Investment Management

First Semester 1388-1389

Introduction

- Learning Objective
- What is investment, speculation and gambling.
- Explain the different modes of investment for investor.
- Discuss the financial investments, physical investments, marketable investments and non marketable investments.
- What are the factors influencing the investment?
- Who is investor? What are the qualities of investor? Discuss the different types of investor.

“An investment operation is one which, upon thorough analysis promises safety of principal and an adequate return. Operations not meeting these requirements are speculative.”

By Graham and Qadd’s Security Analysis

Meaning and Concept of Investment

- Investment is a term for several closely related meanings in finance and economics.

- **Investment according to Theoretical Economics**

- Investment means the production of capital goods - goods which are not consumed but instead used in future production.

- Examples include
- • Building
- • A rail road
- • A Factory clearing land
- • Putting oneself through college

Meaning and Concept of Investment

- **Investment according to Finance Term**

- Investment means buying of Assets.

For Examples

- • Buying stocks and bonds
- • Investing in real estate
- • Mortgages

- These investments may then provide a future income and increase in value (i.e., investing in real estate).

Meaning and Concept of Investment

- **Investment according to Oxford Dictionary**
- Investment means the investing of money.
- **Investment from an Individual Point of View**
- Investment refers to a money commitment of some sort.

For example

- A commitment of money to buy a new car is certainly an “investment”.

CHARACTERISTICS OF INVESTMENT

CHARACTERISTICS OF INVESTMENT

- **Risk**

- **Risk refers to the loss of principal amount of an investment. It is one of the major characteristics of an investment.**

- The risk depends on the following factors:

A. • The investment maturity period is longer, in this case, investor will take larger risk.
B. • Government or Semi Government bodies are issuing securities which have less risk.
C. • In the case of the debt instrument or fixed deposit, the risk of above investment is less due to their secured and fixed interest payable on them. For instance Debentures.

CHARACTERISTICS OF INVESTMENT

- **Risk**

D. • In the case of ownership instrument like equity or preference shares, the risk is more due to their unsecured nature and variability of their return and ownership character.

E. • The risk of degree of variability of returns is more in the case of ownership capital compare to debt capital.

F. • The tax provisions would influence the return of risk.

CHARACTERISTICS OF INVESTMENT

- **Return**
- **Return refers to expected rate of return from an investment**
- Return is the major factor which influences the pattern of investment that is made by the investor.
- Investor always prefers to high rate of return for his investment.

CHARACTERISTICS OF INVESTMENT

- **Safety**
- **Safety refers to the protection of investor principal amount and expected rate of return.**

- Safety is also one of the essential and crucial elements of
- investment. Investor prefers safety about his capital.

For Example

- If investor prefers less risk securities, he chooses Government bonds. In the case, investor prefers high rate of return investor will choose private Securities and Safety of these securities is low.

CHARACTERISTICS OF INVESTMENT

- **Liquidity**
- Liquidity refers to an investment ready to convert into cash position.
- Liquidity means that investment is easily realisable, saleable or marketable. When the liquidity is high, then the return may be low.

- **Marketability**
- Marketability refers to buying and selling of Securities in market.
- Marketability means transferability or saleability of an asset. Securities are listed in a stock market which are more easily marketable than which are not listed. Public Limited Companies shares are more easily transferable than those of private limited companies.

CHARACTERISTICS OF INVESTMENT

- **Concealability**
- Concealability means investment to be safe from social disorders, government confiscations or unacceptable levels of taxation, property must be concealable and leave no record of income received from its use or sale.
- Gold and precious stones have long bee esteemed for these purposes, because they combine high value with small bulk and are readily transferable.

CHARACTERISTICS OF INVESTMENT

- Capital Growth
- Capital Growth refers to appreciation of investment.
- Investors and their advisers are constantly seeking ‘growth stock’ in the right industry and bought at the right time.
- Purchasing Power Stability
- It refers to the buying capacity of investment in market.
- Purchasing power stability has become one of the import traits of investment. Investment always involves the commitment of current funds with the objective of receiving greater amounts of future funds.

