

---

# Portfolio Management

---

- 
- ❖ Portfolio is a combination of securities such as stocks, bonds and money market instruments.
  - ❖ The process of blending together the broad asset classes so as to obtain optimum return with minimum risk is called portfolio management.
  - ❖ Diversification of investments helps to spread risk over many assets.
-

---

# WHY PORTFOLIOS?

- The simple fact that securities carry differing degrees of expected risk leads most investors to the notion of holding more than one security at a time, in an attempt to spread risks by not putting all their eggs into one basket.
  - Most investors hope that if they hold several assets, even if one goes bad, the others will provide some protection from an extreme loss.
-

---

# Diversification

- Efforts to spread and minimize risk take the form of diversification.
  - The more traditional forms of diversification have concentrated upon holding a number of security types( shares, bonds) across industry lines( mining , manufacturing , steel).
  - Most people would agree that a portfolio consisting of two stocks is probably less risk than one holding either stock alone.
-

---

# Approaches in Portfolio Construction

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



- 
- ❖ Traditional approach evaluates the entire financial plan of the individual.
  - ❖ In the modern approach, portfolios are constructed to maximise the expected return for a given level of risk.
-

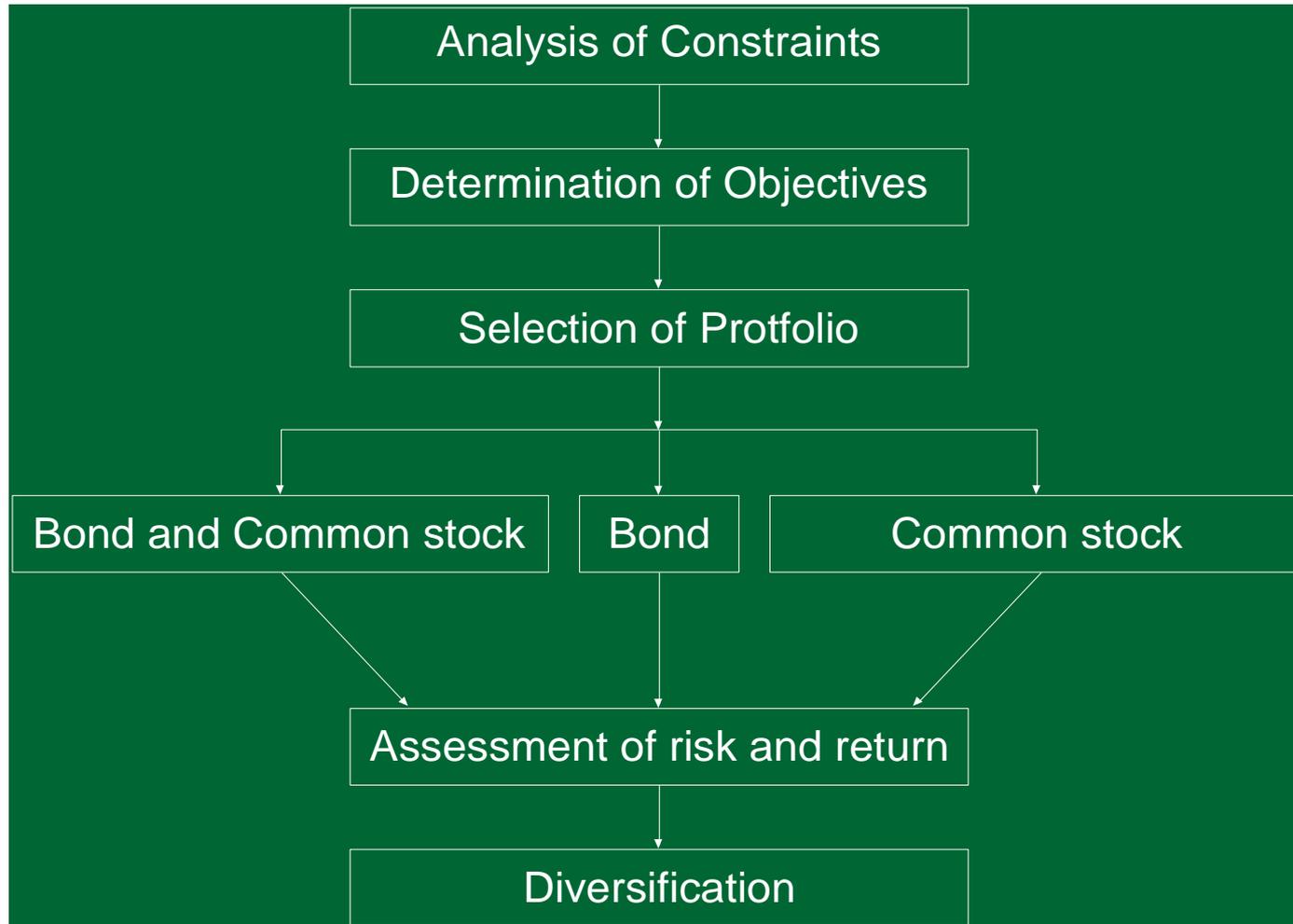
---

