BASICS OF INVESTMENT

Dr.V.Aditya Srinivas

Chief Operating officer and Chief Economist

Bombay Stock Exchange Brokers Forum

FOREWORD

The objective of writing this book in the form of question and answer is that during my session in more than 60 institutions in India covering more than 3000 students, I felt that in all the Question and Answer sessions, the students had lot of confusion in basics concepts. There was a clear gap between what they learn in class room but do not understand the concepts. My humble attempt is to fill this gap. I have taken sessions in top B schools like IIM Indore, IIFT Delhi, Narseemonjee to name a few and also institutions which run the night colleges where the students from working class continue their study. My effort is to spread the basic knowledge about the capital market and the financial system of India among the young students who are going to be the investors for tomorrow. If this young generation is given proper guidance and knowledge then we can develop a new breed of new informed investors who can contribute to the capital markets and also make a living for themselves.

ACKNOWLEDGEMENT

I take this opportunity to sincerely thank **Miss Naik Afifa Khatoon,** studying MBA in Allana Institute of Management Studies, Mumbai, who has done the editing of this book. She has been real help to me in completing this book and ensuring that I am able to do this work along with my busy office work. She has been instrumental in completing this book on timely basis.

ABOUT THE AUTHOR:

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MBA (GOLD MEDAL), PH.D, MDP (IIM AHMEDABAD), CWM, ISO 9001:2008 LEAD AUDITOR

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CAREER SUMMARY

- 12 years of corporate experience in field of financial services with complete knowledge about all the segments of the capital markets and financial products.
- Exposure to research in the capacity of fund manager of various asset allocations and asset linkages.
- Complete knowledge about the working of the operational aspects of the capital market and in specific about the stock market fraternity
- Presented Research papers in national and international conferences which gives complete exposure to International experience
- Complete practical and on hands exposure to the working of the stock broking firms as worked as Leading stock broking houses in various capacities
- IN depth knowledge of Macro Economics and Fundamental Research as worked as Fund Manager.

PROFESSIONAL EXPERIENCE

Working as Chief Operating Officer of BSE BROKERS FORUM from 31st August 2012. From 11th March 2013 given additional responsibility of Chief Economist of Bombay Stock Exchange Brokers Forum.

JOB PROFILE AS COO:

- Handling all member broker related queries and coordination with BSE
- Instrumental in bringing out "Operational Manual" for brokers which has entire operations aspects for broking industry.
- Drafting all correspondence with SEBI,RBI and Ministry of Finance
- Conducting seminars on Compliance, PMLA, E Boss, Service tax issues for member brokers
- Key role in GIFT CITY Project operations part.

JOB PROFILE AS CHIEF ECONOMIST:

- Write Macro Economic Research articles for FORUM VIEWS Magazine
- Published Macro Research papers In International Journals
- Regular appearance on CNBC Bazaar and DD News channel
- Interaction with FOREIGN Delegations who visit BSE and explain them about Indian Economy
- Represented India at Harvard Law School, USA and gave presentation about Indian Economy

QUALIFICATION

- PhD in Economics from Veer Narmad South Gujarat University NAAC Rated 5 star
- Management Development Programme (MDP) from IIM Ahmedabad.
- Chartered Wealth Manager (CWM) awarded Honorary by American Academy of Financial Management.
- MBA Finance (Gold Medal), S.R.Luthra Inst of Management (2004)
- BBA Finance (Distinction) South Gujarat University (2002)
- 30 Research papers published in various books and journals
- 23 Research papers presented in National and International Conferences
- Authored Book on “Introduction to Indian Commodities Market”
- Authored Chapter in the book “Security Analysis and Portfolio management” along with Shalini Talawar from K J Somaiya Institute of Management
- Recognized PhD Guide in UTU University.

UNIQUE ACHIEVEMENTS:

- Dr. Aditya has been referred to be appointed as an Advisor by Member of Parliament (Lok Sabha) Shri Hansraj Ahir to Prime Minister Dr. Manmohan Singh. Received letters from Prime Minister Office (PMO) acknowledging the same.
- Dr. Aditya has been referred to be appointed as an Advisor by Member of Parliament (Lok Sabha) Shri Kaushalendra Kumarji to Prime Minister Dr. Manmohan Singh and also to Shri P Chadambaram. Received letters from Dr. Manmohan Singh and Shri Chidambaram acknowledging the acceptance.

- Dr. Aditya has been referred to be appointed as an Advisor by Member of Parliament (Lok Sabha) Shri Hansraj Ahir to Prime Minister Dr. Manmohan Singh and also to Shri P Chadambaram.
- Dr. Aditya has been referred to be appointed as an Advisor by Member of Parliament (Lok Sabha) Shri Hansraj Ahir to Prime Minister Shri Narendra Modiji.
- Invited by Harvard Law School to attend International Conference on Islamic Finance from April 25 to April 27 2014 held at Boston. Globally only 80 experts had been called to attend the conference from 20 countries.
- Heading Investor Awareness Programme Drive. Have personally taken 310 sessions pan India covering 19,500 participants including IIM Ahmedabad, IIM Indore, NMIMS, S. P Jain, Symbiosis to name a few.
- Regularly invited by DD News and CNBC Bazaar on Monetary policy, CPI WPI data, Trade Data. Have given more than 25 interviews till date.

INTERNATIONAL REPRESENTATIONS:

1. Invited at Harvard Law School, Boston USA for International Conference on Islamic Finance.
2. Addressed 200 International students at Dubai, IMT Gaziabad
3. Represented India at Taiwan for 19 nation conference on International capital markets
4. Addressed 48 Arab National from 7 Gulf countries in Oman for 4 days on capital markets and economy
5. Addressed 25 Government delegates in Maldives for 3 days on Economy and capital market.

6. One on one Interaction with Mr. Shotaro, International Economist with Japan Economic Research and with Mr. Katoti, Senior Economist with Tata Group.
7. One on one Interaction with DR. Michele V Gee, Interim Associate Dean, University of Wisconsin, USA on 6th January 2015 and Dr. Parag Dhumal, from University of Wisconsin, USA.
8. Addressed Delegates at Asian Financial Forum on 19th and 20th January 2015. AFF had 2000 corporates participating across globe. Had interactions with delegates of USA, France, Canada, Philippines, and Asia Pacific Council.
9. Addressed Senior level delegations comprising 48 delegates from 17 countries on 29th January 2015 from IMD Switzerland on Indian Economy and Capital Markets in BSE International Convention Hall.
10. Represented India at Asian Securities Forum 2015 at Seoul, Korea where 20 nations had participated from 20th to 22nd September 2015.
11. One on one interaction with Mr. Matthew Rees, Speech writer and Executive Assistance to Chairman of Securities Exchange Commission, USA on Indian Economy and US Economy integration on 16th December 2015.

KEY ACHIEVEMENTS:

- Took one on one interview of Dr. Siddhartha Roy, Economic Advisor Tata Group (Directly reports to Tata Group Chairman, Cyrus Mistry). The interview was printed in the April 2013 Annual Edition of FORUM VIEWS Magazine.

- Addressed 40 senior management personnel from KPMG Financial Services division at KPMG office in Mahalashmi, Mumbai.
- Addressed Indian Institute of Management (IIM) Ahmedabad, 50 Post Graduate Students of Management
- Addressed Indian Institute of Management (IIM), Indore, 45 Post Graduate Students of Management
- Key speaker at Oman Stock Exchange and Maldives Stock Exchange on Indian Capital Market
- Article published by Hong Kong Securities Association in their journal on the topic "Global Financial Crisis – lessons to be learnt"
- Article published by Tilburg University in International Journal "Faces International" on the topic "Role of Government in Stock Exchanges"
- Conducted Master of Ceremonies (MOC) during the visit of Prime Minister of Hungary Mr. Victor Orban on 18th October at the BSE International Convention Hall.
- Conducted Master of Ceremonies (MOC) during the launch of BSE Currency Derivatives during presence of Shri Salem, Honorable Union Minister of Revenue, Dr. K P Krishnan, Additional Secretary, Government of India.
- Represented India at the Asia Securities Forum held at Taiwan from 23rd October to 25 October 2013. The meet had participation from more than 14 countries with around 50 delegates.
- Addressed 16 member delegation of Western Australia Government delegation through video conference on Investment opportunities in India.