CHARACTERISTICS OF INVESTMENT

- **Stability of Income**
- It refers to constant return from an investment.
- Stability of income must look for different path just as security of principal. Every investor always considers stability of monetary income and stability of purchasing power of income.

- **Tax Benefits**
- Tax benefits refer to plan an investment programme without regard to one's status may be costly to the investor. There are actually two problems:

- • One concerned with the amount of income paid by the investment.
- • Another is the burden of income tax upon that income.

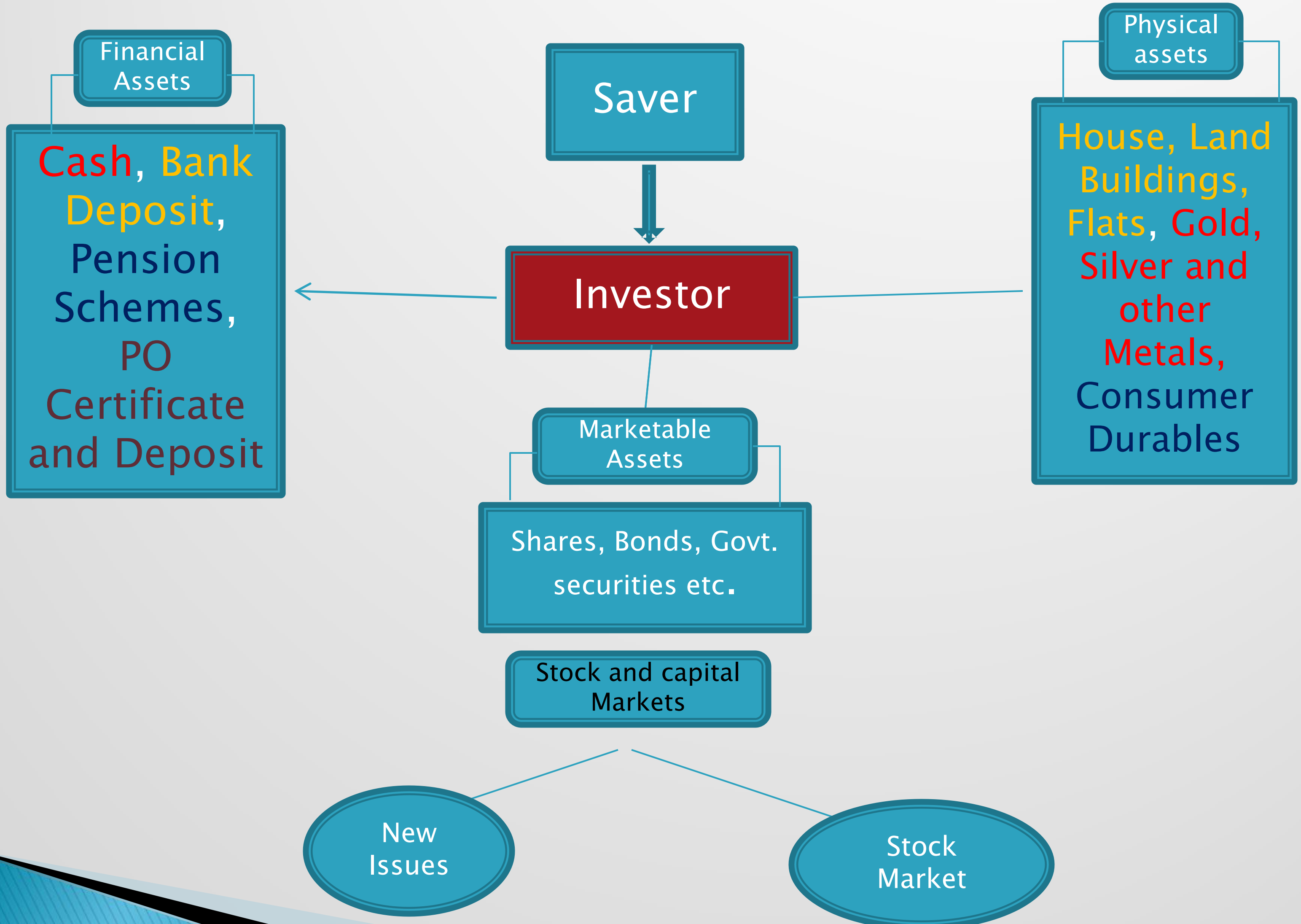
NEED AND IMPORTANCE OF INVESTMENTS

