Investing in Stock Markets PYQ 2021

Q1) “Whilst it’s always recommended to take advice and carry out your own in-depth due diligence before making an investment”. In the light of this statement discuss the different investment opportunities in Indian Scenario. Also explain the trade-off between risk and return with examples.

Ans. In the Indian scenario, there are various investment opportunities available to investors. Some of the common ones are:

1. Equity: Investing in stocks of publicly listed companies is a popular investment option in India. The returns on equity investments are high, but the risks are also high.

2. Mutual funds: Mutual funds are a type of investment vehicle that pool money from several investors to invest in a diversified portfolio of stocks, bonds, or other securities. They offer a way for small investors to invest in a diversified portfolio of securities. The risk and return in mutual funds depend on the type of funds. For example, equity mutual funds have higher risks and returns than debt mutual funds.

3. Fixed deposits: Fixed deposits are a low-risk investment option in India. They offer a fixed rate of return for a fixed period. The returns are lower than equity or mutual funds, but the risk is also low.

4. Real estate: Investing in real estate is also a popular investment option in India. It offers high returns, but the risks are also high.

The trade-off between risk and return is an important consideration when making investment decisions. In general, investments with higher risks offer higher returns, while investments with lower risks offer lower returns. For example, investing in equity offers higher returns but also higher risks, while investing in fixed deposits offers lower returns but also lower risks.

To illustrate this trade-off, let's take the example of two investments:

1. Investing in a blue-chip stock: The stock has a potential to provide high returns in the long run, but it is also subject to market risks and volatility. Hence, the risk is high, but the returns are also high.

2. Investing in a government bond: The bond is a low-risk investment with a guaranteed return. However, the return is also low compared to the potential returns of other investments like equity. Hence, the risk is low, but the returns are also low.

Therefore, investors need to assess their risk appetite and choose investments that offer a suitable balance between risk and return.

Q2) Stock Exchanges play an important role in the Indian Securities Market. Discuss the statement mentioning the role played by the stock exchanges in India.

Ans. Stock exchanges play a crucial role in the Indian securities market. The following are the roles played by stock exchanges in India:

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1. Trading platform: Stock exchanges provide a platform for buying and selling securities like shares, bonds, and other financial instruments. They provide a transparent and regulated marketplace for investors to trade securities.

2. Price discovery: Stock exchanges play a vital role in price discovery. The demand and supply of securities determine the price of securities in the stock exchange. The market forces of demand and supply of securities determine the price of securities, which is reflected in the stock exchange.

3. Liquidity: Stock exchanges provide liquidity to securities. Investors can buy and sell securities quickly and efficiently through stock exchanges. Stock exchanges have a large number of buyers and sellers, which increases the liquidity of securities.

4. Transparency: Stock exchanges provide transparency in transactions. The price and volume of transactions are publicly available. The stock exchange also provides information about the financial health of companies that issue securities, which helps investors make informed decisions.

5. Regulation: Stock exchanges are regulated by the Securities and Exchange Board of India (SEBI). SEBI ensures that stock exchanges follow transparent and fair practices. Stock exchanges are also responsible for ensuring that companies that issue securities follow the rules and regulations of the stock exchange and SEBI.

6. Listing: Companies can list their securities on the stock exchange. Listing on the stock exchange provides companies with a platform to raise capital from the public. It also provides companies with increased visibility and credibility, which helps in attracting investors.

In conclusion, stock exchanges play an important role in the Indian securities market. They provide a regulated and transparent marketplace for investors to trade securities. They also facilitate price discovery, increase liquidity, provide transparency in transactions, and ensure that companies follow rules and regulations.

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Q3) What do you understand by analysing a company? Explain the key financial factors to be considered in the analysis of a company?

Ans. Analysing a company refers to the process of evaluating its financial and operational performance to determine its financial health, future prospects, and investment potential. It involves examining various factors such as financial statements, industry trends, management performance, and economic conditions. The goal of analysing a company is to make informed investment decisions and identify opportunities to invest in companies with strong financial health and growth potential.

The following are some key financial factors to consider in the analysis of a company:

1. Revenue and profit: Revenue is the total income generated by the company from the sale of its products or services. Profit is the amount of revenue left over after deducting all the expenses. It is important to examine the revenue and profit growth rates to understand the company's performance over time.

