INVESTMENT

Meaning of Investment

The action or process of investing money for profit. An investment is an asset or item acquired with the goal of generating income or appreciation. In an economic sense, an investment is the purchase of goods that are not consumed today but are used in the future to create wealth. In finance, an investment is a monetary asset purchased with the idea that the asset will provide income in the future or will later be sold at a higher price for a profit.

Purchase of assets with the goal of increasing future income. Focuses on wealth accumulation. Appropriate for long-term goals

An amount deposited into a bank or machinery that is purchased in anticipation of earning income in the long run are both examples of investments.

Warren Buffett defines investing as "… the process of laying out money now to receive more money in the future." The goal of investing is to put your money to work in one or more types of investment vehicles in the hopes of growing your money over time.

When you invest, you are committing money or another resource in the expectation of some future benefit. A college education, for example, can be considered an investment because you invest your time (a resource) in hopes of earning a degree and a good job after graduating (the future benefit). In a financial sense, investing means that an individual commits money to a financial asset, or security, such as a stock or bond, in hopes of receiving even more money later.

The term "investment" can refer to any mechanism used for generating future income. In the financial sense, this includes the purchase of bonds, stocks or real estate property. Additionally, a constructed building or other facility used to produce goods can be seen as an investment. The production of goods required to produce other goods may also be seen as investing.

Investments and Speculation

Speculation is the act of conducting a financial transaction that has substantial risk of losing all value but with the expectation of a significant gain. With speculation, the risk of loss is more than offset by the possibility of a huge gain. Otherwise, there would be very little motivation to speculate. It may sometimes be difficult to distinguish between speculation and investment, and whether an activity qualifies as speculative or investing can depend on a number of factors, including the nature of the asset, the expected duration of the holding period, and the amount of leverage. The motive is to take maximum advantage from fluctuations in the market. A speculator wouldn't follow this strategy. If a speculator purchased food-company stocks, he would do so because he simply believes the stock is going to increase. **Speculation** is an investment approach in which the investor aims to buy or sell stocks, currencies or other assets solely to make a quick profit.

Speculation is a separate activity from making an investment. Investing involves the purchase of assets with the intent of holding them for the long term, while speculation involves attempting to capitalize on market inefficiencies for short-term profit. Ownership is generally not a goal of speculators, while investors often look to build the number of assets in their portfolios over time.

Although speculators are often making informed decisions, speculation cannot usually be categorized as traditional investing. Speculation is generally considered higher risk than traditional investing, though this can vary depending on the type of investment involved.

Investment refers to the application of resources (money) to make more money, or the buying of goods that are not consumed today, but are used to create future wealth. Investments typically provide income plus growth.

Put simply, one could say that a speculative investment is just about growth, while an investment is about income plus growth.

Essential features of an Investment Programme

1. Safety of principal

Safety of funds invested is one of the essential ingredients of a good investment programme. Safety of principal signifies protection against any possible loss under the changing conditions. Safety of principal can be achieved through a careful review of economic and industrial trends before choosing the type of investment. Most investors prefer to invest in less riskier securities.

The main objective of diversification is the reduction of risk in the loss of capital and income. A diversified portfolio is less risky than holding a single portfolio.

2. Liquidity and Collateral value

A liquid investment is one which can be converted into cash immediately without monetary loss. Liquid investments help investors meet emergencies. Stocks are easily marketable only when they provide adequate return through dividends and capital appreciation. Portfolio of liquid investments enables the investors to raise funds through the sale of liquid securities or borrowing by offering them as collateral security. The investor invests in high grade and readily saleable investments in order to ensure their liquidity and collateral value.

3. Stable income

Investors invest their funds in such assets that provide stable income. Regularity of income is consistent with a good investment programme. The income should not only be stable but also adequate as well.

4. Capital growth

One of the important principles of investment is capital appreciation. A company flourishes when the industry to which it belongs is sound. So, the investors, by recognizing the connection between industry growth and capital appreciation should invest in growth stocks. In short, right issue in the right industry should be bought at the right time. Capital gains are entirely different from yield in that they are only realized when the security is sold for a price that is higher than the price at which it was originally purchased.

5. Tax implications

While planning an investment programme, the tax implications related to it must be seriously considered. In particular, the amount of income an investment provides and the burden of income tax on that income should be given a serious thought. Investors in small income brackets intend to maximize the cash returns on their investments and hence they are hesitant to take excessive risks. On the contrary, investors who are not particular about cash income do not consider tax implications seriously.

