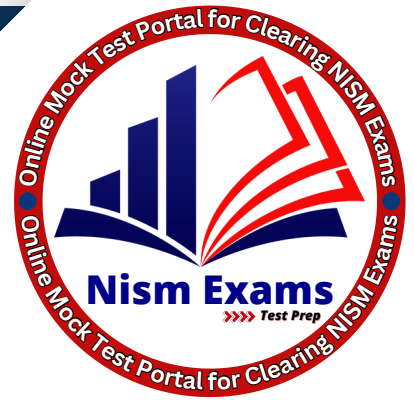


WITH THE UPDATED SYLLABUS OF

2025

Supplementary book for
NISM Series XXI-A

PORTFOLIO MANAGEMENT DISTRIBUTORS

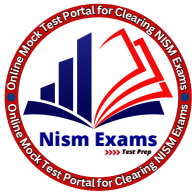


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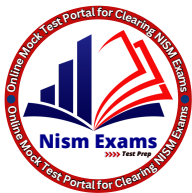
- ✓ Expert Curated Notes
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FOREWORD

This guide is designed to help candidates prepare for the NISM Series XXI-A: PORTFOLIO MANAGEMENT SERVICES (PMS) DISTRIBUTORS Certification Examination. The rapidly growing Indian financial industry, set to expand at 15% annually for the next five years, presents lucrative opportunities. Educational qualifications, especially NISM certifications, are crucial for securing roles in financial services. These certifications serve as prerequisites for various positions, assuring companies of a candidate's knowledge of the stock market. NISM certifications set a common knowledge benchmark, fostering quality market professionals and enhancing investor participation. They also offer structured career paths, allowing individuals to become traders, investors, analysts, advisors, or mutual fund distributors by clearing accredited NISM exams.

DISCLAIMER: The notes presented in this book are supplementary to the NISM workbook. The topics covered here have been curated after taking cognizance of the NISM workbook by professionals having extensive knowledge and experience with the objective of providing students with the synopsis of all the chapters from the exam point of view while ensuring thorough understanding for them.



Syllabus Overview

Chapters	Chapter Name	Proposed Weightages
1	Investments	7
2	Introduction to securities markets	5
3	Investing in stocks	10
4	Investing in fixed income securities	5
5	Derivatives	5
6	Collective Investment Vehicles	5
7	Role of portfolio managers	10
8	Operational aspects of portfolio managers	13
9	Portfolio management process	15
10	Performance measurement and evaluation of portfolio managers	10
11	Taxation	5
12	Regulatory, governance and ethical aspects of portfolio managers	10
Total		100

Multiple Choice Questions

[100 questions of 1 mark each]

$100 \times 1 = 100$ marks

The examination should be completed in 2 hours. The **passing score for the examination is 60 percent**. There shall be **negative marking of 10 percent** of the marks assigned to a question.

CHAPTER 1

INVESTMENTS

An investment is an asset or item acquired to generate income or gain appreciation in value over time and generates wealth.

- Investment versus Speculation

BASIS	INVESTING	TRADING	
Duration	Long-term	Swing/Positional	Intraday
Time	For more than 12 months	For more than a day but less than 12 months	Buying & Selling on the same day
Purpose	Generation of wealth	Regular income	Quick income
Approach	Fundamental approach	Fundamental and technical	Only technical approach
Analysis	Balance sheet, Financial Ratios etc.	Chart patterns and impact of news and events	Only chart patterns
Asset	Creation of asset is possible	No asset is created	No asset is created

- Investment Objectives

- Capital Preservation
- Capital Appreciation
- Current Income by way of dividend, interest, rental income.
- Tax Saving

- Estimating the required rate of return

The required rate of return depends on factor such as:

- Pure time value of money – for investors postpone their current consumption.
- Compensation for expected inflation during the period of investment for the change in the general price levels.
- Risk premium for the uncertainty of future payments.

- Nominal risk-free rate, real risk-free rate, and expected inflation

- **Risk-free rate:** The certainty of receiving the amount without any volatility in future makes it a risk free investment. And the rate of return on the same is called a risk-free rate.
- **Expected inflation:** The rate at which people—consumers, businesses, investors—expect prices to rise in the future.
- **Real risk free rate:** It is the basic rate of return or interest rate, assuming no inflation and no uncertainty about future cashflows.
- **Nominal rate of return:** The total return earned over an investment before adjusting taxes or other deductions. It can be decomposed into: real rate of return and inflation rate.

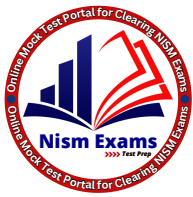
$$NRR = (1 + \text{Real rate of return}) \times (1 + \text{Expected rate of inflation}) - 1$$

- **Risk Premium:** A risk premium is a measure of excess return that is required by an individual to compensate being subjected to an increased level of risk. It is the extra return required to be earned as a compensation for being exposed to volatility and risk.

- Types of risks

In investment, risk is defined as the possibility that the actual earnings could be different from what is expected to be earned.

- **Business risk:** Variation in income flows caused by the nature of a firm's business, is defined as business risk. Ex-Sales volatility and operating leverage.
- **Financial risk:** It is uncertainty caused by the use of debt financing. When a firm borrows, it is required to make fixed payments that must be paid ahead of payments to stockholders. Thus, the use of debt increases uncertainty of stockholder income and causes an increase in the stock's risk premium.
- **Liquidity risk:** Liquidity is the ease of converting an asset into an amount of cash. The more difficult the conversion, the more is the liquidity risk.
- **Exchange rate risk:** Foreign exchange risk, is the risk of financial impact due to exchange rate fluctuations. It arises by acquiring investments denominated in a currency different from that of the investor.
- **Political Risk:** Political risk is the volatility of returns caused by the possibility of a major change in the political or economic environment in a country.
- **Geopolitical Risk:** Geopolitics is influence of geography and politics on the social and economic relationships between countries. Geopolitical risk is the risk associated with wars, terrorist acts, and tensions between states that affect the normal and peaceful course of international relations.
- **Regulatory risk:** Regulatory risk is the risk associated with unpredictability about the regulatory framework pertaining to investments. It is the risk that existing regulations will become more stringent leading to higher transaction costs.



- Types of Investments

CATEGORIES OF INVESTMENTS:

Risky

- Stocks
- Equity mutual funds
- Crypto Currencies
- -
-

Moderate

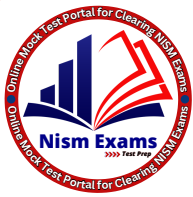
- Real Estate
- Silver
- Dollar
- Corporate debt

Safe Haven

- Bank Deposit
- Postal Deposit
- Govt. Bonds
- PPF/Insurance
- Gold

- **Equity:** Equity share, normally known as ordinary share, paves the way for long-term financing options for firms looking to raise capital. It offers part ownership where each member is a fractional owner, with the right to vote and participation in Profits via Dividend.
- **Fixed income securities:** Debt instruments, also called fixed income instruments, are contracts containing a promise to pay a stream of cashflows during the term of the contract to the investors. The issuer usually pays the bond holder periodic interest payments over the life of the loan.
- **Government versus corporate debt securities:** A Government Security (G-Sec) is a tradeable instrument issued by the Central Government or the State Governments. Such securities are short term (usually called treasury bills, with original maturities of less than one year) or long term (usually called Government bonds or dated securities with original maturity of one year or more). G-Secs carry practically no risk of default and, hence, are called risk-free gilt-edged instruments.

