Portfolio management

Business, Management

A PROJECT REPORT ON PORTFOLIO MANAGEMENT AT SHAREKHAN LTD HYDERABAD A PROJECT REPORT SUBMITTED TO [pic] OSMANIA UNIVERSITY HYDERABAD IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE IN MASTER OF BUSINESS ADMINISTRATION SUBMITTED BY SAFIA MOHAMMADI 1238-11-672-015 VILLA MARIE PG COLLEGE FOR WOMEN SOMAJIGUDA- 82 2011-2013 By DEPARTMENT OF BUSINESS ADMINISTRTION

VILLA MARIE POST GRADUATE COLLEGE, SOMAJIGUDA (Affiliated to Osmania University) 2011-2013 DECLARATION I SAFIA MOHAMMADI student of Master of Business Administration, VILLA MARIE PG COLLEGE FOR WOMEN, hereby declare that the project report entitled “ PORTFOLIO MANAGEMENT” has been carried out at “ SHAREKHAN LTD” and submitted in partial fulfillment for the “ Master’s Degree in Business Administration” in the result of my own work and is original. I have not submitted this project to any other university or college for the award of any other degree or Diploma.

SAFIA MOHAMMADI ACKNOWLEDGEMENT A project is never the work of an individual. It is moreover a combination of ideas, suggestions, review, contribution and work involving many folks. It cannot be completed without guidelines. I wish to express my gratitude to all those who have made significant contribution to the development and presentation of this project. I express my sense of profound gratitude to the Management of “ SHAREKHAN LTD”, Hyderabad for giving me this opportunity to conduct a study on Portfolio Management in their esteemed organization.

My sincere thanks to Mr. DEEPAK, Manager and Ms. SWATHI BASA, Assistant Manager for permitting me to pursue this project and for providing their valuable time, suggestions and support for completing my project work successfully. Their patience and invaluable guidance have proved to be very precious without which this project would not be completed. Acknowledgements are also due to all the other staff members and executives in Sharekhan Ltd. , for providing information at various points of the project, especially the discussions on the market.

I am thankful to our Principal and also I would also like to thank my project guide and all the faculty members of the college for guiding me throughout the process. I also wish to extend my sincere acknowledgement to my parents for their moral and financial support. Lastly, I am indebted to the friends and will-wishers who have extended their support to me during the project. Place: Hyderabad SAFIA MOHAMMADI INDEX CHAPTER-1 INTRODUCTION PORTFOLIO MANAGEMENT: A portfolio is a collection of assets. The assets may be physical or financial like Shares, Bonds, Debentures, Preference Shares, etc. The individual investor or a fund manager would not like to put all hismoneyin the shares of one company that would amount to great risk.

He would therefore, follow the age old maxim that one should not put all the eggs into one basket. By doing so, he can achieve objective to maximize portfolio return and at the same time minimizing the portfolio risk by diversification. Investment may be defined as an activity that commits funds in any financial form in the present with an expectation of receiving additional return in the future. The expectations bring with it a probability that the quantum of return may vary from a minimum to a maximum. This possibility of variation in the actual return is known as investment risk. Thus every investment involves a return and risk. Investment is an activity that is undertaken by those who have savings.

Savings can be defined as the excess of income over expenditure. An investor earns/expects to earn additional monetary value from the mode of investment that could be in the form of financial assets. The three important characteristics of any financial asset are: • Return-the potential return possible from an asset. • Risk-the variability in returns of the asset form the chances of its value going down/up. • Liquidity-the ease with which an asset can be converted into cash. Investors tend to look at these three characteristics while deciding on their individual preference pattern of investments. Each financial asset will have a certain level of each of these characteristics.

An investor invests his funds in portfolio expecting to get a good return consistent with the risk that he has to beat. Portfolio management comprises all the processes involved in the creation & maintenance of an investment portfolio. It deals specifically with Security Analysis, Portfolio Analysis, Selection and Revision & Evaluation. Portfolio Management is a complex process, which tries to make investment activity more rewarding & less risky. ? Portfolio management is the management of various financial assets which comprise the portfolio. ? Portfolio management is a decision – support system that is designed with a view to meet the multi-faced needs of investors.

According to Securities and Exchange Board of India Portfolio is defined as: " portfolio means the total holdings of securities belonging to any person". ? PORTFOLIO MANAGER means any person who pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the client. ? DISCRETIONARY PORTFOLIO MANAGER means a portfolio manager who exercises or may, under a contract relating to portfolio management exercises any degree of discretion as to the investments or management of the portfolio of securities or the funds of the client. Investment avenues

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 risk less. Investment avenues can be broadly categorized under the following head. 1. Corporate securities 2. Equity shares. 3. Preference shares. 4. Debentures/Bonds. 5. Derivatives. 6. Others. Joint stock companies in the private sector issue corporate securities. These include equity shares, preference shares, and debentures. Equity shares have variable dividend and hence belong to the high risk-high return category; preference shares and debentures have fixed returns with lower risk.