6. Stability of Purchasing Power

Investment is the employment of funds with the objective of earning income or capital appreciation. In other words, current funds are sacrificed with the aim of receiving larger amounts of future funds. So, the investor should consider the purchasing power of future funds. In order to maintain the stability of purchasing power, the investor should analyze the expected price level inflation and the possibilities of gains and losses in the investment available to them.

7. Legality

The investor should invest only in such assets which are approved by law. Illegal securities will land the investor in trouble. Apart from being satisfied with the legality of investment, the investor should be free from management of securities. In case of investments in Unit Trust of India and mutual funds of Life Insurance Corporation, the management of funds is left to the care of a competent body. It will diversify the pooled funds according to the principles of safety, liquidity and stability.

8. Marketability

It is another feature of investment that they are marketable. It means buying and selling or transferability of securities in the market.

Characteristics of a good investor

- Goal setting
- Knowledge
- Right decision
- Patience
- Risk aversion

Process of investment

Step 1: Assess Current Financial Situation and Goals

The investment plan process begins financial and non-financial goals, as well as your existing assets. Planning for the future requires having a clear understanding of an investor's current situation in relation to where they want to be. That requires a thorough assessment of current assets, liabilities, cash flow and investments in light of the investor's most important goals. Goals need to be clearly defined and quantified so that the assessment can identify any gaps between the current investment strategy and the stated goals. This step needs to include a frank discussion about the investor's values, beliefs and priorities, all of which set the course for developing an investment strategy.

Step 2: Establish Investment Objectives

Establishing investment objectives centers on identifying the investor's risk-return profile. Determining how much risk that an investor is willing and able to assume, and how much volatility that the investor can withstand, is key to formulating a portfolio strategy that can deliver the required returns with an acceptable level of risk. Once an acceptable risk-return profile is developed, benchmarks can be established for tracking the portfolio's performance. Tracking the portfolio's performance against benchmarks allows smaller adjustments to be made along the way. The objectives of an individual investor may be to accumulate funds to purchase a home or other major acquisition, to have sufficient funds to be able to retire at a specified age, or to accumulate funds to pay for college tuition for children.

Step 3: Determine Asset Allocation

Using the risk-return profile, an investor can develop an asset allocation strategy. Selecting from various asset classes and investment options, the investor can allocate assets in a way that achieves optimum diversification while targeting the expected returns. The investor can also assign percentages to various asset classes, including stocks, bonds, cash and alternative investments, based on an acceptable range of volatility for the portfolio. The asset allocation strategy is based on a snapshot of the investor's current situation and goals, and is usually adjusted as life changes occur. For example, the closer an investor gets to his or her retirement target date, the more the allocation may change to reflect less tolerance for volatility and risk.

Step 4: Select Investment Options

Individual investments are selected based on the parameters of the asset allocation strategy. The specific investment type selected depends in large part on the investor's preference for active or passive management. An actively managed portfolio might include individual stocks and bonds if there are sufficient assets to achieve optimum diversification, which is typically over $1 million in assets. Smaller portfolios can achieve the proper diversification through professionally managed funds, such as mutual funds or with exchange-traded funds. An investor might construct a passively managed portfolio with index funds selected from the various asset classes and economic sectors.

Step 5: Monitor, Measure and Rebalance

After implementing a portfolio plan, the management process begins. This includes monitoring the investments and measuring the portfolio's performance relative to the benchmarks. It is necessary to report investment performance at regular intervals, typically quarterly, and to review the portfolio plan annually. Once a year, the investor's situation and goals get a review to determine if there have been any significant changes. The portfolio review then determines if the allocation is still on target to track the investor's risk-reward profile. If it is not, then the portfolio can be rebalanced, selling investments that have reached their targets, and buying investments that offer greater upside potential.

Investment Alternatives

PPF - The Public Provident Fund (PPF) is one of the most popular investment options in India because of its sovereign guarantee. Some of its features are:
a) Investment offers tax benefit under section 80C, interest earned and maturity are also exemptfrom tax.
b) The scheme has a lock-in period of 15 years.
c) The interest rate is reviewed by the Government every quarter.

Mutual fund- A mutual fund collects money from investors and invests the money in different securities. It charges a small fee for managing the money. Mutual funds are an ideal investment vehicle for regular investors who do not know much about investing. Investors can choose a mutual fund scheme based on their financial goal and start investing to achieve the goal. Mutual funds are professionally managed. It refers to an organization or a company that pools funds from individuals and other organization to invest in portfolio of stocks, bonds and short term securities. It makes diversification of portfolio a possibility for small investors who otherwise may not be able to do so.

