



## SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT

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### **Abstract**

*The activities of large, internationally active financial institutions have grown increasingly complex and diverse in recent years. This increasing complexity has necessarily been accompanied by a process of innovation in how these institutions measure and monitor their exposure to different kinds of risk. One set of risk management techniques that has attracted a great deal of attention over the past several years, both among practitioners and regulators, is "stress testing", which can be loosely defined as the examination of the potential effects on a firm's financial condition of a set of specified changes in risk factors, corresponding to exceptional but plausible events. A concept of security analysis and portfolio management services has been very famous and old among various institutions. This report represents practices application of portfolio management techniques in the portfolio section. Portfolio management is an integrated and exhaustive of fundamental and technical methods which are used for calculation of annul return and earnings per share for the portfolio. Modern portfolio theory suggests that the traditional approach to portfolio analysis, selection and management may yield less than optimum results. Hence a more scientific approach is required, based on estimates of risk and return of the portfolio and the attitudes of the investor toward a risk-return trade-off stemming from the analysis of the individual securities.*



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### **Introduction**

SECURITY ANALYSIS is the systematic study of the performance of companies in the capital market. Equity analysis consists of Fundamental analysis & Technical analysis.

Any decision to be taken in investment of shares should be based on actual movement of share prices of the target scrip. In Equity Analysis, calculations are based on FACTS & not on HOPE. The core of equity analysis lies in the attempt to determine future share price movements with the help of RATIO ANALYSIS, STUDY OF GRAPHS, and many other statistical and research methods. Equity analysis does not discuss how to buy & sell shares, but rather it discusses the methods, which can enable the investor to arrive at any buy or sell decision. The Technical Approach to investment is essentially based on the presumption that prices of any scrip always moves in a trend which can be determined by the changing attitude of investor's toward a variety of economic, monetary, political and psychological forces. The

'art' of technical analysis, is to identify a trend reversal at a relatively early stage and ride on that trend until the weight of the evidence shows or proves the trend has reversed.

### **OBJECTIVES OF THIS STUDY**

- Analysis of Equity Shares.
- Fundamental Analysis of any randomly selected company
- Further Analysis of any randomly selected sector
- Obtain knowledge on various strategies of investment.
- To study and understand the portfolio management concepts.

### **INTRODUCTION TO SECURITY ANALYSIS**

There are two main disciplines of security analysis; fundamental and technical. The fundamental approach considers all aspects of a company's business as it relates to the overall economic environment in an attempt to generate a future value of the stock.

Where this analysis reveals that the expected value of the company is greater than its stock price, an investment opportunity is found.

**What is Price?** Financial theorists define stock price as the present value of all future earnings expectations for the company, divided by its number of shares outstanding. What this means is that the earning capacity of the company is what defines price. Often, companies can get significant value out of a relatively small investment in assets because the ability for those assets to make money is significant. Even companies that lose money today can have a high share price because price is based on the future earnings of the company. No enterprise is in business to lose money, so the expectation is that every business will make money some day. So long as there is the potential for future revenue streams to shareholders, there will be a price that someone is willing to pay for the shares. The earnings that a company could make in the future, the growth that the company could realize and the time to the realization of those goals are all factors which affect the estimate that the market makes on the earnings potential of the company.

### **The Market Mechanism**

Publicly traded companies are worth more than private ones simply because there is greater access to buyers and sellers, and market efficiency can better determine share price. The stock market provides value to any company that chooses to list its shares because the company gains liquidity. In a theoretical sense, any time someone buys the shares of a company in the market, they are effectively stating that they believe the shares of the company are undervalued. The fact that they are buying implies a belief and expectation that

the shares will increase in value in the future. At the same time, the person who is selling the shares is expressing the opposite belief. By selling, they imply that the stock is overvalued and the expectation that the stock will go lower in the future. In this way, the stock market is forum for debate on what the value of the company and its shares is.

### **Information**

Information is the key, as it gives the market a reason to value a stock at a particular price level. The market will price a stock based on all information that the public is aware of. As new information comes into the public realm, the market will adjust prices up or down based on how the market perceives the information will affect the future earnings capacity of the company. The ramification of this is that investors who wait for news to make investment decisions often get into stocks long after the information contained in the news has already been priced in. "Buy on rumor, and sell on news", is a saying that has grown popular because it is often the case that stocks move up in anticipation of positive news and then sell off when expectations have been answered by the news release.

