

Importance of Investing & the World of Investment

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Received May 06, 2017

Accepted May 28, 2017

ABSTRACT

It is always important for an individual, a sole proprietor, a firm or any company to make crucial decision regarding investment and that is why there is so much of importance given to the investment in financial market. This article tries to make one aware of various terminologies and investible options available in the market by analyzing and explaining all the words in a very significant manner. The article explains about various options available in the market and various key words and definition related to the world of investment. The article also tries to make one aware of available investment options by a particular tabular chart and will help one and all to be aware of the various aspects pertaining to the investment.

Key words: Portfolio Management, Risk-Return relationship, SIP (Systematic Investment Planning), Derivatives.

INCEPTION:

Investment is the most crucial part of any economic system in the world, to invest is to allocate money and other means in order to have some solid benefits in the future. Thus it can be assumed that return is the strongest motive for any kind of investment and so it could firmly be said that without expectations of return there happens no investment. While investing it is essential to identify the intensity of the risk involved as it has a proportionate relationship to the investment made. For a simple understanding higher the risk, higher the return and lower the risk, lower the return.

Usually the return consists of capital gain or investment income such as dividends, interest, lease and rental incomes etc. The projected economic return is an approximate discounted value of the future returns. There are various sources available for investments and one has to be very careful while selecting the alternatives available. It is desirable if one invests in many of different alternatives available at the hand as it is wisely said that **“Don't put all your eggs in a single basket”**. Thus **portfolio management** is the most desirable strategy in the current world of investment as it helps in gaining a higher and healthy amount of returns.

1. BASICS OF INVESTING:

A. THE RISK- RETURN RELATIONSHIP:

Every investment is a **trade-off**, the higher is the risk involved in an investment the higher will be the **expected** returns. While more the safety, lesser the expected returns. **Thus the formula is expected returns are directly proportionate to the risk undertaken.** There are certain types of risks which are **Opportunity cost, Investment risks, Market timing risk, Inflation risk, Credit risk, liquidity risk, legislative risk** etc. **Liquidity** is the ease with which you can convert your assets in to cash.

B. THE SIX REASONS FOR INVESTING:

- I. Generate regular income- dividend and interest.
- II. Grow the capital (hedging inflation) – shares.
- III. Enjoyment – home, jewelry etc.
- IV. For future needs – retirement, insurance.
- V. Risk management- hedging.
- VI. Speculation- quick trading.

C. DECISION PARAMETERS:

My individual risk appetite and asset allocation decides my investment style and this is called “goal based financial planning”. The following analysis is a must for a better return on investment and better portfolio management. These questions seek certain information which in response turns out to be very influential for the investment to be made.

QUESTIONS TO ASK:

- Do I want current of future returns?
- How many productive years I have left?
- What is my attitude towards risk?

CAUTION:

Market ups and downs should be used to balance the portfolio nothing more or less.

D.SIP – Systematic Investment Planning:

It is therefore said that when there is no **SIP (Systematic Investment Planning)** you are working for money in the absence of SIP a person is always indulged in some activities which earns him money but when you want your money to work for you it is a must to have a SIP so that you are able to earn a handsome amount further.

E.THE POWER OF COMPOUNDING:

The power of compounding is really a matter of earning a good amount of money it helps you gain money on an earned gain again and thus it helps one to have a healthy return on an investment made. The below mentioned table will help one understand the essentials of compounding. Suppose you save 10000 a month, the following table can be useful to understand the power of compounding. Thus it is very significant to have analyzed the power of compounding and investing in the avenues as per the risk return policy that is to be taken into consideration.

