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Editorial Board

Title

INVESTMENT ANALYSIS AND PORTFOLIO CONSTRUCTION

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ABSTRACT:

Investment is the employment of funds with the aim of achieving additional income or growth in value. There is also a possibility of incurring loss in financial transaction. The aim of the investor is to minimise the risk involved in investment and maximize the return from the investment. Without adequate and appropriate knowledge, it is difficult to measure the rate of return and the risk involved in an investment. Most of the investors are faced with innumerable problems while selecting the portfolio. The study examines the motives for investment, analyses the availability of investment media, identifies the expectations regarding investment avenues, evaluates the performance of investment, and guides in the construction of the portfolio. It concludes that success of every investment decision requires both knowledge and skill. Aim of every investor is to maximize profit by construction of good portfolio.

Key words: Diversification, investment, portfolio, return, risk and security

INTRODUCTION:

When current income exceeds current consumption desire, people tend to save the excess. There are several options for these savings. One possibility is to put the money under a mattress or bury it in the backyard until some future time when consumption desires exceed current income. When they retrieve their saving from the mattress or backyard, they have the same amount they saved. Another possibility is that they can give up immediate possession of these savings for a future larger amount of money that will be available for this trade-off of present consumption for a higher level of future consumption. The savings done with the expectation to make them increase over time is called investment. It is the employment of funds with the aim of achieving additional income or growth in value. The essential quality of an investment is that, it involves “waiting” for a reward. It involves the commitment of resources which have been saved or put away from current consumption in the hope that some benefits will occur in future. There is also a possibility of incurring loss in a financial transaction which is termed risk. Aim of the investor is to get the maximum return at the minimum risk. Diversification is the method adopted for reducing the risk. It essentially results in the construction of portfolio. Group of security is called portfolio. Individual securities have risk return characteristics of their own. It is hoped that if money is invested simultaneously in several securities, the loss in one will be compensated by gain in others. Thus holding more than one security is an attempt to spread the risk.

STATEMENT OF THE PROBLEM:

The aim of the investor is to minimise the risk involved in investment and maximize the return from the investment. If the investment could not earn as much as the rise in price, then the real rate of return would be negative. Without proper knowledge, it is difficult to measure the rate of return and the risk involved in an investment accurately. The Indian investor is faced with a large number of problems while selecting portfolio. Although there are large numbers of investment alternatives available, the investor must choose the right scheme which will suit his objectives and requirements. Construction of portfolio is an important tool for the investor to minimize the risk and maximize the return. Hence, the present study is regarding investment pattern and the portfolio construction.

OBJECTIVES OF THE STUDY:

The specific objectives of the present study are

i) To examine the motives for investment

ii) To analyse the availability of media for investment.

iii) To list out the different avenues for investment.

iv) To evaluate the performance of investment.

v) To guide in portfolio construction.

MOTIVES FOR INVESTMENT:

Investments are both important and useful in the context of present-day condition. Savings kept as cash are burden and do not earn anything, but also lose its value to the extent of rise in prices. Thus rise in prices or inflation erodes the value of money. Savings are invested to provide a hedge or protection against inflation. Some of the important reasons that have made investment decisions increasingly significant are given below.

i) Return

The major factor influencing the pattern of investment is its return because most of the investors always expect a good rate of return from their investment. Return may be in the form of yield or capital appreciation. The excess of market price over the purchase price is capital appreciation and the yield as in the form of interest and/ or dividend is based on the type of security held.

ii) Safety

The safety of capital is the certainty of return on capital without loss of money or time. Principles of safety are different from one mode of investment to another. Investment done with the government assures more safety than with the private party. In all other cases of money lent, some transaction times are involved in getting the funds back and safety of funds are also not perfect. If safety of capital is to be assured, then riskless security like government bonds have to be chosen.

iii) Liquidity

An investor generally prefers liquidity for his investment. If a capital asset is easily realizable, saleable or marketable, then it is said to be liquid. The liquidity depends upon the facilities of marketing and trading. If a portion of the investment could be converted into cash without much loss of time, it would help the investors to meet their emergencies. Assets of listed companies and shares of public limited companies are more easily transferable or liquidable than those of nonlisted companies and private limited companies.