- Addressed German Delegation, France Delegation on Indian Economy at BSE
- Addressed 64 senior level delegation from 16 countries from IMD Switzerland on Indian Economy and Indian Capital Market.
- Invited as Panel Expert at IIFT Delhi at National Finance Symposium
- Editor of monthly magazine "BSE FORUM VIEWS" which has won "Silver" award at 53rd Annual Awards Nite organized by Association of Business Communicators of India along with TATA group

POSITIONS HELD:

1. Editor of the monthly magazine "FORUM VIEWS" which has 2000 hard copy publication. Was awarded "Silver Prize" by the Tata Group and ABCI in 2013 and Bronze Price in 2014 in External Publication category.
2. Member of Expert Panel appointed by NISM (Educational arm of SEBI) for Certification for Research Analyst.
3. Recognized PhD Guide in UTU University, Surat, Gujarat.
4. Member of Board of Studies of Symbiosis Institute of Management Studies, Pune.
5. Member of the Investment Advisory Committee of Concept Securities Private Ltd
6. Member of the Advisory Board of Saint Xavier College.
7. Member of Advisory Board of C.K.Pithawala Institute of Management Studies
8. Member of Editorial Board of "Professional Panorama An International Journal Applied Management and Technology (ISSN 2349-6916)

9. Member of Board of Studies of Symbiosis Institute of Management Studies (SIMS)
10. Member of Editorial Board of "Symbiosis Institute of Management Studies Journal "Jidnyasa" ISSN 0976-0326 JIDNYASA
11. Member of Governing Board of IES Institute of Management Studies, Bandra.
12. Member of Subject Board of Finance at K J Somaiya Institute of Management.
13. Member of Advisory Board of Industry Academia Partnership cell of Saurashtra University, Rajkot, Gujarat.

INTERNATIONAL MOU SIGNED:

Was instrumental in Domestic and International MOU with the following bodies:-

1. Hong Kong Securities Association
2. Mauritius Stock Exchange
3. Maldives stock Exchange
4. Philippines securities association
5. KOFIA (Korea)
6. Thailand Securities Association
7. 6^{th} Sense Consulting firm in UK
8. Bajaj Allianz Life Insurance company

EARLIER EMPLOYMENT

BOMBAY STOCK EXCHANGE TRAINING INSTITUTE:

Worked as Full Time Faculty cum Economist and International Trainer at Bombay Stock Exchange and also as Corporate Trainer representing BSE at various customized National and International Progammes from 8th June 2011 to 30th August 2012)

ROONGTA RISING STOCK PVT. LTD. (Feb 2010 to June 2011)

NATIONAL HEAD – BUSINESS DEVELOPMENT – Equities, Derivatives, Commodities Currency.

- Handled entire business development aspect
- Instrumental in getting BSE membership\

ANGEL BROKING LIMITED (Jan 2009 to Jan 2010)

Regional head South Gujarat Region – operations (handled 583 sub brokers and 9 branches having 40,000 clients and 250 employees)

- Reported to Mr. Santanu Syam, Executive Director
- 7 Department Heads – KYC, Demat, Account, Banking, Quality, HR, Risk management reported to me
- Instrumental in streamline processes and ensuring client satisfaction
- Instrumental in strong recovery from clients and sub brokers
- Instrumental in auditing of sub brokers through external auditor

CONCEPT SECURITIES PVT. LTD. (Dec 2006 - Dec 2008)

ASST. VICE PRESIDENT – Chief Economist and Fundamental Analyst

- Instrumental in getting NSE membership (entire paper work and coordination with exchange)

- Instrumental in getting PMS license (entire documentation and coordination with SEBI)
- Played key role in formation of NRI cell
- Played key role in formation of In house Research Cell.

S.R.LUTHRA INST OF MANAGEMENT (AUG 2005 - Dec 2006)

LECTURER – TAUGHT SUBJECTS ON PORTFOLIO MANAGEMENT, DERIVATIVES

Department of Economics, Veer Narmad South Gujarat University (June 2004-July2005)

LECTURER – TAUGHT SUBJECTS ON STOCK MARKET AND CAPITAL MARKETS

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Q1) What is stock exchange?

A1) Stock exchange provides a platform for the buyers and sellers to deal in securities which are listed on the stock exchange. It acts as bridge between the demanders of the fund and the suppliers of the fund. Stock exchange canalizes the savings of the people into productive investments through the route of listed companies. The participants in the stock market include Government, Retail Investors, Financial Institutions, Mutual funds.

For example, the coal India IPO was listed and it collected Rs.15000 crores from the market. Here the coal India company which is government owned was on the demander's side while other participants who invested in that IPO were on the supplier's side.

Q2) What is equity market?

A2) Equity markets are generally referred to as stock markets in the common parlance. They are aimed to provide sound investment opportunities to the people so that their savings can be invested into fundamentally sound companies and they are able to get decent returns on their investments. The companies' issue their equity shares in the primary market and then get shares listed on the stock exchange to make them traded in the markets.

Q3) What is debt market?

A3) Debt market is the market where the instruments which give fixed rate of return are traded. A debt instrument is one in which the investors is certain to get a fixed amount at the end of the holding period. He is entitled to get interest on the investment. Popular debt instruments are fixed deposit, PPF, NSC, bonds and debentures which offer fixed rate of return to the investors.

For example banks give interest of 8 % in fixed deposit, bonds and debentures give 10 to 12 % interest but one needs to check the credit risk in the bonds and debentures since they are issued by the private companies. Debt market refers the market in which the instruments like bonds, debentures are traded. Debt instruments are those where there is fixed rate of return. The issuer of the debt instrument has to repay the principal amount and the interest to the investor. If the issuer fails to repay the interest or principal amount to the investor then the investor has all the legal rights to sue the issuer and liquidate his assets. The debt market has huge volumes as the Banks and Financial institutions are the main players in the debt market

Q4) What is money market?

A4) Money market is the market for short term source of funds. The money market instrument has less than one year of maturity. The basic objective of the money market is to ensure liquidity management in the system. The following are the main instruments in the money market:

(1) Treasury bill

(2) Commercial paper

(3) Certificate of deposit

(4) Inter corporate deposit.

All these are short term instruments aimed to ensure that liquidity management is done in the system. Banks and financial institutions are the main players in the Indian money market. The call money market is also an important indicator of the short term liquidity situation in the economy. In 2007 the call money rate has become 0.25 % which was abnormally low which indicated that there is huge excess liquidity in the system. The year 2008 had call money rates going to 21% which is again abnormally high and which shows that there is severe liquidity crunch in the system.

Q5) What is capital market?

A5) Capital market is a market for long term source of funds. These funds are raised by the company through 4 types of instruments namely Equity Shares, Preference Shares, Bonds and Debentures. The Equity shares are those where there is no liability of the company to repay the amount unless the company gets winding up order and there is no liability to pay dividends also. This is the best form of capital, a company would like to raise. Preference shares have fixed dividend and the capital taken by the company has to be repaid back at the end of maturity. Bonds and Debentures are debt instruments and fixed interest is to be paid on them by the company issuing these instruments. If the company fails to repay the interest or principal amount, then the bond and debenture holders gets the legal right to initiate the winding up of the company.

Q6) What is currency market?