The classification of corporate securities that can be chosen as investment avenues can be depicted as shown below: DESIGN OF STUDY NEED AND IMPORTANCE OF THE STUDY • Portfolio management presents the best investment plan to the individuals as per their income, budget, age and ability to undertake risks. • Portfolio management minimizes the risks involved in investing and also increases the chance of making profits. • Portfolio managers understand the client’s financial needs and suggest the best and unique investment policy for them with minimum risks involved. • It enables the portfolio managers to provide customized investment solutions to clients as per their needs and requirements. It also focuses on important aspects like Stability of Income, Capital Growth, Liquidity, Safety, Tax Incentives, etc. • Maingoalsof Portfolio Management are To Maximize the value of the portfolio, To Seek balance in the portfolio and To Keep portfolio projects strategically aligned OBJECTIVES OF THE STUDY: • To provide the material frame work of Portfolio Management • To understand how to analyze securities • To know how portfolio management is done. • To study the investment pattern and its related risks & returns. • To help the investors to choose wisely between alternative investment. • To understand, analyze and select the best portfolio. To strike balance between costs of funds, risks and returns. • To find out optimal portfolio, which gives optimal return at a minimize risk to the investor. • To see whether the portfolio risk is less than individual risk on whose basis the portfolios are constituted SCOPE OF THE STUDY: • This study covers the Markowitz model. The study covers the calculation of correlations between the different securities in order to find out at what percentage funds should be invested among the companies in the portfolio. Also the study includes the calculation of individual Standard Deviation of securities and ends at the calculation of weights of individual securities involved in the portfolio.

These percentages help in allocating the funds available for investment based on risky portfolios. METHODOLOGY: Sources of Data Collection The Methodology employed in this study data include both theprimary and secondarycollection methods. Primary collection methods: This method includes the data collected from the personal discussion with the authorized clerks and members of the exchange. Secondary data collection: It includes the following: • Companies Annual Reports • Information From Internet • Publication • Information provided by Stock Exchanges. Period of Study For different companies, financial data has been collected from the year 2007-2012 Selection of Companies

Companies selected for analysis are:- o Wipro o Indian Tobacco Corporation o Dr. Reddy Laboratories o ACC o Bharat Heavy Electricals LIMITATIONS OF THE STUDY: • This study has been conducted purely to understand portfolio management for investor and is done for requirement of Certificate of MBA. • For study purpose 5 companies have been taken for calculations. • Study is limited to period from 2007-2012. • There was a constraint with regard to time allocated for the research study, period of one and half month. • Study is limited to only first 3 steps of phrases of portfolio management. • Detailed study of the topic was not possible due to limited size of project. The availability of information in the form of annual reports and price fluctuations of the companies was a big constraint to the study. CHAPTER-2 REVIEW OF LITERATURE INTRODUCTION TO PORTFOLIO MANAGEMENT The term Portfolio refers to any collection of financial assets such as stocks, bonds, and cash. Portfolios may be held by individual investors and/or managed by financial professionals, hedge funds, banks and other financial institutions. It is a generally accepted principle that a portfolio is designed according to the investor's risk tolerance, time frame and investment objectives. Portfolio management is all about strengths, weaknesses, opportunities and threats in the choice of debt vs. equity, domestic vs. nternational, growth vs. safety, and many other tradeoffs encountered in the attempt to maximize return at a given appetite for risk. The art andscienceof making decisions about investment mix and policy, matching investments to objectives, asset allocation for individuals and institutions, and balancing risk against performance is known as Portfolio Management. ? PORTFOLIO MANAGER means any person who pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the client. DISCRETIONARY PORTFOLIO MANAGER means a portfolio manager who exercises or may, under a contract relating to portfolio management exercises any degree of discretion as to the investments or management of the portfolio of securities or the funds of the client. FUNCTIONS OF PORTFOLIO MANAGEMENT: ? To frame the investment strategy and select an investment mix to achieve the desired investment objectives ? To provide a balanced portfolio which not only can hedge against the inflation but can also optimize returns with the associated degree of risk ? To make timely buying and selling of securities ? To maximize the after-tax return by investing in various tax saving investment instruments.

STRUCTURE / PROCESS OF TYPICAL PORTFOLIO MANAGEMENT In the small firm, the portfolio manager performs the job of security analyst. In the case of medium and large sized organizations, job function of portfolio manager and security analyst are separate. CHARACTERISTICS OF PORTFOLIO MANAGEMENT: Individuals will benefit immensely by taking portfolio management services for the following reasons: ? Whatever may be the status of the capital market, over the long period capital markets have given an excellent return when compared to other forms of investment. The return from bank deposits, units, etc. , is much less than from the stock market. ? The Indian Stock Markets are very complicated.

Though there are thousands of companies that are listed only a few hundred which have the necessary liquidity. Even among these, only some have the growth prospects which are conducive for investment. It is impossible for any individual wishing to invest and sit down and analyse all these intricacies of the market unless he does nothing else. ? Even if an investor is able to understand the intricacies of the market and separate chaff from the grain the trading practices in India are so complicated that it is really a difficult task for an investor to trade in all the major exchanges of India, look after his deliveries and payments. TYPES OF PORTFOLIO MANAGEMENT: Discretionary Portfolio Management Service(DPMS):

In this type of service, the client parts with his money in favour of the manager, who in return, handles all the paper work, makes all the decisions and gives a good return on the investment and charges fee. In the

Discretionary Portfolio Management Service, to maximize the yield, almost all portfolio managers park the funds in the money market securities such as overnight market, 18 days treasury bills and 90 days commercial bills. Normally, the return of such investment varies from 14 to 18 percent, depending on the call money rates prevailing at the time of investment. 2. Non-Discretionary Portfolio Management Service(NDPMS): The manager functions as a counselor, but the investor is free to accept or reject the manager‘ s advice; the paper work is also undertaken by manager for a service charge.

The manager concentrates on stock market instruments with a portfolio tailor-made to the risk taking ability of the investor. Risk of Portfolio Management There was a time when portfolio management was an exotic term. The scenario has changed drastically. It is now a familiar term and is widely practiced in India. The theories and concepts relating to portfolio management now find their way to the front pages financial newspapers and the cover pages of investments journals in India. Capital markets have become active. The Indian stock markets are steadily moving towards efficiency, with rapid computerization, increasing higher market transparency, better infrastructure, better customer service etc.