### **Psychological Factors**

Humans are behind the trading activity of the stock market. Understanding human psychology is extremely valuable when evaluating investment opportunities because human psychology creates and accentuates many of the opportunities that investors can capitalize on. For example, greed often causes stocks to go higher than they deserve to go. New information can cause frenzy in the market that makes investors lose sight of rational valuation and simply buy the stock for fear of being left behind. This phenomenon is the basis for some great speculative bubbles that we have seen in history, the earliest being the buying frenzy of 2007. At the same time, fear motivated by negative information can cause everyone to rush for liquidating their positions. Much of the selling pressure that prevails during market crashes is out of fear, not a rational thought process based on information. Fear and greed present incorrect valuations in the market that can exist for relatively short periods of time but long enough for smart investors to capitalize on.

### **Supply and Demand**

While popular stocks like RIL or Infosys trade millions of shares every day, the majority of stocks that we can choose to invest in do not have such liquidity. As a result, stocks that trade smaller volumes of shares are subject to fluctuations because of supply and demand. If a large shareholder wants to sell a large number of shares into a market with weak liquidity, that shareholder can dramatically move share price. The flip side is also true when a large buy order comes into a market that lacks sellers. Supply and demand can take the short-term

balance out of the stock market and present opportunities for investors who have the patience to see that balance restored. Investors who can anticipate abnormal supply or demand variations can also capitalize.

### **FUNDAMENTAL ANALYSIS**

It's a logical and systematic approach to estimating the future dividends & share price as these two constitutes the return from investing in shares. According to this approach, the share price of a company is determined by the fundamental factors affecting the Economy/ Industry/ Company such as Earnings Per Share, DIP ratio, Competition, Market Share, Quality of Management etc. it calculates the true worth of the share based on its present and future earning capacity and compares it with the current market price to identify the mispriced securities.

Fundamental analysis involves a three-step examination, which calls for:

1. Understanding of the macro-economic environment and developments.
2. Analyzing the prospects of the industry to which the firm belongs.
3. Assessing the projected performance of the company.

### **MACRO ECONOMIC ANALYSIS:**

The macro-economy is the overall economic environment in which all firms operate. The key variables commonly used to describe the state of the macro-economy are:

#### **Growth Rate of Gross Domestic Product (GDP):**

The Gross Domestic Product is measure of the total production of final goods and services in the economy during a specified period usually a year. The growth rate of GDP is the most important indicator of the performance of the economy. The higher the growth rate of GDP, other things being equal, the more favourable it is for the stock market.

#### **Industrial Growth Rate:**

The stock market analysts focus more on the industrial sector. They look at the overall industrial growth rate as well as the growth rates of different industries. The higher the growth rate of the industrial sector, other things being equal, the more favorable it is for the stock market.

#### **Agriculture and Monsoons:**

Agriculture accounts for about a quarter of the Indian economy and has important linkages, direct and indirect, with industry. Hence, the increase or decrease of agricultural production has a significant bearing on industrial production and corporate performance. A spell of good monsoons imparts dynamism to the industrial sector and buoyancy to the stock market.

Likewise, a streak of bad monsoons casts its shadow over the industrial sector and the stock market.

### **Savings and Investments:**

The demand for corporate securities has an important bearing on stock price movements. So investment analysts should know what the level of investment in the economy is and what proportion of that investment is directed toward the capital market. The analysts should also know what the savings are and how the same are allocated over various instruments like equities, bonds, bank deposits, small savings schemes, and bullion. Other things being equal, the higher the level of savings and investments and the greater the allocation of the same over equities, the more favorable it is for the stock market.

### **Government Budget and Deficit:**

Government plays an important role in most economies. The excess of government expenditures over governmental revenues represents the deficit. While there are several measures for deficit, the most popular measure is the fiscal deficit. The fiscal deficit has to be financed with government borrowings, which is done in three ways:

1. The government can borrow from the reserve bank of India.
2. The government can resort to borrowing in domestic capital market.
3. The government may borrow from abroad.

Investment analysts examine the government budget to assess how it is likely to impact on the stock market.

### **Concerned with the basics of industry analysis, this section is divided into three parts:**

- Industry life cycle analysis
- Study of the structure and characteristics of an industry
- Profit potential of industries: Porter model.

### **INDUSTRY LIFE CYCLE ANALYSIS:**

Many industries economists believe that the development of almost every industry may be analyzed in terms of a life cycle with four well-defined stages:

#### **Pioneering stage:**

During this stage, the technology and or the product are relatively new. Lured by promising prospects, many entrepreneurs enter the field. As a result, there is keen, and often chaotic, competition. Only a few entrants may survive this stage.

#### **Rapid Growth Stage:**

In this stage firms, which survive the intense competition of the pioneering stage, witness significant expansion in their sales and profits?