Shares Investment in equity and preference shares. On these shares shareholders get dividend. On preference shares dividend is fixed. Preference shares have the preferential right of claiming repayment of capital in the event of winding up of the company. Preference capital has to be repaid out of assets after meeting the loan obligations and claims of creditors but before any amount is repaid to equity shareholders.

Equity shareholders have a residual claim in the firm. The income left after satisfying the claims of all creditors, Outsiders and preference shareholders, belongs to equity shareholders. Equity shareholders have right to vote on the matters of the company.

Equity shareholders have pre- emptive right which means when new shares are issued they are first offered to equity shareholders at the price less than market price.

Debentures On debentures interest is given which is fixed. Debenture holders are the creditors of the company. Debenture are repayable after a certain period which is specified at the time of the issue.

Bond - The bond is a debt security, under which the issuer owes the holders a debt and (depending on the terms of the bond) is obliged to pay them interest (the coupon) or to repay the principal at a later date, termed the maturity date.[1] Interest is usually payable at fixed intervals (semiannual, annual, sometimes monthly). A **bond** is a contract between two parties. Companies or governments issue **bonds** because they need to borrow large amounts of money. They issue **bonds** and investors buy them (thereby giving the people who issued the **bond** money). This means that at some point, the **bond** issuer has to pay back the money to the investors.

Real estate- People buy a house either for self-occupation or to earn rental income and capital gains from it. However, as per most financial advisors, investing in real estate to earn rental income is not considered as a good investment. This is because:
a) Rental income earned from house ranges usually between 2-3 per cent a year.
b) The appreciation in the prices of house property depends on various factors such as size, locality, location etc. c) Before making an investment in property, one must evaluate based on safety, liquidity, returns and other similar parameters.

Every investor has some part of their portfolio invested in real assets. Almost every individual and corporate investor invest in residential and office buildings respectively. Apart from these, others include:

- Agricultural Land
- Semi-Urban Land

- Commercial Property
- Raw House
- Farm House etc

Gold- One can buy in gold in various forms-physical, paper, and digital. These forms include jewellery, bullion, sovereign gold bonds, digital gold etc.
a) According to an Economic Times report, gold bought on Akshaya Tritya 10-20 years ago has given double digit returns.
b) The returns in recent years, however, have diminished.
c) Gold prices usually go up during times of uncertainty. Financial advisors recommend one should invest only a certain limited percentage in gold to hedge again .

Post office saving scheme - The Post Office Saving Schemes include a bucket list of products that offer reliability and risk-free returns on investment. Such security and returns are perks one mostly associates with a central government-run savings portfolio. These schemes are operated via 1.54 lakh post offices all over the country. Take for instance the PPF scheme; PPF is operated via 8200 branches of public sector banks in addition to the post offices in each city.

Fixed deposit - Fixed deposits are investment instruments offered by banks and non-banking financial companies, where you can deposit money for a higher rate of interest than savings accounts. You can deposit a lump sum of money in fixed deposits for a specific period, ranging from 7 days to 10 years. In a fixed deposit, you put a lump sum in your bank for a fixed tenure at an agreed rate of interest. At the end of the tenure, you receive the amount you have invested plus compound interest.

Life Insurance - Life is full of uncertainties. So insurance is taken to reduce the risk. If a person die soon, the flow of earning will be cut off. While this is not a concern for you personally but It will be a concern for those who depend on your earning. Life insurance is also a good investment. Whole life policy and endowment policy are most popular.

Senior citizen saving scheme - The Senior Citizens Savings Scheme (SCSS) is primarily for the senior citizens of India. The scheme offers a regular stream of income with the highest of safety and tax saving benefits. It is an apt choice of investment for those over 60 years of age. An individual can invest a maximum amount of Rs 15 lakhs, individually or jointly in an SCSS account (in multiples of Rs 1,000). The amount invested in the scheme cannot exceed the money that has been received on retirement. Hence, the individual can invest either Rs 15 lakhs or the amount received as a retirement benefit, whichever is lower. The account can be opened by cash for an amount below Rs 1 lakh and by cheque for an amount exceeding Rs 1 lakh. Tax deduction of up to Rs 1.5 lakh can be claimed under Section 80C of the Indian Tax Act, 1961.