A key source of funds for corporates is debt financing. Corporate fixed income



securities pay higher interest rates than the government securities due to default risk. The difference between the yield on a government security and the corporate security for the same maturity is called “credit spread”.

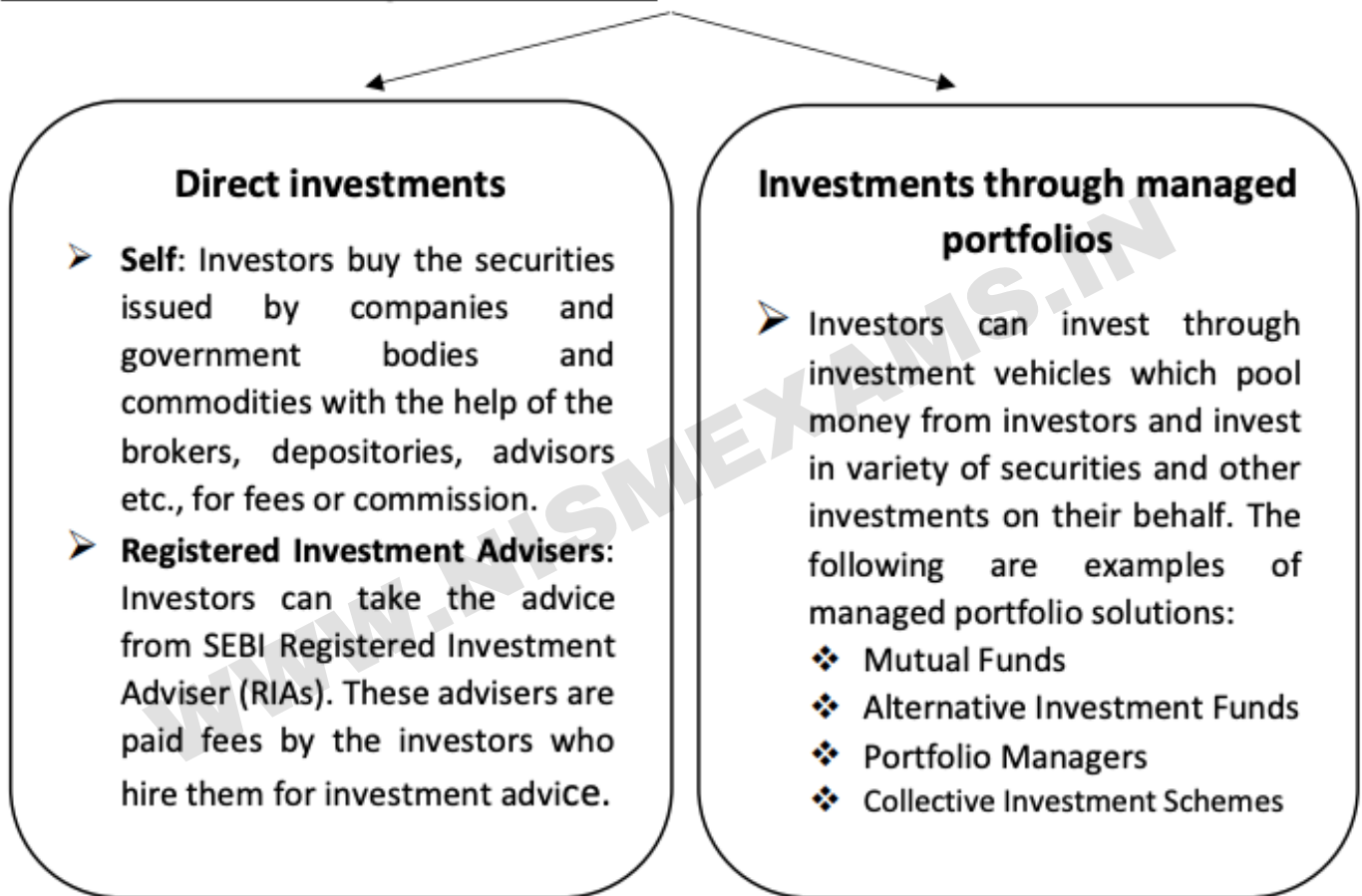
- **Money Market versus capital market:** Money market securities have maturities of one year or less than one year. Treasury bills, commercial papers, certificate of deposits up to one year maturity are referred as money market instruments.

Capital market is a place for long term fund mobilization. Securities with maturities greater than one year are referred to as capital market securities. Stocks and bonds are capital market securities.

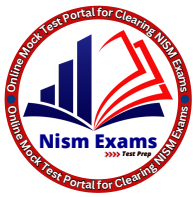
- **Commodities:** Commodities is every kind of movable property other than actionable claims, money and securities. Futures and options trading is organized in such commodities as are permitted by the Central Government. At present, all goods and products of agricultural (including plantation), mineral and fossil origin are allowed for futures trading under the auspices of the commodity exchanges.
- **Structured products:** Structured products are types of investments that meet specific investor needs with a customized product mix. A structured investment can vary in its scope and complexity, often depending on the risk tolerance of the investor. Many structured products are designed to provide risk-adjusted returns that are linked to equity market indices, sector indices, basket of stocks with some particular theme, currencies, interest rates, commodity or a basket of commodities.
- **Distressed Securities:** Distressed securities are the securities of the companies that are in financial distress or near bankruptcy. Investors can make investments in the equity and debt securities of publicly traded

companies. These may be available at huge discounts, however investments in them require higher skills and greater experience in business valuation than regular securities.

- Channels for making investments



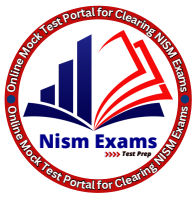
- ❖ **Mutual Fund:** A mutual fund is a trust that pools the savings of a number of investors who share a common financial goal then that money is invested in various investment opportunities such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realized are shared by its unit holders in proportion to the number of units owned by them. The benefits of investing through mutual funds:



- + Professional investment management
- + Risk reduction through diversification
- + Convenience
- + Unit holders account administration and services
- + Reduction in transaction costs
- + Regulatory protection
- + Product variety

❖ **Alternative Investment Fund:** Alternative Investment Fund or AIF is a privately pooled investment vehicle which collects funds from sophisticated investors, for investing it in accordance with a defined investment policy. These private investors are institutions and high net worth individuals who understand the nuances of higher risk taking and complex investment arrangements. AIFs are categorized into three categories under the SEBI AIF Regulations:

- + **Category I AIF** – is an AIF that invests in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable and shall include venture capital funds, SME Funds, social venture funds, infrastructure funds, special situation funds.
- + **Category II AIF** – is an AIF that does not fall in Category I and III and which does not undertake leverage or borrowing other than to meet day-to-day operational requirements or as permitted in the regulations. For this purpose, AIFs such as private equity funds or debt funds for which no specific incentives or concessions are given by the government.
- + **Category III AIF** – is an AIF that employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives such as hedge funds.