**Maturity and Stabilization Stage:**

During the stage, when the industry is more or less fully developed, its growth rate is comparable to that of the economy as a whole. With the satiation of demand, encroachment of new products, and changes in consumer preferences, the industry eventually enters the decline stage, relative to the economy as a whole. In this stage, which may continue indefinitely, the industry may grow slightly during prosperous periods, stagnate during normal periods, and decline during recessionary periods.

**STUDY THE STRUCTURE & CHARACTERISTICS OF AN INDUSTRY:**

Since each industry is unique, a systematic study of its specific features and characteristics must be an integral part of the investment decision process. Industry analysis should focus on the following:

**I. Structure of the Industry and nature of Competition:**

The number of firms in the industry and the market share of the top few (four to five) firms in the industry, Licensing policy of the government, Entry barriers, if any, Pricing policies of the firm, Degree of homogeneity or differentiation among products, Competition from foreign firms

Comparison of the products of the industry with substitutes in terms of quality, price, appeal, and functional performance

**II. Nature and Prospect of Demand:**

Major customer and their requirements, Key determinants of demand, Degree of cyclicity in demand, Expected rate of growth in the foreseeable future

**III. Cost, Efficiency, and Profitability:**

Proportions of the key cost elements, viz. raw materials, labour, utilities, & fuel, Productivity of labour, Turnover of inventory, receivables, and fixed assets, Control over prices of outputs and inputs, Behaviour of prices of inputs and outputs in response to inflationary pressures, Gross profit, operating profit, and net profit margins, Return on assets, earning power, and return on equity

**IV. Technology and Research:**

· Degree of technological stability, Important technological changes on the horizon and their implications, Research and development outlays as a percentage of industry sales, Proportion of sales growth attributable to new products

## **COMPANY ANALYSIS**

Company analysis is the final stage of the fundamental analysis, which is to be done to decide the company in which the investor should invest. The Economy Analysis provides the investor a broad outline of the prospects of growth in the economy. The Industry Analysis helps the investor to select the industry in which the investment would be rewarding.

### **Financial analysis:**

Share price depends partly on its intrinsic worth for which financial analysis for a company is necessary to help the investor to decide whether to buy or not the shares of the company. The soundness and intrinsic worth of a company is known only such analysis. An investor needs to know the performance of the company, its intrinsic worth as indicated by some parameters like book value, EPS, PIE multiple etc. and come to a conclusion whether the share is rightly priced for purchase or not. This, in short is short importance of financial analysis of a company to the investor. Financial analysis is analysis of financial statement of a company to assess its financial health and soundness of its management. "Financial statement analysis" involves a study of the financial statement of the company to ascertain its prevailing state of affairs and the reasons thereof. Such a study would enable the public and investors to ascertain whether one company is more profitable than the other and also to state the cause and factors that are probably responsible for this.

## **PORTFOLIO MANAGEMENT**

### **Concept of Portfolio:**

Portfolio is the collection of securities may be financial or real assets such as equity shares, debentures, bonds, treasury bills and property etc. portfolio is a combination of assets or it consists of collection of securities. These holdings are the result of individual preferences, decisions of the holders regarding risk, return and a host of other considerations.

### **Portfolio management:**

An investor considering investment in securities is faced with the problem of choosing from among a large number of securities. His choice depends upon the risk return characteristics of individual securities. He would attempt to choose the most desirable securities and like to allocate his funds over his group of securities. Again he is faced with the problem of deciding which securities to hold and how much to invest in each.

The investor faces an infinite number of possible portfolio or group of securities. The risk and return characteristics of portfolios differ from those of individual securities combining to form a portfolio. The investor tries to choose the optimal portfolio taking into consideration the risk-return characteristics of all possible portfolios.

As the economic and financial environment keeps the changing the risk return characteristics of individual securities as well as portfolio also change. An investor invests his funds in a portfolio expecting to get a good return with less risk to bear. Portfolio management concerns the construction and maintenance of a collection of investment. It is investment of funds in different securities in which the total risk of the Portfolio is minimized while expecting maximum return from it. It primarily involves reducing risk rather than increasing return.

Return is obviously important though, and the ultimate objective of portfolio manager is to achieve a chosen level of return by incurring the least possible risk.

### **Characteristics of Investment:**

**The characteristics of investment can be understood in terms of as:**

- Return, Risk, Safety, Liquidity etc.

**Return:** All investments are characterized by the expectation of a return. In fact, investments are made with the primary objective of deriving return. The expectation of a return may be from income (yield) as well as through capital appreciation.

