditure pattern and age. A person with a higher income is assumed to have a risk bearing capacity. Therefore investors can be classified as risk seekers, risk avoiders and risk bearers.

A risk seeker is capable of assuming a higher risk. A risk avoider chooses instruments that do not show much variation in return. A risk bearer falls in between these two categories and assumes moderate level of risk.\(^{15}\)

Investors can also be classified on the basis of groups as individuals or institutions. Individual investors are large in number but in terms of value of investment they are comparatively smaller. Institutional investors are organizations with surplus funds beyond immediate business needs or organizations whose business objectives is investment.

3.19 PORTFOLIO MANAGER

Investing can bring many rewards, but it is a process that takes perseverance and commitment. The goal of portfolio manager is to help in building wealth over a long term. The relationship between an investor and portfolio manager is based on much more than stocks and bonds. It's a unique, life-planning partnership, one that responds and changes as events in life change. While saving for child's education, while planning for own retirement or while preserving estate for heirs, ongoing communication with portfolio manager ensures that he or she can adjust the portfolio as circumstances in life may require. The investors restrict themselves by saving grains out of seed in seeking advice of a good financial planner and impede their tree of

\(^{15}\) Ranganathan M & Madhumathi R , Investment analysis and portfolio management, Pearson 2006 Pg 18,19
revenue. They consider charges levied by the advisors as fee not fitting their pocket; not putting a thought that this charge is for the quality of service, advice benefiting them and the time & money spent on the research work and team handling. If the Investment/Financial advisor has a proven track record of delivering consistent returns then investors should avoid doing such negotiations, as this is not a FMCG product wherein one can compare between the prices of products. Financial Advisor is an institute who's manages the investors’ finances and take substantial efforts for stable financial future.

Driven by vision and discipline, the portfolio manager will guide the portfolio through the most challenging of markets. He or she will not only monitor the events that shape the investors life and their financial goals, but those trends and developments that shape the global investment environment, drive the economy and ultimately effect the portfolio's performance. This is a direct partnership and, the lines of communication are always open.

Many investors believe that managing their own money isn't such a great idea. So they seek the help of firms which helps in investment decision making. Here are some tips and resources to help an investor to do the best job. The best way to find a stock portfolio manager is referrals. There are no clear-cut distinctions between a registered investment adviser, a financial planner or a broker. One just needs to determine which company offers the services that are needed.
3.20 INVESTOR’S PROFILE

Table 1
Estimated investor and non-investor households by rural and urban (per cent)

<table>
<thead>
<tr>
<th></th>
<th>Total Investor HH</th>
<th>Non-Investor HH</th>
<th>Total HH</th>
</tr>
</thead>
<tbody>
<tr>
<td>All India</td>
<td>10.74</td>
<td>89.26</td>
<td>100</td>
</tr>
<tr>
<td>Urban</td>
<td>20.75</td>
<td>79.25</td>
<td>100</td>
</tr>
<tr>
<td>Rural</td>
<td>5.99</td>
<td>94.01</td>
<td>100</td>
</tr>
</tbody>
</table>


It is inferred from the above table that those in urban areas are more keen in investment as compared to those in rural areas.

Table 2
Distribution of Investors Across Investment Portfolio (per cent)

<table>
<thead>
<tr>
<th></th>
<th>Bond</th>
<th>Debenture</th>
<th>IPO</th>
<th>Secondary Market</th>
<th>Mutual Fund</th>
<th>Derivative</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>All India</td>
<td>14.89</td>
<td>6.94</td>
<td>10.05</td>
<td>21.59</td>
<td>42.89</td>
<td>3.64</td>
<td>100</td>
</tr>
<tr>
<td>Urban</td>
<td>15.07</td>
<td>8.57</td>
<td>8.47</td>
<td>21.25</td>
<td>40.80</td>
<td>5.85</td>
<td>100</td>
</tr>
<tr>
<td>Rural</td>
<td>14.60</td>
<td>4.26</td>
<td>12.66</td>
<td>22.04</td>
<td>46.44</td>
<td>0.00</td>
<td>100</td>
</tr>
</tbody>
</table>


It is observed from the table that mutual funds are the most preferred avenue of investment when compared to other investment avenues.
Table 3
Choice of Saving Instruments (All India) (per cent)