A6) Currency market trading has started in the year 2008. Current MCX-SX and NSE, United Stock Exchange of BSE also provide this trading platform. In the currency trading, there are four basket of currency that is traded, which is, dollar, yen, pound, euro. The settlement of the trades is done in cash only that is no delivery base settlement. If one feels that the rupee is going to appreciate then one needs to short the contract and if the rupee is going to depreciate then one needs to go long for the rupee contract. The average daily volume in this segment is Rs.25000 crores per day. Banks are allowed to trade in the currency derivatives segment.

Q7) What is IPO?

A7) IPO refers to the Initial Public Offering where a company for the first time comes to the market to raise the money from the public. IPO is the equity capital raised by the company and remains with the company till it goes for liquidation. The company bringing IPO does not have to pay interest nor has to mortgage any asset for bringing the IPO. In case of liquidation of the company, the equity share holders are the last to get their capital back and so equity capital is aptly known as the “risk capital”. IPO in the past have crated huge wealth for the investors. For instance, in the Infosys IPO, where an investor invested Rs.9500 in the IPO, his wealth turns to Rs.2 crores. This shows the power of the equity investment which is often known as the “Wealth Creation”.

Q8) What is savings?

A8) Saving refers to reducing the current consumption so as to accumulate the resources for the future consumption. Savings should be done from what one earns after making the provisions of all the legitimate expenses. Regular Saving results into capital formation which can be invested to create an own asset. For example, Rs.5000 is saved every months results into capital formation of Rs.60000 which can be invested to buy a bike which is debt free asset created.

Q9) What is primary market?

A9) Primary markets are the market where the company brings their issue for the first time to raise money from the people. It is referred to as IPO that is Initial Public Offering. This is the route through which the companies come to the market and raise the money. Primary market reflects the sentiment in the stock market.

Q10) What is secondary market?

A10) It is also referred to as the stock market. It is the market where the companies are listed on the stock exchanges. In India the prominent ones are BSE and NSE where the companies are listed. BSE h s 5174 companies listed while NSE has around 2200 listed companies.

Q11) What is commodity market?

A11) Commodity markets are those exchanges where the commodities are listed and traded. In India there are 16 regional commodity exchanges and 5 national level commodity exchanges. The major ones are the MCX, NCDEX. In MCX market, bullion (gold and silver), metals and energy (crude oil and natural gas) are dealt with. In NCDEX the agriculture commodities are traded. There are both types of settlement that is cash and physical delivery also. The commodities market is affected by the international markets and by international factors.

Q12) What is mutual fund?

A12) Mutual funds are the indirect route of investment in to the stock market. Mutual funds are SEBI registered entities. They invest the money collected from the unit holders and then invest the money into the stock market as per their mandate. For example, Rs.5000 is the minimum application amount that one has to invest in the mutual fund. Now if 10,000 people each of them invest Rs.5000 then this total corpus would be invested in the stock market in say 40 fundamentally sound companies. This reduces the risk as there is diversification.

Q13) What are the benefits of investing in mutual funds?

A13) Benefits of investing in MF are:

- **Diversification:** In mutual funds, the corpus is invested in large number of stock which is fundamentally sound. Typically the funds invest corpus into 40 to 50 stocks. This reduces the risk as the benefit of diversification comes into play. Since different companies from different sectors are selected based on fundamentals, the risk of capital erosions is reduced to some what extent.
- **Decent Returns:** Mutual funds as an instrument provide decent returns as compared to traditional financial instruments like NSC, KVP and PPF, Bank deposits. The mutual funds industry has around 44 mutual funds and more than 800 schemes. One needs to select the mutual funds based on its past performance and on consistency of the performance of the fund.
- **Liquidity:** The investor can redeem the units and would get their investment at the current NAV within four working days. This ensures that investors get their money back at the current market price prevailing of the NAV (Net Asset Value) which is the market price of the units.
- **Taxation:** There is no long term capital gains tax in mutual funds. This means that when the redemption is done after 365 days then no tax is to be paid. If the redemption is done in less than 365 days, then the short term capital gains tax of 15 % is to be paid. There is 15 % dividend distribution tax which is paid by the mutual funds when they declare the dividend. There is no tax on dividend in the hands of the investors.

Q14) What are equity diversified funds?

A14) These are those equity funds in the mutual funds which invest their corpus in the shares listed on the stock exchanges. There asset allocation is from 80 to 100% in stocks only. These are the fund which invests in generally 40 to 50 stocks of various sectors which gives the benefit of diversification and hence reduced risk. These funds are very popular among the retail investors.

Q15) What are debt funds?

A15) These mutual funds invest the corpus of the unit holders in the debt instruments like bonds, debentures, corporate papers, government securities and other fixed income instruments. These funds have the asset allocation of 100 % into debt instruments. The risk and return in these funds are low. These kinds of funds are popular with corporate houses to part their surplus liquidity and also with those retail investors who are risk averse.

Q16) What are balanced funds?

A16) These are the funds which have the asset allocation having both equity and debt. The equity allocation is 65 % and debt allocation is 35%. These funds are ideal for those investors who have moderate risk taking ability. the asset allocation will have shares of fundamentally sound companies and in debt the money is invested in bonds, debentures, government securities and other rated instruments.

Q17) What are gilt funds?

A17) Gilt funds are those where the entire corpus is invested only into the government securities which makes it very safe instrument. The banks, financial institutions and High Net worth individuals use these funds to park their money. The return from these funds is very low since the risk is also lowest.

Q18) What are index funds?

A18) Index funds are those which invest in pre-decided index only. There is no fund manager in these kinds of funds. The entire fund allocation is done in the same manner as the stock have their weight age in index. This is called as Passive Fund Management. The BSE Index from 1979 to 2014 has given CAGR return of 16.25% which shows that over a period of time the index would generate decent returns since the economy grows in the long term. In 2014, the BSE Index gave return of 31 % and so does the index funds also gave similar returns.

Q19) What are sector funds?

A19) Sector funds are those funds which invest in only one sector and this makes them the most risky funds with possibility of highest returns also. The entire exposure of the funds would be only in one sector and this is why their performance is dependent on the government policy on that sector or announcement of any regulatory body on the sector. For instance UTI Pharma fund would invest entire corpus of the fund into the pharma sector stocks only. Reliance Banking fund would invest entire funds into banking stocks only. If the sector has positive announcement from government or regulatory body then the returns of the funds would be very high but if there is any negative news than the entire sector would crash like pin of cards and returns of the fund will also be very low.

Q20) What is ETF?

A20) ETF stands for the Exchange Traded Fund which is the mutual fund which is listed on the stock exchanges. These funds can be bought or sold just like shares at the stock exchanges. Whenever the investor buys or sells these ETF they have to pay the brokerage charges to the broker. Nifty Bees was the first ETF launched in India by Benchmark Mutual Fund.

Q21) What are tax saving funds?

A21) Tax saving fund are those where the investor will get benefit under section 80 C of the income tax act. One can invest Rs. 150000 (Rupees one lakh fifty thousand) in these funds. There is lock in period of 3 years and once cannot withdraw amount before that since one has taken the income tax benefit. The Tax saver funds also invest 100 % of their corpus into the stock market. These funds over a period have given decent returns.

Q22) What is SIP?

A22) SIP stands for Systematic Investment plan where a dedicated amount say Rs.1000 get debited from the bank account and gets invested in the stock market at a pre-defined date. This makes investing a very systematic process and the cost of buying also goes down since the average cost come down. SIP is available in all the mutual funds since it reduces the risk of timing the market also creates a culture of systematic saving among the persons. A person who does SIP of Rs.2000 per month for 30 years at 15% would get Rs.1.21 crores at his retirement.

Q23) What is derivatives?

A23) Derivative is an instrument whose value is derived from the underlying asset. The underlying asset may be financial or non-financial in nature. For example stocks, bonds, gold, silver, wheat, sugar, rice, temperature and even electricity. In India the derivatives market started in the year 2000 with the launch of index future. BSE has launched the SENSEX future which has the underling as the SENSEX itself.

