Investment Basics

1.1 What is Investment?

⇒ Investment = Using savings to earn future returns instead of keeping them idle.

⇒ It is a commitment of current funds in anticipation of future benefits

1.1.1 Why should one Invest?

⇒ Earn return on idle money

⇒ Accumulate funds for specific life goals

⇒ Prepare for uncertain future.

⇒ Beat inflation

Example:

At 6% inflation for 20 years ⇒ ₹100 today

Future value $= 100 \times (1+0.06)^{20} = ₹321$

$= \underline{\text{Present value} \times (1 + \text{Inflation Rate})^{\text{no. of years}}}$

Real rate of return = Return on investment − Inflation rate

= 13% − 6% = 7% real return

Aim: Earn returns above inflation after tax

1.1.2 When to start investing?

Start Early → More time for compounding

Three golden rules

⇒ Invest early

⇒ Invest long-term

⇒ Invest regularly

1.1.3 Care to take while investing

12 Key Steps before investing

⇒ Get written documents about investment

⇒ Read and understand them

⇒ Verify investment legitimacy

⇒ Know costs & benefits

⇒ Assess risk - return profile

⇒ Check liquidity and safety

⇒ Ensure it suits your goals

⇒ Compare with other options

⇒ Ensure portfolio fit (existing investments)

⇒ Deal only through authorized intermediaries

⇒ Clarify doubts; invest only if confident

⇒ Know grievance redress options before investing (problems fix)

1.1.4 What is Interest?

Interest = Price paid for using borrowed money.

Reward to lender / investor

Calculated as % of principal

Can be fixed or variable

1.1.5 Factors determining Interest rates

=> Demand for money

=> Level of government borrowings

=> Inflation rate

=> Supply of money

=> Maturity period

=> RBI and government policies.

1.2 Investment Options

=> Physical Assets

- Real estate, gold, jewellery, commodities

=> Financial Assets

- FDs, small savings, insurance, pension, shares, bonds, MFs etc

Investment Options

Short-term investment	Long-term investment
=> Saving bank account	=> Post office savings
=> Money market funds	=> Public Provident Fund
=> Fixed deposits with bank	=> Company Fixed deposit
	=> Bonds & debentures
	=> Mutual Funds
	=> Life insurance policies
	=> Equity shares
	=> Derivatives

Short-Term investments

=> Savings Bank Account (3-5%)

=> Money market or Liquid funds

-> Short-term mutual funds

-> Protecting your capital and then aim to maximise returns

=> Bank Fixed Deposit

=> low risk

-> 30 days - 1 year

Long-Term Investments

⇒ Post Office Savings: Low risk, 4% p.a, min ₹500

⇒ Public Provident Fund (PPF)
  → 15 year maturity, 7.1 % p.a.
  → Tax benefits
  → Withdraw only upto 50% of
    → Balance at the end of 4th financial year
    → Balance at the end of the previous financial year
  Allowed from 7th year

⇒ Company Fixed deposit
  → 6 months - 5 years, 7 - 12% p.a.
  → Can be cumulative or periodic (monthly, quaterly, semi-annually, annually) interest

⇒ Bonds & Debentures
  → Long term fixed income instruments
  → Bonds → issued by central or state government
  → Debentures → issued by companies
    - Can be convertible
      non convertible
      party convertible
    to equity at the option of debenture holder.

→ Sovereign Gold Bonds
- Issued by RBI on behalf of govt
- Denominated in grams of gold
- 2.5% interest p.a (taxable);
capital gains on maturity = tax free

⇒ Mutual funds
→ Raise money from public and invests in group of assets (shares, debentures, etc.,)
→ Issued and redeemed by the Asset Management Company (AMC)
→ Net asset Value (NAV)

$$= \frac{\text{Total assets - expenses}}{\text{units}}$$

→ Benefits:
Professional money management
Buying in small amounts
Diversification

⇒ Life Insurance Policies

→ Provides financial protection + limited investment value.

→ Types:

- Term Life (pure protection)
- Endowment (Savings + protection)
- Annuity / Pension (Retirement income)
- Unit Linked Insurance Plan (ULIP) (insurance + investment combo)

1.3 Stock exchange and securities

1.3.1 What is a stock exchange?

⇒ Defined by Securities Contract Regulation Act [SCRA] in 1956

⇒ Platform for buying, selling and dealing in securities

⇒ Example: NSE [National Stock Exchange]

1.3.2 What is an Equity / Share?

=> Total equity capital of a company is divided into equal units of small denominations called shares

=> Example: ₹3 crore capital / ₹10 per share = 30 lakh shares

=> Shareholders = Owners of a company with voting rights

1.3.3 What is a Debt Instrument?

=> A contract to lend money with pre-decided interest and repayment

=> Govt => issues bonds

=> Companies => issues debentures

1.3.4 What is a Derivative?

=> Products whose value is derived from underlying asset

=> Underlyings: Stocks, index, forex, commodities, interest rates, bonds

=> Orginated as hedging tools against price fluctuations

=> Post 1970 used in financial markets. Today account for more than 80% of the transactions on NSE.

1.3.5 What is a Mutual Fund?

=> Securities Exchange Board of India SEBI - registered body pooling investors money

=> Mutual Funds is financial intermediaries in the investment business that collects funds from public and invest on behalf of the investors

=> The appreciation of the portfolio or securities in which the mutual funds has invested the money leads to an appreciation in the value of units held by investors

=> Investment objectives specify the class of securities a Mutual Funds can invest in

=> Invests in various asset classes like equity, bonds, debentures, commercial paper and government securities

=> Investors are given the option of getting dividends, which are declared periodically by the mutual funds or to participate only in the capital appreciation of the scheme

1.3.6 What is an index?

⇒ Represents average movement of a group of stocks

⇒ Indicates overall market trend

⇒ Example: Nifty 50 → 50 diversified stocks across 14 sectors

⇒ Used for benchmarking & index-based funds or derivatives

1.4 Depository & Dematerialization

1.4.1 What is a Depository?

⇒ Like a bank for securities (shares, bonds, units, etc)

⇒ Two in India

1. NSDL (National Securities Depository Ltd)
2. CDSL (Central Depository Services Ltd)

1.4.2 What is Dematerialization (Demat)?

⇒ Conversion of physical share certificates into electronic form.

⇒ Credited to investor's Demat Account with a Depository Participant (DP).