- An investment is an important and useful factor in the context of present day conditions. Some factors which indicate significance of Investment are as outlined below:

- • Longer life expectancy or planning for retirement
- • Increasing rates of taxation
- • High interest rates
- • High rate of inflation
- • Larger incomes
- • Availability of a complex number of investment outlets.

Investment Activities

Investment activity involves the use of funds or savings for further creation of assets or acquisition of existing assets.



Classification of Investment

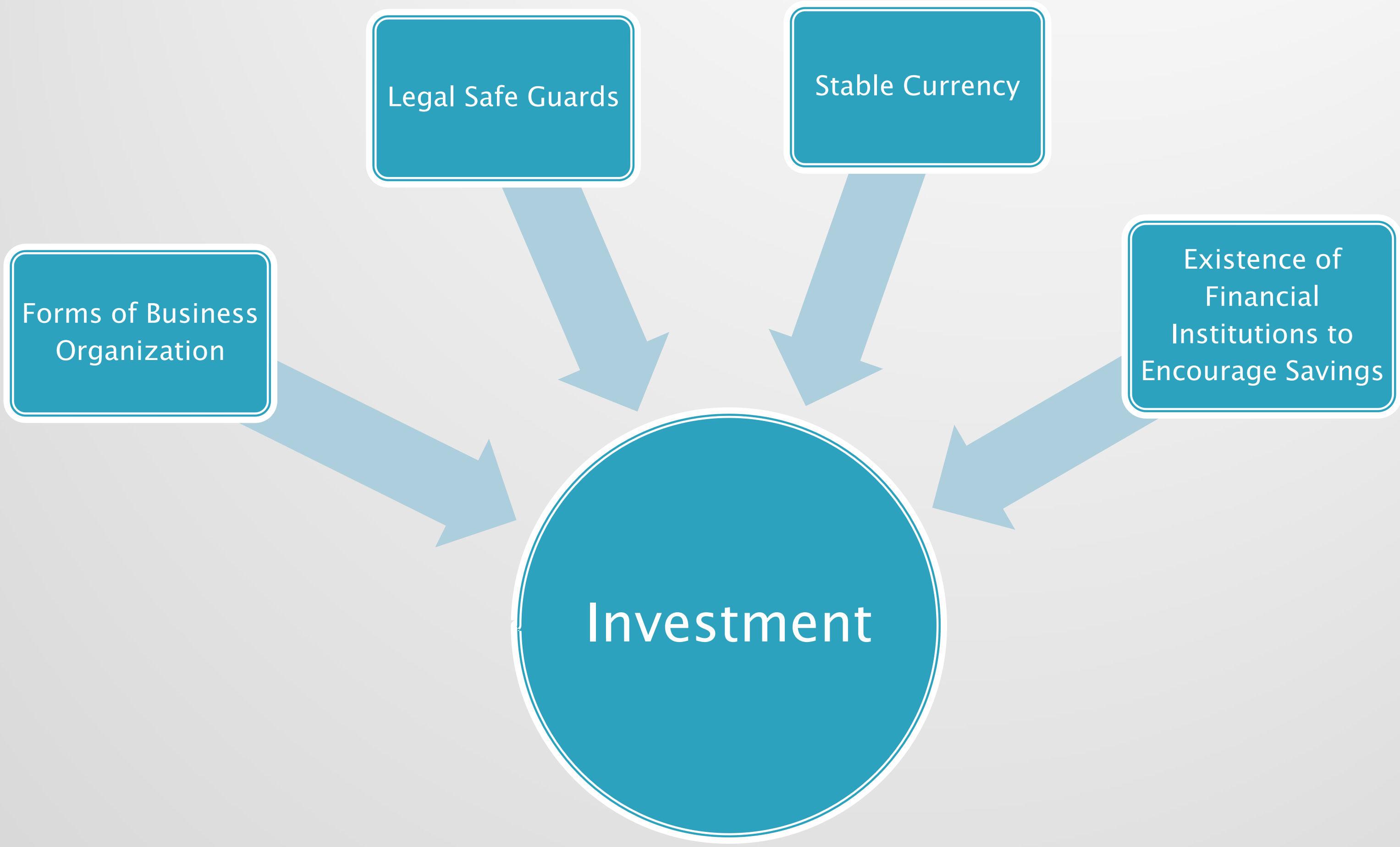
- **On the Basis of Physical Investments**
- • House
- • Land
- • Building
- • Gold and Silver
- • Precious stones