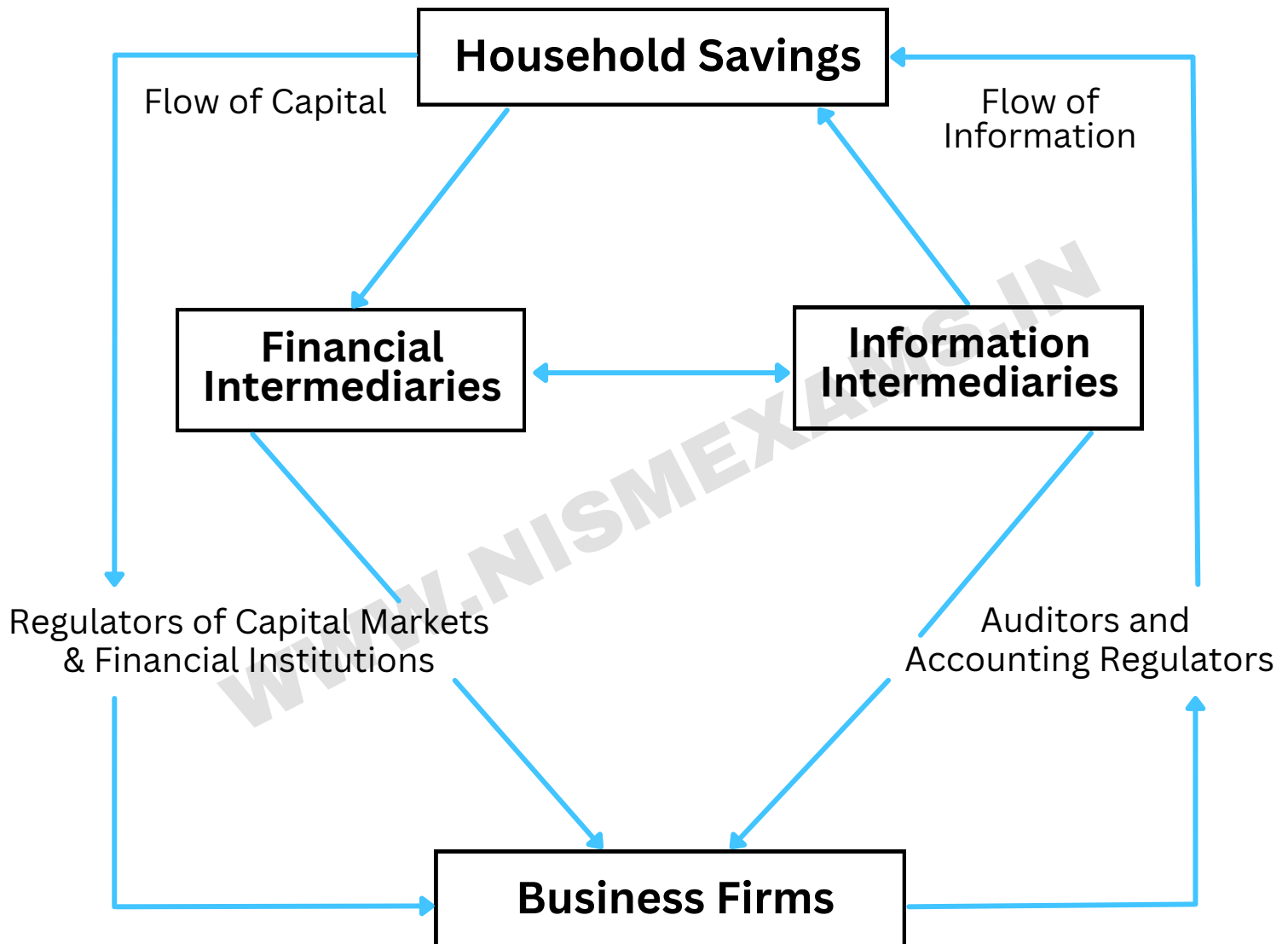


❖ **Portfolio Management Services:** A portfolio manager is a body corporate who advises or directs or undertakes on behalf of the investors the management or administration of a portfolio of securities. There are two types of portfolio management services available. The discretionary portfolio manager individually and independently manages the funds of each investor. The non-discretionary portfolio manager manages the funds in accordance with the directions of the investors.