iv) Hedge against inflation

Inflation is change in price level. There is inflation in almost all the economy. The rate of return should ensure a cover against the inflation. If the rate of return is lower than the rate of inflation, then the investor will sustain loss in real terms. Investment in growth stocks would appreciate in their values overtime and provide a protection against inflation.

v) Longer life expectancy

Investment trend shows longer life expectancy. Thus investment decisions have become significant as people retire between age of 60 and above. A portion of earnings from employment is invested in such a way that the principal and income will be adequate for a greater number of retirement years.

vi) Legality and freedom from care

All investments should be approved by law. Identification of legal securities and investment in such securities help the investor to avoid many problems. One way of being free from care is to invest in securities like Bank deposits, Unit Trust of India. Mutual Fund, Life Insurance Corporation and National Savings Certificates, etc.

vii) Taxation

Taxation is one of the crucial factors in any country which introduces an element of compulsion in personal saving. There are various forms of saving outlets in our country in the form of investment which help in bringing down the burden of tax.

INVESTMENT ANALYSIS:

For those who have some funds and want to invest those funds into a variety of businesses, there are certain things to be done beforehand. Performance of investment analysis is essential before starting to invest. Channel funds into an investment which would successfully deliver a profit.

` Analysis of the right investments can keep away from losses that might occur. Each investment is certainly not always profitable. There are also disadvantages to be gained from an investment. But with good analysis, the investor can reduce the risk of loss and shall assure gain.

Before investing, there are important things that the investor should analyze. The following is an investment analysis the investor should do before starting to invest:

Risk: In any investment there are risks to be borne. Before investing, the investor should understand well the risks of loss that may occur on the money he/she invests. Knowing the risks will help to find solutions to minimize risk. Control and limitation of risks is one of the investment analysis needs to be done to avoid the endless money to be invested.

Investment period: The investor must know whether the type of investment that he/she has to go-in is short-term investments, medium or long. By knowing the investment period, he/she shall find out how long is the period of refund as a result of these investments.

Parties involved in investment: The investor has to know well in the beginning the party with whom the money is to be invested. The investor has to make sure that the parties who will run investment fund are the party professionals who can be trusted.

Possible swelling of the value of investments: The next criterion of investment analysis which is equally important is to know whether the investment fund will grow in the future.

The investor has to be observant and meticulous in an investment. Proper investment analysis will be able to give maximum results from the invested funds. Thus investment analysis is vital before taking investment decisions.

INVESTMENT MEDIA:

The ultimate objective of the investor is to derive a variety of investments to maximize his return. In India many types of investment media or channels are available for making investment. The investor may select any type of security which will maximize his utility. A sound investment program can be constructed if the investor familiarizes himself with the various alternative investments available.

Investment media are of several kinds. Some are simple and direct. Others present complex problems of analysis and investigation. Some are familiar; others are relatively new and unidentified. Some investments are appropriate for one type of investor and another may be suitable to some other person. The investor has to choose the security which will maximize his expected returns. The investment decision is to optimize returns but risk bearing capacity varies from investor to investor. Some investors prefer safe government bonds whereas others may be willing to invest in blue chip equity shares of a company. Many alternative investments exist.

These can be put into different categories. The investment alternatives are given below in Table 1.

TABLE - 1

INVESTMENT ALTERNATIVES

Sl. No	Types of Security	Nature of Investment
1	Cash	Direct fixed principal Investment
2	Saving account	Direct fixed principal Investment
3	Saving Certificates	Direct fixed principal Investment
4	Government bonds	Direct fixed principal Investment
5	Corporate bonds	Direct fixed principal Investment
6	Preference Shares	Direct Variable Principal Investment
7	Equity Shares	Direct Variable Principal Investment
8	Convertible debentures	Direct Variable Principal Investment
9	Real Estate	Direct Non Secured Investment
10	Mortgages	Direct Non Secured Investment
11	Commodities	Direct Non Secured Investment
12	Business Ventures	Direct Non Secured Investment
13	Art. Antiques and other variables	Direct Non Secured Investment
14	Pension fund	Indirect Investment
15	Provident fund	Indirect Investment
16	Insurance Policies	Indirect Investment
17	Investment companies	Indirect Investment
18	Unit Trust and other trust funds	Indirect Investment

Source: Secondary Data

INVESTMENT AVENUES:

The investor has various alternative avenues of investment for his savings to flow in accordance with his preference. A rational investor knows that money is losing its value to the extent of the rise in prices. If money lent cannot earn as much as rise in prices or inflation, the real rate of return is negative. Thus if inflation is of an average annual rate of 5% then the return should be 5% or above to induce savings to flow into investment.

