SRINIVASAN ENGINEERING COLLEGE, PERAMBALUR

DEPARTMENT OF MANAGEMENT STUDIES

NAME OF THE SUBJECT: BA9257 SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT

YEAR / SEM: II / III

TWO MARKS QUESTIONS AND ANSWERS

UNIT (I-V)

1.New Issue Market (Primary Market)

- ✓ Issuer may be a new company or an existing company.
- ✓ In the new issue market the issuer can be considered as a manufacturer. The issuing houses, investment bankers and brokers act as the channel of distribution for the new issues. They take the responsibility of selling the stocks to the public.

2.Relationship between the primary and secondary market:

- ✓ The new issue market cannot function without the secondary market. The secondary market or the stock market provides liquidity for the issued securities. The issued securities are traded in the secondary market offering liquidity to the stock at a fair price.
- ✓ The primary market provides a direct link between the prospective investors and the company. By providing liquidity and safety, the stock market encourage the public to subscribe to the new issues.
- ✓ The health of the primary market depends on the secondary market and viceversa.

3.Who are the parties involved in primary market

- ✓ In the and sixties and seventies, public issue was managed by the company and its personnel. But ,at present public issue involves a number of agencies. The rules and regulation, the changing scenario of the capital market necessitated the company to seek for the support of many agencies to make the public issue a success.

- ➔ Managers to the issue
- ➔ Registrar to the issue
- ➔ Underwriters

4.Book building

- ✓ Book building is a mechanism through which the intial public offerings(IPOs) take place in the U.S.Similar mechanisms are used in the primary market offerings of GDRs also. In this process the price determination is based on orders placed and investors have an opportunity to place orders at different prices as practiced in international offerings.
- ✓ Book – building involves firm allotment of the instrument to a syndicate created by the lead managers who sell the issue at an acceptable price to the public.

5.Issue At premium

a) First issue of new companies set up by existing companies with the case of the following
b) First issue of existing private/closely held or other existing unilisted companies with three – year track record of consistent profitability.
c) Public issue by existing listed companies with the last three years of dividend paying track record.

6.Issue At par value

a) First public issue by existing private, closely held or other existing unlisted companies without three – year track record of consistent profitability and
b) Existing private/closely held and other unlisted companies without three- year track record of consistent profitability seeking disinvestment offer to public without issuing fresh capital (disinvestment).

7.Allotment Of Shares

- ✓ The applications will be categorised according to the number of shares applied for. Then allocation is done by proportionate basis.

- Factors to be considered by the investors

In this context, the investor has to be alert and careful in his investment. He has to analyse several factors.

8.Investors protection in the primary market

SEBI Guidelines to the investor protection

1) Project appraisal
2) Underwriting
3) Disclosuers in the prospectus
4) Clearance by the stock exchange
5) Singing by the board of directors
6) SEBI's role
7) Redressal of investors grievances

9.Recent trends in the primary market

The liberalisation policy adopted by the government in the early nineties resulted in boom in the secondary market. The boom was not restricted to the secondary market alone, the primary market till then was workink under the controller of capital issue act.with the dawn of an era of free pricing more and more companies accessed the primary market.

1) Aggressive pricing
2) Poor liquidity
3) Low returns

   Non implementation of projects, delays changes in the scope and scale of project to justify the cost and non attainment of projected earnings have resulted in the fall in listing price.

4) Low volume
5) Economic slow down

10. Short notes on Stock Exchanges In India

- The origin of the stock exchange in india can be traced back to the later half of 19^{th} century. After the american civil war (1860-61)due to the share mania of the public, the no of brokers delaing in shares increased. The brokers organised an informal association in mumbai named "The native stock and share brokers association" in 1875.

11.List the few Functions Of Stock Exchanges

- Maintains active trading
- Fixation of prices
- Ensures safe and fair dealing
- Aids in financing the industry
- Dissemination of information
- Performance inducer
- Self – regulating organisation

12.Brokers

A member/broker registered with the recognised stock exchange has to apply to the sebi for registration. Likewise a sub-broker even though he is registered with the stock exchange should apply to SEBI for registration .