Q24) What is option?

A24) Option is a derivative product which gives the buyer of the option the right but not an obligation. There are two types of option. They are call option and put option. Call option gives the buyer the right to buy but not an obligation while put options gives the buyer the right to sell but not an obligation. One should buy call option when one feels that the price of the underlying is going to rise and one should buy put options when one feels that price of the underlying is going to fall.

Q25) What is future contract?

A25) In the derivatives market, there are future contract which are traded on the recognized stock exchange. In India we have future contract on the index and on individuals stocks also. There are one month, two month and three month future contract. The future contract are cash settled that is if one makes profit in them then their trading account is credited and if one makes loss in them then their accounts are debited. There is no delivery of shares. Future contracts are leveraged products since only margin amount needs to be paid at the time of taking the positions.

Q26) What are stock market indices?

A26) Index in the stock market is the reflection of the overall market condition. SENSEX which is the index of the Bombay Stock Exchange is called as Barometer of the Economy. This is because it is the broad reflector of the Indian economy. If the index is rising then it indicates that the economy is going to better share and if the index is continuously falling then it is indicator that economy is shrinking.

Q27) What are bonds?

A27) Bonds are the debt instruments on which the issuers has to pay fix rate of interest and repay the principal amount at the time of maturity. Bonds are normally issued by government bodies like RBI bonds, NHAI bonds. These bonds carry fix rate of interest. If the issuer fails to repay the interest or the principal amount at the time of maturity, the investors get the legal right to start the winding up process of the company who has issued these instruments.

Q28) What are government securities?

A28) Government securities are the instruments in which the banks have to compulsorily invest for maintaining their SLR (Statutory Liquidity Ratio) which is currently at 23 %. These are long dated government securities also called as Gilt edge securities. They do not carry any risk since they are issued by the Central Bank itself on behalf of the Government. The ten year Indian Government securities carry a coupon rate of 7.75% which is the highest in the world since the average coupon rate in the world is around 1.5 %. This give the international investors take the advantage of the interest rate arbitrage opportunity and invest into the Indian bond markets.

Q29) What is short selling?

A29) It refers to selling the shares without holding them. This is done in the intraday transaction in the cash market but one needs to square up the deal before the market closes. In the futures market one can do the short selling and keep their positions open since there is no obligation of paying and receiving delivery. In derivatives market one can keep the positions open till the last Thursday of the month.

Q30) What is call option?

A30) Call option gives the buyer the right to buy the call but not the obligation. One would buy the call option when one feels that the price of the underlying security or index is going to rise. The maximum loss in the call option buying is the premium that is paid. The benefit of trading in options is that one knows well in advance that what is the maximum loss he has to bear. Options trading are very useful when there is an event in the country or the results of any company are going to be announced. The volatility is high and hence one can trade in options to get the benefit but limiting the risk to the amount of premium paid.

Q31) What is put option?

A31) Put option gives the buyer the right to sell but not the obligation. One would buy the put option when one feels that the price of the underlying security or index is going to fall. The maximum loss in the put option buying is the premium that is paid. When there is bearish sentiment in the market or any negative event takes place, one can trade in put options and make profit. As the price of the underlying goes down, the premium of the put options will rise and thus will create a profit. Buying put option is very useful when the result of any company is poor or there is negative economic data coming.

Q32) What is dividend?

A32) Dividend is the cash outflow which a company pays to its shareholders for the shares owned by them. It is the way to reward the shareholder for their investment in the shares of the company. The dividend paid by the company is taxed at 15 % which is the dividend distribution tax. The dividend is tax free in the hands of the investor since the tax is already paid by the company giving the dividend.

Q33) What is preference share?

A33) Preference shares have the preference in two conditions one of getting the dividends first then the equity shareholders and at a fixed rate. The other preference is when the company goes for winding up then at that time preference shareholders will get the right first to get their capital back. Preference shares are of various types like cumulative, non-cumulative. In case of cumulative the dividend not paid in one year has to be paid in the next year along with the current year dividend. In case of non-cumulative the dividend not paid in any year gets lapsed.

Q34) What is bonus issue?

A34) Bonus issues means that the existing shareholders are given additional shares free of cost by the company. This is another way to reward the shareholders as their number of the shares would rise but accordingly the price of the share would get adjusted.

Q35) What is right issue?

A35) A Rights issue is where the existing shareholders are offered shares first at the price. If the shareholders want they can transfer their right to another person. This is another way of the company to raise the capital in the stock market. This is done by the companies who are already listed on the stock exchange.

Q36) What is fundamental analysis?

A36) Fundamental analysis deals with the study of the fundamentals of the companies where investment has to be done. The study of fundamentals includes parameters like net profit, EPS, PE ratio, debt equity ratio etc. But here one needs to understand that only company analysis will not be of any help. One needs to do Economic analysis and industry analysis. In economic analysis, the study of macro-economic variables like the GDP, Inflation, Interest rates, Fiscal deficit etc. needs to be studied to understand the impact of these variables on the economy. The Industry analysis would deal with the analyzing the dynamics of a particular industry. The industry analysis would be useful in analyzing how the industry dynamics work.

Q37) What is technical analysis?

A37) Technical analysis is the field which deals with the analyzing the historical price movements and based on that predicting the future price movement. The historical price and the volumes that are number of shares traded are the main inputs for the study of technical analysis. Technical analysis is used for trading purpose and is widely used by the traders for the purpose of intraday trading. Technical analysis is used by the traders to trade in equity, derivatives, commodities and currency markets. Technical analysis is done using software to interpret the charts to analyze the price movement. Software's like ACE, Falcun, Metastock and many others are available in the market which are used to analyze the stocks or any underlying using technical analysis.

Q38) What is GDP?

A38) GDP stands for Gross Domestic Product. It is an important barometer to measure the growth of any economy. It is the barometer used by the Foreign investors to judge the potential of any economy before making the final call of investment. The average growth rate of India has been 8 % for the last one decade though currently the GDP growth rate has come down to below 5 % level. The world's average GDP growth rate for the last one decade has been 2.8 %. The GDP growths of the country to a large extend depends on the demand in the economy which in turn is related to the consumption power of the population. The higher the GDP growth rate, higher is the progress of the economy and vice versa.

Q39) What is inflation?

A39) Inflation is a monetary phenomenon where the purchasing power of the rupee continuously goes down. Due to inflation the cost of living goes up and this affects the common man the most. The salaried class is affected the most as price of the food and daily consumables rise. There are two main causes of inflation. They are

(1) Demand Supply Mismatch

(2) Excess Money Supply.

Inflation is of two types:

(1) Cost Push: In case of Cost Push inflation the cost of manufacturing goes up so the manufacturer has to raise their price in order the cover the increased cost of production. The cost push inflation is more structural and makes the economy unattractive as the cost of production rises which makes the product uncompetitive in the international markets.

(2) Demand pull: Demand pull inflation is there is mismatch between the demand and supply which drives the prices up.

Q40) What is IIP?

A40) IIP stands for Index for Industrial Production. This indicator indicates the industrial growth of the economy. This index tells whether the manufacturing activity is picking up in the economy or not. The rise in the index indicates that manufacturers are bullish about the future demand in the economy and if the index falls it is an indicator that the future demand is going to shrink. The IIP index specifically tracks the manufacturing segment which is very important as manufacturing contributes 26 % to the GDP. India government releases IIP index every month.

Q41) What is PMI?

A41) PMI stands for Purchase Managers Index. This index is developed by HSBC and it releases the data every month. This index has the base reading of 50 that is when the reading is above 50 and rising it is indicator that the economy is expanding. If the reading is below 50 then it is an indicator that the economy is contracting. This data is released for many economies US, China and Europe by HSBC. The reading is vital and is closely observed by the Foreign Investors as an indicator about the growth of the economy.

Q42) What is Index?