There are a large number of investment avenues for savers in India. Some of them are marketable and liquid while others are non marketable. Some of them are highly risky while some others are almost riskless. The investor has to choose proper avenue from among them depending on his preferences, needs and his ability to assume risk.

The investment decision is not only the construction of portfolio that will promise the highest expected return but it is the satisfaction of the need of the investor. Selection of the portfolio depends on the moods of the investor. One investor may face a situation when he requires extreme liquidity. He may also require safety of securities. Therefore, he will have to choose a security with low returns. Another investor would not mind high risk as he is not confronted with financial constrains but he would like a high return. Such an investor can put his savings in growth shares as he is willing to accept risk. Another important consideration is the temperament and psychology of the investor. Some investors are temperamentally suited to take risks; there are others who are not willing to invest in risky securities even if the return is high. Table 2 portrays the different avenues of investment.

TABLE - 2

AVENUES OF INVESTMENT

Sl. No	Types of Investment	Risk	Return/ Current Yield	Capital Appreciation	Liquidity	Tax benefit
1	Saving with post office and Government Bond	Low	Low	Nil	High	High
2	Corporate Bond	High	High	Moderate	Low	Low

3	Preference Shares	Moderate	Low	Moderate	High	Nil
4	Equity Shares	High	Low	High	High	High
5	Debentures	Low	High	Nil	Low	Nil
6	Real Estate	Low	Low	High	Moderate	Nil
7	Business Ventures	High	High	Moderate	Moderate	Nil
8	Pension and public provident Fund	Nil	Low	Nil	Low	Moderate
9	Insurance	Low	Moderate	Moderate	Moderate	High

Source: Secondary Data

INVESTMENT PERFORMANCE EVALUATION:

Every investor wants to know how well he's doing. The best investor carefully monitors the performance of his portfolios and uses that information to determine whether his money is better put to work elsewhere. The measurement of investment performance on a portfolio is not as straightforward as it might appear, but when properly understood, knowledge of performance measures can be used to make better and more rational investing decisions.

The primary motive of buying a share is to sell it subsequently at a higher price. If the investor invests his money for a short period of time it is speculation but when holds if for a fairly long period of time the anticipation is that he would receive some return on his investment. In many cases anticipation is dividend or increase in price level. This expectation is primarily determined by the performance of the company which in turn is influenced by the performance of the industry to which the company belongs and the general economic and socio-political scenario of the country. Fundamental analysis is a method of finding out the future price and yield of a share which an investor wishes to buy. The purpose of fundamental analysis is to evaluate present and future earning capacity of a share based on the economy, industry and company fundamentals and thereby assess the intrinsic value of shares. If the market price of the share is lower than its intrinsic value, the investor would decide to buy the share as it is under priced and it may be expected to move on to match with its intrinsic value. On the other hand when the market price of a share is higher than its intrinsic value, it is perceived to be overpriced, and such a share is expected to come down in future and hence the investor would decide to sell such a share.

Basics of Portfolio Measurement:

Investment performance refers to the rate of return achieved while investing in a portfolio of assets. From a personal standpoint, the investment performance can be thought of as a simple percentage -- in other words, the growth being achieved on the value of the portfolio, often expressed on a yearly basis to avoid conflating market volatility with actual productive gains. This yearly percentage is analogous to the interest earned in many other investment vehicles, like savings accounts, treasury notes, CDs, or bonds.

