NSDL
Technology, Trust & Reach

The Financial Kaleidoscope

Defining the different shapes of investment

April 2016

From The Editor's Desk

Dear Reader,

Many individuals find investments to be fascinating because they can participate in the decision making process and see the results of their choices. Not all investments will be profitable, as investor will not always make the correct investment decisions over the period of years; however, you should earn a positive return on a diversified portfolio. In addition, there is a thrill from the major success, along with the agony associated with the stock that dramatically rose after you sold or did not buy. Both the big fish you catch and the fish that gets away can make wonderful stories.

Investing is not a game but a serious subject that can have a major impact on investor's future well-being. Virtually everyone makes investments. Even if the individual does not select specific assets such as stock, investments are still made through participation in pension plan, employee saving programme or through purchase of life insurance or a home. Each of this investment has common characteristics such as potential return and the risk you must bear. The future is uncertain, and you must determine how much risk you are willing to bear since higher return is associated with accepting more risk.

The individual should start by specifying investment goals. Once these goals are established, the individual should be aware of the mechanics of investing and the environment in which investment decisions are made. These include the process by which securities are issued and subsequently bought and sold, the regulations and tax laws that have been enacted by various levels of government, and the sources of information concerning investment that are available to the individual.

Today the field of investment is even more dynamic than it was a decade ago. The amount of information available to the investors is staggering and continually growing. Furthermore, inflation has served to increased awareness of the importance of financial planning and wise investing.

With the objective of spreading financial literacy, through this issue of Kaleidoscope, we will highlight some of the important factors an investor should look at before investing thus helping them in making the right investment decision.

Best Regards,
NSDL

Basic Investment Objectives

The options for investing our savings are continually increasing, yet every single investment vehicle can be easily categorized according to three fundamental characteristics – safety, income and growth – which also corresponds to types of investor objectives. While it is possible for an investor to have more than one of these objectives, the success of one must come at the expense of others. Let's examine these three types of objectives, the investments that are used to achieve them and the ways in which investors can incorporate them in devising a strategy.

Safety

Perhaps there is truth to the axiom that there is no such thing as a completely safe and secure investment. Yet we can get close to ultimate safety for our investment funds through the purchase of government-issued securities in stable economic systems, or through the purchase of the highest quality corporate bonds issued by the economy's top companies. Such securities are arguably the best means of preserving principal while receiving a specified rate of return.

The safest investments are usually found in the money market, which includes such securities as Treasury bills (T-bills), Certificates of Deposit (CD), Commercial Paper (CP) or bankers' acceptance slips, or in the fixed income (bond) market in the form of municipal and other government bonds, and in corporate bonds. The securities listed above are ordered according to the typical spectrum of increasing risk and, in turn, increasing potential yield. To compensate for their higher risk, corporate bonds return a greater yield than T-bills.

It is important to realize that there's an enormous range of relative risk within the bond market. At one end are government and high-grade corporate bonds, which are considered some of the safest investments around; at the other end are junk bonds, which have a lower investment grade and may have more risk than some of the more speculative stocks. In other words, it's incorrect to think that corporate bonds are always safe, but most instruments from the money market can be considered very safe.

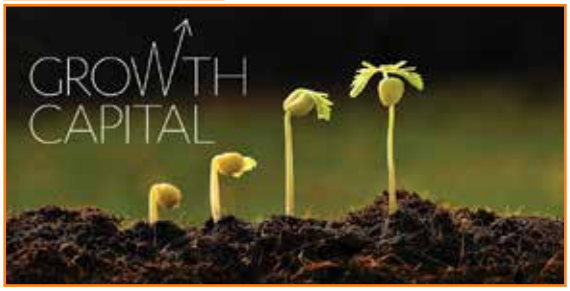
Income

The safest investments are also the ones that are likely to have the lowest rate of income return or yield. Investors must inevitably sacrifice a degree of safety if they want to increase their yields. This is the inverse relationship between safety and yield: as yield increases, safety generally goes down and vice versa.