- **On the Basis of Financial Investment**
- • Marketable and Transferable investments
- • Non-Marketable Investments

- **Marketable and Transferable Investments**
- • Shares
- • Debentures of Public Limited Companies, particularly the listed company in Stock Exchange
- • Bonds of Public Sector Units
- • Government Securities, etc.

- **Non-Marketable Investments**
- • Bank Deposits
- • Provident and Pension Funds
- • Insurance Certificates
- • Post office Deposits
- • National Saving Certificates
- • Company Deposits
- • Private Companies Shares etc.

FACTORS INFLUENCING INVESTMENT



FACTORS INFLUENCING INVESTMENT

- Legal Safeguards
- A stable government brings adequate legal safeguards that encourages accumulation of savings and investments. They want the assurance and protection of their property rights from the government.
- A Stable Currency
- • Price inflation destroys the purchasing power of investments.
- • Deflation is equally disastrous because the nominal values of inventories, plant and machinery and land and building tend to shrink.
- The wise and planned monetary and fiscal management contributes towards proper control, good governance, economic well being and a well disciplined growth-oriented investment market along with the protection to the investor.

FACTORS INFLUENCING INVESTMENT

- Existence of Financial Institutions to Encourage Savings
- Existence of Financial Institutions which encourage savings and directing them effective utilisation of investment through growth of investment market. The financial institutions are generally in existence in most countries in terms of
- • Commercial Banks
- • Life Insurance Companies
- • Investment Companies.

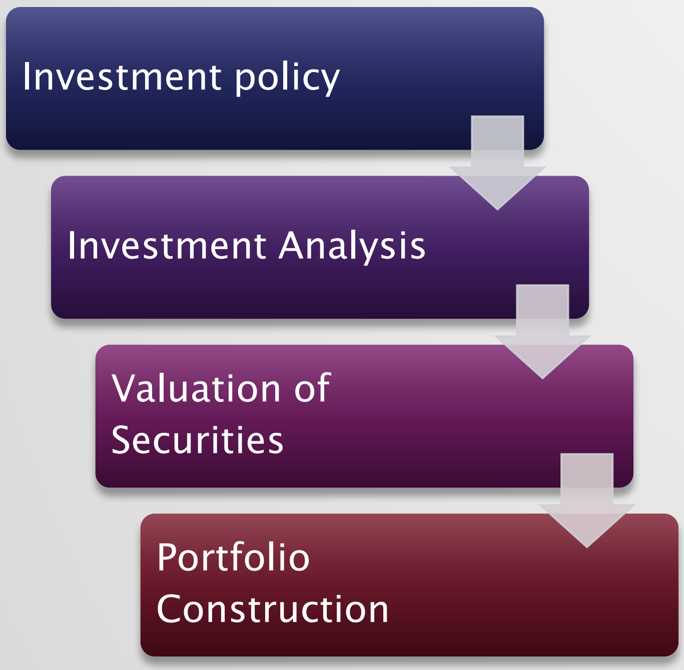
FACTORS INFLUENCING INVESTMENT

- The public limited companies are very useful to investors because of the following reasons:

- • Limited Liability of Shareholders
- • Perpetual Life and Transferability
- • Divisibility of Stock and Shares
- • The Ability to Continue its Business Irrespective of Members Comprising it
- • It gives longevity and soundness to business activity.

