

International Conference on Research in Business Management & Information Technology (ICRBIT - 2015)

ISBN: 978-81-930411-5-4

Organized by



RNS Institute of Technology

Department of MBA & MCA

Vol- 1(Business Management)

Chief Editors: Dr. G.V.Kesava Rao, Dr. Tamizharasi, J.Suhasini

Published By



**ELK
Asia Pacific Journals**

ELK Asia Pacific Journals, -406, Gopal Heights,

Netaji Subash Palace, New Delhi -110034

1. A STUDY ON PORTFOLIO CONSTRUCTION BY CONSIDERING FUNDAMENTAL ANALYSIS AND USING SHARPE'S SINGLE INDEX MODEL: INDIAN CONTEXT

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Abstract

The past few decades of world's new financial order have brought in full liberalization in general and on the front of financial markets in particular, it has led to the emerging market experiencing unparallel capital inflows since 1990. This paper is an effort to look into if the Sharpe's Single Index Model holds in the case of the emerging market of the world. The study covers forty sector in Indian (over 1120 companies) considered three companies in each sector i.e. 120 companies and six year (2009-2014) data chosen for the study. The result of the study indicates that, there are 58 companies as per the model selection and testing these companies for periods of two months to check the feasibility of the model. Since the results are positive for the test period, so can be conclude that Sharpe's Single Index Model holds strong in Indian Capital Market.

Key Words: Capital Market, Sharpe Single Index Model, Portfolio construction.

PORTFOLIO

A portfolio consists of any combination of assets and / or securities, the outcome of which cannot be defined with certainty. A portfolio goes with a saying that "A wise man never puts all his eggs in

one basket". Since it is rarely desirable to invest the entire funds of an individual or an institution in a single security one should always consider investing in a portfolio. It is essential that every security be viewed as a part of portfolio. Two basic principles of finance form the basis for portfolio theory, namely, *Time value of money and the Safety of money.*

Portfolio theory is based on two assumptions. All other things remaining the same-

1. Investors prefer higher rate of return to a lower rate of return, and
2. Investors are risk averse, i.e., would like to avoid risk.

The traditional portfolio managers diversified their funds over a large number of securities to strike a balance between risk and return. However this was done on the basis of their intuition without really understanding the magnitude of risk reduction. The 1950's saw a body of knowledge being developed, which measured the expected rate of return and risk associated with combining assets. This study came to be known as Portfolio Theory.

Portfolio Management is a process that encompasses many activities of investment in assets and securities. It is a dynamic and flexible concept that involves continuous and systematic analysis, judgment and operations. The objective of portfolio management is to help the investors to maximize their returns for a given level of risk appetite. Portfolio Management is an art and requires high degree of expertise. It is essentially a systematic method of managing one's investment efficiently.

The five phases of portfolio management are 1.Security Analysis 2.Portfolio Analysis, 3.Portfolio Selection, 4.Portfolio Revision and 5.Portfolio Evaluation.

WILLIAM SHARPE'S SINGLE INDEX MODEL

"There are two elements of security returns-independent and dependent". The basic notion underlying the single index model is that the movements in stock market affect all stocks. Casual observation of share prices reveals that when the market moves up, prices of most shares tend to increase when the market goes down the prices of most shares tend to decline. William Sharpe assumed that, for the sake of simplicity, the return on security could be regarded as being linearly adapted to a single index like the market index.

Theoretically, the market index should consist of all the securities trading in the market. However a popular average can be treated as a surrogate for the market index. Acceptance of idea of a market index, Sharpe argued, would obviate the need for calculating thousands of co-variances between individual securities in the single underlying factor being measured by the market index. Hence, this