The markets are mutual funds have been set up the country since1987. With this development investment in securities has gained considered momentum. Professional portfolio management backed by competent research began to be practiced by mutual funds, investment consultant and big brokers. The Securities Exchange Board of India (SEBI), The Stock Market Regulatory body in India is supervising the whole process. IMPORTANCE OF

PORTFOLIO MANAGEMENT: ? Emergence of institutional investing on behalf of individuals. A number of financial institutions, mutual funds and other agencies are undertaking the task of investing money of small investors, on their behalf. Growth in the number and size of investible funds – a large part of household savings is being directed towards financial assets. ? Increased market volatility – risk and return parameters of financial assets are continuously changing because of frequent changes in government' s industrial and fiscal policies, economic uncertainty and instability. ? Greater use of computers for processing mass of data. ? Professionalization of the field and increasing use of analytical methods (e. g. quantitative techniques) in the investment decision – making ? Larger direct and indirect costs of errors or shortfalls in meeting portfolio objectives – increased competition and greater scrutiny by investors.

STEPS IN PORTFOLIO MANAGEMENT: ? Specification and qualification of investor objectives, constraints, and preferences in the form of an investment policy statement. ? Determination and qualification of capital market expectations for the economy, market sectors, industries and individual securities. ? Allocation of assets and determination of appropriate portfolio strategies for each asset class and selection of individual securities. ? Performance measurement and evaluation to ensure attainment of investor objectives. ? Monitoring portfolio factors and responding to changes in investor objectives, constrains and / or capital market expectations. Rebalancing the portfolio when necessary by repeating the asset allocation, portfolio strategy and security selection. CRITERIA FOR PORTFOLIO DECISIONS: • In portfolio management emphasis is put on identifying the collective importance of all investor’s holdings. The emphasis shifts from individual assets selection to a more balanced emphasis on diversification and risk-return interrelationships of individual assets within the portfolio. Individual securities are important only to the extent they affect the aggregate portfolio. In short, all decisions should focus on the impact which the decision will have on the aggregate portfolio of all the assets held. • Portfolio strategy should be molded to the unique needs and characteristics of the portfolio‘ s owner. Diversification across securities will reduce a portfolio‘ s risk. If the risk and return are lower than the desired level, leverages (borrowing) can be used to achieve the desired level. • Larger portfolio returns come only with larger portfolio risk. The most important decision to make is the amount of risk which is acceptable. • The risk associated with a security type depends on when the investment will be liquidated. Risk is reduced by selecting securities with a payoff close to when the portfolio is to be liquidated. QUALITIES OF PORTFOLIO MANAGER: 1. SOUND GENERAL KNOWLEDGE: Portfolio management is an exciting and challenging job. He has to work in an extremely uncertain and conflictionenvironment.

In the stock market every new piece of information affects the value of the securities of different industries in a different way. He must be able to judge and predict the effects of the information he gets. He must have sharp memory, alertness, fast intuition and self-confidence to arrive at quick decisions. 2. ANALYTICAL ABILITY: He must have his own theory to arrive at the intrinsic value of the security. An analysis of the security‘ s values, company, etc. is s continuous job of the portfolio manager. A good analyst makes a good financial consultant. The analyst can know the strengths, weaknesses, opportunities of the economy, industry and the company. 3. MARKETING SKILLS: He must be good salesman. He has to convince the clients about the particular security.

He has to compete with the stock brokers in the stock market. In this context, the marketing skills help him a lot. 4. EXPERIENCE: In the cyclical behavior of the stock market history is often repeated, therefore the experience of the different phases helps to make rational decisions. The experience of the different types of securities, clients, market trends, etc. , makes a perfect professional manager. PORTFOLIO BUILDING: Portfolio decisions for an individual investor are influenced by a wide variety of factors. Individuals differ greatly in their circumstances and therefore, a financial programme well suited to one individual may be inappropriate for another.

Ideally, an individual‘ s portfolio should be tailor-made to fit one‘ s individual needs. Investor‘ s Characteristics: An analysis of an individual‘ s investment situation requires a study of personal characteristics such as age, healthconditions, personal habits, familyresponsibilities, business or professional situation, and tax status, all of which affect the investor‘ s willingness to assume risk. Stage in the Life Cycle: One of the most important factors affecting the individual‘ s investment objective is his stage in the life cycle. A young person may put greater emphasis on growth and lesser emphasis on liquidity. He can afford to wait for realization of capital gains as his time horizon is large. Family responsibilities:

The investor‘ s marital status and his responsibilities towards other members of the family can have a large impact on his investment needs and goals. Investor‘ s experience: The success of portfolio depends upon the investor‘ s knowledge and experience in financial matters. If an investor has an aptitude for financial affairs, he may wish to be more aggressive in his investments. Attitude towards Risk: A person‘ s psychological make-up and financial position dictate his ability to assume the risk. Different kinds of securities have different kinds of risks. The higher the risk, the greater the opportunity for higher gain or loss. Liquidity Needs: Liquidity needs vary considerably among individual investors.

Investors with regular income from other sources may not worry much about instantaneous liquidity, but individuals who depend heavily upon investment for meeting their general or specific needs, must plan portfolio to match their liquidity needs. Liquidity can be obtained in two ways: 1. by allocating an appropriate percentage of the portfolio to bank deposits, and 2. by requiring that bonds and equities purchased be highly marketable. Tax considerations: Since different individuals, depending upon their incomes, are subjected to different marginal rates of taxes, tax considerations become most important factor in individual‘ s portfolio strategy. There are differing tax treatments for investment in various kinds of assets. Time Horizon:

In investment planning, time horizon become an important consideration. It is highly variable from individual to individual. Individuals in their young age have long time horizon for planning, they can smooth out and absorb the ups and downs of risky combination. Individuals who are old have smaller time horizon, they generally tend to avoid volatile portfolios. Individual‘ s Financial

Objectives: In the initial stages, the primary objective of an individual could be to accumulate wealth via regular monthly savings and have an investment programme to achieve long term capital gains. Safety of Principal: The protection of the rupee value of the investment is of prime importance to most investors.