- In the case of sole trading concern, partnership are not useful to investors because of the following reasons:
- • Unlimited liability of the owners, partners and members.
- • It suffers short life of the organization.
- In such conditions investors are not ready for investment because there is no safety and security of their investment.

THE INVESTMENT PROCESS/STAGES

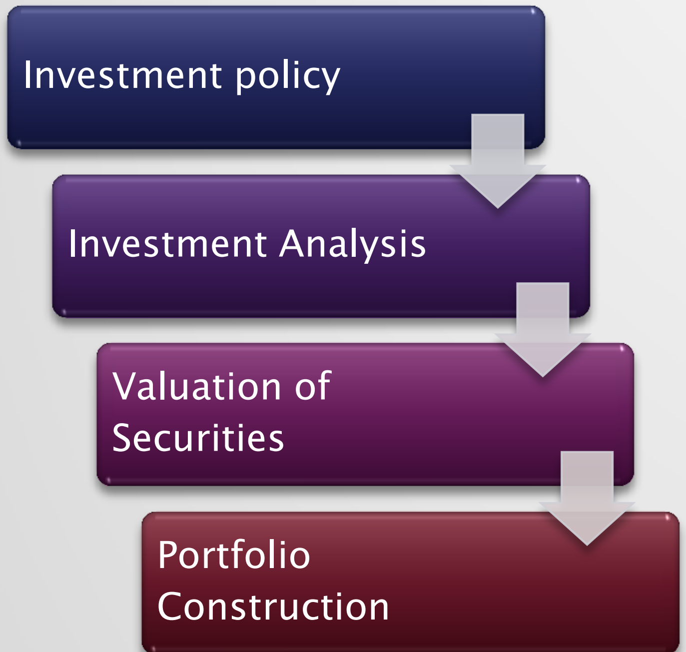


- **Investment Policy**
- • Determination of Investable Wealth
- • Determination of Portfolio Objectives
- • Identification of Potential Investment Assets
- • Consideration of Attributes of Investment Assets
- • Allocation of Wealth to Asset Categories.

- **Investment Analysis**

- • Equity Stock Analysis
- • Screening of Industries
- • Analysis of Industries
- • Quantitative Analysis of Stocks
- • Analysis of the Economy
- • Debentures and Bond Analysis
- • Analysis of Yield Structure
- • Consideration of Debentures
- • Quantitative Analysis of Debentures
- • Other Asset Analysis
- • Qualitative Analysis
- • Quantitative Analysis

THE INVESTMENT PROCESS/STAGES



- **Valuation of Securities**
- • Valuation of Stocks
- • Valuation of Debentures and Bonds
- • Valuation of Other Assets
- **Portfolio Construction**
- • Determination of Diversification Level
- • Consideration of Investment Timing
- • Selection of Investment Assets
- • Allocation of Investable Wealth to Investment Assets
- • Evaluation of Portfolio for Feedback

SOURCES OF INVESTMENT RISK

- According to the Oxford dictionary definition of risk includes the following meanings: "The possibility of meeting danger or of suffering harm or loss." This conforms to the connotations put on the term by most investors. An investor commonly identifies five kinds of investment risks. They are:

- • **Business and Financial Risk**
- • **Interest Rate Risk**
- • **Purchasing Power Risk**
- • **Social/Regulatory Risk**
- • **Other Risk**

SOURCES OF INVESTMENT RISK

- **Business and Financial Risk**

- Business risk is also known as operating risk. Operating risk is associated with day to day operations of the business firm. Financial risk is created by debt and preference shares (Fixed cost securities). Business and financial risk may be caused by a variety of factors as mention below:

A. • Heightened Competition
B. • Emergence of New Technologies
C. • Development of Substitute Products
D. • Shifts in Consumer Preferences
E. • Inadequate Supply of Essential Inputs
F. • Changes in Government Policies
G. • Poor Business Performance.