Measuring Returns: Total vs. Price:

The return on a portfolio can be measured in several ways, none of which is inherently better than the others, but each of which is suited to a specific inquiry. One type of measurement is the difference between total return and price return. The total return on investment measures investment performance including income factors on the asset. Price return, on the other hand, refers only to the actual capital appreciation of the asset and ignores income factors like stock dividends. This distinction is important only when there are differences in how dividends are used. Most investors automatically reinvest dividends, using the extra income to buy more of the stock asset, meaning that total return is more appropriate. Other investors use dividends as a source of regular income, in which case investigating price return might be beneficial.

Measuring Returns: Net vs. Gross:

Another important distinction to consider when measuring return is the difference between net and gross return. A pure gross return is the return before all fees, expenses, and taxes, whereas a pure net return includes all fees, expenses, or taxes deducted. From a personal investment point of view, the more useful factor is net return -- if it costs $8 paid to the broker every time the investor makes a trade, it makes sense to calculate the fee as working against the investors' overall investment performance. But in reality, most returns are not measured either as pure net or pure gross -- in many cases, it makes sense to decide which fees, expenses, and taxes to include as part of investors' return calculation, as only some of these outlays may factor into investment decisions.

Market Comparison:

With a coherent measure of investment performance, the best investors will evaluate their portfolio against what other portfolios of about the same capitalization earned in the past. While positive past returns don't indicate guaranteed positive future returns, if an investor finds that his/her portfolio consistently underperforms broad measures of the market, it might be time for a change. For example, the S&P index measures market performance by following the performance of the top 500 American firms. If an investor's portfolio's growth is consistently behind the yearly percentage gain on the S&P, the investor would do better with a no-load index fund that tracks the S&P than with investor's current investment strategy.

PORTFOLIO CONSTRUCTION:

In today's financial marketplace, a well-maintained portfolio is vital to any investor's success. An individual investor need to know how to determine an asset allocation that best conforms to his/her personal investment goals and strategies. It is rare to find investors investing their entire wealth in a single security. This is because most investors have an aversion to risk. It is hoped that if money is invested in several securities simultaneously, the loss in one will be compensated by the gain in others. Thus holding more than one security at a time is an attempt to spread and minimise risk by not putting all our eggs in one basket. Most investors thus tend to invest in a group of securities rather than a single security. Such a group of securities hold together as an investment is known as a portfolio. The process of creating such a portfolio is called diversification. It is an attempt to spread and minimise the risk in investment.

From a given set of securities, any number of portfolios can be constructed. A rational investor attempts to find the most efficient of these portfolios. Thus efficiency of each portfolio can be evaluated only in terms of the expected return and risk of the portfolio as such. While building a profitable portfolio, the following points should be considered: Determining the appropriate asset, achieving the portfolio designed based on determination of the appropriate asset, review and shifts as between classes of assets to take advantages of risk return characteristics, selection of securities within each asset class, reassessing portfolio weighting and rebalancing strategically.

When constructing a portfolio, the primary consideration is to build the portfolio that is most likely to help an investor achieve his or her financial goals. This optimal portfolio can vary greatly depending on an investor's unique return objectives and risk tolerance. Each investor must choose his own asset allocation strategy according to his constraints, his fundamental convictions and his aversion to risk. Once this strategy has been established, he selects several groups of assets which correspond to his allocation strategy. Pre selection must be carried out on the basis of the criteria of profitability, risk and performance persistence.

CONCLUSION:

The success of every investment decision has become increasingly important in recent times. Making sound investment decision requires both knowledge and skill. Skill is needed to evaluate the risks and returns associated with an investment decision. Knowledge is required regarding the complex investment alternatives available in the economic environment. Aim of the investor is to minimize the risk and maximize the return involved in the investment. This is done only with the help of construction of good portfolio. It is important for each investor to make review of his investment. Failure to do, results in losses.

Some of the investors hold the securities for sentimental reasons. So they don't effect revision whenever it is warranted. Moreover the investors do not use the buy and hold strategy. He sells his shares without a waiting period and thereby incurs loss. Some other types of investors will continue to hold the shares unless they require money. This situation may also lead to loss. Portfolio revision is the only solution for this.

A well-diversified portfolio is the best bet for consistent long-term growth of investments. It protects the assets from the risks of large declines and structural changes in the economy over time. Monitoring the diversification of the portfolio, making adjustments when necessary will greatly increase the chances of long-term financial success.

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