Capital appreciation is the difference between the sale price and the purchase price.

The expectation of return from an investment depends upon the nature of investment, maturity period, and market demand and so on.

**Risk:** Risk is inherent in any investment. Risk may relate to loss of capital, delay in repayment of capital, non-payment of return or variability of returns. The risk of an investment is determined by the investments, maturity period, repayment capacity, nature of return commitment and so on. Risk and expected return of an investment are related. Theoretically, the higher the risk, higher is the expected return. The higher return is a compensation expected by investors for their willingness to bear the higher risk.

**Safety:** The safety of investment is identified with the certainty of return of capital without loss of time or money. Safety is another feature that an investor desires from investments. Every investor expects to get back the initial capital on maturity without loss and without delay.

**Liquidity:** An investment that is easily saleable without loss of money or time is said to be liquid. A well developed secondary market for security increases the liquidity of the investment. An investor tends to prefer maximization of expected return, minimization of risk, safety of funds and liquidity of investment.



**Investment categories:**

**Investment generally involves commitment of funds in two types of assets:**

**Real assets, Financial assets**

**Real assets:** Real assets are tangible material things like building, automobiles, land, gold etc.

**Financial assets:** Financial assets are piece of paper representing an indirect claim to real assets held by someone else. These pieces of paper represent debt or equity commitment in the form of IOUs or stock certificates. Investments in financial assets consist of Securitised (i.e. security forms of) investment- Non-securities investment

The term 'securities' used in the broadest sense, consists of those papers which are quoted and are transferable. Under section 2 (h) of the Securities Contract (Regulation) Act, 1956 (SCRA) 'securities' include: -

- i) Shares, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate.
- ii) Government securities.
- iii) Such other instruments as may be declared by the central Government as securities, and;
- iv) Rights of interests in securities.

**FEATURES OF PORTFOLIO MANAGEMENT:**

The objective of portfolio management is to invest in securities in such a way that one maximizes one's return and minimizes risks in order to achieve one's investment objective.

1) **SAFETY OF THE INVESTMENT:** The first important objective investment safety or minimization of risks is of the important objective of portfolio management. There are many types of risks. Which are associated with investment in equity socks, including super stock.

There is no such thing called **Zero-risk investment**. Moreover relatively low – risk investment gives corresponding lower returns.

2) **STABLE CURRENT RETURNS:** Once investment safety is guaranteed, the portfolio should yield a steady current income. The current returns should at least match the opportunity cost of the funds of the investor. What we are referring to here is current income by of interest or dividends, not capital gains.

3) **APPRECIATION IN THE VALUE OF CAPITAL:** A good portfolio should appreciate in value in order to protect the investor from erosion in purchasing power due to inflation. In other words, a balance portfolio must consist if certain investment, which tends to appreciate in real value after adjusting for inflation.

**4) MARKETABILITY:** A good portfolio consists of investment, which can be marketed without difficulty. If there are too many unlisted or inactive share in your portfolio, you will face problems in enchasing them, and switching from one investment to another. It is desirable to invest in companies listed on major stock exchanges, which are actively traded.

**5) LIQUIDITY:** The portfolio should ensure that there are enough funds available at the short notice to take of the investor's liquidity requirements.

**6) TAX PLANNING:** Since taxation is an important variable in total planning, a good portfolio should let its owner enjoy favourable tax shelter. The portfolio should be developed considering income tax, but capital gains, gift tax too. What a good portfolio aims at is tax planning, not tax evasion or tax avoidance.

### **ANALYSIS AND INTERPRETATION AND CONCLUSION**

From the chart1 the price is located above the EMA. The chart WIPRO represents the variation indifferent price such as open, high, low and close in respect of different weeks which had been taken into consideration 03/02/2011 to 03/03/2014.

The candlestick chart of WIPRO can the stock prices of WIPRO are in short term and medium term is bullish. Already triple top breakout on 26/08/2013 at 483 level next replacement targets 592,660 and 760 and stoploss 540 level expected. The MACD and RSI also indicate the even bought trend. On the basis of the trend investor makes a decision about buy or sell.

### **CONCLUSION**

Online trading is the new concept in the stock market. In India, online trading is still at its infancy stage. Online trading has made it easy to trade in the stock market as now people can trade while sitting at their home. Now stock market is easily accessible by the people. There are some problems while doing the trade through the internet. Major problem faced by online trader is that the investors are loyal to their traditional brokers, they rely upon the suggestions given by their brokers. Another major problem is that the people don't have full knowledge regarding online trading. They find it difficult to trade themselves, as a wrong entry made by them, can bring them huge losses.

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