SOURCES OF INVESTMENT RISK

- Interest Rate Risk
- If the interest rate goes up, the marketing price of existing fixed income securities falls, and vice versa.

- Market Risk
- Even in the case of earning power of the corporate sector and the interest rate structure remain more or less changed, prices of securities, equity shares in particular, tend to fluctuate. There are several reasons for this fluctuation.

- The main reasons are listed below:

- • The changing psychology of the investors.
- • There are periods when investors become bullish and their investment horizons lengthen.
- • An unexpected war, the election year, political activity, illness or death of an important person, speculative activity in the market, the outflow of business-all are tremendous psychologic factors in the market.

SOURCES OF INVESTMENT RISK

- **Purchasing Power Risk**
- Purchasing power risk is the major source of risk faced by investors. The investor select investments whose market values change with consumer prices which compensates them for increase in cost of living. If they do not, they will find that their total wealth has been diminished.

- **Other Risks**
- Other types of risks are particularly associated with investment in foreign securities. It involves monetary value risk and political environment risk. The investors who invest in foreign securities, have faced several risks. They are outlined as below:
- • A change in the foreign government and repudiation of outstanding debt
- • Nationalization of business, firms, that is, seizure by government
- • The desire but inability of the foreign government or corporation to handle its indebtedness.

RECENT TRENDS OF INVESTMENTS

- Recent trends of investments are in Iran:

a) • Increase in working population, larger family income and consequent higher savings

b) • Provision of tax incentives in respect of investments in specified channels provided by government

c) • Increasing tendency of people to hedge against inflation that protected by government

d) • Availability of large and attractive investment alternatives developed

e) • Increase in investment related publicity

f) • Ability to invest to get income and capital gains etc.

Problems in Investment

- • Inadequate comprehension of return and risk
- • Investment policy is not clearly formulated
- • Careless decision making in investment process
- • Simultaneously switching of investment activity
- • Traditional trends affected to the investment
- • Inadequate planning to buy cheap stocks
- • Either over diversification or underdiversification of stock
- • Investors are ready to buying shares of familiar companies that problem for investment in future
- • Wrong attitude towards losses and profits

SPECULATION

- According to the Oxford Dictionary, definition of speculation includes
- the following meanings:

- “A message expressing an opinion based on incomplete evidence.”

- Speculation is the buying, holding and selling of stocks commodities, collectibles real estate or any valuable thing to profit from fluctuations in its price as opposed to buying it to use.

Difference between Speculation and Investment

Basis	Speculation	Investment
Meaning	• A message expressing an opinion based on incomplete evidence	• The investing of money
Types of contract	• Speculator is a owner of the speculation	• Investor is a creditor of the Investment
Length commitment	• In the case speculation the length of commitment is a short term only	• In the case of investment the length of commitment is a long term
Source of Income	• The source of income is fluctuated and changes in market price	• The source of income is earning from the enterprise
Quantity of Risk	• Quantity of risk is the high	• Quantity of risk is the low
Stability of Income	• Income is uncertain and erratic	• Income is very stable
Psychological attitude of Participants	• Speculator psychological attitude is a daring and careless	• Investor psychological attitude is a cautious and conservative
Reasons for Purchase	• It is unscientific analysis of intrinsic worth	• It is scientific analysis of intrinsic worth