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CHAPTER 2

INTRODUCTION TO SECURITIES MARKETS

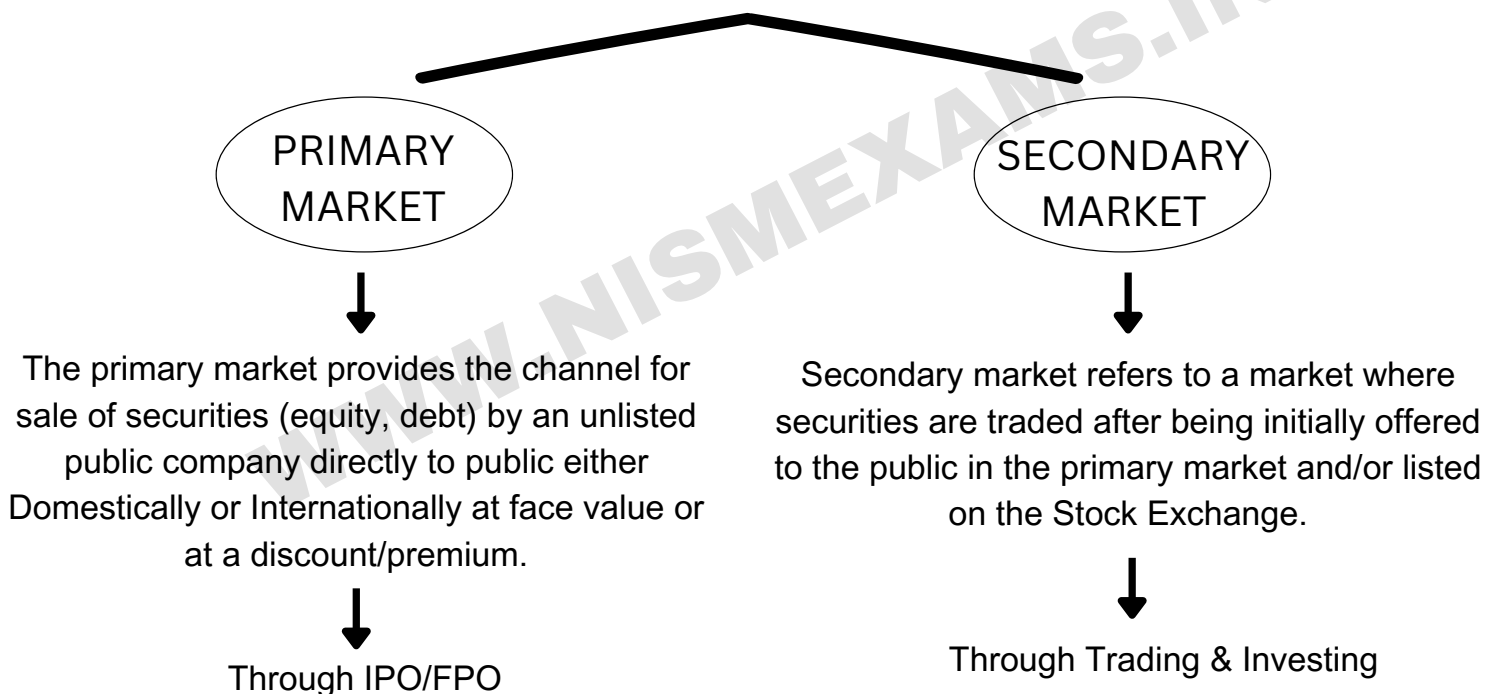


Securities

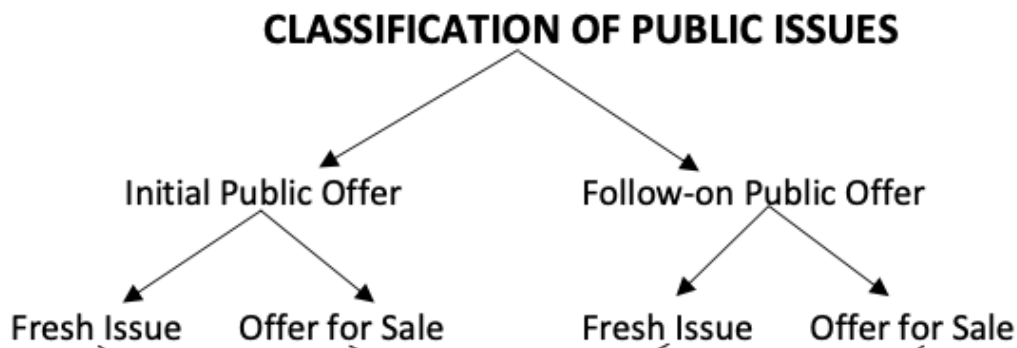
The term “securities” has been defined in Section 2 (h) of the Securities Contracts (Regulation) Act 1956 and includes:

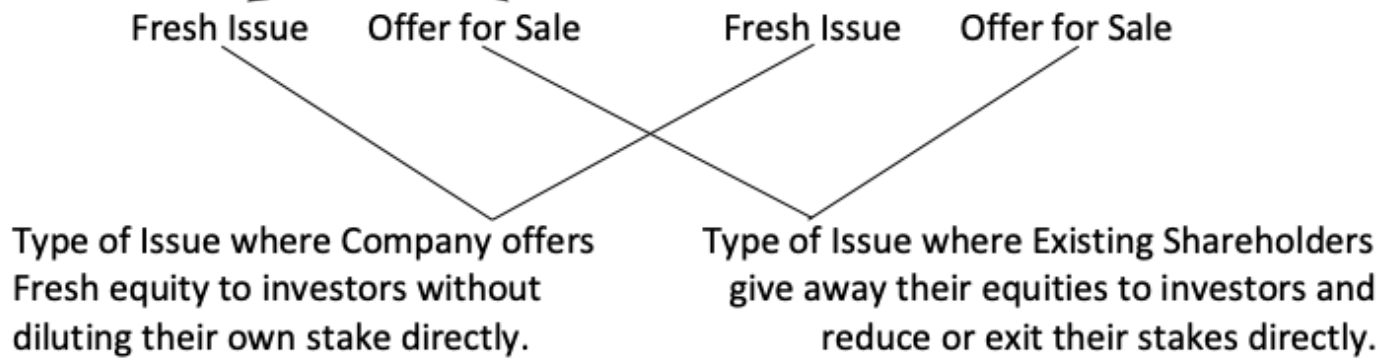
- shares, scrips, stocks, bonds, debentures,
- derivative

- Unites issued by a pooled investment vehicle or any other instrument issued by any collective investment scheme.
- Security receipt as defined under SARFAESI Act, 2002.
- Mutual funds units
- Government Securities.
- Primary Market & Secondary Market



- **Public issue:** Securities are issued to the members of the public, and anyone eligible to invest can participate in the issue. This is primarily a retail issue of securities.





- **Initial Public Offer (IPO):** An initial public offer of shares or IPO is the first sale of a corporate's common shares to investors at large. The main purpose of an IPO is to raise equity capital for further growth of the business.
- **Further Public Offer (FPO):** When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called a further public offer or FPO.
- **Rights Issue:** Shares offered to existing shareholders in proportion to their existing holding in the share capital of the company are termed as "Rights shares" popularly known as rights issue.
- **Private Placement:** When an issuer makes an issue of securities to a select group of persons and which is neither a rights issue nor a public issue, it is called private placement. This is primarily a wholesale issue of securities to institutional investors.
- **Preferential Issue:** Preferential issue is when a listed issuer issues shares or convertible securities, to a select group of persons.
- **Qualified Institutions Placements (QIPs):** Qualified Institutions Placement (QIP) is a private placement of shares made by a listed company to certain identified categories of investors known as Qualified Institutional Buyers (QIBs).
- **Bonus Issues:** A bonus issue of shares is made to the existing shareholders of a company without any consideration from them.