# Traditional Approach

The traditional approach basically deals with two major decisions:

- Determining the objectives of the portfolio.
  - Selection of securities to be included in the portfolio.
-

# Steps in Traditional Approach



---

# Analysis of Constraints

- ❖ Income needs
    - Need for current income
    - Need for constant income
  - ❖ Liquidity
  - ❖ Safety of the principal
  - ❖ Time horizon
  - ❖ Tax consideration
  - ❖ Temperament
-

---

# Determination of Objectives

The common objectives are stated below:

- Current income
  - Growth in income
  - Capital appreciation
  - Preservation of capital
-

---

# Selection of Portfolio

- ❖ Objectives
  - ❖ Growth of income
  - ❖ Capital appreciation
  - ❖ Safety of principal
  - ❖ Risk and return analysis
-

---

# Diversification

- ❖ According to the investor's need for income and risk tolerance level portfolio is diversified.
  - ❖ In the bond portfolio, the investor has to strike a balance between the short term and long term bonds.
-

---

# Stock Portfolio

Following steps as shown in the figure are adopted



---

# Modern Approach

- ❖ Modern approach gives more attention to the process of selecting the portfolio.
  - ❖ The selection is based on the risk and return analysis.
  - ❖ Return includes the market return and dividend.
  - ❖ Investors are assumed to be indifferent towards the form of return.
  - ❖ The final step is asset allocation process that is to choose the portfolio that meets the requirement of the investor.
-