2. Balance sheet: The balance sheet provides a snapshot of the company's financial health at a given point in time. It provides information on the company's assets, liabilities, and equity. It is important to examine the company's liquidity, solvency, and leverage ratios to assess its financial health.

3. Cash flow: Cash flow statement provides information on the company's cash inflows and outflows. It is important to examine the company's operating, investing, and financing cash flows to understand its cash position and ability to meet its financial obligations.

4. Return on investment: Return on investment (ROI) measures the return on investment made by the shareholders. It is calculated by dividing the net profit by the total investment. It is important to examine the company's ROI to determine its profitability and growth potential.

5. Valuation ratios: Valuation ratios such as price-to-earnings (P/E) ratio, price-to-sales (P/S) ratio, and price-to-book (P/B) ratio provide an indication of how the market values the company's stock. It is important to compare the company's valuation ratios with those of its competitors and industry averages to assess its investment potential.

6. Debt profile: Debt profile provides information on the company's debt levels and repayment obligations. It is important to examine the company's debt-to-equity ratio, interest coverage ratio, and debt service coverage ratio to assess its debt profile.

In conclusion, analysing a company involves examining various financial factors to determine its financial health, future prospects, and investment potential. It is important to consider factors such as revenue and profit, balance sheet, cash flow, return on investment, valuation ratios, and debt profile to make informed investment decisions.

Q4) Explain the various types of basic charts used by technical analysts to predict future price behaviour.

Ans. Technical analysts use charts to study price movements and identify trends in financial markets. The following are some of the basic charts used by technical analysts to predict future price behaviour:

1. Line chart: A line chart is the simplest chart used by technical analysts. It plots the closing price of a security over a period of time, usually days, weeks or months. It provides a basic overview of the trend in the price of the security.

2. Bar chart: A bar chart is a more detailed chart that provides additional information on the price movement of a security. It displays the high, low, opening, and closing prices of the security over a period of time. Each bar represents a trading day or week, and the length of the bar represents the price range of the security for that day or week.

3. Candlestick chart: A candlestick chart is a popular chart used by technical analysts to study price movements. It provides more detailed information on the price movement of a security than a bar chart. It displays the opening, high, low, and closing prices of a security for a specific time period. Each candlestick represents a trading day or week, and the color of the candlestick indicates whether the closing price was higher or lower than the opening price.

4. Point and figure chart: A point and figure chart is a chart that uses X's and O's to represent price movements. It provides a simple and clear representation of price trends in the market. Each X or O represents a predetermined amount of price movement, and a new X or O is added to the chart when the price moves in the direction of the trend.

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5. Renko chart: A Renko chart is a chart that uses bricks to represent price movements. It provides a simple and clear representation of price trends in the market. Each brick represents a predetermined amount of price movement, and a new brick is added to the chart when the price moves in the direction of the trend.

In conclusion, technical analysts use a variety of charts to study price movements and identify trends in financial markets. The type of chart used depends on the level of detail required and the specific analysis being performed. Some of the basic charts used by technical analysts include line charts, bar charts, candlestick charts, point and figure charts, and Renko charts.

Q5) A mutual fund made an issue of 10, 00,000 units of Rs.10 each on Jan.1, 2016. No entry load was charged .It made the following investments:

50,000 Equity shares of Rs.100 each @Rs.160	Rs.80,00,000
7% Govt. Securities	8,00,000
9% Debentures (unlisted)	5,00,000
10% Debentures (listed)	5,00,000
	98,00,000

During the year, dividends of RS. 12, 00,000 were received on equity shares. Interest on all types of debt securities was received as and when due .At the end of the year ,the equity shares and 10% debentures are quoted at 175% and 90% respectively .Find out the NAV per unit given that operating expense paid during the year amounted to Rs.5,00,000. Also find out the NAV if the mutual fund had distributed a dividend of Re. 0.80 during the year to the unit holders.

Ans. To calculate the Net Asset Value (NAV) per unit, we need to determine the total value of assets and deduct the operating expenses, and divide by the number of units outstanding.