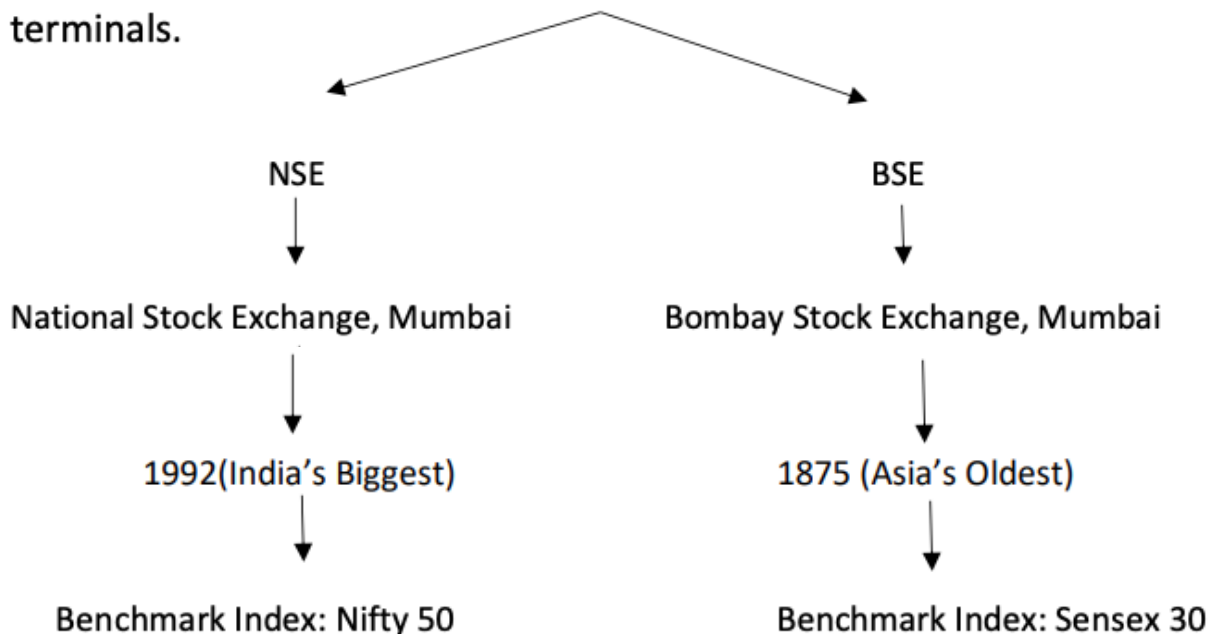
- **Onshore and Offshore Offerings:** While raising capital, issuers can either issue the securities in the domestic market and raise capital or approach investors outside the country. If capital is raised from domestic market, it is called onshore offering and if capital is raised from the investors outside the country, it is termed as offshore offering.
- **Employee Stock Ownership Plan:** Some companies offer employee stock ownership plans that enable employees to own a small stake in the share capital of the company, as an incentive to participate in making the business successful.
- **Foreign Currency Convertible Bonds (FCCBs):** FCCBs are foreign currency (usually dollar) denominated debt raised by companies in international markets but which have the option of converting into equity shares of the company before they mature.
- **Depository Receipts - ADR / GDR:** Depository receipts (DRs) are financial instruments that represent shares of a local company but are listed and traded on a stock exchange outside the country. DRs are issued in foreign currency, usually dollars.
- **Secondary Market**
 - **Over-The-Counter (OTC) Market:** OTC markets are the markets where trades are directly negotiated between two or more counterparties.
 - **Exchange Traded Markets:** The other option of trading in securities is through the stock exchange route, where trading and settlement is done through the stock exchange.
 - **Trading:** A formal contract to buy/sell securities is termed as trading. As defined above, trading can be done either in the Over-The-Counter (OTC) or Exchange Traded Market.
 - **Clearing and Settlement:** Clearing activity is all about ascertaining the net

obligations of buyers and sellers for a specific time period. Settlement is the next step of settling obligations by buyers and sellers by paying money (if transaction is a buy transaction) or delivering securities (if it is a sell transaction).

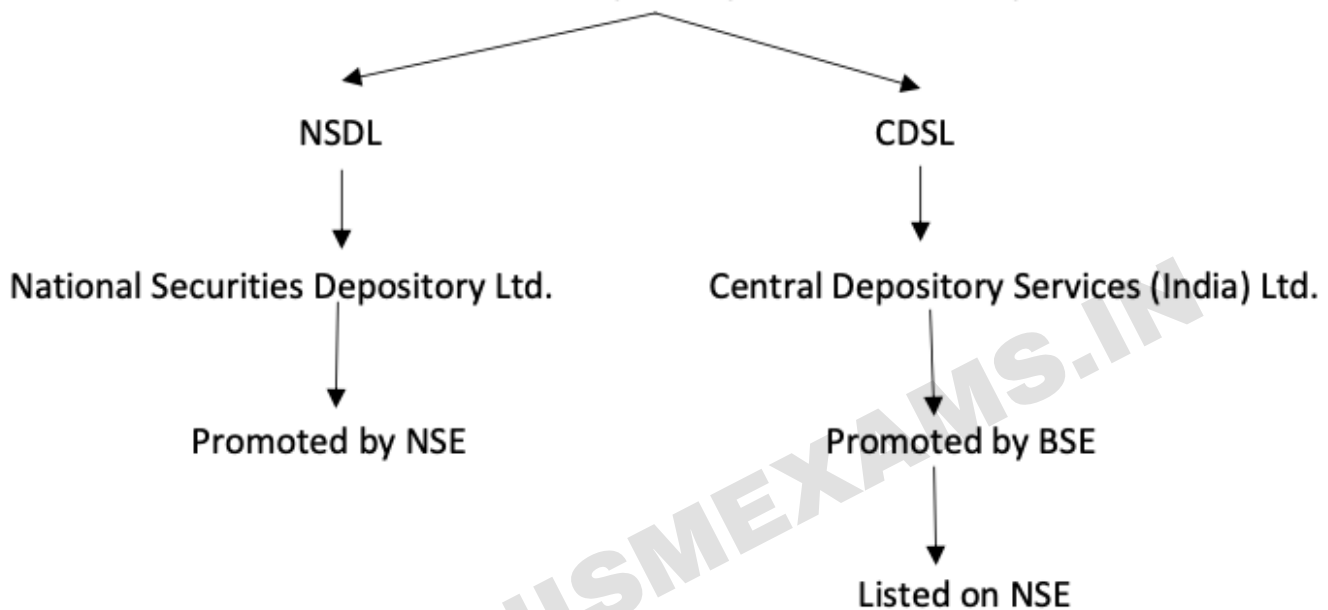
- Market Participants and their Activities

- **Stock Exchanges:** The stock exchanges in India provide a trading platform, where buyers and sellers can meet to transact in securities virtually and there is no need for buyers and sellers to meet at a physical location to trade. They can trade through the computerized trading screens or the internet based trading facility provided by the Brokers.

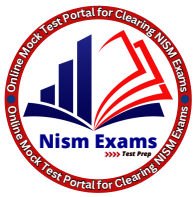
NSE and BSE are the two exchanges in India having nationwide trading terminals.



- **Depository:** A depository is like a bank wherein the deposits are securities (viz. shares, debentures, bonds, government securities, units etc.) in dematerialized form. In India only 2 Depositories are operative which are:



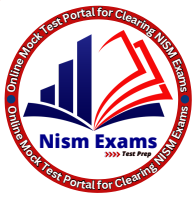
- **Depository Participant:** A Depository Participant (DP) is as Agent of the depository that acts as an intermediary between the depository and the investors. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act and it must be registered as such with SEBI. Most Brokers also functions as DP.
- **Trading Members/Stock Brokers :** A stockbroker is a middleman who is registered with SEBI and has the authority to buy and sell stocks and securities on a stock exchange on behalf of the trader for a commission or a flat fee.
- **Authorized persons (AP):** Authorised Persons are agents of the brokers (previously referred to as sub-brokers) and are registered with the respective stock exchanges. APs help in reaching the services of brokers to a larger number of investors.