---

# Managing the Portfolio

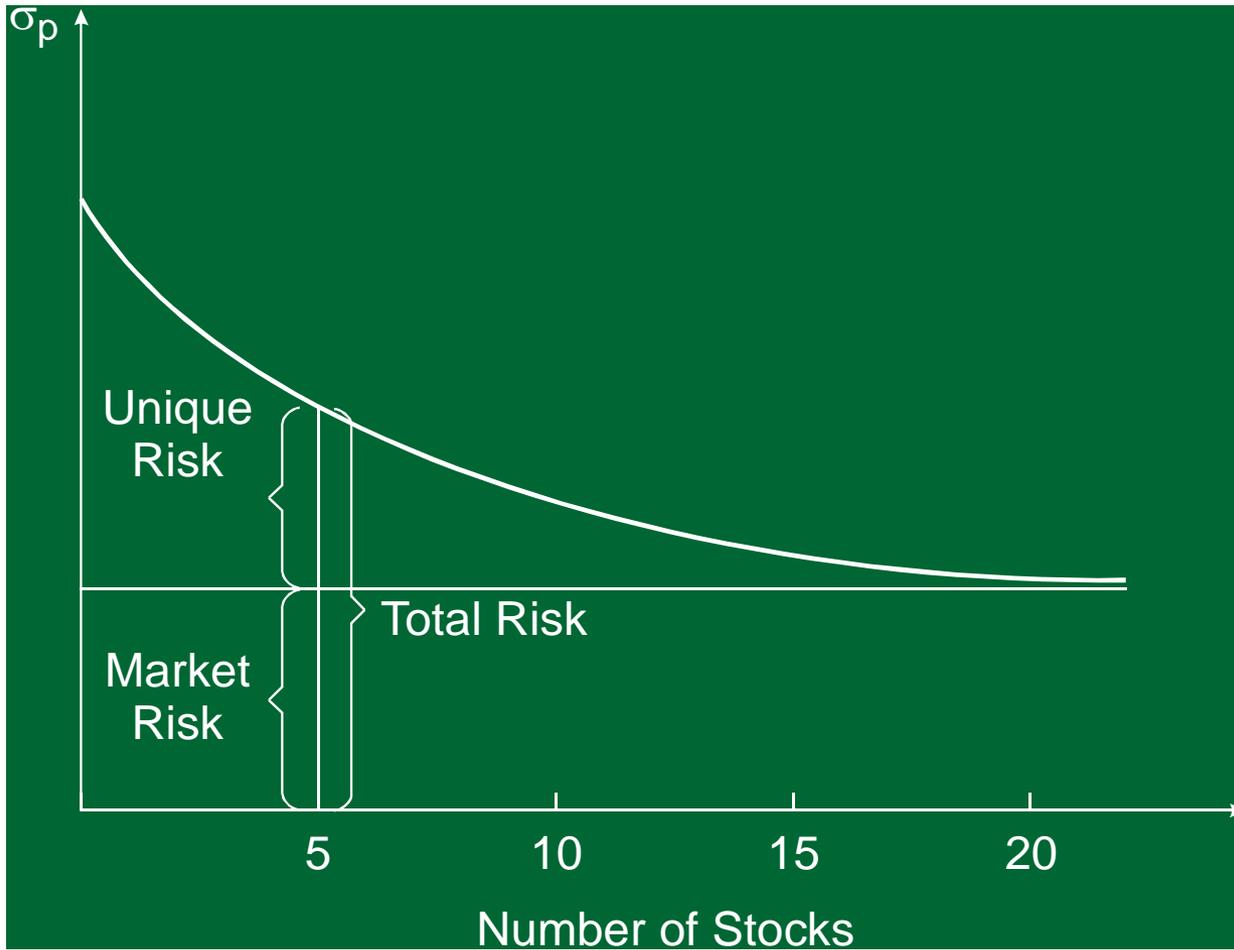
- ❖ Investor can adopt passive approach or active approach towards the management of the portfolio.
  - ❖ In the passive approach the investor would maintain the percentage allocation of asset classes and keep the security holdings within its place over the established holding period.
  - ❖ In the active approach the investor continuously assess the risk and return of the securities within the asset classes and changes them accordingly.
-

---

# Simple Diversification

- ❖ Portfolio risk can be reduced by the simplest kind of diversification.
  - ❖ In the case of common stocks, diversification reduces the unsystematic risk or unique risk.
  - ❖ Analysts says that if 15 stocks are added in a portfolio of the investor , the unsystematic risk can be reduced to zero.
  - ❖ But at the same time if the number exceeds 15, additional risk reduction cannot be gained.
  - ❖ But diversification cannot reduce systematic or undiversifiable risk.
-

# Diversification and Portfolio Risk



- 
- The standard deviations of the portfolios are given in y axis and the number of randomly selected portfolio securities in the X axis.
  - The S.D was calculated for each portfolio and plotted.
  - As the portfolio size increases, the total risk line starts declining.
  - It flattens out after a certain point.
  - Beyond that limit, risk cannot be reduced.
  - This indicates that spreading out the assets beyond certain level cannot be expected to reduce the portfolio's total risk below the level of undiversifiable risk.
-