Total value of assets:

Equity shares = 50,000 x Rs. 160 = Rs. 80,00,000

7% Govt. Securities = Rs. 8,00,000

9% Debentures (unlisted) = Rs. 5,00,000

10% Debentures (listed) = Rs. 5,00,000

Total = Rs. 98,00,000

Dividends received = Rs. 12,00,000

Value of equity shares = 50,000 x Rs. 175 = Rs. 87,50,000

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Value of 10% debentures = 5,00,000 x 90/100 = Rs. 4,50,000

Total value of assets at the end of the year = Rs. 98,00,000 + Rs. 87,50,000 + Rs. 8,00,000 + Rs. 5,00,000 + Rs. 4,50,000 = Rs. 1,03,00,000

Operating expenses = Rs. 5,00,000

Therefore, the NAV per unit = (Total value of assets - Operating expenses)/Number of units outstanding

= (Rs. 1,03,00,000 - Rs. 5,00,000)/10,00,000

= Rs. 98.5

If the mutual fund had distributed a dividend of Re. 0.80 during the year to the unit holders, then we need to deduct the amount of dividend from the total value of assets.

Total value of assets = Rs. 1,03,00,000 - Rs. 8,00,000 + Rs. 12,00,000 - (Re. 0.80 x 10,00,000) = Rs. 1,06,20,000

Operating expenses = Rs. 5,00,000

Therefore, the NAV per unit after distribution of dividend = (Total value of assets - Operating expenses)/Number of units outstanding

= (Rs. 1,06,20,000 - Rs. 5,00,000)/10,00,000

= Rs. 101.12

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6) Write short note on any three of following;

- Cash Flow Statement Analysis

Ans. A cash flow statement is a financial statement that provides information on a company's cash inflows and outflows over a specific period of time. The statement is divided into three sections: cash flows from operating activities, cash flows from investing activities, and cash flows from financing activities.

Cash flow statement analysis is the process of examining the cash inflows and outflows of a company to assess its financial health and future prospects. The analysis helps in determining the company's ability to generate cash, its ability to meet its financial obligations, and the efficiency of its operations.

Some key financial metrics that can be assessed through cash flow statement analysis include:

1. Operating cash flow: This refers to the cash generated or used in a company's operations. A positive operating cash flow indicates that the company is generating sufficient cash from its core operations to fund its growth and other activities.

2. Investing cash flow: This refers to the cash used for investing in assets such as property, plant, and equipment. A negative investing cash flow may indicate that the company is investing heavily in long-term assets to support its growth.

3. Financing cash flow: This refers to the cash generated or used for financing activities such as debt repayments, equity issuances, and dividend payments. A positive financing cash flow may indicate that the company is able to meet its financial obligations and fund its growth through external sources of funding.

4. Free cash flow: This is the cash left over after all operating and capital expenditures have been accounted for. It is a key metric used to assess a company's ability to generate cash and fund its growth.

Cash flow statement analysis can provide valuable insights into a company's financial health and future prospects. However, it should be used in conjunction with other financial statements and metrics to obtain a more comprehensive understanding of the company's financial position.

- Types of orders

Ans. In the context of financial markets, an order is a request to buy or sell a security at a specified price. There are several types of orders that investors can use to execute trades. Here are some of the most common types of orders:

1. Market order: A market order is an order to buy or sell a security at the best available price. It is executed immediately at the current market price.

2. Limit order: A limit order is an order to buy or sell a security at a specified price or better. It is only executed when the market reaches the specified price or better.

3. Stop order: A stop order is an order to buy or sell a security once it reaches a specified price known as the stop price. It is typically used as a risk management tool to limit losses or lock in profits.

4. Stop-limit order: A stop-limit order is similar to a stop order but includes a limit price. Once the stop price is reached, the order becomes a limit order to buy or sell the security at the specified limit price or better.

5. Trailing stop order: A trailing stop order is a type of stop order that is set at a certain percentage or dollar amount below the market price for a long position or above the market price for a short position. The stop price is adjusted as the market price moves in the investor's favor.

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6. All or none order: An all or none order is an order that is executed only if the entire order can be filled at once. Otherwise, it is cancelled.