- **Custodians:** A Custodian is an entity that is vested with the responsibility of holding funds and securities of its large clients, typically institutions such as banks, insurance companies, and foreign portfolio investors.
- **Clearing Corporation** - Clearing Corporations play an important role in safeguarding the interest of investors in the Securities Market. Clearing agencies ensure that members on the Stock Exchange meet their obligations to deliver funds or securities. These agencies act as a legal counterparty to all trades and guarantee settlement of all transactions on the Stock Exchanges.
- **Clearing Banks** - Clearing Bank acts as an important intermediary between clearing members and the clearing corporation. Every clearing member needs to maintain an account with the clearing bank.
- **Merchant Bankers**- Merchant bankers are entities registered with SEBI and act as issue managers, investment bankers or lead managers. They help an issuer access the security market with an issuance of securities.
- **Underwriters** - Underwriters are intermediaries in the primary market who undertake to subscribe any portion of a public offer of securities which may not be bought by investors.
- **Institutional Participants**

Investors in securities market can be broadly classified into Retail Investors and Institutional Investors.

- **Pension Funds:** A fund established to facilitate and organize the investment of the retirement funds contributed by the employees and employers or even only the employees in some cases.
- **Insurance Companies:** Insurance companies' core business is to insure assets. Depending on the type of assets that are insured, there are various insurance companies like life insurance and general insurance etc.



- **Foreign Portfolio Investors (FPIs):** A Foreign Portfolio investor (FPI) is an entity established or incorporated outside India that proposes to make investments in India.
- **Investment Advisers:** Investment advisers work with investors to help them decide on asset allocation and make a choice of investments based on an assessment of their needs, time horizon return expectation and ability to bear risk.
- **EPFO:** EPFO comes under the purview of Ministry of Labour and Employment. From 2015, EPFO is allowed to invest up to 15 per cent of incremental deposits in equity or equity related schemes.
- **National Pension System:** National Pension System (NPS) is a pension cum investment scheme launched by Government of India to provide old age security to Citizens of India. Subsequent to Central Government, various State Governments adopted this architecture and implemented NPS with effect from different dates.
- **Family Offices:** Family office can be defined as the ecosystem which the family builds around itself to manage its wealth. Family offices provide administrative support to investment management services with a view to coordinate the family financial needs, life style goals, charitable givings, estate planning etc.
- **Corporate Treasuries:** Corporate treasuries are increasingly seen as profit centres. Traditionally, the role of corporate treasury has been that of manager of financial risks and provider of liquidity.
- **Retail Participants**

Retail Investors include individual investors who **buy and sell securities for their personal account**, and not for another company or organization. Retail individual investor' means an individual investor who applies or bids for specified securities for a **value of not more than Rs.2 lakh**.

CHAPTER 3

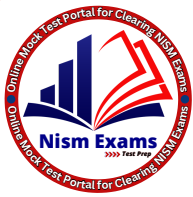
INVESTING IN STOCKS

- Equity as an investment

- Equity investors also known as shareholders have residual claim in the business. Because they are the owners of the company and not lenders, the company which issues equity securities is not contractually obligated to repay the amount it receives from the shareholders.
- Equity investors get voting rights. When equity investor own a sizeable amount of shares in a company, they get an opportunity to participate in the management of the business.
- Investors who purchase equity shares look for capital appreciation and dividend income. There is no assurance of both by the company to the equity investor. While dividend payment depends on the profitability of the company, capital appreciation depends on the share market conditions and peculiarities.

- Diversification of risk through equity instruments

- Diversification is the most meaningful way to risk reduction in equities through cross sectional as well as time as on time series basis.
- Cross sectional risk diversification is reducing risk by holding equities in many different kinds of businesses at a point in time and also across various geographies of the world.
- Reaping the benefits of time diversification requires investing in equities for a long period of time. The belief is that bad times will get cancelled out by good times.



- Risks of equity investments

Equities are often regarded as riskier than other asset classes. The main types of risks are:

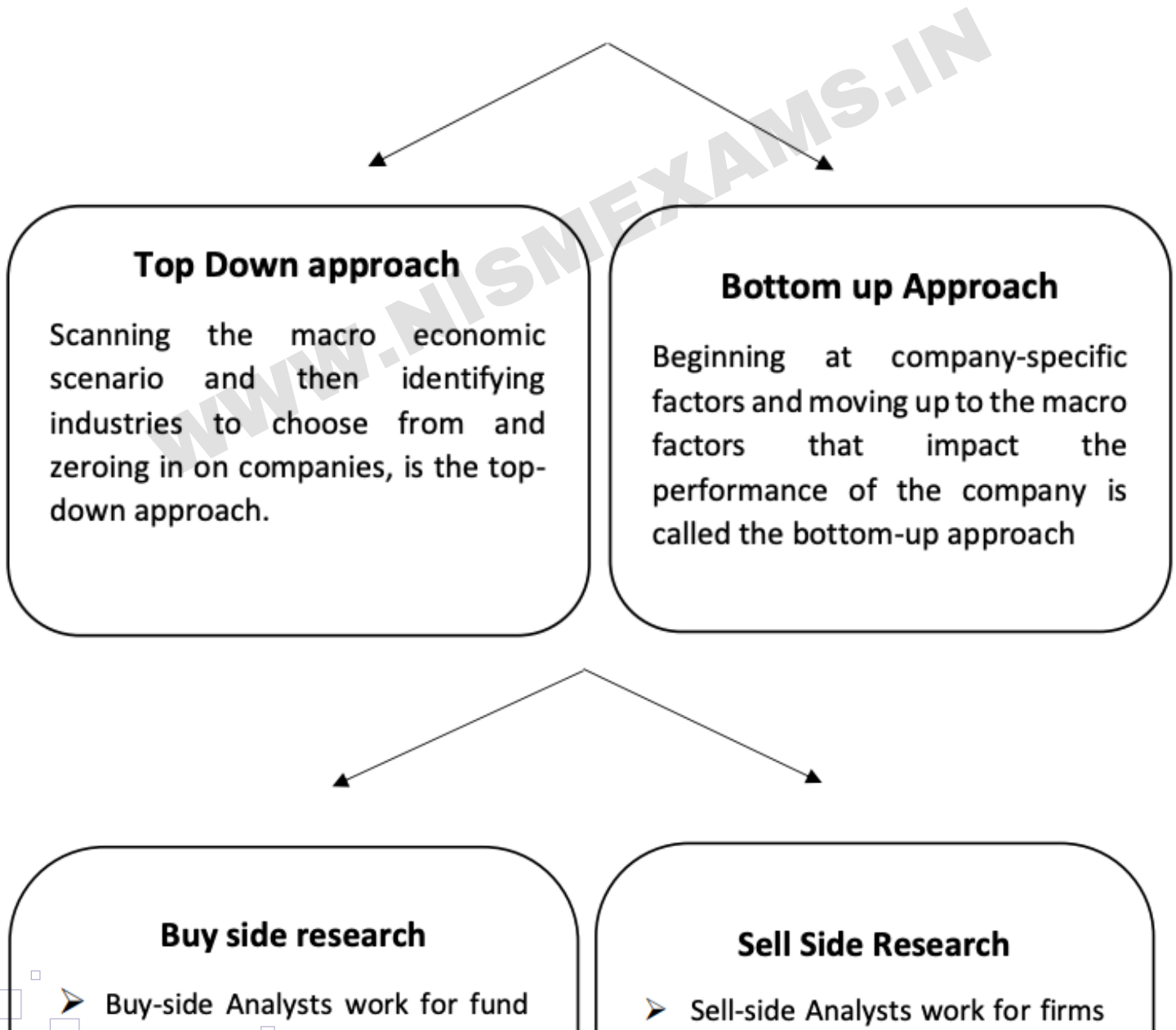
- **Market risk:** It arises due to the fluctuations in the prices of equity shares due to various market related dynamics. It affects entire companies listed under various sectors. Beta is a proxy measure for market risk. Market risk cannot be diversified away, though it can be hedged.
- **Sector specific risk:** Risks due to sector specific factors is part of non-market risks. These risks can be diversified away. Sector specific risk is due to factors that affect the performance of businesses in a particular sector.
- **Company specific risk:** Risks belonging to specific company due to change in management or business policies. Such type of risks can be avoided by diversification.
- **Currency Risk:** Currency risk arises due to uncontrollable, unpredictable and volatile exchange rates of various pairs of currencies. When a significant proportion of players in a financial market belong to the international institutional investors groups, then that financial market is bound to be related to exchange rate movements.