A42) Index refers to the composite representation of the stock market. BSE has the index called as the SENSEX and NSE has the index called as Nifty. The index represents the overall market. SENSEX has 30 shares which constitute the index. The rise of the index means that broadly the market is rising and fall in the index means that the market is falling. One cannot trace all the company shares listed on the stock exchange but the index gives an overview of the market so index is tracked by the market participants. Index is called as the BAROMETER of the Economy. One needs to understand that index is one of the barometer and not the sole barometer of the economy. There have been instances where the markets have gone up but the economy many not be in sound state.

Q43) What are physical shares?

A43) Before dematerialization took place in 2006, the shares on the Indian stock exchanges were traded in the physical form that is in the paper form. The share certificate would contain the details of the company and the shareholder. The seller would send the physical share certificate to the company registrar who in turn would issue the new certificate to the buyer of the share. The problem with physical shares was that settlement took long time and there was risk of forgery, signature mismatch, certificate getting lost etc. In 1996 there government passed the Dematerialization Act which made the DEMAT of all shares compulsory.

Physical shares are the shares which are in the form of certificate. Earlier shares were issued in the physical form by the companies. Due to the physical share certificate the settlement cycle were long in duration. The main problems in the physical shares were loosing of certificate, mismatch of signatures, forged signatures etc. The Depository Act was passed in 1996 and this led to the creation of two national depositories like NSDL and CDSL.

Q44) What is electronic share?

A44) The process of converting physical shares into electronic version is called as dematerialization. The DEMAT shares have T + 2 settlement cycle where the shares are transferred to the DEMAT account once the client makes the payment to the broker. In 1996 the depository act was passed by the government and all the physical shares were converted into electronic form. This fastened the settlement cycle and thus reduced the risk of forged signatures and other delay in transfer of shares. In the current scenario, around 99 % of the shares are in DEMAT form and for any company who brings an IPO, it is now compulsory that the shares are in DEMAT form only.

Q45) What is market order?

A45) Market order is the order which is kept by the buyer or the seller at the current market price. The order would get executed in the market immediately as the price is the current market price. The market order gets executed immediately while any order which is away from the market price will become passive order and would be lying in the system only and thus will not get executed.

Q46) What is stop loss order?

A46) Stop loss order is the kind of order which is aimed to reduce the loss to certain extent. If the buyer buys at the share at Rs.100 and does not want to incur loss more than Rs.10 then at Rs.90 he would put the stop loss order. As soon as the market price would touch Rs.90 the stop loss order in the system would get executed and this would book the loss of the buyer at his desired level. Otherwise if the stop loss order is not there then the price may go down to further lower levels and the loss would keep on rising.

Q47) What is intraday?

A47) Intraday trading refers to the buying and selling of shares during the same day that is before the close of the market. In the intraday trading there is no physical delivery of shares and the difference is only settled between the buy and the sale price. The intraday traders are the main participants who trade in the market and create volume. One should understand that trading in intraday is the most risky activity since one can incur huge losses in this kind of trading.

Q48) What is delivery base?

A48) Delivery base refers to where the investor buys the shares and makes the full payment. The shares are then transferred to the DEMAT account of the client. This kind of trade is for long term investment purpose. The proportion of this kind of delivery base trade are less as they require to make full payment to the broker within 24 hours of the trade done. These are the investment bets which are long term in nature. In Indian stock market, if the delivery base investment is hold on for more than 12 months then there is no long term capital gains tax and if the shares are sold less than 12 months, then there is short term capital gains tax at the rate of 15%. Investment in delivery base fundamental stocks could give very good returns in the long term. For instance those who invested Rs.9000 in Infosys at and held it there investments has become Rs.2 crore.

Q49) What is arbitrage?

A49) Arbitrage refers to buying from the market where the price is low and selling in the market where the price is high. There is price difference between NSE and BSE prices in some stocks which creates an arbitrage opportunity. The arbitrageur will buy the stock from the exchange where the price is low and at the same time, he will sell the share in the exchange where the price is high. When the price in both the exchanges then converge then the arbitrageur will square both the positions and thus make profit. Arbitrage can also be done between cash and future market. In this case one buy the delivery of shares in the cash market and sell the futures contract. On the expiry day, the shares are sold and delivery realized and the stock future contract is squared off.

Q50) What is speculation?

A50) Speculators are the one who take a view on the market and accordingly take the position in the market. If speculator feels that the market will go up then he will take the long position and if he feels that the market will go down, he would take the short positions. The trades are non-delivery that is intraday only in the cash market. There is no delivery base trading done. Speculators plays a vital role in the market as they create liquidity in the particular stock or index. If speculators are not there then there is no liquidity and this makes the stock or index illiquid.

Q51) What is financial inclusion?

A51) Financial inclusion refers to bringing the lowest rung of the society into the main stream economy. It refers to the inclusive growth whereby the down trodden into the society are also given the access to the financial products. RBI had set an ambitious target to cover 73000 villages having 2000 population with the no frills accounts. In this account, there are no documents required but only the village sarpanch would notify his residency and open his account. Stock market could be the ideal means for financial inclusion. The objective is to have the financial benefit to the last man standing in the queue. India has 6 lakh villages but only 30,000 villages have bank branch. Thus we need to have more people in the villages connected with the formal banking system.

Q52) What is Repo Rate?

A52) Repo rate is the rate at which RBI lends money to the commercial bank. Repo rate is the main monetary instrument through which the RBI controls the inflation. When repo rate rises the cost of capital also goes up as the banks would charge higher rate of interest from the customers. When repo rate goes up then the interest on fixed deposit and interest on loans also rise. The rise in the fixed deposit interest shift the money from the stock market to the banks and this has negative effect on the stock market. On the other hand, when the loan interest rates rises, the consumers post pone their buying decisions of home, vehicles which slows down the consumption. Also the corporate don't expand since cost of capital rises so corporate do not go for borrowing. This reduces the job creation and has negative impact on the growth of the economy. Thus repo rate is the key catalyst which drives the economy and creates both negative and positive impact on the economy. At the time of writing this book, the repo rate is 7.5% and the reverse repo rate is 6.5 %

Q53) What is Reverse Repo rate?

A53) Reverse Repo rate is the rate at which the Banks lend their money to the RBI. Whenever RBI is in need of funds, it will borrow from the banks through and pay at the reverse repo rate.

Q54) What is CRR?

A54) CRR stands for Cash Reserve Ratio. This ratio is the amount of deposits kept by the banks with the RBI. At the time of writing this book the CRR is at 4 %. Banks do not get any interest on the CRR kept with the RBI. In fact around Rs.3 lakh crores are with the RBI as CRR of all the banks taken together. The CRR is a measure to ensure that banks capital has been parked with the RBI.

Q55) What is Balance of Payments?

A55) Balance of payment is the statement showing the total transaction of one country with the rest of the world. Balance of payment has two accounts that is one is Current Account and the other is Capital Account. Current Account shows the total imports and exports of goods and services. If the current account is in surplus that means that exports are more than imports and if the current account is in deficit then imports are more than exports. The Capital Account shows total flows capital like FII, FDI, Loans, Aid, Grants etc. If the total inflows of capital are more than the outflows the Capital account would be in surplus and if the total outflows are greater than inflows then there would be a deficit. The total of the capital account and the current account decides the total balance of payment positions. If the balance of payment is continuously is in deficit then it creates a serious question for the economy as they would come on the verge of default. The International Investors also are not comfortable with the high balance of payment deficit as they consider that the economy is not stable and may not be able to honor their foreign commitment. In 1990, Indian Economy had faced severe balance of payment crisis and it had to mortgage 67 tons of gold with the Bank of England and had to take a loan of $ 2 billion from the IMF.

Q56) What is SLR?

