Reasons for choosing the companies finance essay

Finance

IntroductionIn Modern portfolio theory, investors are assumed to be risk averse. For this reason, they will choose a portfolio that maximizes return and minimizes risk. This implies that an investor will only accept a higher level of risk if they are adequately compensated by a higher level of return. Bodie et al. (2010) argues that the risk-return trade-off varies with investors individual risk appetites. A rational investor will select a portfolio that offers the highest return given the most favorable risk-adjusted return. Portfolio optimization mainly relies on diversification is utilized to increase returns while keeping the risk at minimum. The underlying reason behind diversification is that the stock indices are a good representation of return that spreads the risk in different markets.

Risk Attitude

In consideration of an investor's risk profile, it is important to consider two components. The first is the client's ability to assume risk. This is assessed on the basis of client's income goals, age, and propinquity to retirement. The other risk aspect to consider second would be the client's readiness to take risk within the portfolio. Different investors have different approach to investments and risk; their actions are based on personal experiences. The client's risk will be discussed in detail since it is important that the investor is comfortable with the selected asset classes and individual holdings within the portfolio. For this investment proposal, it is assumed that the client's risk attitude is intermediate (balanced). This assumption gives the investment manager a broad asset allocation structure to build in achieving the most suitable balance of risk and return. In order to implement the client's risk

profile, the portfolio will take a more defensive approach with maximum allocation of 95% to equities.

Strategic Asset Allocation

The Strategic Asset Allocation (SAA) will be used by the fund manager. The strategy is designed to provide a reasonable framework for efficient wealth management. The methodology is based on a comprehensive analysis of historical financial data on markets and on forecasts of how these markets will behave in future. This is combined with an in-depth analysis of the client's specific investment objectives, risk profiles and existing investments to propose a customized investment strategy for the longer term. It is important to spend a significant amount of time analysing asset returns and volatility as well as correlations of the major asset classes to comprehend how these assets performed over time. The calculations are made based on assumptions that inflation will be maintain an annual growth rate of 2. 5% over the next ten years and real returns will mimic long-term historic trends. With this information in mind, returns are estimated as annualised historical figures over the past 10 years. We assume that assets will behave relatively in the same manner as historical data. Stock selectionThe stocks are selected as top performing stocks (based on their returns) in 2011. We identify the present stage of the business cycle and expect that changes are likely to occur in the cycle. In addition, the effect of different macro drivers on different stock groupings is evaluated and an earnings based valuation approach is utilised to calculate stock valuations. Portfolio CreationThe investor wants to set up a portfolio consisting of different asset classes. Using the Sharpe Single-Index method, we select, from five stocks, the best

combination of stocks that will maximize return at a given level of risk (this is computed as the variance). In the spreadsheet, the variables are percentage allocations of the investment in each asset class. The calculations rely on the constraint that Portfolio Percentages >= 0 and Total portfolio = 1. The variance is less or equal to 0. 0003. The main objective is to maximize portfolio return (as calculated by the Sharpe method) subject to the above constraints.

ARM Holdings

Resolution

Legal and General

Aggreko

BG Group

TotalPortfolio %30. 00%5. 00%5. 00%50. 00%10. 00%100. 00%Beta-Coefficient0. 7883572191. 3233468171. 6202120730. 8676339551. 163945072

Alpha-Coefficient0. 013979290. 0074582090. 0057001890. 0350181010. 00845809

Residual Variance0. 0045823580. 00384830. 001173310. 0046815990. 001558097

Weighted Variance0. 000410. 000010. 000000. 001170. 00002

Portfolio variance is 0. 30% and portfolio return is 2. 17%. For fixed income, we put together a portfolio consisting of six bonds. The portfolio aims at minimising the risk of loss of principal value as a result of fluctuations in the

interest rate and to ensure that the client will have enough future cash-flow, the average duration of the bonds should be the same as the client's investment time horizon. Looking at the bonds, the maturities of all bonds is 4 years and they only pay interest payment. The objective is to maximize portfolio return given the constraints that portfolio allocation is greater or equal to zero and total portfolio is equal to 1.

Reasons for choosing the companies

ARM Holdings is an amazing company; its chips are found in virtually every electronic, from medical devices and cars to mobile phones. The company is also on an expansion drive, moving into the server market. In addition, Cisco is currently working on a number of projects that will ensure that more than 1 trillion devices are connected through the internet by 2025. This will guarantee more business for ARM, with an increasingly high number of devices using ARM processors. Currently, the company has a very high number of licenses, totaling over 800 processor licenses. The demand for the company's processors is incredible. As a matter of fact, all of the top technological companies, particularly those creating smart phones, and computer hard drives rely on ARM designs. Nonetheless, there is still more opportunity for expansion, including the automotive industry, medical, PC companies, servers, smart cards and digital among others.

Conventionally, fixed income assets are designed to guarantee investors a fixed rate of interest for the duration of the term, the limit is mostly for 5 years. However, for some of the fixed interest investments, the duration is longer or the interest rate is made to be more flexible. For this investment proposal, we select the best fixed rate bonds from the United Kingdom's

financial market that meet the investor's requirements. The disadvantage of the fixed interest savings bonds is that some of them prohibit withdrawals before maturity. Therefore, it is important for the client to choose how long they want to lock up their money. Another advantage is that the investor may lose out if the interest rate rises during the fixed rate term, however in cases of falling interest rates the investor would be better off as they'd be earning a higher interest rate. It cannot be accurately predicted to what direction the interest rates will be moving. Therefore, it important to balance one's options when investing in fixed rate bonds. Investment ProcessThe investment will mainly be third party investment vehicles including Pan-European Equities and fixed income investments. For overseas investment, we will use Pan-European Equities with a combination of business cycles type of investment, giving a detailed analysis of individual firms and a planned approach to risk and return. The use of business cycles in investing is the main strategy that most analysts have used in adding value to investors' portfolios. This type of practical approach is designed to achieve competitive and consistent returns by capturing market inefficiencies and taking advantage of profitable opportunities. Fund managers are responsible for identifying the most accurate valuation matrix suitable to the specific sector. The fair value of the stock will be assessed using valuation measures, including CFROI / DCF analysis; and PE among others. The first step is to separate operating profitability from financial obligations, since firms generate value from the operations. The next step is to analyze the sources of the operating profitability. This is effectively achieved by the reformulation exercise, from whence which Penman (2007) generates clear measures of profitability and a comprehensible distinction of operating profitability from

financial obligations. The entire methodology utilizes both qualitative and quantitative analytics based on the information that is collected from prior researches, case studies, empirical analyses, discussions and formal financial reports and analytics of profitability. The qualitative research will mainly involve determining what has already been addressed with respect to the analysis of drivers of proftiability. An extensive review of the existing literature resources is used for this purpose. The research utilizes peer reviewed journal articles on accounting to support the theories and argument because these articles aims are more accurate and reliable. The relevance of the articles used in the qualitative analysis will be guaranteed by scheming through the abstract of the journals retrieved from online databases before they are incorporated in the study. Tables and graphs will be used in determining the similarities and differences between information from various sources. Use of graphs and tables is aimed at bringing out a clear visual impression of the themes relating to the research questions in the responses. The conclusions are a mixture of factual presentation and the researchers' interpretation. The conclusions, whether factual or deductive, are pointed out as appropriate.