13.Online trading:

The net is used as a medium of trading in internet trading. Orders are communicated to the stock exchange through website. Internet trading started in India on 1^{st} April 2000 with 79 members seeking permission for online trading. The SEBI committees on internet based securities trading services has allowed the net to be used as an Order Routin System (ORS) through registered stock brokers on behalf of their clients for execution of transaction.

- The client has to enter stock code and other parameters such as quantity and price of the scrip on the place order window.
- The client can review the order placed by clicking the review option. He can also reset to clear the values
- Satisfactory orders are sent by clicking the send option
- The client receives an order confirmation message with order number and value of the order

14.Bombay Stock Exchange:

The origin of the Bombay (Mumbai) Stock Exchange dates back to 1875. It was organized under the name of "the Native Stock and Share Brokers Association" as a voluntary and non-profit making association. It was recognized on a permanent basis in 1957. This premier stock exchange is the oldest stock exchange in Asia.

<u>The objectives of the stock exchange are</u>:

- To safeguard the interest of investing public having dealings on the exchange
- To establish and promote honourable and just practices in securities transactions
- To promote, develop and maintain well-regulated market for dealing in securities
- To promote industrial development in the country through efficient resource mobilization by the way of investment in corporate securities

15.Trading System:

In March 1995, the Bombay (Mumbai) Stock Exchange has introduced screen based trading called BOLT (BSE on-line Trading). The BOLT is designed to get best bids and offers from jobbers' book as well as the best buy and sell orders from the order book. Slowly the network is being extended to other cities too.

Price Surveillance:

1. Circuit filters and
2. Margins

16.National Stock Exchange:

The National Stock Exchange (NSE) of India became operational in the capital market segment on 3rd, November 1994 in Mumbai. The genesis of the NSE lies in the recommendations of the Pherwani Committee (1991). Apart from NSE, it had recommended for the establishment of National Stock Market System also. Committee pointed out five major defects in the Indian Stock Market.

17.Promoters of NSE IDBI, ICICI, IFCI, LIC, GIC, SBI, Bank of Baroda, Canara Bank, Corporation Bank, Indian Bank, Oriental Bank of Commerce, Union Bank of India, Punjab National Bank, Infrastructure Leasing and Financial Services, Stock Holding Corporation of India and SBI Capital Market are the promoters of NSE.

18. List the advantages of NSE

- wider accessibility
- Screen based trading
- Non- disclosure of the trading members identity
- Transparent transaction
- Matching of orders

19.Over The Counter Exchange Of India(OTCEI)

The OTCEI was started with the objective of providing a market for the smaller companies that could not afford the listing fees of the large exchanges and did not fulfill the minimum capital requirement for listing.

20. promoters of OTCEI is incorporated as a company under sec.25 of the Indian Companies Act 1956. As per the registration norms, OTCEI will be obliged to plough back all its profits and will not be allowed to declared dividends on its share capital. The promoters are as follows

UTI	GIC
ICICI	SBI Capital Markets

IDBI	Canbank Financial Services
IFCI	LIC

21.National Securities Depository Limited(NSDL)

NSDL performs the following functions through its various participants

- Enables surrender and withdrawal of securities to and form the depository
- Maintains investors holdings in the electronic form
- Effects settlement of securities traded on exchanges
- Carries out settlement of trader that have not been done on the stock exchanges

NSDL (DP) depository participant can be a public financial institution, bank, custodian, registered stock broker or a NBFC subject to approval from the depository company and the SEBI.

22. Securities and exchange board of india(SEBI)

SEBI's regulatory reach has been extended to more areas and there is a considerable change in the capital market. SEBI's annual report for 1997-98 has stated that throughout its six year existence as a statutory body, it has sought to balance the twin objectives of investor protection and market development.

23.**Objectives of SEBI:**

The promulgation of the SEBI ordinance in the parliament gave statutory status to SEBI in 1992. According to the preamble of the SEBI, the three main objectives are

- To protect the interests of the investors in securities
- To promote the development of securities market
- To regulate the securities market

24.SEBI's Role in the Primary Market:

- Entry norms
- Promoters' contribution
- Disclosure
- Book building
- Allocation of shares
- Market intermediaries

25.SEBI and FIIs:

The union Government allowed Foreign Institutional Investors (FIIs) to enter both the primary and secondary markets in India under liberalized policy regime. The large inflow and out flow of capital by FIIs affect the Sensex movements.