In order to increase their rate of investment return and take on risk above that of money market instruments or government bonds, investors may choose to purchase corporate bonds or preferred shares with lower investment ratings. Investment grade bonds rated at A or AA are slightly riskier than AAA bonds, but presumably also offer a higher income return than AAA bonds. Similarly, BBB rated bonds can be thought to carry medium risk but offer less potential income than junk bonds, which offer the highest potential bond yields available but at the highest possible risk. Junk bonds are the most likely to default.

Most investors, even the most conservative-minded ones, want some level of income generation in their portfolios, even if it's just to keep up with the economy's rate of inflation. But maximizing income return can be an overarching principle for a portfolio, especially for individuals who require a fixed sum from their portfolio every month. A retired person who requires a certain amount of money every month is well served by holding reasonably safe assets that provide funds over and above other income-generating assets, such as pension plans.

Growth of Capital



This discussion has thus far been concerned only with safety and yield as investing objectives, and has not considered the potential of other assets to provide a rate of return from an increase in value, often referred to as a capital gain. Capital gains are entirely different from yield in that they are only realized when the security is sold for a price that is higher than the price at which it was originally purchased. Selling at a lower price is referred to as a capital loss. Therefore, investors seeking capital gains are likely not those who need a fixed, ongoing source of investment returns from their portfolio, but rather those who seek the possibility of longer-term growth.

Growth of capital is most closely associated with the purchase of common stock, particularly growth securities, which offer low yields but considerable opportunity for increase in value. For this reason, common stock generally ranks among the most speculative of investments as their return depends on what will happen in an unpredictable future. Blue-chip stocks, by contrast, can potentially offer the best of all worlds by possessing reasonable safety, modest income and potential for growth in capital generated by long-term increases in corporate revenues and earnings as the company matures. Yet rarely is any common stock able to provide the near-absolute safety and income-generation of government bonds.

It is also important to note that capital gains offer potential tax advantages by virtue of their lower tax rate in most jurisdictions. Funds that are garnered through common stock offerings, for example, are often geared toward the growth plans of small companies, a process that is extremely important for the growth of the overall economy. In order to encourage investments in these areas, governments choose to tax capital gains at a lower rate than income. Such systems serve to encourage entrepreneurship and the founding of new businesses that help the economy grow.

Secondary Objectives

Tax Minimization

An investor may pursue certain investments in order to adopt tax minimization as part of his or her investment strategy. A highly-paid executive, for example, may want to seek investments with favorable tax treatment in order to lessen his or her overall income tax burden.

Marketability / Liquidity

Many of the investments we have discussed are reasonably illiquid, which means they cannot be immediately sold and easily converted into cash. Achieving a degree of liquidity, however, requires the sacrifice of a certain level of income or potential for capital gains.

Common stock is often considered the most liquid of investments, since it can usually be sold within a day or two of the decision to sell. Bonds can also be fairly marketable, but some bonds are highly illiquid, or non-tradable, possessing a fixed term. Similarly, money market instruments may only be redeemable at the precise date at which the fixed term ends. If an investor seeks liquidity, money market assets and non-tradable bonds aren't likely to be held in his or her portfolio.

The Bottom Line

As we have seen from each of the five objectives discussed above, the advantages of one often comes at the expense of the benefits of another. If an investor desires growth, for instance, he or she must often sacrifice some income and safety. Therefore, most portfolios will be guided by one pre-eminent objective, with all other potential objectives occupying less significant weight in the overall scheme.

Choosing a single strategic objective and assigning weightings to all other possible objectives is a process that depends on such factors as the investor's temperament, his or her stage of life, marital status, family situation and so forth. Out of the multitude of possibilities out there, each investor is sure to find an appropriate mix of investment opportunities. You need to only be concerned with spending the appropriate amount of time and effort in finding, studying and deciding on the opportunities that match your objectives.

Portfolio

What is a 'Portfolio'?

