[Frequently Asked Questions]

Portfolio Theory (Part - 1)

Subject:	Business Economics
Course:	B. A. (Hons.), 5th Semester, Undergraduate
Paper No. & Title:	Paper – 511 Investment Management
Unit No. & Title:	Unit – 3 Portfolio Theory
Lecture No. & Title:	Lecture – 1 Portfolio Theory (Part - 1)

Frequently Asked Questions

1. **What is a portfolio?**

Portfolio refers to the range of investments held by an individual. This may include a mix of financial assets such as stocks, bond and cash equivalents.

2. **What is portfolio management?**

Portfolio management deals with the process of selection of securities from the number of opportunities available with different expected returns and carrying different levels of risk.

3. **List the steps of portfolio management process.**

The steps are;

I. Specification of investment objectives and constraints:
II. Choice of asset mix
III. Formulation of portfolio strategy
IV. Selection of securities
V. Portfolio execution
VI. Portfolio revision
VII. Performance evaluation

4. **Which are the factors affecting selection of securities?**

The factors are; return, capital appreciation. Form or return, safety and security of funds, risk, liquidity and tax considerations.

5. **What is systematic risk? Give examples.**

It refers to the variation in return caused by the factors that affect the price of all securities. They can be social, political and economic changes. Generally it has a similar impact on prices of securities and is unavoidable. For e.g. market risk, interest rate risk, inflation risk.

6. What is Unsystematic risk? Give examples

It refers to the factors that are a unique to a firm or an industry. For e.g. increase in raw material prices, increase in taxes etc

7. How are risk and return quantified?

The mean of the probable returns gives the expected rate of return and standard deviation or variance which is the square of standard deviation measures risk.

8. Define diversification.

Diversification is a risk management technique where an investor chooses among various investment options to make his portfolio. The main objective is to maximize returns while minimizing risk.

9. What is covariance? How is it interpreted?

Covariance reflects the degree to which the returns of the two securities vary or change together. A positive covariance means that returns of the two securities move in the same direction and negative covariance means that they move in opposite direction.

10. What is correlation? How is it interpreted?

Correlation is the statistical measure of association. If the pair of securities displays negative correlation of returns, then in circumstances where one of the securities is performing badly the other is likely to do well.

11. What is Beta Coefficient? How is it interpreted?

In finance, beta coefficient indicates the measure of volatility or systematic risk. Beta represents the tendency of a security's returns to respond to thumps in the market. A beta less than 1 indicates that the investment is less volatile than the market, while a beta more than 1 indicates that the investment is more volatile than the market.

12.What is a beta of a portfolio? Give the formula

The beta of a portfolio is a weighted average of all beta coefficients of its constituent securities.

$$\beta_P = \sum_{i=1}^{N} w_i \beta_i$$

Where, w_i is the proportion of a given security in a portfolio, β_i is the beta coefficient of a given security, and N is the number of securities in a portfolio.