7. Fill or kill order: A fill or kill order is an order that is executed immediately in its entirety or cancelled if it cannot be filled immediately.

Understanding the different types of orders is important for investors to effectively manage their trades and mitigate risks. Investors should carefully consider the type of order they use based on their investment objectives, risk tolerance, and market conditions.

• Top down and bottom up approaches

Ans. The top-down and bottom-up approaches are two methods used in investment analysis to identify potential investments.

The top-down approach is a macroeconomic approach that starts with an analysis of the overall economy and market trends. It then narrows down to specific sectors and industries and finally to individual companies. The analysis considers factors such as interest rates, economic growth, government policies, and industry trends to identify potential investment opportunities. Once the sectors and industries with the most potential are identified, the analysis is focused on individual companies within those sectors.

The bottom-up approach is a microeconomic approach that starts with the analysis of individual companies. It considers the company's financial statements, management quality, competitive position, and industry dynamics to determine whether the company is a good investment. The analysis then considers the broader industry trends and the overall market to determine how the company fits within the larger context.

Both approaches have their advantages and disadvantages. The top-down approach can help investors identify emerging trends and opportunities in the market, but it may overlook some individual companies that are undervalued. The bottom-up approach is focused on individual companies, which can provide a detailed analysis of each company, but it may not capture larger market trends that could affect the investment.

Investors often use a combination of the top-down and bottom-up approaches to identify potential investments. This helps to ensure that both the macro and micro factors are considered in the investment analysis, providing a more well-rounded investment strategy.

• Security market indices.

Ans. Security market indices are used to measure the performance of a group of securities in the stock market. An index is a statistical measure that helps investors track changes in the stock market and assess the overall health of the economy. Here are some important points about security market indices:

1. Composition: Security market indices are composed of a group of securities, usually stocks, that are selected based on certain criteria such as market capitalization, sector, or region.

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2. Calculation: Security market indices are calculated using a weighted average of the individual securities in the index. The weights are usually based on the market capitalization of each security, which reflects the relative size of the company in the market.

3. Benchmarking: Security market indices are often used as benchmarks for investment performance. For example, mutual funds and exchange-traded funds (ETFs) may aim to outperform a specific index such as the S&P 500.

4. Examples: Some popular security market indices include the S&P 500, Dow Jones Industrial Average, NASDAQ Composite, and Russell 2000.

5. Importance: Security market indices are important because they provide a snapshot of the overall market and can help investors make informed decisions about their investments. By tracking the performance of an index, investors can identify trends in the market and adjust their investment strategies accordingly.

6. Limitations: It is important to note that security market indices have limitations. They may not be representative of the entire market, and changes in the composition of an index can affect its performance. Additionally, past performance is not necessarily indicative of future results, so investors should use caution when making investment decisions based on index performance.

Overall, security market indices provide a valuable tool for investors to track changes in the stock market and assess the performance of their investments.

- IPO & FPO

Ans. IPO (Initial Public Offering) and FPO (Follow-on Public Offering) are both ways in which companies can raise capital by selling shares to the public. Here are some important points about IPOs and FPOs:

1. IPO: An IPO is the first time a company offers its shares to the public. The company raises capital by selling a portion of its ownership to investors. The shares are sold through an underwriter or investment bank, which helps the company set the price and market the shares to investors.

2. FPO: An FPO is a subsequent offering of shares by a company that has already gone public. FPOs are also known as secondary offerings. In an FPO, the company raises additional capital by selling more shares to the public. FPOs are typically used to fund expansion or pay off debt.

3. Pricing: The pricing of IPOs and FPOs is determined through a process called bookbuilding, in which the underwriter solicits bids from institutional investors to determine demand for the shares. The final price is set based on the bids received.

4. Regulation: Both IPOs and FPOs are regulated by the Securities and Exchange Board of India (SEBI) to ensure that investors are protected and that the offering is conducted fairly and transparently.

5. Risks: Investing in IPOs and FPOs carries certain risks, including the possibility that the shares will decline in value after the offering, as well as the risk that the company will not perform as expected.

Overall, IPOs and FPOs are important ways for companies to raise capital and provide opportunities for investors to participate in the growth of these companies. However, investors should carefully consider the risks before investing in any new offering.

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