A portfolio is a grouping of financial assets such as stocks, bonds and cash equivalents, as well as their mutual, exchange-traded and closed-fund counterparts. Portfolios are held directly by investors and/or managed by financial professionals.

Breaking Down 'Portfolio'

Prudence suggests that investors should construct an investment portfolio in accordance with risk tolerance and investing objectives. Think of an investment portfolio as a pie that is divided into pieces of varying sizes representing a variety of asset classes and/or types of investments to accomplish an appropriate risk-return portfolio allocation.

For example, a conservative investor might favor a portfolio with large cap value stocks, broad-based market index funds, investment-grade bonds and a position in liquid, high-grade cash equivalents. In contrast, a risk loving investor might add some small cap growth stocks to an aggressive, large cap growth stock position, assume some high-yield bond exposure, and look to real estate, international, and alternative investment opportunities for his or her portfolio.

Asset Class

What is an 'Asset Class'

An asset class is a group of securities that exhibit similar characteristics, behave similarly in the marketplace, and are subject to the same laws and regulations. The three main asset classes are equities (stocks), fixed-income (bonds) and cash equivalents (money market instruments).

Breaking Down 'Asset Class'

It should be noted that in addition to the three main asset classes, some investment professionals would add real estate and commodities, and possibly other types of investments, to the asset class mix. Whatever the asset class lineup, each one is expected to reflect different risk and return investment characteristics, and will perform differently in any given market environment.

Asset classes and asset class categories are often mixed together. In other words, describing large-cap stocks or short-term bonds asset classes is incorrect. These investment vehicles are asset class categories, and are used for diversification purposes.

Asset Class Breakdown

What is 'Asset Class Breakdown'?

'Asset Class Breakdown' are the relative percentages of core asset classes such as equities, fixed income and cash, along with real estate and international holdings, found within a mutual fund, exchange-traded fund or other portfolio. Further breakdowns are sometimes made within the asset classes into growth stocks, value stocks, market capitalizations (small, medium, large) and various types of fixed income such as government bonds, corporate bonds and municipal bonds. Asset class breakdowns are calculated by dividing the market value of a particular asset class's holdings by the total fund or portfolio assets.

Breaking Down 'Asset Class Breakdown'

The asset class breakdown is a simple way to determine the approximate risk profile of a fund. Higher equities exposure equates to a higher potential return, but with greater risk than a portfolio made up of mostly bonds. Many analysts and economists feel that proper asset allocation is the biggest determinant of overall returns – far greater than sector selection or individual security selection.

How much of your income should you invest?

Deciding how much of your income you should invest can be tricky. You have to estimate your target retirement figure, reconcile your monthly expenses with it, provide for emergencies, and so on. Here are some guidelines that can simplify the process for you.

Estimate your disposable income

The first order of business is to calculate how much money you are left with after meeting your monthly expenses. The remaining amount is your monthly disposable income. It is the maximum amount that you can invest in a month, without disturbing your routine. While calculating disposable income, keep aside a reasonable amount for recreation. You work hard for your money.

Provide for emergencies

The next step is to set aside funds for emergencies, like sudden death and job loss. Invest in a good life insurance policy and a good health insurance policy. Do you have unpaid loans? Buy a life policy with a big cover. This will leave enough money for your family after the loans are repaid. Create a contingency fund as well. A contingency fund is an emergency fund that you can dip into if you lose your job or face an unexpected expense. The contingency fund should be at least three or four months' salary. You can invest whatever remains of your disposable income after providing for emergencies.

Define your investment goal

An investment goal can be anything—retirement, your child's wedding, or an overseas trip. It is important to define the goal because your targeted sum and required return depend on it. Broadly speaking, you should invest between 15 to 20 per cent of your salary each month. But if your target figure is too high, you may need to invest more. In that case, you will have to rethink your monthly budget and put more aside for investing. You can also have several investment goals. But then you will have to maintain separate investment portfolios for each of them.

