

A Study on Portfolio Management

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Abstract: Investing in securities i.e: shares, debentures, bonds are profitable as well as risky. For this it needs a scientific knowledge as well as analytical skills to deal with risk. In these investments an investor has to take decision on the basis of both rationale and emotional perspectives. As per investors point of view investing in financial securities is one of the avenue for investing our savings but on the other side it is acknowledged to be one of the most risky avenue of investment. It is difficult to find investors investing their entire savings in a single security. Instead, they want to invest in a group of securities. Such group of securities is called portfolio. When portfolio is created risk is reduced without sacrificing returns. Portfolio management deals with the theory and practice of optimum combining securities into portfolio. An investor who understands the principles and analytical aspects of portfolio management has a better chance of success.

Keywords: Portfolio, Management.

I. INTRODUCTION

An investor considering investments in securities is faced with the problem of choosing from among a large number of securities and how to allocate his funds over this group of securities. Again the investor faced with the problem of deciding which securities is to be hold and how much to invest in each security. Basically risk and return are the two important characteristics of portfolio. The investor tries to choose the optimal portfolio taking into consideration the risk and return characteristics of all possible portfolios. The characteristics of individual securities as well as portfolio also change. This calls for periodic review and revision of investment portfolio of investors. An investor always invests his funds in a portfolio expecting to get good returns consistent with the risk that he has to bear. The return realized from the portfolio has to be measured and the performance of the portfolio has to be evaluated. It is evident that creation of an investment portfolio always needs a rational investment activity. Portfolio management comprises all the processes involved in the creation and maintenance of a investment portfolio. It deals basically with the security analysis, portfolio analysis, portfolio selection, portfolio revision and portfolio evaluation. Portfolio management makes use of analytical techniques of analysis and conceptual theories regarding rationale allocation of funds.

Portfolio management is a complex process which tries to make investment activity more rewarding and less risky.

II. EVOLUTION OF PORTFOLIO

Portfolio management is essentially a systematic method of maintaining one's investment efficiently. Many factors have contributed to the existence and developments of the concept. In the early years of the century analyst used financial statements to find the value of the securities. the first to be analyzed using this was Railroad Securities of the USA. A book named "The Anatomy of the Railroad "was published by Thomas F. Woodlock in 1900. As time progressed this method became very important in the investment field, although most of the writers adopted different ways to publish their data. They generally advocated the use of different ratios for this purpose. John Moody in his book "The art of Wall Street investing" strongly supported the use of financial ratio to know the worth of the investment. The proposed type of analysis later became "common size" analysis. The other major method adopted was the study of stock price movement with the help of price charts. This method later on was known as Technical Analysis. It evolved during 1900-1902 when Charles H. Dow, the founder of the Dow Jones and Co. presented his view in the series of editorials in the Wall Street Journal in USA. The advocates of technical analysis believed that stock prices movement is ordered and systematic and the definite pattern could be identified. There investment strategy was build around the identification of the trend and pattern in the stock price movement.

A. Approaches in Portfolio Construction

Generally there are two approaches in the construction of the portfolio of securities viz.

- 1.Traditional approach
- 2.Markowitz efficient frontier approach

Traditional Approach: In traditional approach two important decisions are taken care of. They are:

- 1) Determining the objective of the portfolio
- 2) Selection of securities to be included in the portfolio
- 3) Analysis of Constraints: the constraints are normally discussed are: income needs liquidity, time- horizon, safety tax consideration and the temperament.

a)Income Needs: The need of income depends upon the need for income in constant rupees and current rupees. The need for income in current rupees arises from investor need to meet all of the living expenses. the investors when offset the effect of the inflation then the need of constant rupee arise.

b)Liquidity: A liquidity need of the investments is highly individualistic of the investor. When an investor go for high liquidity , then fund should be invested in high quality short term debt maturity issues such as money market funds, commercial papers and shares that are widely traded.

c.) Safety: An, serious constraint to be considered by the investor is the safety of the principal value at the time of liquidation. Investing in bond and debentures is safer than investing in the stocks.

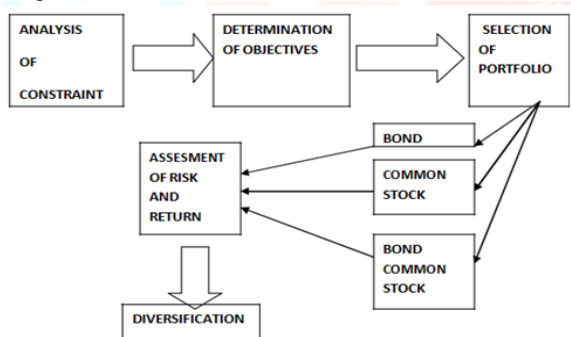


Fig1.