- Equity research and stock selection

As there are thousands of opportunities available to investors in equity market, equity research and stock selection process **plays a very important role in identifying stocks which suits the risk-return-liquidity requirements** of the investors. Equity research involves thorough analysis and research of the companies and its environment. Equity research primarily means **analysing the company's financials and non-financial information**, study the dynamics of the

sector the company belongs to, competitors of the company, economic conditions etc.

- **Fundamental Analysis:** It is the process of determining intrinsic value for the stock depending on underlying economic factors such as future earnings or cash flows, interest rates, and risk variables. Investor should buy the stock if its market price is below intrinsic value and do not buy, or sell, if the market price is above the intrinsic value, after taking into consideration the transaction cost.



managers like those of mutual funds, hedge funds, pension funds, or portfolio managers that purchase and sell securities for their own investment accounts or on behalf of their clients.

- These analysts generate investment recommendations for their internal consumption viz. use by the fund managers within organization.

that provide investment banking, broking, advisory services for clients.

- They typically publish research reports on the securities of companies or industries with specific recommendation to buy, hold, or sell the subject security.
- The sell-side analysts are paid for providing useful information to be acted upon.

- **Stock Analysis Process:** The objective of stock analysis is to make the critical risk-return decision at the market industry-company stock level. It requires analysis of the economy, market and various sectors.

✚ **Economy Analysis:** Changes in various macro-economic factors, Fiscal and Monetary Policies and their impact on the economy, flows from FDI and FPI, Savings and investment patterns, Global factors based on Import and Exports.

✚ **Industry/Sector Analysis:** Different industries face different challenges and opportunities. Their growth drivers could be significantly different. Accordingly, Research Analysts need to understand thoroughly the regulatory environment prevalent in the industry, business models, competition, operating factors, sensitivity of demand to price changes, consumers' behavior etc.

Company Analysis

Company analysis is to be differentiated from stock valuation. Company analysis is conducted to understand its strength, weaknesses, opportunities and threats. These inputs are used to determine the fundamental intrinsic value of the company's stock. Then this value is compared with the market price of the stock. If the intrinsic value is higher than the market price, the stock is bought and vice versa. . There are many components to company analysis.

- **Financial statement analysis** of the company (profit and loss account, balance sheet and the cash flow statement).
- **Conducting SWOT Analysis:** Strengths and weaknesses deal with company's internal ability, like company's competitive advantage or disadvantages. Opportunities and threats deal with external situations and factors the company is exposed to. Opportunities include a favourable tax environment.
- **Michael Porter suggests two major strategies:** Cost Leadership and Differentiation.
 - ❖ **Cost Leadership:** Under this strategy the firm seeks to be the low-cost producer, and hence the cost leader in its industry.
 - ❖ **Differentiation Strategy:** Under this strategy, the firm positions itself as unique in the industry. Again the possibilities of differentiation differ from industry to industry.

- Estimation of intrinsic value

There are various approaches to valuation:

- **Discounted cash flow (DCF) approach** to valuation is the most appropriate approach for valuations when three things are known with certainty:
 - ❖ Stream of future cash flows
 - ❖ Timings of these cash flows, and
 - ❖ Expected rate of return by the investors (called discount rate).

There are three different approaches to DCF models:

- ✚ **Dividend discount model (DDM):** Under this model, the expected future dividends of a company are discounted based on the cost of capital. This model is suitable for companies that pay regular and substantial dividend. Thus, this model is more suitable to matured companies in the defensive industry.

Gordon growth model:
$$P = \frac{D_1}{K - g}$$

Where,

D₁= Expected Dividend
K= Cost of Equity
G= Growth in dividend

- ✚ **Free cash flow to equity model (FCFE):** One of the problems in using DDM is that it is not possible to use for companies that do not pay dividends.

Under this model, equity is valued by discounting the free cash flow to equity share holders instead of the actual dividends paid by the company.

FCFE= Operating cash flows – capital expenditure – interest payments+
Net Borrowings – repayments

(FCFE models are most likely to be useful for companies that are in “high growth” phase)

- ✚ **Free cash flow to firm model (FCFF):** One of the major challenges in using the FCFE model is that, unless a company has an objective debt policy, it is not possible to objectively estimate the net borrowings / (repayment).

FCFF= Operating cash flows – capital expenditure – tax benefit on interest payments

➤ **Earnings Based Valuation Matrices**

- ✚ **Price to Dividend Ratio:** Dividends can be compared with the share price for a sense on cheapness or expensiveness of equities. Popularly known term on this subject is dividend yield, which is defined as:

Dividend Yield = Dividend per share (DPS) / Current price of stock

- ✚ **Price to Earnings Ratio:** When dividend yields are quite low, market analysts move to earning yields. Earning yield may be defined as:

Earning Yield = Earnings Per Share (EPS) / Current price of stock

- ✚ **Growth Adjusted Price to Earnings Ratio (PEG Ratio):** Companies with high (low) growth rate should trade at a premium (discount) compared to their peers. However, determining the amount of premium is likely to be subjective. Growth adjusted price to earnings ratio (also called PEG Ratio) overcomes this problem by factoring in growth rate in its calculations.

Growth adjusted Price to Earnings Ratio = [Current Price of Stock / Earnings Per Share] / Growth rate

- ✚ **Enterprise Value to EBIT(DA) Ratio:** When a company is valued from the perspective of an acquirer or when it is a potential acquisition target, it would be more appropriate to value it based on Enterprise value/EBIT or Enterprise Value/EBITDA ratios.
- ✚ **Enterprise Value (EV) to Sales Ratio:** In the case of companies that have recently managed to break-even, the profit is likely to be much lower than their long-term potential. In such cases, the above multiples would be too high to be meaningful. In these cases, EV/Sales is likely to be a more meaningful metric as sales can never be negative.