Include the inflation factor

In future, things will cost much more than they do today. So, it is important to consider inflation when calculating your target figure. Some estimates inflate current costs by 15 to 20 times when estimating values that are more than 20 years away. For example, if you plan to buy something that costs ₹10 lakh today, you could work with a rough estimate of ₹15–20 lakh in 20 years.

Portfolio allocation

You can invest in two types of assets—equity (shares) and debt. Equity offers higher returns than debt but carries a higher risk of loss. Debt mostly consists of government and corporate bonds. It offers lower returns than equity but involves a lower risk of loss. Your portfolio allocation will depend on the proximity of your investment goal. You can have an equity-heavy portfolio to begin with and a debt-heavy portfolio later on. In this way, you can quickly expand your corpus and have enough time to make up for any early losses. If you are in your mid-20s and are investing for retirement, you can place about 80 per cent of your portfolio in equity. As your goal (retirement) nears, move from a portfolio with more equity to one with more debt.

Enterprise Value & Earnings Before Interest, Taxes, Depreciation and Amortization

The EV/EBITDA multiple for a company can be found by comparing the Enterprise Value (EV), to the Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA).

The EV/EBITDA Multiple Ratio

The EV/EBITDA ratio is a metric widely used to help investors determine the value of a business. It compares a company's value, including debt and liabilities, to its true cash earnings, less noncash expenses. This metric is often used to compare values of companies that operate in the same industry. Lower values can be an indication a company has been undervalued. Generally, analysts interpret any EV/EBITDA value below 10 as positive; however, it is still important to consider the value in relation to EV/EBITDA values of similar firms.

Calculating the EV/EBITDA

The name of the ratio essentially gives away the formula used for its calculation. To determine the value, the company's enterprise value is divided by its earnings before interest, taxes, depreciation and amortization. Enterprise value is calculated as the company's total market capitalization plus debt and preferred shares, minus the company's total cash.

Benefits of the Metric

The EV/EBITDA multiple is often used in conjunction with, or instead of, the price-to-earnings, or P/E, ratio. The former is sometimes considered a better valuation tool for potential investors because it is not affected by changes in a company's capital structure and makes it possible to obtain fair comparisons of companies that have different capital structures. One other advantage of the multiple is it eliminates the effects of noncash expenses that are not typically a major consideration of investors.

Your Questions Our Answers

1. **What is considered a healthy EV/EBITDA?**
   While average EV/EBITDA values vary by sector and industry, a general guideline is an EV/EBITDA value below 10 is commonly interpreted as healthy and above average by analysts and investors.

2. **How do I calculate the P/E ratio of a company?**
   The price-earnings ratio (P/E ratio) is a valuation measure that compares the level of stock prices to the level of corporate profits, providing investors with a sense of a stock's value. To calculate a company's P/E ratio, use the following formula:

   P/E ratio = Price Per Share / Earnings Per Share (EPS)

   Where EPS = earnings/total shares outstanding

   As long as a company has positive earnings, the P/E ratio is calculated this way (a company with no earnings, or one which is losing money, has no P/E ratio). The stock price per share is set by the stock market, and the earnings per share value will vary, depending on the company's financials and which earnings variant is used. Typically, EPS is taken from the last four quarters (trailing P/E; referred to as TTM for trailing twelve months), but it can also be taken from the estimates of earnings expected over the next four quarters (forward P/E) or some other variation. As a result, a company will have more than one P/E ratio, and investors must be careful to compare the same P/E ratio when evaluating different stocks.

3. **What is an alternative ratio to forward P/E?**
   A metric that is an alternative to the forward price to earnings (P/E) ratio is the standard, or trailing, P/E ratio. This ratio is calculated by dividing a stock's current price by the earnings per share (EPS) for the previous 12 months. This varies from the forward P/E ratio because it uses historical data instead of projected future EPS, giving investors and analysts a more accurate idea of the current value of a company. This is the most common and most widely used variation of the P/E ratio. However, because stock prices continuously fluctuate and earnings are not constant, the forward P/E ratio can be of greater importance to analysts or investors in evaluating a company. Analysts and investors should be wary when using the forward P/E, as companies sometimes purposely understate projected earnings to make it easy for the company to outperform the projections.