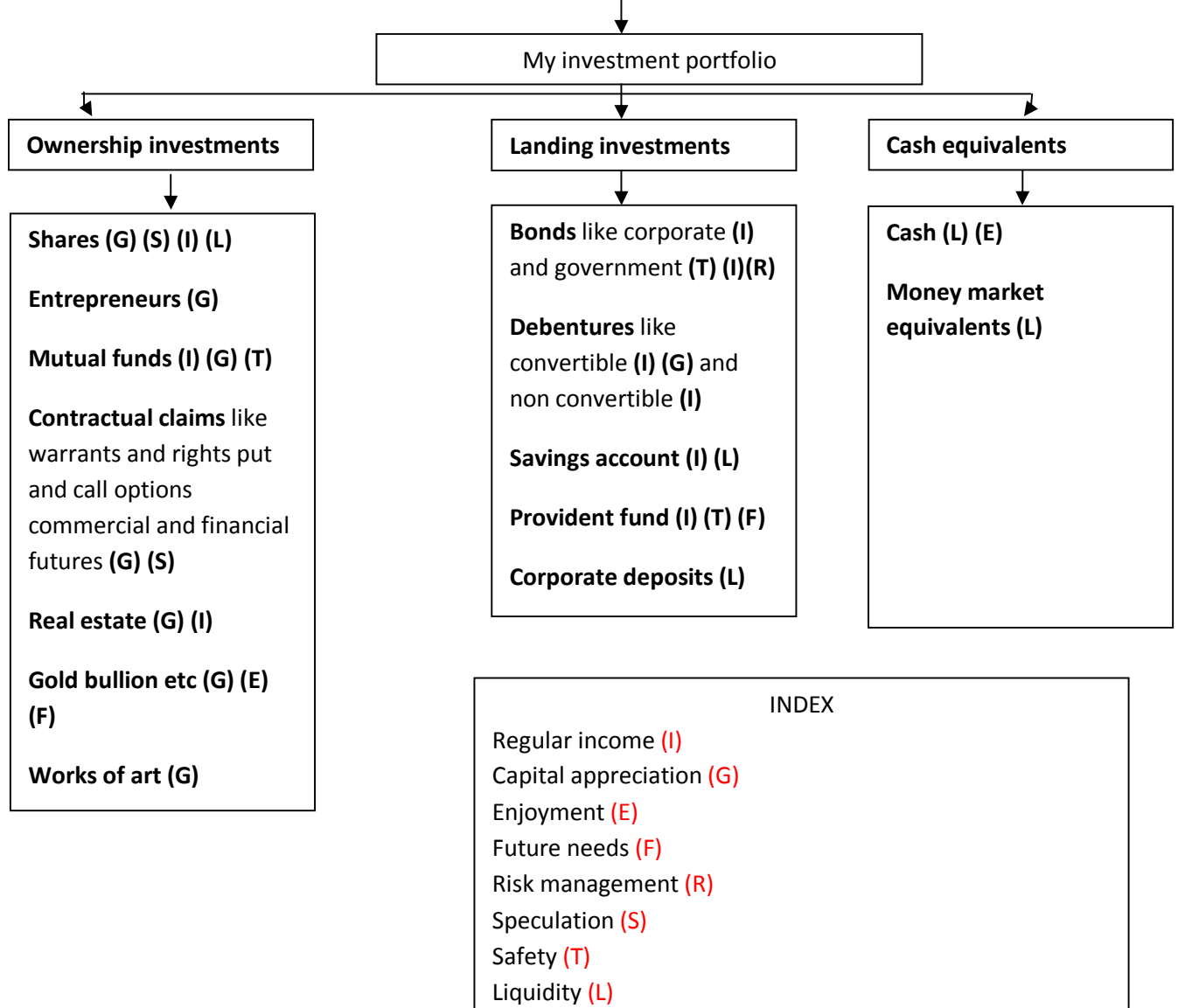
rate of growth in %				
	5%	10%	15%	20%
time (years)				
5	12673	16105	20114	24883

10	16289	25937	40456	61917
15	20789	41772	81371	154070
20	26533	67275	163665	383376
25	33864	108347	329190	953962

From the mentioned table it can be inferred that Small amounts invested regularly and left undisturbed grow to huge sums.