Difference between Investor and Speculator

Base	Speculator	Investor
• Planning Horizon	• A speculator has a very short planning horizon. His holding may be a few to a days to a few months	• An investor has a relatively longer planning horizon. His holding period is usually at least one year
• Risk Disposition	• A speculator risk is high	• An investor risk is less
• Return Expectation	• A speculator looks for a high rate of return	• An investor usually seeks moderate rate of return
• Basis for Decisions	• A speculator relies more on hear say, technical charts and market psychology	• An investor attaches greater significance to fundamental factors and attempts a careful evaluation of the growth of the enterprise
• Leverage	• A speculator normally takes to borrowings, which can be very substantial, to supplement his personal resources.	• An investor uses his own funds avoid borrowed funds

GAMBLING

- According to the Oxford dictionary, gambling means:

- “Taken risk in the hope of a favourable outcome.” Gambling most often refers specifically to the wagering of money on games of chance or more broadly to engaging in high risk behaviour.

Characteristic of Gambling

- Gambling is a typical, chronic and repetitive experience
- Gambling absorbs all other interests
- The Gambler displays persistent optimism without winning
- The gambler never steps while wining
- The gambler eventually take more risk
- The gambler seeks and enjoys a strange thrill from gambling
- The gambler seeks pleasure and pain from gambling
- In gambling artificial and unnecessary risks are created

Specialized Knowledge

Science and Art

- Specialised knowledge, effective and proper management of investment involves:

- • Efficient use of cash and proper distribution of money among different investments channels.
- • Proper analysis of risk and return for each investments.
- • Expertising analysing information in terms of technical analysis and security analysis for proper investment decisions that are based on a study of fundamentals, expectations and mood of the markets.

- • **Safety Players**
- Safety Players who take the path of least resistance, looking primarily for security and safety in their investments and doing what has worked previously.

- • **Entrepreneurs**
- Entrepreneurs are a particularly male-dominated profile driven by a passion for excellence and commitment, and who are not motivated by money in itself. Financial success is a scorecard and stock investment is a method of implementing and demonstrating that success.

- • **Optimists**
- Optimists are non-risk oriented, often near retirement, seeking peace of mind, these are investors who don't like to become too involved with their own financial management as it would cause them stress and reduce their enjoyment of life.

- • **Hunters**
- Hunters are often educated, high-earning women with an impulsive streak, a 'live now attitude.' They have a strong work ethic, much like entrepreneurs, but lack the same confidence in themselves. They may attribute their success to luck rather than ability.

QUALITIES OF INVESTOR

QUALITIES OF INVESTOR

- **• Achievers**
- Achievers are conservative, risk-averse, these investors like to feel in control of their money, with security and protection of their assets a primary consideration. They are often, married, well educated, high-earners who feel that hard work and diligence is more likely to bring financial reward than investing.
- **• Perfectionists**
- Perfectionists are afraid of making financial mistakes, they tend to avoid investment decisions altogether. They lack confidence and self-esteem, and have low pride in handling financial matters, finding every conceivable excuse for not taking action. For them no investment is without fault
- **• Producers**
- Producers are highly committed to their work. They may earn less due to a lack of self-confidence in money management. And with a lack of basic financial knowledge they may have less available funds to invest. They do not appreciate how to evaluate risk appropriately.
- **• High Rollers**
- High Rollers are thrill seekers, power seekers, creative and extroverted, they work hard and play hard. They have to be involved in high risk investing with a large amount of their assets. Financial security bores them - even though their actions may have financially dangerous consequences.

QUALITIES OF INVESTOR

- • **Money Masters**
- Money Masters are tending to have a balanced financial outlook that gives contentment and security, these investors like to be involved with the management of their money and their choice of investments, although they will take onboard good, sound advice.
- • **Adventurers**
- Adventurers are confident ‘go for it’ types who are strong willed and ready to take chances.
- • **Celebrities**
- Celebrities are those who need to be in the center of things and don’t like to be left out, often constantly checking whether they should be in the latest fashionable investment but may not really have any clue as to how to take control of their finances.
- • **Individualists**
- Individualists are confident individuals who make their own decisions but who are methodical, careful, balanced and analytical.
- • **Guardians**
- Guardians are investors, often older ones, who are cautious and intent on safeguarding their wealth, shunning volatility or excitement.
- • **Straight arrows**
- Straight arrows are Mr. or Mrs. Average who do not fall into any of the extremes of the above categories, who is somewhat balanced in their investment approach and willing to take on
- moderate risk.