Your Questions Our Answers (contd.)

Another alternative to the forward P/E ratio is an average between the forward P/E and trailing P/E. Analysts sometimes calculate EPS for the P/E ratio using two quarters (or six months) of a company's historical prices and two quarters of projected earnings.

Along with the price to book (P/B) ratio, the P/E ratio is one of the most widely used equity evaluation metrics. However, the EPS figure in the calculation for the P/E ratio is based on measures of accounting that are easily manipulated. The overall validity of the P/E value depends on the validity of the company's earnings value.

News Articles

Name Change of Participant

Old Name	New Name	DP ID
Ratnabali Capital Markets Limited	Ratnabali Capital Markets Private Limited	IN303639

Investor Education initiatives undertaken by NSDL

Joint Awareness Programmes:

In order to reach out to investors that are spread across the country and to apprise them about the facilities available in NSDL depository system and the awareness on stock markets, NSDL conducted 17 Joint Awareness Programmes during March 2016 in association with Adroit Financial Services Private Limited, Citizen Credit Co-operative Bank Limited, ICICI Securities Limited, Jhaveri Securities Limited, Marwadi Shares & Finance Limited, Shah Investor's Home Limited, The Cosmos Co-Operative Bank Limited, Trustline Securities Limited & jointly with Munoth Financial Services Limited & NSE. NSDL also conducted two Joint Awareness Programmes in association with ArthSanket Newspaper & Lokmanya Seva Sangh & three Joint Awareness Programmes in association with NSE & RAA Media. These programmes were attended by more than 1,900 investors.

Regional Investor Awareness Programme with SEBI & NSE:

In order to reach out to masses spread across the country and to apprise them about the facilities available in NSDL depository system, NSDL conducted four Joint Awareness Programmes with SEBI & NSE during March 2016 which were attended by around 500 investors.

Participation in events conducted by Institutions:

In March 2016, NSDL participated at "India Regulatory Summit 2016" which focused on the latest developments linked to international and domestic regulatory changes across banking and Capital Markets. This event was attended by around 100 delegates.

Training Programmes for Participants:

To spread awareness about Depository related services & the new features introduced in NSDL Depository system, NSDL conducted a training programme for employees of 'SBI Cap Securities Ltd.' during March 2016. This programme was attended by around 70 employees of 'SBI Cap Securities Ltd.'.

"Did You Know"

The rule of 72 is a shortcut to estimate the number of years required to double your money at a given annual rate of return. The rule states that you divide the rate, expressed as a percentage, into 72:

Years required to double investment = 72 ÷ compound annual interest rate

For example, if you want to know how long it will take to double your money at 8% interest, divide 8 into 72 and get 9 years.

"Quote of the month"

"We don't have to be smarter than the rest. We have to be more disciplined than the rest." **- Warren Buffett**

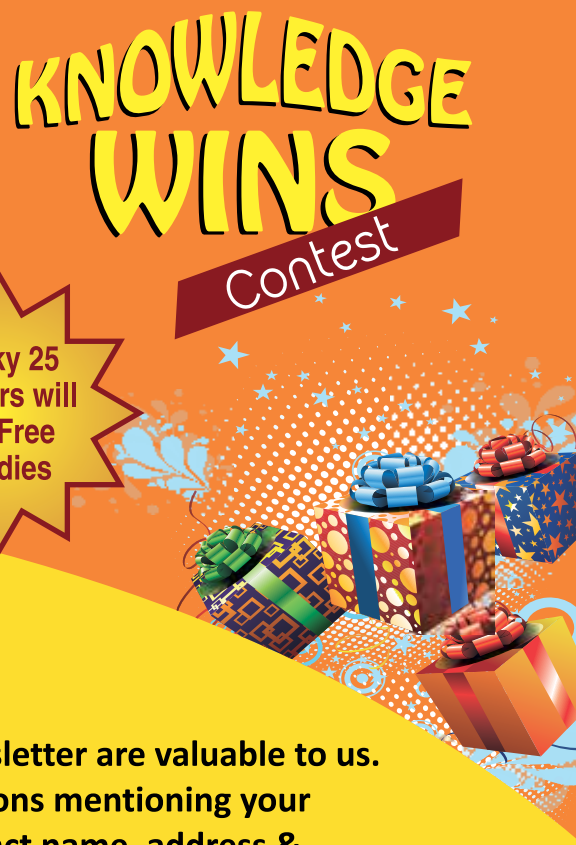
Read and Win!