2. AVENUES OF INVESTMENTS

MY INDIVIDUAL `RISK APPETITE & ASSET ALLOCATION



3. SOME USEFUL DEFINITIONS:

A. shares:

Shares are ownership securities and an individual becomes a part owner of the company by purchasing some number of shares. The shares are traded on stock exchanges and one can make big money from investing in shares if the chosen shares do well in the investment market while on the other hand one may lose everything if it goes other way. Usually the shares are trades on stock exchanges and in India NSE and BSE are the major stock exchanges. **SENSEX is to be referred as Sensitivity Index.**

B. Debentures:

Debentures are creditor ship securities and one becomes a lender to the company or to the government by way of investing some amount of money in any particular company. The lender earns regular amount of interest on it and generally debentures carry a lower risk as compared to Equity owners. There are various **types** of debentures like secured and unsecured convertible and nonconvertible etc. Any project with a long gestation period starts ideally with a convertible debenture.

C. Mutual funds:

Mutual funds are pulled resources and one of the most capital engaging factors in the present investment world. A good example to understand it is to state that **“Don’t put all your eggs in a single basket”** and this means that investment is done in different market sectors and not in just a single commodity. They can be hybrid of sector specific as per the current trends of the market.

D. Derivatives:

Derivative is a financial agreement between two parties that has a value determined by the price and in addition to something else, called the **underlying**. For a better understanding it can be said that it is an arrangement or product (such as a future, option, or warrant) whose value derives from and is dependent on the value of an underlying asset, such as a commodity, currency, or security.

E. Types of shares:

I. Equity share: most basic form of capital generation, no guarantee of return, carry voting rights, most rewarding hence most risky.

II. Rights shares: issued only to existing shareholders and they convert to equity post allotment.

III. Preference shares: no voting rights and preference in dividend allotment

IV. Bonus shares: given for (free of cost) to existing shareholders. there are basically two reasons for that which are (I) as a reward and (II) to capitalize the reserves the equation here is **pre bonus mc = post bonus mc where mc stands for market capitalization**

F. Terminology of shares:

I. Authorized capital: total capital authorized by the regulator

II. Face value: fixed per share, used to calculate dividends

III. Market value: only for listed shares, keeps changing

IV. Dividend: profits shared with the shareholders per annum

V. Return on equity: ratio of profit after tax to equity

VI. EPS (earning per share): company's net profit divided by number of issued and paid up shares

VII. PE (price earning) ratio: market price divided by EPS (Earning per Share)

VIII. IPO (initial public offering): IPO is the first direct offer to the public (primary market)

IX. Primary market: this is the market where IPOs are launched

X. Secondary market: this is the market where share holders trade with each other and already issued commodities are traded here.

XI. Market capitalization: $n \cdot mp$ where n = number of shares and mp = market price

XII. Capital employed: equity capital + debt capital

XIII. Gearing: debt capital divided by share holder funds **high** - possible debt trap **low**-possible slow growth.

XIV. Bulls and bears: bulls buy today sell tomorrow "buy long" bears sell today buy tomorrow "sell short"

XV. PE ratio: it indicates how many years it will take to recover today's investments in a share. A low **p** to **e** is attractive because payback period is less, but a high **p** to **e** is desirable because of high **p** which shows the market's confidence in that share.

4. WHY PORTFOLIO MANAGEMENT?

As it is always crucial to invest in different ventures like shares, mutual funds, deposits, debentures, various treasure bonds and other likewise security investment options available, one has to be very much sure on making any kind of investment. It is advisable to make investment of one's crucial hard earned income in a venture or a scheme that returns a healthy amount. This is why it is said that one should not put all eggs in a single basket. This is why the portfolio management is must in the present world of investment.

CONCLUSION:

Investing has always been crucial in the commercial world and while some enjoy a healthy amount of returns some get tremendous returns on investments involving higher risks and on the other hand there are people who lose due to lack of experience, absence of strategy and knowledge of the investment world. However it has always been essential to have a good portfolio in order to have a better amount of returns on the investment made. One has to be wise in order to understand the sensitivity that exists in the current world of investments.

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Education is learning what you didn't even know you didn't know.

~ Daniel J. Boorstin