The original investment can be recovered only if the security can be readily sold in the market without much loss of value. Assurance of Income: `Different investors have different current income needs. If an individual is dependent of its investment income for current consumption then income received now in the form of dividend and interest payments become primary objective. Investment Risk: All investment decisions revolve around the trade-off between risk and return. All rational investors want a substantial return from their investment. An ability to understand, measure and properly manage investment risk is fundamental to any intelligent investor or a speculator.

Frequently, the risk associated with security investment is ignored and only the rewards are emphasized. An investor who does not fully appreciate the risks in security investments will find it difficult to obtain continuing positive results. RISK AND EXPECTED RETURN: There is a positive relationship between the amount of risk and the amount of expected return i. e. , the greater the risk, the larger the expected return and larger the chances of substantial loss. One of the most difficult problems for an investor is to estimate the highest level of risk he is able to assume. [pic] TYPES OF RISKS:- Risk consists of two components. They are 1. Systematic Risk 2. Un-systematic Risk 1. Systematic Risk:

Systematic risk is caused by factors external to the particular company and uncontrollable by the company. The systematic risk affects the market as a whole. Factors affect the systematic risk are ? economic conditions ? political conditions ? sociological changes The systematic risk is unavoidable. Systematic risk is further sub-divided into three types. They are a) Market Risk b) Interest Rate Risk c) Purchasing Power Risk a) Market Risk: One would notice that when the stock market surges up, most stocks post higher price. On the other hand, when the market falls sharply, most common stocks will drop. It is not uncommon to find stock prices falling from time to time while a company' s earnings are rising and vice-versa.

The price of stock may fluctuate widely within a short time even though earnings remain unchanged or relatively stable b) Interest Rate Risk: Interest rate risk is the risk of loss of principal brought about the changes in the interest rate paid on new securities currently being issued. c) Purchasing Power Risk: The typical investor seeks an investment which will give him current income and / or capital appreciation in addition to his original investment. 2. Un-systematic Risk: Un-systematic risk is unique and peculiar to a firm or an industry. The nature and mode of raisingfinanceand paying back the loans, involve the risk element. Financial leverage of the companies that is debt-equity portion of the companies differs from each other.

All these factors Factors affect the un-systematic risk and contribute a portion in the total variability of the return. ? Managerial inefficiently ? Technological change in the production process ? Availability of raw materials ? Changes in the consumer preference ? Labour problems The nature and magnitude of the above mentioned factors differ from industry to industry and company to company. They have to be analyzed separately for each industry and firm. Un-systematic risk can be broadly classified into: a) Business Risk b) Financial Risk a. Business Risk: Business risk is that portion of the unsystematic risk caused by the operating environment of the business.

Business risk arises from the inability of a firm to maintain its competitive edge and growth or stability of the earnings. The volatibility in stock prices due to factors intrinsic to the company itself is known as Business risk. Business risk is concerned with the difference between revenue and earnings before interest and tax. Business risk can be divided into. i) Internal Business Risk Internal business risk is associated with the operational efficiency of the firm. The operational efficiency differs from company to company. The efficiency of operation is reflected on the company‘ s achievement of its pre-set goals and the fulfillment of the promises to its investors. ii)External Business Risk

External business risk is the result of operating conditions imposed on the firm by circumstances beyond its control. The external environments in which it operates exert some pressure on the firm. The external factors are social and regulatory factors, monetary and fiscal policies of the government, business cycle and the general economic environment within which a firm or an industry operates. b. Financial Risk: It refers to the variability of the income to the equity capital due to the debt capital. Financial risk in a company is associated with the capital structure of the company. Capital structure of the company consists of equity funds and borrowed funds. PORTFOLIO ANALYSIS:

Various groups of securities when held together behave in a different manner and give interest payments and dividends also, which are different to the analysis of individual securities. A combination of securities held together will give a beneficial result if they are grouped in a manner to secure higher return after taking into consideration the risk element. SELECTION OF PROTFOLIO: The selection of portfolio depends on the various objectives of the investor. The selection of portfolio under different objectives are dealt subsequently. Objectives and asset mix: if the main objective is getting adequate amount of current income, sixty per cent of the investment is made on debts and 40 per cent on equities. The proportions of investments on debt and equity differ according to the individual's preferences.

Growth of income and asset mix: Here the investor requires a certain percentage of growth in the income received from his investment. The debt portion of the portfolio may consist of 60 to 100 percent equities and 0 to 40 percent debt instrument. The debt portion of the portfolio may consist of concession regarding tax exemption. Appreciation of principal amount is given third priority. For example computer software, hardware and non-conventional energy producing company shares provides good possibility of growth in dividend. Capital appreciation and asset mix: Capital appreciation means that the valu of the original investment increases over the years.

Investment in real estates like land and house may provide a faster rate of capital appreciation but they lack liquidity. In the capital market, the values of the shares are much higher than their original issue prices. Safety of principal and asset mix: Usually, the risk averse investors are very particular about the stability of principal. According to the life cycle theory, people in the third stage of life also give more importance to the safety of the principal. All the investors have this objective in their mind. No one like to lose his money invested in different assets. Risk and return analysis: The traditional approach to portfolio building has some basic assumptions. First, 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 is dependent upon his ability to judge risk and his ability to take specific risks. Diversification: Once the asset mix is determined and the risk and return are analyzed, the final step is the diversification of portfolio. Financial risk can be minimized by commitments to top-quality bonds, but these securities offer poor resistance to inflation. Stocks provide better inflation protection than bonds but are more vulnerable to financial risks. PORTFOLIO CONSTRUCTION: Portfolio is a combination of securities such as stocks, bonds and money market instruments.