- Custodians
- Preferential allotment
- Recent development

26.Risk

The dictionary meaning of risk is the possibility of loss. In risk, the probable outcomes of all the possible events are listed.

27.**Systematic risk**

The systematic risk affect the entire market. Often we read in the newspaper thah the stock market is in the bear hug or in the bull grip this indicates that the entire market is moving in a particular either downward or upward.

28.Market risk

Jack clark francis has defined market risk as that portionof total variability of return casued by the alternating forces of bull and bear markets. When the security index moves upward haltingly for a siginificants period of time,it is known as bull market.

29.Interest rate risk

Interest rate risk is the variation in the single period rates of return caused by the fluctuations in the market interest rate. Most commonly interest rate risk affect the price of bonds, debentures and stocks. The fluctuations in the interest rates are caused by the changes in the government monetary police and the change that occur in the interest rate of treasury bills and the government bonds.

30.purchasing power risk

variations in the returns are casued also by the loss of purchasing power of currency. Influation, is the reason behind the loss of purchasing power. The level of inflation proceeds faster than the increase in capital value. Purcahsing power risk is the probable in loss in the purchasing power of the returns to the received.

31.**Business risk**

Business risk is that portion of the unsystematic risk caused by the operating environment of the business. Business risk arises from the inability of a firm to maintain its compentitive edge and the growth or stability of the earnings.

32.Internal business risk

Internal business risk is associated with the operational efficiency of the firm. The operational efficiency differs from company to company. The efficiency of operation is reflected on the company's achievement of its pre-set goals and the fulfillment of the promises to its investors.

1) **Fluctuations in the sales**
2) **Research and development(R & D)**
3) **Personnel management**
4) **Fixed cost**
5) **Single product**

33.External risk

External risk is the results of operating conditions imposed on the firm by the circumstances beyond its control. The external environments in which its operates exert some pressure on the firm.

1) **Social and regulatory factors**
2) **Political risk**

34. Financial risk

Its refers to variability of the income to the equity capital due to the dept capital. Financial risk in a company is associated with the capital structure of the company. Capital structure of the company consists of equity funds and borrowed funds.

35.Bond return and valuation

Debt instruments are the cherished for investor's money. An assured return and high interest rate or responsible for the preference of bonds over equities.

36.Bond basics

A bond is a contract that requries the borrower to pay the interest income to the lender. It resembles the promissory note and issued by the government and corporate. The par value of the bond indicates the face value of the bond i.e.the value stated on the bond paper.

1) **Interest rate risk**
2) **Default risk**

3) **Marketability risk**
4) **Callability risk**

37.Return

The return form the stock includes both current income and capital gain caused by the price. The income and the capital gain are expressed as a persentage of money invested in the beginning.

38.Fundamental analysis

The fundamental school of thought apprasied the intrinsic value of shares through

- Economic analysis
- Industry analysis
- Company analysis

39.Economic analysis

The level of economic activity has an impact on investment in many ways. If the economy grows radily,the industry can also be expected to show rapid growth and wise versa. When the level of economic activity is low, stock prices are low, and when the level of economic activity is high, stock prices are high reflecting the properous outlook for sales and profit of the firms.

1) **Gross domestic product(GDP)**
2) **Savings and investment**
3) **Inflation**
4) **Interest rate**
5) **Budget**