A56) SLR stands for Statutory Liquidity Ratio. This ratio indicates the compulsory investment to be made by the banks in Government bonds and Government securities. At the time of writing this book, the SLR stands at 23 %. This is also another measure to ensure that banks capital is invested in 100% safe assets that is Government of India Securities. Now if we see total 27% (CRR +SLR) is with the Government which effectively means that out of Rs.100 that bank has to lend, Rs.27 is with the Government only which ensure that banks are adequately monitored and their capital is always with the safe hands.

Q57) What is Current Account Deficit?

A57) Current Account Deficit is the gap between exports and imports of a particular country. The CAD when it rises above the 3% it creates worry for the finances of the country since it shows that the country obligation for the payment of imports is rising and that exports are not picking up at the same pace. This potentially weakens the Balance of Payments which has a negative impact on the international investor's sentiment who want to invest into the Indian economy. The current Account deficit has touched as high as 6.7% which was alarming for the whole economy as it would reduce the confidence of the Foreign Investors and also indicate that the country is importing more than what it could export.

Q58) What is the effect of gold imports on the economy?

A58) Gold imports are the main reason for the rise in the current account deficit in the economy. India is one of the largest importer of gold in the world. In 2011, India imported 959 tons of gold and in 2012 India imported gold worth 614 tons. Central banks all over the world started buying gold after the global recession of 2008 since they prefer gold as compared to US dollar which had become very weak. The Central bank buying led to the rise in the prices of gold. Central banks globally have 11% average gold holding in their total forex holding. Indian has 8.2 % gold holding in its total forex holding while China has 1.8%. India and China are one of the largest consumers of gold. Due to the high gold imports, there the import bill goes up and this increases the Current Account Deficit and this has negative impact on the working of the economy.

Q59) How is gold as an asset class?

A59) In the last 5 years Gold has been favored by all the investor as it has been giving very good returns. But let's try to understand gold as an investment instrument and whether it does any good to the economy. Gold has historically been a hedge against inflation and against economic bad times. In the last 32 years for the period from 1979 to 2012, the return generated by various asset classes are as under:-

Asset Classes	**Average Return from 1979 to 2012**
Inflation	8.1 %
Fixed Deposit	8.8%
Postal Saving (NSC, KVP, PPF)	8.7%
Gold	11.1%
Equities	17%

Source: Motilal Oswal Research reports

Gold is an unproductive asset from economic view point. Suppose a person keeps Rs.10000 Fixed deposit in a bank, the bank would give that money as loan to some entrepreneur or some other person. As a result the money circulates in the economy and it is put to use for financial instruments. In case of gold it is an unproductive asset since the capital gets blocked in gold once it is invested. Gold investment is an unproductive asset as it blocks the money and the money does not rotate in the economy. The financial saving in the country has reduced from peak of 12 % to 8% and this shift is due to investments going into the Gold. The reduced investment in the financial instruments has slowed down the investment climate.

Q60) What are unique features of Indian Economy?

A60) Indian economy has been able to make impressive growth of 7.5 % GDP in the last ten years as compared to 2.8% world GDP growth rate. The Indian economy has been seen as the world most emerging economy with the inherent domestic consumption model. This model has been able to sustain the growth rate even during the Global Financial Crisis. The year 2008 when the World GDP grew at 1 %, the Indian economy was able to make the growth rate of 6.2% which was very encouraging. There are 3 main features which makes the Indian Economy very unique as compared to its global counterparts.

(1) 70 % of India's working population is less than 35 years age. This means that we have one of the largest work force in the world. This young working population works and earns which means that they spend money which generates demand in the economy. Current Japan, China and US are facing the problems of **"AGING"** population which means that these economies have more old people than young people. China for instance since 1979 has adopted "One Child" policy. This has reduced the number of young people in the economy.

(2) India is a domestic consumption oriented economy. This has ensured that we are able to consume a lot of the production we do here itself. Out of the total production, around 86 % we consume in India and export around 14 %. This was one of the key reasons when the world was in recession in 2008; India was still able to maintain its growth rate due to the inherent consumption. The first point of young working population is directly related to the second one as one is able to correlate that those who earn will spend and this would create demand in the economy and keep the GDP growing.

(3) Savings rate of 31 % of GDP. India has one of the highest saving rates in the world. The world average saving rates has been 24 %. Savings habit has resulted in to capital formation which results into investment and finally asset creation. The Gross capital formation had earlier been 30% which is very healthy sign for the Indian economy.

The reason that the western economies have not been able to get out of their financial and economic problems may be due to the poor saving structure and excessive leverage economies.

Q61) What is Sub-prime crisis?

A61) Sub Prime is the word used to describe the crisis that started from the US and took the world into recession. Sub-prime refers to "No Doc" loans which means that loans given without proper documentation. The US economy had slowed down in the beginning of the last decade. To make the economy revive again, the FED Reserved had reduced the interest rates from 5 % to 1 %. The banks in USA gave away approximately $3.3 trillion loans to anyone and everyone who applied for the loans. For this reasons, these loans were also called as the NINJA loans which means that "No Income, No Job and No Asset". The loans were given with the houses on mortgage. The housing market in the USA was in great boom and the prices of the housing were rising. The banks had the confidence that even if the loan taken defaults; we can sell his house and recover not only the loan but also make profit as the houses prices were going up continuously. But this calculation of US bankers went totally wrong in the year 2007 when there was a very huge default. As very large number of houses came for foreclosure, there was immense supply in the housing market. As a result, the prices of the houses collapsed. The investment bankers could not even recover the principal amount which they had given as loan. This led to huge buildup of bad loans on the balance sheet of the banks. This led to the liquidation of many small and big banks in USA. The last nail in the coffin was the liquidation of Lehman Brothers which shook the confidence of the global investor's world over. Lehman Brothers was 158 years old institutions and the largest in USA and fourth largest in the world. The winding up of the Lehman Brothers freeze the international credit lines and business came to a standstill. This fallout of the US economy has two kinds of impact on the global markets and global economy. Let's understand the impact on both the aspects. In case of the stock markets, globally there was heavy pull out of money by Foreign Institutional Investors (FII). In India, the funds that were pulled out by FII were Rs.52000 crores which reduced the Sensex from 21000 levels to 7600 levels. The effect was that the stock markets globally had a free fall. On the economy front, India was more resilient to the global slowdown. The world GDP had grown at 1% in that year of 2008 while India was able to make the GDP growth of 6.3%. This showed the world economy that Indian economy was much more resilient to the global slowdown. The recession which was typically the housing market problem of USA, led the whole world into recession. The major countries like China, Japan and EU have an export oriented model and USA is the biggest importer. US people lost many jobs and the unemployment rate went as high as 9.2 %. This reduced the consumption of the US consumers and consequently the US economy went into recession. The recession spread to other parts of the world as the world's largest economy faced a slowdown. US contributes 23 % to the world GDP and has a size of $ 16 trillion. India is $ 1.5 trillion and contributes 2.7% in world GDP.

Q62) What is Euro Zone crisis?

A62) Euro Zone crisis started in 2011 and still they are not solved fully. Euro zone was formed with 17 member nations having one common currency that is EURO. This was formed on 1st January 1999. The five countries which are facing the problems of bankruptcy are referred to as P.I.I.G.S which are Portugal, Italy, Ireland, Greece and Spain. These countries have accumulated huge debt on their balance sheets and they are not able to come out of their bankruptcy crisis. The Debt to GDP ratios of these countries are Greece 144 %, Spain 120 % and Italy 160 % of their GDP. This austerity measures adopted by these countries have resulted in the further slowdown of the economy. The European Central Bank, International Monetary Fund and the European Union popularly known as the trio have created a war chest of 500 billion Euro to ensure that no country is allowed to default from the payment obligation. The default of any of the country would result into the removal of that country from the Euro zone which may bring the world economy back into the recession scenario. The main reason for such countries is due to the high leverage balance sheet of these nations. The money which had been taken from the international investor was not put to effective use and it has resulted into the creation of debt which needs to be cleared off.

