Investment Analysis and Portfolio Management

Introduction

Investment or investing is a term with several closely-related meanings in business Management, finance and economics, related to saving or deferring consumption.

Investment is the choice by the individual to risk his savings with the hope of gain. Rather than store the good produced, or its money equivalent, the investor chooses to use that good either to create a durable consumer or producer good, or to lend the original saved good to another in exchange for either interest or a share of the profits.

In the first case, the individual creates durable consumer goods, hoping the services from the good will make his life better. In the second, the individual becomes an entrepreneur using the resource to produce goods and services for others in the hope of a profitable sale. The third case describes a lender, and the fourth describes an investor in a share of the business. In each case, the consumer obtains a durable asset or investment, and accounts for that asset by recording an equivalent liability. As time passes, and both prices and interest rates change, the value of the asset and liability also change.

An asset is usually purchased, or equivalently a deposit is made in a bank, in hopes of getting a future return or interest from it. The word originates in the Latin "vestis", meaning garment, and refers to the act of putting things (money or other claims to resources) into others' pockets. See Invest. The basic meaning of the term being an asset held to have some recurring or capital gains. It is an asset that is expected to give returns without any work on the asset per se.

Investing in various types of assets is an interesting activity that attracts people from all walks of life irrespective of their occupation, economic status, education and family background. When a person has more money than he requires for current consumption, he would be coined as a potential investor. The investor who is having extra cash could invest it in securities or in any other assets like or gold or real estate or could simply deposit it in his bank account. The companies that have extra income may like to invest their money in the extension of the existing firm or undertake new venture. All of these activities in a broader sense mean investment.

We can define investment as the process of, "sacrificing something now for the prospect of gaining something later". So, the definition implies that we have four dimensions to an investment- time, today's sacrifice and prospective gain.

Understanding Investment

- Investment is commitment of fund to one or more assets that is held over some future time period.
- Investing may be very conservative as well as aggressively speculative.
- Whatever be the perspective, investment is important to improve future welfare.
- Fund to be invested may come from assets already owned, borrowed money, saving or foregone consumptions possibilities by increasing their welfare.
- Investment can be made to intangible assets like marketable securities or to real assets like gold, real estates, etc.
- More generally it refers to investment in financial assets.
- Investment refers to the study of the investment process, generally in financial assets like marketable securities to minimize investor's wealth, which is the sum of investor's two primary functions: analysis and management.

Goals of Investment

- Get decent current income.
- Obtain reasonable capital gain.
- Benefit from tax – off.
- Right to participate in growth.
- Reduce risk, given overall return.
- Maximize return, given risk.
- Ensure safety of investment.
- Provide for liquidity Of investment
- Easy transferability
- Preference of pledge ability.
- Protection for future.
- Beat the inflation.
- Sense of participation in national economic development
- Fulfillment of security, social and esteem needs.
- Economic power

Types of Investments

Financial Instruments

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

- **Mutual funds**
  A mutual fund allows a group of people to pool their money together and have it professionally managed, in keeping with a predetermined investment objective. This investment avenue is popular because of its cost-efficiency, risk-diversification, professional management and sound regulation. You can invest as little as Rs. 1,000 per month in a mutual fund. There are various general and thematic mutual funds to choose from and the risk and return possibilities vary accordingly.

- **Bonds**
  Bonds are fixed income instruments which are issued for the purpose of raising capital. Both private entities, such as companies, financial institutions, and the central or state government and other government institutions use this instrument as a means of garnering funds. Bonds issued by the Government carry the lowest level of risk but could deliver fair returns.

- **Deposits**
  Investing in bank or post-office deposits is a very common way of securing surplus funds. These instruments are at the low end of the risk-return spectrum.

- **Cash Equivalents**

  These are relatively safe and highly liquid investment options. Treasury bills and money market funds are cash equivalents.

Non-financial Instruments

- **Real Estate**

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

- **Gold**

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

Investing versus financing

The term 'investing" could be associated with the different activities, but the common target in these activities is to "employ" the money (funds) during the time period seeking to enhance the investor's wealth. Funds to be invested come from assets already owned, borrowed money and savings. By foregoing consumption today and investing their savings, investors expect to enhance their future consumption possibilities by increasing their wealth.

But it is useful to make a distinction between real and financial investments. Real investments generally involve some kind of tangible asset, such as land, machinery, factories, etc. Financial investments involve contracts in paper or electronic form such as stocks, bonds, etc. Following the objective as it presented in the introduction this course deals only with the financial investments because the key theoretical investment concepts and portfolio theory are based on these investments and allow to analyze investment process and investment management decision making in the substantially broader context. Corporate finance area of studies and practice involves the interaction between firms and financial markets and Investments area of studies and practice involves the interaction between investors and financial markets. Investments field also differ from the corporate finance in using the relevant methods for research and decision making. Investment problems in many cases allow for a quantitative analysis and modeling approach and the qualitative methods together with quantitative methods are more often used analyzing corporate finance problems. The other very important difference is, that investment analysis for decision making can be based on the large data sets available from the financial markets, such as stock returns, thus, the mathematical statistics methods can be used.

But at the same time both Corporate Finance and Investments are built upon a common set of financial principles, such as the present value, the future value, the cost of capital). And very often investment and financing analysis for decision making use the same tools, but the interpretation of the results from this analysis for the investor and for the financier would be different. For example, when issuing the securities and selling them in the market the company perform valuation looking for the higher price and for the lower cost of capital, but the investor using valuation search for attractive securities with the lower price and the higher possible required rate of return on his/her investments.

Together with the investment the term speculation is frequently used. Speculation can be described as investment too, but it is related with the short-term investment horizons and usually involves purchasing the salable securities with the hope that its price will increase rapidly, providing a quick profit. Speculators try to buy low and to sell high, their primary concern is with anticipating and profiting from market fluctuations. But as the fluctuations in the financial markets are and become more and more unpredictable speculations are treated as the investments of highest risk. In contrast, an investment is based upon the analysis and its main goal is to promise safety of principle sum invested and to earn the satisfactory risk.

There are two types of investors:

- Individual investors;
- Institutional investors.

Individual investors are individuals who are investing on their own. Sometimes individual investors are called retail investors. Institutional investors are entities such as investment companies, commercial banks, insurance companies, pension funds and other financial institutions. In recent years the process of institutionalization of investors can be observed. As the main reasons for this can be mentioned the fact, that institutional investors can achieve economies of scale, demographic pressure on social security, the changing role of banks.