40.Industry analysis

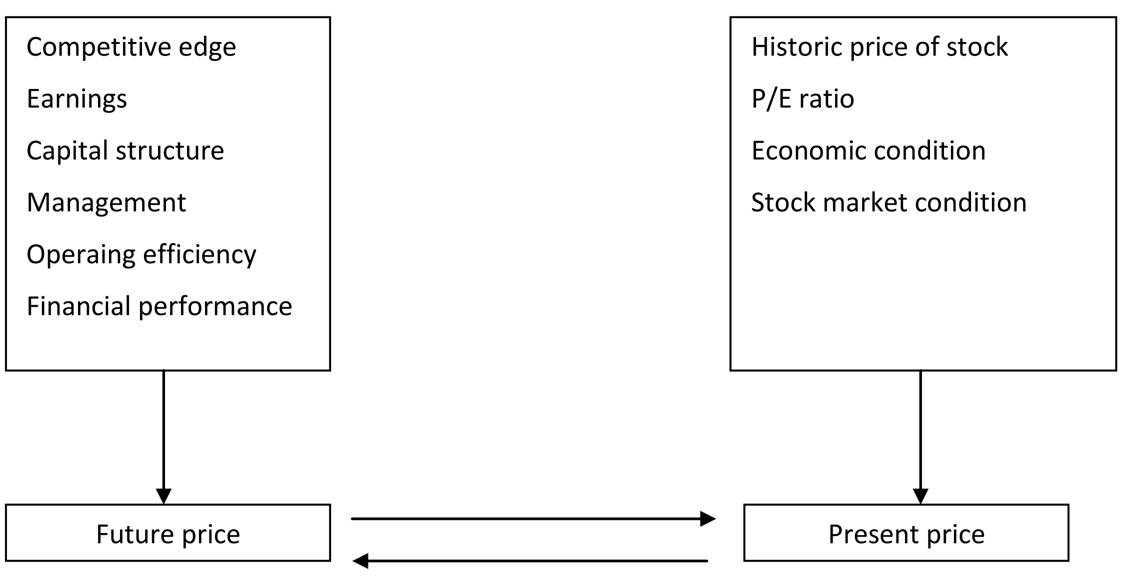
An industry is a group of firms that have similar technological structure of production and produce similar products. For the convenience of the investors, the broad classification of the industry is given in financial dailies and magazines.

1) **Growth industry**
2) **Cyclical industry**
3) **Defensive industry**
4) **Cyclical growth industry**
5) **Industry life cycle**

41.Company analysis

In the company analysis the investor assimilates the several bites of information related to the company and evaluates the presents and furture values of the stocks. The risks and return associated with the purchase of the stock is analysed to take better investment decisions.

FACTORS SHARE VALUE



42.Ratio analysis

Ratio is a relationship between two figures expressed mathematically. Financial ratio provides numerial relationship between two relevant financial data. Financial ratios are calculated from the balance sheet and profit and loss account.

1. Liquidity ratios
2. Turnover ratios
3. Leverage ratios
4. Profit margin ratios
5. Return on investment ratios
6. Valuation ratios

43.Liquidity ratio:

Liquidity means the ability o the firm to meet its short term obligations. Current ratio and acid test ratio are the most popular ratios used to analyse the liquidity.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

44.Turnover ratio:

The turnover ratios show how well the assets are used and the extent of excess inventory, if any. These ratios are also known as activity ratios or asset management ratios. Commonly calculated ratios are sales to current assets, sales to fixed assets, sales to inventory, receivable to sales and total assets to turnover. Each ratio has a specific application.

Inventory turnover ratio = Net sales/ Inventory

Receivables turnover ratio = Net sales/ Receivables

Fixed asset turnover ratio = Net sales/ Fixed asset

Total assets turnover ratio = Net sales/ Total assets

45. leverage ratios:

The investors are generally interested to find out the debt portion of the capital. The debt affects the dividend payment because of the outflow of profit in the form of interest.

Debt to asset ratio= Total debt/ Total assets

46.Interest coverage ratio

This shows how many times the operating income covers the interest payment.

Interest coverage ratio= EBIT/ Interest

47.Profitability ratio

Profitability ratios relate the firm’s profit with factors that generate the profits. The investor is very particular in knowing net profit to sales, net profit to total assets and net profit to equity.

48.Net profit margin ratio

This ratio indicates the net profit per rupee of sales revenue.

Net profit Margin = PAT/ Sales

49.Return on assets

The return on asset measures the overall efficiency of capital invested in business.