Q63) What is Exchange rate?

A63) Exchange rate is an unbiased indicator for the economy. The movement of the currency shows, what is the perception of the foreign investors towards the economy. The Indian currency which has been depreciating in the last more than one year has clearly because of the poor fundamentals which the country is facing. The GDP growth has come down to mere 4.8% in June 2013 which is a decade low. This resulted into the foreign funds being withdrawn from the economy. This makes the rupee depreciate further. The Foreign Institutional Investors when they see that macroeconomic indicators have become weak, then they start selling in the equity markets and also in the debt markets. This leads to further pressure on the rupee which starts depreciating further. Exchange rate globally are calculated in a number of ways. The most commonly used method is the demand supply method where the total inflows and outflow of the foreign currency is taken into consideration for the value of the rupee v/s dollar. This is the method followed globally. China is the country which has pegged its currency with the dollar and manages its currency artificially. This is the reason that Chinese data is always looked by apprehension by the world fraternity. When the currency is artificially managed then one does not know whether the economy is really progressing or it has slowed down. There is another method of currency evaluation which is the **snake in the tunnel** method. In this method, there is a band given within which the country manages its foreign exchange rate. There is another method of currency management which is called as the **"Dirty Float"** in which the central bank manages the currency.

Q64) What is appreciation of currency?

A64) Appreciation of the currency refers that the local currency has become more strong. This is the indication that the economy is becoming strong. For example for every 1 dollar earlier Rs.60 was required and now the same 1 dollar is available for Rs.50 that means that rupee has appreciated. Appreciation of the currency is an indicator that economy is expanding and becoming healthy. It also indicates that more foreign flows is coming into the economy. The foreign flows comes in as they find merits in the Indian economy and that domestic macro-economic factors are sound enough for good investment opportunity. The macro economic factors include rising GDP, low inflation, low interest rates, controlled CAD etc. When these macro-economic factors are sound then foreign flows come into the economy which will ensure that rupee starts appreciating.

Q65) What is depreciation of currency?

A65) Depreciation of currency means that you are paying more of Indian rupees to buy one dollar. The depreciation of the currency is an indicator that the economy is becoming weak. The depreciation in the Indian currency of 21% in the 2011 and 2012 was a clear indicator that Indian economy was becoming weak. The rupee depreciation is an indicator that foreign investor are pulling money out of the country due to the poor macro-economic data like low GDP, high inflation and high interest rates coupled with high Current Account Deficit. All these data reduces the confidence of the foreign investor. This results into something known as the “Capital Flight” where the foreign capital is leaving the country to other better investment opportunities.

Q66) What is Fiscal Deficit?

A66) Fiscal deficit refers to the excess of government expenditure over the government income. If the income of the government is more than the expense then it is in surplus and if the expenditure of the government is more than income than it is called as Fiscal Deficit. High fiscal deficit means that Government is not able to maintain public finance effectively. The high fiscal deficit puts pressure on the government to reduce its expenditure which again has the risk to slow the growth rate of the economy.

Q67) What is A group shares?

A67) A group shares are also called as Blue Chip shares. These shares are of those companies which are fundamentally very strong and have consistently had good performance in terms of results. The A group shares are also main part of the index which has all the large cap shares. These shares are considered relatively better investment opportunities since these shares are of the companies which are the leaders in their industry and have a proven track record. For instance RIL, Tata Steel, Infosys are the best examples of A group shares. Even Foreign Institutional Investors prefer the A group shares as they tend to have better investment opportunities. The A group shares have tendency to follow the broad market breath and they fall also less as compared to mid-cap and small cap shares.

Q68) What is B1 and B2 group shares?

A68) B1 and B2 are the shares which are typically mid-size companies. They are called as the mid cap shares. These are companies which are fundamentally sound but their scale of operations is small in size. They tend to be industry followers and many times are present in niche markets. For example companies like Opt circuit, Sinter Industries are the famous mid cap shares. The mid cap shares have the tendency to rise very fast in terms of price appreciation as compared to Sensex but at the same time these shares also tend to fall more than the broad markets when the markets are weak.

Q69) What is T group shares?

A69) These are the shares which are in Trade to Trade settlement. The shares in which there is abnormal volatility are shifted to this group. The volatility in these shares are very high and they tend to have buyer or seller circuits for many trading sessions. T group shares have many time operator driven stocks and retail investors may get trapped in these shares. The fundamental of these stocks are weak and they have issues related to corporate governance.

Q70) What is Z group shares?

A70) These are the companies which have the least compliance norms and they tend to be suspended or delisted by the stock exchange. Many times these companies also get themselves delisted, which leaves the retail investors in a lull. These companies do not have any fundamentals. Retail investors many times get trapped in these stocks. Investors should be very cautious while stock selection and should buy the shares of the company which are fundamentally sound and have a sound track record.

Q71) What is IPO Grading?

A71) IPO grading has been made mandatory by SEBI for the companies which come out with the IPO. There agencies which do the IPO grading are CRISIL, ICRA, CARE. The IPO grading is done from 1 to 5 scale, 1 being the lowest and 5 being the highest. Any grading of 3, 4, and 5 is considered as sound for investing by the public. While the grading of 1 and 2 is considered as fundamentally not sound and should be avoided by the investors. The IPO grading is aimed to guide the investors to take the informed decisions. Investors mostly are not comfortable to read the whole prospectus as they may not have the required financial knowledge background. The ratings indicate a number which they can easily interpret and understand and gives them a hand holding in taking the decision.

Q72) What are Credit Rating Agencies?

A72) Credit rating agencies give the credit rating indicating the repayment capacity of the companies related to the principal amount and the interest obligation. The rating agencies like CRISIL, ICRA and CARE would do the due diligence of the companies who come out with the debt instruments and want their instruments to be rated. The ratings are aimed to help the investors to take the informed decisions about the company debt product. The rating are aimed to analyze the repayment capacity of the company. The rating are given in the form of symbols like AAA, AA, A, B, BB+, C, D. Normally any rating below than AA should be treated with lot of cautiousness as lower the rating, the risk is higher. The symbols are used to make the retail investors analyze the instruments with ease as they are not accustomed to analyze the whole financials of the company in terms of balance sheet and profit and loss account. These ratings are given for the debt instruments like the bonds or Non-convertible debentures which are issued by the companies to raise the money from the market.

Q73) How is the price in IPO decided?

A73) The current practice followed during the IPO pricing is the Book Building method which is aimed to know the exact demand for the issue. The Merchant Bankers would do the Due Diligence exercise and analyze the issue in terms of Quantitative variables and Qualitative variables. Once the probable fair value of the share if obtained and if the promotes agree with the valuation done by the Merchant Bankers then they would go ahead with the other aspects. The price band is offered to the investor and at that price where the maximum bids are obtained becomes the “cut off” price. The retail investors are only allowed to bid at the “cut off” price while other investor category may fill the amount they consider is appropriate to the issue. The price at which the maximum bids are obtained becomes the “cut off” price and those application which have the price below the “cut off” price are rejected.

Q74) What is the settlement cycle?

A74) Settlement cycle refers to the time taken from the trade day to settle the trade that is payment and receiving of funds T +2 settlement cycle where the trade is done on Monday and it is settled on Wednesday. The pay in of funds and securities takes place on Wednesday morning that is those who have bought the shares will make the payment and those who have sold the shares will give the shares. The payout will start from the afternoon that is exchange starts releasing the funds and shares of those who are at the receiving end. The trades done at the exchange are guaranteed by the Settlement Guarantee Fund. There is no default risk when the trades are done on the platform of the Exchange whether it is stock exchange, commodity exchange or currency exchange.

Q75) What is risk?