2) Determination of Objectives: Portfolio has the common objective of financing present and future expenditures from a large pool of assets. The objective of portfolio range from income to capital appreciation. Basic objectives are: current income, growth in income, capital appreciation, and presentation of capital

3) Selection of portfolio: the selection of portfolio depends on its various objective of the investor. The selection of portfolio under different objectives is deal subsequently.

a)Objectives and asset mix: If the main objective is getting adequate amount of current income, sixty percent of the investment is made in debt instruments and remaining in equity. Proportion varies according to individual preference

b)Growth of income and asset mix: Here the investor requires a certain percentage of growth as the income from the capital he has invested. The proportion of equity varies from 60 to 100 % and that of debt from 0 to 40 %. The debt may be included to minimize risk and to get tax exemption.

c)Capital appreciation and Asset Mix: It means that value of the investment made increases over the year. Investment in real estate can give faster capital appreciation but the problem is of liquidity. In the capital market, the value of the shares is much higher than the original issue price.

d)Safety of principle and asset mix: Usually, the risk adverse investors are very particular about the stability of principal. Generally old people are more sensitive towards safety.

4) Risk and Return Analysis: The traditional approach of portfolio building has some basic assumptions. An investor wants higher return at low risk. But the rule of the game is that more risk, more return. So, while making a portfolio the

investor must judge the risk taking capability and the return desired.

5) Diversification: Once the assets mix is determined and risk –return relationship is analyzed the next step is to diversify the portfolio. The main advantage of diversification is that the unsystematic risk is minimized.

Modern Approach: The traditional approach is a comprehensive financial plan for the individual (focus on the needs such as housing, life insurance). But these types of finance planning approaches are not done in the Markowitz approach. this approach gives more attention to the process of selecting a portfolio. Planning can be applied more in the selection of common stock portfolio than the bond portfolio. Stocks are selected on the basis of risk and return analysis not on the basis of need of income or appreciation. Return includes the market return and dividend. In modern approach the last step is allocation of assets process that is to choose the portfolio that meets the requirement of the investor. The risk taker has to choose the level of risk. High risk taker chooses high level of portfolio lower level risk portfolio is chooses by a lower tolerance risk taker. The risk neutral investor would choose the medium level risk portfolio.

B. Role of Portfolio Management

There was a time when portfolio management was an exotic term. A practice which is beyond the reach of the small investor, but the time has changed now. Portfolio management is now a common term and is widely practiced in INDIA. The theories and concepts relating to portfolio management now find there way in the front pages of the financial newspapers and magazines. In early 90’s India embarked on a program of economic liberalization and globalization, with high participation of private players. This reform process has made the Indian industry efficient, with rapid computerization, increased market transparency, better infrastructure and customer services, closer integration and higher volume. The markets are dominated by large institutional investors with their diversified portfolios. A large number of mutual funds have come up in the market since 1987. With this development investment in securities has gained considerable momentum. Along with the spread of the securities investment way among Indian investors have changed due to the development of the quantitative techniques. Professional portfolio management, backed by research is now being adopted by mutual funds, investment consultants, individual investors and big brokers. The Securities Exchange Board of India (SEBI) is a regulatory body in INDIA. It ensures that the stock market is free from fraud, and of course the main objective is to ensure that the investor’s money is safe. With the advent of computers the whole process of portfolio management has become quite easy. The computer can absorb large volumes of data, perform the computations accurately and quickly give out the results in any desired form. Moreover simulation, artificial intelligence etc provides means of testing alternative solutions.

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The trend towards liberalization and globalization of the economy has promoted free flow of capital across international borders. Portfolio not only now include domestic securities but foreign too. So financial investments can't be reaped without proper management. Another significant development in the field of investment management is the introduction to Derivatives with the availability of Options and Futures. This has broadened the scope of investment management. Investment is no longer a simple process. It requires a scientific knowledge, a systematic approach and also professional expertise. Portfolio management is the only way through which an investor can get good returns, while minimizing risk at the same time. So portfolio management objectives can be stated as: -

- Risk minimization.
- Safeguarding capital.
- Capital Appreciation.
- Choosing optimal mix of securities.
- Keeping track on performance.

III. CONCLUSION

From the above it is concluded that Portfolio is a combination of various securities. Portfolio can be constructed with the help of Traditional approach and Modern Approach. The main objective of portfolio management is to help the investor in investing in various securities so, that risk is to be minimized and to get higher yield of return. In traditional approach the constraints, investors need for current income and constant income are analyzed. The basic objectives of portfolio are current income, constant income, preservation of capital, capital appreciation. As per the objective of portfolio whether it is a stock portfolio or bond portfolio or combination of both is to be decided. After that, equity component of the portfolio is chosen. Traditional approach takes the entire financial plan of the individual investor. In the Modern Approach Markowitz Model is used. More importance is given in this concept to Risk and Return Analysis.

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