Return on assets = Net income/ Total assets

50.Return on equity

Here, the net profit I related to the firm's capital

Return on equity = Net Profit/ Net worth

51.Book value per share

This ratio indicates the share of equity shareholders after the company has paid all its liabilities, creditors, debenture holders and preference shareholders. At the time of liquidation, the holder to find out his real position in the company

$$\text{Book value per share} = \frac{\text{Equity share capital + Reserve}}{\text{Total number of equity shares outstanding}}$$

OR

$$= \frac{\text{Net worth – Preference share capital}}{\text{Total number of equity shares outstanding}}$$

52.Dividend to market price

Dividend is the regular income received by the shareholder. The shareholder would like to know the relationship between the market price and the dividend.

$$\text{Dividend yield} = \frac{\text{Dividend per share}}{\text{Market price per share}}$$

53.Earnings per share

Earnings per share is the earnings after tax divided by the number of common shares outstanding

$$\text{EPS} = \frac{\text{EAT}}{\text{Number of shares outstanding}}$$

Lerner and Carleton have given a model for the EPS.

$$\text{EPS} = \frac{(1-T)\,[R+(R-1)\,L/E]\,E}{\text{Number of common shares outstanding}}$$

EPS – Earnings per share

T – Effective tax rate (Tax exposure/EBT)

R= Before tax return on assets (EBIT/A)

I – effective interest rate (Interest expense/ liabilities)

L – Total liabilities

E – Equity

54.Price earnings ratio

One of the most common financial parameters used in the stock market is the price-earnings ratio (P/E). it relates the share price with earnings per share. Most of the news papers along with the stock price quotations give the P/E ratio too.

$$\text{Price – Earnings Ratio} = \frac{\text{Market price per share}}{\text{Earnings per share}}$$

55.Intrinsic value

The true economic worth of the share is its intrinsic value. The fundamental analysis find out the intrinsic value of a share by using the following formula:

$$E(P/E) = \frac{\text{Cash dividend / E(EPS)}}{\text{Discount rate – growth rate}} \quad \frac{D/E(EPS)}{K\text{-}g}$$

56.Technical analysis:

It is a process of identifying trend reversals at an earlier stage to formulate the buying and selling strategy. With the help of several indicators they analyse the relationship between price- volume and supply-demand for the overall market and the individual stock.

57.Dow Theory:

Dow developed his theory to explain the movement of the indices of Dow Jones Averages. He developed the theory, on the basis of certain hypotheses. The first hypothesis is that, no single individual or buyer can influence the major trend of the market.

According to Dow theory the trend is dividend into primary, intermediate and short term trend. The primary trend may be the broad upward or downward movement that may last for a year or two. The intermediate trends are corrective movements, which may last for three weeks to three months.

58.Trend

Trend is the direction of movement. The share prices can either increase or fall or remain flat. The three directions of the share price movements are called as rising, falling and flat trends. The point to be remembered is that share prices do not rise or fall in straight line.

59.Trend reversal

The rise or fall in share price cannot go on forever. The share price movement may reverse its direction. Before the change of direction, certain pattern in price movement emerges. The change in the direction of the trend is shown by violation of the trend line. Violation of trend line and signals the rise in price.

60.Primary trend:

The security price trend may be either increasing or decreasing. When the market exhibits the increasing trend, it is called bull market. The bull market shows three clear-cut peaks. Each peak is higher than the previous peak. The bottoms are also higher than the previous bottoms.

The reverse is true with the bear market. Here, the first phase of fall starts with the abandonment of hopes. The chances of prices moving back to the previous high level seemed to be low. This would result in the sale of shares. In the second phase, companies are reporting lower profits and dividends.

61. secondary trend:

The secondary trend or the intermediate trend moves against the main trend and leads to correction. In the bull market the secondary trend would result in the fall of about 33- 66% of the earlier rise. In the bear market, the secondary trend carries the price upward and corrects the main trend.

62.Minor Trends:

Minor trends or tertiary moves are called random wriggles. They are simply the daily price fluctuations. Minor trend tries to correct the secondary trend movement. It is better for the investors to concentrate on the primary or secondary trends than on the minor trends.

63.Support and Resistance Level:

Anybody interested in the technical analysis should know the support and resistance level. A suppoert level exists at a price where considerable demand for that stock is expected to prevent further fall in the price level. The fall in the price may be halted for the time being or it may result even in price reversal. In the support level, demand for the particular scrip is expected.

In the resistance level, the supply of scrip would be greater than the demand and further rise in price is prevented. The selling pressure is greater and the increase in price is halted for the time being.

64.Indicators

Technical indicators are used to find out the direction of the overall market. The overall market movements affect the individual share price. Aggregate forecasting is considered to be more reliable than the individual forcasting.