What is Asset Allocation & the advantages of using this method?

Send your replies providing your contact details (Name, address and contact no.) with the subject 'Knowledge Wins Contest – April 2016' to info@nsdl.co.in

Terms and Conditions

- NSDL shall be solely responsible for the execution and administration of this Contest.
- This Contest is only open to Indian Citizens. (NSDL employees are not allowed to participate in this contest.)
- All personal details submitted must be accurate and complete and are subject to proof upon request by NSDL.
- NSDL reserves the right, at any time, to verify the validity of entries and entrants and to disqualify any entry not submitted in accordance with these Terms or which tampers with the entry process.
- NSDL reserves the right to discontinue the contest at any given point of time without prior intimation.
- All prize drawings will made on a strictly random basis and the decision made by NSDL will be final



Your suggestions for newsletter are valuable to us. Send in your suggestions mentioning your contact details (contact name, address & contact number) with the subject "Suggestions for the newsletter" to info@nsdl.co.in

NSDL Offices

Head Office	Branch Offices	
Mumbai Trade World, A wing, 4th & 5th Floors, Kamala Mills Compound, Lower Parel, Mumbai - 400 013. Tel.:(022) 2499 4200 Fax:(022) 2497 6351	**Ahmedabad** Unit No. 407, 4th floor, 3rd Eye One Commercial Complex Co-op. Soc. Ltd., C. G. Road, Near Panchvati Circle, Ahmedabad - 380006 Tel.:(079) - 26461376 | Fax:(079) - 26461375	**Chennai** 6A, 6th Floor, Kences Towers, #1 Ramkrishna Street, North Usman Road, T. Nagar, Chennai - 600 017. Tel.:(044) 2814 3917 / 18 | Fax:(044) 2814 4593
	Kolkata 5th Floor, The Millenium, Flat No. 5W, 235/2A, Acharya Jagdish Chandra Bose Road, Kolkata - 700 020. Tel.:(033) 2281 4661 / 2281 4662 | Fax:(033) 2289 1945	**New Delhi** Unit No.601,603,604, 6th Floor, Tower-A, Naurang House, Kasturba Gandhi Marg, Connaught Place, New Delhi-110001 Tel: (011) 23353814 / 15 | Fax: (011) 23353816

Investor Relationship Cell	NSDL Certification Program
Officer-In-Charge National Securities Depository Ltd. Trade World, A Wing, 4th floor, Kamala Mills Compound, Senapati Bapat Marg, Lower Parel, Mumbai - 400 013. Tel.:(022) 2499 4200 | Fax:(022) 2497 6351 Email: relations@nsdl.co.in	Officer-In-Charge National Securities Depository Ltd. Trade World, 4th floor, Kamala Mills Compound, Senapati Bapat Marg, Lower Parel, Mumbai - 400 013. Tel.:(022) 2499 4200 | Fax:(022) 2497 6351 Email: trainingdept@nsdl.co.in

For more information, email us at info@nsdl.co.in

"Printed & Published by Mr. Manoj Sathe (Editor) on behalf of National Securities Depository Limited and Printed at Printography Systems (India) Pvt. Ltd., 13/D, Kurla Ind. Estate, Nari Seva Sadan Road, Ghatkopar (West), Mumbai - 400 086 and Published from National Securities Depository Limited, 4th Floor, A Wing, Trade World, Kamala Mills Compound, Senapati Bapat Marg, Lower Parel, Mumbai - 400013