The process of blending together the broad asset so as to obtain optimum return with minimum risk is called portfolio construction. Diversification of investments helps to spread risk over many assets. A diversification of securities gives the assurance of obtaining the anticipated return on the portfolio. APPROACHES IN PORTFOLIO CONSTRUCTION: There are two approaches in construction of the portfolio of securities. They are ? Traditional approach ? Modern approach TRADITIONAL APPROACH: Traditional approach was based on the fact that risk could be measured on each individual security through the process of finding out the standard deviation and that security should be chosen where the deviation was the lowest.

Traditional approach believes that the market is inefficient and the fundamental analyst can take advantage of the situation. Traditional approach is a comprehensive financial plan for the individual. It takes into account the individual needs such as housing, life insurance and pension plans. Traditional approach basically deals with two major decisions. They are a) Determining the objectives of the portfolio b) Selection of securities to be included in the portfolio MODERN APPROACH: Modern approach theory was brought out by Markowitz and Sharpe. It is the combination of securities to get the most efficient portfolio. Combination of securities can be made in many ways. Markowitz developed the theory of diversification through scientific reasoning and method.

Modern portfolio theory believes in the maximization of return through a combination of securities. The modern approach discusses the relationship between different securities and then draws inter-relationships of risks between them. Markowitz gives more attention to the process of selecting the portfolio. It does not deal with the individual needs. In the modern approach, the final step is asset allocation process that is to choose the portfolio that meets he requirement of the investor. The risk taker i. e. who are willing to accept a higher probability of risk for getting the expected return would choose high risk portfolio. Investor with lower tolerance for risk would choose low level risk portfolio.

The risk neutral investor would choose the medium level risk portfolio. MARKOWITZ MODEL: Harry Markowitz opened new vistas to modern portfolio selection by publishing an article in the journal of Finance in March 1952. His publication indicated the importance of correlation among the different stocks reruns in the construction of a stock portfolio. Most people agree that holding two stocks is less risky than holding one stock. For example, holding stocks from textile, banking, and electronic companies is better than investing all the money on the textile company’s stock. But building up the optimal portfolio is very difficult. Markowitz provides an answer to it with the help of risk and return relationship.

Markowitz model is a theoretical framework for analysis of risk and return and their relationships. He used statistical analysis for the measurement of risk and mathematical programming for selection of assets in a portfolio in an efficient manner. Markowitz approach determines for the investor the efficient set of portfolio through three important variables i. e. ? Return ? Standard deviation ? Co-efficient of correlation Markowitz model is also called as an “ Full Covariance Model“. Through this model the investor can find out the efficient set of portfolio by finding out the tradeoff between risk and return, between the limits of zero and infinity.

According to this theory, the effects of one security purchase over the effects of the other security purchase are taken into consideration and then the results are evaluated. Most people agree that holding two stocks is less risky than holding one stock. For example, holding stocks from textile, banking and electronic companies is better than investing all the money on the textile company‘ s stock. Markowitz had given up the single stock portfolio and introduced diversification. The single stock portfolio would be preferable if the investor is perfectly certain that his expectation of highest return would turn out to be real. In the world of uncertainty, most of the risk adverse investors would like to join Markowitz rather than keeping a single stock, because diversification reduces the risk. ASSUMPTIONS: All investors would like to earn the maximum rate of return that they can achieve from their investments. ? All investors have the same expected single period investment horizon. ? All investors before making any investments have a common goal. This is the avoidance of risk because Investors are risk-averse. ? Investors base their investment decisions on the expected return and standard deviation of returns from a possible investment. ? Perfect markets are assumed (e. g. no taxes and no transaction costs). ? The investor assumes that greater or larger the return that he achieves on his investments, the higher the risk factor surrounds him. On the contrary when risks are low the return can also be expected to be low. The investor can reduce his risk if he adds investments to his portfolio. ? An investor should be able to get higher return for each level of risk " by determining the efficient set of securities". ? An individual seller or buyer cannot affect the price of a stock. This assumption is the basic assumption of the perfectly competitive market. ? Investors make their decisions only on the basis of the expected returns, standard deviation and covariance's of all pairs of securities. ? Investors are assumed to have homogenous expectations during the decision-making period. ? The investor can lend or borrow any amount of funds at the riskless rate of interest.

The riskless rate of interest is the rate of interest offered for the treasury bills or Government securities. ? Investors are risk-averse, so when given a choice between two otherwise identical portfolios, they will choose the one with the lower standard deviation. ? Individual assets are infinitely divisible, meaning that an investor can buy a fraction of a share if he or she so desires. ? There is a risk free rate at which an investor may either lend (i. e. invest) money or borrow money and There is no transaction cost i. e. no cost involved in buying and selling of stocks. ? There is no personal income tax. Hence, the investor is indifferent to the form of return either capital gain or dividend.

The Effect Of Combining Two Securities: It is believed that holding two securities is less risky than by having only one investment in a person' s portfolio. When two stocks are taken on a portfolio and if they have negative correlation then risk can be completely reduced because the gain on one can offset the loss on the other. This can be shown with the help of following example: Inter-Active Risk Through Covariance: Covariance of the securities will help in finding out the inter-active risk. When the covariance will be positive then the rates of return of securities move together either upwards or downwards. Alternatively it can also be said that the inter-active risk is positive.