A75) Risk refers to the variability of the returns. It is the loss of income or capital appreciation or both. Risk is there when there is no commitment of returns. Investment in stock market has risk since there is no guarantee on capital return while in Bank Fixed deposit there is no risk since the capital and the return are fixed and guaranteed. The risk factor comes in all those options where there is uncertainty on the outcome. When the outcome is sure there is no risk. Stocks markets are inherently have the risk element and that is why the equity capital is also known as the “Risk Capital”. The basic nature of volatility creates the nature of risk.

Q76) What is return?

A76) Return is what one gets from the amount what one has invested. Returns are in two forms. One is capital appreciation and the other is interest return. Capital appreciation is one where the invested capital appreciates while the other gain is in the form of dividend returns. There is no tax to be paid by the investor on the dividend he gets. The company or mutual fund declaring the dividend pays 15 % tax as the Dividend distribution tax. In Indian capital market, there is no long term capital gains tax if the investment in shares or mutual funds is held for more than 365 days.

Q77) What are the types of risk?

A77) There are various types of risk in the capital market. The two major ones are:

(1) Systematic Risk:

Systematic risk refers to the risk which cannot be reduced by diversification. The entire market is affected under this kind of risk. For instance, fears of recession, war, natural calamity, election results are some of the events which cause the systematic risk. There the further 3 kinds of risk in systematic risk. They are market risk, inflation risk and interest rate risk.

1. Market risk is the risk which affects the entire market and diversification does not give protection. Market risk is just like systematic risk.

2. Inflation risk is when the inflation rises; the government is forced to increase the interest rates which makes the cost of capital go up. This reduces the consumption and demand and the whole economy slows down. This has negative effect on the entire stock market and the market comes down.

3. Interest rate risk is the risk which arises when the interest rate in the economy goes up and thus the cost of capital becomes more. This reduces the demand and consumption in the economy and the corporate don't expand. This reduces the job opportunities and thus slows the economy. The retail individual also postpones his buying decisions and thus the whole economy suffers.

(2) Unsystematic Risk:

The unsystematic risk is the risk which can be reduced by diversification. This risk has two types namely the Financial risk and the Business risk.

1. The Financial risk is the risk which deals with capital structure of the firm and it has a major impact on the working of the firm. If the debt equity ratio is high then the lenders will not allow the management to work independently and also the profits would be spend paying the debt that is repayment of interest and principal amount. Also if the firm fails to repay the loan then the lenders would initiative the winding up mechanism for the company.

2. The Business risk refers to the kind of risk which is there in the inherent nature of the business. For instance the appreciating rupee will have negative impact on software companies, export oriented firms so one can avoid these companies from the portfolio and can have shares of other companies. This will ensure that risk is reduced as you have the diversified portfolio.

Q78) What are dividends?

A78) Dividends is the cash flow paid by the company to the investors as a reward for holding the shares of the company. Dividends are paid out of net distributable profits. If a company pays dividend regularly then it is clear proof that the company is fundamentally sound. Dividends are hard cash flow which goes out of the company. This is one of key ways that a company rewards its investors. For many old investors or dependents, dividend income is one the ways to have their regular means of income and survival. Many companies in Indian stock market have given dividends regularly for long tenures.

Q79) What is diversification?

A79) Diversification refers to the investing in different companies of different sectors. It is like "not putting all the eggs in one basket". When the investor is having different stocks from different sectors the logic is that if one sector does not perform there are other sectors that will perform and generate some returns. It is prudent practice to have different stocks from different sectors so that risk is reduced. One could have stocks of large cap companies in the portfolio so that one can have decent returns. For instance the BSE SENSEX have given CAGR return of 17% since 1979 to 2012 which is decent return with the good diversified stocks from various sectors.

Q80) What is Capital Budgeting?

A80) Capital budgeting refers to all those decisions in the company which are capital intensive, have long term implication on the working of the company and are generally irreversible. They are the those decisions which are strategic in nature an involve huge capital outlay. These decisions if they go correct have the potential to make the company. But, at the same time if these decisions go wrong then the company survival also comes under question. For example the Tata Steel take over Corus, Hindalco acquiring Novalis, Bharti Airtel acquiring Zain are the best examples where the companies have made huge capital outlay and these decisions have a far reaching impact on the future cash flows of the company.

Q81) What are the methods of Capital Budgeting?

A81) There are various methods of capital budgeting which are used by the corporate to analyze the projects. They are:

(1) Pay Back method: The Payback period method is aimed to know what is the repayment time during which the initial capital will be recovered from the project. This is the oldest method and the most simple method. But the main drawback of this method is that it does not take into account the time value of money which is very crucial when it comes to analyzing the cash flows from the project.

(2) Average Rate of Return method: The Average Rate of Return method is also simple as it tell us the average return from the project but this method also fails to take into consideration the time value of money which is the main drawback of this method.

(3) NPV method: The another method which is Net Present Value (NPV) which is the most widely used since in this method, the present value of the cash flows is taken into consideration. The criteria here is that if the NPV of a project is positive then accept the project and if the NPV of project is negative then it is negative. In this method the present value of the future cash flows is calculated taking into account discount rate (hurdle rate).

(4) IRR method: The Internal Rate of Return (IRR) method is one where again the present value of future cash flow is taken but here the trial and error is used to select the discount rate.

(5) Profitability Index method: The last method is the Profitability index where if the Profitability index calculated is more than 1 then it is accepted and vice versa.

Q82) What is beta?

A82) Beta is a statistical measure that shows the volatility of the stock versus the volatility of the index. Beta will have 3 variables like greater than 1, less than 1 and equal to 1. If the beta is greater than 1 then the stock will more volatility on either side of the index that is if the index goes up the stock will have higher upside and if the index goes down then the stock will have higher down side. Sectors like information technology, metals, entertainment, and real estate would have beta greater than 1. For those stocks where the beta is equal to 1 then the stock will more or less will have near to index volatility. If the stocks have then beta 1 then the stocks are defensive in nature. These stocks will have less volatility as compared to the index on either side. For conservative's investors these stocks are considered as the best since they rise slowly and they fall also slowly. The sectors like FMCG and Pharma are the best stocks with beta less than 1 which is why Fund Managers shift their portfolios to the defensive shares.

Q83) What is relation between inflation and interest rates?

A83) The inflation and interest rates are the two most important variables which affect the working of the overall economy. Inflation is the independent variable while the interest rates are the dependent variable. When the inflation rises the interest also is raised by the RBI which would lead to rise in the cost of capital. Both the interest rates on fixed deposit and the interest rate son the loans go up. This would lead to curb in the consumption and demand as the consumers postpone their buying behavior. This reduces the GDP growth as the consumption in the economy goes down and subsequently the stock market also goes down. Conversely when the inflation goes down the interest rates are also reduced and this brings down the cost of capital. Once the cost of capital comes down that is the interest rates comes down, the consumption cycle of the economy picks up. Consumers start buying homes, consumer durables and automobiles which creates demand in the economy and subsequently GDP goes up. Thus interest acts as a catalyst in the economy and it can work as double edge sword.

Q84) Why one should be saving?

A84) There are various reasons that require good amount of capital which can be formed only with prudent savings of money on a regular basis. The main reasons why one should save is:

(1) Education.
(2) Marriage.
(3) Retirement planning.
(4) Dream house.
(5) Better standard of life.

In order to achieve the above objectives in life, one needs capital to save and create a pool which ensure that at the right time, there is sufficient capital to fulfill these objectives. The above objectives requires systematic planning to save the money. India's saving rate is 31% of GDP which is the highest in the world as compared to world's average of 24%. The Gross Capital formation in India is 35 %.

Conclusion:

The objective of this book is to share the basic knowledge about the stock market among those novice persons who want to invest but they don't have any basic understanding. I have come to the conclusion of writing this book due to the feedback I got while travelling pan India and taking session in schools and colleges. This inspired me to write this book which is very basic version but useful to all those who have to have some basic understanding of the financial markets and the stock markets. The terms used and explained here are in my own language which is without any technical jargons.