65.breadth of the market

The breadth of market is the term often used to study the advances and declincs that have occurred in the stock market. Advances mean the number of share whose price have increased from the previous day,s trading.

66.**Short sales**

Short selling is a technical indicator known as short interest. Short sales refer to the selling of shares that are not owned. The bears are the short sellers who sell now in the hope of purchasing at a lower price in the future to make profits.

67.Oscillators

Oscillators indicate the market momentum or scrip momentum. Oscillator shows the share price movement across a reference point from one extreme to another. The momentum indicates:

-Overbought and oversold conditions of the scrip or the market

-Signalling the possible trend reversal.

-Rise or decline in the momentum.

68.Relative strength index (RSI)

RSI was developed by wells wilder. It is an oscillator used to identify the inheret technical strength and weakness of a particular scrip or market. RSI can be calculated for a scrip by adopting the following formula.

$$RSI = 100 – (100/1+Rs)$$

$$Rs = \frac{\text{Average Gain Per Day}}{\text{Averag Loss Per Day}}$$

69.Rate of change

Rate of change indicator or the ROC measures the rate of change between the current price and the price 'n' number of days in the past. ROC helps to find out the overbought and oversold positions in a scrip. It is also useful in identifying the trend reversal.

70.Top and bottoms

Top and bottom formation is interesting to watch but what is more important, is the middle portion of it. The investor has to buy after up ternd has started and exit before the top is reached. Generally top and bottom are formed at the beginning or end of the new trend.

71.Double top and bottom

This type of formation singnals the end of one trend and the beginning of another. If the double top is formed when a stock price rises to a certain level, falls rapidly, again rises to the same height or more, and turns down.

72.Invested head and shoulders

Here the reverse of the previous pattern holds true. The price of stock's falls and rises that makes a inverted right shoulder. As the process of fall and rise in price continues the head and left shoulders are created.

73.Triangles

The triangle formation is easy to identify and popular in technical analysis. The triangles are of symmetrical, ascending, descending and inverted.

74.Symmetrical Triangle

This pattern is made up of fluctuations, each fluctuation smaller than the previous one. Tops do not attain the height of the previous tops. Likewise bottoms are higher than the previous bottom. Connecting the lower tops that are slanting downward forms a symmetrical triangle.

75.Ascending triangle

Here, the upper trend line is almost a horizontal trend line connecting the tops and the lower trend line is a rising trend line connecting the rising bottom.

76.Descending triangle

Here, connecting the lower tops forms the upper trend line. The upper trend line would be falling one. The lower trend line would be almost horizontal connecting the bottoms. The lower line indicates the support level.

77.Flags

Flags pattern is commonly seen on the price charts. These patterns emerge either before a fall or rise in the value of the scrips. These patterns show the marked correction of the overbought or oversold situations. The time taken to form these patterns is quick.

78.Pennant

Pennant looks like a symmetrical triangle. Here also there are bullish and bearish pennant. In the bullish pennant, the lower tops form the upper trend line.

79.Options and futures

An option in the right, but not the obligation to buy or sell something on a specified date at a specified price.In the securities market, on option is contract between two parties to buy or sell specified no shares at a later date for an agreed price.

1) The option seller or writer is a person who grants someone else the option to buy or sell. He recieves a premium on its price.

2) The option buyer pays a price to the option writer to include him to right the option.

3) The securities broker acts as an agent to find the option buyer and the seller, and receives a commision or fee for it.

80.Call option

The call option that gives the right to buy in its contract gives the particular of

- The name of the company whose shares are to be bought
- The number of shares to be purchased
- The purchase price or the exercies price of the shares to be bought
- The expiration date, the date on which the contract or the option expires

81.Put option

Put option givies its owner the right to sell (or put) an asset or security to someone else, it is not an obligation but an option.

Like the call option the contract contains.

- The name of the company shares to be sold
- The number of shares to be sold
- The selling price or the stricking price
- The expiration date of the option

82.portfolio construction

Portfolio is a combination of securities such as stocks, bonds and money market instruments. The process of blending together the broad asset classes so as to obtain optimum return with minimum risk is called portfolio construction. Diversification of investments helps to sperad risk over amny assets. A diversification of securities gives the assurance of obtaining the anticipated return on the portfolio.