Secondly, covariance will be zero on two investments if the rates of return are independent. Holding two securities may reduce the portfolio risk too. The portfolio risk can be calculated with the help of the following formula: CAPITAL ASSET PRICING MODEL (CAPM): Markowitz, William Sharpe, John Lintner and Jan Mossin provided the basic structure for the Capital Asset Pricing Model. It is a model of linear general equilibrium return. In the CAPM theory, the required rate return of an asset is having a linear relationship with asset' s beta value i. e. undiversifiable or systematic risk (i. e. market related risk) because non market risk can be eliminated by diversification and systematic risk measured by beta.

Therefore, the relationship between an assets return and its systematic risk can be expressed by the CAPM, which is also called the Security Market Line. Lending and borrowing:- Here, it is assumed that the investor could borrow or lend any amount of money at riskless rate of interest. When this opportunity is given to the investors, they can mix risk free assets with the risky assets in a portfolio to obtain a desired rate of risk-return combination. Rp = Portfolio return Xf = The proportion of funds invested in risk free assets 1- Xf = The proportion of funds invested in risky assets Rf = Risk free rate of return Rm = Return on risky assets The expected return on the combination of risky and risk free combination is Rp= Rf Xf+ Rm(1- Xf)

Formula can be used to calculate the expected returns for different situations, like mixing riskless assets with risky assets, investing only in the risky asset and mixing the borrowing with risky assets. THE CONCEPT: According to CAPM, all investors hold only the market portfolio and risk less securities. The market portfolio is a portfolio comprised of all stocks in the market. Each asset is held in proportion to its market value to the total value of all risky assets. For example, if Reliance Industry share represents 15% of all risky assets, then the market portfolio of the individual investor contains 15% of Satyam Industry shares. At this stage, the investor has the ability to borrow or lend any amount of money at the risk less rate of interest. Eg. assume that borrowing and lending rate to be 12. 5% and the return from the risky assets to be 20%. There is a tradeoff between the expected return and risk. If an investor invests in risk free assets and risky assets, his risk may be less than what he invests in the risky asset alone. But if he borrows to invest in risky assets, his risk would increase more than he invests his own money in the risky assets. When he borrows to invest, we call it financial leverage. If he invests 50% in risk free assets and 50% in risky assets, his expected return of the portfolio would be Rp= Rf Xf+ Rm(1- Xf) = (12. 5 x 0. 5) + 20 (1-0. 5) = 6. 25 + 10 = 16. 5% if there is a zero investment in risk free asset and 100% in risky asset, the return is Rp= Rf Xf+ Rm(1- Xf) = 0 + 20% i. e. 20% if -0. 5 in risk free asset and 1. 5 in risky asset, the return is Rp= Rf Xf+ Rm(1- Xf) = (12. 5 x -0. 5) + 20 (1. 5) = -6. 25+ 30 = 23. 75% EVALUATION OF PORTFOLIO: Portfolio manager evaluates his portfolio performance and identifies the sources of strengths and weakness. The evaluation of the portfolio provides a feedback about the performance to evolve better management strategy. Even though evaluation of portfolio performance is considered to be the last stage of investment process, it is a continuous process.

There are number of situations in which an evaluation becomes necessary and important. i. Self-Valuation: An individual may want to evaluate how well he has done. This is a part of the process of refining his skills and improving his performance over a period of time. ii. Evaluation of Managers: A mutual fund or similar organization might want to evaluate its managers. A mutual fund may have several managers each running a separate fund or sub-fund. It is often necessary to compare the performance of these managers. iii. Evaluation of Mutual Funds: An investor may want to evaluate the various mutual funds operating in the country to decide which, if any, of these should be chosen for investment.

A similar need arises in the case of individuals or organizations who engage external agencies for portfolio advisory services. iv. Evaluation of Groups: Academics or researchers may want to evaluate the performance of a whole group of investors and compare it with another group of investors who use different techniques or who have different skills or access to different information. NEED FOR EVALUATION OF PORTFOLIO: ? We can try to evaluate every transaction. Whenever a security is brought or sold, we can attempt to assess whether the decision was correct and profitable. ? We can try to evaluate the performance of a specific security in the portfolio to determine whether it has been worthwhile to include it in our portfolio. We can try to evaluate the performance of portfolio as a whole during the period without examining the performance of individual securities within the portfolio. Portfolio management has emerged as a separateacademicdiscipline in India. Portfolio theory that deals with the rational investment decision-making process has now become an integral part of financial literature. Investing in securities such as shares, debentures & bonds is profitable well as exciting. It is indeed rewarding but involves a great deal of risk & need artistic skill. Investing in financial securities is now considered to be one of the most risky avenues of investment. It is rare to find investors investing their entire savings in a single security. Instead, they tend to invest in a group of securities.

Such group of securities is called as PORTFOLIO. Creation of portfolio helps to reduce risk without sacrificing returns. Portfolio management deals with the analysis of individual securities as well as with the theory & practice of optimally combining securities into portfolios. The modern theory is of the view that by diversification, risk can be reduced. The investor can make diversification either by having a large number of shares of companies in different regions, in different industries or those producing different types of product lines. Modern theory believes in the perspective of combinations of securities under constraints of risk and return.

PORTFOLIO REVISION: The portfolio which is once selected has to be continuously reviewed over a period of time and then revised depending on the objectives of the investor. The care taken in construction of portfolio should be extended to the review and revision of the portfolio. Fluctuations that occur in the equity prices cause substantial gain or loss to the investors. The investor should have competence and skill in the revision of the portfolio. The portfolio management process needs frequent changes in the composition of stocks and bonds. In securities, the type of securities to be held should be revised according to the portfolio policy.