<table>
<thead>
<tr>
<th>Households’ Profile</th>
<th>Post Office Total Savings</th>
<th>Pension</th>
<th>Life Insurance</th>
<th>Commercial Banks</th>
<th>Regional Banks</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Years of Schooling</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>up to 5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 to 10</td>
<td>15.61</td>
<td>2.98</td>
<td>37.95</td>
<td>40.99</td>
<td>2.48</td>
<td>100</td>
</tr>
<tr>
<td>11 to 15</td>
<td>20.93</td>
<td>4.15</td>
<td>33.26</td>
<td>38.66</td>
<td>3.01</td>
<td>100</td>
</tr>
<tr>
<td>above 15</td>
<td>22.87</td>
<td>5.81</td>
<td>31.75</td>
<td>36.91</td>
<td>2.65</td>
<td>100</td>
</tr>
<tr>
<td><strong>Marital Status</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Married</td>
<td>20.37</td>
<td>4.21</td>
<td>33.74</td>
<td>38.86</td>
<td>2.82</td>
<td>100</td>
</tr>
<tr>
<td>Unmarried</td>
<td>20.13</td>
<td>5.02</td>
<td>37.54</td>
<td>33.82</td>
<td>3.49</td>
<td>100</td>
</tr>
<tr>
<td>Others</td>
<td>19.19</td>
<td>5.88</td>
<td>28.41</td>
<td>42.12</td>
<td>4.40</td>
<td>100</td>
</tr>
<tr>
<td><strong>Occupation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural &amp; Allied</td>
<td>10.54</td>
<td>5.20</td>
<td>39.26</td>
<td>42.04</td>
<td>2.96</td>
<td>100</td>
</tr>
<tr>
<td>White collar</td>
<td>21.08</td>
<td>4.31</td>
<td>33.66</td>
<td>38.13</td>
<td>2.82</td>
<td>100</td>
</tr>
<tr>
<td>Blue collar</td>
<td>19.25</td>
<td>4.88</td>
<td>39.53</td>
<td>33.17</td>
<td>3.17</td>
<td>100</td>
</tr>
<tr>
<td>Business, Transfer and Others</td>
<td>18.73</td>
<td>3.31</td>
<td>27.96</td>
<td>47.01</td>
<td>2.99</td>
<td>100</td>
</tr>
<tr>
<td><strong>Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Lower</td>
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<td>3.74</td>
<td>41.81</td>
<td>39.08</td>
<td>3.47</td>
<td>100</td>
</tr>
<tr>
<td>Middle Lower</td>
<td>17.34</td>
<td>4.00</td>
<td>37.94</td>
<td>37.27</td>
<td>37.27</td>
<td>100</td>
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<td>Category</td>
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<td>33.67</td>
<td>38.84</td>
<td>2.88</td>
<td>100</td>
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<tr>
<td>------------------</td>
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</tr>
<tr>
<td><strong>Middle</strong></td>
<td>22.18</td>
<td>4.11</td>
<td>33.52</td>
<td>37.81</td>
<td>2.38</td>
<td>100</td>
</tr>
<tr>
<td><strong>Middle</strong></td>
<td>21.98</td>
<td>4.14</td>
<td>32.76</td>
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<td>2.48</td>
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</tr>
<tr>
<td><strong>Upper</strong></td>
<td>21.29</td>
<td>4.67</td>
<td>30.83</td>
<td>40.19</td>
<td>3.02</td>
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<tr>
<td><strong>Age</strong></td>
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<td></td>
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<tr>
<td>Young</td>
<td>15.83</td>
<td>5.79</td>
<td>39.49</td>
<td>35.16</td>
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<td>Middle</td>
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<td>3.54</td>
<td>31.32</td>
<td>39.35</td>
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<td>Old</td>
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<td>26.11</td>
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<tr>
<td><strong>Dependency</strong></td>
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<td>Low</td>
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<td>32.05</td>
<td>39.67</td>
<td>2.44</td>
<td>100</td>
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<tr>
<td>Medium</td>
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<td>44.13</td>
<td>34.42</td>
<td>2.42</td>
<td>100</td>
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<td>Middle</td>
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<td><strong>Lower</strong></td>
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<td>33.88</td>
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<td>1.51</td>
<td>100</td>
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<td>Middle</td>
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<td>31.37</td>
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<tr>
<td><strong>Upper</strong></td>
<td>22.89</td>
<td>3.66</td>
<td>31.08</td>
<td>38.43</td>
<td>3.94</td>
<td>100</td>
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<tr>
<td><strong>Total</strong></td>
<td></td>
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<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

The above table shows that the most preferred Savings Avenue is via commercial banks. Life insurance and post office savings scheme are the second and third choice.