TYPES OF INVESTORS

- • **Cautious Investors**
- Cautious Investors are very conservative, this type of investor has a need for financial security and will avoid high-risk ventures as well as listening to professional advice, preferring to conduct their own financial affairs. They don't like to lose even small amounts of money and never rush into investments, always giving financial opportunities a great deal of thought.
- • **Emotional Investors**
- Emotional Investors are easily attracted to fashionable investments or 'hot' tips, these investors act with their heart and not their head. A whim or a gut feeling leads their decisions. They have an unreasonable belief that things will come right in the end and often put their trust in luck or 'providence' to safeguard their financial assets.
- • **Technical Investors**
- Technical Investors are hard facts - numbers - lead this type of investor to active trading based on price movements. They are screen-watchers, sometimes obsession, but their diligence can be rewarded if they spot trends. They may also have a tendency to 'need' and buy the latest technology as they are always looking for some edge.

TYPES OF INVESTORS

- • **Busy Investors**
- Busy Investors need to be involved with the markets, it gives them a buzz when they check the latest price movements, which may be several times a day. They have to keep buying and selling – on rumours, on overheard gossip, from the mass of newspapers and magazines they collect. Any tidbit of information they can glean is imbued with significance and a cause to take financial action.
- • **Casual Investors**
- These individuals are often hardworking and involved with work or family. They tend to believe that once an investment is made it will take care of itself, and that a good job or a profession is the way to make real money. They easily forget that they own investment assets and rarely check on their financial affairs. And, though they may leave the running of their investments to professional advisors, they haven't been in contact with them for years.
- • **Informed Investors**
- Informed Investors use information from a variety of sources and keep an ongoing watch on their investments, the markets and the economy. They listen carefully to financial opinions and expert assessments, and will only go against market fashion, as a contrarian, after weighing up all the pros and cons. They are financially confident and have faith in their decisions, knowing that knowledge and experience will always win out to give them long-term profits.

TYPES OF INVESTORS

- **Passive Investors**
- Passive Investors are characterised as individuals who have become wealthy passively - by inheriting, by a professional career or by risking the money of others rather than their own money. To these investors security is more important than risk. In addition, certain classes of occupation are more likely to contain passive investors. For example, non-surgical doctors, corporate executives, lawyers and accountants who work in companies. Anyone, therefore, with reduced financial recourses is likely to be more risk conscious and hence, a passive investor. For these individuals it's important to hang on to their money.

- Passive investors make good clients because they tend to trust their financial advisor and are more likely to delegate the running of their financial affairs. And because they are risk averse, they tend to like diversified portfolios of investments in quality companies or investment products. However, they can believe that an investment is more risky than it is, which may keep them out of potentially lucrative opportunities. Passive investors are also more likely to need the approval of others and are unlikely to take a first step into unknown investment territory by being a contrarian. Consequently, they are more likely to follow the investment herd when it comes to stock market investment and stick to following the trend.

TYPES OF INVESTORS

- • **Active Investors**

- According to Barnwell, Active Investors are those who have achieve significant wealth, or earned well, during their own lifetime. They are more likely to take risks in investing because they have previous experience of taking risks in their previous wealth creation. These individuals have a high-risk tolerance and less of a need for security. They also need to feel in control of their own abilities.

- The classes of occupation that are likely to be active investors include: small business owners who have developed their own businesses rather than inherited, medical surgeons, independent professionals, such as lawyers or accountants, who work for themselves rather than a large firm, entrepreneurs, and self-employed consultants.

- Active investors are more likely to get personally involved with the running of their financial affairs, and may believe they know more than their advisor does. However, these individuals are more likely to be contrarian in their stock picking habits and have less need to be completely diversified. Age tends to soften their need to be constantly in control, so that older clients may be more malleable and open to their advisors suggestions.