An investor purchases stock according to his objectives and return risk framework. The prices of stock that he purchases fluctuate, each stock having its own cycle of fluctuations. These price fluctuations may be related to economic activity in a country or due to other changed circumstances in the market. If an investor is able to forecast these changes by developing a framework for the future through careful analysis of the behavior and movement of stock prices is in a position to make higher profit than if he was to simply buy securities and hold them through the process of diversification. Mechanical methods are adopted to earn better profit through proper timing.

The investor uses formula plans to help him in making decisions for the future by exploiting the fluctuations in prices. PASSIVE MANAGEMENT:

Passive management is a process of holding a well diversified portfolio for a long 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. The simplest form of passive management is holding the index fund that is designed to replicate a good and well defined index of the common stock such as BSE-sensex or NSE-Nifty. ACTIVE MANAGEMENT: Active management is holding securities based on gthe forecast about the future.

The portfolio managers who pursue active strategy withrespectto market components are called ‘ market timers’. The portfolio managers vary their cash position or beta of the equity portion of the portfolio based on the market forecast. The managers may indulge in ‘ group rotation’s. here, the group rotation means changing the investment in different industries’ stocks depending on the assessed expectations regarding their future performance. FORMULA PLANS: The formula plans provide the basic rules and regulations for the purchase and sale of securities. The amount to be spent on the different types of securities is fixed. The amount may be fixed either in constant or variable ratio. This depends on the investor‘ s attitude towards risk and return.

The commonly used formula plans are i. Average Rupee Plan ii. Constant Rupee Plan iii. Constant Ratio Plan iv. Variable Ratio Plan ADVANTAGES: ? Basic rules and regulations for the purchase and sale of securities are provided. ? The rules and regulations are rigid and help to overcome human emotion. ? The investor can earn higher profits by adopting the plans. ? A course of action is formulated according to the investor‘ s objectives. ? It controls the buying and selling of securities by the investor. ? It is useful for taking decisions on the timing of investments. DISADVANTAGES: ? The formula plan does not help the selection of the security.

The selection of the security has to be done either on the basis of the fundamental or technical analysis. ? It is strict and not flexible with the inherent problem of adjustment. ? The formula plans should be applied for long periods, otherwise the transaction cost may be high. ? Even if the investor adopts the formula plan, he needs forecasting. Market forecasting helps him to identify the best stocks. CHAPTER-3 COMPANY PROFILE SHAREKHAN LTD Sharekhan Ltd. is one of the leading retail stock broking house of SSKI Group which is running successfully since 1922 in the country. It is the retail broking arm of the Mumbai-based SSKI Group, which has over eight decades of experience in the stock broking business.

Sharekhan offers its customers a wide range of equity related services including trade execution on BSE, NSE, Derivatives, depository services, online trading, investment advice etc. The firm's online trading and investment site - www. sharekhan. com- was launched on Feb 8, 2000. The site gives access to superior content and transaction facility to retail customers across the country. Known for its jargon-free, investor friendly language and high quality research, the site has a registered base of over one lakh customers. The content-rich and research oriented portal has stood out among its contemporaries because of its steadfast dedication to offering customers best-of-breedtechnologyand superior market information.

The objective has been to let customers make informed decisions and to simplify the process of investing in stocks. On April 17, 2002 Sharekhan launched Speed Trade, a net-based executable application that emulates the broker terminals along with host of other information relevant to the Day Traders. This was for the first time that a net-based trading station of this caliber was offered to the traders. In the last six months Speed Trade has become a de facto standard for the Day Trading community over the net. Sharekhan's ground network includes over 640 centers in 280 cities in India which provide a host of trading related services. Sharekhan has always believed in investing in technology to build its business.

The company has used some of the best-known names in the IT industry, like Sun Microsystems, Oracle, Microsoft, Cambridge Technologies, Nex genix, Vignette, Verisign Financial Technologies India Ltd, Spider Software Pvt Ltd. To build its trading engine and content. The Morakhiya family holds a majority stake in the company. HSBC, Intel & Carlyle are the other investors. With a legacy of more than 80 years in the stock markets, the SSKI groupventured into institutional broking and corporate finance 18 years ago. Presently SSKI is one of the leading players in institutional broking andcorpor ate finance activities. SSKI holds a sizeable portion of the market in each of these segments.

SSKI's institutional broking arm accountsfo7%of the market for Foreign Institutional portfolio investment and 5% of allDomestic Institutional portfolio investment in the country.

It has 60institutional clients spread over India, Far East, UK and US.

ForeignInstitutional Investors generate about 65% of the organization's revenue, with a daily turnover of over US$ 2 million. The Corporate Finance section has a listof very prestigious clients and has many ' firsts' to its credit, in terms of the size of deal, sector tapped etc. The group has placed over US$ 1 billion in private equity deals. PROFILE OF THE COMPANY: Name of the company : Sharekhan ltd.

Year of Establishment : 1925 Headquarter : ShareKhan SSKI A-206 Phoenix House Phoenix Mills Compound Lower Parel, Mumbai - Maharashtra, INDIA-400013 Nature of Business : Service Provider Services : Depository Services, Online Services and Technical Research. Number of Employees : Over 3500 Website : www. sharekhan. com Slogan : Your guide to the financial jungle Vision To be the best retail brokering Brand in the retail business of stock market. Mission

To educate and empower the individual investor to make better investmentdecisions through quality advice and superior service Sharekhan is infact: • Among the top 3 branded retail service providers • No. 1 player in online business • Largest network of branded broking outlets in the country serving more than7, 00, 000 clients Sharekhan's management team is one of the strongest in the sector and has positioned Sharekhan to take advantage of the growing consumer demand for financial services products in India through investments in research, pan-Indian branch network and an outstanding technology platform. Further, Sharekhan's lineage and relationship with SSKI Group provide it a unique position to understand and leverage the growth of the financial services sector.