Table 4
Reason For Not Investing In Secondary Market (All India)

<table>
<thead>
<tr>
<th>Reasons/ Household Characteristics</th>
<th>Inadequate returns -</th>
<th>Not sure about safety of investments</th>
<th>Investment not very Liquid</th>
<th>Inadequate information</th>
<th>No skills</th>
<th>Dissatisfied with the role of regulator</th>
<th>Inadequate Financial Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Years of Schooling up to 5</td>
<td>4.26</td>
<td>9.53</td>
<td>6.20</td>
<td>28.87</td>
<td>15.82</td>
<td>2.00</td>
<td>33.33</td>
</tr>
<tr>
<td>6 to 10</td>
<td>5.26</td>
<td>11.93</td>
<td>8.19</td>
<td>28.11</td>
<td>15.78</td>
<td>5.44</td>
<td>25.31</td>
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<tr>
<td>11 to 15</td>
<td>5.12</td>
<td>13.81</td>
<td>8.82</td>
<td>26.02</td>
<td>13.07</td>
<td>7.16</td>
<td>26.01</td>
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<td>above 15</td>
<td>4.08</td>
<td>16.50</td>
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<td>24.75</td>
<td>16.92</td>
<td>6.24</td>
<td>24.56</td>
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<td>Marital Status</td>
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<tr>
<td>Married</td>
<td>4.93</td>
<td>13.52</td>
<td>8.32</td>
<td>26.65</td>
<td>14.28</td>
<td>6.26</td>
<td>26.07</td>
</tr>
<tr>
<td>Unmarried</td>
<td>8.79</td>
<td>13.49</td>
<td>7.25</td>
<td>15.04</td>
<td>13.35</td>
<td>10.31</td>
<td>31.81</td>
</tr>
<tr>
<td>Others</td>
<td>2.13</td>
<td>4.43</td>
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<td>32.20</td>
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<tr>
<td>Occupation</td>
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<tr>
<td>Agricultural &amp; Allied</td>
<td>2.04</td>
<td>10.33</td>
<td>7.50</td>
<td>26.75</td>
<td>22.17</td>
<td>9.21</td>
<td>22.01</td>
</tr>
<tr>
<td>Blue collar</td>
<td>4.61</td>
<td>10.40</td>
<td>6.71</td>
<td>23.65</td>
<td>16.53</td>
<td>6.08</td>
<td>32.04</td>
</tr>
<tr>
<td>Business, Transfer and Others</td>
<td>4.81</td>
<td>10.81</td>
<td>10.44</td>
<td>31.86</td>
<td>12.98</td>
<td>4.73</td>
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<td>Income</td>
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<td></td>
</tr>
<tr>
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It is inferred from the above table that the main reason for not investing in secondary market is inadequate information and not having sufficient financial resources to invest.

### 3.21 HISTORY AND DEVELOPMENT OF STOCK EXCHANGE:

Market place where stocks are bought and sold is called as stock exchange. The price at which each the stock is bought or sold is determined by the market forces that is demand and supply for a particular stock. In earlier days buyers and sellers used to assemble at stock exchanges to make a transaction but with the evolution of computer and advancement is
information technology, most of the transactions now takes place electronically. Now trading is possible from home.

**History of the Indian Stock Market - The Origin**

One of the oldest stock markets in Asia, the Indian Stock Markets have a 200 years old history. Only few stock exchanges were recognized by SEBI in 1957. They were:

**Bombay, Calcutta, Madras, Ahmadabad, Delhi, Hyderabad, Bangalore, Indore**

Many more stock exchanges were established during 1980's, namely:

Cochin Stock Exchange (1980)

5. Kanara Stock Exchange Limited (at Mangalore, 1985)
11. Coimbatore Stock Exchange
12. Meerut Stock Exchange

**Trading Pattern of the Indian Stock Market**

Indian Stock Exchanges allow trading of securities of only those public limited companies that are listed on the Exchange(s). They are divided into two categories:
Types of transactions:

The flowchart below describes the types of transactions that can be carried out on the Indian stock exchanges:

- **Specified Securities (Forward List)**
  - Equity Shares of Company that are:
    - Dividend Paying
    - Growth-oriented Companies
    - Paid up capital of atleast Rs. 50 Million
    - Market Capitalisation of atleast Rs. 100 Million
    - Has more than 20,000 shareholders.