National pension system - Investors who wish to receive a pension in their retirement years can look to invest in the National Pension System (NPS). It is a defined contribution system where your contribution is invested in various assets - equity, bonds, government securities, and alternative investments as per your choice.

a) The scheme offers two choices: Auto choice and Active choice. In auto choice mode, your contribution is divided among various assets based on your age (Life Cycle Fund). On the other hand, under the active choice, you decide the ratio in which funds are to be invested in different asset classes.
b) The scheme matures when the investor turns 60 years of age. The lock-in period depends on the entry age of the investor. For example, if you start investing in NPS at the age of 25 years, then the lock-in period will be 35 years.
c) The returns of NPS are market-linked. Amount of pension you will receive post-maturity will depend on the amount of corpus accumulated by you.

NPS offers tax benefit under section 80C for a maximum of Rs 1.5 lakh and an additional tax benefit of Rs 50,000 under section 80CCD (1B). However, at the time of maturity, only 40 percent of the corpus, if redeemed as a lump sum, will be tax-exempt. Pension received will be fully taxable as per your income. No tax is payable during the accumulation period.

Sukanya samriddhi yogna - Sukanya Samriddhi is a scheme for the benefit of the girl child introduced by the government. It currently offers an attractive interest rate of 8.5% per annum, compounded annually. The scheme can be opened in the post office or bank, by any Indian parent with a girl child not more than 10 years old.

The maximum investment eligible for tax deduction in Rs 1.5 lakh. The minimum amount required to invest is Rs 250, with an upper limit of Rs 1.5 lakh per annum. The maturity will be after the girl child attains the age of 21 or 18 (if she is getting married). The tax benefits can be availed by parents or guardians under section 80-C.

Art – Art is a special asset class and requires more involvement than other forms of investments. Artworks are by definition unique (unlike shares, where it does not matter which one you own).It is a investment in painting, drawing, Precious stone, photography, digital, mixed media, sculpture, prints, and even video. Art as a form of investment is quite common in developed nations and the trend is picking up in India. Many affluent Indians buy art preserve it and diversify their portfolios

Venture capital – This is considered as high risk capital. Venture capital is mainly initial capital provided for new ventures in high risk areas where the conventional source of finance are not available. Being a new concept it does not meet the rigid requirements of financial institutions. Venture capital provide financial resources in the form of equity capital to implement the project. Usually, new projects of high technology are taken up. Venture capital not only provide finance but also assist in the management of the enterprise to ensure smooth implementation.

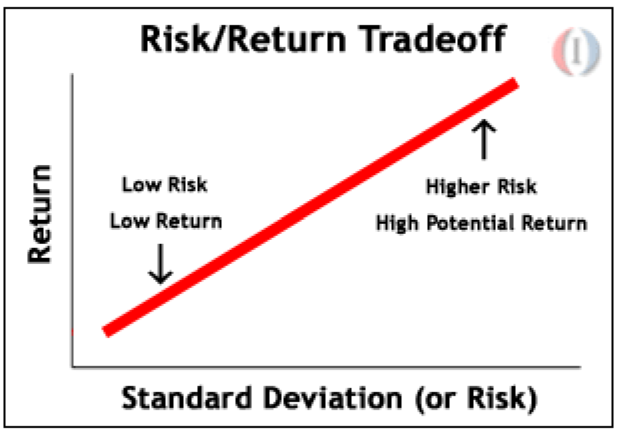
National Savings Certificates (NSCs) –These are one time lump sum investment products which you can buy at any post office network in India. 5-year NSCs and 10-year NSCs will give you 8.50% and 8.80% respectively in the current financial year. Also, your investment will earn you tax exemption under section 80C.

Risk and Return

Higher **risk** is associated with greater probability of higher **return** and lower **risk** with a greater probability of smaller **return**. This trade off which an investor faces between **risk** and **return** while considering investment decisions is called the **risk return** trade off.

Returns are the gains or losses from a security in a particular period and are usually quoted as a percentage.

Risk is the chance that an investment's actual return will be different than expected. Risk means you have the possibility of losing some, or even all, of your original investment. Low levels of uncertainty (low risk) are associated with low potential returns. High levels of uncertainty (high risk) are associated with high potential returns. The risk/return tradeoff is the balance between the desire for the lowest possible risk and the highest possible return.



For example, Rohan faces a risk return trade off while making his decision to invest. If he deposits all his money in a saving bank account, he will earn a low return i.e. the interest rate paid by the bank, but all his money will be insured up to an amount of….