➤ **Assets based Valuation Matrices**

- ✚ **Return on Equity** – Net Profits / Equity capital or Net-worth
- ✚ **Return on Capital Employed** – EBIT / Total Capital Employed (Debt + Net-worth)

ROE and ROCE indicate how well a business allocates its capital and what are the returns on the book values of equity and equity along with debt respectively.

- ✚ **Price to Book Value Ratio-** It focuses on how much an investor needs to invest to gain ownership interest.

Price/Book ratio = Price per share / Book value per share

- ✚ **Enterprise Value (EV) to Capital Employed Ratio-** Enterprise value includes the value of equity and debt of a firm

EV = Value of Equity + Value of Debt – cash and cash equivalents

EV to Capital Employed ratio = Enterprise Value / Capital Employed

✚ **Net Asset Value Approach** - Net asset value (NAV) of equity is the market value of an entity's assets minus the value of its liabilities. Net asset value may represent the current value of the total equity, or it may be divided by the number of outstanding shares to compute net asset value per share. This valuation methodology is used in some businesses which are extremely assets oriented such as Real Estate, Shipping, Aviation etc.

- **Technical Analysis**

Technical Analysis can be defined as an art and science of forecasting future prices based on an examination of the **past price movements** and current demand-supply of the financial instrument by analysing information like prices, **volumes and open interest** on a chart and applying various patterns and indicators to it in order to assess the future price movements.

The analysis could be undertaken on different **time frames** ranging from minutes, daily, weekly, monthly or yearly, depending on the purpose.

- **Assumptions of technical analysis:**

- ❖ The market price is determined by the interaction of supply and demand.
- ❖ Supply and demand are governed by many rational and irrational factors.
- ❖ Price adjustments are not instantaneous and prices move in trends
- ❖ Trends persist for appreciable lengths of time.
- ❖ Trends change in reaction to shifts in supply and demand relationships.
- ❖ These shifts can be detected in the action of the market itself.

- **Technical Rules and Indicators:** There are indicators of overall market momentum, used to make aggregate market decisions. Some of the popular ones are:

- ❖ **Trend-Line Analysis:** The graph (Exhibit 3.4) shows a peak and trough, along with a rising trend channel, a flat trend channel, a declining trend channel.

TRENDS

BULLISH

Represents upward price movement



Higher highs & Higher Lows price movement

Buying position must be initiated

Buy at low price
Sell at high price

SIDEWAYS

When Market lacks Direction and moves in a range



Represents consolidation & Distribution channels

Hold until the market gives a clear price breakout

BEARISH

Represents downward price movement



Lower Highs & lower Lows price movement

Selling position must be initiated

Sell at high price
Buy at low price

- ❖ **Moving-Average Analysis:** The moving average of a time series of past prices can provide a nonlinear graphic of price movements. Generally a 5, 10, 30, 50, 100, and 200 days moving averages are calculated.
- ❖ **Bollinger-Band Analysis:** Bollinger bands use normal distribution to calculate the deviation of the market price from the moving average. For example, when the price goes two standard deviations above the moving average, the stock might be regarded as overbought. If the price goes two standard deviations below the moving average, the stock might be regarded as oversold.

- Understanding Corporate Governance

Corporate governance includes a wide array of mechanisms and expectations that are of importance to businesses, the economy, and society. How these businesses are governed affects not only the shareholders of the companies but also thousands of people who work with such companies, buy products of these companies or are affected by them implicitly. Analysts and investors play a very important role in driving good practices and highlighting companies with poor governance practices. There are some important aspects analysts should look for. For example they should also pay attention to the quality of independent directors in a business. Analysts should focus on the qualifications and experiences of these independent directors, how many meetings they attend and what are their contributions to the business.

CHAPTER 4

INVESTING IN FIXED INCOME SECURITIES

Fixed income securities are issued by legal entities such as the Central and State Governments, Public Bodies, Banks and Institutions, statutory corporations and other corporate bodies.

<i>Market Segment</i>	<i>Issuer</i>
Government Securities	Central Government
	State Governments
Public Sector Bonds	Government Agencies / Statutory Bodies
	Public Sector Undertakings
Private Sector Bonds	Corporates
	Banks
	Financial Institutions

- Bond Characteristics

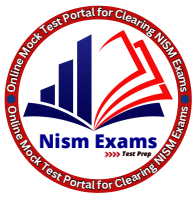
The fixed obligations of the security are the most defining characteristic of bond.

The issuer of a bond agrees to:

- 1) Pay a fixed amount (known as coupon) periodically and
- 2) Repay the fixed amount of principal (known as face value) at the date of maturity.

Mostly bonds make semi-annual coupon payments, though some may make annual, quarterly or monthly coupon payments.

- **Zero coupon bonds** which do not make any coupon payments. Typically, a zero coupon bond is issued for less than its face value and the face value is paid on the maturity date.
- **Perpetual bonds**, which do not have any maturity date exist forever.



- **Money market securities:** Bonds with a year or less than a year maturity.
- **Capital market securities:** Long-term obligations with maturities in excess of 1 year.

- **Traditional Yield Measures**

- **Current Yield:** The current yield is the coupon payment as a percentage of the bond's current market price.

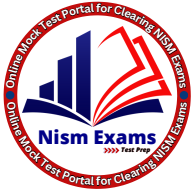
$$\text{Current yield} = (\text{Annual coupon rate} / \text{current market price of the bond}) \times 100\%$$

- **Yield to Maturity:** Yield to Maturity (YTM) is the discount rate which equates the present value of the future cash flows from a bond to its current market price. It is the expected rate of return on a bond if it is held until its maturity.
- **Effective Yield:** Deposit taking institutions often quote two quantities when they advertise interest rates on various products they are selling. The first would be the actual annualized interest rate which is nothing but the nominal rate or the stated rate. The second rate would be an equivalent rate that would produce the same final amount at the end of 1 year if simple interest is applied. This is called the "effective yield". A bond paying 4.20% annual coupon would be worth 4.28% if the coupon is paid every month.

- **Bonds with options**

Bonds can also be issued with embedded options. Some common types of bonds with embedded options are: bonds with call option, bonds with put option and convertible bonds.

- **A callable bond** gives the issuer the right to redeem all or part of the



outstanding bonds before the specified maturity date.

The investor will receive the face value of the bond before its maturity, and will be forced to reinvest that money for the remaining period lower interest rates. This is called **reinvestment risk**.

- **A put** provision gives the bondholders the right to sell the bond back to the issuer at a pre-determined price on specified dates. **Puttable bonds** are beneficial to the bondholder by guaranteeing a pre-specified selling price at the redemption dates.

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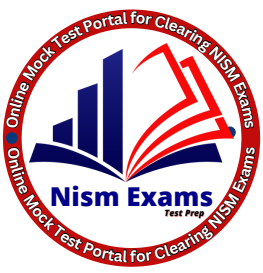
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