- **Non-specified Securities (Cash List)**
  - Equity Shares of companies not covered in Specified Securities

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<th>Spot Delivery Transactions</th>
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<td>* This period shall not be more than 14 days following the date of the contract</td>
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<td>* Transactions in which delivery and payment can be extended by further period of 14 days each</td>
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Over The Counter Exchange of India (OTCEI)

Traditionally, trading in Stock Exchanges in India followed a conventional style where people used to gather at the Exchange and bids and offers were made by open outcry. This age-old trading mechanism in the Indian stock markets used to create much functional inefficiency. Lack of liquidity and transparency, long settlement periods and benami transactions are a few examples that adversely affected investors. In order to overcome these inefficiencies, OTCEI was incorporated in 1990 under the Companies Act 1956. OTCEI is the first screen based nationwide stock exchange in India created by Unit Trust of India, Industrial Credit and Investment Corporation of India, Industrial Development Bank of India, SBI Capital Markets, Industrial Finance Corporation of India, General Insurance Corporation and its subsidiaries and CanBank Financial Services.
Advantages of OTCEI

1. Greater liquidity and fewer amounts of intermediary charges due to widely spread trading mechanism across India.

2. The screen based scripless trading ensures transparency and accuracy of prices.

3. Faster settlement and transfer process as compared to other exchanges.


National Stock Exchange (NSE)

The National stock Exchange was incorporated in 1992 by Industrial Development Bank of India, Industrial Credit and Investment Corporation of India, Industrial Finance Corporation of India, all Insurance Corporations, selected commercial banks and others in order to lift the Indian stock market trading system in par with international standards. NSE provides exposure to investors in two types of markets, namely: wholesale debt market and capital market.

Wholesale Debt Market

Similar to money market operations, debt market operations involve institutional investors and corporate bodies entering into transactions of high value in financial instruments like treasury bills, government securities, commercial papers etc.
Trading at NSE

1. Fully automated screen based trading mechanism
2. Strictly follows the principle of an order driven market
3. Trading members are linked through a communication network
4. This network allows them to execute trade from their offices
5. The prices at which the buyer and seller are willing to transact will appear on the screen
6. When the prices match the transaction will be completed
7. A confirmation slip will be printed at the office of the trading member.

Advantages of trading at NSE

1. Integrated network for trading in stock market of India
2. Fully automated screen based system that provides higher degree of transparency
3. Investors can transact from any part of the country at uniform prices
4. Greater functional efficiency supported by totally computerized network

MADRAS STOCK EXCHANGE (MSE)

The Madras Stock Exchange (MSE) is a stock exchange in Chennai, India. The MSE is the fourth stock exchange to be established in the country and the first in South India. Madras Stock Exchange Ltd is a self
regulatory organization having permanent recognition under the Securities Contracts (Regulations) Act, 1956. Established in the year 1937, the Exchange has a long history of service to the nation and pioneered the development of the capital market in this part of the country by catering to the needs of the industrial entrepreneurs to raise capital for industrial promotion and providing investment opportunities to the public.

The Exchange is a demutualised corporate entity pursuant to the MSE (Corporatization and Demutualization) Scheme, 2005 approved by the Securities and Exchange Board of India (SEBI). The stakeholders of the Exchange include Financial Institution of the Tamil Nadu State Government, leading corporate houses, high net worth individuals and Trading Members of the Exchange. The Exchange is managed by the Board of Directors, representing the various stakeholders in the manner as stipulated in the Demutualization Scheme.

MSE has a strategic arrangement with the National Stock Exchange (NSE) which provides for the facility of trading by the members of MSE on NSE platform and also for trading of MSE listed companies on the NSE.

Empowerment of the investors through education has been the focus of the Exchange. The Exchange has established an exclusive investment education centre named as the “MSE Institute of Capital Markets” to cater to the educational needs of the market participants. This Centre conducts regular and intensive training programmes, seminars and workshops throughout the State of Tamil Nadu & Pondicherry. The Exchange continuously holds monthly Investors’ Meet at its premises in Chennai on the third Saturday of every month.

The Exchange also provides Depository Services as Depository Participant of CDSL and NSDL.
MSE has set up subsidiary - MSE Financial Services Ltd., which is a Corporate Broking House, having membership of BSE and NSE and trading facilities are provided to the investors through the Members of MSE.

In 1996 the MSE was fully computerized and online trading became operational as the MSE was connected to 120 broking offices in and around Chennai through wide area networking.

The MSE has about 120 live members and 1,785 companies listed. The exchange follows the Rolling Settlement system, as per the January 2000 SEBI (Securities Exchange Board of India) guidelines and a proactive Grievance Cell is operational. By this system, investors can log in their complaints, for which a number will be given for further reference, through which investors can keep track of the action taken by the exchange as regards their complaint.

CONCLUSION:

The conceptual review throws a clear light on the various investment avenues at the disposal of the investors. The range of choices is vast yet the investment game is very complicated. Investors, based on their risk taking capacity and knowledge of investment, apply strategies and design a portfolio that suits their needs. The techniques and strategies of investment have been briefed in the conceptual review. It is also seen that investors mostly prefer commercial banks for savings and are hesitant to invest in secondary market due to lack of information. This research is an attempt to know the techniques and strategies adopted by investors with regards to their knowledge about various financial instruments and risk taking attitude.