However, if he invests in equities, he faces the risk of losing a major part of his capital along with a chance to get a much higher return than compared to a saving deposit in a bank

Diversification allows investors to reduce the overall risk associated with their portfolio but may limit potential returns. Making investments in only one market sector may, if that sector significantly outperforms the overall market, generate superior returns, but should the sector decline then you may experience lower returns than could have been achieved with a broadly diversified portfolio.

Concept and component of total risk

Total risk is an assessment that identifies all of the risk factors associated with pursuing a specific course of action.

Total risk represents a combination of the systematic risk and unsystematic risk, including potential internal and external threats and liabilities, Identifying these risks requires performing a total risk assessment, which offers a comprehensive view of potential threats an organization might encounter. The goal of examining total risk is to make a decision that leads to the best possible outcome.

Types of risk

1. Unique/specific Risk – Affect only that firm,also known as unsystematic risk, diversifiable risk, Firm specific, Idiosyncratic Risk
2. Market risk – affect overall stock market, also known as systematic risk, undiversifiable risk

Systematic Risk:
It refers to that portion of variability in return which is caused by the factors affecting all the firms. It refers to fluctuation in return due to general factors in the market such as money supply, inflation, economic recessions, interest rate policy of the government, political factors, credit policy, tax reforms, etc. these are the factors which affect almost all firms. The effect of these factors is to cause the prices of all securities to move together. This part of risk arises because every security has a built in tendency to move in line with fluctuations in the market. No investor can avoid or eliminate this risk, whatever precautions or diversification may be resorted to. The systematic risk is also called the non-diversifiable risk or general risk.

Types of Systematic Risk:
1.**Market Risk**:
market prices of investments, particularly equity shares may fluctuate widely within a short span of time even though the earnings of the company are not changing. The reasons for this change in prices may be varied. Due to one factor or theother, investors' attitude may change towards equities resulting in the change in market price. Change in market price causes the return from investment to vary. This is known asmarket risk. The market risk refers to variability in return due to change in market price of investment. Market risk appears because of reaction of investors to different events. There are different social, economic, political and firm specific events which affect the market price of equity shares. Market psychology is another factor affecting market prices. In bull phases, market prices of all shares tend to increase while in bear phases, the prices tend to decline. In such situations, the market prices are pushed beyond far outof line with the fundamental value.

2. **Interest-rate Risk:** The interest rate risk refers to the variability inreturn caused by the change in level of interest rates. Interest rate risk arises due to changes in market interest rates. In the stock market, this primarily affects fixed income securities because bond prices are inversely related to the market interest rate. In fact, interest rate risks include two opposite components: Price Risk and Reinvestment Risk. Both these risks work in opposite directions. Price risk is associated with changes in the price of a security due to changes in interest rate. Reinvestment risk is associated with reinvesting interest/ dividend income. If price risk is

negative (i.e. fall in price), reinvestment risk would be positive (i.e. increase in earnings on reinvested money). Interest rate changes are the main source of risk for fixed income securities such as bonds and debentures.

3.**Purchasing power or Inflation Risk**:

The inflation risk refers to the uncertainty of purchasing power of cash flows to be received out of investment. It shows the impact of inflation or deflation on the investment. Purchasing power risk arises due to inflation. Inflation is the persistent and sustained increase in the general price level. Inflation erodes the purchasing power of money, i.e., the same amount of money can buy fewer goods and services due to an increase in prices. Therefore, if an investor's income does not increase in times of rising inflation, then the investor is actually getting lower income in real terms.

Unsystematic Risk:

The unsystematic risk represents the fluctuation in return from an investment due to factors which are specific to the particular firm and not the market as a whole. These factors are largely independent of the factors affecting market in general. Since these factors are unique to a particular firm, these must be examined separately for each firm and for each industry. These factors may also be called firm-specific as these affect one firm without affecting the other firms. For example, a fluctuation in price of crude oil will affect the fortune of petroleum companies but not the textile manufacturing companies. As the unsystematic risk results from random events that tend to be unique to an industry or a firm, this risk is random in nature. Unsystematic risk is also called specific risk or diversifiable risk.

Types of unsystematic risk

Business risk – Eg. Strike, Techically outdated technology, accident

Financial risk – Company has more debt than owned funds. It is related to debt- Equity ratio. Company does not perform well and it is unable to Pay its creditors. In addition, Borrowing expose the company to the risk that creditor will file a Legal claim against it.

Liquidity risk – It is when an asset may not be sold easily or may not receive full market value especially it must be sold on short notice. For example, if a company's stock is held by relatively few stockholders and demand for the shares is not high, one of those stockholders might have difficulty finding a buyer.

Systematic Risk and Risk Premiums