SSKI Corporate Finance Private Limited (SSKI) is a leading India-based investment bank with strong research-driven focus. Their team members are widely respected for their commitment to transactions and their specialized knowledge in their areas of strength ITA CORE SERVICES ARE: ? Equities, and

Derivatives trading on the National Stock Exchange of India Ltd. (NSE), and Bombay Stock Exchange Ltd. (BSE), ? Commodities trading on National Commodity and Derivatives Exchange India(NCDEX) and Multi Commodity Exchange of India Ltd. (MCX), ? Depository services, ? Online trading services, ? IPO Services, ? Dial-n-Trade ? Portfolio management services, Fundamental and Technical Research services, ? In addition to this they also provide advisory services and distributions for mutual funds. ? Sharekhan ValueLine (a monthly publication with reviews of recommendations, stocks to watch out for etc.) ? Daily research reports and market review (High Noon & Eagle Eye) ? Pre-market Report ? Daily trading calls based on Technical Analysis ? Cool trading products (Daring Derivatives and Market Strategy) REASONS TO CHOOSE SHAREKHAN: ? Experience : SSKI has more than eight decades of trust and credibility in the Indian Stock Market. In the Asia Money Broker’s Poll held recently, SSKI won the ‘ India’s Best broking house for 2004’ award.

Ever since it launched Sharekhan as its retail broking division in February in 2000, it has been providing institutional-level research and broking services to individual investors. ? Technology: With their Online Trading account one can buy and sell shares in an instant from any PC with an internet connection. Customers get access to the powerful online trading tools that will help them to take complete control over their investments in shares. ? Accessibility: Sharekhan provides Advice, Education, Tools and Education services for investors. These services are accessible through many centers across the country (over 650 locations in 150 cities), over the internet (through the website www. sharekhan. ltd) as well as over the voice tool. ? Knowledge:

In a business where the right information at the right time can translate into direct profits investors get access to a wide range of information on the content rich portal www. sharekhan. com. Investors will also get a useful set of knowledge-based tools that will empower them to take informed decisions ? Convenience: One can call Sharekhan’s Dial-N-Trade number to get investment advice and execute his/her transactions. They have a dedicated call-center to provide this service via a Toll Free Number 1800 22-7500 & 39707500 from anywhere in India. ? Customer Service: Its customer service team assist their customer for any help that they need relating to transactions, billing, demat and other queries.

Their customer service can be contacted via a toll-free number, email or live chat on www. sharekhan. com. ? Investment Advice: Sharekhan has dedicated research teams of more than 30 people for fundamental and technical research. Their analysts constantly track the pulse of the market and provide timelyinvestment advice to customer in the form of daily research emails, online chat, printed reports etc. SHAREKHAN LIMITED’S MANAGEMENT TEAM • Dinesh Murikya : Owner of the company • Tarun Shah : CEO of the company • Shankar Vailaya : Director (Operations) • Jaideep Arora : Director (Products & Technology) • Pathik Gandotra : Head of Research Rishi Kohli : Vice President of Equity Derivatives • Nikhil Vora : Vice President of Research BENEFITS • Free Depository A/c • Instant Cash Transfer • Multiple Bank Option. • Secure Order by Voice Tool Dial-n-Trade. •

Automated Portfolio to keep track of the value of your actual purchases. • 24*7 Voice Tool access to your trading account. • Personalized Price and Account Alerts delivered instantly to your mobile phone • Live chat facility with Relationship manager on Yahoo Messenger. • Special Personal inbox for order and trade confirmations. • On-line customer service via web chat. • Enjoy automated Portfolio. Buy or sell even single share. • Anytime ordering. Sharekhan provides 4 in 1 account: *Demat a/c *Bank a/c: for fund transfer *Dial and Trade: for query relating trading *Trading a/c: for cash calculation DEMAT ACCOUNT: Sharekhan is a depository participant. This means that we can keep the shares in dematerialized form in Sharekhan. But for this one has to the demat account in Sharekhan. Dematerialization is the process by which a client can get physical certificates converted into electronic balances maintained in his account with the DP. In Sharekhan, under demat account there are two types of terminals Classic and Trade Tiger. ACCOUNT OPENING:

Opening a DP account with Sharekhan-One can open a Depository Participant (DP) account, either through a Sharekhan branch or through a Sharekhan Franchisee center. There is no fee for opening DP accounts with Sharekhan. However a nominal deposit (refundable) is charged towards services which will be adjusted against all future billings. All investors have to submit their proof of identity and proof of address along with the prescribed account opening form. CLASSICAL ACCOUNT: This is a user friendly product which allow the client to trade through website www. sharekhan. com and is suitable for all the retial investors who is risk averse and hence prefers to invest in stocks or who does not trade too frequently

Features Online trading account for investing in equity and derivatives via www. sharekhan. com • Live Terminal and Single terminal for NSE Cash, NSE F&O & BSE. • Integration of On-line trading, Saving Bank and Demat Account. • Instant cash transfer facility against purchase & sale of shares. • Competitive transaction charges. • Instant order and trade confirmation by E-mail. • Streaming Quotes (Cash & Derivatives). • Personalized market watch. • Single screen interface for Cash and derivatives and more. • Provision to enter price trigger and view the same online in market watch. SPEEDTRADE SPEEDTRADE is an internet-based software application that enables you to buy and sell inan instant.