

# Investment enhancement paper report examples

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When investing one's money, several factors should be considered starting with evaluating what a portfolio should comprise of. This report will analyze three different items. First of all, it will address the effects of international diversification on the investment portfolio. It will then address alternative investment vehicles and finally it will look at how the derivative securities can also enhance a portfolio performance.

An international portfolio involves people looking at investment choices outside the United States since they create high diversification for customers. International portfolio has provided security of assets. In the event that the United States stock market crashes, investors end up suffering immense losses on their portfolio even if there exist localized dips (Marcus et. al, 2007). However, if the global stock markets consist of only a percentage of the portfolio, an investor would not lose a lot since all investments will not be dependent on how one stock market performs. This leads to a wider diversification in the investment portfolio. Although diversification is beneficial, it can also prevent an investor from making massive money. Therefore, investors should determine the appropriate level of diversification based on an analysis of assets and tolerance of risks. International investment offers more opportunities than enjoyed when investing in local markets only.

International portfolio diversification leads to the reduction of risks as evident in a better risk return trade off as by investing in the US alone. Diversification reduces 73% of risks without affecting returns (Block and Hirth, 2007). Diversified assets widely lead portfolio performing similar to market as a whole. Therefore, international diversification of the portfolio

increases stability of investments and reduce the risk of money loss.

International diversification also presents broad asset choices as assets can be spread into stocks, bonds, commodities and cash which help to create a stable portfolio and increase value in the long run. A diversified portfolio is less exciting and reliable attracting lower maintenance. This creates time to engage in other matters other than watching the market.

There exist substantial regional and international diversification benefits to domestic investors even where it assumes investors cannot short sell. These benefits are many in developing countries relative to developed nations.

International diversification of a portfolio also attracts disadvantages of missed windfalls and increased exposure. Diversifying assets widely in international markets will lead to massive losses as one cannot make enormous profits from one country. However it is not easy to determine where this will occur. Wide diversification also leads to losses as a result of losses in the event of a portfolio dip and missed potentials for profits.

After identifying whether to invest in international portfolio, one should evaluate alternative investment vehicles. Alternative investments differ from traditional investment and include stocks, bonds, mutual funds, property, collector's items, CD's and money markets. Bonds refer to fixed income securities founded on debt while stocks are stocks that make the holder part owner of a business. Mutual funds refer to a collection of stocks and bonds that allow a holder to pool resources with other investors (Liang, 2003).

Alternative investment vehicles also include hedge funds, funds-of-funds, mutual funds, and private equity investors to name but a few. Hedge funds and funds-of-funds performance can be attributed to similar asset class.

Hedge funds are difficult to define but use shorting techniques, make extensive use of derivatives and leverage. They refer to wider investment fund open to limited investors that pays a performance fee to the investment manager.

Activist hedge funds are investment vehicles that seek to influence action by public companies that the hedge fund considers leading to increase in value (Laeven and Driessen, 2004). Activist hedge funds invest for longer periods than traditional institutional investors. Short term investment strategies do not agree with negative impacts on corporate governance. Private equity investor's vehicle seeks to gain control of publicly held companies and includes the property and infrastructure funds. These investors establish meaningful performance incentives to the management of acquired companies. However, private equity investors do not wish to maintain control indefinitely of their target companies.

An alternative investment vehicle that can be used to enhance portfolio's performance is the derivative securities. This refers to a security whose returns depend on current price of an underlying asset and it allows an investor to offset his/her market position. In recent years, the market for derivatives has grown significantly, and these securities provides insurance. They play a similar economic responsibility for insurance of transferring the risk from risk averse individuals to risk lovers at a fee. Hedging is a form of derivative security that provides liquidity for the market to transfer risk. The benefit associated with hedging can be outweighed by the costs that provide access to hedging instruments. However, the derivative market is riskless and funds invested here can be viewed as a gamble. Another form is

swapping which imply contracts that allow swapping fixed interest rate payments for flexible ones (Marcus et. al, 2007). This applies in events where a company that had borrowed funds under adjustable interest rate mortgage fears that interest rates might rise. So it seeks to protect itself from this rise without refinancing the mortgage. Arguably, it considers someone with the will to pay the adjustable interest payment in return for fixed interest rate payment.

Another contract that can enhance portfolio performance is a cap that protects against a rise in interest rates to some extent and a floor that protects against a price drop. Traditional side of the derivative market consists of forward contracts and option such as warrants, puts and calls.

The forward contract refers to a commitment to trade an item at a specified price in a set future date. The standardization provides possibilities for wide, efficient and liquid markets. A call option refers to a right to purchase a share or the underlying security at an exercise price under limited time. Its value depends on the market price at a time, the volatility of its price, interest rate and remaining time until the expiration date. An American option can be exercised any time while a European option gets exercised on expiration (Block and Hirth, 2007). An investment decision in the derivative market must consider these concepts as well as their operations.

Diversifying and building more portfolio requires prudent use of leverage and derivatives. Derivative securities provide an opportunity to analyze and identify efficient portfolio securities that offer greatest returns. It further reduces the risk in an international diversified portfolio. Derivatives and leverage can lead to positive ends when used to diversify risks. A

combination of a derivative market, international portfolio and evaluation of alternative investment vehicles to help investors further diversify their investment. In order to invest funds properly, an investor should investigate and research these alternatives.

## **References**

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